EXECUTION COMMITTEE

ACT NUMBER 4-2006

Session 4-2006 celebrated in the *Banco de Guatemala* building on Friday, January twentieth, two thousand six, at fifteen hours.

The coordinator, with the corresponding quorum, for the consideration of the Execution Committee submitted the project for the order of the day.

FIRST: Approval of Project for acts number 2-2006, corresponding to the session celebrated on January 13, 2006.
(The project of the act circulated.)

SECOND: Market information and monetary variables.

a) Money and Exchange markets.
b) Monetary Variables

THIRD: Balance of Inflation risks

FOURTH: Analysis of the initial conditions in the semi-structural model.

FIFTH: Analysis of the monetary situation and definition of the guidelines of execution for the Monetary, Exchange rate and Credit Policy for the following week.

SIXTH: Other matters.

Not having more observations, the committee approves the order of the day.

FIRST: The coordinator has put to consideration the corresponding project act.

Not having any observations, the committee approved acts number 2-2006.

SECOND: Information of markets and monetary variables.

The coordinator requested that the corresponding information be presented.

a) The Director of the Department of Monetary Stabilization Operations, regarding the Money market informed that during the period from January 16 to 20 of 2006, with partial numbers to date, registered an attraction of LTD's for Q4,393.5 million and maturity of Q3,309.4 million, which gave a net result of fund raising for Q1,084.1 million, associated to the operations in bidding (net attraction for Q103.0 million), in the Money Electronic Banking Table –MEBD- and in the stock exchange (net fund raising of Q841.0 million) and at the window (net maturity for Q140.1 million).

Regarding the interest rates applied in fund raising through LTD's, it was indicated that during the period of January 16 to 20, 2006 for the biddings case, the cut interest rates were of: 5.00% for 91 days, 6.25% for 364 days. On the other hand, in the MEBD and in the stock exchange the fund-raising took place for 7 days, at the leading interest rate of the monetary policy of 4.25%.

As for the weighted average interest rates of total operations of repurchase agreements made in the stock exchange of the country, it was indicated that, during the January 16 to 20, 2006 period, with partial data, the minimum was of 4.27%, observed January 16, 2006, and the maximum of 4.58%, registered on January 20, 2006. It also pointed out that the amounts negotiated were higher with public titles and that the average weighted interest rates during said period were of 4.33% for public titles and of 5.50% for the financial sector titles.

On the other hand, it was informed that during the January 16 to 19, 2006 period, regarding Treasury Bond operations the fund-raising registered was for Q41.0 million and maturity for Q75.2 million and US$26.1 million.

As for biddings on time deposits in US dollars, made on January 18, 2006, it was mentioned that there was a bid for US$1.0 million for 91 days at an interest rate of 5.50%, which was not awarded. It was also informed that the IGSS made a term deposit in US dollars for US$26 million for a 91 day term at an interest rate of 4.30%.

Regarding the Institutional Market for foreign currency the report stated that during the period of January 13 to 19, 2006, the average daily operations for purchase were of US$58.7 million and the sale was of US$63.2 million as the exchange rates showed a slight tendency, in sales toward the rise and for purchase toward the low. In effect, on Friday, January 13 they were of Q7.61329 per US$1.00 for purchase and of Q7.63375 per US$1.00 for sale, on Monday, January 16 the rates were Q7.59883 and Q7.61883, on Tuesday, January 17 they were Q7.58845 and Q7.61007, Wednesday, January 18 they were

Q7.60345 y Q7.62373, and finally, on Thursday, January 19 they were Q7.61212 y Q7.64062.

In the operations of the electronic systems of negotiations of foreign currency administered by the *Bolsa de Valores Nacional, S.A.* (National Stock Exchange, S.A.), for the period of January 13 to 19, 2006, the Private Institutional Foreign Currency System –SPID-, commented that no operations took place. Regarding the Electronic Foreign Currency Negotiation System –SINEDI-, they declared that during the period operations were closed on Monday, January 16 for US$6.5 million, at an exchange rate of Q7.60439 per US$1.00, and the *Banco de Guatemala* received daily, a bid for the purchase of US$10.0 million, with the following prices: January 13 of Q7.60591, on January 16 of Q7.60439, on January 17 of Q7.59906, on January 18 of Q7.59208, and on January 19 of Q7.589, according to the guidelines of the Execution Committee.

