EXECUTION COMMITTEE

ACT NUMBER 54-2005

Session 54-2005 celebrated in the *Banco de Guatemala* building on Friday, October twenty-first, 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 act number 52-2005, corresponding to the session celebrated on October 14, 2005.
(The project of the act circulated.)

SECOND: Evaluation of the position of the bidding for Time Deposits in *quetzales* No. DP-127-2005.

THIRD: Market information and monetary variables.

a) Money and Exchange markets.
b) Monetary Variables

FOURTH: Inflation Risk Balance

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

SIXTH: Other matters.

Not having more observations, the committee approves 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 52-2005.

SECOND: Evaluation of the bidding positions for Term Deposits in *quetzales*. No. DP-127-2005.

The Committee recognized the positions received in the bidding for long term deposits –CDP's- (10.0 million for 1456 days (4 years), at an interest rate of 7.28% and 7.30%; Q25.0 million for 2184 days (6 years), at an interest rate of 7.75%; and, Q1.0 million for 2912 day (8 years), at an interest rate between 8.3998%), 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 for Q5.0 million, the three bids received for a six year term for Q25.0 million an the bid received for an 8 year term for Q1.0 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 October 17 to 21, 2005, with partial numbers to this date, they registered raising funds of CDP's for Q1,542.2 million and maturity for Q1, 077.7 million, which gave a result of net raising funds for Q464.5 million, associated to the operations performed in bidding (net raising funds for Q223.2 million), in the Electronic Banking Money Table –MEBD- and in the stock exchange (net raising funds for Q267.0 million) and in window (net raising funds for Q25.7 million).

Regarding applied interest to raising funds of LTD's, they indicated that during the October 17 to 19, 2005 period, for bidding cases the cut interest rates were of 4.9999% for 91 days, 5.3999% for 182 days, 6.1998% for 364 day and 7.00% for 728 days. For their part, the MEBD and the stock exchange raising funds were for 7 day, and the interest rate was of 3.75%. As to the weighted average interest rates of the total operations the repurchase agreements in the stock exchange of the country indicated that during the October 17 to 21, 2005 period, with partial data to date, the minimum was 2.13%, observed on October 19, 2005, and the maximum was 3.83%, registered on October 18, 2005. Also, it was pointed out that the negotiated sums were higher with public titles and that the weighted average interest rates for said period were of 2.54% for public titles and of 4.20% for titles from the financial sector.

On the other hand, they informed that during the October 17 to 21, 2005 period, regarding the treasury bonds operations they registered a maturity for Q40.2 million.

As to biddings for long term deposits in US dollars, convened on October 18, 2005, there were no demands on the bid presented.

Regarding the Institutional Foreign Currency market they informed that during the October 13 to 19, 2005 period, the average daily purchase operations were for US$57.1 million and sales were of US$58.1 million and that the exchange rates showed a tendency to decline. In effect, on Thursday, October 13 it was Q7.74109 for US$1.00 for purchase and Q7.76938 for US$1.00 for sale, on Friday, October 14 they were Q7.74023 and Q7.76468 on Monday, October 17 they were Q7.71849 and Q7.74147, on Tuesday, October 18 they were Q7.68637 and Q7.70870 and, finally on Wednesday, October 19 they were Q7.64062 and Q7.67955.

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 October 14 to 21, 2005 period, it was commented that in the Private Institutional System of Foreign Currency –SPID-, there were no operations. Regarding the Electronic Negotiation System for Foreign Currency –SINEDI-, it was said that during the period there were no operations, and only the *Banco de Guatemala* on October 14 received a purchase position for US$10.0 million, at a price of Q7.70684, according to the guidelines of the Execution Committee.

On the other hand, the National Stock Exchange Company informed that in the Futures Market for Foreign Currency, did not close operations for the October 14 to 21, 2005 period. As to the closing price, of reference, on Friday, October 21, they indicated that for the maturity to liquidate in December 2005 was for Q7.63670, for the maturity to liquidate in March 2006 was for Q7.68100.

b) The Sub-director for the Economic Studies Department informed that on October 20, 2005, the excess of the daily float of the banking system was located in a position of Q144.4 million, with an average position of Q190.7 million.

