EXECUTION COMMITTEE

ACT NUMBER 43-2005

Session 43-2005 celebrated in the *Banco de Guatemala* building, on Friday, August twenty-sixth, two thousand five, as of fifteen hours and 30 minutes.

The coordinator, with the corresponding quorum, submitted to the Execution Committee the projects of Order of the Day for consideration.

FIRST: Approval for projects in Deed number 41-2005 and 42-2005, corresponding to sessions celebrated on August 19 and 23, 2005, respectively.
(Project deeds circulated.)

SECOND: Evaluation of the positions for bidding of Term Deposits in *quetzales*. Number DP-104-2005.

THIRD: Market Information and Monetary Variables.

a) Money and Exchange markets

b) Monetary Variables

FOURTH: Analysis of the Monetary Situation and Definition for the Guidelines of Monetary, Exchange and Credit Policy execution for the following week.

FIFTH: Other matters.

Not having observations, the Committee approved the Order of the Day.

FIRST: The Coordinator presented the project of the corresponding deed for consideration.

Not having observations, the Committee approved Deeds number 41-2005 and 42-2005.

SECOND: Evaluation of the bidding positions for Term Deposits in *quetzales.* No. DP-104-2005.

The Committee recognized the positions received in the bidding for long term deposits –CDP's- (24.0 million for 1456 days (4 years), at an interest rate of 7.25% and 8%; Q10.0 million for 2184 days (6 years), at an interest rate of 9.00%; and, Q35.0 million for 2912 day (8 years), at an interest rate between 8.25% and 10.0%), taking into account the yield curve for reference calculated through interpolation of current interest rates for public titles, one of the three positions received in the 4 year term and four of the five positions received in the 8 year term are subject to awarding, therefore it agreed to award said positions that together added up to Q35.0 million; so: Q10.0 million for 4 years at an interest rate of 7.25% and Q25.0 million for 8 years at an interest rate of 8.25% and 8.40%.

THIRD: Market and Monetary Variable Information

The coordinator requested that the corresponding information be presented.

a) The Director of the Department of Operations for Monetary Stabilization, regarding the Money Market informed that during the period of August 22 to 26, 2005, with partial numbers to this date, they registered raising funds of CDP's for Q2, 560.4 million and maturity for Q1, 889.8 million, which gave a result of net raising funds for Q670.6 million, associated to the operations performed in bidding (net raising funds for Q7.0 million), in the Electronic Banking Money Table –MEBD- and in the stock exchange (net raising funds for Q551.0 million) and in window (net raising funds for Q112.6 million). Regarding applied interest to raising funds of CDP's, they indicated that during the August 19 to 25, 2005 period, for bidding cases the cut interest rates were of 5.00% for 91 days, 5.65% for 182 days, 5.88% for 364 day and 6.9743% for 728 days. For their part, the MEBD and the stock exchange raising funds were for 7 day, and the interest rate was of 3.50%. As to the average pondered interest rates of the total operations the repurchase agreements in the stock exchange of the country indicated that during the August 22 to 26, 2005 period, with partial data to date, the minimum was 1.78%, observed on August 24, 2005, and the maximum was 3.77%, registered on August 22, 2005. Also, it was pointed out that the negotiated sums were higher with public titles and that the pondered average interest rates for said period were of 2.35% for public titles and of 5.24% for titles from the financial sector. On the other hand, they informed that during the August 22 to 26, 2005 period, regarding the treasury bonds operations they registered a maturity for Q1.9 million.

As to biddings for long term deposits in dollars from the United States of America, made during the August 22 to 26, 2005 period, it was mentioned that only one position of purchase order was presented for US$39.0 million, for 336 days at an interest rate of 3.75%, which was awarded by the Execution Committee. Regarding the Institutional Foreign Currency market they informed that during the August 19 to 25, 2005 period, the average daily purchase operations were for US$55.8 million and sales were of US$57.3 million and that the exchange rates showed a tendency to the rise. In effect, on Friday, August 19 it was Q7.57693 for US$1.00 for purchase and Q7.59499 for US$1.00 for sale, on Monday, August 22 they were Q7.57594 and Q7.59401, on Tuesday, August 23 they were Q7.57925 and Q7.59295, on Wednesday, August 24 they were Q7.58235 and Q7.59821 and, finally, on Thursday 25 of August they were 7.58876 and Q7.60276.