On the other hand, they informed that the Future Foreign Currency Market that is operated by the National Stock Exchange, S.A., during the period of January 16 to 20, 2006, did not close operations. As for the closing price in reference up to Friday, January 20, they indicated that for maturity to liquidate in March of 2006 the price was Q7.65000, and for the maturity to liquidate in June of 2006 it was of Q7.66000.

b) The Sub-director for the Economic Studies Department informed that on January 19, 2006, the excess of the daily float of the banking system was located in a position of Q4.8 million, with an average position of Q407.2 million.

The highlights during the period of January 12 to 19, 2006, were: the main demonetizing factors were the increase in balance the long term deposits constituted in the *Banco de Guatemala* for Q1,027.4 million and the deposits of the rest of the public sector in the Central Bank for Q62.0 million; while the main monetizing factors were the decrease in banking float balance for Q758.9 million and the deposits for the Central Government in the *Banco de Guatemala* for Q124.0 million; and the increase in the balance of the Net International Reserve –RIN- balance for the equivalent of Q4.8 million.

Regarding the indicative variables of the Monetary, Exchange Rate and Credit Policy they indicated that with the projection to December 2005, for December 2006 the total expected inflation estimated with a model of ordinary squared minimums is of 7.54% and with a softened exponential model of 7.34%; the simple average of both models is located at 7.44%, which is above the policy goal (6.0%), which suggests a restrictive monetary policy.

Regarding the expected subjacent inflation for 2006, with data up to December 2005, estimated with an integrated auto-regression model of mobile averages ARIMA was of 7.24%, whereas the estimated with a softened exponential model was of 6.33%; the simple average of both models is of 6.79%, which is above the policy goal (6.0%), which suggests a restrictive monetary policy.

As to the parameter rate, up to January 12, 2006, the lower limit was 1.33%, and the upper limit is 9.23%, while the simple average between the repurchase agreements of 8 to 15 days (4.51%) and the weighted average rate of open market operations –OMA- of up to 91 days (4.53%) was situated at 4.52%, which is located within the estimated for the parameter rate, situation that suggests remaining at an invariable monetary policy. When referring to the parity passive rate, they declared that up to January 12, 2006, the lower limit was 5.96% and the upper limit was 7.54%, and the weighted average rate of long term deposits of the banking system was of 6.94%, which maintains itself within the fluctuation range of the parity passive rate, which advises an invariable monetary policy.

As to monetary issue observed to January 19, 2006, they indicated that it presents a deviation of Q408.8 million according to the upper limit programmed for said variable, which would indicate that there is space available to restrict the monetary policy.

As to the total payment means, to January 12, 2006, it exhibited an inter-annual growth rate of 15.0%, which is within the estimated range for said variable on that same date (14.8% to 16.8%), which advises the monetary policy to remain invariable. Also, up to said date, the banking credit of the private sector registered an inter-annual growth rate of 21.6%, which is above the upper limit of the estimated range for January 12, 2006 (22.3% to 24.3%), which suggests relaxing the monetary policy.

As to inflation expectations of private analysts, they indicated that according to the poll made in December 2005, for December 2006 an inflationary rhythm of 8.78% is expected, which is above the goal for monetary policy (6.0%), an aspect which suggests restricting monetary policy. Also it was indicated that the new implied inflation expectations, for December 2005 showed an inflationary rhythm of 5.55%, which is within the goal range for 2005 (4% to 6%), which suggests an invariable monetary policy.

They mentioned that the Monetary Conditions Index –ICM-, to January 12, 2006, was -3.04 percentage points which is within the range estimated for said variable on that date (-3.71 to -2.11 percentage points), which advises that the monetary policy should remain invariable.

To conclude this report, regarding the orientation of the indicative variables; it was reported that the following remained the same regarding last week: four variables suggest that the monetary policy be restrictive (the total inflation projection, the subjacent inflation projection, the inflation expectations of private analysts and monetary issue); five variables that suggest the monetary policy remain invariable (parity passive rate, Monetary Conditions Indexes, implied inflation expectations, the total payment means and parameter rate); and one suggests to relax it (the banking credit to the private sector).