The highlights during the period of October 13 to 19, 2005, were the main demonetizing factors that were the increase in balances of the long term deposits constituted in the *Banco de Guatemala* for Q450.6 million, and the deposits of the public sector of the Central Bank for Q36.3 million; and the decrease in balance of the Net

International Reserve –RIN- balance for the equivalent of Q186.4 million; while the main monetizing factors were the decrease in the banking float balance for Q446.5 million and the deposits of the Central Government in the *Banco de Guatemala* for Q166.7 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 13, 2005, the lower limit was 3.86%, and the upper limit is 11.76%, while the simple average between the repurchase agreements of 8 to 15 days (3.86%) and the weighted average rate of open market operations –OMA- of up to 91 days (3.96%) was situated at 3.91%, 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 13, 2005, the lower limit was 5.65% and the upper limit was 7.23%, and the weighted average rate of long term deposits of the banking system was of 6.92%, 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 19, 2005, they indicated that it presents a deviation of Q524.7 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 13, 2005, it exhibited an inter-annual growth rate of 16.4%, which is within the estimated range for said variable on that same date (15.1% to 17.1%), 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 19.4%, which is above the upper limit of the estimated range for October 13, 2005 (16.1% to 18.1%), 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 13, 2005, was -3.78 percentage points which is within the range estimated for said variable on that date (-4.19 to -2.59 percentage points), which advises that monetary policy should remain invariable.

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

FOURTH: Inflation Risks Balance.

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

As to external conditions, the prices of international oil have declined recently, up to this date in the year have been higher than the estimated at the end of 2004, therefore it continues to be the main inflationary risk. With the cited behavior, without considering the effects of Tropical Storm Stan, the econometric projection average of the inflationary rhythm for December 2005 increased 7.53% with the numbers to August, at 8.27%, with the information to September.

They made mention that the impact of external inflation continues being a risk as long as the composed inflation index of the main commercial partners of Guatemala continue increasing, particularly because the inflationary rhythm of the United States of

America (country with relatively greater weight within the index) increased from 3.6% in August to 4.7% in September. The registered inflation in September was highlighted in said country (1.20%, associated to the increase in transport and energy) is the highest since March 1980. The previous implied that through external inflation greater pressures in domestic inflation could be presented.

Regarding the effect that the economic policy measures in the United States could have on domestic inflation, it was indicated that in spite of the efforts made in monetary policy matters in said country, the fiscal effort is not as fast or deep and the deficit in current account is not contained, therefore the existing risk is the cessation of the monetary restriction without correcting the fiscal and that, therefore, the capital flow of the United States is renewed in the rest of the world, including Guatemala, which in the context of monetary policy could imply some increase in the monetary offer that, if it would come about, would create inflationary pressures.

As to internal conditions, it was indicated that from the beginning of the second semester of the current year, the level of open market operations has been located under the programmed, whose monetizing effect has been compensated by a higher level of deposits in the Central Government in the *Banco de Guatemala* regarding the programmed for the same period, which reflects the support that the fiscal policy offers the monetary policy; however, in the last weeks a reduction in said deposits has been observed that indicate an acceleration in the budget execution rhythm, therefore the context of greater flow of resources toward the economy and if the level of interest rate is not attractive to investors, said flow of resources might not be translated into greater open market operations, inducing greater inflationary pressures.

Regarding the indicative variables, it was mentioned that if to the date that the variables are informed that suggest that the monetary policy be restricted are the same regarding the observed to August 19, four of them indicate that the monetary must be restricted (the projection of total inflation, the monetary issue, the banking credit to the private sector and the inflation expectations) with greater intensity and two variables suggest not modifying the monetary policy (the total payment means and the parameter rate) tend to restrict it.

The econometric projections prepared by the technical department, using data observed to September 2005 and December 2006, greater than the calculated the previous month, also agree with the deterioration of the balance of risks inflation. In that sense, the fact that the projection for 2006 surpasses 6% was emphasized, this puts into perspective the existence of the inflationary pressures that, in the absence of opportune measures, can manifest themselves in the medium term. On their part, the econometric projections of the subjacent inflationary rhythm for December 2005 and 2006 increased regarding the previous month.

It was indicated that it is probable, according to preliminary estimations, that an increase in prices be observed in the short term, as a consequence of the effects of tropical storm Stan, mainly in vegetables and produce, due to the decrease in offer of said products. Also, we expect an increase in the uncertainty on the general level of prices that have generated offer shock, which suggest restricting the monetary policy.

On the other hand, it was highlighted that the inter-annual variation of the subjacent inflation observed in September decreased regarding that of August, evidencing the non-monetary nature of monthly inflation, aspect that advises prudence in the decision-making of the monetary policy. The same orientation is obtained from the behavior of domestic inflation.

