EXECUTION COMMITTEE

ACT NUMBER 64-2005

Session 64-2005 celebrated in the *Banco de Guatemala* building on Friday, December sixteenth, 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 63-2005, corresponding to the session celebrated on December 9, 2005.
(The project of the act circulated.)

SECOND: Evaluation of the position of the bidding for Time Deposits in *quetzales* No. DP-151-2005.

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. Lic. Castañeda Fuentes made observations on said act; the Committee approved Act 63-2005 with the mentioned observations.

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

No. DP-151-2005.

The committee took note that bids for the Time deposits –LTD, (Q15.5 million for 2919 days (8 years), at an interest rate of between 8.3999% and 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 three bids received at 8 year bids for Q15.5 million.

THIRD: Information of markets and monetary variables.

The coordinator requested that the corresponding information be presented.

a) The Sub-Director of the Department of Monetary Stabilization Operations, regarding the Money market informed that during the period from December 12 to 16, 2005, with partial numbers to date, registered an attraction of LTD's for Q1,185.0 million and maturity of Q1,266.0 million, which gave a net result of fund raising for Q81.0 million, associated to the operations in bidding (net attraction for Q32.4 million), in the Money Electronic Banking Table –MEBD- and in the stock exchange (net maturity of Q190.0 million) and at the window (net fund raising for Q141.4 million).

Regarding the interest rates applied in fund raising through LTD's, it was indicated that during the period of December 12 to 16, 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 12 to 16, 2005 period, with partial data, the minimum was of 3.62%, observed December 13, 2005, and the maximum of 4.12%, registered on December 16, 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 3.94% for public titles and of 5.31% for the financial sector titles.

On the other hand, it was informed that during the December 12 to 16, 2005 period, regarding Treasury Bonds operations the maturity was registered for Q0.5 million and US$3.4 million.

As to the bidding of term deposits in US dollars convened on December 13, 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 9 to 15, 2005, the average daily operations for purchase were of US$86.2 million and the sale was of US$85.3 million as the exchange rates were stable. In effect, on Friday, December 9 they were of Q7.61773 per US$1.00 for purchase and of Q7.63379 per US$1.00 for sale, on Monday, December 12 the rates were Q7.60655 and Q7.63116, on Tuesday, December 13 they were Q7.61066 and Q7.62108, Wednesday, December 14 they were Q7.60727 y Q7.62129, and finally, on Thursday, December 15 they were Q7.60734 y Q7.62463.

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 12 to 16 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* declared to receive a daily income, a bid for the purchase of US$10.0 million, with a price Q7.59452 for Monday, December 12; of Q7.59356 for Monday, December 13, Q7.59088 for Wednesday, December 14 of Q7.58900; for Thursday, December 15 Q7.58900, and for Friday, December 16, 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 12 to 16, 2005, only on Tuesday, December 13 an operation of US$1.5 million was closed, at a price of Q7.64350, to mature in June, 2006. As for the closing price in reference up to Friday, December 16, they indicated that for maturity to liquidate in December of 2005 the price was Q7.63500, and for the maturity to liquidate in March of 2006 it was of Q7.65000 and for the operations to liquidate in June, 2006 was of Q7.64350.

b) The director for the Economic Studies Department informed that on December 15, 2005, the excess of the daily float of the banking system was located in a position of Q646.3 million, with an average position of Q404.4 million.

