

# MONETARY BOARD

## Resolution JM-160-2004

Inserted in second Act 56-2004, corresponding to the session celebrated by the Monetary Board on December 29, 2004.

**SECOND POINT:** Monetary, Exchange and Credit Policy: Evaluation to November, 2004 and proposal for 2005.

**RESOLUTION JM-160-2004.** Known as Sentence CT-4/2004 of the Technical Council of the *Banco de Guatemala*, where it presents its evaluation of the Monetary, Exchange and Credit Policy to November 2004 and of the proposal for 2005; WHEREAS: That in 2004 and the predominating adverse factors for the effectiveness of the monetary policy, especially the impact of imported inflation derived from the shock of international petroleum prices, was a determinant for the inflation to register a tendency toward the rise during 2004 and will be above the established goal for the Monetary, Exchange and Credit Policy determined for said year, given that, according to the Consumer Price Index made up by the National Statistics Institute, the inflationary rhythm was at 9.22% to November 2004, corresponding to 2.81 attributable percentage points to inflation. That the imported inflation exercised its major effects in the months of May, September, October and November 2004, months that, after January, registered the highest inflationary rates of the year (0.83%; 0.78%; 0.98%; and 0.99%); WHEREAS: The rise in the international petroleum prices and given the uncertainty regarding the future of the evolution of prices that was extended during the rest of the year, the need to take action on behalf of the monetary policy was evidenced, in order to abate the inflationary expectations observed, although given the exogenous and temporary imported inflation, and with the finality of maintaining the most favorable conditions for the orderly development of the national economy, the monetary measures must have been executed with special prudence taking into account, that on the one hand, it is insufficient to effectively contribute to the objective of development in the country and, on the other hand, that since the beginning of the month of April an accelerated behavior was registered in the nominal exchange rate toward the appreciation:

WHEREAS: The orientation of the monetary policy for 2005 contemplates that the Central Bank must continue to prudently concentrate and direct the actions in order to achieve stability in the general level of prices, continuing the efforts of maintaining the most favorable conditions of orderly development for the economy, which will allow the credit, goods and labor markets to function efficiently generating production and employment, due to the fact that stability in the general level of prices reduces uncertainty and, therefore cooperates with the economic agents into making adequate decisions in matters of savings, investment, production and employment; WHEREAS: The effectiveness in the reduction in the uncertainty implied that the Central Bank should be transparent and render accounts of its actions, therefore it must provide the public with opportune and truthful information on the inflation goals it pursues in a determined horizon, which implies that the inflation rate is converted in a nominal anchor of the monetary policy; WHEREAS: If we estimate that the inflationary rhythm to December of 2004 is located around 9% due to, as indicated, the shock of the international oil prices observed during the year, the experts in the matter estimate that with the deceleration in 2005 of the economic growth rhythm in the United States of America and in the People's Republic of China, the pressure on the international oil prices attributable to factors of demand will begin to decrease, which are considered to be the most important in the formation of the prices, so, taking into account the behavior projections of crude oil prices in the futures market, it is estimated that in 2005 the inflationary rhythm will be decelerating with regards to the observed levels in 2004; WHEREAS: That the monetary scheme of explicit goals of inflation constitute a reference outline so that the monetary policy, through the use and combination of their different instruments, reaches stabilization effectively in the general level of prices, in a flexible exchange environment, scheme that the *Banco de Guatemala*, even and when it faces obstacles of statistical or analytical nature that make this adoption difficult, has been incorporating some of these aspects since 2000, which were reinforced with the enforcing of the new organic law, therefore it is in a transition period toward said scheme; WHEREAS: In order to fulfill its fundamental objective in 2005, the monetary policy, on the one hand, must support its efforts with the following aspects: i) the continuation of the coordination with the financial policy of the state, in the

