

BANCO DE GUATEMALA



SUMMARY OF THE ARGUMENTS THAT THE MONETARY BOARD TOOK INTO ACCOUNT IN SESSION 4-2006, CELEBRATED ON JANUARY 25, 2006, IN ORDER TO DETERMINE THE LEVEL OF THE LEADING INTEREST RATE OF THE MONETARY POLICY

Guatemala, January 26, 2006

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The Monetary Board in Resolution JM-185-2005, dated December 27, 2005, determined the Monetary, Exchange Rate and Credit Policy for 2006, in which, among other aspects, indicates, on the one hand, that the decisions in matter of determination of the leading interest rate of the monetary policy will be adopted by the Monetary Board, based on the analysis that for the effect would be made by the Execution Committee and, on the other hand, that the Monetary Board would decide once a month on the changes in the leading interest rate of the Monetary Policy according to the calendar of annual reunions, established in annex 2 of the mentioned resolution. After each decision, and with a delay of one month, the publication will be made of a summary of the arguments that the Monetary Board has taken into account, according to the declared in Article 63 of the Organic Law of the *Banco de Guatemala*.

In fulfillment of the decided in the mentioned resolution, the summary of arguments that the Monetary Board took into account in session 4-2006, celebrated on January 25, 2006, to fix its position regarding the level of the leading interest rate of the Monetary Policy is presented in the following.

1. In session 4-2006 celebrated by the Monetary Board of January 25, 2006, the President of the *Banco de Guatemala* and the Monetary Board presented the analysis made by the Execution Committee in session 4-2006 dated January 20, 2006¹ relative to the convenience of adjusting or not the level of the leading interest rate of the Monetary Policy. In that respect the President reported that based on the

¹ A greater detail of the analysis made by the Execution Committee can be consulted in Act 4-2006 corresponding to session dated January 20, 2006, published in the web site of the *Banco de Guatemala*. (www.banguat.gob.gt).

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orientation of the indicative variables and in the balance of inflation risks presented by the technical bodies, the committee initially coincided with the conclusion that the factors prevailed oriented toward restricting the monetary conditions. However, it was reported that there was need to carefully analyze the elements that compose the balance of risks inflation, due to the fact that the different variables could be interpreted diversely and give the same variable, resulting contradictory; for example, the level of inflation expected advises restricting the monetary policy, but its tendency, of maintaining it during January, would suggest the contrary; the same happened with the inflation expectations of private analysts, as well as with the behavior of the oil prices versus the behavior of the fuel prices, especially diesel; all advice caution before arriving at the conclusions on the convenience of adjusting the interest rate of the monetary policy. It was reported that the Committee highlighted an additional aspect that advises acting with reservation; and it was the relative to the behavior toward appreciation observed in the nominal exchange rate in recent days, situation that, if it increases or is kept for a prolonged amount of time, it will influence in the future on some of the indicative variables, such as the monetary conditions index and the parameter rate, in the sense that some of them could come to suggest a neutral policy or, even, relax it. It was also pointed out that the fact that it is important to remain attentive to the decisions made by the Federal Reserve of the United States, since the same can have effects on the flow of capital, and consequently, on the exchange behavior.

The President finally informed that the Committee also took into account that, on the one hand, the resolution of the Monetary Board that determines the Monetary Policy for 2006 indicating that the decisions in matter of the leading interest rate will be adopted by said board based on the analysis made by the Execution Committee based on the System of Prognosis and Analysis of the Monetary Policy and of the follow up of the indicative variables and, on the other hand, that the Prognosis System is still incomplete because it will not be until February when a semi-structural macroeconomic model is given, prudence advises waiting to know the forecasts of inflation in the mid term.

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2. Derived of the exposition of the analysis of the Execution Committee of the *Banco de Guatemala* and of the balance of inflation risks corresponding to January 2006, the members of the Monetary Board began the analysis and the discussion on the determination of the leading interest rate of the monetary policy. In that context, it was an argument, in the sense of keeping the leading interest rate invariable, since it is the most appropriate before the deceleration of inflation occurred in December, since it would be rash to make an upward adjustment in the leading interest rate of the monetary policy, due to the fact that the inflationary rhythm decelerated when going from 10.29% in October to 8.57% in December. Another opinion was expressed in the sense that it was not convenient to change the leading interest rate of the monetary policy until the behavior of the inflation in January 2006 was observed, to verify if the tendency toward deceleration were kept of the inflation observed in December 2005, because it is foreseeable that for the next months said tendency will be consolidated.

