EXECUTION COMMITTEE

ACT NUMBER 7-2006

Session 7-2006 celebrated in the *Banco de Guatemala* building on Friday, February tenth, 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 6-2006, corresponding to the session celebrated on February 3, 2006.
(The project of the act circulated.)

SECOND: Market information and monetary variables.

a) Money and Exchange markets.
b) Monetary Variables

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

FOURTH: 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 6-2006.

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 February 6 to 10, 2006, with partial numbers to date, registered an attraction of LTD's for Q2,532.5 million and maturity of Q2,986.3 million, which gave a net result of fund raising for Q453.8 million, associated to the operations in bidding (net attraction for Q135.0 million), in the Money Electronic Banking Table –MEBD- and in the stock exchange (net fund raising of Q544.5 million) and at the window (net maturity for Q44.3 million).

Regarding the interest rates applied in fund raising through LTD's, it was indicated that during the period of February 6 to 10, 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 February 6 to 10, 2006 period, with partial data, the minimum was of 3.92%, observed February 9, 2006, and the maximum of 4.43%, registered on February 6, 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 4.18% for public titles and of 5.42% for the financial sector titles.

On the other hand, it was informed that during the February 6 to 9, 2006 period, regarding Treasury Bond operations the fund-raising registered was for Q12.0 million and maturity for Q116.5 million and US$1.1 million.

Regarding the Institutional Market for foreign currency the report stated that during the period of February 3 to 9, 2006, the average daily operations for purchase were of US$62.7 million and the sale was of US$67.6 million as the exchange rates remained stable. In effect, on Friday, February 3 they were of Q7.59528 per US$1.00 for purchase and of Q7.61736 per US$1.00 for sale, on Monday, February 6 the rates were Q7.59004 and Q7.61439, on Tuesday, February 7 they were Q7.59408 and Q7.61230, Wednesday, February 8 they were Q7.59526 y Q7.61274, and finally, on Thursday, February 9 they were Q7.59579 y Q7.61245.

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 February 6 to 10, 2006, the Private Institutional Foreign Currency System –SPID-, commented that the following operations took place: on Monday, February 6 for US$1.5 million at a weighted average exchange rate of Q7.60850 per US$1.00, on Thursday, February 9, for US$2.3 million at Q7.60752; and, on Friday, February 10 for US$0.9 million at Q7.61167. 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 February 6 to 10, 2006, did not close operations. As for the closing price in reference up to Friday, February 10, they indicated that for maturity to liquidate in March of 2006 the price was Q7.63750, 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 9, 2006, the excess of the daily float of the banking system was located in a position of Q442.3 million, with an average position of Q447.0 million.

The highlights during the period of February 2 to 9, 2006, were: the main demonetizing factors were the increase in the deposits of the Central Government in the *Banco de Guatemala* for Q650.5 million and the decrease in the balance of the Net International Reserve –RIN- balance for the equivalent of Q107.2 million; while the main monetizing factors were decrease in the balance of the term deposits constituted in the *Banco de Guatemala* for Q463.6 million, and the banking float balance for Q209.2 million and the deposits of the rest of the public sector in the Central Bank for Q45.0 million.

Regarding the indicative variables of the Monetary, Exchange Rate and Credit Policy they indicated that with the projection to January 2006, for December 2006 the total expected inflation estimated with a model of ordinary squared minimums is of 7.40% and with a softened exponential model of 6.49%; the simple average of both models is located at 6.95%, which is above the policy goal (6.0%+/-1 percentage point), which suggests the monetary policy remain invariable.

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 6.95%, whereas the estimated with a softened exponential model was of 5.87%; the simple average of both models is of 6.41%, which is above the policy goal (6.0%+/-1 percentage point), which suggests the monetary policy remain invariable.

As to the parameter rate, up to February 2, 2006, the lower limit was 1.31%, and the upper limit is 9.21%, while the simple average between the repurchase agreements of 8 to 15 days (4.46%) and the weighted average rate of the monetary stabilization operations of up to 91 days (4.56%) was situated at 4.51%, 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 February 2, 2006, the lower limit was 6.30% and the upper limit was 7.88%, and the weighted average rate of long term deposits of the banking system was of 6.95%, 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 9, 2006, they indicated that it presents a deviation of Q367.8 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 February 2, 2006, it exhibited an inter-annual growth rate of 16.6%, which is within the estimated range for said variable on that same date (16.7% to 18.7%), 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 22.6%, which is above the upper limit of the estimated range for February 2, 2006 (22.7% to 24.7%), which suggests relaxing the monetary policy.

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%+/-1 percentage point), 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 (6.0%+/-1 percentage point) which suggests an invariable monetary policy.

They mentioned that the Monetary Conditions Index –ICM-, to February 2, 2006, was -2.82 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 remain invariable to suggesting it relax, also, the “total projection inflation variable” went from suggesting the monetary policy be restricted to recommending it remain invariable, with this the number of variables that suggested the monetary policy remain invariable decreased to six (total inflation projection, the subjacent inflation projection, parity passive rate, the parameter rate, the Monetary Conditions Indexes, the implied inflation expectations); the number of variable that suggest to relax it increased to two (the total payment means and the banking credit to the private sector); the number of variables that suggest to restrict it was reduced to two (the inflation expectations of private analysts and monetary issue).

