

Minutes of a Meeting of the Board of Directors of Banco de la República on June 15, 2007

A regular meeting of the Board of Directors of Banco de la República was held in the city of Bogotá on June 15, 2007.

Present:

Mr. Óscar Iván Zuluaga Escobar, Minister of Finance and Public Credit

Mr. José Darío Uribe Escobar, Governor

Directors:

Mr. Carlos Gustavo Cano Sanz

Mr. Juan José Echavarría Soto

Mr. Juan Mario Laserna Jaramillo

Mr. Fernando Tenjo Galarza

Mr. Leonardo Villar Gómez

The inflation situation was discussed and decisions were reached concerning the Bank's intervention interest rates. The following is a summary of the principal matters addressed.

1. Circumstances

a. Recent Developments in Inflation

Annual consumer inflation was 6.23% in May. This is beyond the target range set by the Board of Directors for December of this year (3.5% - 4.5%) and occurred despite a break in the upward trend in food inflation and in the consumer price index (CPI) without food. Although the average of the three core inflation indicators (non-food CPI, nucleus 20 and CPI without food and regulated items) declined from 5.29% in April to 5.21% last month, it also exceeded the target range for inflation.

Annual inflation in tradables remained at around 2% throughout the year, despite 13% appreciation so far in 2007. Inflation in non-tradables, without food and regulated items, experienced another slight rise, going to 5.1%. These increases were concentrated in rentals, but also were evident in other sub-groups associated with housing and health. Annual inflation in non-tradables, without food and regulated items, has risen by nearly 90 basis points since September, the month when it hit a low point.

The trend in food prices explains almost 77% of what has happened to the overall consumer price index during the course of 2007. This underscores the necessity of weighing the relative importance of temporary or permanent factors in the development of food prices.

Annual food inflation was 10% by the end of the month. This is close to the figure registered in April and was due to the trend in perishable foods (tubers, vegetables and fruits). It is a pattern that was expected to occur as the effects of El Niño weather subside.

However, the price increases in other food groups might be less temporary. In fact, prices for processed foods, including those for meat and food outside the home, continued to rise, as has been the case since March of last year. The increases were mainly in beef and beef substitutes, suggesting the continued effects of more Venezuelan demand and the increase in domestic demand. Inflation in food outside the home was up. Within the processed food group, prices for imported foods and/or those more directly affected by external prices performed well.

b. External Context, Growth and Financial Variables

External markets were more volatile because of the increased perception of risk associated with possible inflationary pressures in the United States and in most of the developed countries. The surge in risk was due, in part, to better indicators for industry, commerce and employment in recent weeks, coupled with gasoline and food price hikes. The recent interest rate hikes by several central banks were also a factor. They affected the performance of asset and foreign currency markets, and pushed up interest rates on international markets. The world economy is stronger than expected, and the likelihood of external interest rate hikes has grown. Even so, fundamental factors such as terms of trade and the growth of trading partners are now more favorable for Colombia, and no significant changes in long-term capital flows into the country are expected.

Available indicators for industry, construction and commerce confirm the fact that the Colombian economy performed quite well during the first quarter of the year. As a result, in addition to the momentum in the agriculture and government service sectors, and the figure released by the National Bureau of Statistics (DANE) on the increase in civil works during the first quarter of 2007 (42.7%), the Bank's technical team estimates that first-quarter growth could exceed 7%. On the demand side, the contribution from investment and household consumption is similar. Consumption would be up by about 8%, which is akin to the increase seen in the second half of 2006. Factors such as the growth in credit and the preliminary figures on imports appear to indicate the momentum has continued in recent months.

By May, the total loan portfolio in the financial system was still growing at an annual rate of 34%, with partial signs of recent lessening, primarily in regular credit. During the past two years, financial institutions continued to fund themselves through deposits and the sale of TES. As to the portfolio in foreign currency, the figures in May showed less of an increase than in April (US\$ 115 million as opposed to US\$ 565 million).

