EXECUTION COMMITTEE

ACT NUMBER 58-2005

Session 58-2005 celebrated in the *Banco de Guatemala* building on Friday, November eleventh, 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 57-2005, corresponding to the session celebrated on November 4, 2005.

(The project of the act circulated.)

SECOND: Evaluation of the position of the bidding for Time Deposits in *quetzales* No. DP-136-2005.

THIRD: Market information and monetary variables.

a) Money and Exchange markets.
b) Monetary Variables

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

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 acts number 57-2005.

SECOND: Evaluation of the positions of bidding for time deposits in *quetzales* No. DP-136-2005.

The committee took note that bids for the Time deposits –LTD, (Q112.0 million at 2,912 days (8 years), at an interest rate of 8.40%) and, taking into account the yield reference curve, calculated through the interpolation of interest rates current for public titles, agreed to award a prorate of the established quota for Q10.0 million for the two bids received for 8 year terms.

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 November 7 to 11 of 2005, with partial numbers to date, registered an attraction of LTD's for Q1,299.3 million and maturity of Q975.9 million, which gave a net result of fund raising for Q323.4 million, associated to the operations in bidding (net attraction for Q199.9 million), in the Money Electronic Banking Table –MEBD- and in the stock exchange (net fund raising of Q265.0 million) and at the window (net fund raising for Q141.5 million).

Regarding the interest rates applied in fund raising through LTD's, it was indicated that during the period of November 7 to 11, 2005 for the biddings case, the cut interest rates were of: 5.00% for 91 days, 5.50% for 182 days, 6.2498% for 364 days; and 7.00% for 728 days. On the other hand, in the MEBD and in the stock exchange the fund-raising took place for 7 days, at the leading interest rate of the monetary policy 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 November 7 to 11, 2005 period, with partial data, the minimum was of 3.68%, observed November 11, 2005, and the maximum of 4.88%, registered on November 9, 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 3.77% for public titles and of 4.50% for the financial sector titles.

On the other hand, it was informed that during the November 7 to 11, 2005 period, regarding Treasury Bonds operations the maturity was registered for Q25.3 million.

Regarding the Institutional Market for foreign currency the report stated that during the period of November 4 to 10, 2005, the average daily operations for purchase were of US$61.2 million and the sale was of US$65.1 million as the exchange rates were stable. In effect, on Friday, November 4 they were of Q7.59188 per US$1.00 for purchase and of Q7.61783 per US$1.00 for sale, on Monday, November 7 the rates were Q7.59964 and Q7.63005, on Tuesday, November 8 they were Q7.59814 and Q7.62597, Wednesday, November 9 they were Q7.59355 y Q7.61732, and finally, on Thursday, November 10 they were Q7.59518 y Q7.62055.

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.), for the period of November 7 to 11 of the present year commented that the Private Institutional Foreign Currency System –SPID-, there were no operations. In the Electronic Foreign Currency Negotiation System –SINEDI-, they declared that during the period there were no operations and that the *Banco de Guatemala* received bids for the purchase of US$10.0 million, with a price of Q7.58900, according to the guidelines of the Execution Committee.

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 November 7 to 11, 2005, did not close operations. As for the closing price in reference up to Friday, November 11, they indicated that for maturity to liquidate in December of 2005 the price was Q7.62500, and for the maturity to liquidate in March of 2006 it was of Q7.63950.

b) The director for the Economic Studies Department informed that on November 10, 2005, the excess of the daily float of the banking system was located in a position of Q398.6 million, with an average position of Q532.1 million.

The highlights during the period of November 3 to 10, 2005, the main demonetizing factors were the increase in balances of the deposits for the Central Government in the *Banco de Guatemala* for Q67.6 million, the long term deposits constituted in the *Banco de Guatemala* for Q48.9 million and the rest of the deposits from the public sector in the Central Bank for Q46.1 million; and the decrease in the Net International Reserve –RIN- balance for the equivalent of Q60.0 million; while the main monetizing factors were the decreases in the banking float balance for Q19.3 million.

