EXECUTION COMMITTEE

ACT NUMBER 41-2005

Session 41-2005 celebrated in the *Banco de Guatemala* building on Friday, August nineteenth, two thousand five, at fourteen hours and thirteen 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 40-2005, corresponding to the session celebrated on August 12, 2005.
(The project of the act circulated.)

SECOND: Evaluation of the position of the bidding for Time Deposits in *quetzals* No. DP-101-2005.

THIRD: Market information and monetary variables.

a) Money and Exchange markets.
b) Monetary Variables

FOURTH: Inflation Risk Balance.

FIFTH: Analysis of the monetary situation and definition of the guidelines of execution for the Monetary, Exchange and Credit Policy for the following week.

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 40-2005.

SECOND: Evaluation of the positions of bidding for time deposits in *quetzals* No. DP-101-2005.

The committee conceded the received positions of bidding for the Time deposits -LTD- long term deposits (Q20.0 million for 2912 days (8years), at an interest rate of 8.25%, observing that when taking the yield curve as a reference calculated through the interpolation of the current interest rates for public titles, the four positions received in the 8 year term are subject to adjudging, therefore it adjudged said positions, that together added up to Q20.0 million at an interest rate of 8.25%.

THIRD: Information of markets and monetary variables.

The coordinator requested that the corresponding information be presented.

a) The Director of the Department of Monetary Stabilization Operations, in relation to Money market informed that during the period from August 15 to 18 of 2005, registered an attraction of LTD's for Q1,751.0 million and maturity of Q1,268.4 million, which gave a net result of attraction for Q482.6 million, associated to the operations in bidding (net attraction for Q151.5 million), in the Money Electronic Banking Table –MEBD- and in the stock exchange (net attraction of Q309.0 million) and at the window (net attraction for Q22.1 million).

Regarding the interest rates applied for attraction of the LTD's, it was indicated that during the August 12 to 19, 2005 period, in the case of biddings, the cut interest rate was of 5.4990% for 182 days and 6.9745% for 728 days. For its part the MEBD and the stock exchange attractions were made for 7 days, at an interest rate of 3.25%.

As for the pondered average interest rates of total operations of repurchase agreements made in the stock exchange of the country, it was indicated that, during the August 15 to 18, 2005 period, the minimum was of 2.20%, observed August 16, 2005, and the maximum of 3.50%, registered on August 17, 2005. It also pointed out that the amounts negotiated were higher with public titles and that the average pondered interest rates during said period were of 2.61% for public titles and of 5.99% for the financial sector titles.

On the other hand, it was informed that during the August 15 to 18, 2005 period, regarding Treasury Bonds operations the maturity was registered for Q0.5 million.

As for biddings on time deposits in dollars from the United States of America, made during the August 15 to 18, 2005 period, they were declared deserted at not having received a purchase order.

Regarding the Institutional Market for foreign currency the report stated that during the period of August 11 to 18, 2005, the average daily operations for purchase were of US$63.5 million and the sale was of US$69.9 million as the exchange rates showed a slight tendency to the rise. In effect, on Thursday, August 11 they were of Q7.57771 per

US$1.00 for purchase and of Q7.59023 per US$1.00 for sale, on Friday, August 12 the rates were Q7.57579 and Q7.59161, on Tuesday, August 16 they were Q7.57358 and Q7.59396, Wednesday, August 17 they were Q7.58038 y Q7.59391, and finally, on Thursday, August 18 they were Q7.57927 y Q7.59327.

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.), commented that the Private Institutional Foreign Currency System –SPID-, for the period of August 12 to 19 of the present year, operations took place on Tuesday, August 16 for US$1.5 million at an average pondered exchange rate of Q7.59250; Wednesday, August 17 US$3.0 million at an average pondered exchange rate of Q7.59250; Thursday, August 18 US$900.0 thousand at an average pondered exchange rate of Q7.59633; and Friday, August 19 US$2.0 million at an average pondered exchange rate of Q7.59700.

