

# **FIRST PART**

## **EVALUATION OF THE MONETARY, EXCHANGE AND CREDIT POLICY TO NOVEMBER OF 2004**

### **I. GENERAL FRAMEWORK**

The Monetary Board, in resolution JM-171-2003 dated December 23, 2003, determined the Monetary, Exchange and Credit Policy for 2004, oriented, mainly to consolidating the stability and confidence of the main macroeconomic and financial variables. In that sense, the fundamental objective of the referred policy, which is to promote the stability in the general level of prices, was manifested in an inflation goal for the end of the year between 4% y 6%.

For the achievement of the fundamental objective of the monetary policy, as well as to avoid the volatility of the money and exchange markets, the main conditioning factors were identified that must be foreseen by the Central Bank in the execution of said policy, one of these being the fiscal discipline, the stability and economic growth, the maintenance of the monetary discipline, the consolidation of the implementation of the new financial legislation and the expectations derived in the reactivation of the world economy.

### **II. QUALITATIVE ASPECTS**

*Inflation.* During 2004, the monetary policy was executed in the presence, external order, of notable improvement in the recovery expectation of the world economy, which is estimated to grow at the highest rate of the last twenty years, behavior associated with a more dynamic recovery foreseen for the economy of the United States of America and strongly dynamic in the Asian region; and, in the internal order, of support for the fiscal policy offered by the monetary policy, through the maintenance in the level of deposits in the *Banco de Guatemala* over the programmed, as well as the formation of the positive expectations of economic growth on behalf of the economic agents, derived not only from the cited recovery of global economy, but also of the finalization of the electoral event, and therefore, of the uncertainty associated with it. Notwithstanding these political aspects,

during the year they also observed adverse events for the effectiveness of the monetary policy, of which the fundamental and determining was the rise in international oil prices, which importantly influenced imported inflation<sup>1</sup> registered at its highest observed in the last three years. On this, we understand, that the level of commodities and services that make up the CPI basket, propane gas, gasoline and electricity were the main titles that evidenced the rise in oil prices. It is worth mentioning that the imported inflation exercised its main effects of inflation in the months of May, September, October and November, in which after January, registered the highest inflationary rates of the year (0.83%; 0.78%; 0.98%; and, 0.99%). Particularly, the inflation of May that interrupted the tendency to decline that in the monthly inflation had been observed since January of the current year.

Another adverse factor to the effectiveness of the monetary policy was the formation of the inflationary expectation of the economic agents<sup>2</sup>, which besides associating with the cited behavior of imported inflation, was derived of the effects that the cited imported inflation had from the excess of primary liquidity originated since May 2003, which, notwithstanding the monetary stabilization efforts made during the referred year, extended during this year. On the other hand, it is also worth indicating that the referred inflationary expectations could have been encouraged by uncertainty associated by the situation of public finance, which was observed during the entire first semester. Even though there was a strong restriction of the observed public expense during said semester and of the reiterated announcement of the governmental commitment to execute a fiscal deficit no higher than 2% of the gross national product in 2004, the way in which they would close the breach within the income and public expense was not cleared until June 29, when the Congress of the Republic approved the reforms of the tax laws, that were enforced at the beginning of the second semester of the year.

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<sup>1</sup> Imported Inflation is the inflation derived of the price of raw materials and intermediary imported products (cost inflation) as well as final imported commodities.

<sup>2</sup> As a reference, according to the results of the Inflation Expectations Survey of the Economic Panel of Experts, as of February the expected inflation for December 2004 registered a rising behavior, going from 6.39% in February to 8.46% in November.

In the context described, the domination of the adverse factors for the effectiveness of the monetary policy, especially the impact of the derived imported inflation of the shock of international oil prices, was determinant so that the inflation had registered a tendency to the rise during 2004. According to the Consumer Price Index made up by the National Statistics Institute, after registering an inter-annual growth of 5.85% to December 2003, the inflationary rhythm was at 9.22% to November 2004, higher by 3.38 percentage points observed to November 2003 (5.84%) and locating itself above the range between 4% and 6% established as the goal for the end of the year in the current Monetary, Exchange and Credit Policy. In this context, we estimate that for December of 2004 the inflationary rhythm will be at 9.3%.

It is convenient to highlight that the imported inflation has significantly influenced in the behavior of total inflation, since, of the 9.22% of the inflationary rhythm of November 2004, 2.81 percentage points are attributable to imported inflation and 6.41 percentage points to domestic inflation. In that sense, if we take into account that the recent historic average of incidence of imported inflation of total CPI is of 0.47 percentage points, and to November 2004 there is an excess of imported inflation of 2.34 percentage points, which would suggest an absence of said excess, the inflationary rhythm to October would be at 6.88%.

***Execution of the Monetary Policy.*** In the presence of a rise in international oil prices and given the uncertainty regarding the future evolution of prices that was extended throughout the year, the necessity to take monetary policy action oriented toward knocking down observed inflationary expectations was evidenced, even though monetary measures, in order to not generate unnecessary distortions in the main macroeconomic variables, must be executed with prudence, so as to, on the one hand, notwithstanding the fact that the economic activity is recovering, its growth rhythm is still insufficient to effectively contribute to the objective of development in the country, and on the other hand, because from the beginning of

the month of April an abrupt behavior in the nominal exchange rate toward appreciation was registered.

In that context, the Execution Committee of the *Banco de Guatemala*, based on the guidelines contained in the Monetary, Exchange and Credit Policy approved by the Monetary Board, adjusted the interest rate on three occasions of the Term Deposit Certificates –LTDs- for 28 day terms, increasing it on March 15 from 4.50% to 4.75%, on April 13 to 5.25% and on June 8 to 5.63%.

Also, taking into account that the inflationary effects of the increase in international oil prices continue manifesting themselves in the second semester of the year and that could influence in the expectations of economic agents, and before the dilemma that implies the insufficiency of the economic growth and the accelerated appreciation of the nominal exchange rate, the Execution Committee of the *Banco de Guatemala*, on September 10, agreed to moderately elevate the interest rate that recognizes because of the CDP investments in terms of 182 days, increasing it from 6.05% to 6.15%, while on October 18 the interest rate was increased to 5.85% to 6.10% for the 91 day term. Due to the indicated, the referred adjustments pursues, on the one hand, to avoid the inflationary pressures derived from the rise in international oil prices to spread to the all the sectors of the economy (second round effect) and, on the other hand, attack the inflationary expectations sending a message to the economic agents on the commitment of the central bank with the macroeconomic stability, especially, with the maintenance of the stability of the general level of prices. The above mentioned indicates that during the year the monetary authority should have paid attention to the evolution of the inflationary rate and of the indicative variables of said policy, taking into account, on the one hand, the exogenous component of the rise in the oil price and on the other hand, the evolution of the inflationary expectations of the economic agents, all with the goal of continuing to adopt the actions that will allow the moderation of price behavior.

**External Sector.** Concerning the external sector, the net international monetary reserves, to November 30, were at US\$3,447.9 million, amount higher by US\$528.6 million to the level registered on December 31, 2003 and that represents 5.1 months of importation of commodities, which denotes the solidity of the external position of the country.

In exchange rate matters; this showed stability during the first trimester of the year, to later register an abrupt tendency toward appreciation, aspect which made, according to the guidelines of the current Monetary, Exchange and Credit Policy, the Central Bank will participate in the exchange market buying foreign currency for US\$305.7 million<sup>3</sup> in order to avoid volatility in the referred variable and, in this manner, avoid unnecessary distortions in the efficiency of the assignment of the economic resources. In this context, it is worth mentioning that during the first trimester of the year the exchange rate<sup>4</sup> depreciated Q0.05 (0.6%), when surpassing Q8.04 for US\$1.00 on December 31, 2003 to Q8.09 for US\$1.00 on March 31 of the current year, behavior associated to the stationary factors while in the April to November period said variable appreciated Q0.34 (4.21%), reaching Q7.75 for US\$1.00 on November 30. The behavior of the exchange rate in this period was associated to the capital flow of temporary nature<sup>5</sup>, which derived an overabundance of United States of America dollars in the international markets and coincided in the beginning of the second trimester of the year with a stationary tendency to the appreciation of the referred period, which was supported by the payments of the domestic market of the Treasury Bonds expressed in foreign currency. In addition, the conjunction of these factors resulted in the formation of a destabilizing speculation that exacerbated the appreciation of the referred variable.

Given the appreciation articulation of the nominal exchange rate and the frame of approved guidelines of the Monetary, Exchange and Credit Policy for the participation in the exchange market, the *Banco de Guatemala*, taking into account

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<sup>3</sup> Additionally, the *Banco de Guatemala* bought US\$51.0 million in order to anticipatedly pay the external debt of the institution, therefore the total bought in SINEDI was of US\$356.7 million.

<sup>4</sup> The referred Exchange rate is the average of purchase and sales in the institutional currency market.

<sup>5</sup> In annex 1 is presented a relevant exercise of the capital flow in Guatemala during the 1997 to 2004 period.

the price of the American currency, acquired foreign currency in the SINEDI for US\$51.0 million with the objective of paying a part of its external debt in advance.

***Interest Rate and Credit to the Private Sector.*** The asset and liable weighted average interest rates in national currency in the banking system, during the first trimester continued with a stable to low tendency, when going from 14.11% and 4.52% on December 31, 2003 to 13.91% and 4.40% on March 31, 2004. During the rest of the year the asset rate continued reduction until it was at 13.56% on November 25, while the liable rate moderately increased until situating itself at 4.54%, which also suggests that during the year it registered a moderate reduction of the banking spread. On its part the weighted average interest rate of the repurchase agreements operations has been maintained, on average, around 2.7% annually.

Regarding the banking credit to the private sector, to November 25, it exhibited an inter-annual growth rate of 13.5%, which is located in the upper range foreseen for the current monetary policy (11.5% -13.5%).

***Treasury.*** To October 31, 2004, according to the preliminary numbers of the *Ministerio de Finanzas Públicas* [Equivalent to the Department of the Treasury], a fiscal deficit of Q573.5 million was observed, amount less by Q2,520.0 registered in the same period for 2003(Q3,093.5 million). This result mainly due to the contention of public expense, which was at Q2, 421.6 million under the observed amount to October 2003, which represents a decrease of 11.3% in said variable; and, complementarily, the increase in the total income which was higher by Q98.4 million to the registered in October of the previous year, which means a 0.5% increase in the fiscal proceeds. This behavior of the Tax administration allowed, that on November 30, the deposits of the central government in the *Banco de Guatemala* were over Q874.5 million regarding the programmed level, which evidences the significant support the fiscal policy offered the monetary policy. In particular, the cited demonetizing behavior of the central government, also

complemented with a demonetizing behavior from the rest of the public sector, cooperating to neutralize the primary liquidity generated by external monetization that was necessary in order to avoid the volatility of the exchange market.

Lastly, it is worth mentioning that the implemented efforts to strengthen the macro economic stability were oriented toward creating an environment of certainty and trust so the economic agents can make adequate decisions in matters of consumption, savings and investment, factors that are fundamental for the propitiation of growth and the orderly development of the national economy.

### **III. MACROECONOMIC SURROUNDINGS**

#### **A. REAL SECTOR: Economic Activity in 2004**

##### **1. General Aspects**

The deceleration that the growth rhythm of national economic activity has been manifesting since 1999 was reverted in 2004; year in which the Gross National Product, GNP, in real terms is foreseen will grow 2.7%, higher rate than the registered the year before (2.1%). It is worth mentioning that this growth rate, even though positive, continues to be lower than the average registered rate, in the nineties (4.1%), but higher for the first time in the last four years, although marginally, to the population growth rate (2.5%)<sup>6</sup>. Said behavior is founded, in the external order, in the higher foreseen growth for the economy of the United States of America as well as for the rest of the main commercial partners of Guatemala<sup>7</sup> (with the exception of Costa Rica); in the internal order, the real growth was favored in the maintenance of the macro economic stability and by the lesser incidence of adverse factors of extra-economic nature<sup>8</sup>. It is worth mentioning that even though the international price of oil constitutes an adverse factor in the national productive activity, the impulse of global economy has grown at a higher

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<sup>6</sup> Estimation made by the National Statistics Institute, INE, based on the Population Census of 2002.

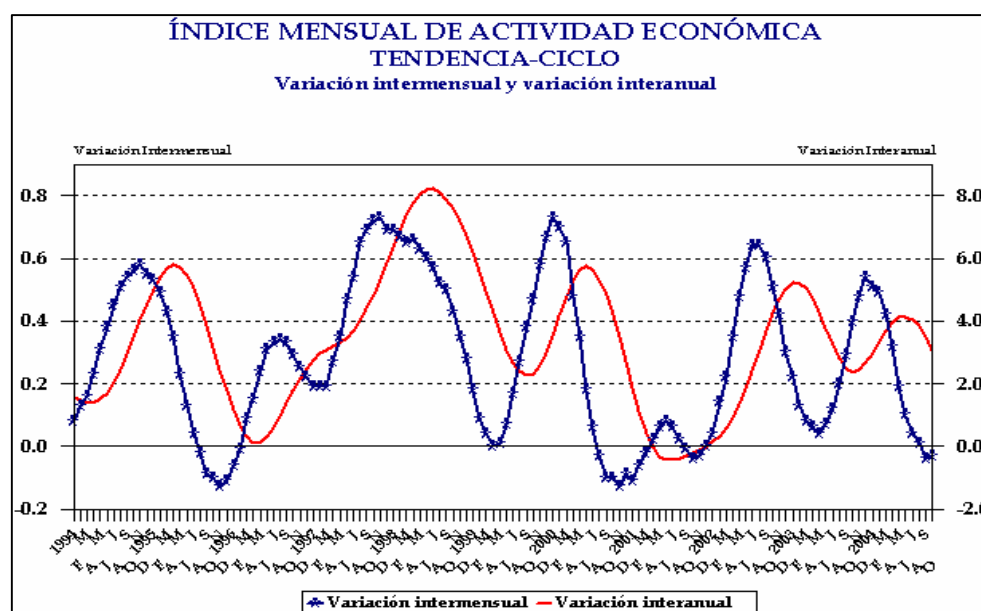
<sup>7</sup> The United States of America (4.3% for 2004 and 3.0% in 2003); Mexico (4.0% for 2004 and 1.3% in 2003); El Salvador (2.0% for 2004 and 1.8% in 2003); Honduras (3.8% for 2004 and 3.2% in 2003); Costa Rica (3.8% for 2004 and 5.6% in 2003); and Nicaragua (3.7% for 2004 and 2.3% in 2003), among others, according to estimations of the International Monetary Fund: IMF

<sup>8</sup> Qualitative factors that generate uncertainty in the economic activity, for example, the political risk factors that businesses of international prestige qualifiers of risk take into account when analyzing the risk country, among them, the socio-economic conditions, the tradition and order of law and the degree of harmony between the government and other sectors of society.

rhythm in the last twenty years, due to, on the one hand, the better expectations of growth in the United States of America; and; on the other hand, the foreseen growth of the commerce of commodities and services<sup>9</sup>, being this a fundamental factor that cooperated with the beginning of the recovery of Guatemala's economy.

As to the Monthly Economic Activity Index, IMAE, its cyclical tendency, after showing acceleration between November 2003 and June 2004, began to decelerate until it reached an inter-annual variation of 3.06% in October 2004, therefore its behavior in the next months will determine if the deceleration is temporary.

(Economic Activity Monthly Index.  
Cyclical Tendency. Inter-monthly variation and  
inter-annual variation)



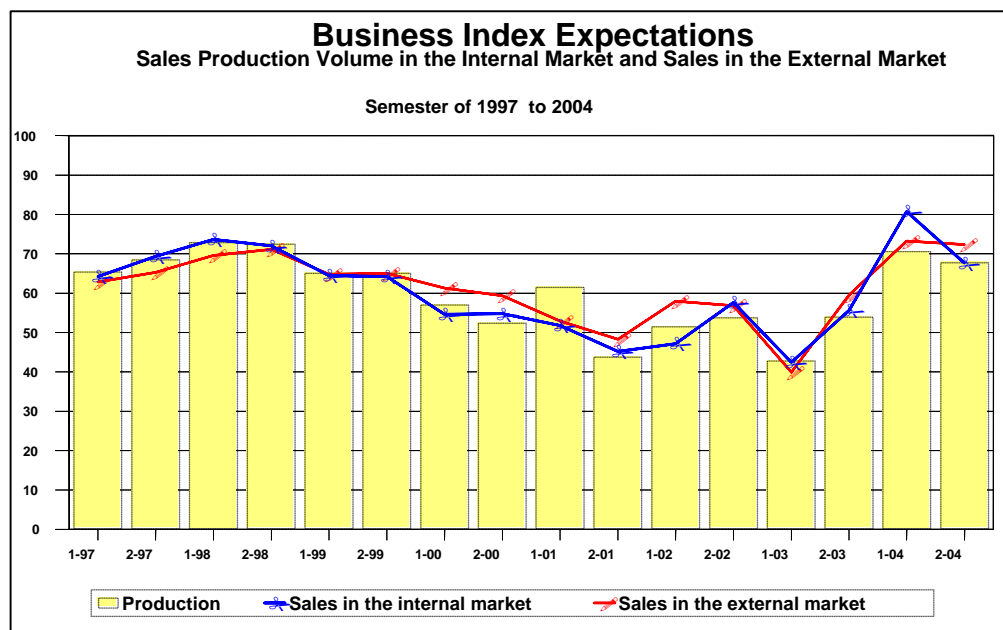
On its part, according to the results of the Business Opinion Survey<sup>10</sup>, the Business Production Expectation Survey<sup>11</sup> shows a slight decrease when

<sup>9</sup> In 2004 we foresee that World Commerce will be 8.8% higher than the observed in 2003, which was 5.1%.

<sup>10</sup> In 2004, the first survey of the year was made in the March to April period and the second in the September to October period. The sample includes 400 industrial establishments, of which 60% are bigger (more than 50 employees), 22% are medium (between 20 and 49 employees) and 18% are small (between 5 to 19 employees).



surpassing 70.7 in the first semester of 2004 to 67.9 in the second semester of the year. However, this index is greater than the registered in the first and second semesters of 2003 (42.9 and 54.1). It is also worth mentioning that according to the indicated survey, similar behavior is observed in the business expectation indexes of sale in the internal markets and of sale in the external markets.

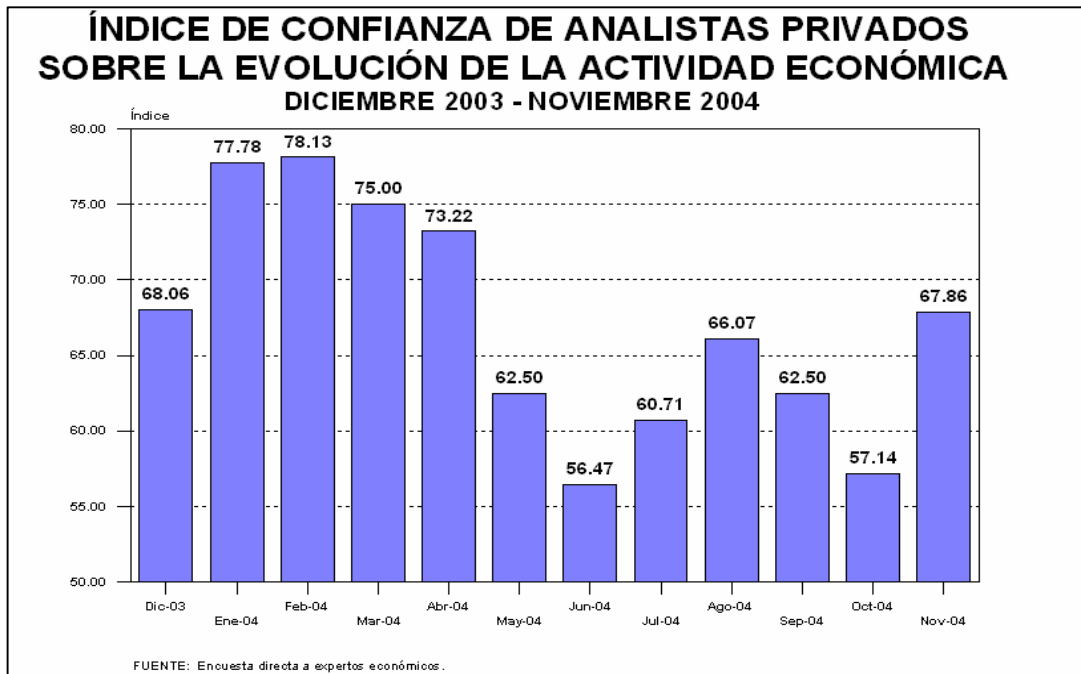


According to the tendency of the Economic Activity Trust Index of Private Analysts<sup>12</sup>, the expectations of economic reactivation during the first four months of the year were kept above the registered to December of the previous year, even though we observe that in the month of November it began a recovery.

<sup>11</sup> Built over the base percentage of answers of businesses that indicate that their production will increase, minus the answer percentage that indicate that its production will decrease. In the first survey of 2004 these percentages were of 54.5% and 13.1%, in the same order, and in the second survey they were 50.0% and 14.3%.

<sup>12</sup> The Economic Activity Trust Index by Private Analysts has the purpose of measuring the perception of the economic analysts, in the current economic situation and the business ambit, as well as in the economic evolution of the country in the near future. It is worth mentioning that the expectations of the national and international panel of experts, are gathered through Inflation Expectations Surveys (EEI, in Spanish), that were made monthly by the *Banco de Guatemala* since December 2003 and whose results are published on the web page.

(Trust Index of Private Analysts on the Evolution of Economic Activity from December 2003 to November 2004)



Another indicator that derives from the opinion of the economic experts' panel is the related to the estimation of growth of the gross national product. In that sense, according to the Inflation Expectations Survey of the month of November, the GNP will grow at a rate of 2.4% for 2004 (2.1% in 2003).

## **2. Gross national product for the production origin**

Based on the origin of the production, for 2004 we foresee positive behavior in the majority of productive sectors, with the exception of the exploitation of mines and quarries; construction; and public administration and defense. In any case, we expect all sectors to register more dynamic growth rates than the observed the previous year.

As to the production of the agricultural, forestry, hunting and fishing sector, based on the estimations provided by the associations of these producers, trade unions and public and private entities, is foreseen that they will experiment greater dynamics regarding the previous year, showing a growth rate of 3.4%, higher to the 3.0% registered in 2003. Said behavior mainly explains, by positive growth rates in the production components of the agricultural sub-sector. We foresee that said sub-sector, in spite of the fall in the production of beans, the lower production of corn and the stall in the production of coffee, will be influenced positively by the increase in the banana, cardamom, sugar cane and fruits and vegetables productions. In the case of coffee production, based on the information provided with the National Coffee Association (ANACAFÉ), we foresee a production of 4,600.0 thousand quintals in 2004, equal to the registered in the previous year, behavior mainly explained in the external order, by the surplus offer of this product at world level and by the low prices of the grain on the international market; and, in the internal order, by the lack of attention in the labor cultures.

The cardamom production, on its part, according to information provided by the Cardamom Producers Association of Guatemala (CARDEGUA), estimates 763 thousand quintals for 2004, 17.3% higher than the previous year, behavior associated with a greater collection on behalf of the farmers and favorable climate conditions. It is worth mentioning that according to the foreign business statistics to October of 2004, a decrease in the exported cardamom was registered (-1.0%), even though the increase observed in the mean price per sack of the aromatic grain on the international market, when surpassing US\$118.93 to US\$122.01 in January to October of 2003 and 2004.

As to the production of fruit and vegetables, we estimate an increase of 2.0% and 3.5% (2.8% and -3.6% in 2003, in its order), result influenced, mainly, by the expected recovery of the demand from the United States of America.

In the case of Basic grains, according to the information provided by the National Coordinator for Basic Grains (CONAGRAB), we expect the corn production to rise to 23,500.1 thousand quintals, registering a 0.5% growth increase (1.0% in 2003) and that the production of beans reaches 2,000.0 thousand quintals, registering a fall of 5.1% (1.0% increase in 2003). The least dynamic behavior was the case of corn with a foreseen fall in the case of beans, are due to the drought that affects the eastern part of the country.

Regarding the cane sugar production, we foresee an increase of 6.6% (3.4% fall in 2003). According to the information of the Cane Sugar Producers Association of Guatemala (ASAZAGUA) and the Guatemalan Sugar Cane Producers Investigation and Training Center (CENGICAÑA), during the 2003 and 2004 sugar cane harvest (between November 2003 and October 2004) we expect a production of 378.3 million quintals of sugar cane, amount higher by 23.4 million quintals to the registered in the 2002/2003 sugar cane harvest (354.9 million quintals). The increase in production of the sweetener mainly explains, due to a higher expected yield of cane per acre planted, and associated with the favorable climate conditions in the producing areas.

In the case of banana production, according to the appreciation of the *Compañía de Desarrollo Bananero, S.A., BANDEGUA* y of the *Compañía Bananera Guatemalteca Independiente, S.A., COBIGUA*, we estimate that for the present year we could reach a production of 22,688.6 thousand quintals, registering a growth of 8.8% regarding the previous year (fall of 3.7% in 2003). The greater production of fruit responds to the beginning phase of production of the new plantations of the southern part of the country, , which were established due to recurring work problems in the banana producing areas of the territorial division of Izabal.

