

## **EXECUTION COMMITTEE**

### **ACT NUMBER 28-2006**

Session 28-2006 celebrated in the *Banco de Guatemala* building located at *séptima avenida número veintidós guión cero uno, zona uno* of this city on Friday, July 7, two thousand six, 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 27-2006, corresponding to the session celebrated on June 29, 2006.

(The project of act 27-2006 circulated.)

**SECOND:** Market information and monetary variables.

- a) Money Market
- b) Exchange Markets.
- c) Indicative Variables
- d) Estimated Monetization Flow

**THIRD:** Discussion and definition of the guidelines of execution for the Monetary, Exchange rate and Credit Policy.

- a) Discussion
- b) Determination of the quotas for long term bidding.
- c) Definition of the Guidelines

**FOURTH:** 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 act number 27-2006.

**SECOND:** Information of markets and monetary variables.

The Coordinator requested the following information be provided.

a) The Sub-director of the Department of Monetary Stabilization Operations, regarding the Money market informed that during the period from July 4 to 7 of 2006, with partial data to date, registered an attraction of LTD's for Q2,172.2 million and maturity of Q2,510.2 million, which gave a result of net maturity for Q338.0 million, associated to the operations made in bidding (net maturity for Q128.0 million), in the Money Electronic Banking Table –MEBD- and in the stock exchange (net maturity of Q159.6 million) and at the window (net maturity for Q50.4 million).

Regarding the interest rates applied in fund raising through LTD's, it was indicated that during the period of July 4 to 7, 2006 for the biddings case, the cut interest rates was 6.22% for 364 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 4.75%.

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 July 4 to 7, 2006 period, with partial data, the minimum was of 4.83%, observed July 5, 2006, and the maximum of 4.91%, registered on July 6, 2006. 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 4.85% for the public titles and of 5.99% for the titles of the financial sector.

On the other hand, it was informed that during the July 4 to 6, 2006 period, regarding Treasury-Bond operations there were placements for Q109.7 million and maturity for Q0.2 million and US\$0.1 million.

As to the long term deposit bidding positions in US dollars convened on July 5, 2006, it was mentioned that no bids were presented.

b) The Sub-director for the Monetary Stabilization Operations Department regarding the Institutional Market for foreign currency reported that during the period of June 28 to July 6, 2006, the average daily operations for purchase were of US\$93.0 million and the sale was of US\$88.4 million and that the exchange rates in the referred period remained stable. In effect, on Wednesday, June 28 they were of Q7.59705 per US\$1.00 for purchase and of Q7.61337 per US\$1.00 for sale, on Thursday, June 29 the rates were Q7.59505 and Q7.61310, on Tuesday, July 4 they were of Q7.58700 and Q7.60832, on Wednesday, July 5

they were Q7.58587 and Q7.60375 and finally, on Thursday, July 6 the rates were Q7.57740 and 7.60075.

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 June 29 to July 7, 2006, it was commented that the Private Institutional Foreign Currency System –SPID-, the only operation made was on Thursday, July 6 for US\$1.0 million, at a weighted average exchange rate of Q7.59750 per US\$1.00. Regarding the Electronic Foreign Currency Negotiation System –SINEDI-, expressed that during the period there were no operations and only the *Banco de Guatemala* registered a daily purchase bid for US\$10.0 million, with a price of Q7.58000, 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 June 29 to July 7, 2006, did not close operations. As for the closing price in reference up to Friday, July 7, they indicated that for maturity to settle in December 2006 was of Q7.62000.

c) The Director for the Economic Studies Department informed that on July 6, 2006, the excess of the daily legal reserve of the banking system was located at Q463.5 million, with an average position of Q438.5 million.

The highlights during the period of June 29 to July 6, 2006 the main demonetizing factors were the increase in the daily legal reserve for Q549.6 million and the balance of the deposits of the Central Government in the *Banco de Guatemala* for Q122.3 million; while the main monetizing factors were the decrease in the balance the long term deposits constituted in the *Banco de Guatemala* for Q338.0 million and the deposits of the rest of the public sector in the Central Bank for Q73.7 million; and the increase in the balance of the Net International Reserve –RIN- balance for the equivalent of Q286.4 million.