THIRD: Risks Balance Inflation.

The Committee continued the discussion begun the week before regarding the analysis that it must present to the Monetary Board in its January 25, 2006 session, when, according to the approved calendar, said certified body must make a decision regarding the level of the leading interest rate of the monetary policy. For the effect, the Committee analyzed the definite balance of risks presented by the technical bodies of the Bank, emphasizing on the following aspects:

As to outer conditions, it was indicated that according to recent information on the international oil market, the price began experimenting a spike in the last days, which confirms that the behavior of the referred price continues to be the main inflationary risk in the country, even though apparently less so than the observed in 2005.

It was indicated that the external inflationary impact will continue to be a risk whereas the compound interest of inflation of the main commercial partners of Guatemala continues to be relatively high. In effect, it was declared that the inflationary rhythm of the United States of America (country with the highest relative weight within the index) accelerated when surpassing 3.26% in 2004 to 3.42% in 2005. In that sense, it was indicated that the compound inflationary rhythm of the main commercial partners of the country –weighted by the commercial structure of Guatemala with each one of them-, to

December 2005 was located at 3.95%, slightly lower to that of December 2004 (3.97%), therefore through this, to December 2005, the imported inflation risks had not improved. However, a deceleration is foreseen for the referred index in 2006 to 3.76%, which would indicate that even though an inflationary risk persists, this would be moderating this year.

As to internal conditions, it was pointed out that regarding the variable subject to follow up in the monetary program, in the first place, to date the level of operations in the open market operations has been located below the programmed and, in second place, the monetary issue observed a deviation over the upper limit of the corridor programmed for said variable.

It was mentioned that if it is true that the inflationary rhythm observed to December 2005 decelerated regarding that of November and that the greater part of excess of inflation over the inflation goal is attributable to exogenous factors, mainly to the effect of fuel prices, it is also because there is a proportion of said excess that is attributable to monetary factors. In that sense, it was pointed out that of 8.57% of inflationary rhythm observed to December, 2.21 percentage points are attributable to imported inflation, of which 0.52 percentage points correspond to historic imported inflation, therefore the remaining 6.88 percentage points of inflation can be attributed to monetary factors, which would imply that in the absence of exogenous shocks, the inter-annual inflation would be outside the goal. In that sense, it was mentioned that an increase in the leading interest rate of the monetary policy could contribute to, through the effect of the interest rates on aggregate demand and the inflationary expectations, propitiating a gradual moderation in the inflation, congruent with the fixed goal by the monetary authority for 2006 and for 2007.

As to the indicative variable, it was indicated that when comparing the situation to date informed regarding the observed on December 16, 2005 (date when the leading interest rate was last adjusted), the number of variables that suggest that the monetary policy be restricted the monetary policy decreased from six to four (the projection of total inflation, the projection of subjacent inflation, the expectations of inflation by private analysts and monetary issue), one variable suggested relaxing the monetary policy (the banking credit to the private sector) and the variables that suggest the monetary policy remain invariable increased from three to four (the parity passive rate, the parameter rate, the total payment means and the Monetary Conditions Index). It was also emphasized that there were three variables in December 2005 that suggested not modifying the monetary policy (the parameter rate, the parity passive rate and the monetary conditions index), in that month they were closer to suggesting restricting the monetary policy, while in the present month they do so with less intensity.

Finally, the econome tric projections of inflation for 2006, prepared by the technical departments, using data observed to December 2005, although reduced regarding the previous month, estimate an inflation estimate (total and subjacent) for December 2006, which are located over the fixed goal (6%).

Of the elements that compose the referred risks balance, the technical departments conclude that the factors that prevail advising restricting the monetary conditions, therefore and adjustment in the leading interest rate of the monetary policy could contribute to placating the inflationary expectations during the course of the year.

FOURTH: Analysis of the initial conditions in the Semi-structural Model.

The Technical Departments presented the short term prognosis corresponding to the first trimesters of 2006 to the Committee, which will be incorporated as initial conditions in the semi-structural model, in order to produce an inflation prognosis for 2006 and 2007, so that the discussion generated in the Committee will serve as a basis to make the necessary adjustments, prior to making the first runner of the model. This procedure obeys the prognosis methods in the short term constituting a highly valuable asset for the semi-structural model, in order to offer the inflation prognosis in the mid-term consistent, on the one hand with the sum of variables and equations of it and on the other hand, with the macroeconomic theory.

