EXECUTION COMMITTEE

ACT NUMBER 12-2006

Session 12-2006 celebrated in the *Banco de Guatemala* building located at *séptima avenida número veintidós guión cero uno, zona uno* of this city on Friday, March seventeenth, 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 11-2006, corresponding to the session celebrated on March 10, 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 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 11-2006.

SECOND: Information of markets and monetary variables.

The coordinator requested the following information be provided.

a) The Sub-director of the Department of Monetary Stabilization Operations, regarding the Money market informed that during the period from March 13 to 17 of 2006, with partial numbers to date, registered an attraction of LTD's for Q2,714.7 million and maturity of Q2,684.3 million, which gave a net result of fund raising for Q30.4 million, associated to the operations in bidding (net attraction for Q53.9 million), in the Money Electronic Banking Table –MEBD- and in the stock exchange (net fund-raising of Q88.0 million) and at the window (net maturity for Q3.7 million).

Regarding the interest rates applied in fund raising through LTD's, it was indicated that during the period of March 13 to 17, 2006 for the biddings case, the cut interest rates were of: 5.00% for 91 days and of 6.2475% 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 13 to 17, 2006 period, with partial data, the minimum was of 3.95%, observed March 16, 2006, and the maximum of 4.51%, registered on March 17, 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 5.62% for the financial sector titles.

On the other hand, it was informed that during the March 13 to 16, 2006 period, regarding Treasury Bonds operations the fund-raising registered was for Q177.0 million and maturity for Q0.2 million and US$5.5 million.

Regarding the Institutional Market for foreign currency the report stated that during the period of March 10 to 16, 2006, the average daily operations for purchase were of US$72.3 million and the sale was of US$67.5 million as the exchange rate for the referred period remained stable. In effect, on Friday, March 10 they were of Q7.62365 per US$1.00 for purchase and of Q7.63799 per US$1.00 for sale, on Monday, March 13 the rates were Q7.61907 and Q7.64050, on Tuesday, March 14 they were Q7.61450 and Q7.63541, Wednesday, March 15 they were Q7.60716 y Q7.62125, and finally, on Thursday, March 16 they were Q7.60905 y Q7.62600.

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 13 to 17, 2006, the Private Institutional Foreign Currency System –

SPID-, the following operations took place: on Wednesday, March 15 for US$1.0 million, at a weighted average exchange rate of Q7.61500; on Friday, March 17 US$0.5 million at Q7.62400. 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 13 to 17, 2006, did not close operations. As for the closing price in reference up to Friday, March 17, they indicated that for maturity to liquidate in June of 2006 it was of Q7.65000.

b) The Director for the Economic Studies Department informed that on March 16, 2006, the excess of the daily float of the banking system was located in a negative position of Q282.7 million, with a negative average position of Q265.6 million.

The highlights during the period of March 9 to 16, 2006 were the main monetizing factors, which were the decrease in the long term deposits constituted in the *Banco de Guatemala* for Q382.6 million; while the main demonetizing factors were the increase in the banking float for Q174.6 million, the deposits of the central government in the *Banco de Guatemala* for Q81.1 million and the deposits of the rest of the public sector in the Central Bank for Q30.1 million; and the decrease in balance of the Net International Reserve –RIN- balance for the equivalent of Q57.6 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 9, 2006, the lower limit was 1.18%, and the upper limit is 9.08%, while the simple average between the repurchase agreements of 8 to 15 days (4.50%) and the weighted average of the monetary stabilization operations of up to 91 days (4.58%) was situated at 4.54%, 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 9, 2006, the lower limit was 5.98% and the upper limit was 7.56%, and the weighted average rate of long term deposits of the banking system was of 6.99%, 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 16, 2006, they indicated that it presents a deviation of Q536.6 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 9, 2006, it exhibited an inter-annual growth rate of 17.5%, which is under the tolerance margin estimated range for said variable on that same date (16.4% to 18.4%), 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 24.0%, which is within the range estimated for March 9, 2006 (22.8% to 24.8%), 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 9, 2006, was -2.99 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 reported it remained the same as the previous week: eight suggest the monetary policy 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.

THIRD: Inflation Risks Balance.

