EXECUTION COMMITTEE

ACT NUMBER 63-2005

Session 63-2005 celebrated in the *Banco de Guatemala* building on Friday, December ninth, 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 62, corresponding to the session celebrated on December 2, 2005.
(The project of the act circulated.)

SECOND: Evaluation of the position of the bidding for Time Deposits in *quetzales* No. DP-148-2005.

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: Prognosis of Inflation in the Mid-term (Pilot estimation).

SIXTH: Other matters.
Not having more observations, the committee approved 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 62-2005.

SECOND: Evaluation of the positions of bidding for time deposits in *quetzales*

No. DP-148-2005.

The committee took note that bids for the Time deposits –LTD, (Q50.0 million at 2,184 days (6 years), at an interest rate of 7.75%); and, Q40.0 million at 2,912 days (8 years), at an interest rate of between 8.40%) and, taking as a reference the yield curve, calculated through the interpolation of interest rates current for public titles, agreed to award the bid received for 6 year terms for Q50.0 million and the bid received for 8 year terms for Q40.0 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 December 5 to 9, 2005, with partial numbers to date, registered an attraction of LTD's for Q1,127.7 million and maturity of Q1,918.6 million, which gave a net result of fund raising for Q790.9 million, associated to the operations in bidding (net maturity for Q13.2 million), in the Money Electronic Banking Table –MEBD- and in the stock exchange (net maturity of Q450.0 million) and at the window (net maturity for Q327.7 million).

Regarding the interest rates applied in fund raising through LTD's, it was indicated that during the period of December 5 to 9, 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 4%.

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 December 5 to 9, 2005 period, with partial data to date, the minimum was of 3.65%, observed December 6, 2005, and the maximum of 4.32%, registered on December 7, 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 3.89% for public titles and of 5.25% for the financial sector titles.

On the other hand, it was informed that during the December 5 to 9, 2005 period, regarding Treasury Bond operations the maturity was registered for Q36.4 million and US$1.0 million.

As to the bidding of term deposits in US dollars convened on December 6, 2005, it was mentioned that no bids were presented.

Regarding the Institutional Market for foreign currency the report stated that during the period of December 2 to 8, 2005, the average daily operations for purchase were of US$59.3 million and the sale was of US$57.9 million as the exchange rates were stable. In effect, on Friday, December 2 they were of Q7.61741 per US$1.00 for purchase and of Q7.64375 per US$1.00 for sale, on Monday, December 5 the rates were Q7.61888 and Q7.64576, on Tuesday, December 6 they were Q7.62135 and Q7.64634, Wednesday, December 7 they were Q7.62649 y Q7.64511, and finally, on Thursday, December 8 they were Q7.61895 y Q7.64281.

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 December 5 to 9 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 no operations were closed and only the *Banco de Guatemala* received daily, a bid for the purchase of US$10.0 million, with the following prices: from December 5 to 7 of Q7.58900, on December 8, Q7.59069 and on December 9 Q7.59332, 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 December 5 to 9 only on Friday 9 operations closed for US$1.0 million, at a price of Q7.65600, to liquidate in June, 2006. As for the closing price in reference up to Friday, December 9, they indicated that for maturity to liquidate in December, 2005 the price was Q7.64000, and for the maturity to liquidate in March, 2006 it was of Q7.65000 and for the maturity to liquidate in June, 2006 it was of Q7.65600.

b) The Sub-director for the Economic Studies Department informed that on December 8, 2005, the excess of the daily float of the banking system was located in a negative position of Q470.1 million, with an average position of Q252.3 million.

The highlights during the period of December 1 to 8, 2005, the main monetizing factors were decreases in the balance in the long term deposits constituted in the *Banco de Guatemala* for Q1,197.8 million, and the increase in the Net International Reserve –RIN- balance for the equivalent of Q12.0 million; while the main demonetizing factor was the increase in banking float balance for Q603.4 million, the deposits of the Central Bank in the *Banco de Guatemala* for Q196.6 million and the deposits of the rest of the public sector in the Central Bank for Q191.4 million.