As to the manufacturing industry, we estimate that it will register a 2.1% growth, higher than the observed in 2003 (1.0%). The most dynamic behavior of

the industry is associated, among other factors, to the expected recovery of the American and Central American markets, facing a better performance of their economies. The total exportation values of industrial products, in dollar terms of the United States of America, registered growth of 14.7% (-1.9% in 2003) to October of the current year, as a result of the 20.9% growth (5.6% of fall in 2003) in the sales toward Central America and of the growth of 4.1% in the exportations to the rest of the world<sup>13</sup> (5.2% growth in 2003).

To October 2004 the imports of raw material and intermediary products destined to the manufacturing industry registered, in United States dollars, a 14.1% increase, contrary to the fall of 1.4% observed to October 2003; so much so that the imports of capital commodities for the industry grew 16.8% (9.5% of the fall to October 2003).

Regarding the commercial sector in bulk and retail, we estimate a growth of 3.5%, higher than the observed the previous year (2.1%), associated to the greater dynamism in the growth rhythm in the agricultural and industrial sectors, as well as the more dynamic behavior expected from the importation of commodities. The mining and quarry sector is foreseen to register a fall of 9.1% (1.6% growth in 2003).

As to Electricity and water, we expect an increase of 5.8%, after an increase of 4.5% observed in 2003. This major dynamism is explained, mainly due to an increase in the total generation of electric energy. It is worth indicating, that according to the Bulk Market Administrator (AMM, for its acronym in Spanish), to October 2004, it registered a generation of 5,900.1 thousand MWH, volume that implies an increase of 6.3% regarding the same period the previous year (4.9% in 2003). Said behavior has influenced, on the one hand, the production of electricity for the internal consumption, which increased in 6.0%, surpassing the 5,197.4 thousand MWH to October 2004 and, on the other hand, the increase in the sales

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<sup>13</sup> It includes the United States of America

of electric energy of El Salvador, which increased in 10.5%, when surpassing 352.1 thousand MWH to October 2003 (growth of 5.3%) to 389.0 thousand MWH to October 2004.

The production of the construction sector is estimated to register a decrease of 15.7% (2.2% fall in 2003). This result would be explained by the fall of 29.8% expected in public construction (6.2% fall in 2003), behavior associated to the restriction in the execution of the applied budget in the investment heading (cut back of about 20.0% applied to the expense budget of the central government); this contraction will be partially counteracted by an 8.8% growth expected in private construction (5.7% in 2003).

The transportation, storage and communications sector is expected to grow 8.6% in 2004 (5.4% in 2003), behavior determined, mainly, by the growth of 14.6% in the communications sub-sector (9.2% in 2003), associated to the activation of 604,405 new telephone lines (556,235 in 2003).

The banking, insurance and real estate sector is estimated to register a positive variation of 2.4% in 2004 (1.5% in 2003), associated with the behavior of the financial intermediation activity.

For the housing ownership and private services sector we expect growth rates of 3.0% and 3.8%, similar to the registered the year before (2.9% and 3.5%, in the same order); in the case of the public and defense administration, we estimate a fall of 8.5%, greater than the observed in 2003 (-4.3%).

EXPENSES DEDICATED TO THE GROSS NATIONAL PRODUCT, MARKET PRICE  
YEARS 2003-2004.  
( Millions of quetzales from 1958)

CONCEPT	2003 p/	2004 e/	variation rates	
			2003	2004
1 Consumer Expenses of persons and private non-lucrative institutions	4,373.1	4,545.7	3.8	3.9
2 Consumer Expenses of the General Government	487.8	426.2	-1.2	-12.6
3 Gross Geographic Formation of Fixed Capital	603.8	628.1	4.0	4.0
Private	460.2	508.4	-2.3	10.5
Public	143.6	119.7	-5.1	-16.7
4 Variation of the existence	190.8	239.1		
<b>GROSS EXPENSES OF THE NATION</b>	<b>5,655.6</b>	<b>5,839.1</b>	<b>2.4</b>	<b>3.2</b>
5 Exportation of commodities and services	833.7	849.2	1.6	1.9
6 Minus: Importation of Commodities and services	1,067.9	1,123.2	3.5	5.2
<b>GROSS NATIONAL PRODUCT</b>	<b>5,421.4</b>	<b>5,565.1</b>	<b>2.1</b>	<b>2.7</b>

p/ Preliminary Numbers

e/ Estimated Numbers

### 3. Gross National Product on the Expense Side

We estimate the variables that integrate the GNP on the expense side, in real terms, with the exception of the consumption and investment by the government, which will register the most dynamic growth rates in 2004 compared to the previous year. The internal demand, constituted by consumption, the investment and the existence variations, are expected to register a growth of 3.2%, greater than the 2.4% shown in 2003.

The private consumption is estimated to register a growth rate of 3.9%, greater in 0.1 percentage points to the observed the year before.

The expense in government consumption, that includes remunerations and the purchase of commodities and services, is estimated to register a decrease of 12.6%, behavior associated with the restriction in the budget execution of the government for this year.

In investment matters, the gross geographic formation of fixed capital we estimate to register a growth of 4.0% (-4.0% in 2003), as a result of the growth of 10.5% in private investment (-2.3% in 2003) and one of contraction of 16.7% in public investment (9.1% fall in 2003). The rise in the growth rate of imported capital commodities mainly influences in the result of private investment, which surpasses -5.5% in 2003 to 14.1% in 2004. The contraction of public investment is influenced by the fall in the construction of roads and public works, which surpasses -7.8% in 2003 to -17.8% in 2004.

**ECONOMIC AND INFLATION GROWTH  
BY SELECTED REGIONS AND COUNTRIES  
EXPECTATIONS FOR 2004  
(Percentual Variation)**

<b>ECONOMIC GROWTH</b>	<b>2003**</b>	<b>2004**</b>	<b>2004***</b>
World Economy	3.9	4.6	5.0
Advanced Economies	2.1	3.5	3.6
United States of America	3.0	4.6	4.3
Area of the Euro	0.5	1.7	2.2
Japan	2.5	3.4	4.4
Emerging Economies of Asia*	7.2	7.2	7.3
People's Republic of China	9.1	8.5	9.0
Emerging Markets and Developing countries	6.1	6.0	6.6
Africa	4.3	4.2	4.5
Middle East	6.0	4.1	5.1
Western Hemisphere (Latin America and the Caribbean)	1.8	3.9	4.6
Argentina	8.8	5.5	7.0
Brazil	-0.2	3.5	4.0
Chile	3.3	4.6	4.9
Mexico	1.3	3.3	4.0
Venezuela	-7.6	8.8	12.1
Central and Eastern Europe	4.5	4.5	5.5
Community of Independent States	7.8	6.0	8.0
Commerce Volume	5.1	6.8	8.8
<b>INFLATION</b>			
Advanced Economies	1.8	1.7	2.1
United States of America	2.3	2.3	3.0
Area of the Euro	2.1	1.7	2.1
Japan	-0.2	-0.4	-0.2
Western Hemisphere (Latin America and the Caribbean)	10.6	6.2	6.5
Emerging Economies of Asia*	2.5	3.8	4.3
People's Republic of China	1.2	3.5	4.0
Countries of the Community of Independent States	12.0	9.8	9.9

\* Includes developing Asia, recently industrialized Asian economies and Mongolia.

\*\*Source: International Monetary Fund (IMF). World Economic Outlook, April 2004 .

\*\*\*Source: International Monetary Fund (IMF). World Economic Outlook, September 2004



The external demand, constituted by the commodities and services exportations, is estimated to register an increase of 1.9% (1.6% growth in 2003). In that sense, it is worth indicating that the external demand will be promoted by the best performance foreseen in the economic activity of the United States of America and the main commercial partners of the country.

On the other hand, the importation of commodities and services (external offer) is estimated to register a growth of 5.2%, greater than the observed the previous year (3.5%). It is worth mentioning that to October 2004 the importations in US dollars registered an increase of 14.4% (6.1% in 2003). Said behavior is associated with greater dynamism in the economic activity. As to the structure of the importations, in American dollars, to October, the capital commodities grew 15.5% (-4.3% in 2003); the raw material and intermediary products 15.7% (0.1% in 2003); the consumer commodities 13.3% (9.1% in 2003); the fuel and lubricants 13.6% (40.1% in 2003) and construction materials 6.1% (4.3% in 2003).

## **B. EXTERNAL SECTOR**

### **1. World Economy in 2004**

According to the International Monetary Fund (IMF, for its acronym in Spanish)<sup>14</sup>, even though, on one hand, from the second trimester of 2004 the economic growth rhythm has decelerated in the United States of America, Japan and in the People's Republic of China and that, on the other hand, during the year has registered a rise in the international price of petroleum, which during October reached its highest level in history<sup>15</sup>, the rhythm of world economic expansion continues exceeding the expectations of nearly all the regions and the indicators suggest that global expansion continues to be solid. In this context, the IMF estimates that for 2004 a growth of the global GNP of around 5%, the highest in the last 20 years. This level of growth is supported by the following factors: expansive macro-economic policies of the economic activity; increases in the

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<sup>14</sup> IMF World Economic Outlook. September 2004

<sup>15</sup> Bloomberg informative Service: October 22, 2004, after reaching a quote record of US\$55.50 per barrel in the New York Stock Exchange, crude oil closed at US\$55.17.

corporate income-yield capacity; increases in the wealth effect through the growth of capital markets and of the prices of real estate; increase in the level of employment; and, particularly relevant for the Asian countries, strong growth for the People's Republic of China.

In the United States of America growth was generally maintained strong during the beginning of the year; notwithstanding, in the second trimester it registered a deceleration in the economic activity rhythm, reflecting the decrease in personal consumption, influenced by the rise in petroleum prices, the weak growth of employment and a marked decrease in the expense of durable commodities. In the external sector, as a result of strong increases in the importations, we estimate that the deficit in current account of the payment balance ascends to 5.8% of the GNP for the current year. On the other hand, it is worth mentioning that even though increases were registered in private investment, motivated by the growth of income-yield capacity, we still observe the sub-use of the installed capacity and the greater levels of performance at the natural rate. In this context and in spite of the mentioned obstacles, we hope the growth of the American economy reaches 4.3% in 2004, overcoming the registered the previous year (3.0%).

In the area of the euro, the recovery has been consolidating itself more and more. In that sense, according to the projections of the IMF, we hope that the economy of said region grows 2.2% in the present year; however, said organism indicates that the growth rhythm of the region will continue being relevantly weak and highly dependent on external demand. In particular, Germany's economy, a third part of the area, has shown sluggishness in the rhythm of its economic activity, estimating a growth of 2% for 2004, which is the result of, on the one hand, the low growth in home income, as a consequence of the adjustments in the work market and, on the other hand, the increase in savings as an answer to future cuts in social benefits according to the recent reform of the pension system.

In Japan the recovery has been vigorous and for the present year, economic activity growth in 4.4% is expected, at the same time there are signals that the long term problems (deflation and the weakness of the financial and corporate sectors) are being resolved; on the other hand, Japan faces risks associated with future increase in the price of oil and a marked hard landing in the People's Republic of China. On the other hand, the emerging economies and those of other developing countries continue experimenting, in general, the firm recovery in the majority of regions. In the emerging countries of Asia, the growth is expected to be 7.3%, promoting strong economic activity in the People's Republic of China, which is estimated to grow 9.0%, as in India, which is foreseen to grow in 6.4%, promoted by global expansion and the expanding monetary conditions.

In general terms, in the Asian region, a strong local demand is observed, a surplus in current accounts of payment balance and a reduction in the breach of product. On the other hand, the vulnerabilities of the region are concentrated in the external activity, in particular, in the rising trend of the international oil prices, in the decline of the prices for information technology and in the probable eventuality of a hard landing in the Chinese economy, that in particular would affect the Asian economies recently industrialized, which are expected to grow 5.5%.

In the Western Hemisphere<sup>16</sup>, recovery seems to consolidate itself and it is estimated that the GNP growth will be of 4.6%, sustained in global recovery, the increase in the prices of merchandise and the recovery of domestic demand. Said behavior obeys the growth estimations of the major economies in the region, Brazil and Mexico, each one of which is estimated to grow 4.0%. On the other hand, the majority of countries have taken advantage of the recent favorable conditions in the financial markets to finance gross debt payments and the IMF estimates that the main risks that face the region are concentrated in the possibility of foreign

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<sup>16</sup> According to the International Monetary Fund (IMF), within the concept of 'Western Hemisphere' are the following countries: Antigua y Barbuda, Argentina, The Bahamas, Barbados, Belize, Bolivia, Brazil, Chile, Colombia, Costa Rica, Dominican Republic, Ecuador, El Salvador, Granada, Guatemala, Guyana, Haiti, Honduras, Jamaica, Mexico, Dutch Antilles, Nicaragua, Panama, Paraguay, Peru, St. Kitts and Nevis, Santa Lucia, St. Vincent and Grenadines, Surinam, Trinidad and Tobago, Uruguay and Venezuela.

crashes, coming from the reduction of economic activity which will affect external demand, as well as future increases in oil prices.

In the corresponding Central American countries, the IMF estimates that in 2004 it will reach an economic growth of 3.3%, slightly higher than that of 2003 (3.2%). It also estimates that the increase in oil prices that have impacted the inflationary level of the area, which, according to the latest inflationary data, is expected to reach 9.4%, higher than that of 2003 (5.9%).

For the Middle East, according to IMF, in spite of the fragility in security matters, the previous estimations on the growth of the GNP have been corrected by the rise in the previous increment in production and in the oil prices, estimating that the region will reach a growth of 5.5% for 2004, less than the registered in the previous year (6.0%). In that sense, the oil exporting countries will grow 5.1%, while the non-producers will grow 3.9%.

In the Community of Independent States, the increase in global demand for oil and metals has given greater impulse to the strong growth that has been registered in the region, which is estimated to surpass 7.8% in 2003 to 8% in 2004. For Russia, the growth rate is estimated at 7.3%, equal to the reached the previous year. The expansion of the countries of Central Europe and the East will also continue and it is estimated that the economic activity will grow 5.5%, higher in a percentage point to the observed growth in the previous year.

In Africa, the growth projection for the GNP for the Sub-Sahara countries has been corrected to the rise, estimating a 4.6% rate for 2004 (the estimation of April will be 4.2%), mainly due to the expected growth in Nigeria (4.0%). Said behavior is explained by the greater macro-economic stability, by the strong increase in the oil production, by the recovery of the agricultural production and with greater political stability.

Regarding global commerce of commodities and services, it is expected to continue recovery showed in the last two years, reaching a growth of 8.8% during 2004 (5.1% in 2003 and 3.3% in 2002). According to IMF, the increase in global demand of commodities has increased their prices, highlighting the case of oil and its derivatives, whose prices have responded to the greater demand and also to the uncertainty generated by the political instability in some crude exporting countries.

On the other hand, the prices of commodities other than oil, which had increased substantially at the beginning of 2004, show a tendency to decrease, partially influenced by the reduction in Chinese economic growth.

The global inflation, on their part, after falling to unusual levels in mid 2003, accelerated during 2004, hoping that the advanced economies reach 2.1% (in 2003) and for other emerging markets and developing economies 6.0% (6.1% in 2003), diminishing the risks of deflation observed the previous year.

In that sense, it is worth mentioning that the inflationary rhythm is mainly due to the increase in oil prices.

The development in financial markets during 2004 has been influenced by the expectations generated by the adjustments in the monetary policy in the United States of America. In that sense, the reaction to financial markets facing adjustments in the interest rates has been orderly and has not generated instability in the financial systems.

In the exchange market, the growing expectations of greater interest rates and the dynamism of growth in the United States of America contributed to a moderate appreciation of the American dollar until April of the current year; since then, it registered volatility in the main world currencies, registering a slight depreciation of the American dollar until October, when the devaluation tendency of the American currency accelerated regarding the euro, the yen and the sterling pound. In other areas, like Asia and Latin America, the depreciation of local

currency that has been registered, basically reflects the deterioration of the external financial conditions.

**ECONOMIC GROWTH AND INFLATION  
BY REGIONS AND SELECT COUNTRIES  
EXPECTATIONS FOR 2004  
(Percentual variation)**

<b>ECONOMIC GROWTH</b>	<b>2003**</b>	<b>2004**</b>	<b>2004***</b>
<b>WORLD ECONOMY</b>	3.9	4.6	5.0
Economic advances	2.1	3.5	3.6
United States of America	3.0	4.6	4.3
Area of the euro	0.5	1.7	2.2
Japan	2.5	3.4	4.4
Emerging economies of Asia*	7.2	7.2	7.3
People's Republic of China	9.1	8.5	9.0
Emerging Markets and developing countries	6.1	6.0	6.6
Africa	4.3	4.2	4.5
Middle East	6.0	4.1	5.1
Western Hemisphere (Latin America and the Caribbean)	1.8	3.9	4.6
Argentina	8.8	5.5	7.0
Brazil	-0.2	3.5	4.0
Chile	3.3	4.6	4.9
Mexico	1.3	3.3	4.0
Venezuela	-7.6	8.8	12.1
Central Europe and the East	4.5	4.5	5.5
Independent States Community	7.8	6.0	8.0
Commerce Volume	5.1	6.8	8.8
<b>INFLATION</b>			
Advanced Economies	1.8	1.7	2.1
United States of America	2.3	2.3	3.0
Area of the euro	2.1	1.7	2.1
Japan	-0.2	-0.4	-0.2
Western Hemisphere (Latin America and the Caribbean)	10.6	6.2	6.5
Emerging economies of Asia*	2.5	3.8	4.3
People's Republic of China	1.2	3.5	4.0
Independent States Community	12.0	9.8	9.9

\* Includes Asia in development, recently industrialized Asia and Mongolia.

\*\*Source:International Monetary Fund (IMF). World Economic Outlook, April 2004 .

\*\*\*Source:International Monetary Fund (IMF). World Economic Outlook, September 2004

### **Transition toward Flexible Exchange Regimens**

#### **-The Experience of Emerging countries in the past decades<sup>a</sup> -**

The benefits of the flexible Exchange regimens will increase in the measure the economies develop and integrate more into the global financial markets. For the industrialized countries the flexible exchange rates have generated macro-economic benefits in better evolution terms, in economic growth as well as in the level of inflation. In the case of emerging countries, to orient themselves to

<sup>a</sup> Summary of "Learning To Float: The Experience of Emerging Market Countries Since the Early 1990s". World Economic Outlook. Pages from 89 to 103. September 2004. IMF.

regimens of flexible exchange rates has also helped to alleviate the risks related to monetary crisis that have characterized the regimens of fixed exchange rates, among them, the attacks to the exchange rate.

It is worth mentioning that notwithstanding that various emerging countries have made their exchange regimen more flexible, others remain with the name 'afraid to float', since the volatility of the exchange rate could generate costs, among which, possible increases in the service of foreign currency and inflation rate stand out, through the pass through effect on prices. Also, when considering the possible presence of costs coming from making the exchange flexible, the political doers in some emerging countries estimate that, in practice, the space necessary to reach an independent monetary policy and make the exchange rate flexible are pretty limited and opt for fixed or semi-fixed regimens.

According to IMF, during the nineties there were emerging countries that made their exchange rates flexible and demonstrated that they can learn to float, as long as the monetary and financial policies can reduce vulnerabilities key to the effect of reducing the fear of floating. In that sense, it is worth indicating that a transition of flexible types of exchange rates must work in the reduction of key vulnerabilities, through monetary policy, the supervision of the financial sector and the financial liberalization.

As to monetary policy, if a central bank has as its main objective to stabilize prices and operates its policy independently, it obtains the confidence of the public in which it can control inflation, and consequently, reduces the 'fear of floating' that originates from the effect of a volatile exchange rate in prices. On the other hand, a supervision of the financial sector adequately helps the participants to better recognize the assumed risks and, therefore, to reduce the undermining of currency and maturity that also help feed the 'fear to float'; and, finally the processes of financial liberalization, when accompanied by strong supervision and healthy financial institutions, are constituted in support of growth.

According to IMF, of a sample of 25 emerging countries, from 1990 to date, the percentage of countries with flexible exchange rate regimens went up 0% to more than 33%; of which half were of free will, while the rest were induced by monetary crisis. The voluntary transitions of exchange rate did not generate macro-economic instability; the key indicators like economic growth and the over valuing of the real exchange rate were marginally affected; and, the behavior of inflation continued to get better after the transition. It is worth mentioning that the majority of the rest of the emerging countries considered in the sample transited, in the indicated period, of fixed exchange regimens to intermediary exchange regimens.

## **2. Balance of payment estimated to December 2004**

### **a) Current Account**

For 2004 it is estimated that the current account balance of payment for Guatemala shows a deficit balance of US\$1,110.5 million, which will imply a deficit as a proportion of the GNP of 4.1%. Said deficit will finance with a surplus of capital and financial account of US\$1,610.5 million, for which it estimates a profit in the international monetary reserves for US\$500.0 million.

The balance of the current account will be the result of the deficit in the commercial balance of US\$4,673.2 million and a surplus, of service balance, of US\$589.0 million, as well as the current net transfers, of US\$2,973.7 million.

The commercial balance, regarding December 2003, will be determined by an increase in FOB value of exportations of US\$325.9 million (12.4%) and an increase in CIF value of importations of US\$907.3 million (13.5%).

The FOB value of exportations will be US\$2,955.7 million, greater by 12.4% to the registered in 2003. In said result, the value of coffee exportations will be



determinant, which will be located at US\$324.8 million, greater by US\$32.5 million (11.1%) to 2003, which would be explained by the increase in the half price of 29.7%, since the export volume will decrease by 14.3% regarding the previous year. The mean price of exportation per quintal will increase by US\$58.79 in 2003 to US\$76.24 in 2004. On its part, the exported volume, in quintals, will reduce when surpassing 4,972.3 thousand in 2003 to 4,260.0 thousand in 2004. The increase in the mean price is explained, according to the International Coffee Organization, OIC, for the decrease in world coffee production in the 2003-2004 harvest, derived in the reduction of cultivation areas of many coffee exporting countries, due to the problems the coffee industry has been experimenting with the low international prices, especially in Latin American countries. Also, another factor that cooperated with the increase in the price of coffee was the considerable increase in the demand of coffee in China.

The value of sugar exportations in 2004 is expected to reach US\$196.9 million, greater by US\$7.7 million (4.1%) to the registered in 2003, situation that would greatly explain the increase of US\$0.62 (9.0%) in the mean exportation price, since the export volume will decrease by 4.4% regarding the previous year. The mean exportation price per quintal would increase from US\$6.88 in 2003 to US\$7.50 in 2004, as to exported volume in quintals, it will decrease when going from 27,481.1 thousand in 2003 to 26,267.5 thousand in 2004. The increase in the world price of the sweetener obeys, on the one hand, the expectations in the increase in the demand in India, the People's Republic of China and other Asian countries, due to low mono-zone rains<sup>17</sup> that affected the sugar cane harvest in the region and, on the other hand, a greater demand of sugar cane to produce ethanol as automobile fuel, derived from the high cost of international oil, situation that would be reducing the amount of sugar available for exportation. Regarding the reduction of the exported volume, it is associated with the exportations toward Russia, due to the protectionist measures on behalf of that country.

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<sup>17</sup> It refers to the rainy season in said region.

The exportation value of banana in 2004 would be US\$241.9 million, greater by US\$11.3 million (4.9%) to the registered in the previous year, which is fundamentally explained by the increase of 823.1 thousand quintals (4.0%) in the exported volume. When referring to the mean price of exportation per quintal, it will increase slightly, when surpassing US\$11.12 in 2003 to US\$11.22 in 2004. The increase in the export volume is fundamentally explained by the reduction of the exportations of Ecuador.

As to cardamom, the value of exportations in 2004 are projected to US\$75.1 million, lower by US\$3.8 million (4.8%) to the registered in 2003. This result is explained in the decrease of 38.4 thousand quintals (6.2%) in the exported volume, compensated in part by the increase in mean exportation price per quintal, which will increase in US\$1.86, when surpassing US\$ 127.20 in 2003 to US\$129.06 in 2004. Said result obeys the conditions of political instability registered in the Middle East, mainly Iraq that influences in the reduction of the cardamom demand in said region.

The value of petroleum exportations would be US\$183.7 million, higher by US\$6.4million (3.6%) to the registered the year before. This increase will be sustained by the increase in the mean price of exportation per barrel, which will surpass US\$21.52 in 2003 to US\$26.76 in 2004; since the exportation volume for 2004 will decrease by 1,372 thousand barrels (16.7%). The increase in mean price will be associated to the increase in the international price that, according to the Organization of Oil Producing Countries (OPEC), is derived, on the one hand by demand, by the expansion of the global economy and by the increase in the consumption by the People's Republic of China.