The Committee continued the analysis beginning the week before, which must be presented to the Monetary Board in its session of March 22, 2006 therefore, according to the calendar approved, said certified body made a decision regarding the leading interest rate of the monetary policy. For the effect, the technical departments of the *Banco de Guatemala* presented the balance of inflation risks to the Execution Committee emphasizing the following aspects:

As to the external conditions, it was indicated that an increase of approximately US$3.00 per barrel was observed in the projections of the international oil prices for 2006, associated, according to Global Insight, to political problems in Nigeria (country that supplies approximately 8.0% of the production of the Organization of Oil Exporting Countries (OPEP, for its acronym in Spanish)) and to the risks regarding Iran's nuclear program, country that offers around 13.0% of the production of the referred organization. Additionally, it was reported that the breach between world supply and demand of oil continues to be minimal, which, according to international experts in the crude oil market, generates a greater volatility in the international price of oil, therefore any event that affects the referred market can make the price of crude oil increase or decrease abruptly. The prior confirms that the referred behavior of the price continues to be the main inflationary risk in the country, even though in a lesser magnitude than in 2005 and than in the first bimester of 2006.

It was indicated that the impact of external inflation continues to be a risk as to how the index of composed inflation of the main commercial partners of Guatemala continues to be relatively high. In effect, the inflationary rhythm of the United States of America in February 2006 (country with the greatest relative weight within the index) was at 3.60%, higher by 0.59 percentage points to the inflationary rhythm observed in February of 2005 (3.01%), therefore in this manner, the imported inflation risks continue to be present.

As to the internal conditions, it was indicated that regarding the variables subject to a follow up in the monetary program, in the first place, to date, the level of monetary operations stabilization is at about Q1,325.0 million below the programmed; and, in second place: the monetary issue continues to observe a deviation of Q540.0 million over the upper limit of the programmed runner for said variable; and in third place, the execution of the public finances for the first semester, expects an acceleration of public expense, which could pressure the aggregate demand and therefore, the general level of prices in the following months.

It was mentioned that the greater part of inflation excess on the goal is attributable to exogenous factors, mainly to the effect of oil prices. Also, the fact that 7.26% of the inflationary rhythm observed in February, 1.97 percentage points are attributable to imported inflation was also emphasized; of which 0.52 percentage points correspond to historic imported inflation, and the remaining 5.81 percentage points can be attributable to monetary factors, that if they are not restrained properly, could erode the credibility of the Central Bank in terms of fulfillment of the inflation goal for December 2006 and December 2007.

Regarding the indicative variables it was pointed out that, when comparing the situation of these informed, to date, regarding the situation observed to February 17, 2006 (date on which the Committee last analyzed the level of the leading interest rate), the number of indicative variables that suggest restricting the monetary policy remained at two, from an ample perspective (the monetary issue and the inflation expectations of the panel of private analysts); the variables that advise relaxing the monetary policy was reduced from two to zero; and the variables that advise the monetary policy remain invariable rose from six to eight (the projection of total inflation, the projection of subjacent inflation, the parity liable rate, the parameter rate, the total payment means and the banking credit to the private sector, the implied inflation expectations and the Monetary Conditions Index).

Finally, the econometric projections of inflation for 2006, prepared by the technical departments, using data observed to February 2006, estimate a total inflation for December 2006, to be located within a margin of tolerance for the policy goal (6% +/- 1 percentage point). Notwithstanding, it was also pointed out that a stricter interpretation of the inflation goal; in other words, when considering the punctual goal of 6%, it indicates that the referred projections are located over said goal (6.43%), which, within the scheme of explicit inflation goals must be interpreted as a signal that the monetary policy must be restrictive. On the other hand, it was also mentioned that the inflation expectations of the panel of private analysts, according to the survey made in February 2006, indicating that the referred panel projects an inflationary rhythm for the end of 2006 over the inflation goal, which could anticipate that the tendency of the inflationary rhythm toward deceleration could be suspended.

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 March 17 to 23, 2006 indicate an increase in the creation of primary liquidity for Q3,194.0 million, fundamentally due to the maturity of LTD's. Also, an increase in the demand for monetary issue for Q31.7 million is foreseen and a daily banking liquidity position for Q214.8 million. Also, monetary issue is deviated in Q719.2 million above the central programmed point for said variable, therefore the excess of aggregate liquidity for the referred period is located at Q4,096.4 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 (Q2,898.9 million, according to registries to March 16, 2006) have to be relocated; and also, make additional fund-raising for around Q1,197.5 million.

Based on the requirement of the Committee made in the session of March 10, 2006, the technical bodies presented information on the trajectory of the nominal exchange rate. In that regard, it was indicated that the referred trajectory is built taking into account two factors: the first, based on the estimation of the variation of the annual exchange rate, which is calculated as the arithmetic difference between the inflation goal of the country for December 2006 and the weighted average inflation projection for December 2006 of the main commercial partners for Guatemala; the second factor, corresponds to an estimated runner based on the seasonal behavior of the variable. On this particular, the center of the expected runner for the week of March 13 to 20, 2006 was of Q7.626 per US$1.00 and the level observed (calculated as the average of the exchange rates for purchase and sale in the institutional market of foreign currency for the period between March 13 and 15, 2006) was of Q7.623 per US$1.00, which interferes with the observed value of the nominal exchange rate is found near the expected level, therefore in this manner there are no foreseeable inflationary o deflationary pressures.