Regarding the indicative variables of the Monetary, Exchange Rate and Credit Policy they indicated that with the projection to June 2006, for December 2006 the total expected inflation estimated with a model of ordinary squared minimums is of 7.58% and with a softened exponential model of 7.41%; the simple average of both models is located at 7.50%, which is found within the margin of tolerance (6.0% +/- 1 percentage point), which suggests restricting the monetary policy; and, for December 2007 the total expected

inflation, estimated with an ordinary squared minimum model, is of 7.76% and with a softened exponential model of 6.42%; the simple average of both models is at 7.09%, which is over the expected policy goal (5.0% +/- 1 percentage point), which suggests a restrictive monetary policy.

Regarding the expected subjacent inflation for 2006, with data up to June 2006, estimated with an integrated auto-regression model of mobile averages ARIMA was of 6.65%, whereas the estimated with a softened exponential model was of 6.42%; the simple average of both models is of 6.54%, which is within the margin of tolerance for the policy goal (6.0% +/- 1 percentage point), which suggests the monetary policy be moderately restrictive; and, for December 2007 the estimated subjacent inflation with an integrated autoregressive model of mobile averages ARIMA, was of 7.03%, whereas the estimated softened exponential model was of 6.01%; the simple average of both models is of 6.52%, which is located over the tolerance margin of the policy goal (5.0% +/- 1 percentage point), which suggests a restrictive monetary policy.

As to the parameter rate, up to June 29, 2006, the lower limit was 3.99%, and the upper limit is 7.94%; while the simple average between the repurchase agreements of 8 to 15 days (4.93%) and the weighted average of the monetary stabilization operations of up to 91 days (4.84%) was situated at 4.89%, which is located within the tolerance margin estimated for the parameter rate, situation that suggests the monetary policy remain invariable. When referring to the parity liable rate, they declared that up to June 29, 2006, the lower limit was 6.77% and the upper limit was 8.35%, and the weighted average rate of long term deposits of the banking system was of 7.03%, which maintains itself within the fluctuation range of the parity liable rate, which advises an invariable monetary policy.

As to primary liquidity it was indicated that monetary issue observed to July 6, 2006, presents a deviation of Q448.3 million regarding the upper limit programmed runner for said variable, which would indicate that there is space available to restrict the monetary policy, as to the behavior of a wide monetary base, to date, is Q488.8 million below the lower limit of the programmed runner, which suggests relaxing the monetary policy. The weighted orientation of the deviations for the present week are for -Q20.2 million, which would indicate relaxing the monetary policy.

As to the total payment means, the inter-annual growth observed to June 29, 2006, it ascended to 18.5%, locating itself within the tolerance margin estimated range for said variable (16.8% to 18.8%), which advises an invariable monetary policy; in which the econometric estimation for the payment means for the end of 2006 is of 17.8%, which is over the upper limit of the estimated range for December 2006 (13.0% to 15.0%), which would be suggesting a restrictive monetary policy. The average orientation of the deviation of 1.40%, therefore suggests, restricting the monetary policy. Also, up to said date, the inter-annual variation of banking credit of the private sector registered growth of 27.2%, which is over the range estimated for June 29, 2006 (23.0% to 25.0%), which suggests a restrictive monetary policy; on the other hand, the econometric estimation for the end of 2006 of the banking credit to the private sector is of 28.0%, which is over the upper limit of the estimated range (16.0% to 18.0%), which suggests restricting the monetary policy. The average orientation of the deviations for the present week of 6.10%, therefore suggests, restricting the monetary policy.

As to inflation expectations of private analysts, they indicated that according to the poll made in June 2006, for December 2006 an inflationary rhythm of 7.73% is expected, which is above the goal for monetary policy (6.0% +/- 1 percentage point), an aspect which suggests restricting monetary policy; and, for December 2007, the inflation projection is located at 7.47%, which is over the monetary policy goal (5.0% +/- 1 percentage point), which suggests restricting the monetary policy.

