EXECUTION COMMITTEE

ACT NUMBER 33-2006

Session 33-2006 celebrated in the *Banco de Guatemala* building located at *séptima avenida número veintidós guión cero uno, zona uno* of this city on Friday, August 11, 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 32-2006, corresponding to the session celebrated on August 4, 2006.
The project of act 32-2006 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 32-2006.

SECOND: Information of markets and monetary variables.

The coordinator requested the following information be provided.

a) The Director of the Department of Monetary Stabilization Operations, regarding the Money market informed that during the period from August 7 to 11, 2006, with partial data to date, registered an attraction of LTD's for Q1, 644.3 million and maturity for Q1,466.6 million, which gave as a result for net fund-raising for Q177.7 million, associated to the operations made in bidding (net maturity for Q88.2 million), in the Money Electronic Banking Table –MEBD- and in the stock exchange (net fund-raising of Q349.0 million) and at the window (net maturity for Q83.1 million).

As to the bidding of LTD's in US dollars convened on August 9, 2005, it was mentioned that no bids were presented.

Regarding the interest rates applied in fund raising through LTD's, it was indicated that during the period of August 7 to 11, 2006 for the biddings case, the cut interest rates was5.4999% for 182 days and of 6.22% 364 days. On the other hand, in the MEBD and in the stock exchange the fund-raising took place for 7 days, the leading interest rate was 5.00%.

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 August 7 to 11, 2006 period, with partial data, the minimum was of 5.07%, observed August 7, 2006, and the maximum of 5.16%, registered on August 9, 2006. It also pointed out that the amounts negotiated were greater with public title guarantees and that the average weighted during said period was of 5.14% for public titles and 5.30% for financial sector titles.

On the other hand, it was informed that during the August 7 to 10, 2006 period, regarding Treasury-Bond operations there were placements for Q15.0 million and maturity for Q0.2 million and US$14.1 million.

b) The Director for the Monetary Stabilization Operations Department regarding the Institutional Market for foreign currency reported that during the period of August 4 to 10, 2006, the average daily operations for purchase were of US$73.9 million and the sale was of US$68.9 million and that the exchange rates in the referred period remained stable. In effect, on Friday, August 4 they were of Q7.57393 per US$1.00 for purchase and of Q7.59018 per US$1.00 for sale, on Monday, August 7 the rates were Q7.57369 and Q7.58951, on Tuesday, August 8 they were of Q7.57190 and Q7.58713, on Wednesday, August 9 they were Q7.57115 and Q7.58339 and finally, on Thursday, August 10 the rates were Q7.56996 and 7.58583.

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 August 7 to 11, 2006, it was commented that the Private Institutional Foreign Currency System –SPID-, the only operation made was on Monday, August 7 for US$0.5 million, at a weighted average exchange rate of Q7.59000 per US$1.00 and on Thursday August 10 for US$3.0 million at Q7.58100 and on Friday, August 11 for US$1.0 million, at Q7.58100. 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$6.0 million, with a price of Q7.57900 per US$1.00, 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 August 7 to 11, 2006, did not close operations. As for the closing price in reference up to Friday, August 11, they indicated that for maturity to settle in December 2006 was of Q7.61000.

c) The Director for the Economic Studies Department informed that on August 10, 2006, the daily legal reserve of the banking system was located at Q452.7 million, with an average position of Q438.6 million.

The highlights during the period of August 3 to 10, 2006 the main demonetizing factors of the monetary issue were the increase in the balance the long term deposits constituted in the *Banco de Guatemala* for Q592.5 million and the decrease in the balance of the Net International Reserve –RIN- balance for the equivalent of Q304.8 million; while the main monetizing factors were the decrease in the long term deposits constituted in the *Banco de Guatemala* for Q452.8 million, the daily legal reserve balance for Q190.4 million and the deposits of the rest of the public sector in the Central Bank for Q24.5 million. Regarding the main demonetizing factors of the Ample Monetary Base; it was reported that these were the increase in the balance of the deposits of the Central Government in the *Banco de Guatemala* for Q592.5 million and the decrease in the balance of the Net International Reserve –RIN for the equivalent to Q304.8 million; while the main monetizing factors were the decrease in the balance of term deposits greater than 91 days constituted in the *Banco de Guatemala* for Q154.7 million and the banking legal reserve in foreign currency for the equivalent to Q59.3 million, and the deposits of the rest of the public in the Central Bank for Q24.5 million.

