EXECUTION COMMITTEE

ACT NUMBER 47-2005

Session 47-2005 celebrated in the *Banco de Guatemala* building, on Friday, September twenty-third, 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 46-2005, corresponding to session celebrated on September 16, 2005.

(Project deeds circulated.)

SECOND: Evaluation of the positions for bidding of Term Deposits in *quetzales*.

Number DP-116-2005.

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 46-2005.

SECOND: Evaluation of the bidding positions for Term Deposits in *quetzales*.

No. DP-116-2005.

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 2913 days (8 years), at an interest rate of 8.50%; and taking into account the yield curve for reference calculated through interpolation of current interest rates for public titles, agreed to refuse positions received at 8 year terms and only award the position received at 4 year terms for Q20.0 million.

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 September 19 to 23, 2005, with partial numbers to this date, they registered raising funds of CDP's for Q2, 341.4 million and maturity for Q1, 846.3 million, which gave a result of net maturity for Q495.1 million, associated to the operations performed in bidding (net maturity for Q30.0 million), in the Electronic Banking Money Table –MEBD- and in the stock exchange (net maturity for Q451.0 million) and in window (net raising funds for Q14.1 million).

Regarding applied interest to raising funds of CDP's, they indicated that during the September 19 to 22, 2005 period, for bidding cases the cut interest rates were of 5.00% for 91 days, 5.5999% for 182 days, 6.2499% for 364 day and 6.9397% 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 3.75%.

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 19 to 23, 2005 period, with partial data to date, the minimum was 2.26%, observed on September 21, 2005, and the maximum was 3.93%, registered on September 23, 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 2.85% for public titles and of 3.88% for titles from the financial sector. On the other hand, they informed that during the September 19 to 23, 2005 period, regarding the treasury bonds operations they registered a maturity for Q0.3 million.

As to biddings for long term deposits in dollars from the United States of America, made on September 20, 2005, it was mentioned that there were biddings of purchase order for Q100.0 thousand for a 91 day term, at an interest rate of 6.0% and Q13.0 thousand for a 336 day term at an interest rate of 4.0%, which were not allocated. Regarding the Institutional Foreign Currency market they informed that during the September 16 to 22, 2005 period, the average daily purchase operations were for US$58.8 million and sales were of US$63.0 million and that the exchange rates showed a tendency to the rise. In effect, on Friday, September 16 it was Q7.59904 for US$1.00 for purchase and Q7.62507 for US$1.00 for sale, on Monday, September 19 they were Q7.60247 and Q7.62470, on

Tuesday, September 20 they were Q7.61035 and Q7.62594, on Wednesday, September 21 they were Q7.60730 and Q7.62585 and, finally, on Thursday September 22 they were 7.61131 and Q7.62780.

Regarding the electronic systems operations for negotiation of foreign currency administered by the National Stock Exchange, S.A., corresponding to the September 19 to 23, 2005 period, they commented that the Private Institutional System for Foreign Currency –SPID-, made the following operations: Monday, September 19 for US$1.5 million, at a pondered exchange rate of Q7.62500 on Tuesday, September 20 for US$2.0 million, at Q7.62500; on Thursday, September 22 for US$500.0 thousands, at Q7.63900; and on Friday, September 23 for US$200.0 thousand, at Q7.65400. 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 Q7.58900, according to the guidelines of the Execution Committee.

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 19 to 23, 2005 period. As to the closing, for reference, on Friday, September 23 they indicated that the maturity to liquidate in March of 2006 was of Q7.71000.

b) The director of the Economic Studies Department informed that on September 22, 2005, the excess of daily float and the average of the banking system were located in a position of Q75.0 million with an average position of Q190.2 million. It was highlighted that in the period of September 15 to 22, 2005, the main demonetizing factors was the increase in the term deposit balances in the *Banco de Guatemala* for Q395.2 million, while the deposits of the rest of the public sector in the Central Bank for Q248.1 million; while the monetizing factors were the decreased banking float balance for Q313.5 million and the deposits of the Central Government in the *Banco de Guatemala* for Q56.8 million; and the increase in the balance of the Net International Reserves –RIN- for the equivalent of Q0.8 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 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 15, 2005, the lower limit was of 3.02%, whereas the upper limit was at 10.92%, while the resulting simple average between repurchase agreements at 8 to 15 days (3.63%) and the average pondered rate of the open market operations –OMA- of up to 91 days (3.70%) was located at 3.67%, 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 15, 2005, the inferior limit was of 6.30% and the upper limit of 7.88%, as to the pondered average rate of long term deposits in the banking system was of 6.91%, which is within the parity passive rate range, which advises an invariable monetary rate.

