EXECUTION COMMITTEE

ACT NUMBER 29-2006

Session 29-2006 celebrated in the *Banco de Guatemala* building located at *séptima avenida número veintidós guión cero uno, zona uno* of this city on Friday, July 14, 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 28-2006, corresponding to the session celebrated on July 7, 2006.
The project of act 28-2006 circulated.

SECOND: Market information and monetary variables.

a) Money Market
b) Exchange Markets.
c) Indicative Variables
d) Estimated Monetization Flow

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

a) Discussion
b) Determination of the quotas for long term bidding.
c) Definition of the Guidelines

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 act number 27-2006.

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 July 10 to 14 of 2006, with partial data to date, registered an attraction of LTD's for Q2,679.6 million and maturity of Q2,201.1 million, which gave a result of net maturity for Q478.5 million, associated to the operations made in bidding (net maturity for Q116.0 million), in the Money Electronic Banking Table –MEBD- and in the stock exchange (net fund-raising of Q642.8 million) and at the window (net maturity for Q48.3 million).

Regarding the interest rates applied in fund raising through LTD's, it was indicated that during the period of July 10 to 14, 2006 for the biddings case, the cut interest rates was 5.4950% for 182 days and 6.22% 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 4.75%.

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 July 10 to 14, 2006 period, with partial data, the minimum was of 4.83%, observed July 11 and 12, 2006, and the maximum of 5.02%, registered on July 14, 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 4.91%.

On the other hand, it was informed that during the July 10 to 13, 2006 period, regarding Treasury-Bond operations there were placements for Q110.0 million and maturity for Q60.1 million and US$1.0 million.

As to the long term deposit bidding positions in US dollars convened on July 12, 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 July 7 to 13, 2006, the average daily operations for purchase were of US$69.2 million and the sale was of US$70.8 million and that the exchange rates in the referred period remained stable. In effect, on Friday, July 7 they were of Q7.58046 per US$1.00 for purchase and of Q7.59772 per US$1.00 for sale, on Monday, July 10 the rates were Q7.57012 and Q7.58933, on Tuesday, July 11 they were of Q7.57141 and Q7.58568, on Wednesday, July 12 they were

Q7.57794 and Q7.59372 and finally, on Thursday, July 13 the rates were Q7.58213 and 7.59959.

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 July 10 to 14, 2006, it was commented that the Private Institutional Foreign Currency System –SPID-, the only operation made was on Wednesday, July 12 for US$0.1 million, at a weighted average exchange rate of Q7.60000 per US$1.00. Regarding the Electronic Foreign Currency Negotiation System –SINEDI-, expressed that during the period there were no operations and the *Banco de Guatemala* registered a purchase bid on July 10 for US$10.0 million, with a price of Q7.58000 per US$1.00, 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 July 10 to 14, 2006, did not close operations. As for the closing price in reference up to Friday, July 14, they indicated that for maturity to settle in December 2006 was of Q7.62000.

c) The Director for the Economic Studies Department informed that on July 13, 2006, the excess of the daily legal reserve of the banking system was located at Q251.0 million, with an average position of Q413.3 million.

The highlights during the period of July 6 to 13, 2006 the main monetizing factors was the decrease in the daily legal reserve balance for Q332.4 million; while the main demonetizing factors were the increase in the balance the long term deposits constituted in the *Banco de Guatemala* for Q243.5 million and the decrease in the balance of the Net International Reserve –RIN- balance for the equivalent of Q76.8 million.

Regarding the indicative variables of the Monetary, Exchange Rate and Credit Policy they indicated that with the projection to June 2006, for December 2006 the total expected inflation estimated with a model of ordinary squared minimums is of 7.58% and with a softened exponential model of 7.41%; the simple average of both models is located at 7.50%, 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 7.76% and with a softened exponential model of 6.42%; the simple average of both models is at 7.09%, 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 June 2006, estimated with an integrated auto-regression model of mobile averages ARIMA was of 6.65%, whereas the estimated with a softened exponential model was of 6.42%; the simple average of both models is of 6.54%, which is over the punctual value of the inflation goal and within the margin of tolerance for the policy goal (6.0% +/- 1 percentage point), which suggests the monetary policy be moderately restrictive; and, for December 2007 the estimated subjacent inflation with an integrated autoregressive model of mobile averages ARIMA, was of 7.03%, whereas the estimated softened exponential model was of 6.01%; the simple average of both models is of 6.52%, which is located over the tolerance margin of the policy goal (5.0% +/- 1 percentage point), which suggests a restrictive monetary policy.

