EXECUTION COMMITTEE

ACT NUMBER 59-2005

Session 59-2005 celebrated in the *Banco de Guatemala* building on Friday, November eighteenth, 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 58-2005, corresponding to the session celebrated on November 11, 2005.
(The project of the act circulated.)

SECOND: Evaluation of the position of the bidding for Time Deposits in *quetzales* No. DP-139-2005.

THIRD: Market information and monetary variables.

a) Money and Exchange markets.
b) Monetary Variables

FOURTH: Balance of Inflation risks

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

SIXTH: 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 58-2005.

SECOND: Evaluation of the positions of bidding for time deposits in *quetzales*
No. DP-139-2005.

The committee took note that bids for the Time deposits –LTD, (Q10.0 million for 1456 days (4 years), at an interest rate of 7.25%; Q10.0 million for 2184 days (6 years), at an interest rate of 7.75%; and, Q41.0 million for 2919 days (8 years), at an interest rate of 8.40%) and, taking as a reference the yield curve calculated through the interpolation of current interest rates for public titles, according to the awarded by the two bids received at 4 year bids for Q10.0 million, the two bids received for 6 year terms for Q10.0 million for and a prorated quota established for Q30.0 million for 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 14 to 18 of 2005, with partial numbers to date, registered an attraction of LTD's for Q1,773.7 million and maturity of Q1,370.9 million, which gave a net result of fund raising for Q402.8 million, associated to the operations in bidding (net attraction for Q18.2 million), in the Money Electronic Banking Table –MEBD- and in the stock exchange (net fund raising of Q351.0 million) and at the window (net fund raising for Q33.6 million).

Regarding the interest rates applied in fund raising through LTD's, it was indicated that during the period of November 14 to 18, 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 14 to 18, 2005 period, with partial data, the minimum was of 2.83%, observed November 14, 2005, and the maximum of 4.27%, registered on November 17, 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 3.10% for public titles and of 4.87% for the financial sector titles.

On the other hand, it was informed that during the November 14 to 18, 2005 period, regarding Treasury Bonds operations the maturity was registered for Q0.5 million.

Regarding the Institutional Market for foreign currency the report stated that during the period of November 11 to 17, 2005, the average daily operations for purchase were of US$74.7 million and the sale was of US$76.4 million as the exchange rates were stable. In effect, on Friday, November 11 they were of Q7.60460 per US$1.00 for purchase and of Q7.62504 per US$1.00 for sale, on Monday, November 14 the rates were Q7.59459 and Q7.62219, on Tuesday, November 15 they were Q7.59170 and Q7.61684, Wednesday, November 16 they were Q7.59942 y Q7.62156, and finally, on Thursday, November 17 they were Q7.60673 y Q7.61418.

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 14 to 18 of the present year commented that the Private Institutional Foreign Currency System –SPID-, only on Tuesday, November 15, there was an operation for US$1.0 million, at a weighted average exchange rate of Q7.61500. In the Electronic Foreign Currency Negotiation System –SINEDI-, they declared that during the period no operations were closed and only the *Banco de Guatemala* received daily, a bid 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 14 to 18, 2005, did not close operations. As for the closing price in reference up to Friday, November 18, 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 17, 2005, the excess of the daily float of the banking system was located in a position of Q190.7 million, with an average position of Q457.0 million.

The highlights during the period of November 10 to 17, 2005, the main monetizing factors were the decreases in the banking float balance for Q176.7 million and the increase in the Net International Reserve –RIN- balance for the equivalent of Q13.6 million; while the main demonetizing factors were the increase in balances of the long term deposits constituted in the *Banco de Guatemala* for Q145.1 million and the deposits for the Central Government in the *Banco de Guatemala* for Q49.3 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 9.71%; 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 10, 2005, the lower limit was 4.27%, and the upper limit is 12.17%, 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 (4.22%) was situated at 4.36%, which is located within the estimated for the parameter rate, situation that suggests an invariable monetary policy. When referring to the parity passive rate, they declared that up to November 10, 2005, the lower limit was 6.01% and the upper limit was 7.59%, 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 advises an invariable monetary policy.

As to monetary issue observed to November 17, 2005, they indicated that it presents a deviation of Q418.7 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 November 10, 2005, it exhibited an inter-annual growth rate of 16.1%, 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 21.1%, which is above the upper limit of the estimated range for November 10, 2005 (15.2% to 17.2%), 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 10, 2005, was -2.90 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, regarding the orientation of the indicative variables; it was reported that regarding last week, the "parameter rate" variable went from suggesting that the monetary policy be restrictive to suggest it remain invariable, giving a decrease to five 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); there was an increase to four variables that suggest the monetary policy remain invariable (parity passive rate, Monetary Conditions Indexes and the total payment means and parameter rate); and none suggest to be lax with it.

