



## **Minutes of a Meeting of the Board of Directors of Banco de la República on September 21, 2007**

A regular meeting of the Board of Directors of Banco de la República was held in the city of Bogotá on September 21, 2007.

Present:

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

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

Full-time Associate Directors:

Mr. Carlos Gustavo Cano

Mr. Juan José Echavarría

Mr. Juan Mario Laserna

Mr. Leonardo Villar

The inflation situation was discussed and monetary-policy decisions 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 declined in August for the fourth month in a row, closing at 5.2% (55 bp below the rate in July). All the other core inflation indicators performed similarly.

Annual food inflation continued to decline, as was expected, mainly because the weather returned to normal. The reduction was in processed foods as well as perishables, particularly meat and potatoes.

Non-tradable inflation, excluding food and regulated prices, was 5.56%, having been 5.45% the month before. This indicator has climbed steadily since October 2006. One prominent item was rental inflation, which increased in August to 4.9%.

The past month saw a drop in tradable inflation, excluding food and regulated prices. Although regulated price inflation remained stable in August (6.6%), the figures were higher than expected.

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

As to growth in domestic demand, available data continue to reflect strong momentum. DANE reported an increase of 6.87% in GDP during the second quarter of the year, fueled by investment and the build-up in family consumption. Positive performance is forecast for the rest of 2007, as suggested by industrial growth during July and the good outcome for the consumer confidence indicator.

The increase in total exports stabilized at around 15% during the second quarter of 2007. Traditional exports were up by 12.8%, on average, between April and June, while the annual growth in non-traditional export was 21.8% by June. Exports to the United States are down; however, that reduction has been offset, in part, by increased sales to Venezuela and other countries.

With the figures at August, the high growth rate for imports continued (26.8% compared to January-August 2006), although less so than during the early months of the year (30% for January-April). The slowdown is particularly noticeable in capital and consumer goods imports.

#### **The International Context**

On the international front, the markets continue to reflect a great deal of uncertainty, due to the mortgage crisis in the United States. It raised risk perception worldwide and placed constraints on liquidity in a number of markets, prompting several central banks to intervene. The United States Federal Reserve Bank cut its policy rate by 50bp, leaving it at 4.75%. This was done in an effort to soften the impact of the drop in home prices in that country.

It is uncertain how the Colombian economy will be affected by the recent changes in the international context. On the one hand, the risk that the financial turbulence will spell less growth in the United States has increased, even though international analysts do

not foresee a recession in that country. On the other, the recent increase in prices for various commodities exported by Colombia, such as oil and coffee, could have an expansive impact on aggregate demand. Moreover, the hike in prices for some imported agricultural products, such as wheat, can cause inflationary pressures.

## **Financial Variables**

The slowdown in monetary aggregates continued during August, due to less growth in cash. The increase in liabilities subject to reserve requirements (LSRR) slowed as well, but remains high, and the relative recovery in CDs, compared to current accounts, continues.

Credit decelerated again in August. Annual growth in the total gross loan portfolio in pesos was 24%. This is 145 basis points less than in July. All types of credit experienced a slowdown, with the exception of mortgages, which continued to gain momentum. The annual increase in mortgages went from 19% in July to 19.8% in August.

The interbank rate (TIB in Spanish) stayed slightly above the Bank's intervention rate. Even though there was no change in the intervention rate, interest rates on CDs and average lending rates were up during August.

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

The following points were raised during the meeting:

- (i) Although the pace of annual inflation slowed considerably during August, the annual increase in prices continues to exceed the Bank's targets.
- (ii) The impact of peso appreciation on prices for tradables has been limited.
- (iii) The upward trend in non-tradable inflation, excluding food and regulated prices, continues.
- (iv) Available indicators suggest that aggregate demand continues to grow at a high rate.
- (v) Inflation expectations have declined, but are still above the targets set by the Bank.

The Board believes the various indicators show that its monetary policy measures (intervention interest rate hikes and the change in reserve requirements) have cut back on the increase in monetary aggregates and credit.

The factors that explain the high rate of economic growth are still in play. External demand continue to be strong, terms of trade remain favorable, as illustrated by the increase in oil and coffee prices in recent weeks, and the growth rates for credit are still high. On the whole, these factors make for a scenario where aggregate demand will continue to increase at a fast pace, fueling short-term economic growth.

The Board's deliberations focused on: (i) the impact of monetary policy, given the lag in monetary policy measures; (ii) uncertainty about how inflation will behave during the remainder of the year; (iii) developments in the current account, particularly the possibility that changes in the international context could prompt major changes in the exchange rate; (iv) the impact of the widening output gap; and (v) the uncertainty generated by the extreme volatility on international markets and how it could affect the Colombian economy.

The Board unanimously agreed to continue to hold off on further hikes in the Bank's intervention interest rates until more information is available to assess the possible consequences of the external crisis and the impact of the country's monetary policy on aggregate demand and prospects for inflation. The considerable uncertainty surrounding forecasts for inflation and economic growth, given the international context, was emphasized. On the one hand, the return to rates of growth in domestic demand that are consistent with the inflation targets and sustainable external accounts might be slower than expected, which would lead to future hikes in the intervention rate. On the other, the solution to the mortgage crisis in the United States could be slower in coming and have more of an impact on world economic growth than was anticipated initially. For Colombia, this could affect demand, export prices, and future access to the international capital market.

### **3. Policy Decision**

The Board of Directors unanimously agreed to make no change in the Bank's intervention interest rates.

Bogotá D.C. October 5, 2007