The short term prognosis presented, as was indicated, corresponds to the first trimester of 2006, and refer to two types of variables:

a) exogenous variables to the model; and,

b) endogenous variables to the model.

Regarding the exogenous variables, prognosis from specialized external sources, for interest rates, subjacent inflation and US product breach were presented, as well as for petroleum and diesel prices.

Regarding the endogenous variables, prognosis for the Monthly Economic Activity Index –IMAE (for its acronym in Spanish) - regarding its potential level, as well as the breaches of the two IMAE components: one for production for domestic destination and the other for production for external destination (exportation). In the case of total IMAE, the breach in the third trimester of 2005 is positive and negative values for the fourth trimester of 2005 and for the first trimester of 2006 were foreseen, and a neutral position (breach close to zero) was foreseen for the second trimester of 2006.

In the case of IMAE for domestic purposes, the breach in the third trimester of 2005 is also positive and is foreseen will decrease in the fourth trimester of 2005, that it will be neutral in the first trimester of 2006 and that it will be negative in the second trimester of 2006. As to IMAE for foreign purposes, the breach in the third trimester of 2005 is neutral and is foreseen will have negative values for the following trimesters. The positive breaches of total IMAE and of the IMAE for domestic purposes in the third trimester of 2005 are mainly explained by the contributions of the sub-indexes of commercial activity, of the banking activity and of the public and defense administration.

As to the inflation, the yearly and non seasonal value of this variable in the fourth trimester of 2005 is of 10.57%, and values of 6.16% and 7.22% are foreseen for the first and second trimesters of 2006, respectively, in a base scenario. In terms of the inter-annual variation rhythm of the Consumer Price Index –CPI-, the following percentages are projected: for the fourth trimester of 2005, 9.36%; for the first trimester of 2006, 8.98%; and for the second trimester of 2006, 8.88%. The prognosis for the first trimester of 2006 is mainly founded on the expected decrease in subjacent inflation of the United States of America (variable statistically correlated with the Guatemalan inflation), as well as with the foreseen inflation of the international prices of oil. On the other hand, the prognosis for the second trimester of 2006 is founded mainly on the expected increase in the subjacent inflation of the United States of America.

Taking into account that in the last few days an increase in the international price of oil has been observed, the technical departments consider it pertinent to present the inflation prognosis in the short term, coherent with an alternate scenario, in which trimesterally annualized out-of-season inflation rates are given of 6.83% and 8.22% for the first and second trimesters of 2006, respectively. Said values are equivalent to the inter-annual inflation rhythms for these same trimesters, in their order, of 9.14% and 9.28%. However, given that the appreciation of the international experts point out that it is still uncertain if the observed increases in the international prices of oil, lately, will be kept during the two foreseen trimesters, the technical departments indicate that, for the moment, they will use the prognosis derived of the base scenario as initial values for the macroeconomic semi-structural model, in order to produce the inflation prognosis for 2006 and for 2007.

Finally, the technical departments point out that the results of the first run of the semi-structural macroeconomic model will be ready in the third week of February.

The Committee made some comments regarding the short term prognosis corresponding to the first two trimesters of 2006, particularly regarding, on the one hand, that it is necessary to verify in what measure the econometric estimations of inflation are assigned an elevated weighting to the data observed most recently and, on the other hand, what is attractive about the fact that the prognosis of the total IMAE breaches indicated that there is no excess existent in the aggregate demand, so much so that the prognosis of inflation indicates the contrary. The Committee is awaiting the results that the semi-structural model of the mid term will give out for the first time next month.