FOURTH: Inflation Risks Balance.

The Economic Studies Manager, with the purpose of counting on information to sustain the decision to be adopted in this session, regarding to the elevation or to maintain the leading interest rate of the monetary policy, referred to the inflation risks balance with data to October 2005, prepared by the technical department, emphasizing on the following aspects:

As to outer conditions, he indicated that the behavior of international oil prices has decreased, continuing in higher levels than the estimated at the end of 2004, therefore said variable will continue being the main inflationary risk. Based on that scenario, the econometric projection of inflationary rhythm for December 2005 increased 8.27% with numbers to September, at 9.71%, with information from October.

As reference data it was indicated that in the last weeks the price of gasoline in the United States of America has decelerated, but in Guatemala this lowering behavior has not been reflected. It was indicated that, given the levels that present the price of crude oil in the international market, it would be expected that the inflationary rhythm would decelerate in the following months, but at a slower rate than is proportional to international prices.

The external impact of inflation was mentioned, as it continues to be a risk, whereby the compound index of inflation of the main commercial partners of Guatemala continues to be elevated, notwithstanding that the inflationary rhythm of the United States of America (country with greater relative weight within the index) decelerated from 4.69% in September to 4.35% in October 2005, but even like that it is greater than the rhythm observed to October 2004, which was of 3.19%, therefore via here, inflationary pressures still persist.

As to internal conditions, it was indicated that since the beginning of the second semester of this year, the level of open market operations has been below the programmed, whose monetizing effect has been partially compensated by a greater level of deposits by the Central Government in the *Banco de Guatemala* regarding the programmed for the same period, which reflects the support that the fiscal policy has offered the monetary policy. However, in the last weeks a reduction of said deposits has been observed, which indicates an acceleration of the rhythm of budgetary execution, which is consistent with the foreseen for 2005, therefore in a context of greater resource flow toward the economy and if the level of interest rate is not attractive to the investors, said flow of resources may not materialize in greater open market operations, inducing greater inflationary pressure.

It was mentioned that if the greater part of the excess of inflation over the goal established by the Monetary Board (4.0%-6.0%) is attributable to exogenous factors, like the effect of the price of fuel and the effects of Hurricane Stan, there is a proportion of said excess that is attributable to monetary factors. It was pointed out that of the 10.29% of the inflationary rhythm observed to October, 1.01 percentage points are attributable to the effect of the one time occurrence of Hurricane Stan, 2.66 percentage points to extraordinary imported inflation, therefore the remaining 6.62 percentage points 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 an increase of the leading interest rate of the monetary policy is necessary so that, through the effects of the interest rates over the added demand and the inflationary expectations, a gradual moderation of the inflation be propitiated toward a mid-term goal.

As to the indicative variable, it was indicated that if to the date that the variables are announced, which suggest that the monetary policy be restricted are the same regarding the observed on September 16 (last date of adjustment of the leading interest rate), all of them will do so with greater intensity than the previous month (the projection of total inflation, the projection of subjacent inflation, the monetary issue, the banking credit to the private sector and the inflation expectations); also, a variable that does not suggest a modification of the monetary policy (the parameter rate) is closer to suggesting that the same be restricted. Also, it was highlighted that the information of the deviation of variables of monetary offer variable is maintained (monetary issue and banking credit to the private sector) regarding the programmed, manifesting itself on the particulars that an increase in the leading interest rate could contribute to reducing said excesses of monetary offer.

The econometric projections prepared by the technical departments, using data observed to October, estimate greater inflation (total and subjacent) for December 2005 and December 2006 than the forecasted in September, which also produces a deterioration of the balance of inflation risks. In that sense, the fact that the projection for 2006 surpasses 6% was emphasized; therefore, when taking into account that an increase in the leading interest rate exercises its' effects with deference; it is necessary to immediately adjust said interest rate in order to moderate the inflation in the next year. To the latter, is added the fact that in October 2005, was the first time that the inflationary rhythm surpassed the "psychological border of 10%", which deepens the risk of increasing inflationary pressures via an exacerbation of the inflation expectations of inflation of economic agents. Also, it was reiterated that the private analysts, according to the survey of inflation expectations made at the end of October, foresee inflation for the end of 2005 and 2006, which is greater than the estimated in September.