As to the parameter rate, up to July 6, 2006, the lower limit was 3.44%, and the upper limit is 7.39%; while the simple average between the repurchase agreements of 8 to 15 days (4.98%) and the weighted average of the monetary stabilization operations of up to 91 days (4.85%) was situated at 4.92%, 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 July 6, 2006, the lower limit was 6.83% and the upper limit was 8.41%, and the weighted average rate of long term deposits of the banking system was of 7.03%, which maintains itself within the fluctuation range of the parity liable rate, which advises an invariable monetary policy.

As to primary liquidity it was indicated that monetary issue observed to July 13, 2006, presents a deviation of Q493.7 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 behavior of a wide monetary base, to date, is found within the programmed runner, which suggests an invariable monetary policy. The weighted orientation of the deviation for the present week is for Q246.9 million, which would indicate restricting the monetary policy.

As to the total payment means, the inter-annual growth observed to July 6, 2006, it ascended to 17.8%, locating itself within the tolerance margin estimated range for said variable (15.9% to 17.9%), which advises an invariable monetary policy; in which the econometric estimation for the payment means for the end of 2006 is of 17.6%, which is over the upper limit of the estimated range for December 2006 (13.0% to 15.0%), which suggests a restrictive monetary policy. The average orientation of the deviation of 1.30%, therefore suggests, restricting the monetary policy. Also, up to said date, the inter-annual variation of banking credit of the private sector registered growth of 27.0%, which is over the range estimated for July 6, 2006 (23.1% to 25.1%), which suggests a restrictive monetary policy; on the other hand, the econometric estimation for the end of 2006 of the banking credit to the private sector is of 27.3%, which is over the upper limit of the estimated range (16.0% to 18.0%), which suggests restricting the monetary policy. The average orientation of the deviations for the present week of 5.60%, therefore suggests, restricting the monetary policy.

As to inflation expectations of private analysts, they indicated that according to the poll made in June 2006, for December 2006 an inflationary rhythm of 7.73% 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 7.47%, 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 June 2006 showed an inflationary rhythm of 6.03%, which is within a tolerance margin of the monetary policy for 2006 (6.0% +/- 1 percentage point), which suggests a moderately restrictive monetary policy.

They mentioned that the Monetary Conditions Index –ICM-, to July 6, 2006, was -2.79 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.

Regarding the Semi-structural Macroeconomic Model (MMS) used for foreseeing the total inflationary rhythm, projected a rhythm of 6.88% for December 2006, conditioned by gradual adjustments in the leading interest rate of the monetary policy until locating itself at the end of the year at 5.47%, which suggests restricting the monetary policy. Also, the prognosis for said model for a mid-term horizon, projects that for December 2007 an inflationary rhythm of 5.13%, conditioned to gradual adjustments in the leading interest rate of the monetary policy until stopping at 3.52%, which would be suggesting restricting the monetary policy.

To conclude, regarding the orientation of the indicative variables, it was indicated that regarding the previous week, the variable “primary liquidity” went from suggesting that the monetary policy relax to advising it be restrictive, with which, according to the relative weight assigned to the indicative variables by the members of the Monetary Board, they indicated that 63.72% of the same advise a restrictive monetary policy orientation; (53.26% the previous week); 24.23% suggest an invariable monetary policy orientation; (same percentage of the previous week); and 12.05% advise a moderately restrictive monetary policy (same as the previous week); and 0.00% suggest an orientation toward relaxing the monetary policy (10.46% the previous week).

Finally, they indicated that regarding the behavior of the nominal exchange rate, the center of the expected runner for the week of July 10 to 14, 2006 was of Q7.646 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 July 10 and 12) was of Q7.581 per US$1.00, which allows inferring that the observed value of the nominal exchange rate is found slightly below the lower limit of the expected fluctuation band, therefore in this light inflationary or deflationary pressures are not foreseen.