Regarding the indicative variables of the Monetary, Exchange and Credit Policy they indicated that with the projection to October for December of 2005 the total inflation estimated with a model of ordinary squared minimums is of 9.60% and with a softened exponential model of 9.81%; the simple average of both models is located at 9.71%, which is above the policy range goal (4.0%-6.0%), which suggests a restrictive monetary policy.

Regarding the expected subjacent inflation for 2005, with data up to October 2005, estimated with an integrated auto-regression model of mobile averages ARIMA, was of 7.57%, whereas the estimated with a softened exponential model it was of 8.62%; the simple average of both models is of 8.10%, which is above the policy range goal (4.0%-6.0%), which suggests a restrictive monetary policy.

As to the parameter rate, up to November 3, 2005, the lower limit was 4.22%, and the upper limit is 12.12%, while the simple average between the repurchase agreements of 8 to 15 days (4.25%) and the weighted average rate of open market operations –OMA- of up to 91 days (4.17%) was situated at 4.21%, which is located beneath the estimated for the parameter rate, situation that suggests a restrictive monetary policy. When referring to the parity passive rate, they declared that up to November 3, 2005, the lower limit was 6.05% and the upper limit was 7.63%, 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 advises an invariable monetary policy.

As to monetary issue observed to November 10, 2005, they indicated that it presents a deviation of Q387.2 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 November 3, 2005, it exhibited an inter-annual growth rate of 15.9%, which is within the estimated range for said variable on that same date (14.6% to 16.6%), which advises the monetary policy to remain invariable. Also, up to said date, the banking credit to the private sector registered an inter-annual growth rate of 20.5%, which is above the upper limit of the estimated range for November 3, 2005 (15.4% to 17.4%), which suggests a restrictive monetary policy.

As to inflation expectations of private analysts, they indicated that according to the poll made in October of 2005, for December of 2005 an inflationary rhythm of 9.14% 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 November 3, 2005, was -2.80 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 "parameter rate" variable went from suggesting that the monetary remains invariable to suggest it remain restrictive, giving an increase to six variables that suggest restricting the monetary policy (the total inflation projection, the subjacent inflation projection, the inflation expectations of private analysts, monetary issue and banking credit to the private sector and the parameter rate); there was a decrease to three variables suggest that monetary policy remain invariable (parity passive rate, Monetary Conditions Indexes and the total payment means); and none suggest to be lax with it.

On the other hand, the information of the Consumer Price Index was presented to October, 2005, reported by the National Statistics Institute –INE- (monthly inflation was of 1.76%, higher by 0.91 percentage points to that of September, 2005; the inflationary rhythm was located at 10.29%, higher in 0.84 percentage points to September, 2005 and higher by 1.65 percentage points to the observed in October, 2004; the subjacent inflation registered a rhythm of 8.52%, higher by 0.59 percentage points to that of September, 2005 (7.93%) and higher to that of October, 2004 (8.17%); the estimations of the imported and domestic components of inflation (from 10.29% of the inflationary rhythm to October, 2005, 3.18 percentage points are attributable to the imported inflation, of which, 2.05 percentage points correspond to the indirect imported inflation (second round effect); therefore, the inflationary rhythm, 7.11 percentage points correspond to domestic inflation). Additionally, it was indicated that the estimations of the technical departments of the Banco de Guatemala of the effect of Hurricane Stan in the inflationary rhythm increased to 1.01 percentage points, and if said effect is reduced to its domestic component of inflation, this in net terms is located at 6.10%.

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 previewed for the week of November 11 to 17, 2005 indicate an increase in the creation of primary liquidity for Q1,293.4 million, fundamentally due to the maturity of LTD's. Also, an increase is foreseen for the demand for monetary issue for Q6.0 million and a daily position of banking liquidity for November 17, 2005 for 577.4 million. Also, monetary issue is deviated in Q516.2 million above the central programmed point for said variable, therefore the excess of added liquidity for the referred period is located at Q2, 381.0 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 (Q1,665.3 million, according to registries to November 10, 2005) have to be relocated; and also, make additional raising funds for around Q715.7 million.

