EXECUTION COMMITTEE

ACT NUMBER 52-2005

Session 52-2005 celebrated in the *Banco de Guatemala* building on Friday, October fourteenth, two thousand five, at fifteen hours and thirty 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 acts number 50-2005, and 51-2005, corresponding to the session celebrated on October 7 and 13, 2005.
(The project of the act circulated.)

SECOND: Evaluation of the position of the bidding for Time Deposits in *quetzales* No. DP-124-2005.

THIRD: Market information and monetary variables.

a) Money and Exchange markets.

b) Monetary Variables

FOURTH: Inflation Risk Balance

FIFTH: 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 50-2005 and 51-2005.

SECOND: Evaluation of the positions of bidding for time deposits in *quetzales* No. DP-124-2005.

The committee conceded the received positions of bidding for the Time deposits -LTD- long term deposits (Q160.0 million for 1457 days (4years), at an interest rate of 7.25% and 9.00%; Q5.0 million for 2184 days (6 years), at an interest rate of 7.75%; and Q20.0 million for 2912 days (8 years), at an interest rate of 8.40%, observing that when taking the yield curve as a reference calculated through the interpolation of the current interest rates for public titles, agreed to adjudge the first bid received for a four year term for Q150.0 million, the bid received for a 6 year term for Q5.0 million and two bids received for 8 year terms for Q20.0 million.

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, regarding the Money market informed that during the period from October 10 to 14 of 2005, with partial figures to this date, registered an attraction of LTD's for Q2,107.9 million and maturity of Q2,337.5 million, which gave a net result of attraction for Q229.6 million, associated to the operations in bidding (net attraction for Q6.8 million), in the Money Electronic Banking Table –MEBD- and in the stock exchange (net attraction of Q82.0 million) and at the window (net attraction for Q154.4 million).

Regarding the interest rates applied for attraction of the LTD's, it was indicated that during the October 10 to 13, 2005 period, in the case of biddings, the cut interest rate was of 5.00% for 91 days and 6.1998% for 364 days. For its part the MEBD and the stock exchange attractions were made for 7 days, at an interest rate of 3.75%.

As for the weighted average interest rates of total operations of repurchase agreements made in the stock exchange of the country, it was indicated that, during the October 10 to 14, 2005 period, the minimum was of 2.80%, observed October 14, 2005, and the maximum of 3.92%, registered on October 10, 2005. It also pointed out that the amounts negotiated were higher with public titles and that the average weighted interest rates during said period were of 3.07% for public titles and of 4.76% for the financial sector titles.

On the other hand, it was informed that during the October 10 to 14, 2005 period, regarding Treasury Bonds operations the maturity was registered for Q0.5 million.

As for biddings on time deposits in US dollars, convened on October 11, 2005, it was mentioned that there were no bids declared.

Regarding the Institutional Market for foreign currency the report stated that during the period of October 6 to 13, 2005, the average daily operations for purchase were of

US$57.0 million and the sale was of US$55.2 million as the exchange rates showed a slight tendency to rise. In effect, on Thursday, October 6 they were of Q7.72428 per US$1.00 for purchase and of Q7.74840 per US$1.00 for sale, on Friday, October 7 the rates were Q7.73429 and Q7.76264, on Monday, October 10 they were Q7.73670 and Q7.77097, Tuesday, October 11 they were Q7.74224 y Q7.77123, and finally, on Thursday, October 13 they were Q7.74109 y Q7.76938.

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.), corresponding to the period of October 7 to 14 of the current year, commented that in the Private Institutional Foreign Currency System –SPID-, the following operations took place on Monday, October 10 for US$400.0 million at an average weighted exchange rate of Q7.77250 and on Thursday, October 13 US$200.0 thousand, at Q7.76850.

In the Electronic Foreign Currency Negotiation System –SINEDI-, they declared that during said period no operations were held and only the *Banco de Guatemala* took in daily purchase bids for US$10.0 million, whose prices were the following; for Friday Q7.67074, for Monday, October 10 for Q7.68529, for Tuesday, October 11 Q7.69516, for Thursday, October 13 for Q7.70226 and for Friday October 14 for Q7.70684.