The highlights during the period of December 8 to 15, 2005, the main monetizing factors were the decreases in the deposits for the Central Government in the *Banco de Guatemala* for Q421.6 million and the deposits of the rest of the public sector in the Central Bank for Q256.6 million; and the increase in the Net International Reserve –RIN- balance for the equivalent of Q18.4 million; while the main demonetizing factors were the increase in balances of the banking float for Q224.7 million and the long term deposits constituted in the *Banco de Guatemala* for Q122.3 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 inflation estimated with a model of ordinary squared minimums is of 9.15% and with a softened exponential model of 9.22%; 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 8, 2005, the lower limit was 3.72%, and the upper limit is 11.62%, 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 (4.53%) was situated at 4.39%, 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 December 8, 2005, the lower limit was 5.81% and the upper limit was 7.39%, 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 15, 2005, they indicated that it presents a deviation of Q571.7 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 December 8, 2005, it exhibited an inter-annual growth rate of 15.7%, which is within the estimated range for said variable on that same date (12.7% to 14.7%), 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 21.3%, which is above the upper limit of the estimated range for December 8, 2005 (13.1% to 15.1%), 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 8, 2005, was -3.04 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 everything remained the same as last week: six variables suggest restricting the monetary policy (the total inflation projection, the subjacent inflation projection, the inflation expectations of private analysts, monetary issue, banking credit to the private sector and the total payment means); there are three variables that suggest the monetary policy remain invariable (parity passive rate, Monetary Conditions Indexes and parameter rate); and none suggest to be lax with it.

FOURTH: Inflation Risks Balance.

The Economic 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 invariable, referred to the inflation risks balance with data to November 2005, prepared by the technical department, emphasizing on the following aspects:

As to outer conditions, he indicated that the level of international oil prices reverted the tendency toward the decrease that had been manifesting itself since October and continues at superior levels than those estimated at the end of 2004, therefore said variable continues being the main inflationary risk. Based on that scenario, the econometric projection of inflationary rhythm for December 2005 will be at 9.19%.

It was indicated that the impact of external inflation will continue being the risk whereas the compound index inflation of the main commercial partners of the United States of America (country with the greater relative weight within the index) decelerated from 4.35% in October to 3.46% in November, 2005. In that sense, it was indicated that the compound inflationary rhythm of the main commercial partners of the country – weighted for the structure of commerce of Guatemala with each one of them-, to November, 2005 was located at 4.03%, similar to that of November, 2004 (4.17%), therefore in this manner, the risks of imported inflation still have not bettered substantially.

As to the 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. In that sense, it was indicated that, notwithstanding, the deviation of monetary issue is still not worth worrying about, given the results of the econometric studies made by the technical departments, an increase of these could influence in the inflation expectations of the private analysts, and therefore it is not desirable that it increase.

It was mentioned that if the inflationary rhythm to November decelerated regarding October, for the normalization effect in the distribution of goods and services affected the previous month by Hurricane Stan, 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, mainly the effect of the price of fuel, there is a proportion of said excess that is attributable to monetary factors. It was pointed out that of the 9.25% of the inflationary rhythm observed to November, 2.52 percentage points are attributable to imported inflation, (of which, 0.52 percentage points correspond to historic imported inflation), therefore the remaining 6.73 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, propitiate a gradual moderation of the inflation toward a mid-term goal.

As to the indicative variables, 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 August 19 – when the prognosis of total inflation in the mid-term was found within the fixed goal - (monetary issue, total payment means, the banking credit to the private sector and the inflation expectations); also one variable that did not suggest to modify the monetary policy (the parameter rate) continues keeping closer to the lower limit of the range of tolerance for said variable, which indicates that a certain tendency of the parameter rate exists that suggests restricting the monetary policy. 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. In particular, it was indicated that it is necessary to pay special attention to the behavior of the credit to the private sector, that in the last weeks, it has not behaved with the tendency foreseen and whose inter-annual growth rate has kept increasing to levels higher than 20%, which is to be highlighted in virtue of the one adequate behavior of said variable is fundamental to assure the sustainability of the stability, because, even in practice an accelerated growth in credit can coexist with a moderate inflation rate (especially in the short term), an excessive increase in credit can produce lack of stability and lack of sustainability in the real sector of the economy.

The econometric projections prepared by the technical departments, using data observed to November, estimate greater inflation (total and subjacent) for December 2005 and December 2006 than the forecasted in October, which is not enough to revert the deterioration it has been manifesting of the balance of inflation risks for the last several months. 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 November 2005, where the inflationary rhythm remains around the "psychological border of 10%", which makes the risk that the inflationary pressures decelerate 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 November, foresee inflation for the end of 2005 and 2006, which is greater than the estimated in October.

