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Cartagena Customer Branch
Cartagena

Chapter 2

Our Operational Environment

We make it easier for our customers to do business around the world.

Due to the Bank's globalization strategy, we are present in 11 different countries, giving our customers quick and easy access to global markets.

2. Our Operational Environment

International Context

Global economic activity displayed a stabilizing trend during the first semester of the year, although signs of moderate growth were evident in some of the world's major economies. While the United States and Japan showed signs of improved activity, the Eurozone came out of its recession, and China continued with healthy, moderate economic growth. Overall, global growth forecasts were lowered, and the International Monetary Fund is now projecting 3.1% growth for 2013. Nevertheless, the second half of the year is pointing to an improved scenario, with a stronger US economy and a recovery in the Eurozone.

In terms of prices, inflation continues to take a back seat. The first semester recorded the lowest inflation annual increase of the last decade (excluding the global financial crisis of 2008-2009) The trend was influenced by a drop in the price of commodities, which relented during the semester despite the stability recorded in petroleum. Inflation is expected to increase moderately for the rest of the year, and it is not seen as a significant risk by most of the world's central banks. The International Monetary Fund is forecasting an annual growth of 3.8% for 2013, lower than the previous three years.

The monetary policy was the most commented factor over the semester because of the significant changes that came up toward the end of the fiscal year. While it was confirmed that the monetary stimulus in the US will be reined in soon, central banks in the Eurozone and England adopted a forward guidance policy on interest rates, anticipating that it will remain low for a prolonged period. Meanwhile, Japan began an aggressive monetary stimulus that is expected to double the country's monetary base in two years, and China's central bank sought to hold back the accelerated lending dynamic by limiting the economy's liquidity.

Regarding emerging economies, they saw a new round of cuts in their interest rates, with some surprises in the magnitude or timing of these adjustments. Excluding Brazil, Indonesia and Egypt, all the major emerging economies held or reduced their interest rates, seeking to support sub-par growth potential with low levels of inflation.

The American monetary policy announcements were particularly relevant and marked international market trends, propitiating generalized increases in fixed income rates, credit spread expansions, a generalized strengthening of the dollar against other currencies, and losses in most of the world's stock markets, except for the US stock market.

> The global economy trended towards stabilization due to the improvement in activity in the United States and Japan

Colombia

As a result of a still challenging international scenario and some specific events in the local environment, the **Colombian economy** began the year with a low annual growth of 2.8% during the first quarter. The best performance was seen in the construction sector, with 16.9% annual growth, while on the other extreme the industry continued shrinking by -4.1%. Meanwhile, mining grew at a mere 1.4%, affected by coal industry strikes, while agriculture grew by 2.4% despite farmers' protests. On the demand side, investment performed well (7.2%), as did consumption (3.5%), but the external sector shrank.

Nonetheless, multiple activity indicators for the second quarter confirmed that the worst of the slowdown appears to be over, and that the economy began to recover this period. **Consumer and trader confidence** improved, retail sales rebounded, and there were positive signs from the construction industry. Also, the expansive monetary policy impacted the lending dynamic. Thus, Banco de Bogotá is keeping its growth forecast just below 4.0% for 2013.

Despite moderate growth, and in response to the recovery experienced during the second quarter, national **unemployment** dropped to 9.2%, the lowest percentage in this period since monthly measurement of this indicator began. Although the employment outlook continues to improve, some sectors such as construction and industry limited the decrease of unemployment.

Decreased growth continued to be a restraining factor on prices, causing **inflation** to average 2.0% for the semester, just below the goal set by the Central Bank of Colombia (2.0%-4.0%). The outcome for basic inflation was also favorable, averaging 2.2%, excluding

food prices, and 2.6%, also excluding regulated goods. In inflation by category, food, transportation and tradeable goods account for the low price variation, while healthcare, education and particularly, electricity represent the high price.

