



Minutes of a Meeting of the Board of Directors of Banco de la República on December 14, 2007

A regular meeting of the Board of Directors of Banco de la República was held in the city of Bogotá on December 14, 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. Fernando Tenjo

Mr. Leonardo Villar

The situation with respect to inflation, economic growth and prospects for the future was discussed, and monetary-policy decisions were reached. The following is a summary of the principal topics addressed during the meeting.

1. Background

Recent Developments in Inflation

By November, the annual variation in the consumer price index came to 5.41%, which is 25 basis points more than in October (5.16%). The increase was concentrated in foods and, to a lesser extent, in tradables and regulated prices, particularly electricity and fuel prices. Most of the core inflation indicators behaved in the same way.

The annual variation in food prices was due to the sharp increase in prices for perishable and processed foods. Inflation in vegetable prices was particularly high, due to winter weather, as was inflation in cereals and oils, which are tied to the behavior of international prices.

Annual inflation in non-tradables, excluding food and regulated prices, declined from 5.33% in October to 5.27% in November. Rentals were down for the third month in a row, as were prices in the banking services sub-group, offsetting the increase in entertainment, culture and leisure activity.

Growth, the External Context and Financial Variables

Local economic growth remained strong. The limited amount of new information, such as the consumer confidence index and figures on the labor market, is consistent with the GDP growth forecasts listed in the September 2007 edition of the *Inflation Report* published by Banco de la República, which predicted the second half of the year would see less momentum than the first.

Export growth remained high. By August, the annual increase in total foreign sales, in dollars, was 18.5%. Most of the growth was in sales to the Venezuelan market, which were up by 76.8% and accounted for 14.9% of total Colombian exports.

The International Context

During the past month, the extent and duration of the recession in the US housing market and its impact on world economic growth was still uncertain. Several leading indicators for the industrial and non-industrial sectors suggest a weakening US economy and persistence of the problems facing the mortgage sector and various financial institutions. The Federal Reserve lowered its benchmark rate by 25 bp at a meeting on December 11, and, in conjunction with other central banks, offered the market more liquidity to alleviate the liquidity problems of certain financial institutions.

These doubts about the US economy have fueled fears of a slowdown in other developed economies. Added to this is the emergence of new inflation pressure originating with high oil and food prices and uncertainty about the future of Colombian exports to Venezuela.

Prices for most export commodities are expected to remain high, which would keep terms of trade favorable for Colombia.

Financial Variables

In the financial system, annual growth in the total gross loan portfolio denominated in Colombian pesos slowed from 25.1% in October to 24.1% in November. Less growth also was evident in the consumer loan portfolio, with annual rates of 36.7% and 35% for the same dates. The commercial and mortgage loan portfolios lost momentum as well, but not as much. They were up by 19.6% and 17.8%, respectively, compared to 20.3% and 18.3% the month before.

In November, interest rates on deposits were again on the rise, particularly the average CDT rate. The average lending rate was 16.7%, which is a reduction of 11b.p. with respect to October.

2. Discussion and Policy Options

The following points were emphasized during the discussion:

- (i) Prices continue to rise at a pace that exceeds the targets set by the Board of Directors.
- (ii) Food weighs heavily on inflation in an international context marked by upward pressures.
- (iii) Non-tradable inflation, without food and regulated prices, continued to decline, but is still above levels that are compatible with the targets for inflation.
- (iv) Available indicators suggest the momentum in aggregate demand remains high compared to production, but is showing signs of moderation.
- (v) The future of the world economy and that of our major export markets, particularly Venezuela, remains uncertain.
- (vi) What are the monetary-policy implications of the inflation targets set by the Board and how will inflation expectations respond to those targets?

The Board believes the various indicators show the benchmark rate hikes and the change in reserve requirements have been effective in helping to curb the increase in credit. The channels for monetary policy pass-through have been reinforced in recent months. In any case, credit continues to grow at high rates and the increase in local demand still exceeds the rise in national production, but is slowing.

External demand remains strong. Terms of trade continue to be favorable, and even are improving.

The Board's deliberations focused on: (i) the effect of monetary-policy measures, given the lag in their impact; (ii) the elements that will influence inflation forecasts for 2008; (iii) the increase in the current account deficit, which indicates local demand is growing faster than national production; (iv) the fact that international developments, in the context of a current account deficit, might lead to future adjustments in the exchange rate; (v) the uncertainty sparked by extremely volatile international markets and how that volatility could affect the Colombian economy; and (vi) the need for the monetary authority to enhance its credibility as a strategy to anchor inflation expectations, given the upward price trends countries have had to contend with.

The Board emphasized that the current environment, which is one of considerable uncertainty, makes it difficult to anticipate precise decisions on benchmark interest rates. Several members noted that, in spite of the policy measures adopted throughout the year, inflation continues to display a troubling upward tendency that distances it from the long-term target defined at the last meeting. This has been manifest partly in the behavior of expectations. At the same time, the need for additional hikes at some time in the future cannot be ruled out if the figures suggest they are advisable to ensure the inflation targets are met and to maximize sustainable economic growth.

Other members reiterated an opinion expressed at the Board meeting on November 23 of this year, in the sense that the current interest rate is consistent with a contractionist monetary policy. It was stressed that available information does not

suggest the need for future benchmark rate hikes, that the country's monetary policy has been fulfilling its objectives in terms of curbing growth and credit and anchoring expectations towards meeting the targets for inflation, and that it would be possible to return to a more neutral stance, depending on how external conditions and local price and employment levels develop.

The Board unanimously agreed to hold its benchmark rate at 9.50%. It believes the impact the international economic situation could have on growth, as well as the effect of inflation pressures originating with international food and fuel prices must continue to be monitored carefully.

3. Policy Decision

The Board of Directors unanimously agreed to make no change Banco de la República's benchmark rate.

Bogotá D.C., Colombia
December 28, 2007