In the Electronic Foreign Currency Negotiation System –SINEDI-, they declared that during the period of August 11 to 18, 2005, they closed operations only on Thursday, August 11 at US$12.0 million with a pondered average exchange rate of Q7.58917, corresponding to purchases by the *Banco de Guatemala* according to the guidelines of the Execution Committee. In the daily operations, they indicated that up to the hour of the meeting, in SINEDI they were in the purchase position for the *Banco de Guatemala* for US$10.0 million, at a price of Q7.58800, and that operations were not yet closed.

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 August 12 to 19, 2005, did not close operations. As for the closing price in reference up to Friday, August 19, they indicated that for maturity to liquidate in September of 2005 the price was Q7.64000, for the maturity to liquidate in December 2005 it was of Q7.67000, for the maturity to liquidate in March of 2006 it was of Q7.71000.

b) The director for the Economic Studies Department informed that on August 18, 2005, the excess of the daily exchange rate of the banking system was located in a position of Q124.1 million, with an average position of Q359.7 million.

The highlights during the period of August 11 to 18, 2005, were the main demonetizing factors that were the increase in balances of the long term deposits constituted in the *Banco de Guatemala* for Q529.7 million and the rest of the deposits from the public sector in the Central Bank for Q90.4 million; while the main monetizing factors were the lower float balances for Q384.2 million and of the deposits for the Central Government in the *Banco de Guatemala* for Q185.3 million; and the increase in the Net International Reserve –RIN- balance for the equivalent of Q56.0 million.

Speaking of the indicative variables of the Monetary, Exchange and Credit Policy they indicated that with the projection for July to December of 2005 the total inflation estimated with a model of ordinary squared minimums is of 6.61% and with a softened exponential model of 8.12%; the simple average of both models is located at 7.37%, which is above the policy range goal (4.0%-6.0%), which suggests a restrictive monetary policy.

With the expected subjacent inflation for 2005, with data up to July 2005, estimated with an integrated auto-regression model of mobile averages ARIMA, was of 8.32%, whereas the estimated with a softened exponential model it was of 8.09%; the simple average of both models is of 8.21%, which is above the policy range goal (4.0%-6.0%), which suggests a restrictive monetary policy.

As to the parameter rate, up to August 11, 2005, the lower limit was 3.37%, and the upper limit is 11.27%, while the simple average between the repurchase agreements of 8 to 15 days (4.00%) and the pondered average rate of open market operations –OMA- of up to 91 days (3.42%) was situated at 3.71%, which is located within the limits of the parameter rate, situation that suggests the convenience of the invariable monetary policy. When referring to the parity passive rate, they declared that up to August 11, 2005, the lower limit was 6.65% and the upper limit was 8.23%, and the pondered average rate of long term deposits of the banking system was of 6.91%, which maintains itself within the range of the parity passive rate, which is advised by the invariable monetary policy. As to monetary issue observed to August 18, 2005, they indicated that it presents a deviation of Q301.0 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 August 11, 2005, it exhibited an inter-annual growth rate of 14.8%, which is within the estimated range for said variable on that same date (13.6% to 15.6%), which is what monetary policy advises to remain invariable. Also, up to said date, the banking credit to the private sector registered an inter-annual growth rate of 20.1%, which is above the upper limit of the estimated range for August 11, 2005 (17.3% to 19.3%), which suggests a restrictive monetary policy.

As to inflation expectations of private analysts, they indicated that according to the poll made in July of 2005, to December of 2005 an inflationary rhythm of 8.19% is expected, which is above the goal range for monetary policy (4.0% to 6.0%), an aspect which suggests restricting monetary policy. They mentioned that the Monetary Conditions Index –ICM-, to August 11, 2005, was -2.68 percentage points which is within the range estimated for said variable on that date (-4.19 to -2.59 percentage points), which advises that monetary policy should remain invariable.