Regarding the indicative variables of the Monetary, Exchange and Credit Policy they indicated that with the projection to November for December of 2005 the total expected inflation estimated with a model of ordinary squared minimums is of 9.15% and with a softened exponential model of 9.19%; the simple average of both models is located at 9.19%, 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 November 2005, estimated with an integrated auto-regression model of mobile averages ARIMA, was of 7.87%, whereas the estimated with a softened exponential model it was of 8.01%; the simple average of both models is of 7.94%, which is above the policy range goal (4.0%-6.0%), which suggests a restrictive monetary policy.

As to the parameter rate, up to December 1, 2005, the lower limit was 3.79%, and the upper limit is 11.69%, while the simple average resulting 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 (4.35%) was situated at 4.30%, which is located within the estimated for the parameter rate, situation that suggests that the monetary policy remain invariable. When referring to the parity passive rate, they declared that up to December 1, 2005, the lower limit was 5.82% and the upper limit was 7.40%, and the weighted average rate of long term deposits of the banking system was of 6.94%, which maintains itself within the range of the parity passive rate, which advises an invariable monetary policy.

As to monetary issue observed to December 8, 2005, they indicated that it presents a deviation of Q505.6 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 December 1, 2005, it exhibited an inter-annual growth rate of 15.9%, which is within the estimated range for said variable on that same date (12.9% to 14.9%), which advises to restrict the monetary policy. Also, up to said date, the banking credit to the private sector registered an inter-annual growth rate of 21.5%, which is above the upper limit of the estimated range for December 1, 2005 (13.7% to 15.7%), which suggests a restrictive monetary policy.

As to inflation expectations of private analysts, they indicated that according to the poll made in November of 2005, for December of 2005 an inflationary rhythm of 10.17% 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 December 1, 2005, was -3.01 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 "total payment means" variable went from suggesting that the monetary policy be restricted to suggest it be invariable, giving a decrease to six, the number of 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 total payment means); there was a increase to three variables that suggest the monetary policy remain invariable (parity passive rate, the parameter rate, and the Monetary Conditions Indexes); and none suggest to be lax with it.

On the other hand, the information presented by the Consumer Price Index to November, 2005, reported by the National Statistics Institute –INE- (the monthly inflation was of 0.045, lower by 1.72 percentage points to that of October, 2005; the inflationary rhythm was at 9.25%, lower by 1.04 percentage points to that of October, 2005 and higher by 0.03 percentage points to the observed in November, 2004; the subjacent inflation registered a rhythm of 8.03%, lower by 0.49 percentage points to that of October, 2005 (8.52%) and lower to that of November, 2004 (8.39%)); as well as the estimations of the imported and domestic components of inflation (of 9.25% of the inflationary rhythm to November 2005, 2.52 percentage points are attributable to imported inflation, of which, 1.61 percentage points correspond to indirect imported inflation (second round effect); therefore, of the inflationary rhythm, 6.73 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 previewed for the week of December 9 to 15, 2005 indicate an increase in the creation of primary liquidity for Q1, 175.4 million, fundamentally due to the maturity of LTD's. Also, an increase is foreseen for the demand for monetary issue for Q392.0 million and a daily position of negative banking liquidity for December 15, 2005 for Q683.3 million. Also, monetary issue is deviated in Q633.9 million above the central programmed point for said variable, therefore the excess of added liquidity for the referred period is located at Q2, 100.6 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 (Q1,334.1 million, according to registries to December 8, 2005) have to be relocated; and also, make additional raising funds for around Q766.5 million.

Based on the information received, the Committee began a discussion on the decision that it must adopt in its next session as to the modification or maintenance of the level of the leading rate of the monetary policy. In that regard, in the heart of the Committee it was signaled that one of the aspects to take into consideration is the fact that the domestic inflation in November increased (from 6.10% in October to 6.73% in November), which puts the convenience of considering a new adjustment for the monetary policy in perspective. In that same sense, a member of the Committee highlighted that, when analyzing the composition of the inflationary rhythm in November, 2005 regarding November 2004, it was observed, that although, the levels are similar (9.22% in 2004 and 9.25% in 2005) there is a relevant change in the composition due to that in 2004 the inflationary rhythm was more influenced by the imported inflation than in 2005 (2.81 percentage points in 2004 compared to 2.52 percentage points in 2005), which indicates the pertinence of restricting the monetary conditions.

