EXECUTION COMMITTEE

ACT NUMBER 45-2005

Session 45-2005 celebrated in the *Banco de Guatemala* building, on Friday, September ninth, two thousand five, at fifteen hours and 30 minutes.

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

FIRST: Approval for projects in Deed number 44-2005, corresponding to session celebrated on September 2, 2005.

(Project deeds circulated.)

SECOND: Evaluation of the positions for bidding of Term Deposits in *quetzales*. Number DP-110-2005.

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 Deed number 44-2005.

SECOND: Evaluation of the bidding positions for Term Deposits in *quetzales*. No. DP-110-2005.

The Committee recognized the positions received in the bidding for long term deposits –CDP's- (20.0 million for 1456 days (4 years), at an interest rate of 7.2397%; Q20.0 million for 2184 days (6 years), at an interest rate of 7.75%; and Q37.0 million for 2912 day (8 years), at an interest rate between 8.25% and 8.50%, 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, the two postures received a six year and three of the four positions received in the 8 year term are subject to awarding, therefore it agreed to award said positions that together added up to Q67.0 million; so: Q20.0 million for 4 years at an interest rate of 7.2397% and Q20.0 million for 6 years at an interest rate of 7.75% and Q27.0 million for 8 years, at an interest rate between 8.25% and 8.40%.

THIRD: Market and Monetary Variable Information

The coordinator requested that the corresponding information be presented.

a) The Sub-Director of the Department of Operations for Monetary Stabilization, regarding the Money Market informed that during the period of September 5 to 9, 2005, with partial numbers to this date, they registered raising funds of CDP's for Q2, 274.2 million and maturity for Q2, 649.8 million, which gave a result of net maturity for Q375.6 million, associated to the operations performed in bidding (net maturity for Q75.3 million), in the Electronic Banking Money Table –MEBD- and in the stock exchange (net maturity for Q147.0 million) and in window (net raising funds for Q153.3 million). Regarding applied interest to raising funds of CDP's, they indicated that during the September 5 to 9, 2005 period, for bidding cases the cut interest rates were of 5.00% for 91 days, 5.75% for 182 days, 6.3997% for 364 day and 7.00% for 728 days. For their part, the MEBD and the stock exchange raising funds were for 7 day fixed terms, and the interest rate was of 3.50%. As to the average pondered interest rates of the total operations for the repurchase agreements in the stock exchange of the country indicated that during the September 5 to 9, 2005 period, with partial data to date, the minimum was 2.06%, observed on September 8, 2005, and the maximum was 3.05%, registered on September 7, 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 2.50% for public titles and of 3.27% for titles from the financial sector. On the other hand, they informed that during the September 5 to 9, 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 September 5 to 9, 2005 period, it was mentioned that there were two biddings convened and there were no purchase orders presented. Regarding the

Institutional Foreign Currency market they informed that during the September 2 to 8, 2005 period, the average daily purchase operations were for US$53.7 million and sales were of US$53.8 million and that the exchange rates showed a tendency to the rise. In effect, on Friday, September 2 it was Q7.58478 for US$1.00 for purchase and Q7.60392 for US$1.00 for sale, on Monday, September 5 they were Q7.57775 and Q7.60087, on Tuesday, September 6 they were Q7.58211 and Q7.60015, on Wednesday, September 7 they were Q7.58854 and Q7.60640 and, finally, on Thursday September 8 they were 7.58817 and Q7.60451. Regarding the electronic systems operations for negotiation of foreign currency administered by the National Stock Exchange, S.A., corresponding to the September 5 to 9, 2005 period, they commented that the Private Institutional System for Foreign Currency –SPID-, made the following operations: Thursday, September 8 for US$1.0 million, at a pondered exchange rate of Q7.60400. Regarding the Electronic Negotiation System of Foreign Currency –SINEDI-, presented that during the period no operations were closed and only the *Banco de Guatemala* made a daily income proposal for purchase of US$10.0 million, at a price of Q7.58800. On the other hand, they informed that Future Foreign Currency Markets that operate the National Stock Exchange, S.A. did not close operations for the September 5 to 9, 2005 period. As to the closing, for reference, on Friday, September 9 they indicated that the maturity to liquidate in September of 2005 was of Q7.65000, for the maturity to liquidate in December, 2005 it was of Q7.67000 and for the maturity to liquidate in March, 2006 it was of Q7.71000.