To conclude this report, orientation of the indicative variables remains the same regarding the previous week: five variables suggest that the monetary policy be restrictive (the total inflation projection, the subjacent inflation projection, the inflation expectations of private analysts, monetary issue and banking credit to the private sector); four variables suggest that monetary policy remain invariable (parameter rate, parity passive rate, Monetary Conditions Indexes and the total payment means); and do not suggest to be lax with it.

FOURTH: Inflation Risks Balance.

The Economic Manager, with the purpose of illustrating the decision adopted with the adjustment of the leading interest rate of monetary policy, referred to the inflation risks balance with data up to July 2005, emphasizing on the following aspects:

As to outer conditions, he indicated that the behavior of the rise of international oil prices continues to be the main inflationary risk and that, for that reason, the inflation risks balance had deteriorated compared to the previous month.

As a reference point, he stated, that given the behavior of the prices for gasoline in the capital city offered by the *Ministerio de Energía y Minas* (Equivalent to the Department of Energy) for the last two and a half months, it could be said that producers were having an easier time applying higher prices, even though this should be viewed cautiously, due to the fact that the information is restricted to a small portion of the national territory. In relation to the impact of the second round of imported inflation on domestic inflation, it was mentioned that when building a composed index of inflation of the main commercial partners, pondered by the relative importance of the commerce of Guatemala with them, since the United States of America is the country with the biggest relative weight within the index and that the inflation of said country has increased in a moderate but sustained manner, they have presented a slightly larger inflationary pressure through this. When referring to the impact that economic policy measures in the United States of America could have on domestic inflation, it was indicated that even though efforts were made in monetary policy affairs in said country, the fiscal effort is not as fast or deep and the deficit in current accounts is not contained, therefore the existing risk is that the monetary restriction would cease without the fiscal correction, and that, therefore, the flow of capital from the United States of America to the rest of the world would begin again, including Guatemala, which in monetary policy context could mean some increase in the monetary offer that, if it happens, would create inflationary pressure.

As to internal conditions, it was indicated that the econometric projections prepared by the technical departments, using data observed to July, they estimate inflation for December 2005 and December 2006 to be greater than the estimation calculated the previous month, which also coincides in the deterioration of the inflation risks balance. Also, it was indicated, that the private analysts, according to the poll of inflation expectations made at the end of July, foresee inflation for the end of 2005 and 2006 to be higher than that estimated the previous month.

Within the fiscal perimeter, the satisfactory fiscal execution to this date was noted, and the perspectives that said behavior should maintain itself the rest of the year, aspect which would indicate that the inflationary pressures on the fiscal side were almost void. Notwithstanding, it was highlighted that the importance of good fiscal performance should not be affected by tendency measures to grant subsidies or tributary incentives to specific sectors.

In relation to the indicative variables, it was mentioned that if the variables in this month that suggest that the monetary policy be restricted are the same as those of the previous month, there is an important difference since now five of those variables indicate with greater intensity that the monetary policy must be restricted (the projection of the total inflation, the projection of the subjacent inflation, the parity passive rate, the banking credit of the private sector and the expectations of the inflation of private analysts.)

FIFTH: Analysis of the monetary situation and definition of the guidelines of Monetary, Exchange and Credit Policy execution for the following week.

a) Analysis of the monetary situation

The Committee took note that the monetizing and demonetizing factors previewed for the week of August 19 to 25, 2005 indicate an increase in the creation of primary liquidity for Q2,473.4 million, fundamentally due to the maturity of LTD's and the use of central government deposits in the *Banco de Guatemala* (associated to the payment of salaries.) Also, a decrease in the demand for monetary issue for Q123.0 million is foreseen and an accumulated position of banking liquidity for Q206.1 million. Also, monetary issue is deviated in Q429.4 million above the central programmed point for said variable, therefore the excess of liquidity added for the referred period is located at Q3, 231.9 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 (Q2.067.9 million, according to registries to August 18, 2005) have to be relocated; and also, make additional raising funds for around Q1,164.0 million.

