



## **Minutes of a Meeting of the Board of Directors of Banco de la República on October 26, 2007**

A regular meeting of the Board of Directors of Banco de la República was held in the city of Bogotá on October 26, 2007.

Present:

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

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

Full-time Associate Directors:

Mr. Carlos Gustavo Cano

Mr. Juan José Echavarría

Mr. Juan Mario Laserna

Fernando Tenjo Galarza

Mr. Leonardo Villar

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

### **1. Background**

#### **a. Recent Developments in Inflation**

Annual consumer inflation declined in September for the fifth month in a row, closing at 5.01% (21 bp below the rate in August). All the other core inflation indicators performed similarly.

As expected, following the negative supply shock attributed to El Niño weather conditions, annual food inflation continued to decline and accounted for much of the drop in inflation. The reduction was in both processed and perishable foods.

Non-tradable inflation, excluding food and regulated prices, was 5.55%, which is similar to the figure registered in September. It should be noted, however, that this indicator still exhibits no sign of a downward trend.

The past month saw a drop in tradable inflation, excluding food and regulated prices, that was consistent with the way the exchange rate performed. The total producer price index (PPI) registered negative annual growth for the fourth month in a row (0.91%), which also had an impact on regulated price inflation.

## **b. Growth, the International Context and Financial Variables**

Domestic economic growth remained strong. Although estimated GDP growth for the second quarter (6.9%) was lower than the last quarter figure (8.1%), available data suggest the outcome for growth at the end of the year will be similar to what it was in 2006.

The figures for June-August point to 11% unemployment in the 13 major metropolitan areas. This is 1.5 percentage points below the unemployment rate for the same quarter in 2006. Other job-market indicators show a continued rise in employment in industry and commerce, as indicated by the July figure, with respective annual variations of 2.9% and 6.2%.

The momentum in exports (15.3% growth, in dollars) is due largely to the increase in sales of non-traditional products, which accounted for nearly 64% of the rise in export value. Venezuela is still our fastest growing trading partner, with an annual increase of 73.1% in accumulated exports between January and June. Exports to the United States were down by 6.4% during the same period.

Imports continued to grow at a high rate, although there are signs of less momentum compared to the early months of the year, particularly with respect to capital and consumer goods.

### **International Context**

The world financial markets are still uncertain about the magnitude and duration of the recession in the US housing market and how it will effect growth in the developed economies.

The economic growth estimates for some of our major trading partners have been revised downward. However, prices for most export commodities are expected to remain high, which would maintain favorable terms of trade.

### **Financial Variables**

The rate of growth in monetary aggregates has exhibited a downward trend. However, it was not seen in September. The annual variation in M3, base money and cash was 16.4%, 11.8% and 8.1%, in that order. As to liabilities subject to reserve requirements, the relative recovery in CDs compared to current accounts was maintained.

In September, the annual growth in credit was 27%, which is more than the figure at August. The annual increase in the consumer loan portfolio was 39.4%, down slightly with respect to the month before. In contrast, commercial loan portfolio growth went from 20.5% to 22.2% and the mortgage loan portfolio continued to increase at an annual rate of 19.2%.

The interbank interest rate (TIB in Spanish) was slightly above Banco de la República's intervention rate. In real terms, the fixed-term (DTF in Spanish) and lending rates increased significantly during the third quarter. Although these levels are higher if compared to the leading rates during recent periods of lower inflation.

## **2. Discussion and Policy Options**

The following points were raised during the meeting:

- (i) Despite the sizeable reduction in annual inflation at September, prices continue to grow at rates that exceed the targets set by the Board of Directors.
- (ii) Food played a major role in the recent decline in inflation.
- (iii) The impact of peso appreciation on prices for tradable goods has been limited.
- (iv) Non-tradable inflation, excluding food and regulated prices, still shows no sign of a downward trend.
- (v) Available indicators suggest the momentum in aggregate demand remains high.
- (vi) Inflation expectations have declined, but continue to exceed the established targets.

The Board believes the various indicators are proof that its monetary policy measures (intervention interest rate hikes and changes in reserve requirements) have been effective in terms of reducing the growth in monetary aggregates and credit. In the recent months, these measures have strengthened monetary policy transmission channels generating important lending interest rates increases, which in turn has placed these rates at more coherent levels with a moderate aggregate demand. However, it was noted that last month have witnessed an increase in some credit components and in the growth rates for monetary aggregates.

Furthermore, external demand is still strong, terms of trade continue to be favorable and even improved recently, and credit continues to grow at high rates. As a whole, these factors constitute a scenario where aggregate demand is still on the rise.

The main points of discussion focused on: (i) the effect of monetary policy measures, given the lag in their impact; (ii) the elements that affect inflation forecasts for the remainder of 2007 and 2008; (iii) developments in the current account and particularly the possibility that changes in the international context could lead to future adjustments in the exchange rate; (iv) the impact of the output gap on prices; (v) the uncertainty sparked by high volatility on international markets and the effect it could have on the Colombian economy; and (vi) the possible aggregate demand growth deceleration as an effect of monetary policy decisions made so far.

The Board unanimously agreed it would continue to hold off on further hikes in Banco de la República's intervention interest rates until more information is available to assess the consequences of the external crisis and the ripple effect of the country's monetary policy on aggregate demand and prospects for inflation. It also emphasized the high degree of uncertainty

surrounding forecasts for inflation and economic growth, given the international situation. On the one hand, a return to rates of growth in domestic demand coherent with the targets for inflation and sustainable current accounts might be slower than expected, which could mean future hikes in the intervention rate. On the other hand, the mortgage crisis in the United States might take longer to solve and have more of an impact on world economic growth than was thought initially. In the case of the Colombian economy, this would affect demand, export prices and future access to international capital markets.

The Board emphasized that, with inflation and inflation expectations tied to medium and long-term targets, the monetary authority would have more freedom to implement an anti-cyclical policy in the event of an unfavorable scenario for the Colombian economy.

### **3. Policy Decision**

The Board of Directors unanimously agreed not to alter Banco de la República's intervention interest rates.

Bogotá D.C. November 9, 2007