Therefore, by offer, they influenced extra-economic events, such as terrorist attacks in Iraq and Saudi Arabia; the political uncertainty occurring in Nigeria and Venezuela; the problems between the Russian oil company AOA Yukos Oil, Co. (main producer in Russia) and with the Russian government due to fiscal aspects;

and to the effects left by hurricane Ivan in the Gulf of Mexico, that damaged several oil ducts, causing the suspension in production of crude oil. Regarding the exported volume, this was influenced by a decrease in the national production, due to minor yield in the oil wells.

The exportation values of other products would be US\$1,933.3 million, higher by US\$271.8 million (16.4%) to the registered in 2003. This result obeys the foreseen increase of exportation, in Central America as well as in the rest of the world, which would increase by 14.1% and 20.7%. The previous is attributed to the greater demand, associated with the recovery of the world economic activity.

The CIF value of importations in 2004 would be US\$7,628.9 million, greater by US\$907.3 million (13.5%) to the registered the year before. The increase in heading for raw material and intermediary products is highlighted in this growth (14.7%); in machinery, equipment and tools (14.2%); in consumer commodities (12.8%); in fuels and lubricants (12.6%) and in construction material (5.9%).

On the other hand, the services balance in 2004 will register a surplus balance of US\$589.0 million, higher by US\$9.7 million (1.7%) to the registered the year before. Said result will be determined by the surplus of US\$945.1 million in non factorial services and due to the deficit of US\$356.1 million in factorial services. The surplus in non factorial services will obey, on the one hand, to a greater increase in tourism and trips and, on the other hand, to the favorable unfolding of the culture. On their behalf, the deficit of the factorial services will be mainly explained by the increase in the foreign debt service from the non financial business sector.

Regarding the current net transfers, these will register a surplus balance of US\$2,973.7 million, mainly derived from the continuous growth of net income from the family remittances that are estimated to reach US\$2,500.0 million.

## **b) Capital and Financial Account**

The capital and financial account of payment balance in December 2004 will register a surplus balance of US\$ 1,610.5 million, higher by US\$10.3 million than

the registered the year before. The balance of the financial and capital account will be the result of the surplus balances of the transfers of capital; from the official capital and banking account; and, of the private capital account. In 2004, the capital transfers will register a surplus balance of US\$138.6 million, greater by US\$4.8million (3.6%) to the registered the year before. The official capital and banking account will register a surplus balance of US\$230.8 million in 2004, less by US\$54.5 million than the registered in 2003 (US\$285.3 million). Said result would be explained, on the income part, by the placement of net bonds with non residents for US\$238.0 <sup>18</sup>million and by the disbursement of loans to the public non-financial sector of US\$263.6 million; and, on the expense side, due to the amortizations of the foreign debt to the non financial public sector for US\$202.7 million and for the external debt payment of the *Banco de Guatemala* for US\$68.0 million.<sup>19</sup>

Regarding the private capital account, this will register a surplus balance of US\$1,241.1 million, higher by US\$60.0 million (5.1%) to the registered in 2003. Said surplus would be explained by the income in concept of the direct foreign investment for US\$124.5 million, by the net income of mid and long term capital for US\$573.4 million, as well as by the net income of capital in the short term by US\$543.2 million.

Derived by the operations in current account and in the capital and financial account in the payment balance, is estimated by the year 2004 in increase of the net international monetary reserves for the amount of US\$500.0 million.

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<sup>18</sup> Includes a placement in the international financial market for US\$330.0 million on October 6, 2004

<sup>19</sup> Said amount includes US\$61.1 million that correspond to the anticipated payment on the balance of the external debt of the *Banco de Guatemala*.

**Payment Balance**  
YEARS 2003 - 2004  
-In millions of US Dollars-

CONCEPT	2003 <sup>p/</sup>	2004 <sup>e/</sup>	Variaciones	
			Absolutas	Relativas
<b>I. CURRENT ACCOUNT (A+B+C)</b>	<b>-1,050.6</b>	<b>-1,110.5</b>	<b>-59.9</b>	<b>5.7</b>
A. COMMERCIAL BALANCE	<b>-4,091.8</b>	<b>-4,673.2</b>	<b>-581.4</b>	<b>14.2</b>
1.Exportations FOB	2,629.8	2,955.7	325.9	12.4
Main Products	968.3	1,022.4	54.1	5.6
Other Products	1,661.5	1,933.3	271.8	16.4
2.Importations CIF	6,721.6	7,628.9	907.3	13.5
<b>B. SERVICES</b>	<b>579.3</b>	<b>589.0</b>	<b>9.7</b>	<b>1.7</b>
1. Net Factorials	-352.3	-356.1	-3.8	1.1
2. Net non-factorials <sup>1/</sup>	931.6	945.1	13.5	1.4
C. CURRENT TRANSFERENCES (Net)	2,461.9	2,973.7	511.8	20.8
<b>II. CURRENT CAPITAL AND FINANCIAL (A+B+C)</b>	<b>1,600.2</b>	<b>1,610.5</b>	<b>10.3</b>	<b>0.6</b>
A. CAPITAL TRANSFERENCE	133.8	138.6	4.8	3.6
B. CURRENT CAPITAL OFFICIAL AND BANKING	285.3 <sup>a/</sup>	230.8 <sup>b/</sup>	-54.5	-19.1
C. CURRENT PRIVATE CAPITAL <sup>2/</sup>	1,181.1	1,241.1	60.0	5.1
<b>III. BALANCE OF THE PAYMENT BALANCE</b>	<b>549.6</b>	<b>500.0</b>		
<b>Net Reserves (- increase)</b>	<b>-549.6</b>	<b>-500.0</b>		

<sup>1/</sup>

<sup>2/</sup> 1/ Includes Multure for US\$418.5 million for 2003 and US\$458.9 million for 2004

<sup>a/</sup> 2/ Includes Errors and Omissions

<sup>b/</sup> a / Includes US\$300.0 million for income by placement of bonds- Peace on the international market

<sup>p/</sup> p / Preliminaries

<sup>e/</sup> e / Closing estimates

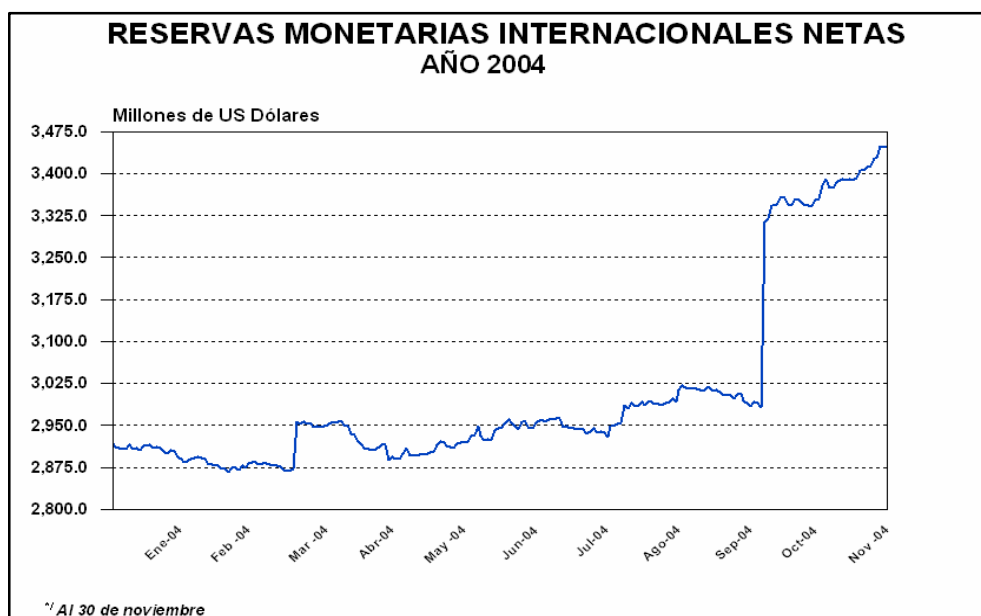
**Current Account Balance /GNP: -4.2% for 200 3 and -4.1% for 2004**

### 3. Net international monetary reserves

To November 30, 2004, the net international monetary reserves were at US\$3,447.9 million, which means an increase of US\$528.6 million regarding the level observed to December 31, 2003. Said increase is the result of foreign currency income for US\$922.8 million, expenditure of foreign currency for US\$576.9 million and other income for net operations for US\$182.7 million. In regards to income, we can highlight the bond placement with residents and non-residents for US\$380.9 million, the purchases made by the *Banco de Guatemala* in the SINEDI for US\$356.7 million, and the disbursements received by the Non-Financial Public Sector for US\$185.2 million. Regarding the expenditures, these were mainly originated by the payments of the service for the external foreign debt for US\$307.8 million, of which US\$281.2 million correspond to the Non-financial

Public Sector and US\$26.6 million to the *Banco de Guatemala*; and, for the payment of capital and interest of the bonds expressed in US dollars for US\$ 269.1 million. In regards to the movement of other net operations, it is worth mentioning that the income for royalties for oil exploration for US\$58.4 million, the increase in banking float in foreign currency for US\$51.8 million, the interest perceived on RIN investments for US\$30.5 million and other net income for US\$42.0 million. The international monetary reserves are considered adequate, since it is located at 5.1 months of commodities imports; in particular, if we deduct the short term government obligations in US dollars (sensitivity test), even then it would be over the limit suggested by international standards<sup>20</sup>, since it would be around 3.6 months of importations.

(Net International Monetary Reserves, Year 2004)



The solidity of the external position of the country could be measured through the coverage of the foreign debt. In that sense, to November 30 the RIN level was equivalent to 7 times the service amount of the external public debt of the country to one year (6.1 times that of November 28, 2003.)

### C. FISCAL SECTOR

<sup>20</sup> As to international monetary reserves must be sufficient for the financing of at least 3 months of commodities imports

## 1. Analysis of the budget execution

According to the preliminary numbers of the *Ministerio de Finanzas Públicas*, MFP [Equivalent to the Department of the Treasury.] the financial situation of the central government to October (latest available information) registered a fiscal deficit of Q573.5 million, amount lower by Q2,520.0 million (81.5%) to the registered in October 2003. The fiscal income to October ascended to Q18, 499.2 million, higher by Q98.4 million (0.5%) to the observed in the same period the previous year, which represents a revenue of 80.2% regarding the adjusted budget for 2004 (82.5% in 2003). From tributary income Q17, 452.6 million were perceived, amount greater by Q222.2 million (1.3%) to the registered in the same period the year before. Said increase is explained by the greater revenue of indirect taxes, since the perceived by direct taxes was contracted.

Regarding indirect income, its increase (7.0%) was mainly due to the greater revenue of the Added Value Tax (IVA) that rose to Q8, 274.0 million, amount greater by Q681.8 million (9.0%) regarding the income of crude oil distribution and fuel derivatives registering a level of Q1, 460.2 million, greater by Q230.8 million (18.8%) regarding October of the previous year. The tax on revenue tax stamps registered a revenue of Q247.4 million, greater in Q105.8 million (74.7%) to the amount observed in the same period the year before.

The decrease in the revenue of direct taxes by Q636.8 million (12.9%) is explained by the lesser income obtained by the Tax on Mercantile and Agricultural businesses (IEMA), which were at Q849.5 million, less by Q1677.9 million (66.4%) regarding October 2004<sup>21</sup>. For the Extraordinary Tax and Temporary Support for the Peace Agreements (IETAAP)<sup>22</sup>, Q618.7 million was collected. Through

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<sup>21</sup> The Constitutionality Court decreed the partial suspension of Decree Number 99-98 of the Congress of the Republic, Law of Mercantile and Agricultural Businesses Tax, IEMA, as of February 3, 2004. The Extraordinary and Temporary Tax for Support of the Peace Agreements dated June 29, 2004 in the publication of the *Diario de Centro America*, through Decree 19-04, which derogated the decree before mentioned.

<sup>22</sup> This tax falls on individual and juristic persons through mercantile or agricultural businesses, as well as trust, participation contracts, irregular companies, trust assignment, branches, agencies or permanent or temporary establishments by foreign persons that operate in the country, co-ownerships, commodities communities, undivided hereditary property and other forms of organizational business, that have personal property, realize mercantile or agricultural activities within the national territory and that obtain a gross margin over 4% of its gross income.

Income Tax, ISR, Q2, 822.8 million were perceived, amount greater by Q422.5 million (17.6%) to the registered in the same period the year before.

Regarding the expenses executed to October, these registered an amount of Q19,072.7 million, less by Q2, 421.6 million (11.3%) to the observed in the same period the year before, which represents an execution of 68.9% regarding the adjustment of the budget for 2004 (in 2003 the execution in the same period was of 73.2%).

The work expense reached Q14, 072.4 million, less by Q225.6 million (1.6%) than those of the same period the year before. In this behavior the operation expenses stand out with a level of Q7, 090.7 million, less by Q576.4 million (7.5%) to those in the same period the year before; within these the major expense was salary and wages, which registered a level of Q5, 540.0 million greater by Q33.0 million (0.6%) equal to the period of the previous year.

Regarding the current transfers, these registered an amount of Q4, 841.4 million, amount greater by Q46.1 million (1.0%) to the commissions of the public debt was of Q2, 140.3 million, greater by Q304.7 million (16.6%) of the period the year before.

The capital expenses were at Q5, 000.3 million, lower by Q2, 196.0 million (30.5%) to those of a similar period the year before, registering an execution of 55.6% regarding the budgeted expenses for 2004 (67.5% in 2003). Said result was determined by the lesser expenses of indirect investment and of direct investment that registered a level of Q3, 178.0 million and Q1, 282.3 million, lesser in Q2, 023.2 million (35.2%) and Q172.8 million (11.9%) to the observed in October 2003.

Regarding the financing of the deficit registered to October, the net internal financing was of Q1, 954.2 million, result of bonds negotiations for Q3, 438.1 million and matures at Q1, 483.9 million. The net external financing reached Q2, 884.8 million, due to the disbursement of loans for Q1, 601.1 million, negotiation of



bonds on the international market for Q2, 595.9 million and amortizations for Q1, 312.2 million. Therefore, the fiscal till registered an increase of Q 4, 265.5 million.

**CENTRAL GOVERNMENT**  
**EXECUTION OF THE BUDGET TO OCTOBER**  
**YEARS 2003 - 2004**  
-In millions of quetzales-

CONCEPT	2003	2004	VARIATIONS	
			ABSOLUTE	RELATIVE
<b>I. Income and donations</b>	<b>18,400.8</b>	<b>18,499.2</b>	<b>98.4</b>	<b>0.5</b>
A. Income	18,085.6	18,267.5	181.9	1.0
1. Income current	18,067.6	18,267.0	199.4	1.1
a. Tributary	17,230.4	17,452.6	222.2	1.3
i. Direct taxes	4,935.2	4,298.4	-636.8	-12.9
ii. Indirect taxes	12,295.2	13,154.2	859.0	7.0
b. Non Tributary	837.2	814.4	-22.8	-2.7
2. Capital Income	18.0	0.5	-17.5	0.0
B. Donations	315.2	231.7	-83.5	-26.5
<b>II. Total Expenses</b>	<b>21,494.3</b>	<b>19,072.7</b>	<b>-2,421.6</b>	<b>-11.3</b>
A. Administration	14,298.0	14,072.4	-225.6	-1.6
1. Of Operation	7,667.1	7,090.7	-576.4	-7.5
2. Transfers	4,795.3	4,841.4	46.1	1.0
3. Interest per debt	1,835.6	2,140.3	304.7	16.6
B. Capital	7,196.3	5,000.3	-2,196.0	-30.5
1. Direct Investment	1,455.1	1,282.3	-172.8	-11.9
2. Indirect Investment	5,741.2	3,718.0	-2,023.2	-35.2
<b>III. Fiscal Deficit or Surplus</b>	<b>-3,093.5</b>	<b>-573.5</b>	<b>2,520.0</b>	<b>-81.5</b>
<b>IV. Savings in Current Account</b>	<b>3,769.6</b>	<b>4,194.6</b>	<b>425.0</b>	<b>11.3</b>
<b>V. Financing</b>	<b>3,093.5</b>	<b>573.5</b>	<b>-2,520.0</b>	<b>-81.5</b>
A. Net External Financing	2,456.4	2,884.8	428.4	17.4
B. Net Internal Financing	637.1	-2,311.3	-2,948.4	-462.8
1. Net Negotiation of Bonds	3,085.7	1,954.2	-1,131.5	-36.7
2. Till Variation	-2,448.6	-4,265.5	-1,816.9	74.2
(-Increase and Decrease				

SOURCE: Ministerio de Finanzas Públicas [Equivalent to the Department of the Treasury].

## 2. Public Debt

### a) Internal

The balance of the internal public debt to October, according to preliminary numbers, was located at Q12, 991.0 million, higher by Q1, 954.4 million<sup>23</sup> (17.7%) to the observed balance in December 2003. This increase mainly obeyed the negotiation of Treasury Bonds with the private, banking and public sectors. Each

<sup>23</sup> Said variation resulted of negotiations of public titles for Q3, 438.1 million and maturities for Q1, 483.9 million. It is worth indicating that through Decree 20-04 of the Congress of the Republic, current as of July 8 of the current year, is authorized to the Executive Branch of the bonds issue for Q4, 400 million (having negotiated the international market US\$330.0 million, equivalent in *quetzales* for Q2, 595.9 million that form part of the salary of the external public debt).

one of them increased their security holdings by Q1, 637.5 million (40.7%), Q866.3 million (43.5%) and Q76.8 million (2.1%). The non-resident sector reduced its investments by Q626.2 million (46.1%).

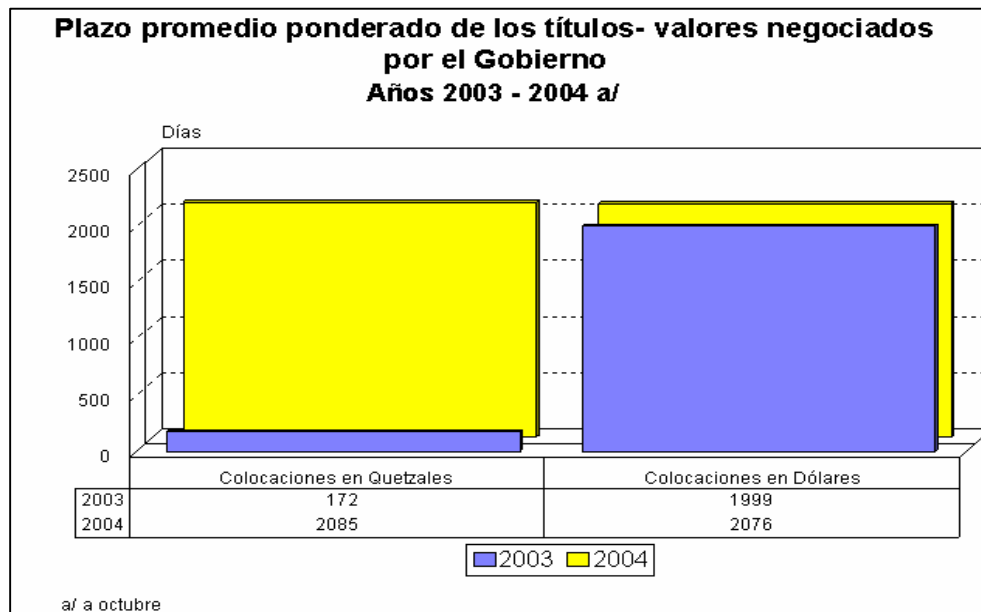
**Central Government**  
**Balance of the Internal Public Debt**  
**Years 2003 - 2004**  
**- In millions of *quetzales* and in percentages -**

Holder	AI 12/31/2003	Structure	AI 10/31/2004	Structure	Variation	
					Absolute	Relative
<b>Total</b>	<b>11,036.6</b>	<b>100.0</b>	<b>12,991.0</b>	<b>100.0</b>	<b>1,954.4</b>	<b>17.7</b>
Banking Sector	1,992.8	18.0	2,859.1	22.0	866.3	43.5
Public Sector	3,662.4	33.2	3,739.2	28.8	76.8	2.1
Non Resident Sector	1,358.1	12.3	731.9	5.6	-626.2	-46.1
Private Sector	4,023.3	36.5	5,660.8	43.6	1,637.5	40.7

SOURCE: Section of Values, *Banco de Guatemala*.

Regarding the structure of the internal debt by holder, the same varied due to greater negotiations with the private and banking sector. To December 31, 2003 the participation of said sectors was of 36.5% and 18.0% of the total; while to October of the current year they were located at 43.6% and 22.0%. In contrast the public and non resident sectors decreased their relative participation from December 2003 to October 2004, when surpassing 33.2% and 12.3% to 28.8% and 5.6%. As to debt placement terms, it is important to point out that in 2003 the weighted average of placements in *quetzales* was of 172 days, while to October 2004 it was located at 2, 085 days; this increase in the term of debt placement responds to the fact that in 2004 the same was made through treasury bond negotiations, contrary to the occurred in 2003 that was made with Treasury Letters (short term debt). Referent to the US dollar placements, the weighted average term in 2003 was of 1,999 days, while in October 2004, they were placed at 2, 076 days.

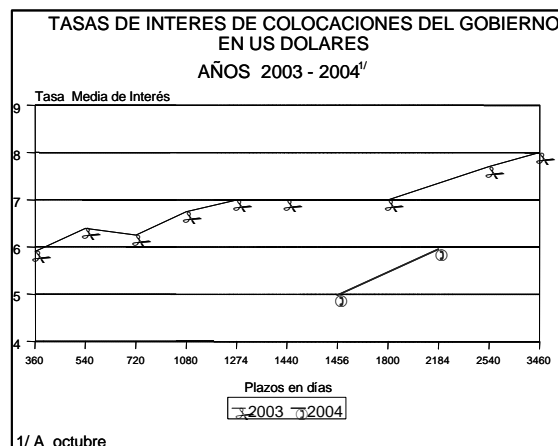
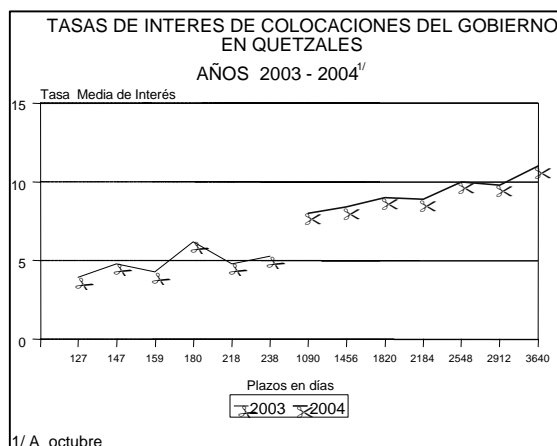
(Average weighted Term for Titles and Negotiated Values for the Government)



Regarding the average weighted interest rate of placement by the government expressed in *quetzales*, it was located at 4.55% in 2003, year where they only negotiated Treasury Letters: while in October of the current year, the weighted average interest rate was located at 9.16%. The weighted average interest rate of dollars placement negotiated in the local market registered a tendency toward the decline when going from 7.05% in 2003 to 5.81% in October of 2004.

Government Placement Interest Rates  
 IN QUETZALES YEARS 2003 - 2004 <sup>1/</sup>

Government Placement Interest Rates  
 IN US DOLLARS YEARS 2003 - 2004 <sup>1/</sup>



## **b) External**

According to the preliminary numbers, to October 2004 the balance in the external public debt <sup>24</sup> was at US\$3, 765.8 million, greater by US\$368.9 million of the balance to December 2003. Said increase is the result of disbursements for US\$199.6 million, negotiation of bonds in the international financial markets for US\$330.0 million, amortizations for US\$180.2 million and an increase of US\$19.5 million derived of the appreciation of the US dollar regarding other currencies that integrate the units of accounts where some loans are named. Therefore, the net transfer of resources, understood as the result of the difference between the disbursed resources and the amortization of capital, were positive by 349.9 million.

As to central government loan disbursements in the period, the creditor, those coming from the Inter-American Development Bank, BID (Spanish acronym), stand out for US\$102.3 million, the Central American Economic Integration Bank, BCIE (Spanish acronym), for US\$58.9 million and of the International Reconstruction and Promotion Bank, BIRF (Spanish acronym), for US\$24.1 million.

Regarding the negotiation of bonds in the international financial market, it is worth mentioning that this took place on October 6 of the current year, for an amount of US\$330.0 million, for a 30 year term and an interest rate of 8.125% yearly.

## **3. Closing Estimation to December 2004**

According to the estimations of the *Ministerio de Finanzas Públicas* [Equivalent to the Department of the Treasury], for 2004 the fiscal deficit will reach a level of around 1.4% of the GNP. In the referent to the fiscal charge, the same will be located around 9.8% (10.3% in 2003).