The technical departments, after expressing the relative to the elements that make up the inflation risks balance, as well as the behavior of the indicative variables of the monetary policy, reached a conclusion that the factors that advise restricting the monetary policy prevail, therefore an adjustment in the leading interest rate contributes to, on the one hand, continue moderating the inflationary expectations of the economic agents and on the other hand, to strengthen the credibility of the Central Bank in the management of the monetary policy, aspect of great importance for the fulfillment of the inflationary goal for December 2006 and 2007.

According to the analysis made by the technical bodies, and based on the orientation of the indicative variables, the balance of inflation risks, some members of the Committee expressed that even when some of the judgment elements mentioned are perceived as favorable for the execution of the monetary policy, this perspective is valid only in a very short term, but that when considering the horizon in the mid term the factors that suggest restricting the monetary conditions through an increase in the leading interest rate prevail.

In the described context, the Committee considered that notwithstanding that the inflation continued its tendency toward deceleration in February; it is observed that the prognosis of inflation is located over the punctual goal of inflation of 6% for 2006 (in a strict interpretation), therefore it is advisable to have in mind the actions of the monetary policy in a scheme of explicit inflation goals that must be, at the same time, opportune and gradual, in order that the inflationary expectations are moderate and reach the inflation goal in the lowest cost possible, at the same time, that they strengthen the credibility of the central bank before the real money and exchange markets, since the best reasonable management of the mentioned expectations is fundamental for the monetary policy to fulfill its fundamental objective, which is the stability in the general level of prices. Also, it was indicated that the other source of inflationary pressure in the mid term is represented in the direct imported inflation, given that the compound index of inflation of the main commercial partners of Guatemala continue to be relatively high.

Another subject analyzed was the behavior of the international price of fuels. In that regard, the Committee analyzed that the last information available points to an increase sustained in the international price of oil lately and future prices higher than those the international markets projected in February 2006, tendency that if sustained, surely could generate inflationary pressures in the next months. Additionally, it was indicated that the information on the breach existing between world supply and demand of oil in Global Insight has to be considered, because it continues to be minimal (around 0.6 million barrels daily) when in normal conditions, said breach is approximately 3.0 million barrels daily, which shows vulnerability of said market, therefore any event of economic or political nature could influence positively or negatively in the behavior of prices.

The Committee also considered it adequate to debate on the behavior of the indicative variables. In that sense, they analyzed that regarding the previous month, the global balance of these deteriorated in relative terms, therefore that two variables that last month went from suggesting the monetary policy relax (the total payment means and the credit to the private sector), now suggest that it remain invariable. Also, it was pointed out that precaution must be had when interpreting the variables of banking credit to the private sector and payment means, especially since the conclusion of the evaluation of the validity of the method of projection of the expected runners that are being used for both variables are still pending.

Also, the fact that the relative variables to the monetary program are still highlighted (particularly the monetary issue and the monetary stabilization operations) continue deviated (in an expansive sense), situation that has been observed for several months.

The Committee also made reference to the fact that according to the information provided by the *Ministerio de Finanzas Públicas* (Equivalent to the Department of the Treasury); on the one hand, the level of execution of public expense will accelerate in the next months, which, notwithstanding the fact that the deposits of the Central Government in the *Banco de Guatemala* have been over the programmed, which will imply making a greater monetary effort through an increase in the monetary stabilization operations and, on the other hand, that the execution of public finances in February 2006 registered a deficit of Q574.8 million, higher to the observed in February 2005 (Q125.5 million), therefore, in order to moderate the inflationary pressure that could arise from that direction, it would be convenient to restrict the monetary conditions.

A member of the Committee indicated that the factors described clearly indicate the need of an adjustment in the leading interest rate of the monetary policy, given that the same would give certainty to the economic agents regarding the promise of the Central Bank on fulfilling the inflation goal for 2006 and for 2007. The above, they mentioned, is complemented with the fact that, for example, the inflation expectations of the panel of private analysts, according to the results of the survey made in February 2006, not only reverted its tendency in the mentioned month, but it is located over the inflation goal for the end of the current year.

In the described context, in the heart of the Committee the analysis was denied that in the current situation it will correspond to make an adjustment in the leading interest rate of the monetary policy.

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 Q60.0 million and Q50.0 million, respectively, and for the 182 day term to be convened on Friday to be of Q50.0 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 20 to 24, 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 20 to 24, 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 Q60.0 million and Q50.0 respectively and on Friday for 182 days, with a fund-raising quota of Q50.0 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.

FIFTH: 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.