Also it was indicated that the variable implied inflation expectations, for June 2006 showed an inflationary rhythm of 6.03%, which is within a tolerance margin of the monetary policy for 2006 (6.0% +/- 1 percentage point), which suggests a moderately restrictive monetary policy.

They mentioned that the Monetary Conditions Index –ICM-, to June 29, 2006, was -2.84 percentage points which is within the fluctuation margin estimated for said variable on that date (-3.71 to -2.11 percentage points), which advises that the monetary policy should remain invariable.

Regarding the Semi-structural Macroeconomic Model (MMS) used for foreseeing the total inflationary rhythm, projected a rhythm of 6.88% for December 2006, conditioned by gradual adjustments in the leading interest rate of the monetary policy until locating

itself at the end of the year at 5.47%, which suggests restricting the monetary policy. Also, the prognosis for said model for a mid-term horizon, projects that for December 2007 an inflationary rhythm of 5.13%, conditioned to gradual adjustments in the leading interest rate of the monetary policy until stopping at 3.52%, which would be suggesting restricting the monetary policy.

To conclude, regarding the orientation of the indicative variables, it was indicated that regarding the previous week, the variable “primary liquidity” went from suggesting that the monetary policy be restrictive to advising it to relax, with which, according to the relative weight assigned to the indicative variables by the members of the Monetary Board, they indicated that 53.26% of the same advise a restrictive monetary policy orientation; (63.27% the previous week); 24.23% suggest an invariable monetary policy orientation; (same percentage of the previous week); and 12.05% advise a moderately restrictive monetary policy (12.50% the previous week); and 10.46% suggest an orientation toward relaxing the monetary policy (0% the previous week).

Finally, they indicated that regarding the behavior of the nominal exchange rate, the center of the expected runner for the week of July 4 to 7, 2006 was of Q7.643 per US\$1.00 and the observed level (calculated as the average of the exchange rates for purchase and sale in the Institutional Market of Foreign Currency for the period between July 4 and 5) was of Q7.596 per US\$1.00, which allows inferring that the observed value of the nominal exchange rate is found within the expected fluctuation band, but near the lower limit, therefore in this light inflationary or deflationary pressures are not foreseen.

Finally, the Consumer Price Index presented a report to June 2006 based on the report from the National Statistics Institute (INE for its acronym in Spanish), indicated that the monthly inflation was of 0.60%, lower by 0.03 percentage points to May 2006 and lower by 0.06 percentage points to the observed in June 2005; the inflationary rhythm was at 7.55%, lower by 0.07 percentage points to May 2006 (7.62%) and lower in 1.25 percentage points to the observed to June 2005 (8.80%); the subjacent inflation registered a rhythm of 6.91%, lower by 0.38 percentage points to that of May 2006 (7.29%) and lower by 1.31 percentage points to June 2005 (8.22%).

d) The Committee took note that the monetizing and demonetizing factors foreseen for the week of July 7 to 13, 2006 indicate an increase in the creation of primary liquidity

for Q2, 704.9 million, fundamentally due to the maturity of LTD's and to the use of deposits of the Central Government in the *Banco de Guatemala*. Also, an increase in the demand for monetary issue for Q31.3 million is foreseen and a daily banking liquidity position for Q360.9 million. Also, monetary issue is deviated in Q630.9 million above the central programmed point for said variable, therefore the excess of aggregate liquidity estimated for the referred period is located at Q3,665.4 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 (Q2,200.8 million, according to registries to July 6, 2006) have to be relocated; and, also, have additional fund raising for around Q1,464.6 million.