Regarding monetary issue observed to September 22, 2005, they indicated that the present deviation of Q412.1 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 15, 2005, they exhibited an inter-annual growth of 14.9%, which is within the estimated range for said variable on the same date (14.0% to 16.0%), 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 21.2%, which is above the upper limit of the estimated range for September 15, 2005 (18.3% to 20.3%), 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 15, 2005, was of -2.83 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 variables 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.

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 23 to 29, 2005 indicate an increase in the creation of primary liquidity for Q2, 807.8 million, fundamentally due, to maturity of CDP's. They also foresee an increase in the demand of monetary issue for Q177.3 million and an accumulated position for banking liquidity for Q163.8 million. Also, that the monetary issue is deviated in Q540.7 million above the central programmed point of said variable, therefore the excess of added liquidity for the referred periods is located at Q3,335.4 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 CDPs that expire during that period (Q2,607.2 million, according to registries to September 22, 2005) have to relocate; and, also, make additional raising funds for about Q728.2 million.

The Committee discussed the petition proposed by the Monetary Board in the last session, regarding the elimination of the reception of long term deposits due to the cost of said raising funds represent for the execution of the monetary policy. For the effect, the Committee received the analysis made by the technical bodies on the origin and justification of said operations, as well as the pros and cons of continuing the operations of said terms.

i) The funds raising of CDPs through long term deposits (like those of 6 to 8 years) have the purpose of the Central Bank gradually changing its debtor position regarding the money market toward a lesser debt or a neutral position, aspect that is convenient for the complete adoption of explicit inflation goal schemes (like those suggested by the technical assistance missions of the International Monetary Fund –IMF-), at the same time it strengthens the credibility of the monetary policy by anchoring the fundamental objective firmly.

ii) According to the recommendations of the report made by Sebastián Edwards and Rodrigo Vergara (November 20004), the *Banco de Guatemala* must separate monetary policy from the policy they call 'internal debt' (long term CDPs). Given the *Banco de Guatemala* has a significant balance with the Open Market Operations –OMAs-, continuous roll over is necessary. In that regard they suggested: a) bid for quotas in a way that the market determines the interest rate; b) Gradually increase the terms for fund raising to avoid the risk of significant accumulation of a great amount of maturities in a short period of time. c) Concentrate on the debt (Long term CDPs) in two or three terms, so that the market for said titles deepens.

iii) On the other hand, the recommendations report of the *Inflation Targeting* mission for the IMF (June, 2005), also indicate that the *Banco de Guatemala* must configure a yield curve that includes fund raising of long term CDPs; however, they emphasize that the number of said terms should not be more than three. That allows, on the one hand, generation of important points of congruent liquidity with the management of inflation expectations in the mid-term and, on the other hand, that it not compete unnecessarily with the placement of Treasury Bonds of the *Ministerio de Finanzas Públicas* [Equivalent to the Department of the Treasury of the United States of America], whose purpose is to finance the budgetary execution and not the management of primary liquidity of the economy. Due to the above, the elimination of the mentioned terms could be congruent with the economy. Due to the above, the elimination of mentioned terms could be congruent with the recommendations of the IMF (that were also made before by Professor Sebastian Edwards), in the sense that the Central Bank offer less terms for fund raising.

iv) The evidence presented by the technical departments indicates that, even though there were increases in the leading interest rate of the monetary policy (7 day CDPs), the interest rates of the rest of the current terms would not increase in a relevant manner, which could be associated with the economic agents discounting a minor inflationary premium (Fischer effect) in the interest rates that require long term investments, an element that, at the same time, associates with major credibility on the part of the investors in the monetary restriction measures.