Regarding the operations of the electronic negotiation system of foreign currency that is administered by the *Bolsa de Valores Nacional, S.A.* (National Stock Exchange Company), corresponding to the period of August 22 to 26, 2005 period, it was commented that in the Private Institutional System of Foreign Currency –SPID-, there were only operations on Thursday, August 25 for US$1.3 million, at a pondered average exchange rate of Q7.60096. Regarding the Electronic Negotiation System for Foreign Currency –SINEDI-, it was said that during the period they did not close operations, and only the *Banco de Guatemala* received a daily purchase position for US$10.0 million, at a price of Q7.58800. On the other hand, the National Stock Exchange Company informed that in the Futures Market for Foreign Currency, it did not close operations for the August 22 to 26, 2005 period. As to the closing price, of reference, on Friday, August 26, they indicated that for the maturity to liquidate in September 2005 was for Q7.64000, for the maturity to liquidate in December 2005 was for Q7.67000 and for the maturity to liquidate in March 2006 was for Q7.71000.

b) The Director for the Department of Economic Studies informed that August 25, 2005, the daily float excess of the banking system was located in a negative position of Q164.8 million, with an average position of Q182.1 million; therefore the Committee asked the department advisors to analyze the behavior of the banking liquidity in the last few weeks compared to its effect on the Monetary Base, variable that, after showing an important deviation to the programmed upper limit, had returned in the last day to the foreseen levels at the beginning of the year.

It stood out that in the August 18 to 25, 2005 period, the main demonetizing factors were increased in the balance of the long term deposits at the *Banco de Guatemala* for Q581.2 million and the decrease in the Net International Reserves –RIN- for the equivalent of Q60.0 million; while the main monetizing factors were decreased in the banking float balance of Q265.2 million, of the deposits of the Central Government in the *Banco de Guatemala* for Q110.4 million; and of the deposits of the rest of the private sector in the Central Bank for Q46.2 million.

Regarding the indicative variables for the Monetary, Exchange and Credit Policy they indicated that with the July projection, for December 2005 the total estimated awaited inflation with a model of ordinary squared minimums is of 6.61% and with a softened exponential model is of 8.12%; the simple average of both models is located at 3.37%, which is above the goal range of policy (4.0% to 6.0%), which suggests a restrictive monetary policy.

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

As to the parameter rate, they reported that on August 18, 2005, the lower limit was of 3.39%, whereas the upper limit was located at 11.29%, while the resulting simple average between the repurchase agreements for 8 to 15 days (3.40%) and the pondered average rate for the open market operations –OMA's- of up to 91 days (3.40%) was located at 3.40%, which is within the parameter rate limits, situation that suggests the convenience of an invariable monetary policy. Referring to parity passive rate, they declared that on August 18, 2005, the lower limit was of 6.70% and the upper limit was of 8.28%, whereas the pondered average for long term deposits of the banking system was of 6.91%, which is within the margins of the parity passive rate, which advises an invariable monetary policy.

As to the monetary issue observed to August 25, 2005, they indicated a deviation of Q304.8 million compared to the programmed upper limit for said variable, which would indicate an existing space for monetary policy restriction.

As to total payment means, to August 18, 2005, it exhibited an inter-annual growth of 14.6%, which is within the estimated parameters for said variable of the same date (13.9% to 15.9%), which advises an invariable monetary policy. Also, to the indicated date, the banking credit to the private sector registered an inter-annual growth of 19.8%, which is above the upper range limit estimated for August 18, 2005 (17.2% to 19.2%), which suggests a restrictive monetary policy.

Regarding the inflation expectations of private analysts, it was indicated that, according to the polls made in July 2005, for December 2005 they expect an inflationary rhythm of 8.19%, which is above the goal range for monetary policy (4.0% to 6.0%), aspect which suggests a restriction on monetary policy. They mentioned that the Monetary Conditions Index –ICM-, to August 18, 2005, was of -2.66 percentage points which is within the estimated range for said variables to date (-4.19 to -2.59 percentage points), which advises maintaining an invariable monetary policy.

To conclude, they reported that the orientation of the indicative variable remains the same compared to the previous week: five variables suggest that the monetary policy be restrictive (the total inflation projection, the subjacent inflation projection, the expectations of inflation of private analysts, monetary issue and the banking credit to the private sector); four variables suggest that the monetary policy remain invariable (the parameter rate, the parity passive rate, the Monetary Conditions Index and the total payment means); and none suggest letting it relax.

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

i) Analysis of the Monetary Situation

The committee noted that the monetizing and demonetizing factors foreseen for the week of August 26 to September 1, 2005 period indicate an increase in the creation of primary liquidity for Q2, 599.5 million, fundamentally due, to maturity of CDP's. They also foresee an increase in the demand of monetary issue for Q211.0 million and an accumulated position for banking liquidity for Q196.4 million. Also, that the monetary issue is deviated in Q433.5 million above the central programmed point of said variable, therefore the excess of added liquidity for the referred periods is located at Q3, 018.3 million; if these factors are given, the Committee considered it would be necessary, to make the issue offer compatible with the programmed demand, that the CDP that expire during that period (Q2, 559.5 million, according to registries to August 25, 2005) have to relocate; and, also, make additional raising funds for about Q458.8 million.