FIFTH: Analysis of the monetary situation and definition of the guidelines of Monetary, Exchange Rate and Credit Policy execution for the following week.

a) Analysis of the monetary situation

The Committee took note that the monetizing and demonetizing factors foreseen for the week of January 20 to 26, 2006 indicate an increase in the creation of primary liquidity for Q4,863.9 million, fundamentally due to the maturity of LTD's, and a use of the deposits of the Central Government in the *Banco de Guatemala*. Also, a decrease in the demand for monetary issue for Q37.8 million is foreseen and a daily negative banking liquidity position for January 26, 2006 for Q42.3 million. Also, monetary issue is deviated in Q591.4 million above the central programmed point for said variable, therefore the excess of aggregate liquidity for the referred period is located at Q5, 450.8 million; if these factors are given, the Committee considered that it would be necessary to make the issue offer compatible with the demand programmed, that the LTD's that expire during the period (Q4,461.3 million, according to registries to January 19, 2006) have to be relocated; and also, make additional fund-raising for around Q 989.5 million.

According to the analysis made by the technical bodies, and based on the orientation of the indicative variables and on the balance of the risks inflation, some members of the Committee coincided initially with the conclusion of the technical bodies, in the sense that the factors oriented toward restricting the monetary conditions prevail, especially in consideration of the inflation prognosis with which we count. However, one member of the Committee pointed out that it is necessary to carefully analyze the elements that compose the balance of risks inflation, due to the fact that the different variables can be interpreted diversely and give, the same variable contradictory results; for example, the level of inflation expected advises restricting the policy, due to its tendency of keeping the same level in January, would suggest the contrary; the same happens with the inflation expectations of the panel of experts, as well as with the behavior of the oil prices versus the behavior of the price of fuels (especially diesel); all of this advises caution before arriving to conclusions on the convenience of adjusting the monetary policy rate.

Another member of the Committee highlighted the additional aspect that advises acting cautiously, and is that of the behavior toward the appreciation observed in the type of nominal change in recent days. situation which, if it would heighten or be maintained for a period of time, would influence in the future on some of the indicative variables (like the monetary conditions index and the parameter rate), in the sense that the same could come to suggest a neutral policy or, event, relaxed; emphasis was made on the fact that attention has to be kept on the decisions made by the US Federal Reserve, since these can have the same effect on the capital flow and, consequently, on the exchange behavior. Regarding this, one advisor commented that, in the opinion of the markets (measured through surveys) there exists a high probability that at the end of January of 2006 the Federal Reserve may raise its policy rate in 25 basic points. In that sense, another advisor of the Committee suggested that the participation rule should be taken into account in the exchange market that is currently taking place, and in determined moments, is incompatible with the explicit inflation goals scheme, since, if the tendency were pronounced toward the appreciation of the quetzal, this would force the purchase of foreign currency on behalf of the *Banco de Guatemala*, which could reach elevated amounts, with the following generation of monetization excess; therefore, indicating that there is no rule that allows a more moderate participation of the Central Bank in the exchange market; in other words, a rule that is more compatible with the principles of exchange participation established in the monetary policy, approved by the Monetary Board (in other words, more compatible with the scheme of explicit inflation goals), any decision in matters of adjustment of the leading rate can generate capital flow that distorts in the monetary or exchange conditions.

On the other hand, a member of the committee pointed out that the Resolution of the Monetary Board that established the Monetary, Exchange Rate and Credit Policy for 2006 indicates that the decisions in matters of the leading interest rate will be adopted by said Board based on the analysis made by the Execution Committee, for the function of the System of Prognosis and Analysis of the Monetary Policy and of the follow-up of the indicative variables; indicating that, in this sense, the prognosis system is still incomplete because it will not be until next month when the macroeconomic semi-structural model will be counted on, that will give the mid-term prognosis, essential in the scheme of explicit inflation.

In that regard, another member of the Committee emphasized that, in the absence of said model, an important indicative variable that, in the experience of other central banks, provides the basic guide within the scheme of explicit inflation goals, is the parameter rate; in that regard it was indicated that, according to the exercise of said variable that he requested be prepared by the technical bodies, where the calculations are slightly modified since they use a tolerance margin of a half standard deviation (instead of a deviation), said variable suggests elevating the leading interest rate of the monetary policy during the entire year of 2005 (just like, in general, it did last year), but that for January 2006 it suggests keeping the orientation of the monetary policy invariable, aspect which even though it is a great measure attributable to the difference that exists between the inflation goal of 6% for 2006 and the central point of the goal for 2005 (5%), does not therefore quit recommending prudence at the moment of determining the level of the leading interest rate in the current economic venture.