v) To illustrate the costs of the mentioned operations, the technical departments presented a calculation that indicates the cost in which the monetary policy incurs over the raising of funds by the CDPs for 6 and 8 years to rise an average of Q6.0 million annually, over what it would incur if the raised funds for said terms would be transferred to immediately inferior terms, therefore the elimination of said terms could generate financial savings in that amount.

vi) It was indicated that said analysis of the additional financial cost for the operations of longer terms in comparison to the fund raising in the short term is also valid for any term longer than 7 days, if the relevant consideration to define the terms of the OMAs were only financial costs, they should eliminate all the 7 day CDP terms, that are different. That, however, would not be advisable, to generate a concentration of maturities in the short term, would place the bank in a vulnerable situation and could impress volatility in the interest rates of the market.

vii) Finally, they considered the Guatemalan financial market does not count on a developed secondary market in that, due to the fact that the *Ministerio de Finanzas Públicas* [Equivalent to the Department of the Treasury of the United States of America] concluded to place Treasury Bonds for 2005, two months ago; so the long term CDPs provide a channel for excess liquidity that, otherwise, could be transferred to a greater expansion of banking credit for the private sector, aspect which could induce a relaxation of their own granting policy, in detriment of the credit risk, which could, on the one hand, produce a deterioration in the quality of the credit portfolio with the following negative effects in the current stability of the financial system and, on the other hand, generate an unusual increase in the imports and, as a consequence, in the deficit of the current account of the payment balance.

The committee debated widely on the presented elements. Some members were inclined towards the long term operations stand, because of the eminent temporary nature of the long term operations, that the costs (though higher) could be considered moderate given the favorable conjunction for its realization, that fills a blank in the financial market that softens in the reasonable management of banking liquidity, and that contributes to the objective of the central bank of gradually leaving a permanent debtor position with regard to the banking system, which will contribute to a more efficient scheme of explicit inflation goals. Other members of the Committee pointed out that it is prudent to find a balance between the achievement of operational goals that demand a scheme of inflationary goals and the achievement of objectives convenient for cost reduction of the OMAs, also highlighting that among the objectives is the reduction of the number of terms which are set for long term deposit bids, which could coincide with the cost reduction objective if they eliminated some terms which are financially more expensive. After the deliberation on the subject, the Committee concluded that whichever decision made for reduction of the number of terms currently available, would be taken congruently with the other operative measures that are implemented in the adoption of the scheme of inflationary goals, based on the program we requested the advisors have a proposal for next week. As soon as the corresponding decision is made, a member of the Committee suggested that, given the limited competition observed in the last weeks on the position of CDPs for 8 years, a measure that could be adopted, for now, is the establishment of a restricted quota for fund raising in said term, that promotes greater competition in that term and limits the financial costs of the associates. Taking into account this suggestion, the Committee agreed that the restricted quota be fixed (not higher than the intermediate terms) for the fund raising of term deposits for 8 years.

Regarding the determination of the quotas for the biddings of the following week, the daily proportionate flow of monetization estimated for the following week was taken into account and the established rules for the quota determination, based on what the Committee agreed, was the quota for funds raising for the 91 and 364 day terms to be convened on Monday be established at Q20.0 million each and for the 182 and 728 day terms be convened on Wednesday be Q20.0 million each. On the other hand, as indicated, we establish the fund raising quota at Q20.0 million for the 2,912 day 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 26 to 30, 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 3.75%, whereas, the proposal for the liquidity offers 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, on Wednesday, the 182 day and 728 day terms, with a quota for raising funds of Q20.0 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, for the 4 and 6 year terms without a pre-established quota for raising funds and the 8 year term with a quota for Q20.0 million. 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 as the *Ministerio de Finanzas Públicas* (Equivalent to the Department of the Treasury). On the other hand, the Committee agreed to continue funds raising 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 mobile average for each term, of the pondered average interest rate resulting from the four previous bidding events. As to the fund raising with the public, the interest rate, for each term cannot be higher than the corresponding pondered average from 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 without excluding the possibility that if the proposals that are received deserve a higher 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 awards for long term deposits expressed in said currency.

Regarding 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 for the effect.

FIFTH: Other matters.

Not having other matters to deal with, the session ends at seventeen hours and fourteen minutes, the attending parties sign in agreement.