Another member of the Committee indicated that it is necessary to pay special attention to the credit behavior of the private sector that, in the last weeks, has not behaved with the foreseen tendency and whose inter-annual growth rate has continued increasing to levels higher than 20%, therefore they declared that they considered it pertinent that the Committee take into consideration the following aspects:

i) That an adequate behavior of credit to the private sector is fundamental in order to ensure the sustainability of stability because, even though in practice a very accelerated credit growth can coexist with a moderate rate of inflation (especially in the short term), an immeasurable credit increase can provoke lack of balance and sustainability in the real sector of the economy.

ii) That diverse theoretical analysis and the empiric evidence indicate that many episodes against the holders are originated from situations of instability of the real sector generated by uncontrolled credit growth, including a benign inflationary surroundings; such is the case of the "Great Depression" in the 1930's in the United States and the "bubble economy burst" of Japan in the 1990's.

iii) That in Guatemala's case, it is worth remembering that the "credit booms" of 1992, 1995 and 1998, when the availability of liquid resources was propitious that the banking credit grew about 30%, supported by interest rates (sustainable) lows. They pointed out that if the rates could cooperate in increasing investment when converting certain projects into profitable ones, on the other hand, they would not be (for example, in housing), can also, at the same time can, propitiate a very accelerated growth in the banking credit.

iv) That credit booms are short-lived, such as is shown in Latin American experience in the decade of the 90's. It was pointed out that interest rates are a two-way street: when these come down, savings do not have incentive and, when reduced, the boom is over. The previous not only affects economic growth but it deteriorates the quality of the banking portfolios; the private sector bought assets with money that it borrowed from the banking system, and when a rise in the interest rate is given (product of the reduction of savings or credit offer) and a stalling in the price of assets, a patrimonial problem is generated for businesses and that problem eventually is transferred to the banks in a way that increases its expired portfolio.

v) They highlighted the repercussions of this matter in the established financial system since, in a strong credit expansion context, the parameters are relaxed for their assignment, which, eventually gives a repercussion on the quality of the portfolios. With the credit boom, a problem of private sector debt is generated with the banking system, generating a patrimonial problem at the same time with the companies, which eventually transfer to the banks through an increase in the expired portfolio, which worsens when the regulatory framework is not the most appropriate. It is for that reason that credit booms are not only short-lived, but weaken the financial system itself.

vi) It was pointed out that, added to its dimension of systemic financial sanity, the follow-up of the credit to the private sector also is an important indicative variable that is highly related with the secondary creation of money, therefore the performance of this variable has to be consistent with the necessary financing for the economic activity growth and with the inflation goal. Also, it was pointed out that the banking credit must be consistent with the result of the external sector, in order to avoid generating credit booms that, like those that occurred in 1992, 1995 and 1998, threaten the sustainability of the current account of the payment balance.

On the other hand, the Committee saw the presentation of the technical departments that assist the requirement of the previous session relative to the analysis of the effect of the leading interest rate of the monetary policy on the long term interest rate of the banking system. On this regard, the Committee was advised that an econometric study made recently through and Autoregressive Vectors – VAR- model established that, up to this date in 2005, the impact that the different increases in the referred leading interest rate have had is not reflected in the relevant increases in the active interest rates of the banking system (interest rate for new loans, interest rate for credit portfolio, interest rate for notes discounted and the total active interest rate).

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 for each term and for the 182 and 728 day terms to be convened Wednesday, the raising funds quota was established at Q60.0 million and Q50.0 million, respectively. 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 December 12 to 16, 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 venues; 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 Q50.0 million for each term; and Wednesdays for 182 and 728 day terms, with raising funds quotas for Q60.0 million and Q50. million, respectively. The interest rates would be determined according to the market conditions, reflected in the bids 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 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.

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 also 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 said 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: Mid-Term Inflation Prognosis (Pilot Estimation)

The Committee heard a presentation from the Prognosis Team of the *Banco de Guatemala* referring to the preliminary results obtained from the semi-structural model of inflation prognosis, run in the context of pilot plan for the Prognosis and Analysis of the Monetary Policy System –SPAPM (for its acronym in Spanish). On this subject, some of the members of the Committee made suggestions to the Prognosis Team, oriented toward fine-tuning the calibration of the model, especially regarding the regulation of the Monetary Policy. In that sense, it was agreed that said adjustments and other fine-tuning will be taken into account for the model, when it is run again in January, 2006.

SIXTH: Other matters.

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