



BANCO DE GUATEMALA

PRESS BULLETIN

THE EXECUTIVE COMMITTEE OF THE BANCO DE GUATEMALA INCREMENTS THE INTEREST RATE OF THE MONETARY POLICY FROM 3.50% TO 3.75%, AS OF MONDAY, SEPTEMBER 19, 2005

1. The general level of prices, measured by the Consumer Price Index, in August presented a 0.36% increase, even though it is the lowest monthly increase during this year, it did not prevent the inflationary rhythm (interannual variation) from rising 9.37%. The increase in prices in general is still fundamentally determined by the increase in international oil prices and their derivatives, which continue to show uncertain and volatile behavior.
2. The referred behavior of international oil prices and its derivatives, combined with the inflationary rhythm, forms a stage that negatively influences on the expectations of the economic agents, for which the Execution Committee considered it necessary to raise the leading interest rate in the monetary policy, with the purpose of appeasing such expectations.
3. It is worth mentioning that the inflation in Guatemala does not reach alarming levels when compared with those registered in other countries in the rest of the region, and that the underlying inflation (that eliminates factors of a stationary nature, among others, from the equation) decelerated in August, even though it is shown at a step above the inflation goal for December of 2005.
Notwithstanding the abovementioned, we must not lose sight of the importance, that for an economy like Guatemala's, it is to maintain a total inflationary rhythm at one digit levels, in order to avoid inconvenient decisions being generated in consumer, savings and investment affairs on behalf of the economic agents, therefore, the Central Bank has considered it appropriate to make a moderate adjustment in the leading interest rate of the monetary policy.
4. The Execution Committee hopes that with this latest adjustment in the leading interest rate, the inflationary rhythm will begin to decelerate and gradually converge in the coming months within a range of 4% and 6%, so that, in the measure that it happens, and in the measure of a satisfactory result in the execution of fiscal policy, the reached levels by said leading interest rate will result adequate in maintaining inflation of a domestic origin, under control, and continue being compatible with the perspectives of major dynamics in national economy.

Guatemala, September 16, 2005

The documents where the deliberations and decisions adopted within the Execution Committee, can be consulted on the webpage of the Banco de Guatemala www.banguat.gob.gt



BANCO DE GUATEMALA

Attachment to the Press Bulletin

The inflation Goal and the International Price of Oil

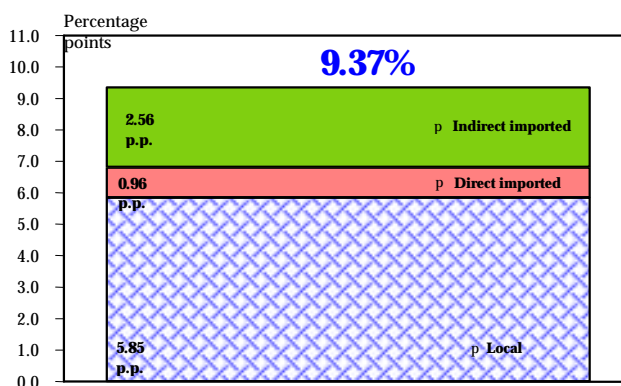
1. **The inflation goal is established based on the suppositions of the behavior of different economic variables and is used as a parameter for decisions of Monetary Policy.**

The goal of inflation is established based on the estimations of the expected evolution of different indicative variables (monetary issue, credit to the private sector, volume of payment means, etc.), that the Central Bank uses to propose and evaluate monetary policy. The observed inflation and the projections of its future evolution are contrasted with the inflation goal, in such a way that a price increase will give way to monetary restriction measures so that the inflation observed will come closer to the established goal. The unforeseen phenomenon, whether they be internal (atmospheric phenomenon that affect production) or external (war or an increase in international prices), must be considered in a special manner, in order to procure the set goals without affecting other parameters; like jobs and economic growth. A deviation of real inflation with respect to the goal generates an explanation for the reasons for deviation, but it should not give way to a change in the goal, because it would therefore lose its orienting nature.

2. **Excess inflation is mainly attributable to the world phenomenon of oil price increases**

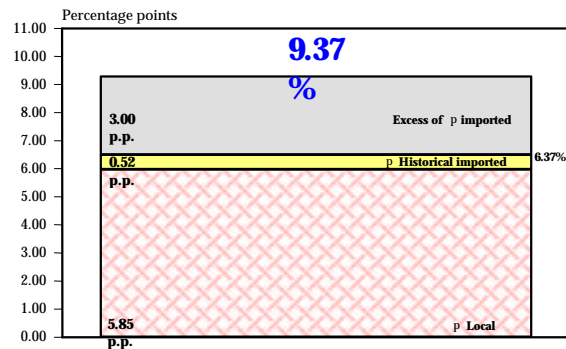
- The increase in oil prices is manifest, on one hand, in the direct increase of the components of the Basic food basket; which are fuel and lubricants (directly imported inflation) and on the other hand, through the effects that it has on the rest of the prices of goods and services that use said fuels in the production process or transportation (indirectly imported inflation).