outline of the fulfillment of the fiscal goals determined for 2005; ii) the consolidation of the implementation of the financial legislation; iii) the subscription for 2005 of a Stand-by agreement with the International Monetary Fund, and on the other hand, in the external order, it must contemplate the persistence of diverse economic phenomenon that could influence in its effectiveness, such as: i) the adjustment of the deficit in the current account of the payment balance of the United States of America; iii) the evolution of the international oil prices; and, iv) the deceleration of the economic growth of the People's Republic of China; WHEREAS: That the deficit in the current account of the Payment Balance of Guatemala remains at relatively high levels in comparison with the size of the economy, with the levels historically registered in the country and with the observed in other countries in similar situations and that said lack of external balance, even though it is has been financed with external capital flow, it constitutes a vulnerability over the expectations of the economic agents that can generate volatility in the exchange and monetary variables, therefore it is fundamental to continue promoting a disciplined monetary policy so that, with the necessary support of the fiscal policy and in coordination with an integral economic policy, it will allow not only the strengthening ability of the country to absorb external shock, but also set the basis for the achievement of a more dynamic and sustainable economic growth; WHEREAS: According to the estimations of income and expense of the *Ministerio de Finanzas Públicas* (equivalent to the Department of the Treasury) for 2005, and in the context of the eventual subscription of a new Stand-by Agreement with the International Monetary Fund, will be foreseen with the budget execution that would locate the fiscal deficit at about 1.8% of the Gross Domestic Product, which, even if it is higher than the projected for December 2004, it is estimated that it still allows a manageable cost, to continue maintaining the macroeconomic stability; WHEREAS: A disciplined monetary policy, duly supported by the fiscal policy, will keep stability within the general level of prices, and keeping in mind the processes of guarantees and transparency of the public finances and the acquisition of a sustainable external position, through the maintenance of an adequate level of international monetary reserves, are factors that favor the positive expectations of the national and international economic agents, regarding the future performance of

the Guatemalan economy in the mid and long terms, all of which would reinforce the possibility of subscribing a Stand-by agreement with the International Monetary Fund; WHEREAS: That the proposal of the Monetary, Exchange and Credit Policy for 2005 presented to this board contains principles, instruments and measures that make it coherent with the efforts of advancing the adoption of a complete monetary scheme with explicit goals of inflation, that consist in establishing said policy in the election of inflation as a nominal anchor of the economy, based on the regimen of a type of flexible exchange, in the operations of monetary stabilization giving privilege to market decisions, as well as in the perfecting of the transparency of the actions taken by the Central Bank, all of which will allow the consolidation of the stability and confidence in the main macroeconomic and financial variables; WHEREAS: In the current exchange regimen, the exchange rate will be determined by the interaction of the offer and demand of foreign currency in the market, which is consistent with the monetary scheme of explicit goals for inflation; but even so, it is necessary to give certainty to the economic agents as to the participation of the Central Bank in the referred market, therefore it requires moving on to a more flexible exchange regimen, based on the explicit rules that avoid volatility in the exchange rate without affecting its tendency, eliminating discretionary stands in the decisions of intervention of the *Banco de Guatemala*; WHEREAS: For adequate execution of the Monetary, Exchange and Credit Policy in a changing macro-financial environment, that is consistent with a monetary scheme of explicit inflation goals, it is indispensable that it be founded in the application of instruments and measures that allow it to act opportunely, and that at the same time, it be based on the clearly defined principles of participation in markets that impulse major clarity in the actions of the Central Bank; WHEREAS: For the institutional strengthening of the macroeconomic policy it is necessary to continue promoting the efficient and effective coordination of the monetary and fiscal policies through the institutional strengthening of the Work Group: *Banco de Guatemala* and *Ministerio de Finanzas Públicas* (Equivalent to the Department of the Treasury), in charge of periodically following up on the operations made by said entities in the frame of a coherent monetary program, that with the ends of materializing the efforts that allow the fiscal and monetary policies to fulfill their objectives;