## **D. FINANCIAL SECTOR**

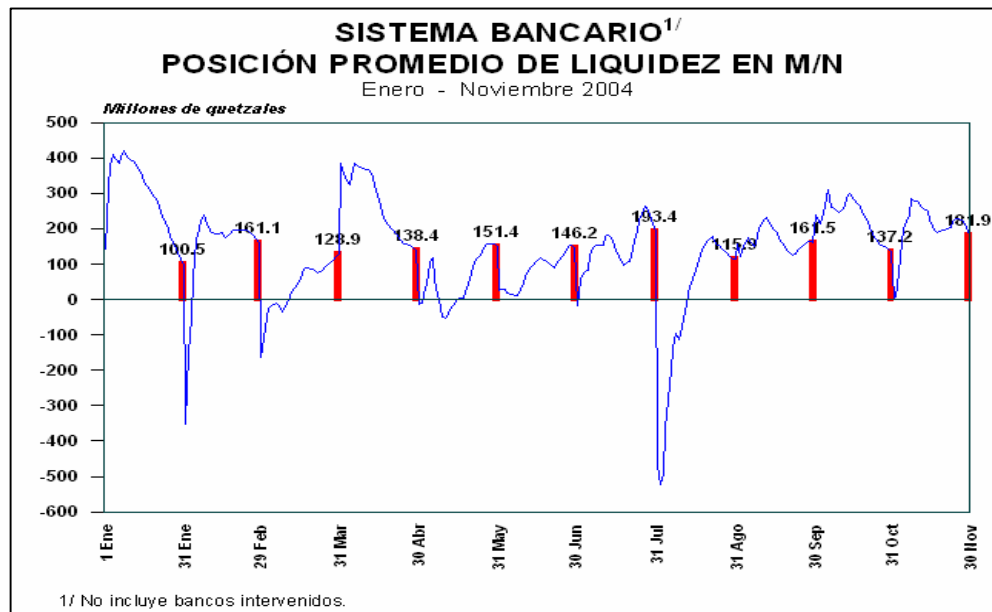
### **1. Banking Liquidity**

#### **a) In national currency**

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<sup>24</sup> Does not include the balance of the foreign debt of the *Banco de Guatemala*, which was at US\$42.0 to October 31, 2004

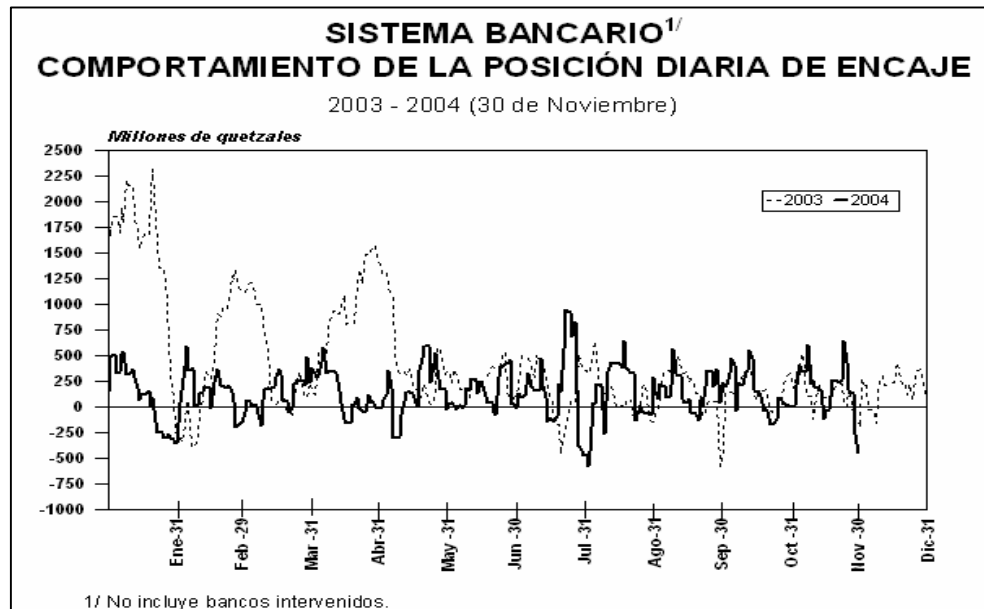
(Banking System, Average Position of Liquidity in M/N; January to November 2004)



The banking liquidity measure for the excess or float deficiencies, shows the immediate availability of the financial resources in the banking system. During the greater part of the period from January to November, 2004, the banking system showed, on average, positive and moderate levels of liquidity. Said variable was located between Q100.5 million in January and Q193.4 million in July.

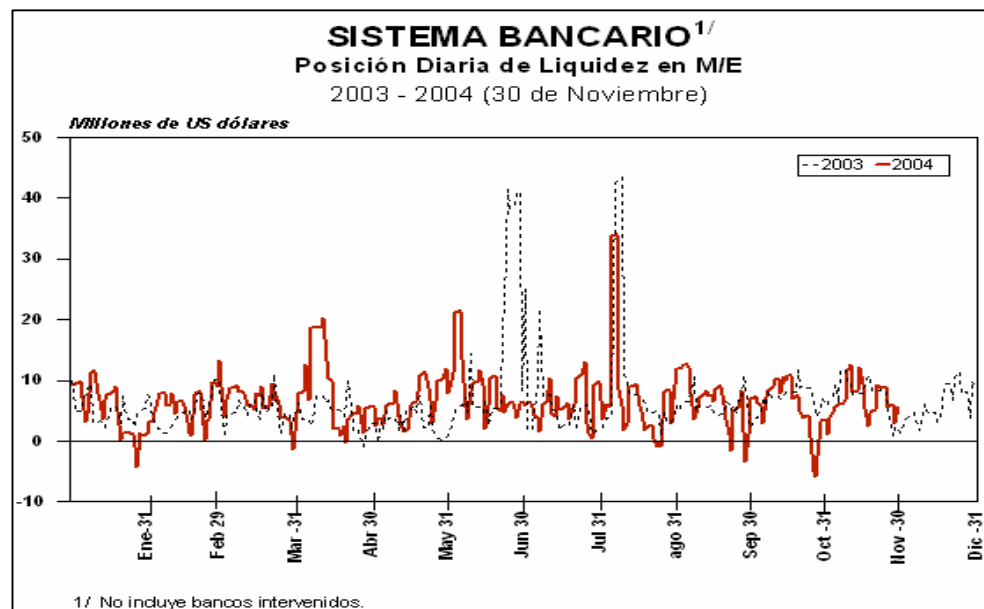
The daily liquidity that the banks registered from January to November 2004 also showed greater stability regarding the behavior that it observed the previous year, mainly during the first four months of 2003. Regarding, between January and November of the current year, the daily liquidity registered its maximum point on July 23, when it was at Q947.9 million and its lowest level was –Q577.1 million, corresponding August 2. To November 30 the daily liquidity balance was at –Q445.2 million.

(Banking System, Behavior of the Daily Float Position)



Banking System<sup>1/</sup>

Daily Liquidity Position in M/E



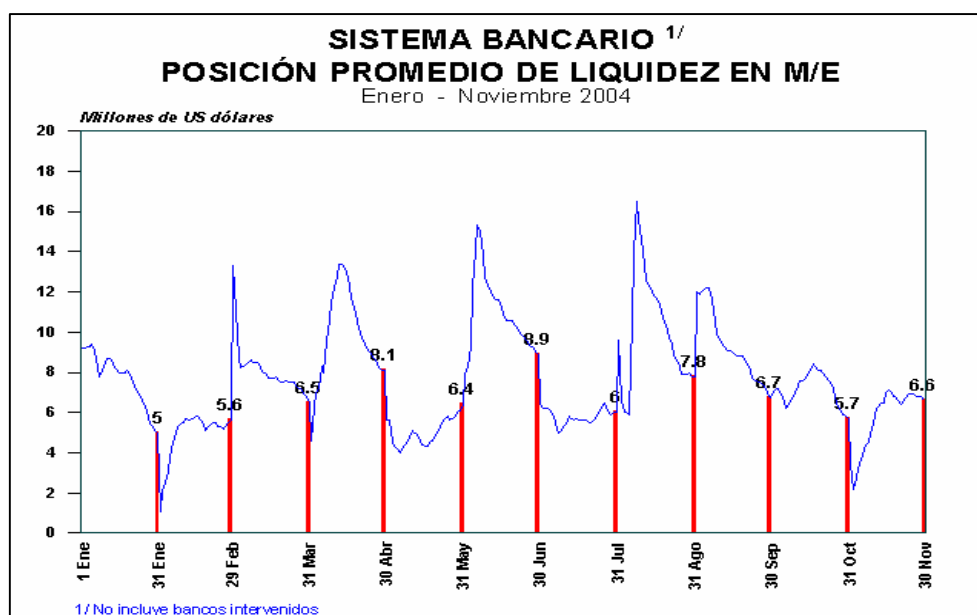
The moderate and stable behavior of the banking level liquidity during 2004 is mainly associated with the greater volume of resources channeled toward credit to the private sector, the increase of the investments of the banks in Term Deposits

of the *Banco de Guatemala*, CDP's, as well as the significant increase in the investments made in the titles issued by the central government.

### **b) In foreign currency**

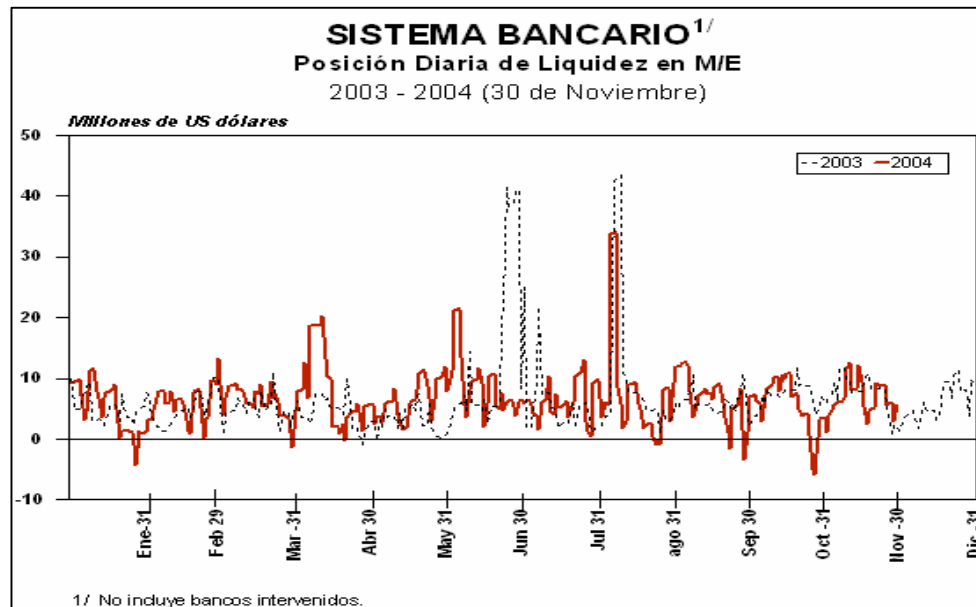
The average banking liquidity in foreign currency, during the January-November 2004 period, was, on average, between US\$5.0 million (January) and US\$8.9 million (June). To November 30, 2004 it was at US\$6.6 million.

(Banking System, Average Liquidity Position in M/E; January to November)



During 2004 the daily foreign currency liquidity showed relatively stable behavior, similar to the observed in the previous year, registering a low point on October 27 (US\$5.8 million) and a high point on August 8 (US\$34.0 million).

(Banking System, Daily Liquidity Position in M/E; November 30)



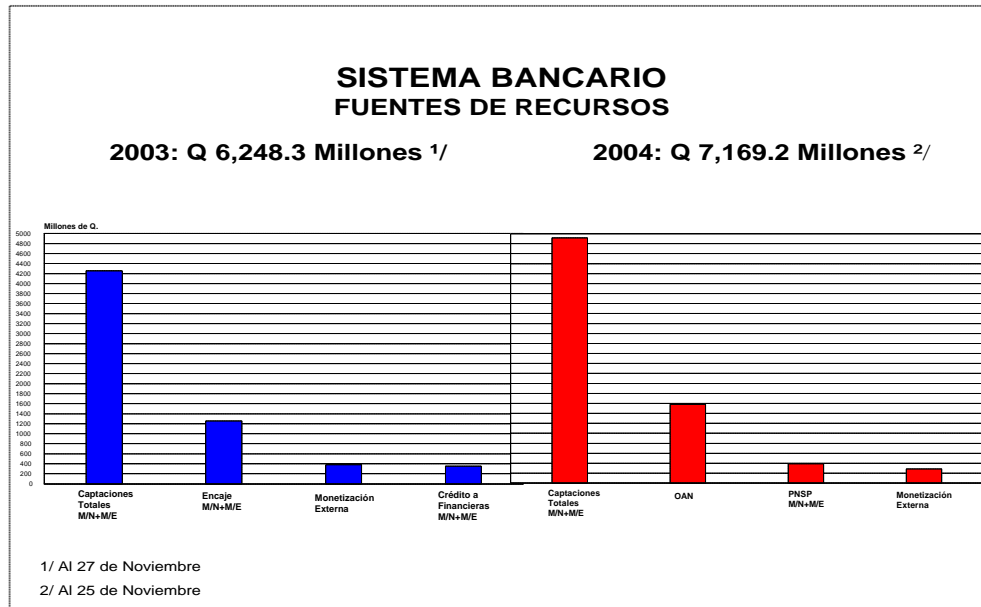
The behavior observed in the banking liquidity levels, in foreign currency, during 2004 is associated, in part, to the fact that during the first nine months of the year the banks destined a part of their resources to amortization obligations contracted to foreign banks. It is worth indicating that in October the banks reactivated the financial contracting abroad, whose resources did not influence on the banking liquidity due to the fact that these were channeled toward credit.

## **2. Sources and uses for the funds of the banking system**

To November 25, 2004 the banking system had obtained resources from other sectors of the economy in order to fulfill its function of financial intermediary for the amount of Q7, 169.2 million, so much so that for a similar period the year before, these were Q6, 248.3 million.

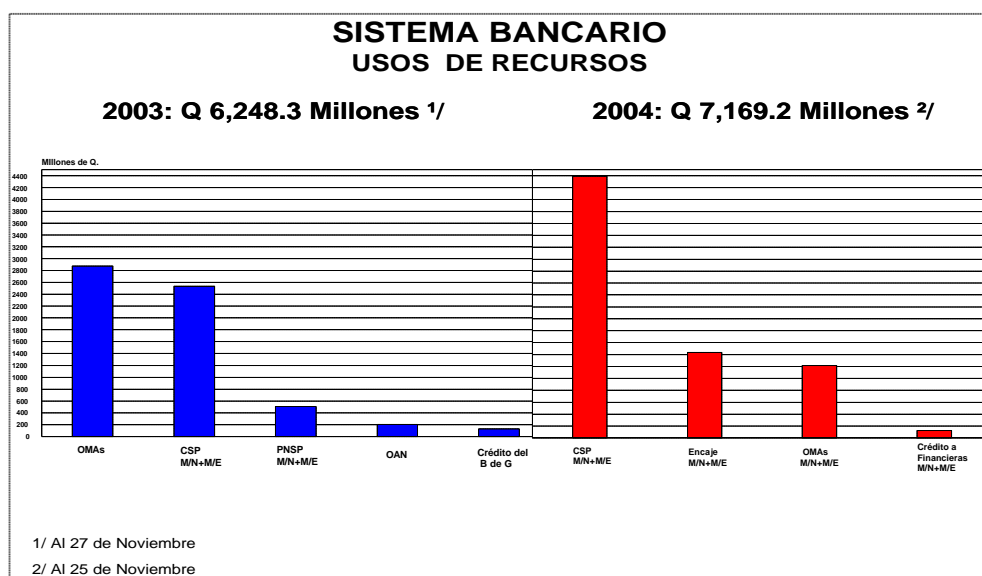


(Banking System, sources of resources. 1. To November 27  
2. To November 25)



As you can appreciate in the graph, to November 2004 the main sources of resource for the banking system were constituted by the total fund raising by deposits from the public (in national currency and in foreign currency) for Q4, 918.3 million, due to the variation of the other net assets for Q1, 577.9 million, from the net resources from the public sector (deposits minus investments) for Q387.4 million and due to the obtaining of net credits from abroad for Q285.6 million. On their part, in 2003 the main sources of resources were the total fund raising of deposits from the public for Q4, 253.2 million, the decrease in banking float in national currency and foreign currency for Q1, 259..7 million and the obtaining of net credits abroad for Q380.7million. As to the use the banking system gave the referred resources, as is appreciated in the following graph, in 2004 the same were mainly destined to the granting of credit to the private sector in national currency and foreign currency for Q4, 391.5 million, to the increase in banking float in national currency and foreign currency for Q1, 438.3 million and to the investment in LTDs of the *Banco de Guatemala* for Q2, 875.4 million and to grant credit to the private sector for Q2,534.4 million.

### (Banking System, Uses for Resources)

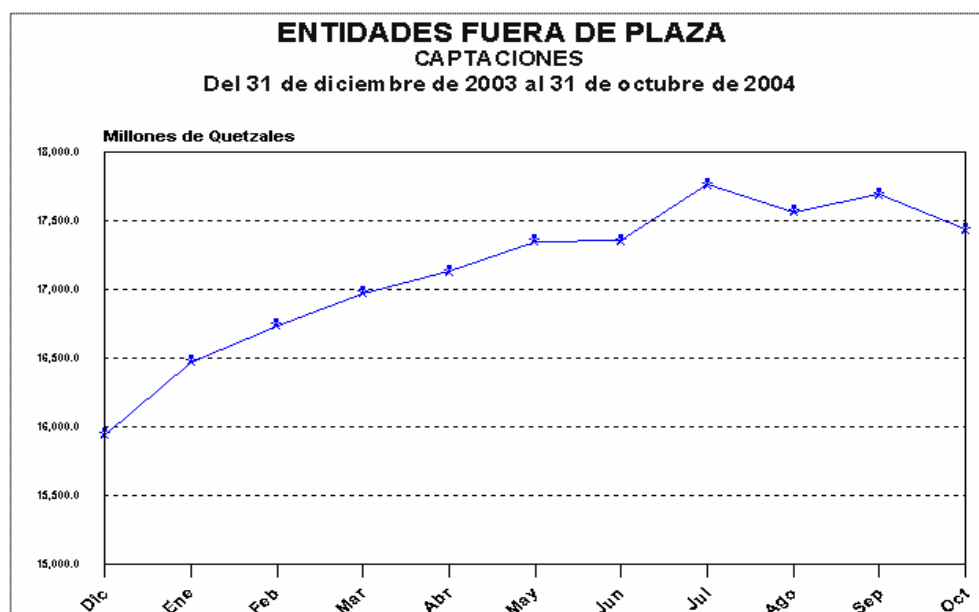


### 3. Offshore Entities

#### a) Fund raising

The fund-raising by Offshore entities to October 31, 2004, registered an equivalent level in *quetzales* of Q17, 433.4 million, with a growth of Q1, 488.2 million (9.3%) regarding the balance registered to December 31, 2003. It is worth mentioning that to December 31, 2003, the fund-raising of offshore entities represented a 33.4% of total fund-raising to the national banking system, so much so that, to October 31, 2004 said proportion was at 34.0%.

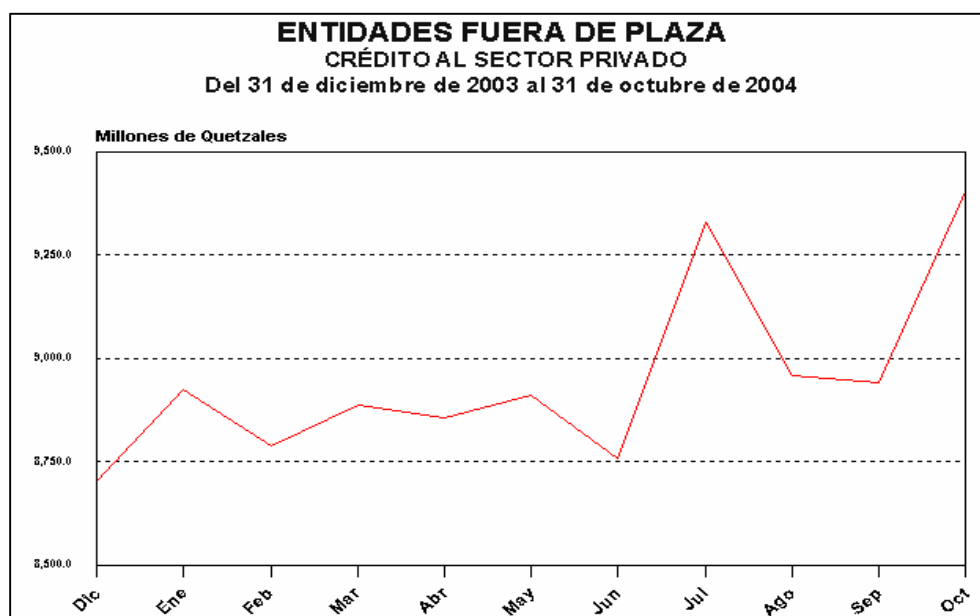
#### (Offshore entities, Fund raising from December 31, 2003 to October 31, 2004)



### **b) Credit to the private sector**

The credit granted to the offshore entities of the private sector to October 31 show a balance equivalent in *quetzales* to Q9, 404.3 million, which is greater by Q700.5 million (8.0%) to the registered on December 31, 2003. It is worth mentioning that at the end of the previous year, the credit granted by the offshore entities to the private sector represented 25.5% of the total granted by the national banking system, so much so that, to October 31, 2004, said proportion was at 28.4%.

(Off Shore Entities, Credit to the Private Sector, from December 31, 2003 to October 31, 2004)



## **4. Advances in the strengthening process of the national financial system<sup>25</sup>**

### **a) Financial groups**

During 2004, the Monetary Board, within the process of putting together the financial groups in resolution JM-19-2004, dated March 3, 2004, authorized the conformation of the '*Grupo Financiero Banco Internacional*' (International Bank

<sup>25</sup> In Annex B a report is presented on the Tendency of the Banking System in Guatemala for the 1990 to 2004 period.

Financial Group). Also, in resolution JM-38-2004, said board authorized the conformation of '*Grupo Financiero de Inversión*' (Investment Financial Group). It is worth mentioning that to date, with these resolutions, they have authorized 14 financial groups. On the other hand, the Monetary Board approved the Regulations to determine the Quote for Inspection of Members of Financial Groups that do not count on a specific calculation in other legal agreements.

### **b) Financial Consolidation**

The Monetary Board authorized the transfer of a substantial part of the balance of Lloyds TSB Bank Plc, Branch Guatemala, in favor of the *Banco Cuscatlán de Guatemala, S.A.* bank, in resolution JM-35-2004, which includes the total of the credit assets, whose balance to February 29, 2004 was of Q333.1 million. Said operation was formalized on June 25, 2004.

Through resolution JM-51-2004, dated May 19, 2004, the Monetary Board authorized the fusion for consolidation of *Financiera Granai & Townson, S.A.* and *Financiera Industrial y Agropecuaria, S.A.* giving origin to a new entity named '*Financiera G&T Continental, S.A.*'. Also, in resolution JM-113-2004, dated October 6, 2004, the Monetary Board authorized the fusion for consolidation of the *Banco SCI, S.A.* with *Banco Corporativo, S.A.*, giving origin to a new banking entity named '*CORPOBANCO SCI, S.A.*'. On the other hand, in resolution JM-142-2004, dated November 17, 2004, the Monetary Board authorized *Financiera Crédito, S.A.* its conversion to a national private bank, under social name '*Banco de Crédito, S.A.*' The authorization of the Monetary Board contemplates that the new bank must count with a minimum of initial paid capital of Q105.0 million.

### **c) Strengthening of the financial security net**

In Decree number 74-2002 of the Congress of the Republic of Guatemala, on November 15, 2002, the Banking Capitalization Fiduciary Fund, FCB, was created, with the objective of financially supporting the process of reparation and strengthening the national banking system within the context of bank fusion processes, asset acquisition and exclusion of assets and liabilities processes, that

are made according to the Law of Banks and Financial Groups. Derived from the above, in Ministerial Agreement Number 51-2004 the *Ministerio de Finanzas Públicas* [Equivalent to the Department of the Treasury], dated September 24, 2004, the following regulation was approved:

- a) Regulation of the Technical Committee of the Fiduciary Trust Fund for Bank Capitalization;
- b) Regulation of Eligibility of Banks to be financed by the Fiduciary Trust Fund for Bank Capitalization;
- c) Regulation of Financial Assistance to banks from the system;
- d) Regulation for the sale of Assets by the Fiduciary Trust Fund for Bank Capitalization; and,
- e) Policy of Investment of the Resources of the Fiduciary Trust Fund for Bank Capitalization.

On its part, the International Reconstruction Promotion Bank, dated December 2, 2004, made a second disbursement of the BIRF-7130-GU Loan 'Financial Sector Adjustment' for US\$50.0 million, resources destined to capitalizing, on the one hand, the Fund for Savings Protection for the equivalent in *quetzales* of US\$25.0 million and, on the other hand, the Fiduciary Fund for Bank Capitalization, FCB, for the equivalent in *quetzales* of US\$25.0 million.