**COMPILATION OF INFLATIONARY RHYTHM
AUGUST 2005**



- To August of 2005, approximately 38% of the total inflation was attributable to imported inflation.
- Domestic inflation to August of 5.85%, is within the goal range established for 2005.

**COMPILATION OF INFLATIONARY RHYTHM
AUGUST 2005**

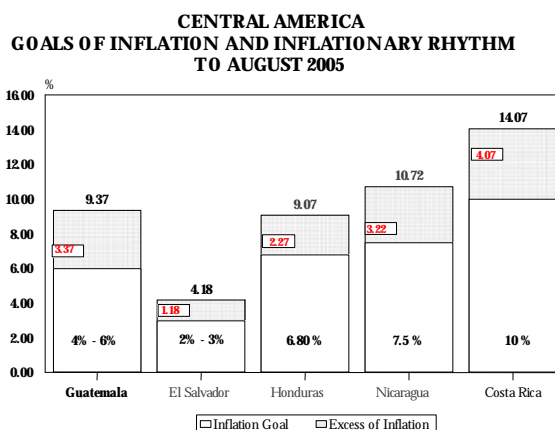


3. The abovementioned does not imply that BANCO DE GUATEMALA should not react before the inflationary phenomenon

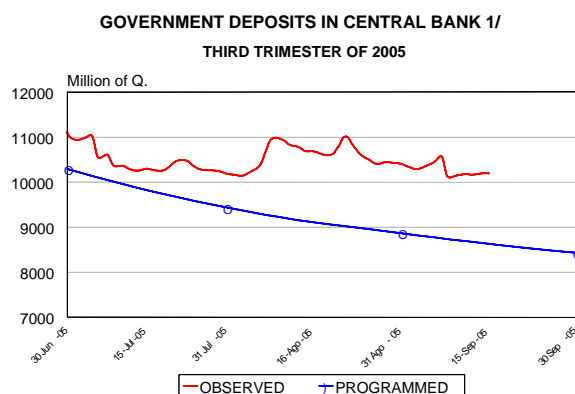
- There are at least two reasons that justify that the monetary policy act (“pinching” the monetary conditions) to moderate inflation, including the reason that if the excess of inflation with respect to the goal is attributable to exogenous factors (out of control of this policy).
- The first reason to act has to do with the expectations management. A growing inflation can generate self complacent expectations with respect to future inflation; for an economy like Guatemala’s it is important to maintain the inflationary rhythm at one digit levels, with the intent of avoiding inconvenient decisions generated in consumption, savings and investment on behalf of the economic agents used to stabilize prices.
- The second reason that justifies “pinching” monetary policy refers to the fact that there is always a (“normal”) historic level of imported inflation. In Guatemala’s case, the recent historic level of inflation has been in 0.52 percentage points. Extraordinary imported inflation (due to oil price increases) is within 3.0 percentage points.
- Therefore, if we add domestic inflation (5.85%) to the imported historic inflation (0.52%), the “normal” inflationary rhythm will be located at around 6.37%, which is even higher than the goal, which means that there exists a space for monetary policy to act (raising the leading interest rate), to moderate the rise in prices and lead it to its goal, at least in its “normal” component.
- Therefore, the monetary policy goal is not modified, since it serves as a parameter to measure “normal” inflation (sum of domestic inflation and the historic imported inflation) is behaving according to the foreseen. The estimations of the *Banco de Guatemala* point at the total inflation (sum of the normal inflation and the extraordinary imported inflation) ending the year at 7.53%, which would imply that the normal inflation at the end of the year could be situated within the goal.

4. The adjustments of the (leading) Interest rate of Monetary Policy must be done in a prudent manner

- An abrupt increase in the leading interest rate could unnecessarily make credit and investment more expensive, affecting with it the levels of production and employment, which would complicate existing difficulties in the productive scene already affected by high costs due to fuel.
- There are other factors which give certain relief to monetary policy and which allow it to act with certain moderation.
 - a) Stable behavior (of an occasional tendency towards the low) which has declared the exchange rate helps that imported product prices have a lesser effect over prices.
 - b) Inflation in Guatemala is even lower than in other Central American countries with their own currency.



- c) The substantial support that the fiscal policy has offered to the monetary policy during 2004-2005. Up to September 13 the government deposits to the central bank have been Q1, 700 million higher than the originally programmed amount, which contributes to creating more stable conditions that decidedly support monetary policy.



Guatemala, September 16, 2005.