Let's ***Make Progress***

Chapter 2

Our Operational Environment

145 Years Making Progress

We believe in the value of being close to our clients, assisting them with financial services wherever they are, thanks to our presence in 12 countries in the region.

2. Our Operational Environment

International Context

In the second half of 2015, the central issue in the markets was the US monetary policy and, especially, the first increase in the interest rate by the Federal Reserve (Fed) in December. This was the first time since 2006 that the Central Bank increased the interest rate and it is now in the range of 0.25% to 0.50%.

However, the path toward this increase was fraught with upheavals. In July, the indicators of activity and statements from members of the Fed hinted at the possibility of an increase in rates in September. The emerging currencies depreciated significantly and a record high in the Mexican rate of exchange was reached, as was a several-year high against the Brazilian real.

The breaking point in this trend came from China. The slowdown in activity, the depreciation of the yuan, and the steep plunge in share prices explained the multiple and recurrent episodes of risk aversion. As bears repeating, at the start of 2016, the volatility of financial markets reached particularly high levels: the VIX, the primary risk measurement worldwide, was at its highest level since the European debt crisis of 2012. The emerging currencies and other risky assets continued to depreciate, this time not due to an expected increase in the Fed rate but to risk aversion. Specifically, the deterioration in financial conditions and the uncertainty generated regarding the global course of activity led to the Fed's decision in its September meeting not to raise the interest rate.

At the start of 2016, volatility in the financial markets ***reached particularly high levels.***

Insofar as the negative factors associated with China moderated and US activity maintained a rate of moderate growth, the groundwork began to be laid for an increase in the interest rate in December. As had been a constant since 2015, the progress in the job market continued to be the most notable aspect of the economic recovery. The low level of unemployment and the creation of new jobs were a pleasant surprise. At the close of the year, unemployment stood at 5.0%, at precisely the same level as that of the US economy in the years prior to the international financial crisis. The 12-month moving average for job creation remained above 200 thousand per month throughout the year, a sign of the unequivocal improvement in employment indicators.

It should be noted that inflation remained a concern. It increased at the end of 2015 and closed at 0.7% per annum, but the gap versus the long-term target (2.0%) remained. The US monetary policy committee, with its dominant position, deemed the gap to be temporary, and believed that the favorable development of the job market would generate upward pressure on inflation.

In this context of an upturn in the job market and confidence in the eventual return to the target inflation rate, the Fed decided to increase the interest rate in its December meeting. The Central Bank stressed the gradual and moderate character of the upward cycle that had just begun. According to the forecasts published by Fed officials in December, there will be four rate increases throughout 2016 in what stands to be the most moderate upswing in recent decades. In the weeks following the decision, the markets remained relatively calm considering the historical significance of the event.

In conclusion, and by way of postscript, it is worth noting the new instances of risk aversion associated with China. In the first days of 2016, several of the factors seen last August, and which had prompted a similar reaction, reemerged: the depreciation of the yuan reached levels unprecedented for several years, share prices tumbled sharply, and the health of the emerging economies was again a cause for concern. As had been the case in September, global uncertainty and deteriorating conditions made the Fed refrain from increasing the interest rate in its March meeting.

United States Federal Reserve ***increased its interest rate for the first time since 2006.***

Colombia

In the fourth quarter of 2015, the Colombian economy maintained a favorable rate of growth of 3.3% per year, in excess of the three preceding quarters of the year (3.0%). Thus, in 2015, overall an annual growth rate of 3.1% was achieved, prolonging the slowdown that stretched back to the beginning of 2014.

The best-performing sectors in the entire year were: financial establishments (4.3%), trade (4.1%) and construction (3.9%); while transport (1.4%), industry (1.2%) and mining (0.6%) lagged behind. Mining was affected by the downturn in the coal sector, while oil maintained slow but positive growth. It is worth pointing out the industry's recovery, which posted its best performance since 2011, after three years of an average annual growth of 0.6%.

After ending 2015 with acceptable growth given the oil price shock, at the start of 2016, the downside risks on growth remained latent, while the limited information available points to an additional slowdown in household consumption. On the other hand, the ongoing reactivation of Cartagena refinery operations will support growth, as will the fourth generation (4G) infrastructure works, especially in the second half of the year. For 2016, we project annual growth of 3.0%.

Inflation in the second half-year was affected not only by food prices and the effects of depreciation on the exchange rate, but, in addition, internal demand was sufficient to generate a more widespread price increase. Indeed, not only did overall inflation accelerate considerably, but the basic inflation measures that exclude the volatile components did, too.

Thus, overall inflation rallied from 4.4% at the close of the first half-year to 6.8% at the end of the second, and this gradual rise continued into 2016 to date (7.6%). The average of the basic inflation rates favored by the Central Bank of Colombia to measure price pressures accelerated from 4.3% to 5.4%, and then to 6.1%, for the above-mentioned cuts.