b) The director of the Economic Studies Department informed that on September 8, 2005, the excess of daily float and the average of the banking system were located in a position of Q591.4 million with a negative average position of Q10.0 million. It was highlighted that in the period of September 1 to 8, 2005, the main demonetizing factors was the increase in the banking float balances for Q1,132.0 million, while the main monetizing factors were the decrease in the balance of long term deposits in the *Banco de Guatemala* for Q756.2 million, of the deposits of the Central Government in the *Banco de Guatemala* for Q233.8 million and of the deposits of the rest of the public sector in the Central Bank for Q9.3 million; and the increase in the balance of the Net International Reserves –RIN- for the equivalent of Q66.4 million. Regarding the indicative variables for the Monetary, Exchange and Credit Policy they indicated that the projection to August, for December, 2005 the total estimated inflation with a model of ordinary minimum squared is of 6.69% and with a softened exponential model of 8.37%; the simple average of both models is located in 7.53%, which is found in the goal range for policy (4.0% to 6.0%), which suggests a restrictive monetary policy. Regarding the expected subjacent inflation for 2005, with data to August, 2005, estimated with a mobile averages integrated auto-regression model ARIMA, was of 7.43%, and estimated with a softened exponential model it was of 7.89%; the simple average of both models is of 7.66%, which is above the goal range of policy (4.0% to 6.0%), which suggests a restrictive monetary policy. Regarding the parameter rate, the report for September 1, 2005, the lower limit was of 3.03%, whereas the upper limit was at 10.93%, while the resulting simple average between repurchase agreements at 8 to 15 days (3.60%) and the average pondered rate of the open market operations –OMA- of up to 91 days (3.64%) was located at 3.62%, which is located within the parameter rate limits, situation which suggests the convenience of an invariable monetary policy. Regarding the parity passive rate, they declared that to September 1, 2005, the inferior limit was of 6.82% and the upper limit of 8.40%, as to the pondered average rate of long term deposits in the banking system was of 6.90%, which is within the parity passive rate range, which advises an invariable monetary rate.

Regarding monetary issue observed to September 8, 2005, they indicated that the present deviation of Q393.0 million with regard to the upper programmed limit for said variable, which would indicate an existing space to restrict monetary policy. As to total payment means, up to September 1, 2005, they exhibited an inter-annual growth of 14.4%, which is within the estimated range for said variable on the same date (13.5% to 15.5%), which advises that monetary policy remain invariable. Also, up to the same date, the banking credit for the private sector registered an inter-annual growth rate of 21.3%, which is above the upper limit of the estimated range for September 1, 2005 (18.6% to 20.6%), which suggests a restrictive monetary policy.

Regarding the inflation expectations of private analysts, they indicated that, according to the polls of August, 2005, for December, 2005 they expect an inflationary rhythm of 8.39%, which is above the goal range for monetary policy (4.0% a 6.0%), aspect which suggests restricting monetary policy.

They mentioned the Monetary Conditions Index –ICM-, to September 1, 2005, was of -2.69 percentage points which is within the estimated range for said variables for that date (-4.19 to -2.59 percentage points), advises that the monetary policy remain invariable.

To conclude, they informed that the orientation of the indicative variable remain the same as the week before: five variables suggest the monetary policy be restrictive (the total inflation projection, the subjacent inflation projection, the expectations of inflation by private analysts, the 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 to relax it.

On the other hand, the information presented by the Consumers Price Index to August of 2005 reported by the National Statistics Institute –INE-(the monthly inflation was 0.36% lower in 0.58 percentage points than the one in July of 2005; the inflationary rhythm was located at 9.37%, higher by 0.07 percentage points than that of July of 2005 and higher in 1.71 percentage points than the observed in August, 2004; the subjacent inflation registered a rhythm of 8.07% lower by 0.31 percentage points than that of July, 2005 (8.38%), but higher than that of August, 2004 (7.68%); as well as the estimations of the imported and domestic components of inflation (from 9.37% inflationary rhythm to August, 2005, 3.52 percentage points are attributable to imported inflation, which itself has 2.56 percentage points that correspond to indirect imported inflation (second round effect); therefore, the inflationary rhythm, 5.85% percentage points correspond to domestic inflation).

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

a) Analysis of the Monetary Situation

The committee noted that the monetizing and demonetizing factors foreseen for the week of September 9 to 14, 2005 indicate an increase in the creation of primary liquidity for Q1, 690.6 million, fundamentally due, to maturity of CDP's. They also foresee an increase in the demand of monetary issue for Q109.3 million and an accumulated position for banking liquidity for Q24.0 million. Also, that the monetary issue is deviated in

Q521.6 million above the central programmed point of said variable, therefore the excess of added liquidity for the referred periods is located at Q2,078.9 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 (Q1,859.2 million, according to registries to September 8, 2005) have to relocate; and, also, make additional raising funds for about Q219.7 million.

While evaluating the information received, the Committee began a discussion as to the decisions they would have to adopt in the next session if they should modify or maintain the level of the leading interest rate of monetary policy. In that sense, the heart of the Committee considered that to adequately base any decision for modifying or maintaining the leading interest rate, it would be convenient to clarify the factors that suggest continuing to restrict monetary conditions, such as those that advise to maintain restricted or relaxed conditions.

For that purpose, the heart of the Committee presented, on one hand, the elements that advise to not modify the level of the leading interest rate for monetary policy, among them are the following:

i) Even though the (inter-annual) rhythm of total inflation in August was higher than July, the domestic inflationary rhythm was reduced, situation which would bring somewhat of a breather to the monetary policy;

ii) The subjacent inflationary rhythm observed in August decreased in comparison to July; and,

iii) The econometric projection of the referred variable for December, 2005 and 2006 was also reduced, which could suggest that it is not necessary to modify the monetary conditions.