## **THEREFORE:**

Based on the considered, in the agreed to in articles 132 and 133 of the Political Constitution of the Republic of Guatemala, 3, 4, 13, 26 and 48 of Decree number 16-2002 of the Congress of the Republic, Organic Law of the *Banco de Guatemala*, as well as considering Sentence CT-4/2004 of the Technical Council of the *Banco de Guatemala*, and in the opinion of its members,

## **THE MONETARY BOARD**

### **RESOLVES:**

**I. CONSIDERS HAVING EVALUATED THE MONETARY, EXCHANGE AND CREDIT POLICY OF 2004;**

**II. HAVING DETERMINED THE MONETARY, EXCHANGE AND CREDIT POLICY FOR 2005, IN THE FOLLOWING MANNER:**

**A: FUNDAMENTAL OBJECTIVE AND POLICY GOAL:**

**1. Fundamental Objective:**

Congruent with the mission that corresponds to the *Banco de Guatemala*, the fundamental objective of the Monetary, Exchange and Credit Policy for 2005 is to create and maintain the most favorable conditions for orderly development of the national economy, therefore it will propitiate the monetary, exchange and credit conditions that promote stability in the general level of prices.

In support of the achievement of the fundamental objective, and with the purpose that in the mid term, the domestic inflation converges toward the observed levels in the industrialized economies, the application of the monetary policy must be complemented by actions in the financial modernization and in the consolidation of fiscal equilibrium ambits, in the frame of the integral economic and sustainable programs that propitiate competitiveness and productivity in the productive sector.

**2. Policy Goal:**

For December 2005, and in the twelve months following, the inflationary rhythm, measured by the inter-annual variation of the Consumer Price Index, IPC (for its acronym in Spanish) must be located between a 4%-6% range.

## **B. Indicative Variables:**

With the purpose of guiding and orienting the actions of the Monetary, Exchange and Credit Policy and evaluating in what measure the goal is being achieved, as well as with the finality of opportunely detecting the effects that exogenous events can have over the financial markets and act accordingly and opportunely; the following indicative variables will be followed up on:

### **1. Expected Inflation:**

Follow up will be given to fixed inflationary goal for December 2005, and the twelve following months, comparing it to the inter-annual inflationary rhythm projected for those same periods.

Also, follow up will be given to the Expected Subjacent Inflationary Index (for December 2005 as well as for the twelve subsequent months), which excludes the IPC titles that have an elevated variability that is not explained with monetary reasons.

### **2. Interest Rates:**

For 2005, with the finality of finding the money market conditions with the achieved inflation goal, will give follow up to the parameter rate (adjusted Taylor rate), comparing it with the pondered average interest rate of the report operations between 8 and 15 days, as well as the relevant interest rate of the monetary stabilization operations. Also, with the goal of evaluating the competitiveness conditions of the internal financial market compared to the exterior financial markets, we will continue to follow up on the passive parity interest rate, which, for the comparison effects, will be adjusted by the fluctuation margin of a deviation standard.

### **3. Monetary Issue:**

According to the monetary program for 2005 (annex), we estimate that the demand for monetary issue will grow around the 8% regarding the estimated level of closing for the monetary program of 2004, compatible with an estimated growth rate of the Gross Domestic Product, in real terms, of around 3.2% and with an inflation goal of around 4%-6%.

### **4. Means of Payment:**

Congruent with the growth estimation of the economic activity, with the inflation goal and with the circulation speed of money, we estimate that the total payment means (M2) will grow between 10% and 12%, in inter-annual terms.

## **5. Banking Credit to the Private Sector:**

Consistent with the growth of payment means, we expect the growth of total banking credit to the private sector to reach between 11.5% and 13.5%, in inter-annual terms.

