EXECUTION COMMITTEE

ACT NUMBER 6-2006

Session 6-2006 celebrated in the *Banco de Guatemala* building on Friday, February third, two thousand six, at fifteen hours and thirty minutes.

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 act number 5-2006, corresponding to the session celebrated on January 27, 2006.
(The project of the act circulated.)

SECOND: Market information and monetary variables.

a) Money and Exchange markets.
b) Monetary Variables

THIRD: Yield Curve: Conceptual aspects and empiric evidence.

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

FIFTH: 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 5-2006.

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 30 to February 3, 2006, with partial numbers to date, registered an attraction of LTD's for Q3,667.0 million and maturity of Q3,969.3 million, which gave a net result of fund raising for Q302.3 million, associated to the operations in bidding (net attraction for Q7.8 million), in the Money

Electronic Banking Table –MEBD- and in the stock exchange (net fund raising of Q277.0 million) and at the window (net maturity for Q33.1 million).

Regarding the interest rates applied in fund raising through LTD's, it was indicated that during the period of January 30 to February 3, 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 30 to February 3, 2006 period, with partial data, the minimum was of 3.28%, observed January 31, 2006, and the maximum of 4.53%, registered on February 3, 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 4.04% for public titles and of 5.66% for the financial sector titles.

On the other hand, it was informed that during the January 30 to February 3, 2006 period, regarding Treasury Bond operations the fund-raising registered was for Q42.0 million and maturity for Q35.1 million and US$1.1 million.

As for biddings on time deposits in US dollars, made on February 1, 2006, it was mentioned that no bids were presented.

Regarding the Institutional Market for foreign currency the report stated that during the period of January 27 to February 2, 2006, the average daily operations for purchase were of US$72.3 million and the sale was of US$74.5 million as the exchange rates remained stable. In effect, on Friday, January 27 they were of Q7.59747 per US$1.00 for purchase and of Q7.61589 per US$1.00 for sale, on Monday, January 30 the rates were Q7.59222 and Q7.61332, on Tuesday, January 31 they were Q7.59663 and Q7.61168, Wednesday, February 1 they were Q7.59110 y Q7.61434, and finally, on Thursday, February 2 they were Q7.59537 y Q7.61547.

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 30 to February 3, 2006, the Private Institutional Foreign Currency System –SPID-, commented that the following operations took place: on Monday, January

30 for US$0.2million at a weighted average exchange rate of Q7.60750 per US$1.00, on Wednesday, February 1, US$2.0 million at Q7.61000; and, on Thursday, February 3, for US$0.2 million at Q7.61250. Regarding the Electronic Foreign Currency Negotiation System –SINEDI-, they declared that during the period no operations were closed, and only the *Banco de Guatemala* received daily, a bid for the purchase of US$10.0 million, with a following price of: Q7.58900, 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 30 to February 3, 2006, did not close operations. As for the closing price in reference up to Friday, February 3, they indicated that for maturity to liquidate in March of 2006 the price was Q7.64000, 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 February 2, 2006, the excess of the daily float of the banking system was located in a position of Q421.2 million, with an average position of Q393.4 million.

The highlights during the period of January 26 to February 2, 2006, were: the main monetizing factors were the decrease in the balance of the deposits constituted in the *Banco de Guatemala* for Q768.6 million and the deposits of the rest of the public sector in the Central Bank for Q49.4 million; while the main demonetizing factors were the increase in the banking float balance for Q436.5 million and the deposits of the Central Government in the *Banco de Guatemala* for Q220.7 million; and the decrease in the balance of the Net International Reserve –RIN- balance for the equivalent of Q74.4 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 26, 2006, the lower limit was 1.32%, and the upper limit is 9.22%, while the simple average between the repurchase agreements of 8 to 15 days (4.40%) and the weighted average rate of the monetary stabilization operations of up to 91 days (4.51%) was situated at 4.46%, 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 26, 2006, the lower limit was 6.16% and the upper limit was 7.74%, 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 February 2, 2006, they indicated that it presents a deviation of Q363.8 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 26, 2006, it exhibited an inter-annual growth rate of 16.1%, which is within the estimated range for said variable on that same date (15.9% to 17.9%), 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 22.5%, which is above the upper limit of the estimated range for January 26, 2006 (22.5% to 24.5%), which suggests maintaining the monetary policy invariable.

As to inflation expectations of private analysts, they indicated that according to the poll made in January 2006, for December 2006 an inflationary rhythm of 7.53% 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 January 2006 showed an inflationary rhythm of 5.95%, which is within the goal range for 2006 (6%), however, when considering the margin of tolerance of the policy goal for 2006 (6% +/-1%), suggests an invariable monetary policy.