Based on the information received, the Committee began a discussion on the decision that they will have to adopt in their next session, whether to modify or maintain the level of the leading interest rate of the monetary policy. In the first session, the members of the Committee reminded that the decision the previous month of not modifying the leading interest rate prevailed because of the consideration of awaiting the evaluation that was being made on the economic impact of Hurricane Stan. In this regard, the recently concluded analysis by the Economic Commission for Latin America and the Caribbean –CEPAL-, where the estimation of the socio-economic impact of the disaster to October, 2005 in Guatemala, which concludes that Hurricane Stan was an event that adds to preexisting conditions of poverty and marginalization, and whose negative effects are of a social character more than an economic one. In the second term, the Committee in a detailed manner, analyzed the information of inflation for the month of October and its components, and discussed the implications of the same in terms of decisions by the monetary policy.

In this regard, a member of the Committee presented, as an analytical frame, in first place, that it is convenient to take into account that the estimation of CEPAL on the economic impact of Hurricane Stan, clearly indicated that "the macroeconomic effect of the disaster is not significant", reason why the "compassion pause" that the Executive Committee adopted in its decision of policy in October is no longer valid, therefore, given the inflationary conditions, the monetary policy must reinitiate an adjustment in the leading interest rate to placate the inflationary expectations and gradually conduce the inflationary rate toward a mid-term goal. On second term, the externalization of the opinion of being explicit with the reasons that justify an increase in the leading interest rate of the monetary policy, referring, among others, to the following:

a) That if the majority of excess inflation over the established goal by the Monetary Board (4%-6%) is attributable to exogenous factors, like the effect on fuel prices and the effect of Hurricane Stan, a proportion of said excess exists that is attributable to monetary factors, indicating the effect that of 10.29% of the inflationary rhythm observed to October, 1.01% is attributable to Hurricane Stan and 2.7% to extraordinary imported inflation, therefore the remaining 6.6% of inflation can be attributed to monetary factors, which would imply that, in the absence of exogenous shocks, the inter-annual inflation would be outside the goal. In that sense, it was mentioned that the increase in the leading interest rate of the monetary policy is necessary so that, through the effect of the interest rate on the added demand and the inflationary expectations, a moderation of inflation is propitiated;

b) That the econometric projections of inflation to December, 2006 (the total as well as the subjacent) were located above the goal, therefore when taking into account that an increase in the leading interest rate exercises its effects with delay, making it necessary to make an immediate adjustment in said rate to be able to moderate inflation in 2006;

c) That the inflationary rhythm to October has surpassed the "psychological frontier" of 10%, which significantly intertwines the risk of exacerbating the inflationary expectations of the economic agents, which, according to the results of the monthly surveys made by the panel of experts, were already elevated. In that sense, an increase in the leading interest rate was mentioned, as advisable in order to strengthen the credibility of the Central Bank in its commitment of submitting the inflation to its control; and,

d) That the number of indicative variables of the monetary policy, which advises restricting it, has increased. Also, that the information of the deviation of the monetary offer variables (monetary issue and banking credit to the private sector) regarding the program, has been maintained.

In the third term they pointed out, that just as it is convenient to explain the reasons that suggest an increase in the leading interest rate, it is also necessary to explain why said adjustment must be gradual and not abrupt, mentioning as examples the following arguments:

a) That the inflationary effect of Hurricane Stan is a shock at one time, which must be reverted automatically in the following months (just as it occurred during Hurricane Mitch).
b) That the international prices of fuel have registered a slight decrease, that eventually will be transmitted to the domestic market;
c) That the econometric projections of inflation for December 2006 must be taken cautiously, since they do not net the effect at one time from Hurricane Stan; and,
d) That it is not convenient to send panic messages, since it is considered that the inflation can be controlled through the gradual adjustments of the leading interest rates.

The members of the Committee debated on the ideas presented and, in general, declared their agreement. Some members pointed out the convenience of including the subjacent inflation issue, its components and perspectives in order to illustrate the decision to be adopted on November 18, 2005, together with the additional information produced in the following week. Other members highlighted the need that in the following days it will be necessary to adequately and actively explain the inflationary situation and the possible actions made by the monetary policy to warrant the effectiveness of them to the markets.