In the context described the Committee arrived at the conclusion that in this opportunity, prudence advises not adjusting the leading interest rate and waiting until the month of February to make a decision in that sense, if the circumstances warrant it, especially taking into account that for then, new elements of judgment will be counted on, between them are the following: a) the decision that the US Federal Reserve would make at the end of January; b) the definition of the rule of participation of the Central Bank in the exchange market in order to reduce the volatility of the exchange rate; and, c) the first results of the semi-structural model that would offer an inflation prognosis in the mid-term based on the interrelation of the different real and financial variables, endogenous and exogenous.

Regarding the determination of quotas for the biddings in the following weeks, the information provided by the daily monetization flow was taken into account, estimated for the following week: (which reports elevated amounts of liquidity excess, mainly originated by the maturity of LTDs) and the rule established for the effect, the Committee agreed that for the following week the fund-raising quota the 91 and 364 day terms to be convened on Monday to be established at Q95.0 million and Q90.0 million, respectively, and for the 182 day term to be convened on Friday to be of Q90.0 million.

Regarding the convening to bidding of LTDs in US dollars, the Committee agreed that for the following week there would be important maturities for Treasury Bonds expressed in US dollars, with residents, reason why it was agreed that for the week of January 23 to 27, 2006, to be convened for bidding of LTDs in the mentioned currency.

b) Definition of the guidelines of the execution of the Monetary, Exchange Rate and Credit Policy for the following week:

Based on the analysis of the monetary situation, the Committee agreed that for the week of January 23 to 27, 2006, to keep the execution guidelines of the monetary policy observed during the present week of; in other words, continue with operations in the MEBD and in the stock exchange, for fund-raising as well as giving liquidity to the market. The fund-raising operations were made for 7 day terms without quotas, at a leading interest rate of 4.25%, and the bids of liquidity offer in 7 day terms, at a leading interest rate of 7.65%, whose guarantee of said operations will be constituted only by receiving public titles. It is worth indicating that the Committee reiterated the importance of participating in both venues; in other words, keeping simultaneous liquidity giving bids and the retiring of liquidity, considering said participation constitutes a signal of willingness by the Central Bank to moderate the volatility in the short term interest rate.

The Committee taking into account the agreed in matters of coordination with the fiscal policy for the participation in the money market, agreed that the convening for the biddings of the term deposits be on Monday and Friday, that way: on Monday for the 91 and 364 day terms, with a fund raising quota for Q95.0 million and Q90.0 respectively and on Friday for 182 days, with a fund-raising quota of Q90.0 million. The interest rates will be determined according to the conditions of the market, reflected in the bids received, considering the yield curve established by the technical departments.

On the other hand, the Committee agreed to continue fund raising directly at the window, with the official and public entities. In the case of the official entities, that the fund raising continue to be according to the prevalent financial conditions; in other words, the interest rate for the 7 day terms will be the one applied by the *Banco de Guatemala* in the MEBD and in the stock exchange and, for the other terms, the interest rate will be the mobile average, for each term, of the weighted average interest rate of the previous four bidding events. As to fund raising for the public, the interest rate for each term, can not be higher than the weighted average of the corresponding bid minus one percentage point.

On the other hand, the Committee agreed to summon biddings for term deposits in US dollars –DP in US$-, on Wednesday January 25, 2006, the 91 and 364 day terms, for an amount of up to US$30.0 million. The bids received can be awarded taking as a reference the interest rates of the Treasury Letters of the United States of America in similar terms, without excluding the possibility that, if the bids received deserve better rates, a session with the Committee will be convened to decide its awarding.

The Committee agreed to continue accepting the constitution of term deposits in United States dollars directly at a window, from public entities, in current terms of (91 days and 364 days) and that the interest rate applied would be 4.30% for 91 days and of 4.45% for 364 days.

As for the participation of the *Banco de Guatemala* in the Exchange market, the Committee discussed some options with the technical bodies in order to continue defining the participation rule in the exchange market that was approved by the Monetary Board in the next few weeks, having agreed to present a new proposal in the shortest time possible; meanwhile, the Committee agreed that it should continue participating in the SINEDI through participation rules established in session 55-2005 dated October 27, 2005.

SIXTH: Other matters.

Not having any other matter to discuss, the session ends at seventeen hours, all who attended sign in agreement.