The Board of Directors has gradually raised the REPO interest rate since April 2006. There was less of an increase in the 90-day fixed deposit rate (DTF in Spanish), as was the case with other lending and deposit rates; some even declined in real terms, and real lending rates are at historically low levels. It is believed the increase in REPO rates will begin to have more of an impact on the other rates in the economy during the coming months.

In May, nominal interest rates on deposits remained unchanged, while lending rates had increased. The rise in interest rates on consumer and credit card loans might be associated with the adjustment in the usury rate.

Conditions for growth in aggregate demand remain favorable. There is still strong external demand, and terms of trade continue to be advantageous. These elements have softened the impact of appreciation on the tradable sectors.

2. Discussion and Monetary Policy Options

The following points were highlighted during the discussion: (i) the annual rate of growth in prices still exceeds the targets set by the Bank; (ii) non-tradable inflation continues to show no downward trend; (iii) the Bank's technical team raised its GDP growth projection for this year, reflecting the significant momentum in aggregate demand, which has gone beyond initial projections; (iv) the projections by the Bank's technical team suggest that inflation could exceed the target range set by the Board, even though some decline in inflation during the second half of the year is likely; and (v) prices for tradable goods have yet to reflect appreciation in the exchange rate.

Emphasis was placed on the fact that the Colombian economy continues to exhibit significant momentum. The technical team raised its GDP growth projections in the first quarter of the year as result of that momentum. Available indicators show that investment and consumption continue to perform well, and there have been no major changes in the international context that would have a negative impact on terms of trade. The risk of demand-pulled inflationary pressures is expected to continue, even though the effects of the interest rate hikes are expected to be more evident in the second half of the year. Also underscored was the important growth in credit, which has slowed a bit in recent weeks.

The main points of divergence among Board members concern: (i) the possibility of a reversal in food prices during the remainder of the year; (ii) the trend in prices for tradable goods and the impact of peso revaluation; and (iii) the lag in the pass-through of previous hikes in intervention interest rates to market interest rates, and the advisability of adopting further changes at the present meeting.

Several Board members voiced their concern about rising food prices and the possibility that the decline expected during the second half of the year could be less than was projected initially, by being concentrated exclusively in perishable food prices. Essentially, this is because both the demand for food in Venezuela and high international prices could last longer than expected. However, other Board members noted that prices for certain raw materials used to produce biofuels have lost ground at the international level. Sugar is one example, and the same might happen to the others. The price of corn could decline, given the anticipated size of the corn harvest in the United States. These elements can have an important effect in terms of lowering food inflation.

Several Board members stressed the importance of carefully examining the trend in prices for tradable goods. Their annual growth rate has not slowed, despite the performance of the exchange rate, and this situation could become even more pronounced during the second

half of the year. Others pointed to this as evidence of the current strength of aggregate demand, which is considerable.

One group of Board members said it was advisable not to raise intervention interest rate at this meeting and to review the matter again, at the next meeting, expecting that measures already adopted on this and other monetary policy fronts would achieve results in terms of more favorable rates of inflation. They emphasized that although there has been more of a lag in pass-through of the measures adopted by the Board, due to the change in the structure of funding for credit institutions, which are selling off TES investments in favor of loans, some deposit rates are reacting to the increase. They called attention to the possible effects stimulating more of an influx of foreign capital could have on the exchange rate, and warned that tightening monetary policy too much, at a time when GDP and employment have registered satisfactory growth for four years, and inflation is converging towards its long-term target, could frustrate economic growth.

Other members reminded the Board that market interest rates, in real terms, are historically low, despite recent adjustments; some have declined since this Board began to raise rates in April 2006. They also underscored the importance of inflation forecasts and the need to stabilize expectations of inflation as a condition for the inflation rate to converge towards the long-term targets. Finally, they noted that the risk balance, at present, indicates more threat of higher inflation than less growth.

3. Policy Decision

By a majority of votes, the Board of Directors agreed to an increase of 25 basis points in Banco de la República's intervention interest rates.

Bogotá D.C. June 29, 2007