#### **d) Modernization of the Payment System**

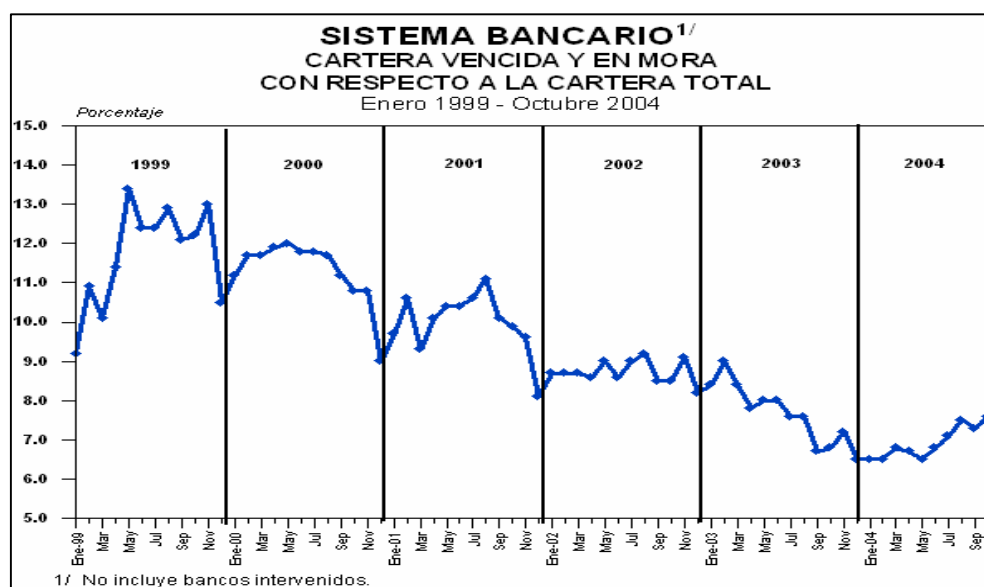
The Monetary Board, in Resolution JM-140-2004 dated November 17, 2004, among other resolved points, approved the Matrix of the Modernization of the Payment System, with the objective of counting on a legal base and a regulation founded on the basic principles for the payment system of systemic importance that would contribute to the efficiency and the transparency of the financial operations made in said system; b) Implement a modern payment system, with the objective of counting on the modern technological tools to optimize the efficiency in the liquidation of the operations, applying international standards; and, c) Achieve the institutional cooperation for the modernization of the payment systems, with the objective of promoting the process of discussion with the participant of the system

in the country in order to count on a modern system of payment, as well as with the central banks from the rest of the region in order to harmonize the payment system for the Central American countries and the Dominican Republic.

## 5. Expired and Default Portfolio

The expired portfolio plus the default portfolio of the banking system (contaminated portfolio), excluding the portfolio of the administratively intervened banks, has shown a slight increase. To October 31, 2004 said portfolio was at Q2, 599.8 million, amount that represents 7.6% of the total portfolio of the banking system, higher by 0.8 percentage points to the observed on the same date the previous year (6.8%). The expired portfolio represents 4.1% (3.6% to October 2003) and the default portfolio represented by 3.5% (3.2% to October 2003).

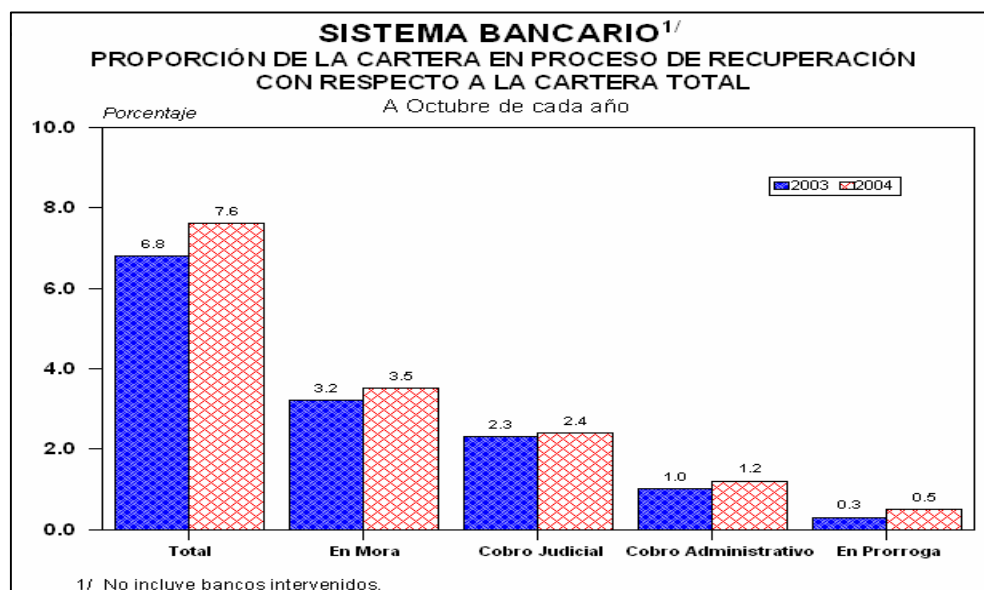
(Banking System, Expired and Default Portfolio Regarding Total Portfolio, From January 1999 to October 2004)



When evaluating the proportion represented by each one of the headings that integrate the portfolio in recovery process regarding the total portfolio, we observe that from October 2003 to October 2004 the default portfolio showed a

slight increase, when going from 3.2% to 3.5%, the portfolio in juristic recovery of 2.3% to 2.4%, the administrative recovery portfolio of 1.0% to 1.2%, and the portfolio in extension process of 0.3% to 0.5%.

(Banking System, Proportion of the Portfolio in Recovery Process regarding Total Portfolio to October of each year)

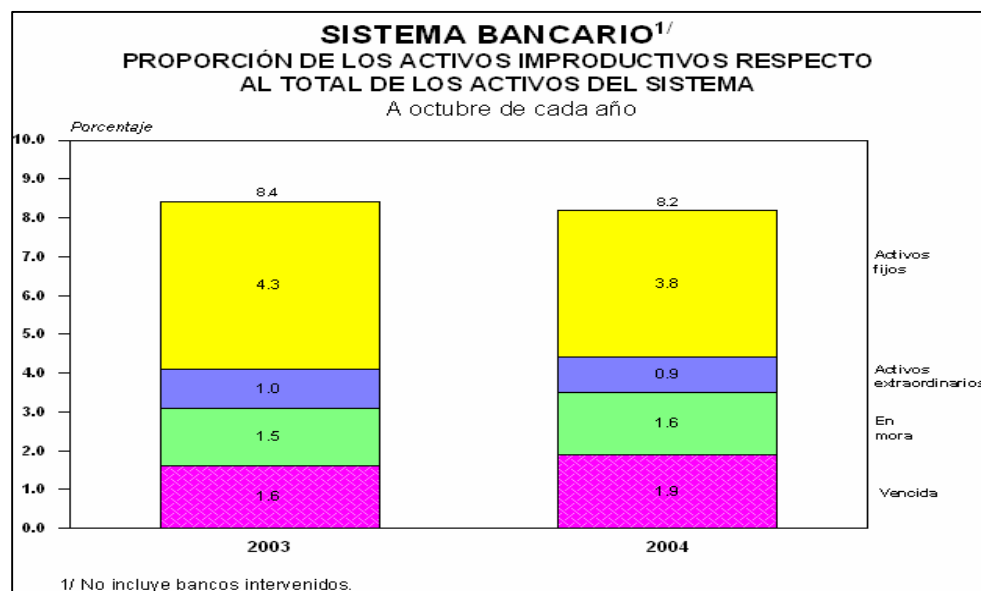


## 6. Unproductive Assets

The unproductive assets<sup>26</sup> of the banking system, as a proportion of the total assets, continue with a tendency toward the decline, located at 8.2% in October 2004 (8.45% in October 2003).

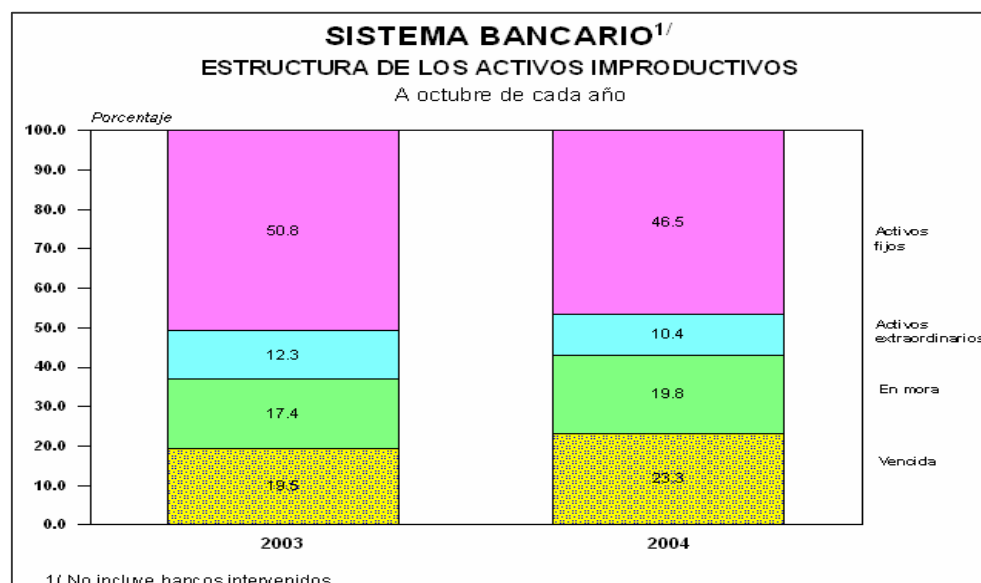
<sup>26</sup> It is made up of the contaminated portfolio, the net extraordinary assets and the fixed assets.

(Banking system, Proportion of unproductive assets regarding total assets in the system, to October of each year)



As to the structure of unproductive assets, it is worth mentioning that from October 2003 to October 2004 the fixed assets and the net extraordinary assets declined their participation regarding the total unproductive assets, when going from 50.8% to 46.5%; and, from 12.3% to 10.4%. On the other hand during the same period, the expired portfolio and the default portfolio increased their participation, when going from 19.5% to 23.3%; and, from 17.4% to 19.8%.

(Banking System, Structure of Unproductive Assets to October of each year)

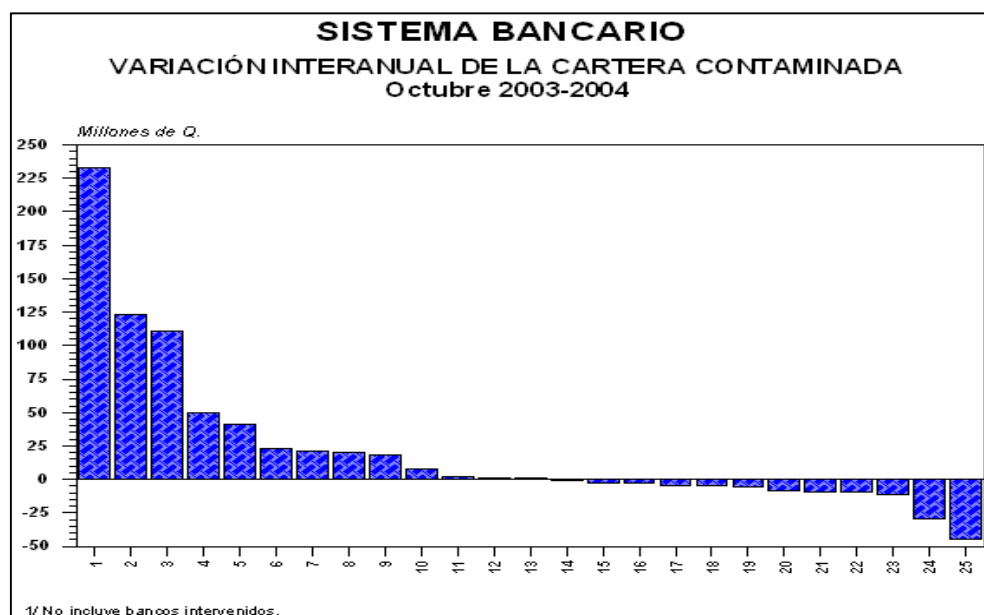




The decrease in the fixed assets is due to the depreciation of the movable commodities and real estate, so much so that the reduction of net extraordinary assets is due to the increase in the estimations of appraisal of these and from the sale of these assets.

As to the increase that the default portfolio has shown and the expired portfolio, it is important to mention that 90.4% of the increase is concentrated in three institutions. When removing the referred increase of the contaminated portfolio that was registered in October 2003 to October 2004 (Q516.2 million), it was determined that the banks showed increases that situated them among the following intervals: a) an institution increased its contaminated portfolio in Q232.6 million; b) two banks increased between Q110.7 million and Q123.4 million; c) seven banks increased said portfolio between Q7.6 million and Q50.0 million; and, d) three banks remained with the same levels of portfolio as the previous year, since the increases were between Q0.9 million and Q2.5 million. It is important to indicate that twelve banking institutions reduced their contaminated portfolio by (Q97.1 million) for amounts that were between Q0.8 and Q44.6 million.

(Banking System, Inter-annual variation of the Contaminated Portfolio)

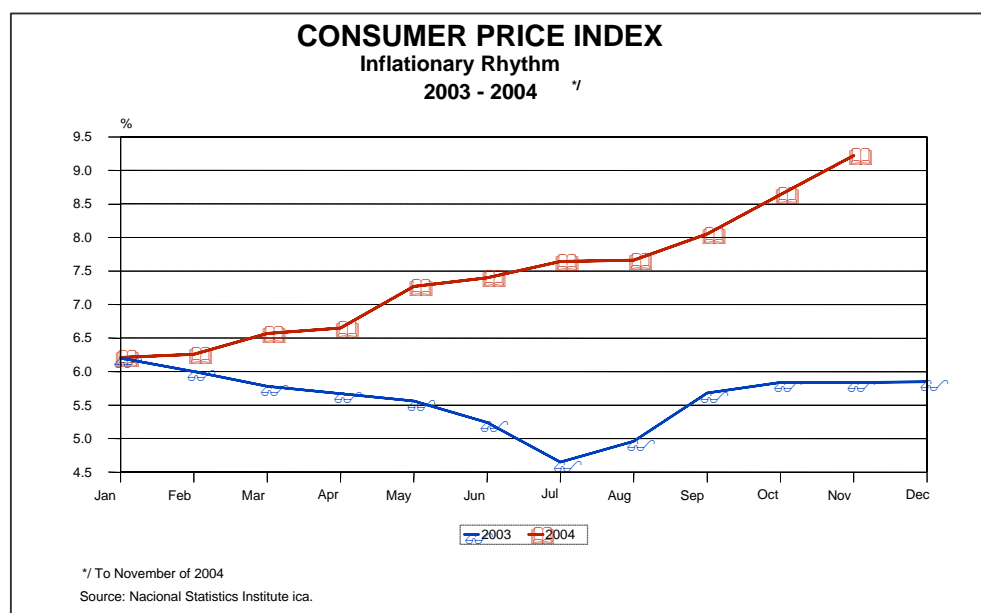


## IV. EVOLUTION OF THE MONETARY VARIABLES

### A. INFLATION GOAL

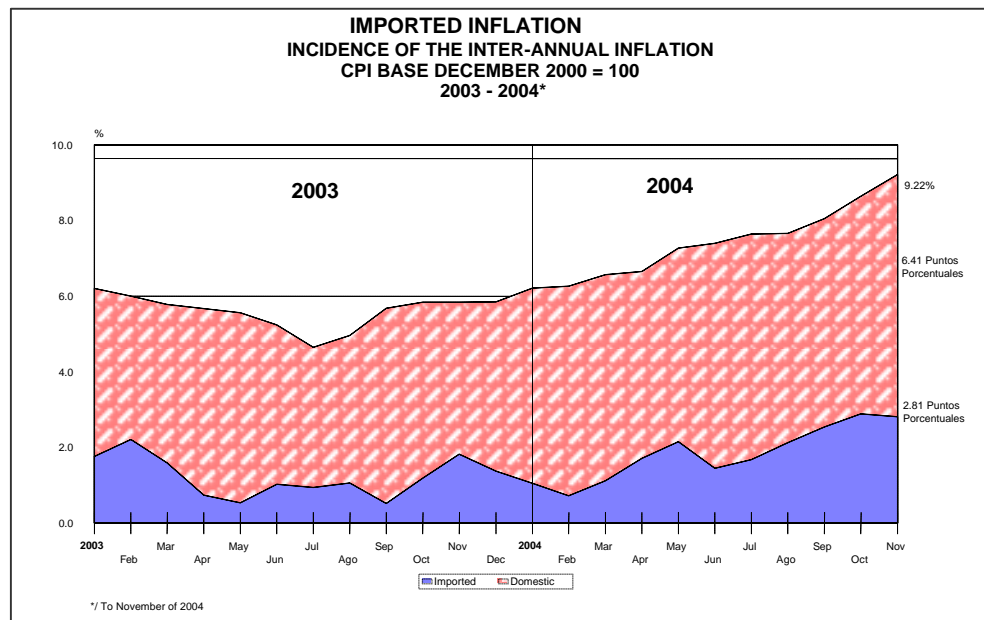
According to the Consumer Price Index, CPI, made by the National Statistics Institute, INE, to November 30, 2004, in the entire republic the inflationary rhythm was registered at 9.33%, percentage greater than the established goal of the Monetary, Exchange and Credit Policy for 2004 (4.0% - 6.0%).

The percentage referred to resulted higher by 3.38 percentage points to the observed in November of 2003 (5.84%).



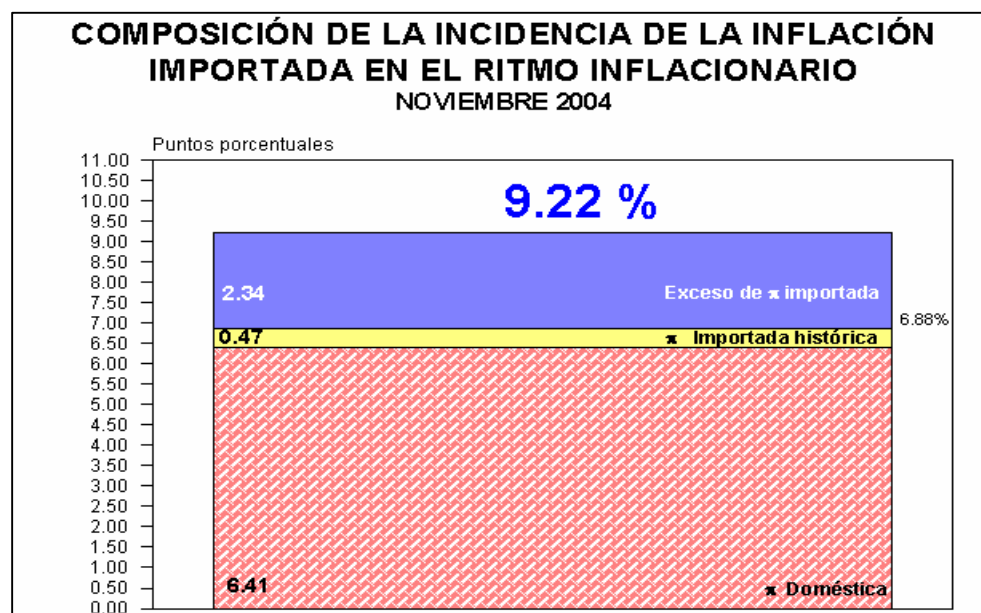
It is worth mentioning that to November of the current year, total inflation was (9.22%), 2.81 percentage points that correspond to imported inflation<sup>27</sup> and 6.41percentage points that correspond to domestic inflation.

<sup>27</sup> It is that which reflects on price increase of imported products included in CPI. An extensive analysis on this matter is within the Conjoined Informative Memorandum 1-2004, dated October 22, 2004, regarding the relation between the monetary policy and imported inflation, which is found on the webpage of the *Banco de Guatemala*.

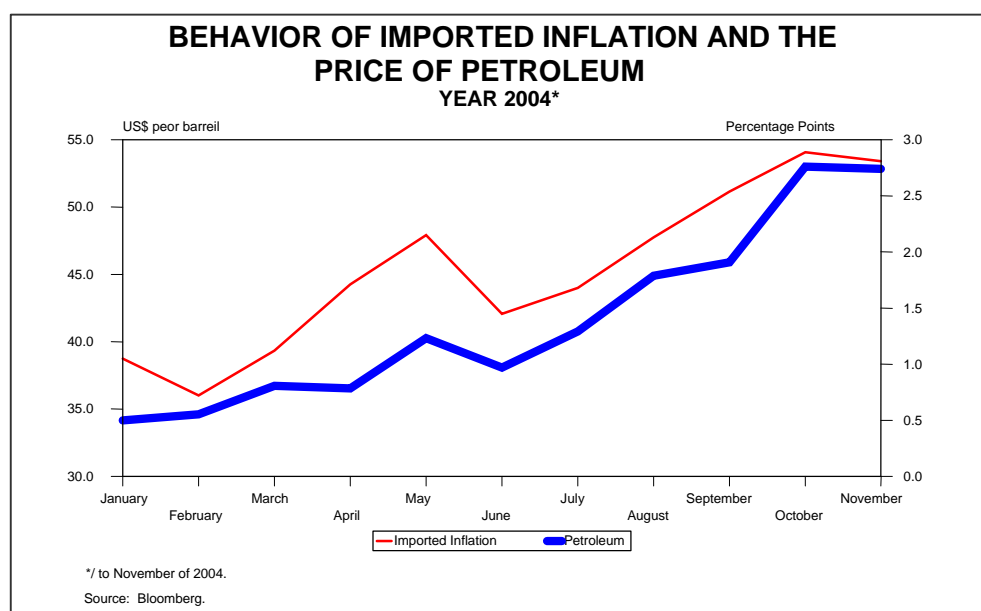


During the 2001 to 2003 period, on average, 0.47 percentage points of inflation was attributable to imported inflation. In those years, the behavior of oil prices was stable, therefore the referred average could be considered a normal historic level. Therefore, if from the imported inflation number to November of the present year (2.81%) the reference average is subtracted, we will have an excess of imported inflation of 2.34 percentage points. In that sense, as illustrated in the following graph, if to total inflation (9.22%) we subtract the excess imported inflation, the inflationary rhythm to November will have been 6.88%. It is worth mentioning that the calculation of imported inflation does not include the effect that the rise in fuel has on the prices of domestic products (for example, higher cost in transportation), therefore if this second round effect were taken into account, imported inflation would be greater.

(Composition of the Incidence of Imported Inflation in the Inflationary Rhythm,  
November 2004)



Therefore we can confirm that imported inflation is the fundamental cause of excess inflation regarding the goal that at the same time is a consequence of the rise in international oil prices.



### THE INTERNATIONAL PRICE OF OIL

In 2004 the international price of crude oil reached the highest historic levels<sup>28</sup>, due to simultaneous factors, in offer as well as demand.

#### DEMAND FACTORS

- ⌚ Increase of the oil importations on behalf of the United States of America, main consumer and importer of the world.
- ⌚ Source demand of energy on behalf of the economy of China, second energy consumer of the world, who is increasing its oil reserve strategy.

#### OFFER FACTORS

- ⌚ Prolonging of the armed conflict in Iraq.
- ⌚ Political conflicts in Nigeria, sixth World oil exporter.
- ⌚ Stand-still, with a tendency to decline, in the crude oil extraction on behalf of Venezuela, due to the absence of new investments for the development and maintenance of fields.
- ⌚ Problems of supply provoked by hurricanes that affected the oil installations in the Gulf of Mexico in September and October.
- ⌚ Economic and fiscal problems with the Yukos company, the biggest oil producer in Russia.

It is worth mentioning that the oil crisis of 1973, 1979 and 1990, the problem was the lack of oil in the market (offer phenomenon), whereas in 2004 the oil crisis is explained, by offer factors as well as demand factors, predominated by the latter.

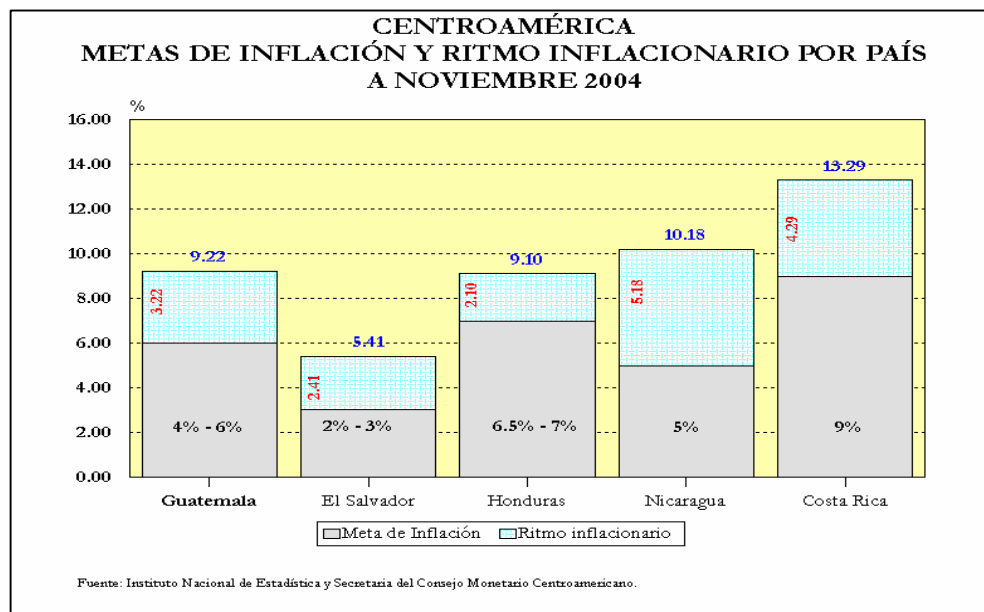
Source: Bloomberg.