Regarding the indicative variables of the Monetary, Exchange Rate and Credit Policy they indicated that with the projection to July 2006, for December 2006 the total expected inflation estimated with a model of ordinary squared minimums is of 6.85% and with a softened exponential model of 7.38%; the simple average of both models is located at 7.12%, which is found over 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 7.71% and with a softened exponential model of 6.48%; the simple average of both models is at 7.10%, which is over the expected policy goal (5.0% +/- 1 percentage point), which suggests a restrictive monetary policy.

Regarding the expected subjacent inflation for December 2006, with data up to July 2006, estimated with an integrated auto-regression model of mobile averages ARIMA was of 6.44%, whereas the estimated with a softened exponential model was of 6.65%; the simple average of both models is of 6.55%, which is over the punctual value of the inflation goal and 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 6.90%, whereas the estimated softened exponential model was of 6.05%; the simple average of both models is of 6.48%, 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 August 3, 2006, the lower limit was 3.06%, and the upper limit is 7.01%; while the simple average between the repurchase agreements of 8 to 15 days (5.25%) and the weighted average of the monetary stabilization operations of up to 91 days (5.00%) was situated at 5.13%, 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 August 3, 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 7.06%, which is located 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 August 10, 2006, presents a deviation of Q469.2 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 at Q76.1 million under the lower limit of the programmed runner, which suggests a relaxed monetary policy. The weighted orientation of the deviation for the present week is for Q196.5 million, which would indicate restricting the monetary policy.

As to the total payment means, the inter-annual growth observed to August 3, 2006, it ascended to 18.1%, locating itself over the tolerance margin estimated range for said variable (16.3% to 18.3%), which advises an invariable monetary policy; in which the econometric estimation for the payment means for the end of 2006 is of 17.5%, which is over the upper limit of the estimated range for December 2006 (13.0% to 15.0%), which suggests a restrictive monetary policy. The average orientation of the deviation of 1.25%, 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 August 3, 2006 (22.6% to 24.6%), 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 27.2%, 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 5.90%, therefore suggests, restricting the monetary policy.

As to inflation expectations of private analysts, they indicated that according to the poll made in July 2006, for December 2006 an inflationary rhythm of 7.40% 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 7.07%, 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 July 2006 showed an inflationary rhythm of 5.90%, which is within a tolerance margin of the monetary policy for 2006 (6.0% +/- 1 percentage point), which suggests a moderately relaxed monetary policy.

They mentioned that the Monetary Conditions Index –ICM-, to August 3, 2006, was -2.68 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 even though the individual orientation of each variable remains unchanged regarding the previous week, the weightings for the inflation prognosis changed when counting on new inflation data observed in July, decreasing the relative importance of said prognosis for 2006 and increased for 2007. From this account, according to the relative weight assigned to the indicative variables for the members of the Monetary Board, indicated that 64.23% of the same advise an orientation of restrictive monetary policy (63.72% the previous week); 24.23% suggests an invariable monetary policy orientation (equal percentage of the previous week); 8.67% a moderately relaxed monetary policy (percentage equal to that of the previous week); and, 2.87% advises a moderately restrictive monetary policy orientation (3.38% the previous week).

On the other hand, they indicated that regarding the behavior of the nominal exchange rate, the center of the expected runner for the week of August 7 to 11, 2006 was of Q7.667 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 August 7 to 9) was of Q7.579 per US$1.00, which allows inferring that the observed value of the nominal exchange rate is found slightly below the lower limit of the estimated fluctuation band (Q7.607 per US$1.00).

Finally, the information presented by the Consumer Price Index to July, 2006 based on the report from the National Statistics Institute, INE (for its acronym in Spanish), indicated that the monthly inflation was of 0.46%, lower by 0.14 percentage points to that of June 2006 and lower by 0.48 percentage points to the observed in July 2005; the inflationary rhythm was at 7.04%, lower by 0.51 percentage points to the registered in June 2006 (7.55%) and lower by 2.26 percentage points to the observed in July 2005 (9.30%); the subjacent inflation registered an a rhythm of 6.62%, lower by 0.29 percentage points to the observed in June 2006 (6.91%) and lower by 1.76 percentage points to that of July of 2005 (8.38%). Regarding the estimations of the imported and domestic components of total inflation, reported that 7.04% of the inflationary rhythm to July 2006, 2.79 percentage points are attributable to imported inflation, of which, 2.18 percentage points correspond to indirect imported inflation (second round effect); therefore, the inflationary rhythm, 4.25 percentage points correspond to domestic inflation.

d) The Committee took note that the monetizing and demonetizing factors foreseen for the week of August 11 to 17, 2006 indicating increase in the creation of primary liquidity for Q1, 430.2 million, fundamentally due to the maturity of LTD’s. Also, a decrease in the demand for monetary issue for Q158.6 million is foreseen and a daily negative banking liquidity position for Q34.0 million. Also, monetary issue is deviated in Q651.8 million above the central programmed point for said variable, therefore the excess of aggregate liquidity estimated for the referred period is located at Q2,206.6 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 (Q1,732.1 million, according to registries to August 10, 2006) have to be relocated; and, also, have additional fund raising for around Q474.6 million.