**THIRD:** Discussion and Definition of the execution guidelines of the Monetary, Exchange rate and Credit Policy

a) Discussion

When analyzing the behavior of the monthly inflation to June 2006, a member of the Committee declared that, if it is true that the monthly variation and the inflationary rhythm decreased slightly regarding the observed the month before, it is opportune to consider that if in the rest of 2006 the monthly inflation behaves as it has in the last two years, the inflation goal will probably not be reached at the end of the year, unless the gradual adjustments in the leading interest rate of the monetary policy continues. Additionally, another member of the Committee also shared the criteria that it is necessary to increase the leading interest rate, taking into account that the econometric projection for the total inflationary rhythm for December 2006 and for December 2007 increased regarding the projection made with data to May of this year. Another member of the Committee declared that a factor that could eventually be considered in order to not increase the leading interest rate at the moment is the appreciation that has been observed in the type of nominal exchange rate in the last two weeks. Notwithstanding, they indicated that according to the historic information on this variable, the mentioned behavior obeys the seasonality that it presents at this time and that it is estimated to revert in the next weeks. In any case, it was emphasized that the important thing to consider for an adjustment in the

leading interest rate is the orientation of the indicative variables toward the restriction, which according to the synthetic index corresponds to 53.26%.

b) Determination of the quotas for term deposit bidding.

Regarding the determination of quotas for the biddings in the following week, the information provided by the daily monetization flow was taken into account, on the one hand, the measure adopted regarding a reduction of quotas and the number of weekly bids; as well as alternating the bidding terms. Based on the above, the Committee agreed that the fund-raising quota for the 182 and 364 day terms to be established at Q25.0 million and Q85.0 million, respectively and the convening to be transferred to Wednesday, July 12, 2006 instead of Monday 10, in virtue of the fact that for this last date a lack of liquidity is foreseen in the money market.

Regarding the convening to bidding of LTD's in US dollars, the Committee took into account the foreseen maturity of Treasury Bonds expressed in US dollars and considered that for the week of July 10 to 14, 2006, it is necessary to convene biddings in LTD's in said currency.

c) Definition of the guidelines of the execution of the Monetary, Exchange and Credit Policy.

Based on the discussed, the Committee agreed that for the week of July 10 to 14, 2006, it will continue with the execution guidelines of the monetary policy observed during the present week; in other words; continue with operations in the MEBD and in the stock exchange, for fund-raising as well as giving liquidity to the market. The fund-raising operations were made for 7 day terms without quotas, at a leading interest rate of 4.75%, and the bids of liquidity offer in 7 day terms, at a leading interest rate of 7.65%, whose guarantee of said operations will be constituted only by receiving public titles. It is worth indicating that the Committee reiterated the importance of participating in both venues; in other words, keeping simultaneous liquidity giving bids and the retiring of liquidity, considering said participation constitutes a signal of willingness by the Central Bank to moderate the volatility in the short term interest rate.

The Committee taking into account the agreed in matters of coordination with the fiscal policy for the participation in the money market, agreed to convene a bid for the term deposit on Wednesday, July 12 for the terms of 182 and 364 days, with a fund-raising quota

for Q25.0 million and Q85.0 million, respectively. The interest rates will be determined according to the conditions of the market, reflected in the bids received.

On the other hand, the Committee agreed to continue fund raising directly at the window, with the official and public entities. In the case of the public entities, that the fund raising continue to be according to the prevalent financial conditions; in other words, the interest rate for the 7 day terms will be the one applied by the *Banco de Guatemala* in the MEBD and in the stock exchange and, for the other terms, the interest rate will be the mobile average, for each term, of the weighted average interest rate of 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 convene bidding for term deposits in United States dollars, on Wednesday July 12, 2006 in 91 days and 364 day terms, for an amount of up to US\$30.0 million. The bids received will be awarded the reference interest rates of the Treasury Letters of the United States of America in similar terms, without excluding the possibility of receiving higher rates if they merit it, convening a session of the Committee to decide the awarding.

The Committee agreed to continue accepting the constitution of term deposits in United States dollars directly at the window, from public entities, in current terms of (91 days and 364 days) and that the interest rate applied will use the interest rates of the Treasury Letters of the United States of America in similar terms as a reference.

As for the participation of the *Banco de Guatemala* in the exchange market, the Committee agreed to continue participating through the electronic negotiating system of foreign currency, with a bid of US\$10.0 million at a price equal to that of the last purchase made by the *Banco de Guatemala* and according to the participation regulations established for the effect.

**FOURTH:** Other matters.

Not having any other matter to discuss, the session ends at sixteen hours and forty five minutes, in the same place and on the same date indicated, all who attended sign in agreement.