As has been the case for quite some time, the inflation outlook is under control, and future risks are few. Even so, it is probable that inflation will continue an upward trend for the remainder of the year on account of the normalization of food prices, a moderate increase in inflation of tradeable goods as a result of the recent dollar appreciation, and some more pressure by the non-tradeable goods as the economy recovers.

In August 2013, the annual increase in inflation was of 2.27% and year to date, it showed a variation of 1.86%. Banco de Bogotá anticipates inflation of around 2.4% by year's end.

As indicated earlier, the macroeconomic balance began the semester with growth-related risks, which resulted in additional **interest rate cutbacks by the Central Bank of Colombia** to 3.25% in March from a high of 4.25% at the end of 2012. Since then, the Board, along with its two new members, has maintained the reference rate, but it continued to intervene on the monetary policy by retracting liquidity through placing the monetary control TES (MC TES). At the close of semester, there were COP 9 trillion of this type of securities in circulation, and the entity announced that it intended to continue auctioning them off to replace securities that mature in the short-term. Banco de Bogotá expects a 25-basis points reduction in the interest rate to 3.0% in the coming months, and after that, it should be stable until the end of the year.

In the first semester, the Colombian economy experienced limited growth in a difficult international environment.

The need for reduction in the current liquidity is derived from the Central Bank of Colombia's exchange intervention. In May, it extended the dollar-buying program until September for USD 2,500 million. The Central Bank of Colombia bought USD 4,300 million between January and June, and if the totality of the announced purchases is made, 2013 would set the record for the year with the highest intervention, with almost USD 5,800 million in accumulation of international reserves.

Increased intervention, repeated government announcements about its concern over the exchange rate, the possibility (albeit delayed) of an adjustment to minimum profitability regulation and currency hedging of pension fund portfolios, marginal moderation of dollar flows reaching the country, and more importantly, worldwide appreciation of the dollar in the face of a reduced excess supply of dollars, all accounted for the peso's depreciation during the semester. **The exchange rate** was COP 1,929 in June.

Although the market has been very volatile and may continue thus in coming months, Banco de Bogotá estimates that the exchange rate will end 2013 between COP 1,870 and COP 1,900. At the end of August 2013, the exchange rate was COP 1,935, with a semester devaluation of 8.7%.

Central American Economic Environment

Economic growth in Central America, as measured by the **Monthly Indicator of Economic Activity** (**IMAE** by its Spanish acronym) in June, exhibited positive annual growth in all those economies, resulting in joint progress of 3.0%. Panama and Nicaragua made noteworthy progress, with growths of 5.3% and 4.9%. Guatemala followed this dynamic closely with 4.0% growth, while Costa Rica (2.7%), El Salvador (1.7%) and Honduras (1.7%) showed more moderate growth.

The activities that affected results the most vary considerably by country. For example, in Panama most sectors showed a positive performance , the energy sector made the largest contribution in Nicaragua, and financial intermediation stood out in Guatemala.

The International Monetary Fund (IMF) predicted **economic growth** for 2013 in the Central American countries of 4.5%, with a broad range of 1.6% in El Salvador to 9.0% in Panama. Costa Rica and Nicaragua were to grow around 4.0% or more, and Guatemala and Honduras were do so at 3.3%.

In terms of prices, the region's **inflation** in July was 4.7%, above that recorded the previous year and the previous month. The trend was affected by an upturn in the price of oil, as exports of this product are significant for these economies. Stability is evident by country: El Salvador (1.1%), Panama (4.1%), Honduras (5.6%) and Costa Rica (5.8%), and upturns in Guatemala (4.7%) and Nicaragua (7.7%). It should be noted that the risk of inflation is present only in the latter. The IMF is forecasting inflation of 4.7% for the region in 2013.

With regard to **exchange rates**, countries with their own currencies (Honduras, Costa Rica, Guatemala and Nicaragua) recorded scant volatility, as is usually the case given their exchange systems.

On the **monetary policy** front, the Central Bank in Costa Rica reduced the reference interest rate by 100 bps to 4.0%, while Guatemala experienced a small increase of 25 bps to 5.25%. The interest rate in Honduras held at 7.0%. Overall, the reserves for economies that use the tool were unaltered for the period in question.

