EXECUTION COMMITTEE

ACT NUMBER 25-2006

Session 25-2006 celebrated in the *Banco de Guatemala* building located at *séptima avenida número veintidós guión cero uno, zona uno* of this city on Friday, June 16, two thousand six, as of sixteen 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 24-2006, corresponding to the session celebrated on June 9, 2006.
(The project of act 24-2006 circulated.)

SECOND: Market information and monetary variables.
a) Money Market
b) Exchange markets.
c) Indicative Variables
d) Estimated Monetization Flow

THIRD: Determination of bidding quotas for term deposits.

FOURTH: Inflation risks balance

FIFTH: Discussion and definition of the guidelines of execution for the Monetary, Exchange rate and Credit Policy.

SIXTH: 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 act number 24-2006.

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 June 12 to 16 of 2006, with partial data to date, registered an attraction of LTD's for Q2,502.2 million and maturity of Q2,144.8 million, which gave a result of net fund-raising for Q357.4 million, associated to the operations made in the Money Electronic Banking Table –MEBD- and in the stock exchange (net fund-raising of Q421.5 million) and at the window (net maturity for Q64.1 million).

Regarding the interest rates applied in fund raising through LTD's, it was indicated that during the period of June 12 to 16, 2006 for the biddings case, the cut interest rates were of: 6.22% 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 4.50%.

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 June 12 to 16, 2006 period, with partial data, the minimum was of 4.44%, observed June 15, 2006, and the maximum of 4.67%, registered on June 16, 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 4.57% for the public titles and of 6.00% for the titles of the financial sector.

On the other hand, it was informed that during the June 12 to 15, 2006 period, regarding Treasury-Bond operations the fund-raising registered was for Q200.0 million and maturity for Q0.3 million and US$3.4 million.

As to the long term deposit bidding positions in US dollars convened on June 14, 2006, it was mentioned that no bids were presented.

b) The Director for the Monetary Stabilization Operations Department regarding the Institutional Market for foreign currency reported that during the period of June 9 to 15, 2006, the average daily operations for purchase were of US$66.1 million and the sale was of US$67.2 million and that the exchange rates in the referred period remained stable. In effect, on Friday, June 9 they were of Q7.60306 per US$1.00 for purchase and of Q7.62131 per US$1.00 for sale, on Monday, June 12 the rates were Q7.59964 and Q7.61755, on

Tuesday, June 13 they were of Q7.60150 and Q7.61784, on Wednesday, June 14 they were Q7.60037 and Q7.61927, and finally, on Thursday, June 15 they were Q7.60249 y Q7.62028.

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 June 12 to 16, 2006, it was commented that the Private Institutional Foreign Currency System –SPID-, the following operations were made: on Tuesday, June 13 for US$2.0 million, at a weighted average exchange rate of Q7.61750 per US$1.00 and on Friday, June 16 for US$0.2 million for Q7.62550. Regarding the Electronic Foreign Currency Negotiation System –SINEDI-, expressed that during the period there were no operations and only the *Banco de Guatemala* registered a daily purchase bid for US$10.0 million, with a price of Q7.58000, 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 June 12 to 16, 2006, did not close operations. As for the closing price in reference up to Friday, June 16, they indicated that for maturity to settle in June of 2006 it was of Q7.61000 and for the maturity to settle in December 2006 was of Q7.62000.

c) The Director for the Economic Studies Department informed that on June 15, 2006, the excess of the daily legal reserve of the banking system was located at Q46.7 million, with an average position of Q360.8 million.

The highlights during the period of June 8 to 15, 2006 the main demonetizing factors were the increase in the balance of the deposits of the Central Government in the *Banco de Guatemala* for Q468.8 million and the long term deposits constituted in the *Banco de Guatemala* for Q360.5 million and the deposits of the rest of the public sector in the Central Bank for Q47.8 million; and the decrease in the Net International Reserve –RIN- balance for the equivalent of Q201.6 million; while the main monetizing factors were the decrease in the balance of the daily legal reserve for Q451.2 million.