It is worth mentioning that the imported inflation impact is being observed in all Central American countries, in which, as a result, the inflationary rhythm is located above the foreseen goal.

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<sup>28</sup> On October 22 in the New York Stock Exchange petroleum closed at US\$55.17 per barrel, after reaching the quote record of US\$55.50 during the session.

(Central America; Inflationary Goals and Inflationary Rhythm per Country to November 2004)



### Analysis of the expense divisions of the CPI

The rhythm of CPI to November 2004 is the result of index growth of the nine expense decisions that make up the total index, particularly the division of Food, non-alcoholic beverages and Take-out food (weighting 38.75%), that registered an inter-annual variation of 13.14% and explains the 57.90% of the inter-annual variation of CPI. Other divisions of expense that explain the behavior of the inflationary rhythm are Housing, electricity and water; and, Transportation and communications, which, together with the Food, non-alcoholic beverages and take-out food, explain 78.83% of the inflationary rhythm registered to November of this year.

Consumer Price Index  
INFLATIONARY RHYTHM  
Republic Level  
(Base: December 2000 = 100.0)  
November 2004

Expense Division	Weighted Expense	November2003	November2004	inflationary Rhythm /1	PARTICIPATION IN THE INFLATIONARY RHYTHM /2	PARTICIPATION IN INFLATIONARY RHYTHM AS A PERCENTAGE /3
<b>GENERAL INCIDENCE</b>	<b>100.00</b>	<b>121.87</b>	<b>133.11</b>	<b>9.22</b>	<b>9.22</b>	<b>100.00</b>
1. Food Non alcoholic beverages and take out food	38.75	128.12	144.95	13.14	5.34	57.90
2. Clothing and Shoes	7.94	116.58	120.83	3.65	0.28	2.99
3. Housing, water, Light and others	10.00	111.96	124.77	11.44	1.05	11.40
4. Movable, housing furniture and routine maintenance in the home	7.95	117.41	125.31	6.73	0.52	5.68
5. Health	5.48	120.88	127.33	5.34	0.30	3.20
6. Transportation and Communications	10.92	109.99	119.75	8.87	0.88	9.53
7. Recreation and culture	6.83	128.61	130.33	1.34	0.09	1.03
8. Education	5.60	125.82	134.94	7.25	0.42	4.54
9. Commodities and diverse services	6.53	122.12	128.59	5.30	0.34	3.73

Source: Instituto Nacional de Estadística -INE-

1/ Variation rates are the same as the same month the previous year.

2/ Incidence in the variation.

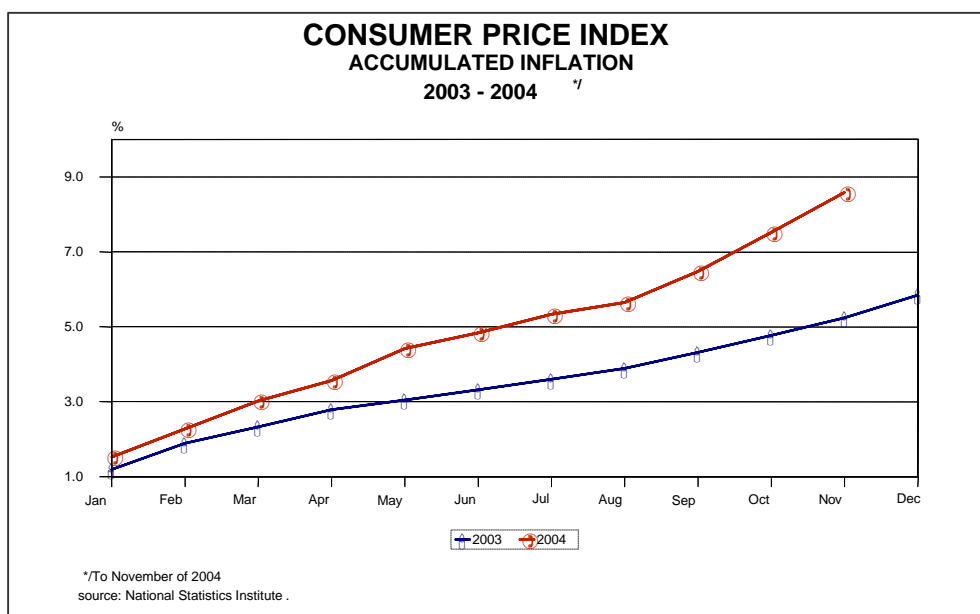
3/ Participation in the variation: (Incidence/ Variation total) \* 100.

In the division of expenses for *Food, non-alcoholic beverages and take-out food*, the variation is explained by the rise in the expense groups of *Bread and cereals; Fruit and vegetables; Prepared foods outside the home; and, Meats*, that together make up 83.22% of the inter-annual variation of this division.

The division of *Housing, water, electricity, gas and other fuels* registered an inter-annual variation of 11.44%, mainly determined by the increase in the mean price of the basic expense of *propane gas, maintenance service and home repair, home water service and electricity* that together explain 11.40%.

The division of *Transportation and Communications* registered an inter-annual variation of 8.87%, mainly determined by the increase in mean prices of the basic expense of *urban transportation, gasoline and sub-urban transportation*, which represents 9.53% in conjunction of the variation of the total CPI.

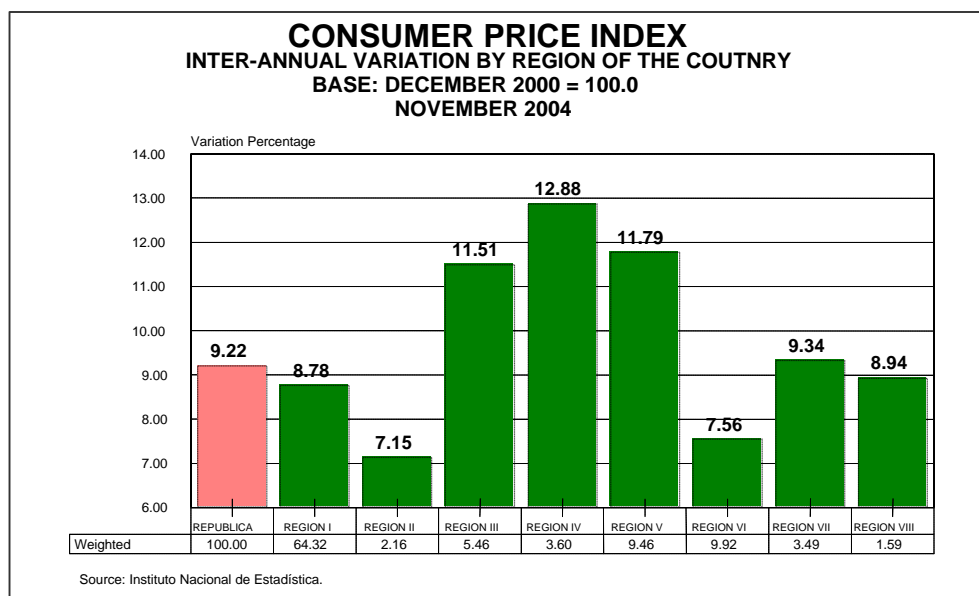
As to the accumulated inflation in the republic to November of the current year, the same was located at 8.59%, higher by 3.35 percentage points to the registered the same period the previous year (5.24%).



At region level<sup>29</sup>, Region IV (Southeast) reached the highest inflationary rhythm, with 12.88%, followed by Region V (Central) and Region III (Northeast), which registered a rhythm of 11.79% and 11.51%. Region I (Metropolitan), which has the highest weighting within the total of regions (64.32%), presented an inflationary rhythm of 8.78%, lower by 0.44 percentage points to the weighted average in the entire republic (9.22%). The region that observed the lowest inflationary rhythm was Region II (North) with 7.15%.

<sup>29</sup>Region I, Metropolitan (Guatemala); Region II, North (Alta Verapaz and Baja Verapaz); Region III, Northeast (El Progreso, Zacapa, Izabal and Chiquimula); Region IV, Southeast (Santa Rosa, Jalapa and Jutiapa); Region V, Central (Chimaltenango, Sacatepequez and Escuintla); Region VI, Southwest (San Marcos, Quetzaltenango, Totonicapán, Retalhuleu and Sololá); Region VII, Northwest (Huehuetenango and Quiché); and, Region VIII, El Petén ( El Petén)





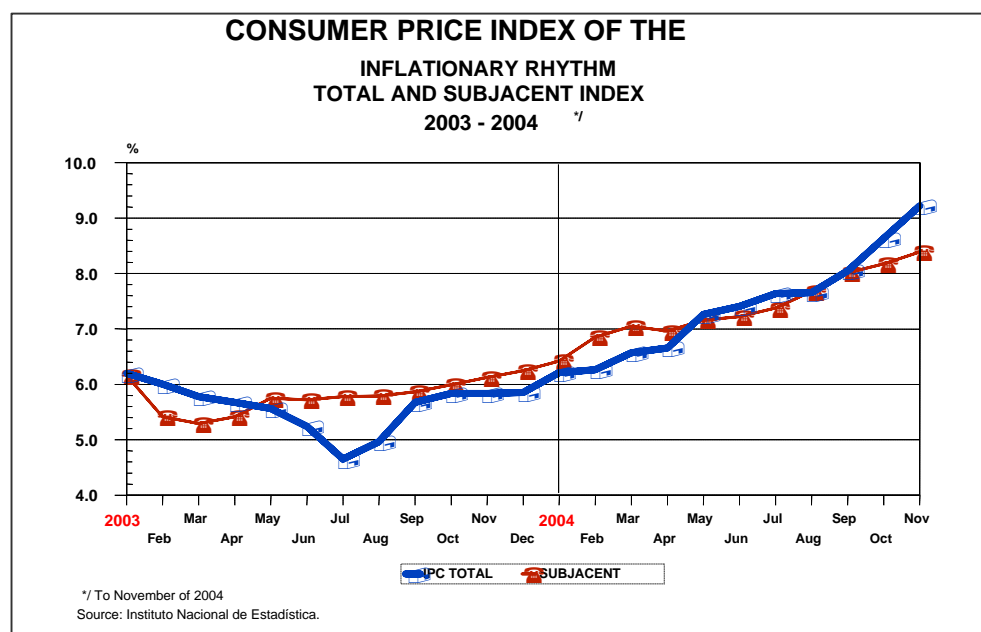
### Subjacent Inflation

In general terms, the subjacent inflation is the growth rate of the price index that, with the purpose of eliminating volatility in the results that difficult interpretation, excludes some goods and services whose prices are highly volatile or are subject to external shocks. In Guatemala's case, the indexes of expense groups for *Fresh, dry and conserved fruit; produce, legumes and tubercles; manufactured and natural gas and liquefied gases from petroleum; and gasoline*, whose weights within the CPI are of 1.28%, 3.77%, 1.09% and 2.04%, for a total of 8.18%. In that sense, the subjacent inflation registered to November 2004, an inter-annual variation of 8.39%, lower by 0.83 percentage points to total inflation (9.22%).

When comparing subjacent inflation with total inflation, it is observed that in the period from January to April and in August, the subjacent inflation was higher than the total inflation. Among the causes of said behavior are, for the case of January to April, that the variation of mean price of basic expense of gasoline was

lower than the total inflation<sup>30</sup> and, for August, that the mean price of produce, legumes and tubercles registered a negative inter-annual.

From May to July and September to November, the subjacent inflation was lower than the total inflation, this mainly due to the fact that mean prices of gasoline and propane gas registered a significant rise.



## B. BALANCE ACCOUNTS OF THE BANCO DE GUATEMALA

### 1. Net External Assets (AEN, for its acronym in Spanish)

The net external assets of the *Banco de Guatemala* -AEN-<sup>31</sup> or Net International Reserves -RIN-, to November 30, 2004 reached a level of US\$3, 447.9 million, showing an increase of US\$528.6 million regarding the balance

<sup>30</sup> When observing that a variation of a mean price of goods and services quoted in the CPI is lower than that of the total inflation, it can be deduced that this variation contributed so that the inflation was not greater than the registered.

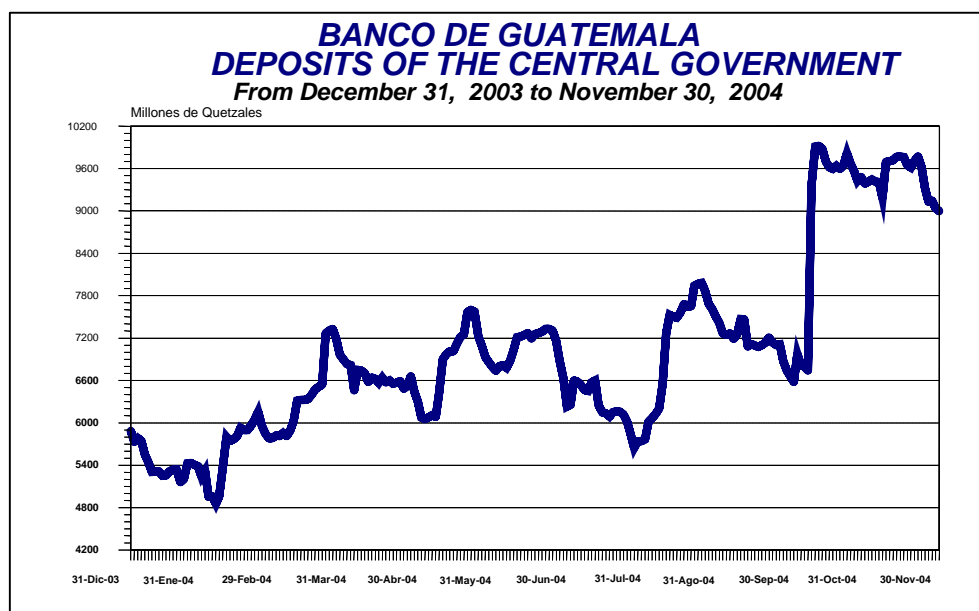
<sup>31</sup> According to the Monetary and Financial Statistics Manual and the International Monetary Fund (IMF, in Spanish), the term net external assets is a synonym for Net International reserves (RIN, in Spanish).

registered to December 31, 2003. The increase in RIN, as indicated, is the result of the income of foreign currency for US\$922.8 million, expenditure of foreign currency for US\$576.9 million and other income for net operations for US\$182.7 million.

## 2. Net internal assets (AIN, for its acronym in Spanish)

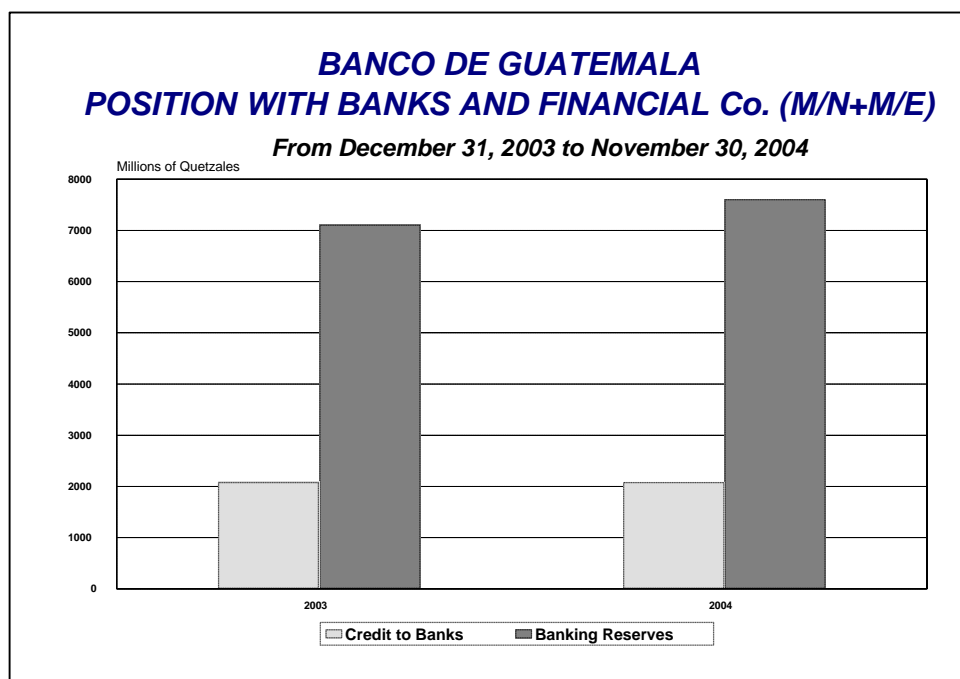
### a) Position with the public sector

To November 30, the level of deposits by the central government in the *Banco de Guatemala* reached Q8, 997.5 million, which represents an increase of Q3, 112.7 million regarding the registered at the end of December of the previous year. This result mainly explains itself by the income from the placement of bonds on the international financial market, by the revenue of taxes and by the income from royalties for oil exploration. On their part, the position with the entities of the rest of the public sector were of Q4, 603.6 million showing an increase of Q556.5 million regarding the closing of 2003. This result derives, on the one hand, on the increase registered en the CDP investments for Q751.6 million, of which Q574.8 million correspond to the *Instituto Guatemalteco de Seguridad Social (IGSS)* [Guatemalan Social Security Entity], and on the other hand, of the decrease in the deposits in the *Banco de Guatemala* for Q195.1 million.



## b) Position with banks and financing companies

To November 30 the *Banco de Guatemala* presented a position with banks and financial companies of Q5, 527.0 million, greater by Q503.3 million to the observed to December 2003, resulting in the increase of the amount kept by the banking entities in the central bank in concept of banking float, deducting the credits amortizations granted to the banks of the system in previous years. The banking float increased in the period by Q499.5 million, Q300.9 million corresponding to the banking float in national currency and Q198.6 million to the banking float in foreign currency. On the other hand, the banks made amortizations to the central bank for Q3.8 million, of which Q1.0 million correspond to the advance payments for making the financial reconstruction programs viable that were granted in 2000 and Q2.8 million to the values issued in the decade of the eighties by the banks of the system, which were acquired by the *Banco de Guatemala* with the objective of channeling resources to finance the construction and acquisition of housing.

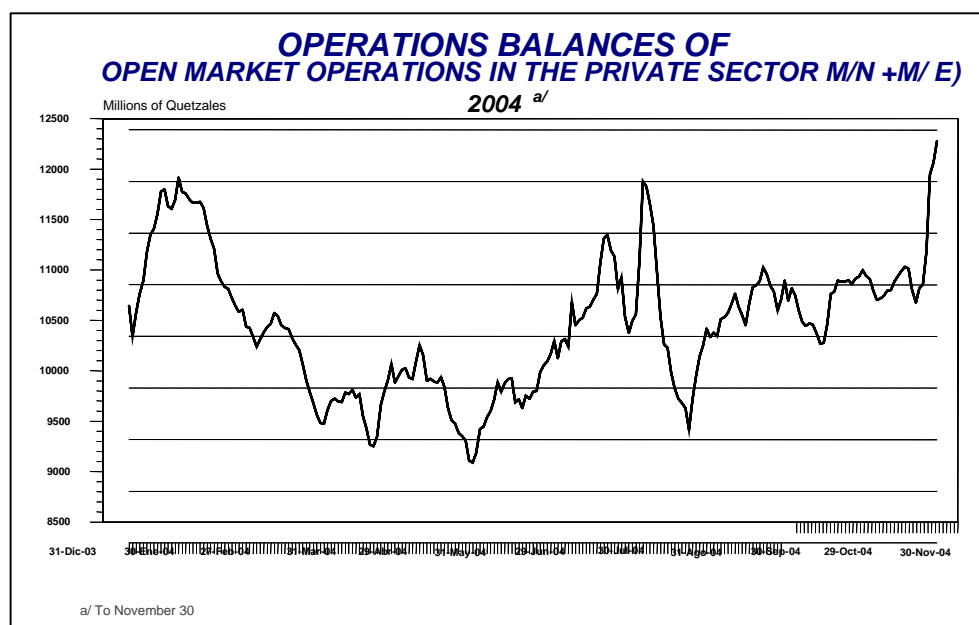


## c) Open Market Operations with the private sector

The open market operations with the private sector, that are the adjustable variable of the monetary program and the main instrument of monetary regulation, to November 30 registered growth in national currency for Q1,546.0 million regarding the level observed at the end of the previous year, registering a balance of Q12,342.8 million. As to open market operations in foreign currency, these registered a level equal to Q50.6 million<sup>32</sup>.

Regarding the expiration of the LTDs in national currency in the hands of the private sector, 31.1% will expire in the remainder of 2004, 54.1% in 2005, 13.7% in 2006 and the remaining 1.1% during 2008. As to the maturity of the LTDs in foreign currency in the hands of the private sector 100.0% will expire in 2005.

It is worth mentioning that as to the structure of the terms of total placements, at the end of December of the previous year, 22.2% was in shorter than 30 day terms, while 77.8% were in terms of between 30 and 875 day terms; so much so that on November 25, 2004, 4.0% were placed in terms of less than 30 days, while 96.0%, in terms of between 30 and 1456 days.



<sup>32</sup> The Monetary Board through Resolution JM-99-2004 dated September 24, authorized the *Banco de Guatemala* to receive term deposits in US dollars. It is worth mentioning that on October 25 the first bidding was adjudicated for the referred term deposits.

## **d) Expenses and products**

The net result of expenses and products of the *Banco de Guatemala*, to November 30, rose to Q938.5 million, amount greater by Q78.3 million to the observed in a similar period the previous year. The monetizing effect is the result of the payment of interest from placement of LTDs made in 2003, whose maturity is concentrated in the first semester of 2004, as well as the payment of interest derived of the open market operations during the present year. The component with greatest participation in total expenditures corresponds mainly to the interest of the open market operations for Q863.8 million and, as to income, the interest perceived by the investment of external assets for Q299.7 million.

## **C. INDICATIVE VARIABLES**

In resolution JM-171-2003, dated December 23, 2003, the Monetary Board decided, among other aspects, that with the purpose of guiding and orienting the Monetary, Exchange and Credit Policy actions and evaluating in what measures they were achieving their goals, they must give follow up to ten indicative variables. With that in mind, the presentation of the following behavior during 2004 showed each one of the referred variables and is now presented:

### **1. Monetary Issue**

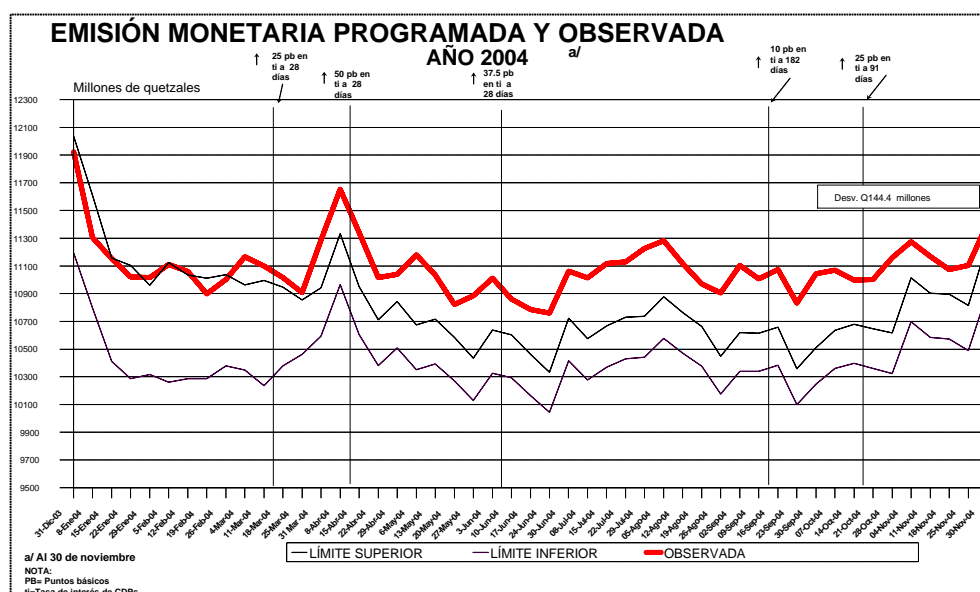
According to the monetary program reviewed for 2004<sup>33</sup>, it was estimated that the demand of monetary issue would grow at the end of the year at around 5% regarding the level observed at the end of 2003. Said variation is compatible with

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<sup>33</sup> The Monetary Board through Resolution JM-82-2004, dated August 4, 2004, in order to recognize the report from the Monetary Policy to June 2004, modified the monetary program in light of the available information observed the first semester of the year and, fundamentally, of the fiscal projections for the second semester provided by the *Ministerio de Finanzas Publicas*, based on the fiscal modifications that on June 29 were approved by the Congress of the Republic. In that context, offer of monetary issue was adjusted in the international monetary reserves, taking into account the purchase of foreign currency made in the SINEDI during the first semester of the year; the new external financing foreseen for Eurobonds, as well as external loans; the foreseen bond placement with residents in foreign currency; and the needs of the public sector to assist the service of its foreign debt. It is worth mentioning that the new fiscal numbers that incorporated the reforms of imposing laws, the fiscal deficit was kept at 2% regarding the gross national product. As to the estimation of the

a growth rate expected of the economic activity of 2.6% and with the inflation goal of between 4% and 6%. One of the characteristics of the demand of monetary issue is that its seasonality and tendency allow the programming of its behavior according to a corridor that can include the possible changes that could be registered in the year.