Following were expressed the relative arguments of not modifying the leading interest rate of the monetary policy, not only due to the factors and the events that must be observed at the end of January, such as the inflationary tendency that results from the inflation data from January and the evolution of the interest rates in the international markets associated to the decision of the Federal Reserve of the United States regarding the objective interest rate, but because an increase in the leading interest rate could generate a greater flow of foreign currency toward the country; especially if the income is taken into account that has been received from the *Ministerio de Finanzas Públicas* [Equivalent to the Department of the Treasury] for US\$199.0 million, as a result of the disbursement of the loan by the Central American Bank for Economic Integration, that if it strengthens the external position of the country, together with the rise in the interest rate, could generate expectations on the exchange rate and the *Banco de Guatemala* would have to go out and buy foreign currency, which would generate a dangerous circle for the monetary policy. Also, the importance of the Work Group of the *Banco de Guatemala* and of the *Ministerio de Finanzas Públicas* [Equivalent to the Department of the Treasury] was pointed out for giving follow up to these variables in order to establish what the

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appropriate balance between the interest rate and the amount of the Treasury Bonds and the Term Deposit Certificates to be placed in the market, combined with the disbursement of dollars received in the present year and of those expected in the future is.

Two members of the Board spoke up regarding the diverse indicators regarding the interest rate. The first pointed out that in the future they must carefully analyze the behavior of the parity liable rate because, even the weighted average rate of term deposits was within the foreseen range for the liable parity rate, even with inflow of capital, therefore it is a key variable to observe for any movement to be made in the interest rate. They added that the same can be said of the parameter rate, because the average repurchase agreement rate is very close to the parameter rate, which, according to their opinion, indicates that it would be a neutral point as to the leading interest rate in the monetary policy, but for the moment both of these variables support the decision oriented toward not changing the leading interest rate. It was also added that it is important to analyze the yield curve of the interest rate with more detail, because up to now the interest rates have been kept pretty stable, but if inflation decreases in January, it is something that must be evaluated because if the margins between the different terms compared to those had were previously lower, they will result in being too big for said conditions.

3. After having presented all the arguments and observations to fix the level of the leading interest rate, the Monetary Board was of the unanimous opinion that for the moment, prudence advised keeping the leading interest rate of the monetary policy invariable at 4.25%, considering that for the next month additional judgment elements will be counted on, such as the inflationary tendency that results from inflation data in January and the evolution of the interest rate in international markets, associated to the decision of the Federal Reserve of the United States regarding the objective interest rate. Also, it was decided that a press bulletin in order to communicate this decision be issued (see annex).

ANNEX



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PRESS RELEASE

THE MONETARY BOARD MAINTAINS THE LEADING INTEREST RATE OF THE MONETARY POLICY INVARIABLE AT 4.25%

After analyzing the report presented by the Execution Committee of the *Banco de Guatemala*, whose content refers to the Prognosis and Analysis System of the Monetary Policy, to the follow up of the indicative variables and to the inflation risks balance corresponding to January 2006, the Monetary Board, in its session celebrated on January 25, 2006, decided to maintain the leading interest rate of the Monetary Policy.

The Monetary Board highlighted the fact that the forecasts of inflation for 2006 and for 2007 still show levels that are higher than the fixed goal by said Board; notwithstanding, they pointed out that it is foreseeable that for the next months a deceleration of the inflationary rhythm will take place (except for unexpected rises in the international price of oil).

Also, other relevant variables of the Monetary Policy were taken into account, such as banking credit to the private sector, payment means (money offer) and the parameter rate (which is an estimation of the level that the short term interest rate must have to be compatible with the maintenance of economic stability), variables whose evolution is found within the foreseen levels for 2006 and, therefore are consistent with the dynamism which is foreseen for the economic activity of the country.

Within the described context, the Monetary Board was of the opinion that, at this moment, prudence advises waiting until the month of February to review the level of the leading interest rate, considering that for then, additional judgment elements will be counted on, such as the inflationary tendency that results from inflation data from the month of January and the evolution of the interest rates in international markets.

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A month behind, a summary of the arguments presented in each session of the Monetary Board, where the leading interest rate of the Monetary Policy is decided, will be able to be consulted on the web page of the Banco de Guatemala at www.banguat.gob.gt