Regarding the indicative variables of the Monetary, Exchange Rate and Credit Policy they indicated that with the projection to May 2006, for December 2006 the total expected inflation estimated with a model of ordinary squared minimums is of 7.67% and with a softened exponential model of 7.18%; the simple average of both models is located at 7.43%, which is found within the margin of tolerance (6.0% +/- 1 percentage point), which suggests restricting the monetary policy; and, for December 2007 the total expected inflation, estimated with an ordinary squared minimum model, is of 7.78% and with a softened exponential model of 6.32%; the simple average of both models is at 7.05%, which is over the expected policy goal (5.0% +/- 1 percentage point), which suggests a restrictive monetary policy.

Regarding the expected subjacent inflation for 2006, with data up to May 2006, estimated with an integrated auto-regression model of mobile averages ARIMA was of 6.89%, whereas the estimated with a softened exponential model was of 6.41%; the simple average of both models is of 6.65%, which is within the margin of tolerance for the policy goal (6.0% +/- 1 percentage point), which suggests the monetary policy remain invariable; and, for December 2007 the estimated subjacent inflation with an integrated autoregressive model of mobile averages ARIMA, was of 7.17%, whereas the estimated softened exponential model was of 5.99%.; the simple average of both models is of 6.58%, which is located over the policy goal (5.0% +/- 1 percentage point), which suggests a restrictive monetary policy.

As to the parameter rate, up to June 8, 2006, the lower limit was 2.03%, and the upper limit is 9.93%; while the simple average between the repurchase agreements of 8 to 15 days (4.75%) and the weighted average of the monetary stabilization operations of up to 91 days (4.72%) was situated at 4.74%, 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 June 8, 2006, the lower limit was 6.21% and the upper limit was 7.79%, and the weighted average rate of long term deposits of the banking system was of 7.04%, which maintains itself within the fluctuation range of the parity liable rate, which advises an invariable monetary policy.

As to monetary issue observed to June 15, 2006, they indicated that it presents a deviation of Q504.2 million regarding the upper limit programmed runner for said variable, which would indicate that there is space available to restrict the monetary policy.

As to the total payment means, to June 8, 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 (17.1% to 19.1%), which advises an invariable monetary policy. Also, up to said date, the banking credit of the private sector registered an inter-annual growth rate of 27.1%, which is over the range estimated for June 8, 2006 (24.5% to 26.5%), which suggests a restrictive monetary policy.

As to inflation expectations of private analysts, they indicated that according to the poll made in May 2006, for December 2006 an inflationary rhythm of 7.80% is expected, which is above the goal for monetary policy (6.0% +/- 1 percentage point), an aspect which suggests restricting monetary policy; and, for December 2007, the inflation projection is located at 6.87%, which is over the monetary policy goal (5.0% +/- 1 percentage point), which suggests restricting the monetary policy.

Also it was indicated that the variable implied inflation expectations, for May 2006 showed an inflationary rhythm of 6.34%, 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 June 8, 2006, was -2.88 percentage points which is within the fluctuation margin 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, said orientation remained unchanged: six variables suggest that the monetary policy remain invariable (the subjacent inflation projection for 2006, the parameter rate, the parity liable rate, total payment means, the implied inflation expectations and the Monetary Conditions Index); seven variables continue advising the monetary policy remain restrictive (the total inflation projection for 2006 and for 2007, the subjacent inflation projection for 2007, the monetary issue, the banking credit to the private sector and the inflation expectations of the private analysts for 2006 and for 2007); and no variables suggest relaxing the monetary policy.

On the other hand, it was indicated that regarding the behavior of the nominal exchange rate, the center of the expected runner for the week of June 12 to 16, 2006 was of Q7.662 per US$1.00 and the observed level (calculated as the average of the exchange rates for purchase and sale in the Institutional Market of Foreign Currency for the period between June 12 to 14) was of Q7.609 per US$1.00, which allows inferring that the observed value of the nominal exchange rate is found within the expected fluctuation band, but close to the lower limit, therefore in this light inflationary or deflationary pressures are not foreseen.

d) The Committee took note that the monetizing and demonetizing factors foreseen for the week of June 16 to 22, 2006 indicate an increase in the creation of primary liquidity for Q2, 782.8 million, fundamentally due to the maturity of LTD's. Also, a decrease in the demand for monetary issue for Q16.5 million is foreseen and a daily banking liquidity position for Q7.9 million. Also, monetary issue is deviated in Q686.9 million above the central programmed point for said variable, therefore the excess of aggregate liquidity estimated for the referred period is located at Q3,478.3 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 (Q2,331.3 million, according to registries to June 15, 2006) have to be relocated; and, also, have additional fund raising for around Q1,146.9 million.