Colombian Banking System

The Colombian Banking System Is Highly Competitive and Has Maintained Solid Growth

The Colombian Banking System reflects a solid structure that is highly competitive and performs well in the main indicators, which allows it to finance the country's development and to transfer the benefits to the people. Its structure has been strengthened with the entry of new local players, the consolidation of traditional banking, the globalization of local banks and the arrival of international entities, which allows it to offer:

1. Wider and better range of products and services
2. Cost reduction reflected in placement rates
3. On-going support for government initiatives in the housing sector
4. Continued Bank financing of domestic production
5. Greater dynamism and depth in the Capital Market
6. Financial inclusion and promotion of new virtual channels
7. Reduced service costs
8. Wide coverage

Banking system assets closed at COP 365.3 trillion in the first semester of 2013 (an annual growth of 17.2%). One outstanding feature is the positive loan placement performance, which recorded 16.6% annual growth in net portfolio, reaching COP 236 trillion. Commercial and consumer loans recorded growth of 16.7% and 13.5%, respectively. Growth took place with proper risk management: Loan quality was placed at 2.96%, while the level of coverage was 152.6%.

Furthermore, total investments were COP 69.2 trillion, with an annual growth of 17.6%. In May and June, the investment

[1]Most recent Central Bank comments available

portfolios of some banks in the system were affected by a reduction in the TES rates, but they performed well in terms of assets and profits.

Moreover, deposits grew 21% and closed at COP 239 trillion. Savings accounts recorded significant growth (24.3%) and totaled COP 119.3 trillion.

Equity for the first semester of 2013 closed at COP 47.4 trillion, COP 4.5 trillion more than the same period of the previous year.

The sector's positive performance made it possible for the accumulated profits in June to rise to COP 3.5 trillion, 1% more than the same period of the previous year. In terms of financial indicators, as of June 2013, the banking system's ROE closed at 15.0%, while the ROA closed at 2.0%. In general, while profitability indicators show a slight moderation, profits and equity confirm the system's soundness.

Banco de Bogota's Share of the Colombian Banking System

At June 2013, the Bank's operation in Colombia increased its share in investments, consumer loans, mortgage loans, savings accounts, TDs, equity, net commissions and profits. Similarly, the Bank stands out in the Banking System because of its share of main line items: assets of 14.6%, net loans at 13.7%, deposits of 15.1% and profits of 22.7%.

Banco de Bogotá, Cali Branch

Central American Banking System

The Central American Financial Market Has Great Opportunities for Growth

The Central American banking system continues to grow (11.3%)*. Loan placements and deposits increase alongside the diversity of products offered on the market. At the same time, the low level of bank depth in Central American countries (41.7%) has allowed them to expand business volume and income generation.