On the other hand, other factors were also discussed which advise restricting monetary conditions, among them are:

i) The econometric projection of total inflation for December, 2005 increased according to the data calculated to July, situation which could be related to the fact that even though the inflation in August was lower than that of July, it was not as low as it should have been to comply with the estimations made the previous month;

ii) In the same sense, a member of the Committee emphasized on two elements that advise the restriction of the indicated monetary conditions, on one hand, that the inflationary rhythm registered in August (9.37%) is the highest it has been in the last four years and, on the other hand, that this is the first time the total inflationary projection for December 2006 exceeds the upper range goal (6%), which has to be considered carefully due to the fact that on the temporary horizon of a scheme of explicit goals for inflation, not only does it have to center on the current situation of inflation, but also in the medium range.

iii) To this date the fiscal policy has offered important support in the monetary, which is reflected in the highest maintenance of deposits in the central bank according to the programmed. However, the programming of till of the government points out an important increase in the use of resources, that in the last three weeks has manifested itself in a reduction of the referred deposits (approximately Q865.0 million between August 22 to September 9, 2005.) The acceleration programmed in the budget execution rhythm will imply the need to increase the level of operation in the open market in order to avoid inflationary risks through here. Regarding this, one member of the Committee pointed out that from the beginning of the second semester the operations level in the open market has been situated below the programmed and that if the interest rate level does not look attractive to investors, the flow of resources associated to the programmed budget execution could not channel itself toward open market operations, inducing higher inflationary pressure.

iv) Another member of the Committee pointed out that he foresees that the economic activity will continue with the same dynamics that have been observed to this date, aspect from which we can infer that there is still room to restrict monetary conditions. In the described context, the Committee agreed to continue to delve deeper into the analysis of the mentioned factors in order to count on the adequate foundation for the next session, with the support of the experts of the *Banco de Guatemala*, who must consider the current and future evolution of the international oil price, as well as the effects the same has on the level of prices and on the economic growth of the country and review the most recent projections on the behavior of international oil prices.

Regarding the quota determinations for the biddings of the following week, the information provided for estimated daily flow of monetization for the week of September 9 to 14 was taken into account as the established rule for the determination of quotas, based on what the Committee agreed with the quota for raising funds for the 91 and 364 day terms to be convened on Mondays to be Q13.0 million for each one and the 182 and 728 day terms to be convened on Wednesdays of Q16.0 million for each term.

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

Regarding the analysis of the monetary situation, the Execution Committee agreed that for the week of September 12 to 16, 2005, it should maintain the execution guidelines for the monetary policy observed during the present week; in other words, continue operations in MEBD and in the stock exchange, in raising funds as well as in giving liquidity to the market.

The raising funds operations at 7 day term, without quota, at an interest rate of 3.50%, whereas, the proposal for the liquidity offer at a 7 day term, at an initial interest rate of 7.65%, whose guarantee of said operations will be constituted receiving only public titles. It is worth mentioning that the Committee reiterated the importance of participating in both venues; in other words, maintaining simultaneous positions for giving liquidity to the market and retiring liquidity, considering that said participation constitutes a sign of disposition of the Central Bank for moderating the volatility in the short term interest rate.

The Committee, taking into account the agreed in coordination matters with the fiscal policy for the participation in the money market, agreed that the summons for biddings for long term deposits should continue on Mondays, Wednesdays and Fridays of every week; therefore; on Monday, 91 day terms and 364 day terms, with a quota of raising funds of Q13.0 million for each term; and on Wednesday, the 182 day and 728 day terms, with a quota for raising funds of Q16.0 million, for each terms. 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 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 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, an advisor to the Committee declared that, derived from recent conversations held with experts from the *Banco de la República* (Colombia), he is worried because the accumulation of international reserves, resulting in the application of the third threshold of the current exchange regulations, in an environment where the level of inflation is above the goal, it could be interpreted as an inconsistency of monetary policy, which suggests an evaluation of the convenience of modifying the second and third thresholds of the regulations of exchange participation, since the same could generate the referred inconsistency. In that respect, a member of the Committee indicated that as a part of the criteria that an inconsistency risk exists, due to the relative rigidity of the third threshold; but that any modification to the exchange regulations must be analyzed with caution, because it could have counterproductive effects in the expectations of economic agents, therefore, before making a decision of the described nature, it is fundamental to know, with precision, the way in which the monetary transmission mechanism works, which forms part of the structure model in which the central bank experts are working, which evidences the urgency for having such a model. In that same sense, another member of the Committee agreed indicating that for the adoption of a measure like the above-mentioned, the more educated opinions had; the better the decision will be.

The Committee agreed to continue participating in the SINEDI through the rules of participation established for the effect.

FIFTH: Other matters.

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