Based on the analysis made, the Committee agreed that the inflationary risks balance did not get better in comparison to the previous month, and that it resulted convenient to effect an adjustment to the leading interest rate of the monetary policy. Regarding the magnitude of the adjustment, some members of the Committee declared that the same must serve the purpose of moderating the inflationary expectations.

Other members indicated that the increase in the rate, on this occasion, should be moderate, similar to the previous occasions when the rate was increased 25 basic points, since a higher increase could be counterproductive, sending an unnecessarily alarming message, which could exacerbate the inflation expectations of the economic agents. The Committee agreed, in any case, that it would be useful to be explicit with the Committee's decision to make additional adjustments in the coming months, where necessary, until an adequate moderation of expectations is reached; also, we have to take into account that monetary policy actions exercise their effects with a certain remainder, therefore sight must not be lost on the focus of the medium range, that has been incorporated in the execution of said policy. After the deliberations, the Committee resolved to issue the following press release:

"THE EXECUTION COMMITTEE OF THE BANCO DE GUATEMALA INCREASES THE INTEREST RATE OF THE MONETARY POLICY FROM 3.25% TO 3.50%, AS OF MONDAY, AUGUST 22, 2005.

1. Due to the increase in the general level of prices observed in July of 0.94%, which was the second highest of the year, the measure adopted by the Execution Committee is oriented to lessening the inflationary pressures that could be associated to the exceptional increase in international oil prices and, also to joint events that increased the prices in July in two specific account headings of the basic food basket: one, meat (whose price increased when the demand of the product in international markets increased, which increased its exportation, especially to Mexico); the second, vegetables (that were scarce in the domestic market due to excessive rains registered in June and July).

2. Although some extraordinary factors will not present themselves in August, the possibility that the excessive increase in the price of crude oil will continue to manifest itself, which added to the fact that inflationary rhythm in July went over 9%, it could negatively affect the inflationary expectations of the economic agents, which makes it necessary to adjust the leading inflationary rate of the monetary policy, in order to appease such expectations.

3. Although inflation in Guatemala does not reach alarming levels when compared to the rest of the countries in the Region and if the subjacent inflation is taken into account it hasn't shown an extraordinary rise, do not lose sight of the importance that for an economy like Guatemala's it is important to keep the total inflationary rhythm down to one digit, in order to avoid generating inconvenient decisions in consumer, savings and investment affairs on behalf of the economic agents, therefore the Central Bank could consider its future adjustments in the leading interest rate for the monetary policy, when necessary, until it insures the inflationary expectations are under control.

4. The actions of the Execution Committee make sure the inflationary rhythm converges in 2006 between 4% and 6%, all within satisfactory result margins reached through the execution of the fiscal policy and in consistency with the perspectives of more dynamics in the national economy."

Regarding the determination of quotas for biddings in the following week, the information provided for estimated daily flow of monetization for the week of August 19 to 25 as an established rule for determining quotas, based on what the Committee agreed that the quota of raising funds for the 91 and 364 day terms to be convened on Monday would be established at Q20.0 million and Q30.0 million, was taken into account, respectively; emphasizing that the differentiation in the amounts obeys the intention of promoting more competition in the 91 day term. For the 182 and 728 day terms to be convened Wednesday, the raising funds quota was established at Q30.0 million each.

On the other hand, the Committee began a proposed analysis for a member of the Monetary Board in its last session to evaluate the convenience of maintaining terms for more than four years in the monetary stabilizing operations, since these represent a higher financial cost. Some members of the Committee state that, since the beginning of these types of operations, the same were announced as a temporary measure, to fill the financial space that the treasury bonds operations left, and they would then disappear at the end of the year. However, the possibility of limiting the quotas of said operations in favor of shorter term operations was not dismissed, and the advising departments were called in to analyze this matter deeper.

