Minutes of a Meeting of the Board of Directors of Banco de la República on May 30, 2011

A regular meeting of Banco de la República's Board of Directors was held in the city of Bogotá on May 30, 2011.

Present:

Mr. Juan Carlos Echeverry, Minister of Finance and Public Credit
Mr. José Darío Uribe, Governor, Banco de la República

Full-time Board Members in Attendance:
Mr. Carlos Gustavo Cano
Mr. Juan José Echavarría
Mr. Fernando Tenjo
Mr. Cesar Vallejo

The situation with respect to inflation and economic growth was discussed, as were their prospects for the future, and decisions on monetary policy were reached. The following is a summary of the main topics addressed at the meeting.

1. BACKGROUND

a. Recent Developments in Inflation

Annual consumer inflation in April was 2.84% (0.12% for the month), which is 35 basis points (bp) less than in March.

Downward pressure was exerted by the annual change in regulated prices, with 6.4% inflation in April compared to 6.9% in March. Food also was a factor in this respect, with 2.8% inflation in April as opposed to 3.9% in March. In the case of the latter, less inflation was due primarily to fuel and public utilities, while the reduced pressure from food originated primarily with perishables and, to a lesser extent, with processed foods. In contrast, upward pressure was brought to bear by the annual variation in prices for non-tradables and tradables without food and regulated prices. Respectively, these variations were 3.45% and -0.06% in April compared to 3.4% and -0.17% in March.

As for the annual core inflation indicators, their average remained stable in April compared to what it was in March. At 1.9%, the CPI excluding food and regulated items was still the lowest indicator. The change in producer prices (PPI) was 4.7% by April, which is less than the variation posted in March (4.9%). In terms of its composition, the imported component was primarily responsible for the reduced rate of inflation.

Banco de la República's monthly expectation survey, with data at April, suggests inflation would be 3.1% by the end of 2011. This is less than what was anticipated last month (3.3%). In the case of longer term expectations (at five years), which are based on government bonds, the reduction was clearer and expectations are within the target range.

b. Growth

The various real indicators on hand for the first quarter of the year show economic activity remained dynamic. This positive performance would be supported by an important increase in internal demand, but also by good export performance.

Household consumption maintains a significant degree of momentum, judging by the positive way retail sales performed. They were up by an annual rate of 14.6% at March. This demand has continued to fuel largely by spending on durables, as is evident from the strong growth in vehicle sales and imports of consumer durables. This has been possible thanks to improving job-market conditions, particularly with respect to the quality of employment, and other factors. For example interest rates for consumers are still historically low, and consumer lending is growing at high rates (20.5% average nominal rate for April), with a tendency to accelerate.

During the first quarter, transport machinery and equipment, as a component of applications for imports of capital goods, suggested good performance. Investment in construction, both buildings and civil works, also is expected to grow considerably, as indicated by cement sales and building permits for March. Added to these indicators are low commercial interest rates, which would support an expansion in investment during the remainder of the year.

With respect to external demand, the results on hand for March, in dollars, point to good export performance, even better than expected. This applies not only to sales of commodities, but also to manufactured goods. A look at the different destinations shows March witnessed an important increase in industrial sales to the countries in the region. Those to the United States experienced a recovery in level, even though annual growth remained negative. At the same time, imports continued to post a high rate of growth by March. Accordingly, a positive contribution to growth from net external demand still is not expected.

On the supply side, industrial production had increased by March at an annual rate of 5.2%. Vehicles, non-metallic minerals and petroleum refining were the most dynamic sectors, while iron and steel production fell again, due to the temporary shutdown of operations at Cerro Matoso for repairs. With the March data, growth in industry accelerated during the first quarter compared to the end of last year. Its expansion coincides with that of other indicators associated with the sector; namely, orders and inventories (Fedesarrollo), commercial lending, and the demand for unregulated energy.

The figures on hand for the second quarter are scarce. The most relevant one is the Fedesarrollo consumer confidence indicator, which fell considerably in April and is below its historic average. Nevertheless, these results may be influenced by winter weather, among other phenomena.

c. Financial Variables

In April, average nominal interest rates on consumer and ordinary lending were 17.5% and 10.1% respectively, with a 10 bp drop in consumer lending and a 7 bp increase in ordinary lending compared to the month before. The mortgage lending rate was 12.5%, which is 7 bp less than in March.

Average nominal annual growth in the total gross loan portfolio in domestic currency came to 17.7% in April, having been 16% the previous month. The consumer and mortgage loan portfolios were still the most dynamic, posting respective average nominal annual variations of 20.5% and

18.8%. In April, the average nominal annual increase in the commercial loan portfolio stood at 15.6%.