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 October 7 to 14, 2005, did not close operations. As for the closing reference price up to Friday, October 14, they indicated that for maturity to liquidate in December of 2005 the price was Q7.76900, and for the maturity to liquidate in March of 2006 it was of Q7.78000.

b) The director for the Economic Studies Department informed that on October 13, 2005, the excess of the daily float of the banking system was located in a position of Q573.5 million, with an average position of Q56.1 million.

The highlights during the period of October 6 to 13, 2005, were the main demonetizing factors that were the decrease in balances of the long term deposits constituted in the *Banco de Guatemala* for Q369.9 million, of the deposits of the Central Government in the *Banco de Guatemala* for Q245 million; while the main demonetizing factors were increased in the balance of the banking float for Q283.9 million and the deposits of the rest of the public sector in the Central Bank for Q45.6 million; and the decrease in balance of the Net International Reserve –RIN- balance for the equivalent of Q47.2 million.

Speaking of the indicative variables of the Monetary, Exchange and Credit Policy they indicated that with the projection to September, for December of 2005 the total inflation estimated with a model of ordinary squared minimums is of 7.50% and with a softened exponential model of 9.04%; the simple average of both models is located at 8.27%, 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 September 2005, estimated with an integrated auto-regression model of mobile averages ARIMA, was of 7.52%, whereas the estimated with a softened exponential model it was of 7.93%; the simple average of both models is of 7.73%, which is above the policy range goal (4.0%-6.0%), which suggests a restrictive monetary policy.

As to the parameter rate, up to October 6, 2005, the lower limit was 3.63%, and the upper limit is 11.53%, while the simple average between the repurchase agreements of 8 to 15 days (3.89%) and the weighted average rate of open market operations –OMA- of up to 91 days (3.91%) was situated at 3.90%, 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 October 6, 2005, the lower limit was 5.62% and the upper limit was 7.20%, and the weighted average rate of long term deposits of the banking system was of 6.93%, 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 October 13, 2005, they indicated that it presents a deviation of Q425.7 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 October 6, 2005, it exhibited an inter-annual growth rate of 15.6%, which is within the estimated range for said variable on that same date (14.8% to 16.8%), 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 19.5%, which is above the upper limit of the estimated range for October 6, 2005 (16.4% to 18.4%), which suggests a restrictive monetary policy.

As to inflation expectations of private analysts, they indicated that according to the poll made in September of 2005, for December of 2005 an inflationary rhythm of 8.66% 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 October 6, 2005, was -3.66 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.

On the other hand, the Consumer Price Index information to September presented, based on the report by the National Statistics Institute, INE, (monthly inflation was of 0.85%, higher by 0.49 percentage points to that of August 2005; the inflationary rhythm was at 9.45%, higher by 0.08 percentage points to that of August 2005 and higher by 1.4 percentage points to the observed in September 2004; the subjacent inflation registered a rhythm of 7.93% lower by 0.14 percentage points to that of August 2005 (8.07%) and lower to that of September of 2004 (8.01%); as well as the estimations of the imported and domestic inflation components (from 9.45% of the inflationary rhythm to September 2005, 3.67 percentage points are attributable to the imported inflation, which, at the same time, 2.71 percentage points correspond to the indirect imported inflation (second round effect); therefore, from the inflationary rhythm 5.78 percentage points correspond to domestic inflation).

FOURTH: 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 foreseen for the week of October 14 to 19, 2005 indicate an increase in the creation of primary liquidity for Q1, 365.1 million, fundamentally due to the maturity of LTD's. Also, a decrease in the demand for monetary issue for Q112.1 million is foreseen and a daily banking liquidity position for Q307.5 million. Also, monetary issue is deviated in Q554.5 million above the central programmed point for said variable, therefore the excess of liquidity added for the referred period is located at Q2, 339.3 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 (Q1.432.4 million, according to registries to October 13, 2005) have to be relocated; and also, make additional raising funds for around Q906.9 million.

Based on the information received, the Committee began a discussion on the decision that will have to be adopted in their next session in order to modify or maintain the level of the leading interest rate for the monetary policy. In that sense, the factors that advise to increase the interest rate as well as those that advise to keep it invariable were analyzed.