## **6. Inflation Expectations by Private Analysts:**

The expectations on the future behavior of the prices in the economy can, in determined circumstances, influence on the determination of the inflation rate that will finally be observed in the period, for which it must be given follow up, as an indicative variable, the prognosis of inflation comes from the survey to the private analyst panel on inflation expectations.

## **7. Monetary Conditions Index, ICM (for its acronym in Spanish):**

The Monetary Conditions Index will be given follow up, that measures the interrelation between the changes in the interest rate and in the nominal exchange rate regarding a date in time. For its follow up, we will establish an agent whose central focus will be the ICM value for 2000 (base year) and its superior and inferior values will be located in (+/-) 0.8 percentage points, regarding the central value indicated; a higher ICM value than the indicated by the agent will be interpreted as the presence of a restrictive monetary policy regarding the base, whereas a lower value indicated by the agent will be interpreted as the presence of an expansive policy regarding said base.

## **8. Indicator of the Monetary Policy Orientation:**

With the objective of counting on an indicator that explicitly includes the economic activity such as the parameter to monitor the performance of the monetary policy, the *Banco de Guatemala* will present it to the Monetary Board, for its approval, the proposal of an indicator to give follow up during 2005, that will measure the restriction of said policy in function of comparing the situation of interest rates with a measure of the nominal productive activity.

# **C. MEASURES OF THE MONETARY, EXCHANGE AND CREDIT POLICY**

## **1. Principles for Market participation:**

With the purpose of continuing with the adoption process of a monetary scheme of explicit inflation measures, the principles that regulate the participation of the Central Bank, in the monetary market as well as the exchange market are the following:

### **a) Use of the monetary stabilization operations in market conditions:**

The operations of monetary stabilization of the Central Bank constitute a key instrument in the monetary scheme of explicit inflation goals, because they allow moderating the behavior of the added demand of the economy and influencing on the evolution of the interest rates, so as to contribute to the achievement of the fundamental objective of the monetary policy.

The monetary scheme of explicit inflation goals requires an operational frame based on the operating of monetary stabilization conditions of market that, not only promote the efficiency of the primary market of public titles, but also, at the same time promote the development and deepening of a secondary market for said titles, so that the Central Bank sends clear and explicit signals to the monetary market on the orientation of its policy, as well as receive from this, the information that allows it to depend on the additional elements for decision making.

For this, they will adopt, with the necessary gradualness, the pertinent modifications to the effect of establishing an operations scheme for the monetary stabilization operations, consisting with the scheme of explicit goals for inflation. Said modifications will be oriented to the following principles:

- i) **Converge toward the use of an only leading interest rate for the monetary stabilization goals in the short term.** This rate will give the markets the signal on the orientation of the monetary policy at any given moment. The corresponding operations will be oriented to influencing conditions and expectations of the market, with the end of achieving inflationary goals. The decisions in matter of determination of the leading interest rate will be adopted to function for the projections of inflation and the follow up of the indicative variables of monetary policy.
- ii) **Accommodating the bidding mechanism for CDP's for the stabilization operations of monetary stabilization of the liquidity for structural origin.** The Central Bank must make sure that said liquidity is kept sterile to terms longer than a year, and, for the effect, their will be quotas established for each of the terms, to be bid upon with a lesser frequency than the operations referred to in the previous clause (i). The interest rates will be the result of the best bids for each term set up for bidding.



- iii) **Without discredit to the inflationary objective achieved, watch over the stability of the short term interest rates.** They will watch over that the interest rates in the short term (represented mainly by the rates in the repurchase agreements markets) don't fluctuate in an abrupt manner, therefore the Central Bank could participate in the Electronic Banking Table of Money or in the Stock Exchange, giving liquidity to the market or retiring liquidity in the moment when it observes volatility in the market.
- iv) **Effectiveness in the Communication of the actions of the monetary stabilization.** The *Banco de Guatemala* must continue catching up in the analysis and studies that allow deeper explanations to the public on how the monetary policy decisions influence the economic conditions and the general level of prices.