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

a) Discussion

The technical departments presented the Committee with some advances in the third running of the Semi-structural Macroeconomic Model. The purpose of the mentioned presentation was to obtain feedback from the Committee to fine-tune what was necessary in order that the mid-term inflation prognosis would be consistent from the empiric point of view as well as the theoretical, to present the results to the Monetary Board in the next meeting in which they would decide, regarding the level of the leading interest rate of the Monetary Policy.

Based on the information received, the Committee began the discussion on the analysis that must be presented to the Monetary Board in its Wednesday, August 23, session when, according to the calendar approved, the Board will make a decision regarding the leading interest rate of the monetary policy. For the effect, in the heart of the Committee they analyzed the factors that advise raising the referred interest rate, as well as those that advise keeping it invariable, so that the same take into account the inflation risks balance that the technical departments will present in the next Committee meeting.

As to the factors that advise raising the leading interest rate, the following are mentioned:

i. The behavior of the rise in the international price of oil continues to be the main inflationary risk factor in the country, given that for 2006 it is expected that said price will remain high. In effect, according to the last quote of the futures oil price, it was located at US$76.89 per barrel for the end of 2006, level over the prevalent quote to July 21 (date in which the Committee discussed the level of the leading interest rate) that was of US$76.44 per barrel. It was indicated that, as a result of maintaining high oil prices since the end of July, an important increase in the prices of gasoline was observed (around Q1.00 per gallon), situation that could affect inflation in August.

ii. The orientation of the indicative variables toward the restriction of said monetary conditions, according to the synthetic index, correspond to 64.23% (63.72% in the session from the previous month).

iii. The total inflation projection for December 2006 (based on the econometric methods) decreased 0.38 percentage points regarding the projection made in past July, notwithstanding its level still remained over the inflation goal, even when taking into account the tolerance margin of +/- 1 percentage point.

On the other hand, among the factors which advise keeping the leading interest rate of the monetary policy invariable; the following were indicated:

i. In July domestic inflation was reduced regarding the observed the month before from 4.86 percentage points to 4.25 percentage points, including registering the lowest level observed during the present year; also, if domestic inflation were added to historic imported inflation (0.52 percentage points), said rhythm ascends to 4.77%, located slightly below the lower limit of the inflation goal of the tolerance margin (6.0% +/- 1 percentage point).

ii. The result of the inflation expectations panel of private analysts' survey made in July reflects a decrease of 0.33 percentage points in the projection of the inflationary rhythm for December 2006, when going from 7.73% in June to 7.40% in July. It is worth indicating that the referred survey was made before making known the reduction of the inflationary rhythm in July, therefore the mentioned inflation expectations could be reduced even more in the survey corresponding to August.

iii. According to Bloomberg, there is a 93.5% probability that the US Federal Reserve objective interest rate remain at 5.25% in its September 20, 2006 meeting.

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 guideline to keeping the quota amount limited and the number of weekly bids. Based on this, the Committee agreed that the fund-raising bid for the 182 day and 364 day terms be established at Q10.0 million and Q25.0 million, respectively and that the convening be transferred to Wednesday, August 16, instead of Monday 14, due to the fact that according to the established in the coordination meeting with the *Ministerio de Finanzas Públicas* (Equivalent to the Department of the Treasury), derived from the August 15 holiday, the latter will convene a bid for Treasury Bonds on Monday 14.

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 August 14 to 18, 2006, it is not 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 August 14 to 18, 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 the monetary policy 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, August 16 for the terms of 182 and 364 days, with a fund-raising quota for Q10.0 million and Q25.0 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 not convene bidding for term deposits in United States dollars.

The Committee agreed to continue accepting the constitution of term deposits in United States dollars directly at the window, from public entities, in terms of 91, 182 days and 364 days and for the interest rate to be 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 seventeen hours and thirty minutes, in the same place and on the same date indicated, all who attended sign in agreement.