EXECUTION COMMITTEE

ACT NUMBER 11-2006

Session 11-2006 celebrated in the *Banco de Guatemala* building located at *séptima avenida número veintidós guión cero uno, zona uno* of this city on Friday, March 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 10-2006, corresponding to the session celebrated on March 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 10-2006.

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 March 6 to 10 of 2006, with partial numbers to date, registered an attraction of LTD's for Q3,336.8 million and maturity of Q2,128.3 million, which gave a net result of fund raising for Q1208.5 million, associated to the operations in bidding (net attraction for Q58.5 million), in the Money Electronic Banking Table –MEBD- and in the stock exchange (net maturity of Q1,334.0 million) and at the window (net maturity for Q67.0 million).

Regarding the interest rates applied in fund raising through LTD's, it was indicated that during the period of March 6 to 10, 2006 for the biddings case, the cut interest rates were of: 5.00% for 91 days and of 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 March 6 to 10, 2006 period, with partial data, the minimum was of 4.02%, observed March 9, 2006, and the maximum of 4.81%, registered on March 7, 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 4.32% for public titles and of 5.76% for the financial sector titles.

On the other hand, it was informed that during the March 3 to 9, 2006 period, regarding Treasury Bond operations the fund-raising registered was for Q140.0 million and maturity for Q60.2 million and US$5.1 million.

Regarding the Institutional Market for foreign currency the report stated that during the period of March 3 to 9, 2006, the average daily operations for purchase were of US$66.5 million and the sale was of US$64.8 million as the exchange rates showed a slight tendency, in sales toward the rise and for purchase toward the low. In effect, on Friday, March 3 they were of Q7.61507 per US$1.00 for purchase and of Q7.63737 per US$1.00 for sale, on Monday, March 6 the rates were Q7.61659 and Q7.63989, on Tuesday, March 7 they were Q7.62071 and Q7.63747, Wednesday, March 8 they were Q7.62155 y Q7.63993, and finally, on Thursday, March 9 they were Q7.62219 y Q7.64046.

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 March 6 to 10, 2006, the Private Institutional Foreign Currency System –SPID-, the following operations took place: on Monday, March 6 for US$1.5 million, at a weighted average exchange rate of Q7.63717; on Tuesday, March 7 US$1.0 million at

Q7.63570; and on Friday, March 10, US$1.4 million at Q7.64000. 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 March 6 to 9, 2006, did not close operations. As for the closing price in reference up to Thursday, March 9, 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 9, 2006, the excess of the daily float of the banking system was located in a negative position of Q140.7 million, with a negative average position of Q300.5 million.

The highlights during the period of March 2 to 9, 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 Q172.8 million and the deposits of the rest of the public sector in the Central Bank for Q41.2 million; and the increase in balance of the Net International Reserve –RIN- balance for the equivalent of Q7.2 million; while the main demonetizing factor were the increase in the banking float for Q176.4 million and the increase in the long term deposits constituted in the *Banco de Guatemala* for Q53.2 million.

Regarding the indicative variables of the Monetary, Exchange Rate and Credit Policy they indicated that with the projection to February 2006, for December 2006 the total expected inflation estimated with a model of ordinary squared minimums is of 6.83% and with a softened exponential model of 6.03%; the simple average of both models is located at 6.43%, which is found within the margin of tolerance (6.0% +/- 1 percentage point), which suggests the monetary policy remain invariable.

Regarding the expected subjacent inflation for 2006, with data up to February 2006, estimated with an integrated auto-regression model of mobile averages ARIMA was of 6.11%, whereas the estimated with a softened exponential model was of 5.53%; the simple average of both models is of 5.82%, which is within the margin of tolerance for the policy goal (6.0% +/- 1 percentage point), which suggests the monetary policy remain invariable.

As to the parameter rate, up to March 2, 2006, the lower limit was 1.02%, and the upper limit is 8.92%, while the simple average between the repurchase agreements of 8 to 15 days (4.45%) and the weighted average of the monetary stabilization operations of up to 91 days (4.58%) was situated at 4.52%, which is located within the tolerance margin estimated for the parameter rate, situation that suggests the monetary policy remain invariable. When referring to the parity liable rate, they declared that up to March 2, 2006, the lower limit was 5.95% and the upper limit was 7.53%, and the weighted average rate of long term deposits of the banking system was of 6.98%, 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 9, 2006, they indicated that it presents a deviation of Q523.2 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 March 2, 2006, it exhibited an inter-annual growth rate of 16.5%, which is under the tolerance margin estimated range for said variable on that same date (16.5% to 18.5%), 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 23.6%, which is within the range estimated for March 2, 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 March 2, 2006, was -2.97 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 the previous week, the variable "total payment means" went from suggesting that the monetary policy relax to advising that the same remain invariable, with which the variables that suggest the monetary policy remain invariable increased to eight (the total inflation projection, the subjacent inflation projection, parameter rate, parity liable rate, the total payment means, 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 none suggest to relax it.

On the other hand, the information of the Consumer Price Index for February, 2006 reported by the National Statistics Institute (INE for its acronym in Spanish) was presented (the monthly inflation was negative by 0.03%, lower by 0.94 percentage points to January 2006 and lower by 0.77 percentage points to the observed in February 2005; the inflationary rhythm was at 7.26%, lower by 0.82 percentage points to that of January 2006 and lower by 1.78 percentage points to the observed in February 2005; the subjacent inflation registered a rhythm of 7.03%, lower by 0.59 percentage points to that of January 2006 (7.62%) and lower than that of February 2005 (8.10%)); as well as the estimations of the imported and domestic components of inflation (from 7.26% inflationary rhythm to February 2006, 1.97 percentage points are attributable to imported inflation, at the same time 1.30 percentage points correspond to the indirect imported inflation (second round effect); therefore, the inflationary rhythm, 5.29 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 March 10 to 16, 2006 indicate an increase in the creation of primary liquidity for Q3,161.8 million, fundamentally due to the maturity of LTD's. Also, a decrease in the demand for monetary issue for Q4.0 million is foreseen and a daily banking liquidity position for Q61.3 million. Also, monetary issue is deviated in Q705.8 million above the central programmed point for said variable, therefore the excess of aggregate liquidity for the referred period is located at Q3,810.3 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 (Q3,443.6 million, according to registries to March 9, 2006) have to be relocated; and also, make additional fund-raising for around Q366.7 million.