Finally, the Consumer Price Index presented a report to June 2006 based on the report from the National Statistics Institute (INE for its acronym in Spanish), indicated that the monthly inflation was of 0.60%, lower by 0.03 percentage points to May 2006 and lower by 0.06 percentage points to the observed in June 2005; the inflationary rhythm was at 7.55%, lower by 0.07 percentage points to May 2006 (7.62%) and lower in 1.25 percentage points to the observed to June 2005 (8.80%); the subjacent inflation registered a rhythm of 6.91%, lower by 0.38 percentage points to that of May 2006 (7.29%) and lower by 1.31 percentage points to June 2005 (8.22%); as well as the estimations of the imported and domestic components of total inflation, pointing out that of the 7.55% of the inflationary rhythm to June 2006, 2.69 percentage points are attributable to imported inflation, of which 2.06 percentage points correspond to the indirect imported inflation (second round effect); therefore, of the inflationary rhythm, 4.86 percentage points correspond to domestic inflation.

d) The Committee took note that the monetizing and demonetizing factors foreseen for the week of July 14 to 20, 2006 indicate an increase in the creation of primary liquidity for Q3, 018.1 million, fundamentally due to the maturity of LTD's and to the use of deposits of the Central Government in the *Banco de Guatemala*. Also, an increase in the demand for monetary issue for Q82.6 million is foreseen and a daily banking liquidity position for Q232.3 million. Also, monetary issue is deviated in Q676.3 million above the central programmed point for said variable, therefore the excess of aggregate liquidity estimated for the referred period is located at Q3,844.0 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 (Q2,562.0 million, according to registries to July 13, 2006) have to be relocated; and, also, have additional fund raising for around Q1,282.1 million.

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

a) Discussion

Based on the information received, the committee began the discussion on the analysis that must be presented to the Monetary Board in its Wednesday, July 26, 2006 session when, according to the programmed calendar, the Board will make a decision regarding the leading interest rate of the monetary policy. A review was made of some factors that advise raising the referred interest rate, as well as those that advise keeping it invariable, so that these are taken into account in the inflation risks balance that the technical departments will present in the next Committee meeting.

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

i. The behavior toward the rise in international oil prices continues to be the main inflationary risk in the country. According to the last quote of the future price of oil, it will increase to US$79.60 per barrel at the end of 2006, level that contrasts the prevailing quote to June 16 (date in which the Committee discussed the level of the leading interest rate) that was of US$71.83 per barrel. It is worth indicating that, according to Bloomberg, the oil price on July 13 reached a historic record at US$76.70 per barrel.

ii. The orientation of the indicative variables toward restriction, according to the synthetic index corresponds to 63.72%.

iii. The inflationary rhythm projections for December 2006, (based on the econometric projections) increased regarding the projections made in last June: the projection of the total inflation for December 2006 (7.50%) continues locating itself over the inflation goal determined in the monetary policy (6.0% +/- 1 percentage point).

Regarding the factors that advise keeping the leading interest rate of the monetary policy invariable, the following were identified:

i. The price of gasoline in the domestic market has remained stable, which could contain the inflationary pressures in this way in the present month.

ii. Regarding the decomposition of the inflationary rhythm in imported and domestic inflation, it was observed that the domestic inflation has been reduced in a sustained manner, when going from 6.36% in December 2005 to 4.86% in June 2006; also, that if the domestic inflation is added to the average of historic imported inflation (0.52%), said rhythm ascends to 5.38%, locating itself within the tolerance margin of the inflation goal (6.0% +/- 1 percentage point).

b) Determination of the quotas for term deposit bidding.

Regarding the determination of quotas for the biddings in the following week, the information provided by the daily monetization flow was taken into account, on the one hand, the measure adopted regarding a reduction of quotas and the number of weekly bids; 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, July 17 to be established at Q20.0 million and Q40.0 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 and considered that for the week of July 17 to 21, 2006, it is necessary to convene biddings in LTD's in said currency.

c) 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 July 17 to 21, 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 4.75%, 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, July 17 for the terms of 91 and 364 days, with a fund-raising quota for Q20.0 million and Q40.0 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 Wednesday July 19, 2006 in 91 days and 364 day terms, for an amount of up to US$30.0 million. 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 terms of 91, 182 days and 364 days and for the interest rate to be 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.

FIFTH: Other matters.

In the heart of the Committee the convenience on the participation of a Sub-director of the Economic Studies Department and the Chief of the Financial Programming Section of said department, to the sessions of the Execution Committee, taking into consideration the support the information that said department provides, was analyzed. Therefore, the Committee agreed that as of the present meeting, a Sub-director of the Economic Studies Department and the Chief of the Financial Programming Section of said department will permanently participate.

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.