(Programmed and Observed Monetary Issue for the Year 2004)



The observed and programmed behavior of the monetary issue during 2004 can be observed in the previous graph.

Until February 26, 2004 the trajectory of the monetary issue was kept around the upper limit of the programmed broker, which was possible because the level of OMAs increased by Q536.0 million, this way neutralizing the excess primary liquidity generated in the period.

In the period between February 27 and that of November 30, 2004, the trajectory of monetary issue was kept above the upper limit of the programmed broker. The referred deviation origin is basically associated with the external

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demand of Monetary Issue, the same was adjusted, according to the econometric results obtained by the Economic Studies Department of the *Banco de Guatemala*.

monetization derived of the purchase of foreign currency made by the *Banco de Guatemala* in the Institutional Market of Foreign Currency. Said monetization was partially moderated by the most demonetizing behavior that, regarding the programmed, had the position of the Consolidated Public Sector and the position with banks and financing companies, as well as with the increase of the OMAs that were issued as of mid October, which was fundamental so that, after reaching levels of around Q500.0 million in the third trimester of the year, at the end of November the deviation of monetary issue was located at Q144.4 million.

Regarding the behavior of open market operations we can distinguish five phases. The first, covering the first three weeks of January, when it increased its level to around Q866.0 million, mainly due to programmed monetary issue. The second phase that covers the fourth week of January and the months of February and March, in which the level of open market operations is reduced to around Q1, 464.0 million. This behavior is associated with, on the one hand, that the Central Bank in order to not generate unnecessary distortions in the main macroeconomic variables and given that in the months of January and February the inflationary rhythm increases the levels not higher than the foreseen range with a goal for the end of the year by the Monetary Board, executed said policy in a gradual and prudent manner, and on the other hand, so that the framework of the coordination of the fiscal and monetary policy, the *Banco de Guatemala* and the *Ministerio de Finanzas Públicas* [Equivalent to the Department of the Treasury] agreed that as of January 23, the first would participate placing LTDs in terms of less than a year, while the referred *Ministerio* would make longer terms. The third phase covers the period of April, May and June, in which the monetary issue deviation was kept around the observed levels at the end of March, which was possible due to the fact that the level of open market operations increased in about Q1, 030.0 million. The increase of the OMAs can be associated to a positive answer on the part of the investors to the increases made in April and June of 2004 in the interest rate for the placement of LTDs to 28 day terms, which propitiated the increase in fund raising.



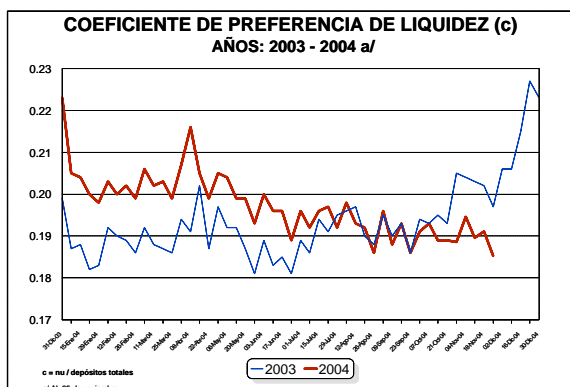
In the fourth phase that was registered in July and October, the deviation of the monetary issue increased regarding the third trimester, observing up to October 28, the highest level of the year (Q544.7 million). It is worth mentioning that in this period the monetization generated by the purchase of foreign currency by the *Banco de Guatemala* in the SINEDI for US\$129.0 million (equivalent to about Q1,032.0 million) was neutralized for the demonetizing effect that generated the increase in the deposits of the Central Bank in the *Banco de Guatemala*, which were over Q1,473.0 million regarding the programmed; however, notwithstanding the adjustments made in this period regarding the monetary operations, the balance of open market operations with the private sector was lower by Q1,633.0 million regarding the programmed.

In the described context, it is worth mentioning that the Execution Committee of the *Banco de Guatemala*, in the framework of the Monetary, Exchange and Credit Policy current to 2004, adopted the following measures: In the first term, on July 22, the Execution Committee agreed that they should establish a quota for fund raising for the 28 day operations with the purpose, on the one hand, to discourage the demand of titles in that term (in the context of a marked exchange appreciation that could be making even more profitable investments than the referred term and attracting speculative capital from neighboring countries) and on the other hand, encouraging the demand of longer terms in order to propitiate a more permanent neutralization of the primary liquidity that would contribute to the reduction of the deviation of the monetary issue; in the second term, with the objective of strengthening the cited decision, the Execution Committee agreed on August 31 to quit operating the 28 day term in order to transmit the precise message that the adopted measure did not imply a monetary relaxation, it agreed that in the operations made on the Electronic Banking Table of Money (MEBD) it would add the 91 and 182 day terms, establishing a fund-raising quota for them; and, in third term, if there does not exist evidence that the placements for 28 day terms were attracting foreign capital, the Execution

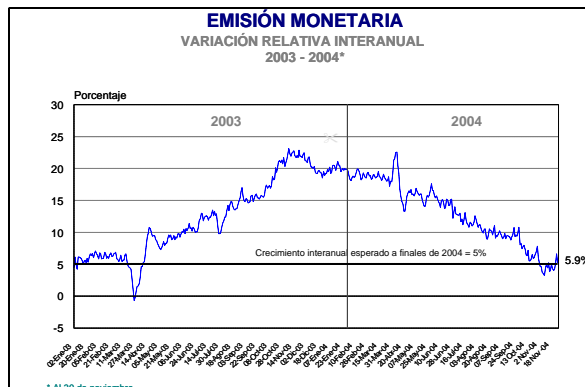
Committee considered it possible to re-open this term without risk of it producing additional capital flow. In that sense, on October 25, it agreed to re-open the 28 day term and in addition the 21 day term in MEDB and in the stock exchange. With the application of the strict measures described it was able to recompose the placement of LTDs toward longer terms (particularly toward the 91 day terms, whose rate at the moment was converted in the rate the policy had given that econometrically demonstrated that was the term that exercised the greatest influence on inflation).

The fifth and last phase began as of November, in which the deviation of the monetary issue was notably reduced, when surpassing Q544.7 million on October 28 to Q144.4 million on November 30. Said reduction is mainly associated to an increase in the level of open market operations with the private sector regarding the programmed for Q2, 188.0 million. It is worth indicating that among the demand factors that have contributed to the reduction of monetary issue deviation in the year is the preference liquidity coefficient on behalf of the public, which has been being reduced in the course of 2004, exactly as it has been in other post-electoral years (1991, 1996 y 2000), situation which has allowed the inter-annual growth rhythm of monetary issue to decelerate gradually in the course of 2004, at around the programmed level for the end of the year, on November 30.

#### Liquidity Preference Coefficient



#### Monetary Issue Inter-annual Relative Variation



As to behavior of open market operations in the cited period, it is worth mentioning that these increased approximately Q1, 272.0 million, situation which is mainly associated with a greater demand of titles from the Central Bank on behalf of the investors, particularly in the short term.

Last, it is worth indicating that in order to avoid that the inflationary effect of increase in international oil prices be extended to the sectors of the economy, in order to abate the inflationary expectations observed in the course of the year they adjusted the interest rate of the monetary operations from the Central Bank on five occasions. Said adjustment, given that the inflationary effect of the increase of the international price of oil persisted during the entire year and that could negatively influence on the expectations of the economic agent, they adopted them in order to send a message of commitment from the Central Bank with macroeconomic stability, especially, with the maintenance of the general level of prices.

## **2. Expected Subjacent Inflation**

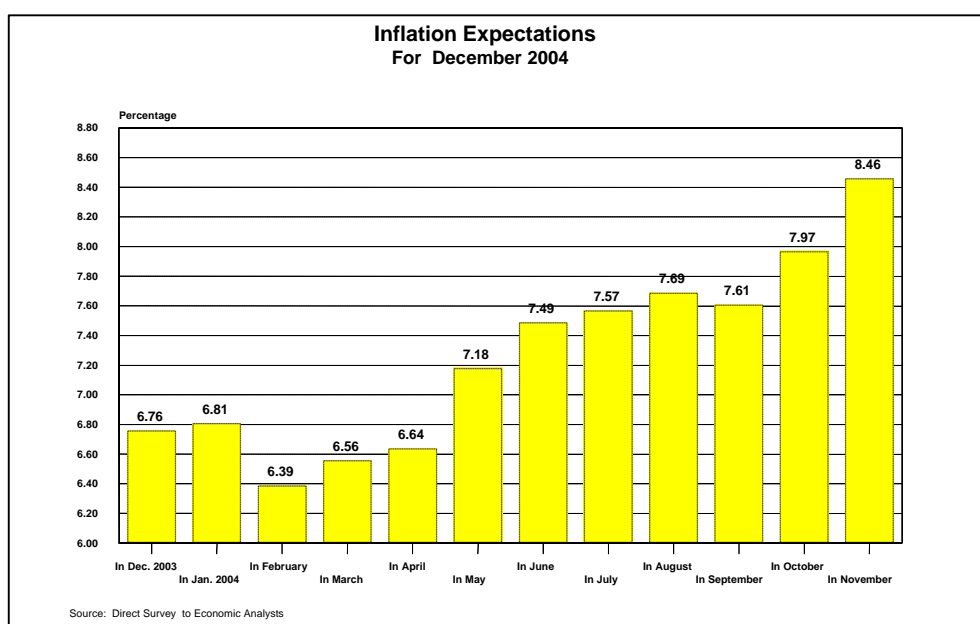
In the Monetary, Exchange and Credit Policy for 2004 it was established that, in addition to the monitoring of the observed subjacent inflation, they would use the expected subjacent inflation as a follow-up variable. The estimation of said variable was calculated through an ARIMA model (autoregressive time series model, integrated and of mobile averages) that contains monthly statistic information of the subjacent inflation from January 2004 until the last available date (November 2004). According to said model, to November 2004 the estimation of the subjacent inflation for the end of the year is of 8.47%, higher to the goal range determined by the Monetary, Exchange and Credit Policy for 2004 (4% - 6%).

## **3. Expectations of inflation by the economic panel of experts**

The expectations of inflation are defined as the public belief on the future behavior of prices within the economy. The inflationary expectations that for a certain period the economic agents from could, in some circumstances,

substantially influence (and independently of the fundamentals behavior of the economy) in the determination of the inflation rate that finally is observed in that period.

The Expectation Survey of Inflation by the Panel of Economic Experts from the Private Sector, EEI<sup>34</sup>, is made monthly; according to the results of the survey in November, the surveyed foresee that for December of the current year the inflationary rhythm will be set at 8.46%, a higher percentage than the established goal by the Monetary, Exchange and Credit Policy for 2004 (4% - 6%).



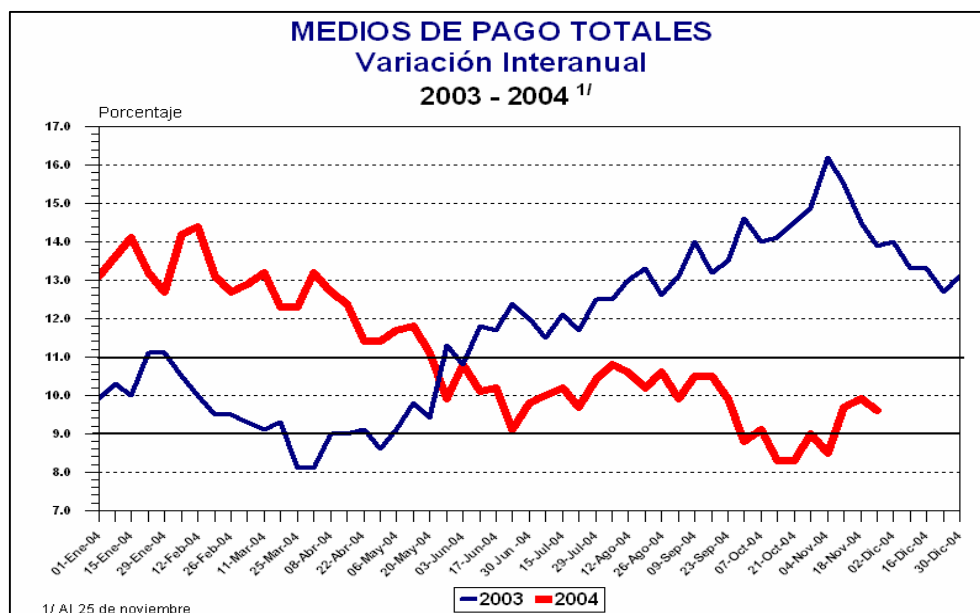
#### 4. Payment Means

In the Monetary, Exchange and Credit Policy for 2004 it was estimated that, congruently with the growth of the economic activity, with the inflation goal and with the speed of money circulation, the total payment means (M2 and M3) will grow between 9% and 11% in inter-annual terms. To November 25, the total payment means (national and foreign currency) corresponding to M2 reached a level of

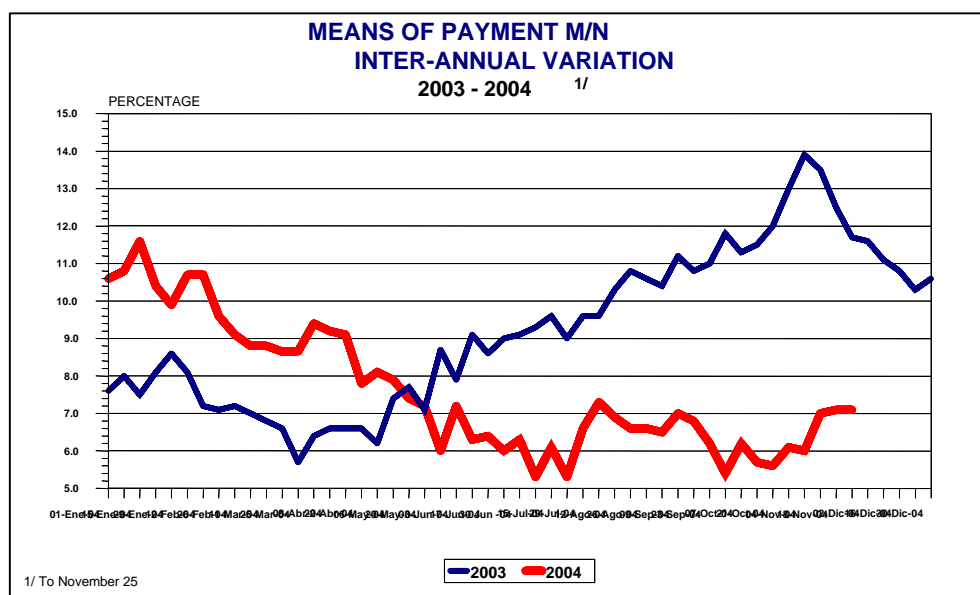
<sup>34</sup> Monthly survey directed at national and international experts of the private sector, knowledgeable of the operative procedures of the monetary policy, that allow the measure of their impressions regarding the future evolution of the inflationary rhythm in Guatemala.

Q62, 220.7 million, which represents growth, in inter-annual terms of 9.6%. Said percentage is found within the foreseen range of the current monetary policy.

(Total Means Payment, Inter-annual Variation)

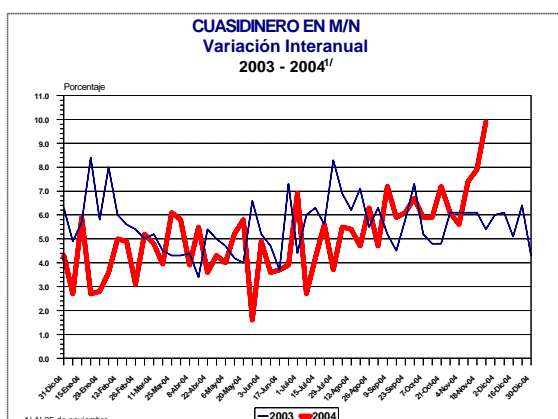


The M2 in national currency, on their behalf registered, to November 25, a balance of Q55, 478.4 million, with an inter-annual growth of 7.1% (Q3, 685.0 million), lower by 4.6 percentage points to the observed in the same period of the previous year (11.7%).

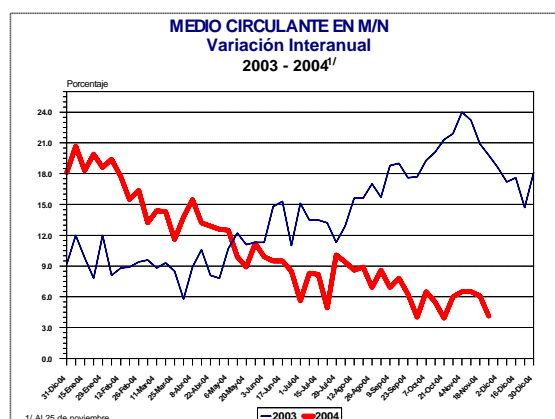


Among the components of the payment means (M2) in national currency, the near money registered an inter-annual growth of 9.9% (Q2, 695.3 million) and the circulating means of 4.0% (Q989.7 million).

Near money in M/N  
Inter-annual variation



Circulating Means in M/N  
Inter-annual variation



On their part, the payment means (M2) in foreign currency to November 25 registered a balance equivalent to Q6,742.2 million with an inter-annual growth rate of Q1,775.6 million (35.8%) lower by 7.4 percentage points to the observed in the same period the previous year (43.2%). In foreign currency, the near money grew for the equivalent to Q951.9 million (34.9%) and the monetary deposits equivalent to Q823.7 million (36.8%), both in inter-annual terms.

Last, the added M3 in national currency is made up of M2 in national currency plus the term deposits made in the *Banco de Guatemala* and the bonds issued by the private financial companies, both in the hands of the private, non-banking sector, reached, to November 25, a balance of Q57, 732.9 million, with an inter-annual growth of 6.3%. The total added monetary in national currency and in foreign currency (M3) was of Q65, 143.0 million, equivalent to an increase of Q3,

741.0 million (6.1%) regarding the observed level in December 2003 and an increase of Q5, 278.3 million (8.8%) in inter-annual terms.

## **5. Credit to banks in the private sector**

### **a) Growth rate**

In the Monetary, Exchange and Credit Policy for 2004 it was estimated that the banking credit to the private sector reached an inter-annual growth rate of between 11.5% and 13.5%, consistent with the growth of the payment means, with the inflation goal and with the expected economic growth.

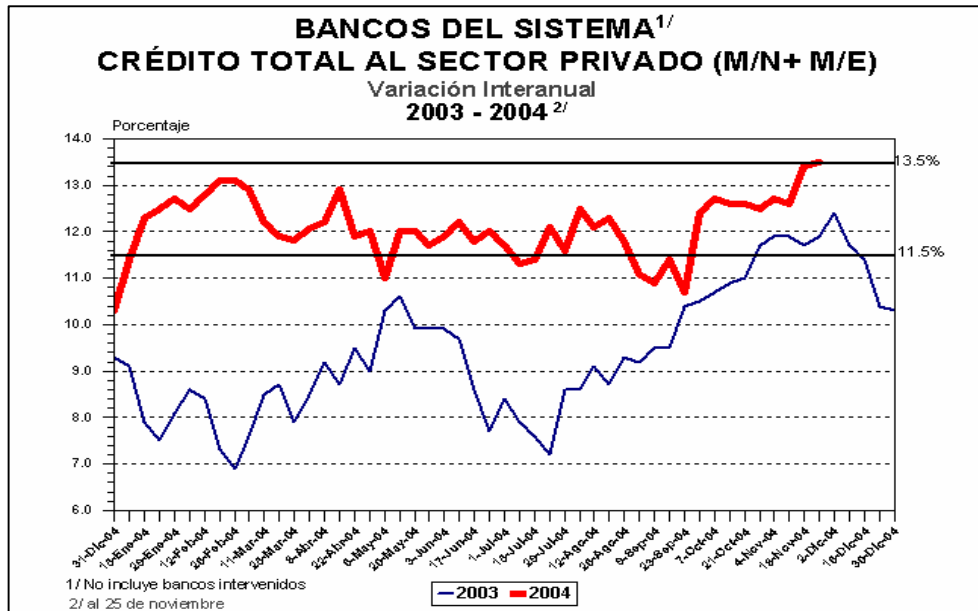
To November 25, 2004, the total banking credit to the private sector (national currency plus foreign currency) was at Q38, 510.0 million, registering an inter-annual growth rate of 13.5%<sup>35</sup>(Q4,589.1 million), which is found in the upper limit of the foreseen range in the current monetary policy.

When analyzing the behavior registered during 2004 of the total banking credit to the private sector, it observed that the greater part of the year of the inter-annual variation was between the established range in the Monetary, Exchange and Credit Policy for 2004.

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<sup>35</sup> Does not include the three administratively intervened banks.

(Banks in the System, Total Credit to the Private Sector (M/N + M/E)  
Inter-annual variation)



Regarding credit to the private sector in national currency, this was located at Q28, 760.1 million, with an inter-annual growth rate of 13.7% (Q3, 474.3 million), greater by 6.8 percentage points to the observed in the same period during the previous year (6.9%). The credit to the private sector in foreign currency registered a balance equivalent to Q9, 749.9 million, with an inter-annual growth rate of 12.9% (Q1, 114.8 million), lower by 16.5 percentage points to the observed in the same period of the previous year (29.4%).

#### **b) Credit portfolio for economic activity**

To October 31, 2004 (last available information), without including the administratively intervened banks, the credit portfolio of the banking system was at Q34, 234.9 million, amount higher by Q3, 108.3 million (10.0%) to the registered on the same date the year before. It is worth indicating that 91.3% of the banking



credit is concentrated in the consumer and transfer; commerce; industry; construction and agriculture sectors.

Regarding the variation of the credit portfolio for economic activity, from January to October 2004 it has been distributed in the following manner:

**SISTEMA BANCARIO<sup>1/</sup>**  
**CARTERA CREDITICIA POR ACTIVIDAD ECONOMICA**  
**EN LOS PERIODOS QUE SE INDICAN**  
- Millones de quetzales y en porcentajes -

DESTINO	DICIEMBRE 2003 (A)	OCTUBRE 2004 (B)	VARIACION ACUMULADA		ESTRUCTURA %	
			ABSOLUTA B - A	RELATIVA (%) B/A	DICIEMBRE 2003	OCTUBRE 2004
Total	31,126.6	34,234.9	3,108.3	10.0	100.0	100.0
Agricultura, ganadería silvicultura, caza y pesca	2,757.9	2,502.0	-255.9	-9.3	8.9	7.3
Explotación minas y canteras	14.1	11.0	-3.1	-22.0	0.0	0.0
Industria manufacturera	3,473.4	3,384.9	-88.5	-2.5	11.2	9.9
Electricidad, gas y agua	452.3	669.7	217.4	48.1	1.5	2.0
Construcción	1,919.3	2,742.1	822.8	42.9	6.2	8.0
Comercio	7,287.2	6,627.7	-659.5	-9.1	23.4	19.4
Transporte y almacenamiento	224.5	226.2	1.7	0.8	0.7	0.7
Establecimientos financieros, bienes inmuebles y servicios prestados a las empresas	1,227.1	1,155.5	-71.6	-5.8	3.9	3.4
Servicios comunales, sociales y personales	979.8	926.9	-52.9	-5.4	3.1	2.7
Consumo, transferencias y otros	12,791.0	15,989.0	3,198.0	25.0	41.1	46.7

1/ No incluye bancos intervenidos.