Based on the information received, the Committee began the discussion on the analysis that must be presented to the Monetary Board in its session on Wednesday, March 22, 2006 when according to the approved calendar, the Board will make a decision regarding the leading interest rate of the monetary policy. For the effect, the convenience of the importance of analyzing the factors that advise raising the referred interest rate was agreed, like those that advise it remain invariable, in order that they be incorporated to said analysis in the balance of inflation risks that the technical departments will present in their next Committee meeting.

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

i. The international price of oil is expected to remain high for 2006, but with a lower volatility than the observed in 2005, factor that continues to be the main inflationary risk in the country, even though in a lesser magnitude than in 2005.

ii. Regarding the variables subject to the follow up in the monetary program, in the first term, the level of operations of monetary stabilization to date have been below programmed and, in the second term, the monetary issue continues observing a deviation over the upper limit the programmed runner for said variable.

On the other hand, regarding the factors that advise keeping the leading interest rate invariable, the following were highlighted:

i. The inflationary rhythm (total as well as subjacent) observed in February was reduced regarding the previous month; also, the observed inflation in February is the lowest registered in the referred month since 2001, when the current structure of the Consumer Price Index was implemented.

ii. The econometric projection of the total inflationary rhythm as well as the subjacent in February decreased regarding January. A member of the Committee highlighted the fact that when considering the punctual goal of 6% plus the margin of +/- a percentage point, the projection of the total inflationary rhythm for December 2006 (6.43%) is located within said margin, which offers a sign of rest. However, it was mentioned that a stricter analysis, considering the punctual goal, would indicate that the projection of the inflationary rhythm for the end of the year is still over the goal.

iii. The number of indicative variables that advise restricting the monetary policy is at two regarding the observed in February 2006, whereas the number of variables that suggest keeping the monetary policy invariable increased from six to eight.

Taking into account the above, the Committee agreed to continue analyzing the mentioned factors and to require the technical departments continue investigating into these, also considering others that would rise from the inflation risks balance.

In particular, a member of the Committee referred to the fact that the result of the survey of inflation expectations of the panel of private analysts made in February reflected an increase of 0.52 percentage points in the projection of inflationary rhythm for December 2006, when going from 7.53% in January to 8.05% in February. In that regard, it was indicated that notwithstanding that on the date of the survey there still was no data available on inflation in February, if this had produced a reduction of inflation in January regarding that of December 2005, therefore it is called to attention that the referred panel of analysts had not reviewed the prognosis toward the low, therefore it is convenient to ask oneself if said increase in the expectations could be reflecting that, at not having adjusted the leading interest rate, some of the analysts consulted had interpreted that in the absence of such adjustments the inflation could be higher at the end of the year. On this particular, it was indicated that, when consulted, none of the analysts explicitly indicated that their expectations were influenced by the decisions to not modify the leading interest rate. The Committee asked the technical departments to analyze the relative aspects of the treatment of the prognosis provided by the panel of analysts.

A member of the Committee made reference to the Semi-structural Macroeconomic model, asking that if for session of the Monetary Board of March 22, 2006 the second running of the mentioned model would be available, given that they already count on the inflation data for February 2006. In that regard, the technical bodies indicated that according to the recommendations of the experts of the International Monetary Fund that have offered technical assistance to the *Banco de Guatemala* in the elaboration of the Prognosis and Analysis System of the Monetary Policy, SPAPM (for its acronym in Spanish), the implementation of the scheme of explicit inflation goals in small and open economies suggests that a macroeconomic model of said nature must be used trimesterally, not monthly, especially if the following aspects are considered:

i. The referred prognosis system is a complex conjunction that at the same time constitutes the initial conditions of the model.

ii. The fact that only the monthly information is included in the model can generate volatility in the results and demand action from the monetary policy that is not necessarily consistent with the future tendencies of all variables that make up the mentioned model.

iii. Last, the semi-structural model requires adjustments of calibration as well as the different equations that make it up; like the different coefficients that integrate it.

In the frame of revision of the indicative variables that the technical bodies are making, a member of the Committee suggested that, given the importance that the monitoring of liquidity has in a scheme of monetary issue, is give follow up to the monetary base (that represents the money of high power), using an estimated runner for the effect.

Another member suggested that it would be convenient to periodically inform on the evolution of the type of nominal exchange rate regarding its expected seasonal behavior, in order to evaluate the possible inflationary or deflationary pressures that could rise in this manner.

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 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 Q50.0 million and Q40.0 million, respectively, and for the 182 day term to be convened on Friday to be of Q45.0 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 13 to 17, 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 13 to 17, 2006, to keep the execution guidelines of the monetary policy observed during the present week; 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: on Monday for the 91 and 364 day terms, with a fund raising quota for Q50.0 million and Q40.0 respectively and on Friday for 182 days, with a fund-raising quota of Q45.0 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 the 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 will have to be approved by the Monetary Board in the next few weeks, to continue participating through the electronic negotiating system of foreign currency, according to the established in session 55-2005 dated October 27, 2005.

FOURTH: Other matters.

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