THIRD: Determination of the bidding quotas for the term deposits.

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 on the other hand, the adopted measures of the previous week regarding the reduction of quotas and the number of weekly biddings; as well as alternating the bidding terms. Based on the above, the Committee agreed that the fund-raising quota for the 91 and 364 day terms to be convened on Monday, June 19, 2006 to be established at Q15.0 million and Q30.0 million, respectively.

Regarding the convening to bidding of LTD's in US dollars, the Committee took into account the foreseen maturity of Treasury Bonds expressed in US dollars with US$110.0 in accountable capital, reason why it agreed that for the week of June 19 to 23, 2006, on the one hand, convene biddings in LTD's in said currency on Wednesdays and Fridays, in 91, 182 and 364 days and, on the other hand, that the biddings be made without a predetermined quota.

FOURTH: Inflation Risks Balance.

The Committee continued the analysis begun the previous week, which must be presented to the Monetary Board in its June 21 session, so that according to the approved calendar, said body make a decision regarding the leading interest rate of the monetary policy. For said effect, the technical departments presented the Committee with the inflation risks balance, emphasizing the following aspects:

As to the external conditions, according to Bloomberg, the international price of oil to June 15 was at US$71.83 per barrel registering a slight decrease of around US$1.90 regarding the observed value to May 18, 2006 (date in which the inflation risks balance was analyzed the month before). It was also mentioned that the price of gasoline in Guatemala has a similar behavior to the prices of gasoline in the United States, with a slight delay. It is worth mentioning that the domestic price of gasoline has shown a slight decreasing tendency in the last few weeks, which obeys, among other factors, the delayed effect from the observed decrease in the gasoline prices in the United States.

The composed inflation index of the main commercial partners of Guatemala was indicated as continuing to be relatively high, showing a tendency to rise since February. The inflationary rhythm of the United States in May, 2006 was located at 4.17%, higher by 1.37 percentage points to the observed inflationary rhythm in May 2005 (2.80%); given that said country has a greater relative weight within the referred index, considering that imported inflation risks coming from it will continue to be present.

Reference was made to the survey made by Bloomberg, which declares there is a 100% probability that the interest rate of the federal funds will increase to 5.25% (increase in 25 basic points) in the meeting with the Open Market Federal Operations Committee for June 29.

As to the internal conditions, it was indicated that regarding the variables subjected to follow up in the monetary program, to date, the level of monetary stabilization operations as well as the monetary issue continue to be deviated regarding the programmed, when observing average deviations approximately Q1,984.0 million and Q504.0 million, respectively.

It was indicated that the execution of public finance to May 31, 2006, a deficit of Q101.2 million was observed (surplus of Q541.2 million to April 30, 2006).

As to inflation, it was highlighted that of the inflationary rhythm observed in May (7.62%), 3.18 percentage points are attributed to imported inflation; associated to the effects of higher oil prices, therefore 4.44 percentage points correspond to domestic inflation. It was added that when analyzing the evolution of inflation throughout the year, imported inflation notably increased its relative weight, when going from 2.21 percentage points in December 2005 to 3.18 percentage points in May, 2006, while domestic inflation during said period showed a decrease of 1.92 percentage points (from 6.36 percentage points to 4.44 percentage points, in that order). Notwithstanding, it is estimated that 2.47 percentage points are the proportion of imported inflation that is attributable to second round effects, which, different from first round imported inflation, can be moderated through monetary policy measures.