With the price increase, the inflation expectations rose to a precarious position above the target range set by the Central Bank of Colombia of between 2% and 4%. Moreover, the upside price risks materialized, with adverse effects. Food

prices, already high because of the supply problems at the start of 2015, increased further as a result of the emergence of a severe El Niño phenomenon. Secondly, the exchange rate depreciation rose to new highs, putting pressure on the inflation of tradable goods. And, finally, the high inflation led to a considerable increase in the minimum wage (7%), which, added to a high benchmark at the close of the year, could generate price increases through indexing (dependence on past inflation).

For 2016, inflation will remain high, and will only begin to move toward the target in the second half of the year, reaching the objective in early 2017.

With an economy that maintained an acceptable dynamic, but with high inflation, the Central Bank of Colombia initiated a cycle of interest rate increases, raising the benchmark from 4.50% to 5.75% at the close of 2015. The risk of expectations not being met were coupled with imbalances in external accounts, causing the monetary policy to continue with the rate tightening cycle at the start of 2016, with three increases of +25bp in January, February and March, bringing the rate to 6.50%. The economic rates have started to react, and the monetary policy transmission is operational. Further increases in the interest rate benchmark are anticipated, with a probable short-term rise to 7.00%.

On the external front, the vulnerability in the balance of payments continued, mainly due to an extensive deficit in the trade balance. In 2015, exports rose to USD 35,700 million, while imports totaled USD 51,600 million (FOB). Though in both cases falls were recorded from previous years, the decline in total exports was steeper, at -35%, while that for imports was -16%. In addition, the breakdown of exports showed that only coffee posted better results, while oil, coal and ferronickel slumped, mainly due to the price effect. Non-traditional exports also lost ground, dropping by -13% per year. The net deficit in the trade balance was -USD 15,900 million, the equivalent of -5.8% of GDP. Moreover, this component continues to be the main determinant of the considerable current account deficit, which, as at the third quarter of 2015, totaled -6.6% of the GDP.

Financing for the current account shortfall continued to be provided, primarily through foreign direct investment of USD 13,000 million as of September, and foreign investment portfolio of USD 12,400 million for the same period. However, given the international uncertainty, these flows could be threatened, as predicted by investors and markets, which took the exchange rate to new historic highs. In the second half of 2015, the Representative Exchange Rate stood at an average of COP 2,999, rose to COP 3,149 by the close of the year, and posted an annual devaluation of 32%. More recently, the exchange rate reached a high of COP 3,435, primarily spurred by the international situation and the continued decline in oil prices. From this peak, the exchange rate has since fallen and stabilized at lower levels.

Even though the flexible exchange rate operates as an adjustment variable in response to imbalances in the external accounts, as mentioned previously, the accelerated devaluation put considerable pressure on inflation, which prompted the Central Bank of Colombia to reactivate its exchange intervention by way of the dollar sales mechanism through call options. The mechanism was not activated in 2015, as a Representative Exchange Rate deviation threshold of 7% was applied to the 20-day moving average, and was later adjusted to 5%. In both cases, the benchmarks were too distant to activate the foreign exchange intervention. In February 2016, in the midst of a less adverse international environment, the Central Bank of Colombia again adjusted the intervention threshold, to 3%, which implies a greater likelihood of participation by the entity in the foreign exchange market in the event of risk aversion returning.

The Central Bank of Colombia initiated a cycle of interest rate increases to control inflation and its expectations, in the midst of acceptable growth.

Colombian Financial System

From 2015, the entities subject to the oversight of the Financial Superintendence of Colombia (SFC, for the Spanish original) implemented the new technical regulatory framework for the International Financial Reporting Standards (IFRS). During the same year, the SFC introduced the regulations for due compliance with the process by these entities, and the instructions for reporting financial statements under IFRS, taking as a frame of reference the 2013 version of XBRL taxonomy issued by the IASB.

The IFRS are fully applicable to the preparation and presentation of consolidated financial statements, and include some exceptions for the individual and separate financial statements of monitored entities (Investments, Loan Portfolio and Goods Received in Payment from Credit Institutions). Given these exceptions, the impact of IFRS implementation is not material.

In the face of the uncertain global economic context that prevailed in the second half of 2015, local banking has been able to maintain a good position within the market, keeping its main indicators at positive levels. The following features during the year stood out: 1. Increased trust in the Financial system, 2. Growing Indicators of Financial Deepening, 3. Consolidation in the Quality of Capital (Solvency of Credit Institutions in excess of minimum regulatory levels), 4. Adequate behavior of the Liquidity Indicators of Credit Institutions, 5. Increase in Savers' Deposit Balances, 6. Loan Portfolio Growth in line with the expectations of the economic cycle, 7. Higher Profits of Credit institutions due to better loan portfolio performance and the profit levels of subsidiaries, 8. Increase in coverage through correspondent banks, expanding the service provision capacity in strategic locations, and 9. Connection to the banking system on the rise, with financial education allowing an ever-increasing number of adults to acquire products from credit institutions.