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

Based on the monetary situation analysis, the Execution Committee agreed that for the week of August 22 to 26, 2005, they would maintain the execution guidelines for the monetary policy observed during the present week; in other words, continue to operate in MEBD and in the Stock exchange, in raising funds as well as in giving liquidity to the market. The raising funds operations will be 7 day terms without quota, at an interest rate of 3.50%, taking into consideration an increase of the agreed 25 basic points, as of Monday, August 22, 2005, whereas, the offer position of liquidity at 7 day terms, with an initial interest rate of 7.65%, whose guarantee of said operations will be constituted by receiving public titles, only. It is worth mentioning that the Committee stressed the importance of participating in both; in other words, maintaining simultaneous positions of giving liquidity to the market and liquidity withdrawal, considering said participation constitutes a sign of disposition of the Central Bank to moderate the volatility of the short term interest rate.

The Committee, taking into consideration the agreed with the fiscal policy to participate in the money market, agreed that the calling for biddings for term deposits would continue on Mondays, Wednesdays and Fridays of each week; so Monday for 91 and 364 day terms, with an raising funds quota of Q20.0 million and Q30.0 million, respectively; and Wednesdays for 182 and 728 day terms, with raising funds quotas for Q30.0 million for each of the terms. The interest rates would be determined according to the market conditions, reflected in the positions received, considering the established yield curve by the technical department; and on Fridays the 1456 day (4 years), 2184 day (6 years) and 2912 day (8 years) terms, without a pre-established raising funds quota. For the corresponding awarding, the committee will decide the amount to award for each term and for the determination of the interest rate to apply, as reference the one that corresponds to each one of the mentioned terms in a yield curve calculated through interpolation in the interest rates for 364 days (1 year) and 10 year terms will be taken. The payment of interest for the terms longer than 364 days will be at each semester, so as to keep with the same conditions held by the *Ministerio de Finanzas Públicas* (Equivalent to the Department of the Treasury). The committee authorized the General Manager of the *Banco de Guatemala* so that, with the bidding of August 22, 2005, he would award the amounts required of the 91 and 182 day positions, according to the new yield curves established by the technical departments for these terms, as long as they are within the established quota. In the event the interest rates required at those terms would be higher than the reference rates, the positions must be refused automatically. On the other hand, the Committee agreed to continue acquiring directly at the window, with official and public entities. In the case of official entities, that the raising funds continue according to the prevalent financial conditions; in other words, the interest rate for 7 day terms would be the one that applies for the *Banco de Guatemala* in the MEBD and in the stock exchange and, for the other terms, it would be the pondered average that resulted from bidding the term deposits in *quetzales*. For those terms that are not rewarded or that are not included in the bidding, during the last week, the rate to apply will be determined through interpolation of the rate for 7 days and the pondered average resulting from the shortest term in the last awarded bidding. Whereas the raising funds for the pubic, the interest rate for each term, cannot be higher than the pondered average of the bidding corresponding to less than a percentage point.

On the other hand, the Committee agreed that the summons for biddings in the term deposits in dollars from the United States of America –DP in US$- should be made every Tuesday and Thursday for 91 and 336 day terms, for an amount of up to US$30.0 million. The positions received can be awarded interest rates of up to 3.05% for the 91 day term and up to 3.40% for the 336 day term. However, if the interest rate required by investors would be closer to the prevailing interest rates in the domestic market of the United States of America for the same terms, due to the last adjustment made by the Federal Reserve to its objective interest rate, a meeting by the Committee will be convened to decide on its awarding.

The Committee agreed to continue accepting the constitution of term deposits in dollars from the United States of America directly at a window, from public entities, in current terms of (91 days and 336 days) and that the interest rate applied would be the resulting pondered average from the last awarded bidding for long term deposits in that currency.

As for the participation of the *Banco de Guatemala* in the Exchange market, the Committee agreed that it should continue participating in the SINEDI through participation rules established for the effect.

SIXTH: Other matters.

Not having any other matter to see, the session ends at sixteen hours, all that attended sign in agreement.