



Minutes of a Meeting of the Board of Directors of Banco de la República on August 24, 2007

A regular meeting of the Board of Directors of Banco de la República was held in the city of Bogotá on August 24, 2007.

Present:

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

Mr. José Darío Uribe, Governor of Banco de la República

Directors:

Mr. Carlos Gustavo Cano

Mr. Juan José Echavarría

Mr. Juan Mario Laserna

Mr. Fernando Tenjo

Mr. Leonardo Villar

The situation with respect to inflation was discussed and monetary-policy decisions were reached. The following is a summary of the principal matters addressed at the meeting.

1. Circumstances

a. Recent Developments in Inflation

Consumer inflation declined in July, for the third month in a row, closing at 5.77%. This is 26 basis points (bp) below the rate in June and 49 bp less than the high point in April.

All the core inflation indicators used by Banco de la República performed well. Their average declined from 5.1% to 5.0% between June and July. This is a continuation of the downturn observed since April, when the average was 5.3%.

As expected, annual food inflation continued to fall, primarily because the weather returned to normal and lowered perishable food prices. Processed food inflation was down as well, thanks to a small reduction in meat prices.

Tradable inflation, without food, went from 1.76% in June to 1.62% in July. This is, however, a minor decline compared to cumulative appreciation of the peso during the past year.

Non-tradable inflation, without food and regulated prices, continued to climb, as it has been the case since April, and was 5.45%, as opposed to 5.1% the month before. Annual inflation in rentals, a component of this group, went from 4.6% in June to 4.8% in July. Annual inflation in the “Others” sub-group, which does not include rentals, rose by 43 bp to 6.3%, basically because of the increase in “entertainment, culture and leisure”.

Inflation in regulated prices was down. These prices are tied, in part, to the producer price index (PPI), and have benefited from the absolute decline in this indicator, which is linked closely to developments in the exchange rate. The pace of inflation in consumer price index (CPI) regulated goods and services declined from 7.4% in June to 6.6% in July, despite upward pressure from fuels prices and public transportation fares.

b. Growth, the External Context and Financial Variables

Available data continue to show strong domestic economic growth. DANE reported an increase of 11.9% in industrial production during June and 9.2% growth in commercial sales compared to the same month last year. The total number of workers hired was up by 4.2% in industry and 6.6% in commerce. The trend in building permits at June (39% growth) is an indication this economic activity will expand considerably during the second half of the year.

The cumulative increase in exports for the 12 months ended at May was 15.0%. This is explained by the way traditional and non-traditional exports have performed, particularly exports to Venezuela, which were up by 47.0%.

The strong growth in imports up to June (26% accumulated for the 12 months) demonstrates no major change compared to the tendencies witnessed in past months. Imports of consumer goods, in dollars, grew this month at a rate of more than 30%. Imports of capital and intermediate goods increased at a rate of nearly 25%, reflecting the good momentum in industrial manufacturing.

The International Context

The markets have been more volatile than in previous months, because of the sub prime mortgage crisis. Uncertainty about its impact, coupled with high leveraging by investors, has dampened the appetite for risky assets and has caused a substantial reduction in market liquidity.

The emerging markets have been affected by this situation through an increase in the risk premium (measured by the EMBI+). However, it has been less than the increase in the risk premium on high-yield bonds in the US market. The exchange rate in Colombia reacted more sharply than in other countries throughout the region, but the loss in stock market value was moderate. Other domestic assets, such as long-term TES, also experienced losses.

Financial Variables

The slowdown in monetary aggregates continued during July, partly because of less cash growth. The increase in liabilities subject to reserve requirements has eased recently, but was still high in July. The last few months have witnessed a relative recovery in certificates of deposit compared to checking accounts.

Credit slowed again in July. Annual growth in the total loan portfolio was 28.5% following 29.5% the month before. The slowdown applies to all types of loans, except mortgages, which continued to gain momentum. The annual increase in mortgages was 17.3% in June and 19.4% in July. Annual growth in the consumer loan portfolio has been 23.4% in recent months. This amounts to an annualized quarterly growth rate of 31%.

The interbank interest rate (TIB) averaged 9% in June, with an increase of 20 bp last month and 310 bp since April 2006, when the Board of Directors of Banco de la República began to raise its intervention interest rates. Nominal lending rates increased slightly in July (between 16 bp and 21 bp), accumulating an almost 180 bp hike since April 2006 (240 bp for CDs alone). There was more of an adjustment in lending rates, particularly on consumer and credit card loans, which have approached the usury rates. Between April 2006 and July 2007, the rates on preferential and treasury loans accumulated respective increases of 424 and 457 bp. The rise in interest rates on ordinary, consumer and credit card loans during the period has been much less: 183, 230 and 280 bp, respectively. In most cases, the real rates are near average historic highs for the decade, with the exception of interest rates on preferential and treasury loans, which have surpassed those highs.

2. Discussion and Policy Options

The following points were raised during the discussion: (i) the figures for July confirm the upward trend in annual price growth has ended, as was detected during the last two months; (ii) even so, inflation continued to exceed the Bank's targets; (iii) the upward trend in non-tradable inflation, without food and regulated prices, continued; (iv) the momentum in aggregate demand remains strong; (v) prices for tradable goods do not fully reflect exchange rate appreciation; and (vi) all expectations of inflation have declined. The mid-term expectations are below 4%; however, although the short-term expectations remain above target.

The factors that explain the high economic growth rate are still in place. External demand continues to be strong, terms of trade remain favorable, and credit

continues to grow at a fast pace. On the whole, these factors make for a scenario where aggregate demand will continue to grow, bolstering economic growth in the short term.

The Board believes its intervention interest rate hikes and the change in reserve requirements are continuing to have the desired effect on prices, credit growth and monetary aggregates.

The discussion centered on: (i) the impact of monetary policy, given the lag in monetary policy measures; (ii) uncertainty about the behavior of inflation during the remainder of the year and the possibility that prices might increase less than was forecast a month earlier; (iii) the impact of a wider output gap; (iv) developments in the current account, particularly the possibility that changes in the international context could lead to major adjustments in the availability of external financing and in exchange and relevant interest rates for the emerging economies; and (v) the uncertainty generated by the extreme volatility of international markets and how it could affect the Colombian economy.

A majority of the Board members felt it was appropriate to hold off on further hikes in the Bank's intervention interest rate until more is known about the possible consequences of the volatility on international markets and the impact of monetary policy on aggregate demand and prospects for inflation. In this respect, it was noted that available figures show increased pass-through of monetary policy to interest rates. The rise in interest rates in the economy and the slowdown in growth in monetary aggregates and credit are evidence of this pass through.

Other members said they preferred to continue to raise the Bank's intervention interest rates, particularly because of the sharp momentum in aggregate demand, the increase in prices for non-tradable goods, except food and regulated prices, and the fact that growth in monetary aggregates and credit remains high. Even though inflation and inflationary expectations have shown signs of a downturn, some Board members expressed concern that inflation has declined less than expected, which jeopardizes convergence toward the future targets for inflation. Lastly, they indicated that postponing an increase in these rates might imply the need for higher interest rates in the future.

3. Policy Decision

By a majority of votes, the Board of Directors decided to leave the Bank's intervention interest rates unchanged.

Bogotá D.C., September 7, 2007