**b) Exchange Flexibility:**

The exchange regimen will continue to be flexible therefore the exchange rate will be determined by the interaction between the offer and demand of foreign currency in the market. The *Banco de Guatemala* will respect the trajectory of market of the type of exchange and will be limited to participate in the exchange market, in order to avoid its volatility. Also, the *Banco de Guatemala* will also be able to participate in the exchange market with the strict purpose of acquiring the foreign currency that is required by the bank itself, the central government and other entities of the public sector, to the effect of covering its obligations in foreign currency.

In that sense, and with the purpose of increasing the efficiency of all the mechanisms through which the *Banco de Guatemala* participates in the exchange market, gradual modifications will be introduced to said mechanisms, in order to fulfill the following principles that will allow a flexible exchange system:

- i) Be consistent with the monetary scheme of explicit goals of inflation;
- ii) Be based on explicit, transparent and comprehensible regulations for the markets;
- iii) Eliminate the discretionary participation of the *Banco de Guatemala*;  
and,

- iv) Avoid the volatility of the exchange rate, without affecting its tendency.

For the effect, the *Banco de Guatemala* must present, for the approval of the Monetary Board, a regulation proposal that contains the norms that will regulate its participation in the exchange market, evaluating the use of both options for purchase and sale of dollars.

## **2. Instruments to maintain the macro-financial stability**

### **a) Monetary Stabilization Operations**

For 2005 the monetary stabilization operation, for giving or retiring liquidity to the market, will be made according to the principles of participation indicated in section II.C.1.a) of the present resolution. In this sense, monetary stabilization operations will be made in terms up to a year and, when the conditions of the market advise it, they will also be able to make monetary stabilization operations for terms of more than one year.

### **b) Fund raising of term deposits in dollars from the United States of America**

To counteract the risk of accelerated appreciation of the nominal exchange rate associated with the affluence of capital to the country; in 2005 the *Banco de Guatemala* will have the instruments available that will allow picking up the liquidity in the market in foreign currency through fund raising with long term deposits in United States dollars, with the objective of, that if the circumstances allow, softening the behavior of the exchange rate, according to the established in Resolution JM-99-2004 dated September 8, 2004.

The amounts to be raised in funds and the terms of the proposed operations will continue to be determined by the Execution Committee of the *Banco de Guatemala*, and in the dispositions that the Monetary Board will issue opportunely, will be oriented only to solving the temporary liquidity problems, with the end of forbidding said problems to worsen and could unnecessarily put pressure on the interest rates or go against the good functioning of the payment system.

## **3. Measures to Effectively Support the Monetary Policy**

### **a) Coordination with the fiscal policy**

In order to consolidate the efficiency and credibility of the macro economic policy, it is necessary to continue strengthening the institutional

coordination through the work group of the *Banco de Guatemala-Ministerio de Finanzas Públicas* [Equivalent to the Department of the Treasury], constituted since 2002 by both entities, with the goal of materializing the efforts that could allow the fiscal and monetary policy to fulfill the objective in matters of macro-economic stability. In particular, they must coordinate conditions in which they will issue Treasury bonds that, in agreement with the proposed in article 9 of the Organic Law of the *Banco de Guatemala*; the Income and Expense Budget of the state for the 2005 Fiscal Year was included, in order to effectively use in support of the monetary policy.

**b) Continue with the Modernization of the Payment System**

With the purpose of procuring the good functioning of the payment system, strengthening the trust and security, preserving a healthy financial system and favoring the conditions for the sustained growth of the national economy, in 2005 they will implement the Main Modernization of the Payment System approved by the Monetary Board in resolution JM-140-2004 dated November 17, 2004, whose objective is to set up the gross liquidation system in real time and the electronic banking compensation chamber, under an integral regulatory framework that fulfills the basic principles for the payment systems of systematic importance, as well as international standards.