They mentioned that the Monetary Conditions Index –ICM-, to January 26, 2006, was -2.90 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 regarding last week, the variables of "payment means" and "banking credit to the private sector" went from suggesting that the monetary policy relax to suggesting it remain invariable, with this the number of variables that suggested the monetary policy remain invariable increased to six (parity passive rate, the parameter rate, the Monetary Conditions Indexes, the implied inflation expectations, total payment means and the banking credit to the private sector); the number of variables that suggest to restrict it remains at four (the total inflation projection, the subjacent inflation projection, the inflation expectations of private analysts and monetary issue) and none suggest to relax it.

THIRD: Yield Curve: Conceptual Aspects and Empiric Evidence.

The technical departments made a presentation in the heart of the Committee regarding the yield curve, making emphasis on the conceptual aspects and on the empiric evidence at the international level, particularly in the following aspects:

i) The yield curve is the graphic representation in the existent relation between the yield rates and the maturity terms of the instrument of the bonds market;

ii) The yield curve can not be directly observed due to the fact that breaches exist in the maturity structures, which implies that only the discreet values can be observed. In that sense, the yield curve continues to be built through the interpolation of the discreet observations;

iii) The yield curve provides valuable information regarding the expectations of the investors in relation to the future behavior of inflation. In effect, an increase in the incline of the curve is indicative of what the economic agents expect that the inflation increase, while a reduction in the incline of said curve is interpreted as an expectation of the inflation reduction; and,

iv) Regarding the empiric evidence, it was indicated that yield curves exist that exhibit, on the one hand, a positive incline in one stretch and, on the other hand, a negative incline on another stretch, which demonstrates a degree of inflationary expectations that exist in the economic agents, such is the case of the yield curves of the United States of America and Mexico, which have a short term negative stretch.

In reaction to the cited elements, a member of the Committee indicated that the presentation made by the technical bodies allows an appreciation that, in practice, it is normal that negative segments of the yield curve exist; also, that the yield curve is generally flatter (with less incline) when the inflation expectations of the economic agents are less, which marks a greater credibility in the monetary policy; and, last, that the yield curve contains relevant information regarding the conduction of the monetary policy, therefore any action that would try to interfere with the fixation of the interest rates in the market can distort the economic and financial signals that must provide a yield curve for the Central Bank as well as the economic agents, which would be particularly inconvenient in a scheme of explicit inflation goals.

Another member of the Committee emphasized the fact that, in general, a yield curve offers better information for monetary policy effects when a base is built on the transactions made in the secondary market, which again marks the need to continue advancing in improvements for the operative procedures of the monetary policy, tending to form the secondary market.

FOURTH: 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 February 3 to 9, 2006 indicate an increase in the creation of primary liquidity for Q2,894.8 million, fundamentally due to the maturity of LTD's. Also a demand is foreseen in the monetary issue for Q82.6 million and a daily banking liquidity position for February 9, 2006 for Q398.4 million. Also, that the monetary issue is deviated by Q546.3 million over the central programmed point for said variable, therefore the excess of aggregate liquidity for the referred period is located at Q3,922.1 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 (Q3,531.7 million, according to registries to February 2, 2006) have to be relocated; and also, make additional fund-raising for around Q 390.4 million.

Regarding the determination of quotas for the biddings in the following week, the information provided by the daily monetization flow was taken into account, estimated for the following week: (which reports significant 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 Q70.0 million and Q55.0 million, respectively, and for the 182 day term to be convened on Friday to be of Q55.0 million.

Regarding the convening to bidding of LTDs in US dollars, the Committee took into account the maturity of the Treasury Bonds expressed in US dollars that are registered in the current dates and considered it prudent that for the week of February 6 to 10, 2006, the bids be convened for LTDs in said currency would not be necessary.

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 February 6 to 10, 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 Q70.0 million and Q55.0 respectively and on Friday for 182 days, with a fund-raising quota of Q55.0 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.

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 reference for the interest rate applied would taken from the Treasury Letters of the United States in similar terms.

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 will be submitted for approval by the Monetary Board in the next few weeks, meanwhile the Committee agreed that it should continue participating in the SINEDI through participation rules established in session 55-2005 dated October 27, 2005.

FIFTH: Other matters.

A member of the Committee distributed a set of recent press releases, issued by the monetary authorities or by the execution committees of fifteen different central banks with different reasons for decisions adopted in matters of determination of the interest rate of the monetary policy. It was indicated that the purpose of presenting said documents is to petition the technical bodies of the bank to analyze them and, as possible, to use them as a reference as to form and content, which could be useful to prepare proposals of briefs that must be issued when the Monetary Board adopts the decision corresponding to the coming months. It was also indicated that it would be useful if the Monetary Board received a copy of said documents in their next session.

Last, it was suggested that the technical departments have a systematic follow-up, possibly monthly, of said releases (that are obtained on the web page of the central banks) so they are heard in the heart of the Committee.

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