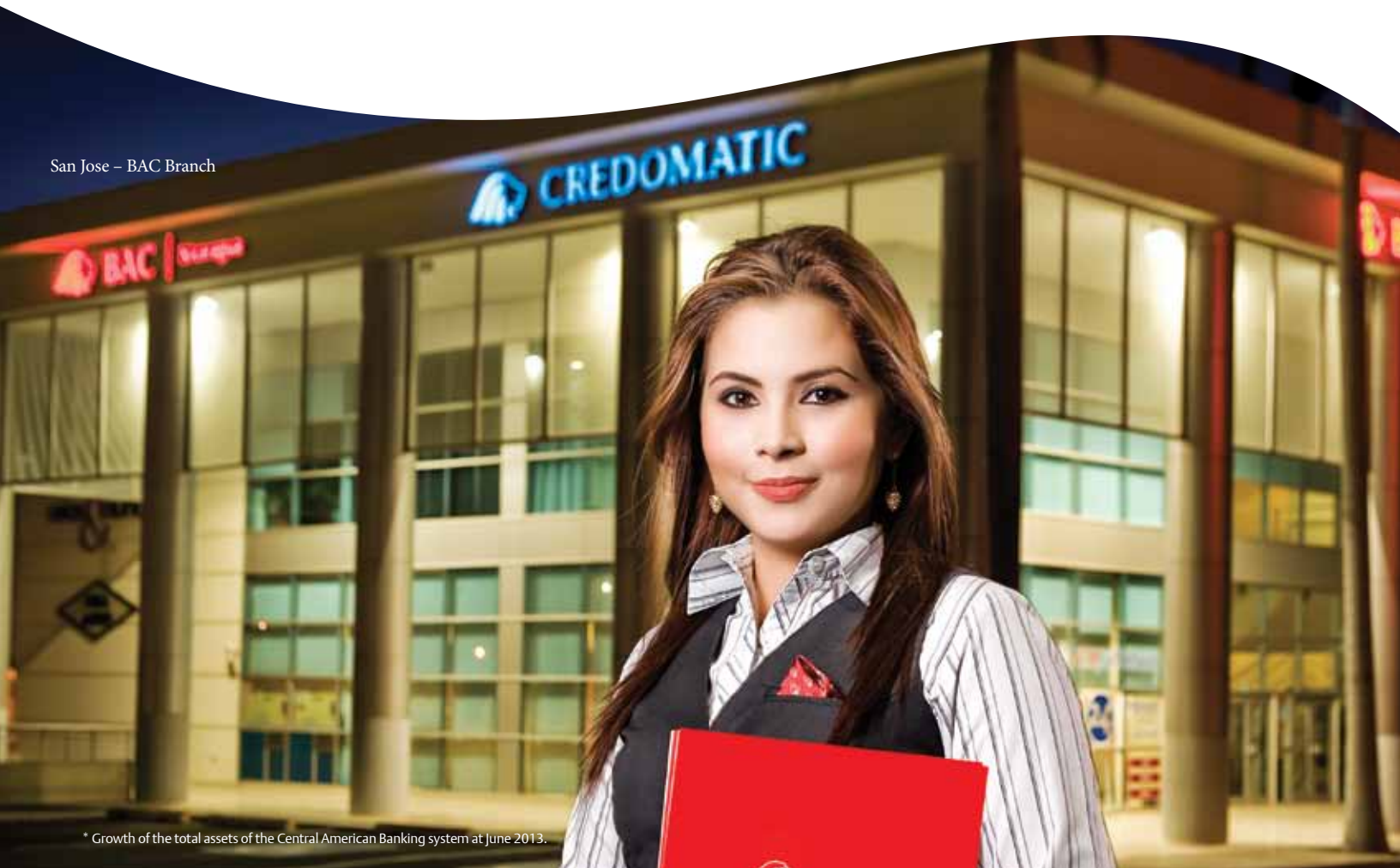
Profitability indicators have improved in the region, and the risk levels reflected in loan quality rates remain conservative.

Because of this positive performance, the Central American banking system has encouraged both the regionalization of local groups and the entry of international players, primarily from South America.

In recent years, the Central American banking system has been characterized by the strengthening of the Colombian Banking system in the region, through acquisition agreements in different countries. BAC Credomatic is no exception. With its recent purchase agreements for Grupo Financiero Reformador in Guatemala, and BBVA Panama, it will increase its market share and strengthen its competitive position regionally.

BAC Credomatic currently maintains a solid position against its competitors, as it has the most profits.

BAC Credomatic maintains a strong leadership position in Profits.



San Jose – BAC Branch

* Growth of the total assets of the Central American Banking system at June 2013.

"We made a good connection"

"We came to Banco de Bogotá 10 years ago because they handle currencies. Most customers pay us in dollars because they are exporters. We came on board because the Bank has an agency in Miami, and we made a good connection between payments abroad and business in Colombia. We have a strong bond with the Bank because of its coverage and because it has always provided us with timely answers to all our requests. That is why we appreciate Banco de Bogotá."

Edgar Perdomo, *Customer at the Cartagena Branch*