On the other hand, the information of the Consumer Price Index to January, 2006 that was presented, was reported by the to *Instituto Nacional de Estadística -INE-* (National Statistics Institute) (the monthly inflation was of 0.91%, higher by 0.95 percentage points than that of December 2005 and lower by 0.45 percentage points to the observed in January 2005; the inflationary rhythm was at 8.08%, lower by 0.49 percentage points to that of December 2005 and lower by 0.96 percentage points to the observed in January 2005; the subjacent inflation registered a rhythm of 7.62%, lower by 0.12 percentage points to that of December 2005 (7.74%) and inferior to that of January 2005 (8.13%)); as well as the estimations of the imported and domestic components of inflation (from the 8.08% of the inflationary rhythm to January 2006, 2.81 percentage points are attributable to the imported inflation, of which, 1.90 percentage points correspond to the indirect imported inflation (second round effect); therefore, the inflationary rhythm, 5.27 percentage points (correspond to domestic inflation).

THIRD: 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 10 to 16, 2006 indicate an increase in the creation of primary liquidity for Q2,820.8 million, fundamentally due to the maturity of LTD's. Also a demand is foreseen in the monetary issue for Q97.2 million and a daily banking liquidity position for February 16, 2006 for Q381.7 million. Also, that the monetary issue is deviated by Q550.4 million over the central programmed point for said variable, therefore the excess of aggregate liquidity for the referred period is located at Q3,850.1 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 (Q3,011.6 million, according to registries to February 9, 2006) have to be relocated; and also, make additional fund-raising for around Q 838.4 million.

The technical departments presented the Committee with some advance of the first running of the semi-structural model. The purpose of the mentioned presentation was to obtain feedback from the Committee for the fine-tuning that would be necessary in order to foresee that the inflation in the mid term has consistency from the empiric as well as the theoretical point of view, to later give the final results to the Monetary Board in the next meeting, in which it should decide the leading interest rate level of the monetary policy. On this particular subject, a member of the Committee suggested that for the evaluation of the probabilistic inflation risks balance offered by the semi-structural model, it should take into consideration, on the one hand, the prognosis of the international oil prices in 2006, given that according to the opinion of various international experts, the referred price will remain high but stable during the present year, according to the current levels observed. On the other hand, the fact that the calibration of the semi-structural model incorporates the restriction that the inflation prognosis for 2006 and 2007 converge toward the goal of monetary policy fixed by the Monetary Board for those years was highlighted, in order to estimate the effort that the monetary policy should realize for said convergence to materialize without harming the real production performance.

Based on the information received, the Committee began the discussion on the analysis that must be presented to the Monetary Board on Wednesday, February 22 when it has to make a decision on the leading interest rate of the monetary policy. For the effect, the factors were analyzed that advise raising the referred interest rate, as well as those that advise keeping it invariable, in order to consider the incorporation of the same, where the balance of the inflation risks that the technical departments will present in the next reunion of the Committee could be.

As to the factors that advise raising the leading interest rate the following were mentioned:

i) According to the analysis made by the international experts, in 2006 it is expected that the international oil prices remain high, but with a lesser volatility than the observed in 2005. The price of crude oil will continue to be the main inflationary risk in the country, even though in a lesser magnitude than in 2005.

ii) Regarding the variables subject to follow up in the monetary program, in the first term, the level of monetary stabilization operations to date has been lower than the programmed and, in second term, the monetary issue continues observing a deviation over the upper limit of the programmed runner for said variable, even though in lesser magnitude than in January 2006.

On their part, regarding the factors that advise keeping the leading interest rate of the monetary policy invariable, the following were highlighted:

i) The inflationary rhythm –total as well as subjacent- observed in January was reduced regarding the previous month.

ii) The econometric projection as well as the total inflationary rhythm and the subjacent decreased regarding the previous month. In that regard, a member of the Committee highlighted the fact that when considering the punctual goal plus the margin of +/- one percentage point, the projection of the total inflationary rhythm for 2006 (6.95%) was located within said margin, situation that does not occur since August 2005, which offers a sign of tranquility. However, other members of the Committee indicated that the analysis of the referred indicative variable has to be handled with caution, due to the fact that the punctual goal is of 6%, therefore any estimation over this, minimal as it may be, should be interpreted as an orientation toward restricting the monetary policy. In that sense, a member of the Committee required the technical departments to find the most adequate manner of interpreting this variable, taking into consideration for the effect, the best practices on an international level on the subject.

iii) The number of indicative variables that suggest restricting the monetary policy were reduced from four to two regarding the observed in January 2006, and the number of variables that suggest keeping the monetary policy invariable increased from five to six. In that regard, the Committee discussed the behavior of the indicative variables "payment means" and "banking credit to the private sector"; in particular, it was mentioned that the interpretation of both variables has been worked on in function of its deviation regarding a weekly runner estimate, whose calculation methodology is based on the behavior of 2005, particularly in the case of the banking credit to the private sector, which may not perform according to the expected (just as it occurred last year), therefore the Committee asked the technical departments to analyze it carefully and consider the inclusion of some criteria that measures its projection at the end of the year.

The heart of the Committee taking into account the above, decided that it is necessary to continue analyzing the mentioned factors; therefore, it asked the technical departments to continue investigating the mentioned aspects, as well as others, which would come up from the balance of inflation risks. Also, the Committee made emphasis on the importance that the calculations and projections have, that are derived from the running of the semi-structural model, whose first results will be presented in the next Committee session and will be included in the analysis which will be submitted for consideration before the Monetary Board in its next session on February 22.

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 Q70.0 million. A member of the Committee asked the technical departments to review the estimation of the banking liquidity included in the daily monetization flow, in virtue of the fact that this can be susceptible to fine-tuning and, consequently, offer more precise information for the effects of aggregate liquidity estimation.

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 13 to 17, 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 13 to 17, 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 Q70.0 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, based on the market interest rates.

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.

FOURTH: Other matters.

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