On the other hand, the Committee discussed the need to effectively communicate the inflationary situation to the markets, as well as the relation that exists between the inflation goal and the monetary policy decisions. For that, the Committee agreed in that the provided explanation to the press during the conference offered by the President of the *Banco de Guatemala* on Thursday, August 25, contain the central elements for the communication of these affairs to the markets.

Said explanation is summarized in the following manner:

A) THE INFLATION GOAL IS ESTABLISHED, BASED ON THE SUPPOSITIONS OF BEHAVIOR OF DIFFERENT ECONOMIC VARIABLES AND IT IS USED AS A PARAMETER FOR MONETARY POLICY DECISIONS.

The inflation goal is in line with the estimations over the expected evolution of different indicative variables (monetary issue, private sector credit, volume of payment means, etc.), that the Central Bank uses to propose and evaluate monetary policy. The behavior of the prices and the projection of its future evolution, contrasts with the inflation goal, so that a greater price growth gives way to monetary restriction with the object of procuring real inflation oriented toward the established goal, where the unforeseen phenomenon, whether they be internal (atmospheric phenomena that affect production) or external (war or international price rises) must be considered in a special manner, with the end of procuring the goal without affecting other parameters such as employment and economic growth. In these cases, the real inflationary deviation regarding the established goal simply explains the reasons for deviation, but it must not change the goal, because this way it would lose its orienting character.

B) THE INFLATION EXCESS IS MAINLY ATTRIBUTABLE TO THE WORLD PHENOMENON OF INCREASE IN OIL PRICES.

The increase in oil prices manifests itself, on the one hand, in a direct increase of the components of the basic food basket which are fuel and lubricants (direct imported inflation) and, on the other hand, through the effect that it has on the rest of the prices of goods and services that use said fuel in the process of production or transportation (indirect imported inflation).

To July 2005, around 36% of the total inflation is attributable to imported inflation. Domestic inflation, as such, to July (5.99%), is under the established upper limit established as a goal for 2005.

C) THE PREVIOUS DOES NOT IMPLY THAT THE MONETARY POLICY SHOULD REMAIN IMPASSIBLE BEFORE THE INFLATIONARY PHENOMENON.

There are at least two reasons that justify that monetary policy act (“pinching” the monetary conditions) to moderate inflation, including the excess according to attributable goal of exogenous factors (out of control of said policy). The first reason for action has to do with the management expectations. A growing inflation could generate self-accomplished expectations compared to future inflation; for an economy like Guatemala's it places importance on the maintenance of inflationary rhythm to one digit levels, with the goal of avoiding generating inconvenient decisions in consumer, savings and investment affairs on behalf of economic agents, accustomed to stable prices.

The second reason that justifies "pinching" monetary policy refers to the fact that there has always been an existent historic level ("normal") of imported inflation. Recently, for Guatemala, the historic level of imported inflation is located at 0.52 percentage points. The extraordinary imported inflation (due to the rise in oil prices) is then located at 2.79 percentage points. Therefore, if we add historic imported inflation (0.52%) to domestic inflation (5.99%), the "normal" inflationary rhythm will be at 6.5%, this is above the goal, which implies that there is a space for the monetary policy to act (raising the interest rate), to modify the rise in prices and reaching its goal, at least in its "normal" component.

Therefore, the goal of monetary policy does not modify itself, since it serves as a parameter to measure if "normal" inflation (addition of domestic inflation and historic imported inflation) is behaving according to the foreseen. The estimations of the *Banco de Guatemala* point toward total inflation (sum of normal inflation and extraordinary imported inflation) ending the year at 7.37%, which would imply, that normal inflation could end the year well within the goal limits.

D) THE ADJUTMENTS OF THE INTEREST RATE (LEADING) OF MONETARY POLICY SHOULD BE HANDLED PRUDENTLY.

An abrupt increase in the leading interest rate could unnecessarily make credit and investment very expensive, affecting with it the production and employment levels, which would complicate the difficulties that affect the productive sector in raising production costs due to the price of fuel. There are other factors that give monetary policy certain relief and allow it to act with moderation:

a) Stable behavior (and with a tendency to the low) that has been manifest in the exchange rate that helps in imported products costs having less effect on prices.

b) Guatemala's inflation is lower than other Central American countries with their own currency.

c) The substantial support that fiscal policy has offered monetary policy during 2004-2005. To August 23 the government deposits in the central bank were more than Q2 billion, the number originally programmed, which contributes to the stability that decidedly supports monetary policy.