Regarding the first, the following can be mentioned:

1. That the inflationary rhythm continued increasing and that the registered to September (9.45%) is highest in the last four years and the second highest in the last eight years.
2. That the accumulated inflation (6.69%) surpassed the upper limit of the programmed goal range (6%) and that, in the context of rising inflationary expectations, it is unlikely that a negative inter-monthly inflation would be registered in the next months, therefore it is evident that the inflation goals for the end of the year will not be fulfilled, situation that strongly advises the Central Bank to restrict the monetary conditions in order to restrain the inflationary expectations associated to said behavior.
3. That with the observed increase of the inflationary rhythm as well as accumulated inflation; the inflation expectations for December 2005 by the private sector

analysts for the present month could be foreseen as rising regarding those registered last month.

4. That with the increase observed in the indirect imported inflation (second round effect) the adjustments to the inflationary expectations rise are confirmed on behalf of the economic agents, which deeply involves the risk that these are discounting a greater inflationary rate.
5. That the consequences for Guatemala from Tropical Storm Stan in inflationary matters, since we are dealing with shock offer, make it likely that for this month a greater volatility will be registered in the prices, mainly in the agricultural and animal products, which in the short term could be translated into greater inflationary pressure.
6. That in the context of monetary policy execution within the monetary scheme of explicit inflation goals, the most important thing within a Central Bank is the follow-up of expected subjacent inflation, in order to opportunely act in the achieving of the set inflationary goal for the short term. In that sense, emphasis was made in that the observed rise with data from September in the econometric projections of said variables for December 2005 and 2006, suggest increasing the leading interest rate for the monetary policy.
7. If a good part of inflation is explained due to the effects of imported inflation, we must be aware that said inflation generates inflationary expectations that can self-fulfill or generate behavior in the economic agents that unbalances the economic resource assignments; therefore the Central Bank must act opportunely in order to appease the inflationary expectations.

Regarding the factors that are against modifying the leading interest rate of the monetary policy the following were indicated:

1. That in the present month the international price of oil is being restrained, which could contribute to partly reducing the inflationary pressure through said channel.
2. That the inter-annual variation of the observed subjacent inflation in September declined regarding that of August, evidencing the non-monetary nature of monthly inflation.

3. That in spite of the emergency situation derived from Tropical Storm Stan, that would imply the need to expand public expense in the remainder of 2005 for the rehabilitation activities that correspond to the Central Government, the evolution of the budget execution to date according to the programmed, and according to the *Ministerio de Finanzas Públicas* (Roughly equivalent to the Department of the Treasury), makes it foreseeable that it would be unnecessary to recur to a significant monetary expansion, therefore, the actions of the monetary policy should be prudent.

In order to count on more elements of judgment for correct decisions in the current occasion, the committee was presented with a report by the technical departments on the role the monetary policy must have after a natural disaster, like the one that occurred recently in Guatemala. In the report it indicates that the monetary policy analysis must focus on the following parameters: that a hurricane is an offer shock, therefore disaster is a temporary shock and that the immediate measures to soften the humanitarian crisis are those oriented to the reconstruction of the economic productive capacity. In that sense, the following arguments are emphasized:

i) Offer Shock. Hurricane Stan is an offer shock that directly affects the added economic production function, which means that said phenomenon can produce unemployment and price increase (since the curve of added offer to the economy moves toward the left). The fact that it is offer shock, function added from production, implies that the solution to said problem must be held in the measure that they induce the adjustment on the offer side. In that context, the monetary policy has no incidence on the necessary adjustment, since it only counts on the instruments that affect the economy demand. This means that the monetary administration must continue with its function of maintaining price stability.

ii) Horizon of the problem. The disaster generated by the hurricane is of a temporary nature, which implies that it requires temporary measures. This is based on the economic principle that indicates that a problem of temporary nature can be financed, while a permanent one requires an adjustment to the economy. This reinforces the expressed in the sense that the monetary policy must continue fulfilling its fundamental objective, which is to maintain the stability of the general level of prices, and it pertains to the government to introduce the temporary measures to finance the destined actions to correct the problems of the emergency period as well as of the reconstruction.