In spite of the emergency situation derived from tropical storm Stan that would imply the need to expand public expense during the rest of 2005 for the rehabilitation activities corresponding to the Central Government, the evolution of the budget execution according to the programmed date, and according to the information of the *Ministerio de Finanzas Públicas* (Equivalent to the Department of the Treasury), making if foreseeable that it is not necessary to recur to a significant monetary expansion, therefore, in that case, the actions of the monetary policy can be considered prudent.

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

a) Analysis of the monetary situation

The Committee took note that the monetizing and demonetizing factors foreseen for the week of October 21 to 27, 2005 indicate an increase in the creation of primary liquidity for Q2, 952.4 million, fundamentally due to the maturity of LTD’s. Also, a decrease in the demand for monetary issue for Q175.1 million is foreseen and a daily banking liquidity position for Q364.7 million. Also, monetary issue is deviated in Q653.1 million above the central programmed point for said variable, therefore the excess of liquidity added for the referred period is located at Q3, 795.1 million; if these factors are given, the Committee considered that it would be necessary to make the issue offer compatible with the demand programmed, that the LTD’s that expire during the period (Q2.575.9 million, according to registries to October 19, 2005) have to be relocated; and also, make additional raising funds for around Q1, 219.2 million.

Based on the information received, the Committee coincided that in the inflation balances risk to September have greater factor weighting that advise restricting the monetary policy. Notwithstanding the above, there was consensus in the Committee in the sense that in the current emergency situation that the country faces derived from tropical storm Stan, before making a monetary policy decision, it is advisable to wait for the quantification of the economic effects of the referred natural disaster, which we expect to have soon. On this, the technical bodies of the institution are in the process of collecting information, among others, from the following institutions: *Unidad de Políticas e Información Estratégica* -UPIE-(Policy Units and Information Strategy) of the *Ministerio de Agricultura, Ganadería y Alimentación* -MAGA-(Equivalent to the Department of Agriculture) ; *Coordinadora Nacional de Productores de Granos Básicos* -CONAGRAB-(National Coordinator of Basic Grains); *Asociación Nacional del Café* -ANACAFE-(National Coffee Producers Association); *Asociación de Cardamomeros de Guatemala* -CARDEGUA-(Cardamom Producers Association of Guatemala); and, *Compañía de Desarrollo Bananero de Guatemala* –BANDEGUA (Banana Development Company of Guatemala). Also, shortly we expect to count on the report of the destruction of Tropical Storm Stan made by the Economic Commission for Latin America and the Caribbean, CEPAL (for its acronym in Spanish), petitioned by the Government of the Republic, where the *Banco de Guatemala* participated in its making. In the heart of the Committee, it was pointed out that said evaluations will allow the approximate quantification the impact of the storm and the following reconstruction effort can have on the added demand and the macro economic equilibrium, which will serve as a base for the decision that the Committee will adopt on the leading interest rate in its November 18th, session. After the deliberations, the Committee resolved to issue the following Press Release:

"THE EXECUTION COMMITTEE MAINTAINS THE LEADING INTERST RATE OF THE MONETARY POLICY WITHOUT VARIATION AT 3.75%

The Execution Committee, in its session celebrated on October 21, 2005, decided to keep the leading interest rate of the monetary policy invariable.

There was consensus in the heart of the Committee, that in a normal situation (if there had not been Tropical Storm Stan), the leading interest rate would have had to be increased given the behavior shown to September in the general level of prices.

Notwithstanding the above, the Committee agreed that in the current emergency situation that the country is facing, it would be prudent to wait until the quantification of the economic effects of the natural disaster were tallied, which is expected in the short term."

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 Q20.0 and Q40.0 million, and for the 182 and 728 day terms to be convened on Wednesdays be of Q30.0 million for each. On the other hand, a fund raising quota for the 2, 912 day (8 years) term of Q30.0 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 24 to 28, 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 Q20.0 million and Q40.0 million, and on Wednesday, the 182 day and 728 day terms, with a fund raising quota 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, for the 4 and 6 year terms without a pre-established fund raising quota and the 8 year term with a quota for Q30.0 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 with the proposal of the exchange rule presented by the technical departments and later the corresponding analysis, the Committee agreed on some modifications and instructed that the modified versions be presented to the Monetary Board in its next session. Meanwhile they also agreed that the *Banco de Guatemala* continue participating in the SINEDI according to the established in session 53-2005 dated October 19, 2005.

SIXTH: Other matters.

Not having any other matter to determine, the session ends at sixteen hours and forty five minutes and all that attended, sign in agreement.