Last, 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.

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 December 16 to 22, 2005 indicate an increase in the creation of primary liquidity for Q1, 732.5 million, fundamentally due to the maturity of LTD's. Also, an increase is foreseen for the demand for monetary issue for Q621.0 million and a daily position of banking liquidity for December 22, 2005 for Q. 494.8 million. Also, that the monetary issue is deviated in Q700.4 million above the central programmed point for said variable, therefore the excess of added liquidity for the referred period is located at Q2, 306.7 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 (Q1,482.1 million, according to registries to December 15, 2005) have to be relocated; and also, make additional fundraising for around Q824.6 million.

Based on the analysis made, the Committee coincided in that, in the risks balance with data from November, 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. A member of the Committee highlighted the fact that, according to the inflation projections and, particularly, according to the results presented to the Committee when they were shown preliminary results of the semi-structural macro-economic model, under the current circumstances it is not possible to reach the goal of inflation of 2006 without making some additional adjustments to the leading interest rate, even in a scenario of international oil price stability.

As to the magnitude of the adjustment, there was consensus in the heart of the Committee as to, if the same should reflect the gradualness that has been applied for the previous adjustments. The Committee coincided that in the gradualness of the execution of Monetary Policy it is advisable to avoid that it be a source of distortions or political clashes that generate instability in the macroeconomic variables; therefore, it is advisable to continue applying a monetary policy that attacks the inflationary phenomenon in a firm, but gradual manner, recognizing that the referred gradualism necessarily implies that the reduction in the inflation rate also follows a gradual process.

In that sense, in congruence with the moderate adjustments that have been made on previous occasions, the Committee agreed to increase the leading interest rate in 25 basic points (from 4.00% to 4.25%). After the deliberations, the Committee resolved to issue the following press release:

"THE EXECUTION COMMITTE OF THE *BANCO DE GUATEMALA* INCREASED THE LEADING INTEREST RATE OF THE MONETARY POLICY FROM 4.00% TO 4.25%, AS OF MONDAY, DECEMBER 19, 2005

After analyzing the behavior of the general level of prices to November, as well as the nature and perspectives, the Execution Committee, in its session celebrated on December 16, 2005, decided to increase the leading interest rate of the monetary policy. The Committee highlighted that inter-annual inflation still shows higher levels than the programmed goal for the end of the year and the next twelve months, which contributes to setting a stage in which it can negatively influence on the expectations of the economic agents, which consequently advises to continue adjusting the leading interest rate of the monetary policy, in order to appease the expectations and cooperate so that, in the following months, the inflationary rate converges gradually toward the mid term goal.

However, in its analysis the Committee took note, on the one hand, that the monthly inflation observed in November showed a deceleration that was predictable when the processes of distribution of goods and services affected in the previous month by tropical storm Stan normalized; on the other hand, that an important portion of goal inflation excess is attributable to the behavior of petroleum prices (imported inflation).

The Committee also took note of the vigorous growth rhythm shown in the credit to the private sector, as well as the existing perspectives of a more dynamic economic growth, positive evolution toward sustainability in the mid term must be insured making it coherent with the maintenance of stable macro economic conditions."

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 Q60.0 million for 91 days and Q50.0 million for 364 days; and for the 182 and 728 day terms to be convened Wednesday, the raising funds quota was established at Q50.0 million and Q60.0 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 Thursday.

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 19 to 23, 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 4.25%, 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 Q60.0 million and Q50.0 million, respectively, for each term; and Wednesdays for 182 and 728 day terms, with raising funds quotas for Q60.0 million and Q50.0 million, respectively. 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 Thursday 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-announced 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 liquidation of said bidding will be on December 27, of this year. 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-five minutes, all who attended sign in agreement.