Regarding indicative variables, it was pointed out that when comparing its situation to date, regarding the observed on May 18 (last date in which the Committee analyzed the leading interest rate level), it reported 62.71% of the total indicative variables suggested a restrictive monetary policy; 14.64% suggest it be moderately restrictive; 22.65% suggest it be variable; and 0.00% that it relax (percentages calculated according to weightings of the members of the Execution Committee for each one of the variables).

Finally, the econometric projections of inflation for 2006, made by the technical bodies, using data observed to May 2006, estimating that the total inflationary rhythm for December 2006 will be over the tolerance margin of the policy goal (6.0% +/- 1 percentage point). On its part, the subjacent inflationary rhythm for December 2006 was within the tolerance margin of the mentioned policy goal. Also, when evaluating the prognosis in total inflation as well as subjacent inflation for December 2007 regarding the foreseen inflation goal for the end of the year (5.0% +/- 1 percentage point), both prognosis are over the referred goal, including taking into account the tolerance margin. On the other hand, it was also indicated that the inflation expectations of the private analysts continues projecting an inflationary rhythm for the end of 2006 over the inflation goal.

FIFTH: Discussion and Definition of the execution guidelines of the Monetary, Exchange rate and Credit Policy

a) Discussion:

The technical departments of the *Banco de Guatemala*, having presented the elements that compose the inflation risks balance, as well as the behavior of the indicative variables of the monetary policy, came to the conclusion that the factors that advise restricting the monetary conditions prevail, therefore an adjustment in the leading interest rate would contribute to, on the one hand, moderating the inflationary expectations of the economic agents and, on the other hand, strengthening the credibility of the Central Bank in the management of the monetary policy, aspect of particular importance for the fulfillment of the inflation goal for 2006 and 2007.

Based on the presentations of the technical departments and taking into consideration the orientation of the indicative variables and the inflation risks balance, the Committee was of the opinion that the contained in said presentations reasonably reflected the current junction of the monetary policy.

The Committee emphasized the fact that since March 2006 the tendency toward deceleration had reverted that the inflationary rhythm has shown between November 2005 and February 2006, and that in April and May 2006 the inflation rate registered a growing tendency. Also, emphasis was made on the fact that the prognosis of total inflationary rhythm for the end of 2006 and 2007, obtained form the econometric models that have been used, located over the inflation goal, including taking into account the tolerance margin of +/- 1 percentage point, which advises adopting restriction measures of the monetary conditions. On the other hand, the results of the survey of inflation expectation of the private panel of analysts made in May showed an increase in the inflationary rhythm projected for 2006 and a slight decrease for 2007; it also highlighted, on the one hand, that said prognosis were located over the inflation goal established for both years, and on the other hand, that to the date of the survey, the inflation results to May were still unknown.

In the Committee there was consensus that the risks where the monetary policy execution takes place as a whole had to be taken into account. As to the risks associated to the external ambit, one topic of discussion was the international price of oil. It was reminded that, unlike the rise of 2004 and 2005, the current increase is attributable to factors that affect world oil offer, which reduces the maneuverability margin available to countries to adopt policies oriented toward restricting demand. Also, it was reiterated that the monetary policy has a fundamental role to perform in lessening the "second round" effects derived from the rise in fuel prices and associated to the expectations of the economic agents as well as the manner in which said expectations can affect the determination of costs and future's prices in the market, reason why it is pertinent to adopt opportune measures that moderate the inflationary expectations. A member of the Committee highlighted the fact that the international oil price stabilized, later an important rise was registered in the third week of April and that, as of the second week to May had begun to register a decreasing tendency, which was sustained after the death of the main Iraqi terrorist leader, since the markets expect that this fact will tend to reduce the terrorist pressures in the Middle East and, consequently, to contain the volatility in the international price of crude oil.

As to the internal ambit risks, it was pointed out that the behavior of the nominal exchange rate throughout the month had registered certain stability and greater congruency with its seasonality therefore the Central Bank has not participated in the exchange market. In that regard, a member of the Committee indicated that the considerations of the exchange rate regarding the possible increase in the leading interest rate should be taken into account that, according to Bloomberg, there exists a 100% probability that the Federal Reserve of the United States will again increase its objective interest rate in the next meeting to be held on June 29, therefore the differential of the interest rates regarding the policy rate in the mentioned country will be greater each time (in favor of the US interest rates) and with a tendency to continue increasing, therefore a moderate adjustment in the leading interest rate should not significantly affect the exchange market. Another member of the Committee indicated that, in the exchange context, an additional relevant topic is the review of the participation regulation of the Central Bank in the exchange market, which, in their opinion, does not allow sufficient flexibility in the participations of the Central Bank in the mentioned market, reiterating that on this aspect there already exists a plan proposed to the Monetary Board in the Monetary Policy Report to March 2006, that is being discussed.