It was indicated that the impact that the policy measures could have in the United States of America on domestic inflation, generated by the reduction of the breach of domestic and external interest rates (that at the same time could generate a depreciation of the exchange rate) would not be significant, given that the empiric evidence for Guatemala indicates that the Pass-Through effect is low.

On the other hand, in the heart of the Committee a declaration by Ben Bernanke, successor of Alan Greenspan was commented; whom in his audience of confirmation on behalf of the senate of said country, on November 15, indicated that the Federal Reserve "could achieve a greater transparency in its actions of monetary policy if the inflation rate were explicitly fixed, whether it be as a central point or as a range which would be considered consistent with the objective of long-term price stability, a practice currently employed by many central banks of the world". Also, the declaration of the president of the Central Bank of Europe, Jean Claude Trichet, was commented when he indicated on November 18 that said central bank was ready to raise its interest rate for the first time in five years, in order to contain the inflation of the 12 countries which currently integrate the Euro-zone.

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 previewed for the week of November 18 to 24, 2005 indicate an increase in the creation of primary liquidity for Q2, 407.2 million, fundamentally due to the maturity of LTD's. Also, an increase is foreseen for the demand for monetary issue for Q151.0 million and a daily position of banking liquidity for November 24, 2005 for Q. 323.0 million. Also, that the monetary issue is deviated in Q547.4 million above the central programmed point for said variable, therefore the excess of added liquidity for the referred period is located at Q3, 126.6 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 (Q1,984.6 million, according to registries to November 17, 2005) have to be relocated; and also, make additional fundraising for around Q1,142.0 million.

Based on the analysis made, the Committee coincided in that in the risks balance, with data from October, factors that advise the restriction of the monetary conditions, prevail; therefore it is convenient to make the adjustment to the leading interest rate of the monetary policy. As to the magnitude of the adjustment, there was consensus in the heart of the Committee that it must be moderate, taking into account the following aspects:

i) That the inflationary effect of Hurricane Stan is a one-time shock, which must revert automatically in the following months (just as it did after Hurricane Mitch). This will imply, among other aspects, that the estimated inflation for the following months must be corrected when the referred effect disappears.

ii) That the international price of oil has registered a slight decrease, whose effects will eventually be transmitted to the domestic market.

iii) That it is not convenient to send a message of panic to the markets, given that it is considered that inflation is controllable through gradual adjustments in the leading interest rate.

In that sense, in congruence with the moderate adjustments that have been made in previous occasions, the Committee agreed to increase the leading interest rate of the monetary policy by 25 basic points (of 3.75% to 4.00%). After the deliberations, the Committee resolved to issue the following Press Release:

"THE EXECUTION COMMITTEE OF THE BANCO DE GUATEMALA INCREASES THE LEADING INTEREST RATE OF THE MONETARY POLICY FROM 3.75% TO 4.00%, AS OF MONDAY, NOVEMBER 21, 2005

The Committee estimated that a considerable part of observed inflation to October is explained by the behavior of oil prices (imported inflation) and for the temporary effect (one-time) generated by Hurricane Stan on the prices of some agricultural goods, effect which must be reverted automatically in the following months, such as occurred on the occasion of Hurricane Mitch in 1998. Notwithstanding the temporary nature of the referred inflationary pressures, the Committee coincided in that, given that inter-annual inflation reached a two-digit level, a scenario that influences negatively on the expectations of the economic agents is configured, therefore in the context of monetary policy, an adjustment in the leading interest rate must be reinitiated, in order to placate said expectations and cooperate so that, in the following months, the inflationary rate converges gradually toward the mid-term goal.

Because of the above, and after analyzing the behavior of the general level of prices to the month of October, as well as the nature and perspectives, the Execution Committee, in its session celebrated on November 18, 2005, decided to increase the leading interest rate of the monetary policy."

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 Q50.0 million and Q75.0 million, respectively, for each term; and for the 182 and 728 day terms to be convened Wednesday, the raising funds quota was established at Q50.0 million each. On the other hand, a fund raising quota for Q50.0 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 21 to 25, 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 4.00%, 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 a raising funds quota of Q50.0 million and Q75.0 million, respectively, for each term; and Wednesdays for 182 and 728 day terms, with raising funds quotas for Q50.0 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 Q50.0 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 as those 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 session 48-2005, 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.

SIXTH: Other matters.

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