iii) Periods of Crisis and Reconstruction. The measures to be adopted to reestablish the economic activity must orient themselves toward resolving the immediate or emergency problems and those of mid and long terms to make the orderly growth of the country's economy. In the emergency period (typified by the humanitarian actions) the economic considerations were secondary, being able to count on international help, to external indebting or the introduction of temporary taxes to finance the measures. On the contrary, the reconstruction measures require actions in mid and long terms, considering economic and prudent economic themes that allow solid economic growth. It is worth mentioning that a natural disaster like hurricane Stan negatively affects the physical and productive infrastructure of the country, which implies shrinking of potential production. That is why the oriented actions to reestablish the productive capacity of the economy are the responsibility of the public finance sector, physical infrastructure, and the private sector through the productive investment, while the contribution to the monetary policy is reduced to propitiating macro economic stability.

iv) The role of the monetary policy in the emergency period. In this period the offer shock generates volatility in the short term in the level of prices of various products, therefore the monetary policy must be oriented especially toward calming the inflationary expectations that could be generated. An example is the recently observed in the United States, where after a few days after the devastation of Hurricane Katrina, the Federal Reserve continued adjusting the objective rate of the Federal Reserve with the object of abating inflationary pressures. In that sense, in Guatemala's case, the policy decision must also be within the context of the analysis of inflation projections that could be influenced by the offer shock and its consequent impact on inflationary expectations.

v) The role of the monetary policy in the reconstruction of the economy. The reconstruction, as was mentioned, must be sustained in the solid and orderly growth of the national economy. This implies that the central bank must maintain stable prices to induce adequate behavior as well as the expectations of the economic agents as a stable and solid macro economic stage. It is important to point out that the uncertainty generated by inflation can negatively affect the reconstruction ability of the country, since said uncertainty is highly pernicious to private investment, fundamental pivot for the reconstruction of the national economy's productive activity. The empiric international evidence corroborates the mentioned, since in countries like Mexico and the United States, that have been affected by similar disasters, have maintained the orientation of the monetary policy toward the stabilization of prices maintenance, since there is the possibility of a solid and sustainable recuperation of the domestic economy.

The Committee debated on the information presented and several of its members coincided in that the monetary policy must be firm, in the current circumstances, in order to appease the inflationary expectations derived of natural disasters and, at the same time, set the bases for the recovery of the sustainable economy in a climate of stability. However, some members of the committee indicated that, notwithstanding the indicated, it is convenient to evaluate the situation more slowly, in light of the particular case of Guatemala with the effects of Hurricane Stan, since even a moderate rise in the leading interest rate with difficulty would have a negative effect sensible to the credit flow of the economic activity, in the current occasion it is prudent to count on more information on the real magnitude of the damage in order to foment the monetary policy division. In that sense, the Committee agreed to continue deepening the analysis of the mentioned factors in order to count on, with an added degree of certainty, with the adequate fundamentals in order to decide on the next session, if the leading interest rate level is adjusted or maintained for the monetary policy.

Regarding the determination of the quotas for the bids for the following week, the information provided by the daily monetization flow estimated for the following week and the established rule for the determination of quotas, therefore the Committee based on this agreed that the quota for fund raising for the 91 and 364 day terms to be convened on Monday will be established at Q15.0 and Q30.0 million, and for the 182 and 728 day terms to be convened on Wednesdays be of Q25.0 million for each. On the other hand, a fund raising quota for the 2, 912 day (8 years) term of Q25.0 million to be convened on Fridays was established.

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 October 17 to 21, 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 terms, 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, with a fund raising quota for Q15.0 million and Q30.0 million, and on Wednesday, the 182 day and 728 day terms, with a fund raising quota of Q25.0 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 fund raising quota and the 8 year term with a quota for Q25.0 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 the raising of 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 mobile average for each term, of the weighted average interest rate resulting from the four previous bidding events. As to the raising of funds with the public, the interest rate, for each term cannot be higher than the corresponding weighted 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 3.89% for the 336 day term, according to the agreed in session 48-2005, 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 weighted 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 any other matter to see, the session ends at sixteen hours and forty five minutes and all that attended, sign in agreement.