As to inflation, in the Committee it was highlighted that based on the decomposition of the inflationary rhythm, in imported and domestic inflation, we observe, on the one hand, that domestic inflation has had a steady reduction, when going from 6.36% in December 2005 to 4.44% in May 2006 and, on the other hand, that if we add the average domestic inflation to the average historic imported inflation (0.52%), said rhythm ascends to 4.96%, locating itself within the tolerance margin of the inflation goal (6.0% +/- 1 percentage point). Notwithstanding, it is estimated that the total relative weight of imported inflation in the total inflationary rhythm (3.18 percentage points) 2.47 percentage points are attributable to second round effects, of which, a difference in first round imported inflation, can modify through policy measures.

In the described context, in the heart of the Committee the analysis that an increase is justifiable in the leading interest rate of the monetary policy, taking into account, on the one hand, that the monetary policy should act opportunely with the purpose of moderating the inflationary expectations in order to lessen the “second round” effects, associated to the imported inflation, taking into account that the monetary policy acts delayed in inflation (as is confirmed in the empiric studies made by the technical bodies of the *Banco de Guatemala*) and, on the other hand, that they must act with a mid-term vision in order to ensure that the increase foreseen in the economic growth be sustainable in time, which requires an environment of macroeconomic stability. Also, it was mentioned that a modest adjustment to the leading interest rate, as has been said in previous sessions, has the advantage of avoiding that in the future more intense adjustments are adopted to achieve the same purpose. In that sense, there was consensus in that the increase of the leading interest rate should be moderated (25 basic points) in order to not generate volatility in the short term interest rate in the money market.

Just as the previous month, the Committee also analyzed the possible impact of a rise in the leading interest rate, reiterating the criteria that, given that the national economic activity seems to be growing robustly, a small adjustment in the leading interest rate would hardly affect the growth rhythm in the short term and, possibly would favor it in the long term; in any case, if there were a growth effect, this would be very small (according to the confirmed by the Semi-structural Macroeconomic Model) and would be more than compensated by the reduction in the inflation risk or in the external imbalances, financial or futures exchange. In that sense, an opportune adjustment of the leading interest rate can have positive effects in matter of certainty and, therefore, favor the sustainability of the economic growth in the mid term.

Last, the members of the Committee reiterated the manifested on previous occasions in the sense that just as the leading interest rate can rise when circumstances prevail like the current ones, it should also reduce said rate when said circumstances show inverse behavior.

b) Definition of the guidelines of the execution of the Monetary, Exchange and Credit Policy.

Based on the discussed, the Committee agreed that for the week of June 19 to 23, 2006, it will continue with 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 4.50%, 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 to convene a bid for the term deposit on Monday, June 19 for the terms of 91 and 364 days, with a fund-raising quota for Q15.0 million and Q30.0 million, respectively. 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 public 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 convene bidding for term deposits in United States dollars, on Wednesdays and Fridays, in 91 days, 182 days and 364 day terms, without a predetermined quota. The bids received will be awarded the reference interest rates of the Treasury Letters of the United States of America in similar terms, without excluding the possibility of receiving higher rates if they merit it, convening a session of the Committee to decide the awarding.

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, 182 days and 364 days) and that the interest rate applied will use the interest rates of the Treasury Letters of the United States of America in similar terms as a reference.

As for the participation of the *Banco de Guatemala* in the exchange market, the Committee agreed to continue participating through the electronic negotiating system of foreign currency, with a bid of US$10.0 million at a price equal to that of the last purchase made by the *Banco de Guatemala* and according to the participation regulations established for the effect.

SIXTH: Other matters.

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