For 2015, the Banking System increased its Assets by 14.1%, giving a total of COP 504.6 trillion. Meanwhile, the Financial Lease and Loan Portfolio was subject to an annual variation of 15.7%, giving an absolute increase of COP 47.6 trillion. In particular, the Commercial and Consumer Loan Portfolio posted growths of 12.1% and 11.7%, respectively. The indicators of Quality and Coverage were located at levels of 2.8% and 156.0%, respectively.

For their part, deposits posted a 10.1% growth, mainly explained by the increase in Savings Accounts, which grew by COP 19.5 trillion (14.4%), followed by the CDs, which rose by 12.0%.

Our Share in the Colombian Banking System

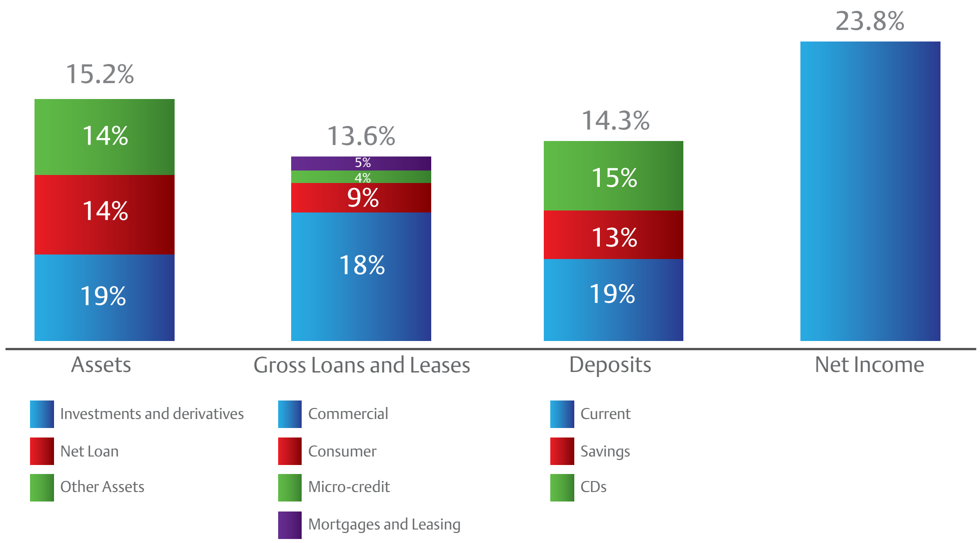
At the close of the second half of 2015, we secured a 15.2% share of the Assets segment of the Colombian Banking System, and of 20.5% in Derivative Transactions and Investments. Gross Loans and Leases, Commercial, Consumer, and Mortgage portfolios had shares of 13.6%, 18.0%, 9.5% and 4.5%, respectively.

In addition, our share of total Deposits within the System is 14.3%, with Checking Accounts representing the greatest contribution (19.2%), followed by CDs (14.7%) and Savings Accounts (13.1%).

Finally, regarding Net Income and Equity, our Bank had a share in the System of 23.8% and 22.9%, respectively.

Colombian Market Share

(Market Share Figures as of December 2015)



Acesco,
an ally to boost the Coast's development

Acerías de Colombia (Still mills of Colombia) was founded in 1970 in the city of Bogotá, and is recognized on the market through its Acesco brand.

Banco de Bogotá has been present over the last 30 years, supporting the company's growth and internationalization process through permanent support and the handling of important foreign currency, legal currency and working capital transactions, among others. In addition, the financial entity's coverage in Central America through BAC Credomatic allows commercial relations to be strengthened for the firm's business in Panama (Metalco Panamá) and Costa Rica (Metalco). Acesco also operates in Ecuador (Rooftec) and Puerto Rico (Acesco Caribe).

Acerías' medium-term projects include consolidating the structural pipes business and expanding the product portfolio for the construction sector.

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The good relations that the Bank has sustained with Acesco for years go beyond the commercial, and are strengthened in shared values and in environmental commitment. The company has taken great pains to work with environmentally-friendly materials with a minimal carbon footprint and recycled components. It takes a sustainable approach that encompasses the economic, environmental and social plans. It remains an organization with a great sense of social responsibility.

Moreover, the Acesco Foundation promotes social initiatives with the community of Malambo through art and education, and in Eastern Caldas through the strengthening of small farmer associations.

145 Years Transforming Entrepreneurial Histories. Portafolio journal.