EXECUTION COMMITTEE

ACT NUMBER 10-2006

Session 10-2006 celebrated in the *Banco de Guatemala* building located at *séptima avenida número veintidós guión cero uno, zona uno* of this city on Friday, March 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 9-2006, corresponding to the session celebrated on February 24, 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 9-2006.

SECOND: Information of markets and monetary variables.

The coordinator requested the following information be provided.

a) The Director of the Department of Monetary Stabilization Operations, regarding the Money market informed that during the period from February 27 to March 3 of 2006, with partial numbers to date, registered an attraction of LTD's for Q2,563.7 million and maturity of Q2,675.8 million, which gave a net result of fund raising for Q112.1 million, associated to the operations in bidding (net attraction for Q38.9 million), in the Money

Electronic Banking Table –MEBD- and in the stock exchange (net maturity of Q38.9 million) and at the window (net maturity for Q40.2 million).

Regarding the interest rates applied in fund raising through LTD's, it was indicated that during the period of February 27 to March 3, 2006 for the biddings case, the cut interest rates was 6.2499% 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 27 to March 3, 2006 period, with partial data, the minimum was of 4.31%, observed February 27, 2006, and the maximum of 4.89%, registered on February 28, 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 4.53% for public titles and of 5.50% for the financial sector titles.

On the other hand, it was informed that during the February 27 to March 2, 2006 period, regarding Treasury Bond operations the fund-raising registered was for Q48.3 million and maturity for Q30.1 million.

Regarding the Institutional Market for foreign currency the report stated that during the period of February 24 to March 2, 2006, the average daily operations for purchase were of US$74.5 million and the sale was of US$72.6 million as the exchange rates showed a slight tendency, in sales toward the rise and for purchase toward the low. In effect, on Friday, February 24 they were of Q7.59882 per US$1.00 for purchase and of Q7.61803 per US$1.00 for sale, on Monday, February 27 the rates were Q7.60217 and Q7.62177, on Tuesday, February 28 they were Q7.61350 and Q7.62862, Wednesday, March 1 they were Q7.61173 y Q7.62913, and finally, on Thursday, March 2 they were Q7.61705 y Q7.63572.

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 27 to March 3, 2006, the Private Institutional Foreign Currency System –SPID-, the following operations took place: on Monday, February 27 for US$0.4 million, at a weighted average exchange rate of Q7.62125 per US$1.00 and on Tuesday, February 28, for US$0.2 million at Q7.63100, on Thursday March 2, US$1.1 million, at

Q7.63514; and on Friday, March 3, US$0.8 million at Q7.63700. Regarding the Electronic Foreign Currency Negotiation System –SINEDI-, they declared that during the period no operations were closed; and the *Banco de Guatemala* received a daily bid for the purchase of US$10.0 million, with a 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 27 to March 3, 2006, did not close operations. As for the closing price in reference up to Friday, March 3, 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 Q7.65000.

b) The Director for the Economic Studies Department informed that on March 2, 2006, the excess of the daily float of the banking system was located in a negative position of Q4.8 million, with a negative average position of Q40.6 million.

The highlights during the period of February 23 to March 2, 2006 were the main monetizing factors, which were the decrease in the balance for the deposits for the Central Government in the *Banco de Guatemala* for Q203.7 million and the deposits of the rest of the public sector in the Central Bank for Q52.4 million and the banking float balance for Q13.7 million; and the increase in balance of the Net International Reserve –RIN- balance for the equivalent of Q113.7 million; while the main demonetizing factor was the increase in the long term deposits constituted in the *Banco de Guatemala* for Q40.3 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 January 2006, 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 23, 2006, the lower limit was 1.54%, and the upper limit is 9.44%, while the simple average between the repurchase agreements of 8 to 15 days (4.46%) and the weighted average of the monetary stabilization operations of up to 91 days (4.59%) was situated at 4.53%, which is located within the tolerance margin estimated for the parameter rate, situation that suggests remaining at an invariable monetary policy. When referring to the parity liable rate, they declared that up to February 23, 2006, the lower limit was 6.45% and the upper limit was 8.03%, and the weighted average rate of long term deposits of the banking system was of 6.97%, which maintains itself within the fluctuation range of the parity liable rate, which advises an invariable monetary policy.

As to monetary issue observed to March 2, 2006, they indicated that it presents a deviation of Q404.5 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 23, 2006, it exhibited an inter-annual growth rate of 15.9%, which is under the tolerance margin estimated range for said variable on that same date (17.0% to 19.0%), which advises relaxing the monetary policy. Also, up to said date, the banking credit of the private sector registered an inter-annual growth rate of 22.8%, which is within the range estimated for February 23, 2006 (22.6% to 24.6%), which suggests an invariable monetary policy.

As to inflation expectations of private analysts, they indicated that according to the poll made in February 2006, for December 2006 an inflationary rhythm of 8.05% 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 February 2006 showed an inflationary rhythm of 6.08%, which is within a tolerance margin of the monetary policy for 2006 (6.0% +/- 1 percentage point), which suggests an invariable monetary policy.

They mentioned that the Monetary Conditions Index –ICM-, to February 23, 2006, was -2.85 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 they remained the same regarding the previous week: seven variables that suggest the monetary policy remain invariable (the total inflation projection, the subjacent inflation projection, parameter rate, parity liable rate, the banking credit to the private sector, implied inflation expectations, and the Monetary Conditions Index); two variables remain that advise the monetary policy be restrictive (monetary issue, the inflation expectations of private analysts); and one variable suggests a relaxed monetary policy (the total payment means).