Regarding the quota determination for bidding of the following week, the information provided by the estimated daily flow of monetization for the week of August 26 to September 1 was taken into account, as an established rule for the determination of quotas, based on this the Committee agreed that the quota raising funds for the 91 and 364 day terms to be summoned on Monday should be established at Q10.0 million and Q30.0 million, respectively, reiterating that the differentiation in amounts obeys the intention of promoting greater competition for the 91 day term.

For the 182 and 728 day terms a summons will be made on Wednesday, the raising funds quota established is of Q30.0 million for each.

ii) Definition of the Guidelines for Monetary, Exchange and Credit Policy Execution for next week.

Based on the analysis of the monetary situation, the Executive Committee agreed that for the week of August 29 to September 2, 2005, they will keep the execution guidelines for monetary policy observed during the current week; in other words, they will continue making operations in MEBD and in the stock exchange, in raising funds and in giving liquidity to the market. The operations of raising funds will be made in 7 day terms without quotas, at an interest rate of 3.50%, whereas, the position of liquidity offers in 7 day terms, at an interest rate of 7.65%, whose guarantee of said operations will constitute receiving only public titles. It is worth mentioning that the Committee reiterated the importance of participating in both venues; in other words, keeping simultaneous positions in giving liquidity to the market and in removing liquidity, considering said participation constitutes a signal of the disposition of the Central Bank to moderate the volatility in the interest rate in short term. The Committee, taking into account the agreed in coordination affairs with the fiscal policy for the money market participation, agreed that the summons for biddings of term deposits continue to be on Mondays, Wednesdays and Fridays of each week; on Monday 91 day terms and 364 day terms, with a quota of raising funds of Q10.0 million and Q30.0 million, respectively; and on Wednesday the 182 day and 728 day terms, with a quota for raising funds of Q30.0 million for each term. The interest rates will be determined according to the conditions of the market, reflected in the received positions, considering the established yield curve by the technical departments; and on Friday the 1456 day (4 year), 2184 day (6 year) and 2912 day (8 year) terms, without a pre-established quota for raising funds. For the corresponding awarding, the Committee will decide on the amount to award for each term and for the determination of the interest rate to apply, as a reference they will take each corresponding term onto a calculated yield curve and through interpolation of the interest rates of 364 day (1 year) and 10 year terms to determine the awards. The payment of interest for the terms of more than 364 days will be per semester, that, with the goal of maintaining the same conditions with which the *Ministerio de Finanzas Públicas* (Equivalent to the Department of the Treasury). On the other hand, the Committee agreed to continue raising funds through the window, directly, with official and public entities. In the case of the official entities, the raising of funds will continue to be according to the prevalent financial conditions; in other words, the interest rate for the 7 day term will be the one applied by the *Banco de Guatemala* in the MEBD and in the stock exchange and, for the other terms, it will be a pondered average that results in the bidding of term deposits in *quetzales*. For those terms that are not awarded or that have not been included in the summons for bidding, during the last week, the rate to apply will be determined through interpolation of the term rate for 7 days and the remaining pondered average for the shortest term of the last awarded bidding. As to the raising of funds with the public, the interest rate, for each term, can not be higher than the pondered average corresponding to the bidding minus one percentage point.

On the other hand, the Committee agreed that the summons for bidding of term deposits in United States dollars –DP in US$- be made on Tuesdays and Thursdays of each week in 91 and 336 day terms, for up to US$30.0 million. The proposals received can be awarded an interest rate of up to 3.05% for the 91 day term and up to 3.75% for the 336 day term. However, if the interest rates requested by the investors are close to the prevalent interest rates in the domestic market of the United States of America for the same terms, due to the latest adjustment by the Federal Reserve, to the objective interest rate, the Committee would convene a meeting to decide on the awarding.

The Committee agreed to continue accepting the constitution of long term deposits in dollars from the United States of America, directly at the window, from public entities, in the current terms (91 days and 336 days) and that the applied interest rates will be the pondered average interest rates resulting in the latest bidding awarding of long term deposits expressed in said currency.

As to the participation of the *Banco de Guatemala* in the exchange market, the Committee agreed to continue participating in the SINEDI through the rules of participation established in Session 15-2005.

FIFTH: Other matters.

Not having other matters to deal with, the session ends at sixteen hours and thirty-eight minutes, the attending parties sign in agreement.