Regarding the determination of quotas for biddings in the following week, the information provided for estimated daily flow of monetization for the following week and as an established rule for determining quotas, based on what the Committee agreed that the quota of raising funds for the 91 and 364 day terms to be convened on Monday would be established at Q30.0 million for each term and for the 182 and 728 day terms to be convened Wednesday, the raising funds quota was established at Q30.0 million each. On the other hand, a fund raising quota for Q30.0 million for a period of 2, 912 days (8 years) is to be convened on Friday.

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

Based on the monetary situation analysis, the Execution Committee agreed that for the week of November 14 to 18, 2005, they would maintain the execution guidelines for the monetary policy observed during the present week; in other words, continue to operate in MEBD and in the Stock exchange, in raising funds as well as in giving liquidity to the market. The raising funds operations will be 7 day terms without quota, at an interest rate of 3.75%, whereas, the offer position of liquidity at 7 day terms, with an initial interest rate of 7.65%, whose guarantee of said operations will be constituted by receiving public titles, only. It is worth mentioning that the Committee stressed the importance of participating in both; in other words, maintaining simultaneous positions of giving liquidity to the market and liquidity withdrawal, considering said participation constitutes a sign of disposition of the Central Bank to moderate the volatility of the short term interest rate.

The Committee, taking into consideration the agreed with the fiscal policy to participate in the money market, agreed that the calling for biddings for term deposits would continue on Monday, Wednesday and Friday for the following week; so Monday for 91 and 364 day terms, with an raising funds quota of Q30.0 million for each term; and Wednesdays for 182 and 728 day terms, with raising funds quotas for Q30.0 million for each of the terms. The interest rates would be determined according to the market conditions, reflected in the positions received, considering the established yield curve by the technical department; and on Fridays the 1456 day (4 years), 2184 day (6 years) and 2912 day (8 years) terms, for the 4 and 6 year term without a pre-established raising funds quota and for 8 years with a fund raising quota for Q30.0 million. For the corresponding awarding, the committee will decide the amount to award for each term and for the determination of the interest rate to apply, as reference the one that corresponds to each one of the mentioned terms in a yield curve calculated through interpolation in the interest rates for 364 days (1 year) and 10 year terms will be taken. The payment of interest for the terms longer than 364 days will be at each semester, so as to keep with the same conditions held by the *Ministerio de Finanzas Públicas* (Equivalent to the Department of the Treasury).

On the other hand, the Committee agreed to continue acquiring directly at the window, with official and public entities. In the case of official entities, that the raising funds continue according to the prevalent financial conditions; in other words, the interest rate for 7 day terms would be the one that applies for the *Banco de Guatemala* in the MEBD and in the stock exchange and, for the other terms, the interest rate would be the mobile average, for each term, of the weighted average interest rate resulting in the previous four bidding events. As to fund raising for the public, the interest rate for each term, can not be higher than the weighted average of the corresponding bid minus one percentage point.

On the other hand, the Committee agreed to summon biddings for term deposits in US dollars –DP in US$- to be made on Tuesdays of each week for 91 and 336 day terms, for an amount of up to US$30.0 million. The bids received can be awarded an interest rate of up to 3.05% for 91 day terms and up to 3.89% for 336 day terms, according to the agreed in the 48-2005 session, without excluding the possibility that, if the bids received deserve better rates, a session with the Committee will be convened to decide its awarding.

The Committee agreed to continue accepting the constitution of term deposits in United States dollars directly at a window, from public entities, in current terms of (91 days and 336 days) and that the interest rate applied would be the resulting weighted average from the last awarded bidding for long term deposits in that currency.

As for the participation of the *Banco de Guatemala* in the Exchange market, the Committee agreed that it should continue participating in the SINEDI through participation rules established in session 55-2005 dated October 27, 2005.

FIFTH: Other matters.

Not having any other matter to see, the session ends at sixteen hours and eighteen minutes, all who attended sign in agreement.