**c) Transparency and rendering of accounts of the *Banco de Guatemala***

In order to continue the strengthening of the transparency and the rendering of accounts in the actions of the Central Bank, they will opportunely fulfill the elaboration of the different reports and publications contained in the organic law, in order to inform the public in a comprehensible and accessible manner of the objective of the monetary, exchange and credit policy, as well as the actions taken for the execution of said policy.

**d) Improvement of the National Statistics System**

Support is expressed to the Executive Branch in its efforts to consolidate the National Statistics System, which will allow it to count on efficient, trustworthy and opportune statistics that will ease decision-making.

**III. MAINTAIN THE OTHER AGREEMENTS OF THE MONETARY, EXCHANGE AND CREDIT POLICY CURRENT, WHICH DO NOT OPPOSE THE CONTENTS OF THE PRESENT RESOLUTION.**

**IV. AUTHORIZE THE SECRETARY OF THIS BOARD TO PUBLISH  
THE PRESENT RESOLUTION, WHICH WILL BE CURRENT AS OF  
JANUARY 1, 2005.**

[Illegible signature.] Armando Felipe Salas Alvarado, Secretary, Monetary Board. [To the right is a round rubberstamp seal which translates:] *Banco de Guatemala*, Monetary Board, Guatemala, C.A.

**ANEX  
MONETARY AND FISCAL PROGRAM 2005  
In millions of Q.**

Concept	I TRIM	II TRIM	III TRIM	IV TRIM	TOTAL
<b>FISCAL ACCOUNTS</b>					
Income	5,291	6,573	6,462	6,687	25,014
Expenditure	6,196	6,517	8,091	8,506	29,309
Current	4,765	4,606	5,573	5,467	20,411
Capital	1,431	1,912	2,517	3,038	8,898
Deficit (% of GNP)	904	-56	1,628	1,819	4,295 2
NET External Financing	-141	103	220	41	222
NET Internal Financing	866	964	803	-12	2,622
Till Variation	179	-1,123	606	1,789	1,452
<b>A. MONETIZING (+) AND DEMONETIZING (-) FACTORS</b>					
<b>I. International Net Reserves</b>	<b>-527</b>	<b>-56</b>	<b>-446</b>	<b>-50</b>	<b>-1,079</b>
RIN US\$	-66	-7	-56	-6	-135
<b>II. Net Internal Assets</b>	<b>6,231</b>	<b>105</b>	<b>1,911</b>	<b>3,502</b>	<b>11,749</b>
1. Central Government	179	-1,123	606	1,789	1,452
2. Rest of the Public Sector	399	98	8	18	523
3. Position with banks	156	-332	-151	-307	-634
Credit to banks	0	0	0	0	0
Banking Reserve	156	-332	-151	-307	-634
4. Other Net Assets	320	391	259	477	1,447
Expenses and products	316	229	241	277	1,063
Others	4	162	18	200	384
5. Maturity of OMAs	5,177	1,071	1,190	1,524	8,962
<b>III. CREATION OF LIQUIDITY</b>	<b>5,704</b>	<b>49</b>	<b>1,465</b>	<b>3,452</b>	<b>10,670</b>
<b>B. DEMAND OF MONETARY ISSUE</b>	<b>-575</b>	<b>-356</b>	<b>-271</b>	<b>2,169</b>	<b>967</b>
<b>C. EXCESS (-) OR MISSING (+) LIQUIDITY (B-III)</b>	<b>-6,279</b>	<b>-405</b>	<b>-1,736</b>	<b>-1,283</b>	<b>-9,703</b>
<b>D. PLACEMENT OF OMAs</b>	<b>6,279</b>	<b>405</b>	<b>1,736</b>	<b>1,283</b>	<b>9,703</b>
<b>E. NET PLACEMENT OF (-) OMAs</b>	<b>-1,102</b>	<b>666</b>	<b>-546</b>	<b>241</b>	<b>-741</b>