During May, interest rates on one-year government bonds were up by 9 bp, while those on five and ten-year bonds declined by 20 bp and 31 bp, respectively.

d. The External Context

The most important news on the external front came from the developed world. The economic recovery in the United States is less vigorous than anticipated. At the same time, the financial difficulties in the European periphery continue to worsen. Added to this complex panorama for the developed countries is the build-up in inflationary pressures, particularly within the Euro zone. The emerging economies, on the other hand, continue to experience high growth rates, coupled with inflationary pressures that have led the central banks to change the stance of their monetary policy.

The United States economy grew less in the first quarter of this year than in the final quarter of 2010. The slowdown was due to the cutback in government spending and the rainy weather at the start of the year. The pace of growth in household consumption was affected by the rise in energy prices, and the leading indicators at hand show no rebound in industrial and real estate activity during the second quarter. In contrast, although the figures for the job market indicate it remains loose, the reduction for the second straight week in applications for unemployment benefits may foretell an improvement in the employment situation.

Once again, the data on first-quarter growth in the Euro zone showed a contrast between the performances of two groups of countries. While Germany and France report good growth, the peripheral European countries exhibit no clear signs of recovery. Portugal rounded out two quarters of decline in a row, and Spain continued to grow at rates barely above zero.

Risk perception in the peripheral European economies continued to rise. Interest rates on Greece’s government bonds remain at record highs and fears about its sustainability are escalating. New fiscal adjustment measures are expected, particularly in Greece and Portugal.

There is an upward trend in inflation in the developed countries. This is especially the case in the Euro Zone, where inflationary pressures have begun to pass through to core inflation. Even so, intervention interest rates in the United State are not yet expected to increase. However, the situation in the Euro zone is less clear. In April, the ECB raised the rate to curb inflationary pressures and, in May, it decided to leave it unchanged so as not to jeopardize the peripheral European economies.

The emerging economies still are experiencing high growth rates. This, in turn, has reinforced the inflationary pressures in those countries. In the case of Latin America, inflation in Brazil and Peru continues to rise.

In recent weeks, oil and other raw material prices have posted declines associated with uncertainty about the performance of the developed countries and an increase in inventories. No additional falling off is anticipated in the coming months, although more volatility is expected.

2. DISCUSSION AND POLICY OPTIONS

The members of the Board of Directors weighted the possibility of raising intervention interest rates at this meeting, as part of the continuing effort to gradually undo the monetary stimulus.

The following points were emphasized:

(i) Interest rates are at record low levels in nominal and real terms.

(ii) All the lending components continue to grow at significant rates and there has been a build-up in household debt as well.

(iii) The new information suggests the rate of expansion in economic activity between January and March could be in the upper part of the forecast range (3.9% to 5.5%).

(iv) Terms of trade continue to improve and have reached record high levels, contributing to the growth in national income.

(v) Consumption continues to perform positively, and investment in machinery and equipment remains dynamic. The same is expected to be the case with civil works.

(vi) The indicators of quality employment in the job market have improved.

(vii) There is an increased likelihood of output being close to its potential.

(viii) Inflation expectations for the short and mid-term have adjusted downward and are within the target range.

(ix) Recent appreciation of the peso.

The following was noted with respect to risk:
(i) Despite some reductions, international oil prices are expected to remain high.
(ii) High international food prices continue to pose an international inflation risk.
(iii) Inflationary pressures persist in many countries, as do interest rate hikes by some central banks in Latin America and Asia.
(iv) Particularly low real interest rates for an excessively long period of time ultimately can pose a risk to financial stability. Moreover, the rate may be inconsistent with the near potential growth expected in 2011 and 2012 and a forecast for inflation near the mid-point of the long-term target range.

Considering all these factors and the time it takes monetary policy to have an impact on aggregate spending and inflation, the Board of Directors felt the move towards a less expansive monetary policy must continue. The new level of Banco de la República's intervention interest rate still supports short-term growth in output and employment.

The intervention rate hikes will assist in keeping inflation within the target range for this year and the next, and will help to avoid financial imbalances in the future. Likewise, the anticipated monetary-policy actions, coupled with an austere fiscal stance, should reduce the extent to which the intervention interest rate would have to be raised in relation to the levels witnessed in past economic cycles.

3. POLICY DECISION

The Board of Directors agreed to raise Banco de la República's intervention interest rate by 25 basis points, placing it a 4.0%.

Bogotá, Colombia
June 10, 2011