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 March 3 to 9, 2006 indicate an increase in the creation of primary liquidity for Q3,625.1 million, fundamentally due to the maturity of LTD's. Also, a decrease in the demand for monetary issue for Q78.3 million is foreseen and a daily banking liquidity position for Q26.9 million. Also, monetary issue is deviated in Q587.1 million above the central programmed point for said variable, therefore the excess of aggregate liquidity for the referred period is located at Q4, 317.4 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 (Q3,300.7 million, according to registries to March 2, 2006) have to be relocated; and also, make additional fund-raising for around Q 1,016.8 million.

When examining the information received, in the heart of the Committee the calculation and interpretation of some variables was reflected on. As to the variables "banking credit to the private sector" and "total payment means", a member of the Committee reiterated that, in their opinion, it was convenient to review given that, on the one hand, the inter-annual growth rhythm of both variables to date does not coincide with the estimated runner and, on the other hand, that for the fourth trimester of 2006 a deceleration in the respective inter-annual growth rates is projected; on this it was suggested that a formal proposal be made on the methodological changes that, if they were necessary, could be made on said variables to improve their interpretation as monetary policy guides. Also, the convenience of reviewing the calculation of the “parameter rate” variable was presented, particularly as to the amplitude of the tolerance margin, which, in the opinion of some of the members of the Committee, is too ample and that makes the interpretation of the variable lose use. In that sense, another member referred to the indicative variables regarding inflation: the expected inflation (total and subjacent); the inflation expectations of the panel of private analysts; and, the implied inflation expectation; in this regard, it was pointed out that when the inflation goal for 2006 is compared (6% +/- 1 percentage point), in their opinion, it is not correct to interpret when the number observed is within the margin of tolerance of +/- 1 percentage point, but close to the upper limit, this suggests an invariable monetary policy, given that that could give a false ease signal; in that regard, in the Committee it was indicated that the correct interpretation of these variables is a theme that has been dealt with in other sessions and that, according to the agreed, they are still pending the determination based on the better practices on the subject. In that regard, the Committee agreed that the review of these indicative variables is an aspect that still needs discussion and to be added to the analysis made of the monetary policy report to March 2006 and that said occasion be taken advantage of to present the modifications that are necessary to the Monetary Board regarding the methodology and the interpretation of said indicative variables.

On the other hand, the Committee made reference to the petition that one of the members of the Monetary Board regarding the need to review the yield curve that forms part of the financial information of the *Banco de Guatemala* and that is presented weekly, to said body. In that regard, a member of the Committee indicated that said revision could be seen from three different points of view. The first, refers to the theoretical aspects of the yield curve and on the manner in which it is made in other countries; the second, is evaluate how the process of improving the manner in which the Monetary Stabilization Operations made can affect or contribute to the conformation of a yield curve in the Guatemalan market; and, the third, is related with evaluating the convenience that the Central Bank tries to interfere in the manner the yield curve is determined in the market. The Committee agreed in that the analysis of these three points of view mentioned can be approached taking into account, among others, the following aspects:

i. Review the purely theoretical themes regarding: What is a yield curve?; What is it for?; How is it calculated? Go deeper into the facts that give the yield curve, at least from the theoretical point of view, and how it is given follow up in other countries, according to graphs that reflect the behavior of the secondary market, activity that in Guatemala still is not developed;

ii. Go deeper into the fact that in the majority of countries with developed financial systems, the secondary markets operate with values titles in terms that are not so long (30, 40 and even 50 years), which is not a given in Guatemala, either; notwithstanding this, analyze the manner in which it can improve the presentation of the interest rate curves that are presented to the Monetary Board, to better adequate them to international practice standards;

iii. Analyze the manner in which the conformation of the yield curve fits in within the efforts of the Central Bank to improve the operative aspects of the monetary policy, within the process of implementation of the scheme of explicit inflation goals; in particular, the recommendations must be taken into consideration of the International Monetary Fund mission, that the previous year indicated that "the reduction in number and frequency in the bids, with pre-established quotas, as well as the issue of LTDs with a maturity date can improve liquidity in the secondary market and help establish a real yield curve" in the market; and,

iv. Last, reflect on the convenience that the Central Bank hopes to determine more than one point of the yield curve; particularly, taking into account the observations of the mission of the IMF and of Professor Sebastian Edwards, who, in his report to the Monetary Board in 2004, indicated that the central bank does not have "the capacity to know how a yield curve behaves, because there is no way to know", and that the intentions of interfering with said curve have propitiated that the same "have a behavior that is inefficient and conduces to speculation that creates unnecessary capital movements that tie the hands of the *Banco de Guatemala*."

Taking into consideration the aspects pointed out, the Committee required the technical departments to deepen the theoretical aspects as well as the empiric aspects of the yield curve.

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 and the rule established for the effect, the Committee agreed that for the following week the fund-raising quota for the 91 and 364 day terms to be convened on Monday to be established at Q80.0 million and Q30.0 million, respectively, and for the 182 day term to be convened on Friday to be of Q60.0 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, and considered that for the week of March 6 to 10, 2006, it would not be necessary to convene a 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 March 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 Q80.0 million and Q30.0 respectively and on Friday for 182 days, with a fund-raising quota of Q60.0 million. The interest rates will be determined according to the conditions of the market, reflected in the bids received.

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 interest rate applied use the interest rates of the Treasury Letters of the United States of America in similar terms.

As for the participation of the *Banco de Guatemala* in the Exchange market, the Committee agreed that while they continue discussing and analyzing the fine-tuning of the participation rules 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.

FOURTH: Other matters.

Not having any other matter to discuss, the session ends at sixteen hours and forty-five minutes, in the same place and on the same date indicated, all who attended sign in agreement.