**Banking System<sup>1/</sup>**  
**CREDIT PORTFOLIO FOR ECONOMIC ACTIVITY**

Agriculture, Livestock forestry, hunting and fishing

Mines and quarries exploration

Manufacturing Industry

Electricity, gas and water

Construction

Commerce

Transportation and storage

Financial establishments, real estate and services rendered to businesses

Community, social and personal services

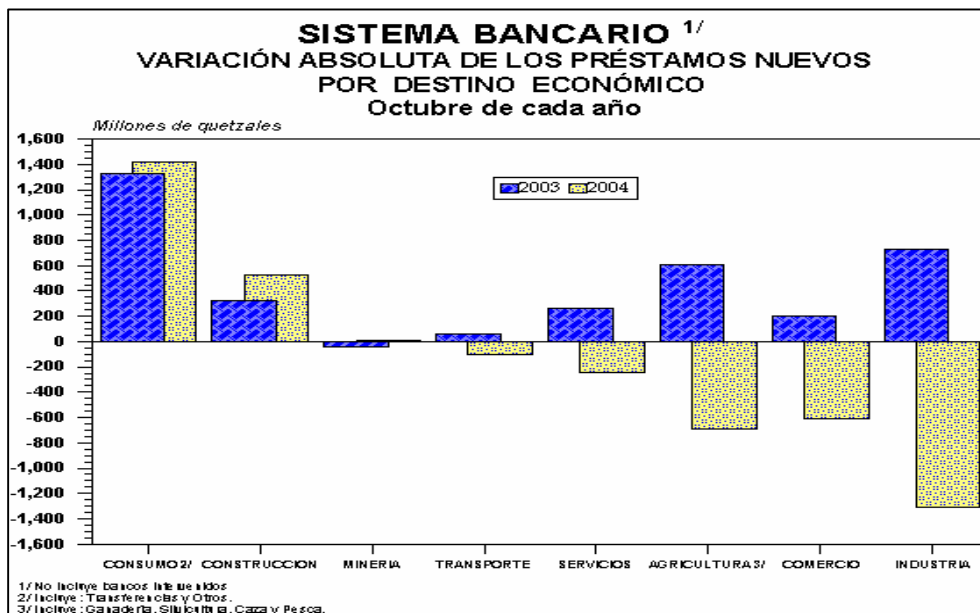
Consumer, transfers and others

### c) New loans, extensions and renewals

To October 31, 2004 the amount in new loans, that included extensions and renewals, rose to Q21,760.7 million, amount lower by Q1,021.9 million (4.5%) to the registered in an equal period the year before.

The reduction in new loans reflects, on the one hand, the decrease in the financing channeled to the industry (Q1, 313.0 million); to agriculture (Q694.6 million); to commerce (Q614.0 million); to services (Q247.5 million); and to transportation (Q107.0 million); as well as the increase registered in the financing to consumption (Q1, 418.3 million); to construction (Q529.3 million); and to mining (Q6.6 million).

(Banking System, Absolute Variation of the New Loans According to Economic Destination. October of each year)



## **6. Interest Rate**

### **a) Of open market operations**

#### **i) In national currency**

During the period between January and November of 2004, in the open market operations in short terms made in the Electronic Banking Table of Money and in the stock exchange, the interest rates corresponding to the 7 and 14 day terms were stable, whereas, derived from the decisions of the Execution Committee of the *Banco de Guatemala*, oriented to avoiding that the inflationary effect of the increase in oil prices extend to all the sectors of the economy, and in order to lessen the inflationary expectations, in the 28 day term the interest rate registered nominal raises of 25 basic points to March 15, 50 basic points to April 13 and of 37.5 basic points to June 8.

As of September, the Execution Committee decided to add the participation of the referred mechanisms for the 91 and 182 day terms, with the purpose of making gradual changes in the composition of the fund raising achieved toward longer terms and, with the additional objective of discouraging the capital flow toward the country, it temporarily suspended the 28 day term participation. Additionally, before the persistence of inflationary pressure, on October 18, said committee decided to increase the interest rate of 91 day terms in 25 basic points.

At the end of October the Execution Committee added the 21 day term and decided to reopen the 28 day term, decision that was oriented to avoiding the volatility in the money market associated to the management of the banking liquidity. The reopening of the 28 day term also responded to the fact that there was no evidence that said term was encouraging capital flow to the country<sup>36</sup>. For that effect, the interest rates of said terms were determined according to the rates of the 14 and 91 day terms of the term deposits. Following is the presentation of

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<sup>36</sup> When eliminating the 28 day term, it was observed that the resources were being neutralized in that term were transferred to the 91 and 182 day terms, without having decreased the balance of the open market operations substantially

the behavior of the monthly average weighted interest rate in the referred mechanisms.

(Monthly Weighted Average Interest Rates of Open Market Operations, Money Banking Electronic Table and Stock Exchange, From January to November 2004 – In Percentages-)

TASAS DE INTERÉS PROMEDIO PONDERADO MENSUAL DE OPERACIONES DE MERCADO ABIERTO  
MESA ELECTRÓNICA BANCARIA DE DINERO Y BOLSAS DE VALORES  
DE ENERO A NOVIEMBRE DE 2004  
- En porcentajes -

PLAZO EN DÍAS	ENERO	FEBRERO	MARZO	ABRIL	MAYO	JUNIO	JULIO	AGOSTO	SEPTIEMBRE	OCTUBRE	NOVIEMBRE
7	2.55	2.55	2.55	2.55	2.55	2.55	2.55	2.55	2.55	2.55	2.53
14	2.61	2.61	2.61	2.61	2.61	-	2.61	2.61	2.61	2.61	2.61
21	-	-	-	-	-	-	-	-	-	-	2.93
28	4.50	4.50	4.72	5.17	5.25	5.58	5.63	5.54	-	-	3.24
91	-	-	-	-	-	-	-	-	5.85	5.93	6.10
182	-	-	-	-	-	-	-	-	6.10	-	-

The open market operations interest rates in terms greater than 28 days and up to 364 days, through bidding, from January to August, were adjusted according to the modifications on the 28 day term<sup>37</sup> interest rate. The 128 day interest rate registered nominal raises of 30 and 35 basic points in April and June, while the 364 day term increased in 50 basic points in June.

As of September, the interest rates greater than one year were adjusted in function of the 91 day terms<sup>38</sup>. In that sense, the operations interest rate for 728 days registered a decrease of 50 basic points. Following is a presentation of the behavior of monthly average weighted interest rates through bidding.

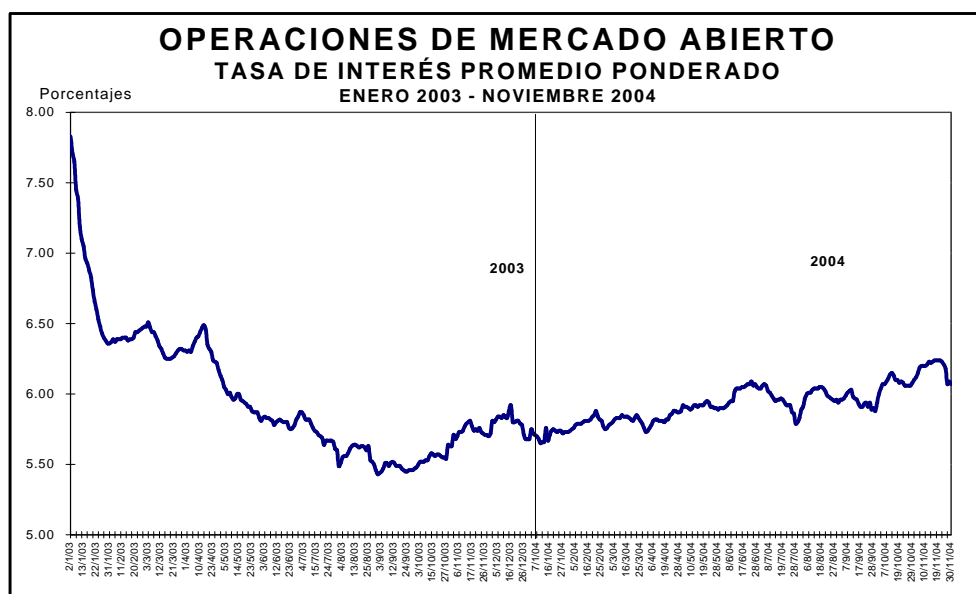
TASAS DE INTERÉS PROMEDIO PONDERADO MENSUAL  
DE OPERACIONES DE MERCADO ABIERTO  
LICITACIÓN  
DE ENERO A NOVIEMBRE 2004  
- En porcentajes -

PLAZO EN DÍAS	ENERO	FEBRERO	MARZO	ABRIL	MAYO	JUNIO	JULIO	AGOSTO	SEPTIEMBRE	OCTUBRE	NOVIEMBRE
91	4.89	4.90						5.85	5.85	6.02	6.10
154			5.25								
182				5.36	5.65	6.00	6.00	6.00	6.08	6.15	6.15
336	5.93										
364		6.00	6.00	6.00	6.00	6.48	6.50	6.50	6.50	6.50	6.50
490	6.66										
546					7.00	7.00	6.96	6.95			
700	7.65										
728						7.65	7.65		7.15	7.15	7.15
1456									8.20	8.20	8.20

As to the weighted average interest rate the total balance of the open market operations, during the January to November 2004 period, showed a moderate to rise behavior, when going from 5.68% a 6.07%, due to the nominal increases in the interest rates and due to the change in the structure of the balance of the OMAs, from the short to the longer terms.

### (OPEN MARKET OPERATIONS

WEIGHTED AVERAGE INTEREST RATE, January 2003 to November 2004)



To November 30, 2004, the current balance of the total open market operations was at Q16, 806.1 million<sup>39</sup>.

The behavior per term of the total balance of the monetary operations can be divided into two periods, depending on the term where they are placed: the first, from January to July, in which a gradual increase can be observed in the balance of the operations in short terms (up to 28 days); and, the second, from August to November, in which the opposite behavior is evidenced, since a decrease in the short term operations can be observed and an increase in the long term. In that context, during the analyzed period the net short term placements decreased Q1,

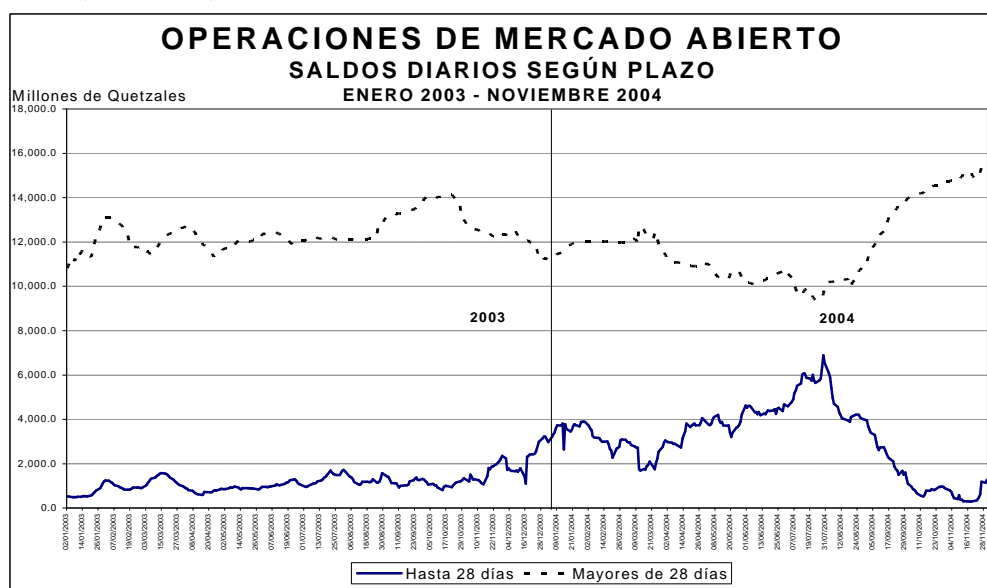
<sup>39</sup> Includes the balance due, pending payment for Q30.7 million.

951.0 million, so much so that the net long term placements increased Q4, 229.8 million.

As can be observed in the following graph, during the analyzed period, said operations have been concentrated in greater terms at one month, when representing 92.4% of the current balance.

### OPEN MARKET OPERATIONS DAILY BALANCE ACCORDING TO TERM JANUARY 2003 - NOVEMBER 2004

Millones de Quetzales  
up to 28 days More than 28 days



## **b) Parameter Rate**

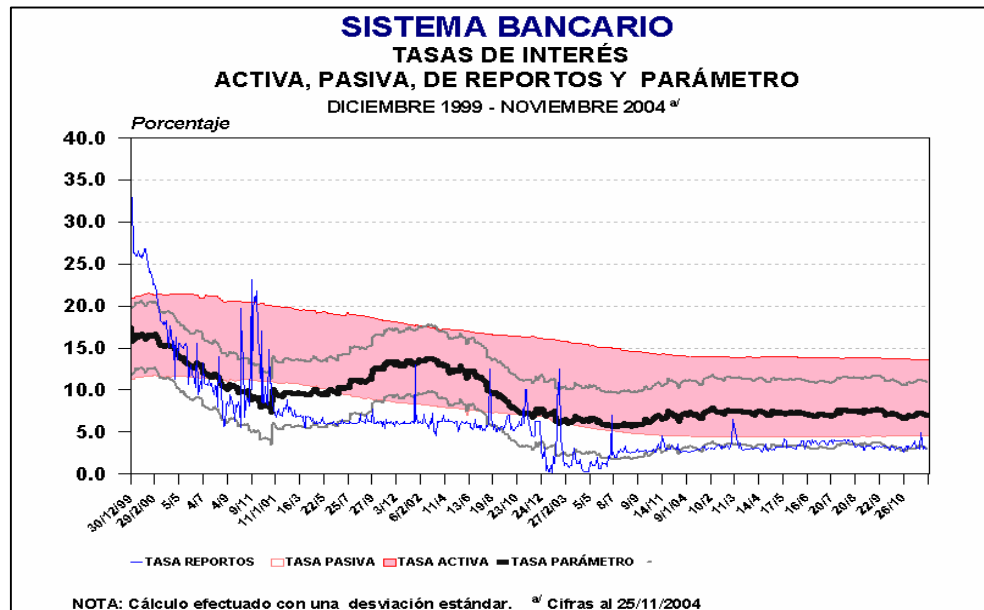
The parameter rate is an indicator based on the 'Taylor Rule'<sup>40</sup>, that incorporates adjustments on a base rate (or neutral) in function of inflation differentials, of added demand and of the nominal exchange rate, so that the resulting exchange rate indicated the level of interest rate that should be avoided in the market to be compatible with the existing inflation levels.

To November 25, the parameter rate was at 6.95% and its upper and lower limits, calculated with a standard deviation, were at 10.90% and 3.00%. It is worth mentioning that the positive liquidity volumes in the banking system during 2004, the repurchase agreement rate for the term of 8 to 15 days has been kept around the lower limit of the band of the parameter rate. In particular, to November 25, said rate was at 3.07%, above the lower limit of the referred band. If the repurchase agreement rate is compared to the asset and liability rate, weighted average of the banking system, the same has remained and can be observed during the greater part of the period even under the liable rate and with stable behavior.

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<sup>40</sup> The Taylor Rule is an indicator that is used by many central banks to orient participation decisions in the monetary market, since it reflects the adjustments of the interest rate due to inflation and excessive demand that result compatible with the fundamental objective of the monetary policy. In the case of Guatemala it has been considered convenient to add an adjustment due to exchange movements, therefore it has been named the 'parameter rate'.

(Banking System, Interest Rates, Asset, Liabe, Repurchase Agreements and Parameter; December 1999 to November 2004)



### c) External Competitivity in the domestic interest rate

The external competitiveness of the domestic interest rate in national currency can be evaluated if compared with the parity interest rate. This last can be defined as the sum of the following: (i) a comparable international interest rate; (ii) a prime exchange risk and (iii) a premium for risk country.

The 'parity condition not covered by the interest rate' is a condition of no-arbitration in the financial market that is fulfilled when the domestic interest rate in national currency is equal to the corresponding parity rate and, therefore, the yield of a financial asset in national currency is equal to those that can be obtained with a foreign currency substitute (abstracting the transaction costs).<sup>41</sup> In that case, an economic agent would be indifferent when operating in national currency or foreign currency. On the contrary, when a positive rift exists between the domestic interest

<sup>41</sup> It is worth indicating that the parity rate, asset as well as liabe, if they still possess limitations of statistical nature, associated tot he lack of information on the transaction costs and financial instruments that can be perfectly substituted on the market, represent a standard indicator of the external competitiveness of the domestic interest rate.



rate in national currency regarding the corresponding parity interest rate, the economic agents are stimulated to return capital to the country; then, when the rift is negative, it can propitiate capital leaving.

For mediation effects, in the present analysis the LIBOR rate (London Interbank Offered Rate) is used and the LIBID (London Interbank Bid Rate) as external interest rates comparable to domestic interest rates in asset and liable national currency (term deposits). In addition, as an approximate measurement of the exchange premium of risk a different average exchange rate is used (purchase and sale) observed and the average exchange rate (purchase and sale) negotiated in the Guatemalan futures market. At the same time, to approximately measure the premium of risk country, the difference between the return rate of Guatemalan Eurobonds, in circulation in the international financial market and the return rate of the US Treasury Bonds, corresponds to the same rate.

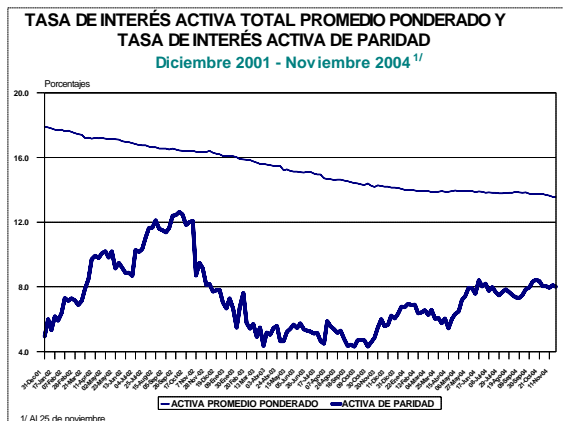
During the period of December 31, 2003 and November 25, 2004, the domestic asset interest rate observed was greater than the parity asset interest rate, which is an indicator that the credit abroad resulted cheaper than the internal credit. In theory, this difference will create the contracting of external credits and, therefore, in income of capital. It is worth mentioning to November 25 the weighted average asset interest rate was located at 13.56%, therefore the asset parity rate was 8.01%.

On their part, during the January to May period the weighted average interest rate in term deposit (domestic liable rate) was greater than the parity passive rate. As of the first two weeks of May, the parity liable rate was greater than the weighted average interest rate of term deposit. In effect, to November 25, the term deposit rate reached 6.84%, so much so that the parity liable rate was of 7.88%. Without taking into account the transaction costs, said situation would indicate to the economic agents that from mid May there would be a more favorable result saving abroad.

Weighted Average Total Asset Interest Rate and  
Parity Asset Interest Rate

Interest Rate of Term Deposits and Interest Rate  
Parity Liable

December 2001 - November 2004 <sup>1/</sup>

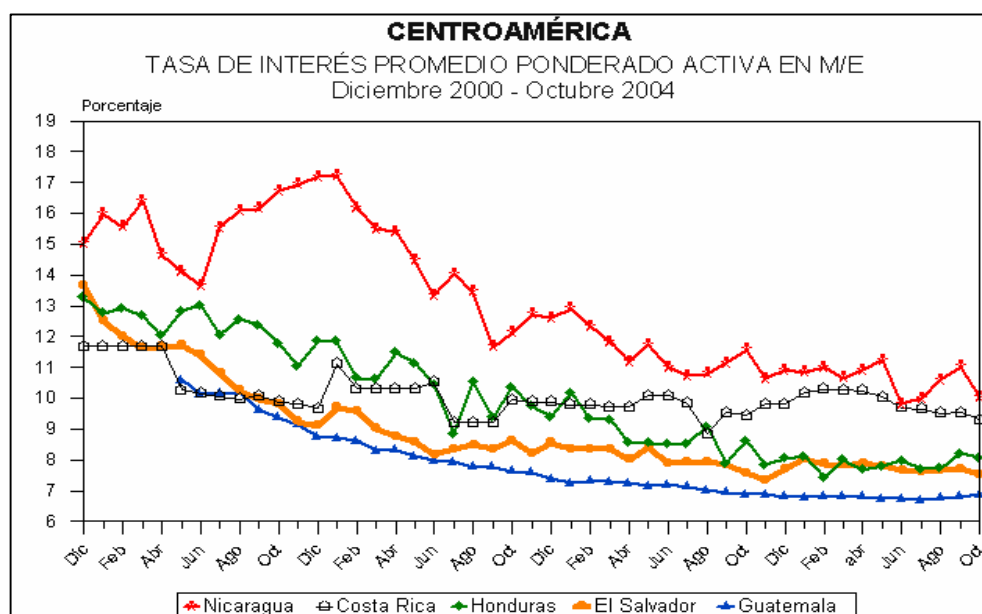


#### d) Interest rates in foreign currency, average weighted, in Central America

Taking into account the importance of comparing financial homogeneous instruments between countries in the Central American areas, in the present clause we will compare the interest rates applied in the area banks in asset and liable operations in US dollars.

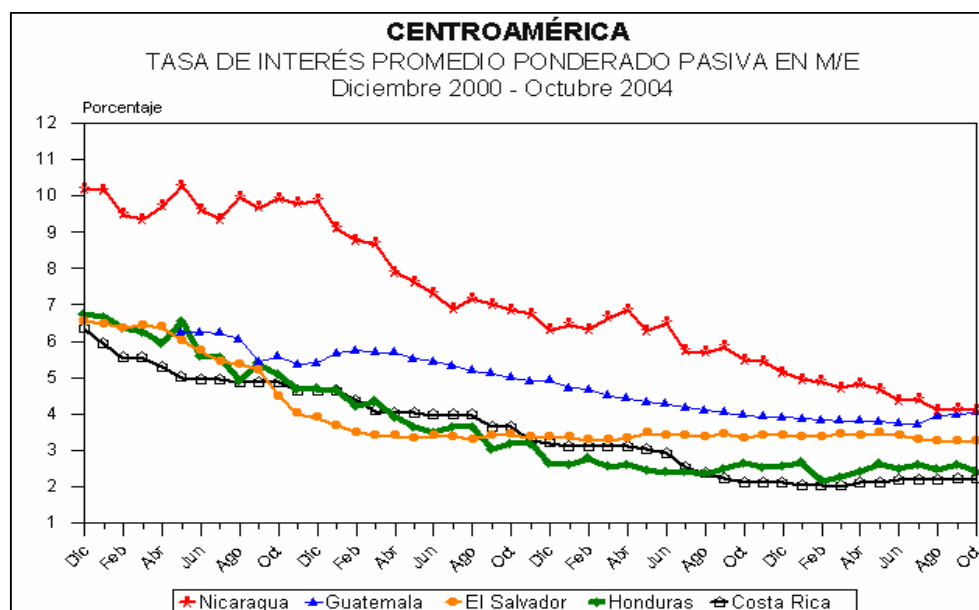
Within this context, according to available information to October 2004, Nicaragua presented the highest asset interest rate, at 10.05%; followed by Costa Rica, Honduras and El Salvador, with rates of 9.30%, 8.08% and 7.53%, and last is Guatemala, with an asset rate in the banking system of 6.89%.

(Central America, Weighted Average Asset Interest Rate in M/E, December 2000 to October 2004)



As to the liable interest rates in term deposits in US dollars, according to the latest available information to October 2004, Nicaragua also presented the highest rate at 4.09%, followed by Guatemala, El Salvador y Honduras that reached 4.04%, 3.26% y 2.41%, and last, Costa Rica with a rate of 2.21%.

(Central America, Weighted Average Liable Interest Rate in M/E, December 2000 to October 2004)



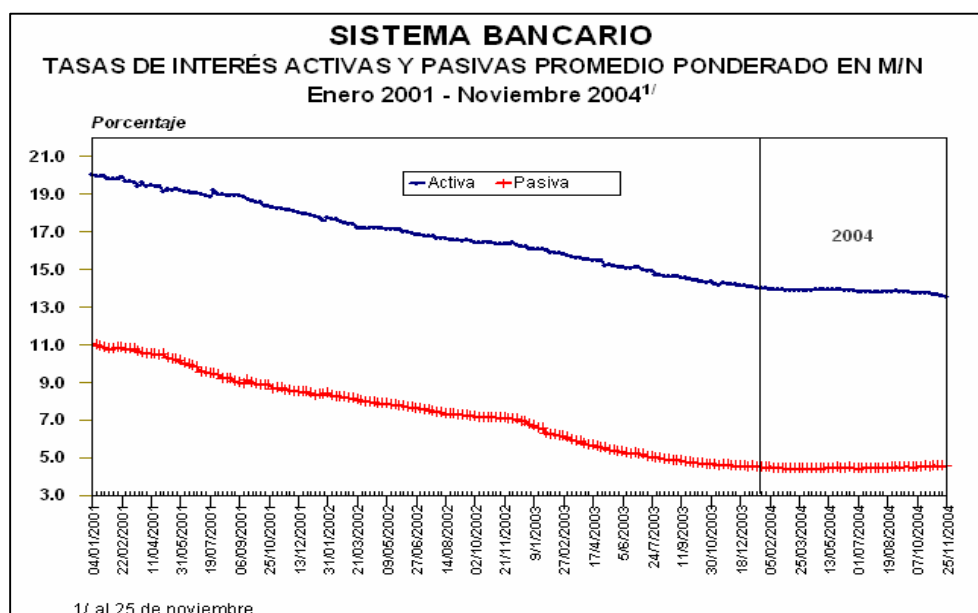
Taking as a reference the interest rates, weighted average, of the banking systems in Central America, can be inferred that, without taking into account the risk country or the cost of the transaction, it is more favorable to be financed in the Guatemalan banking system and save in the Nicaraguan banking system.

### **e) Asset and Liabe Interest Rates, weighted average, of the banking system**

#### **i) In national currency**

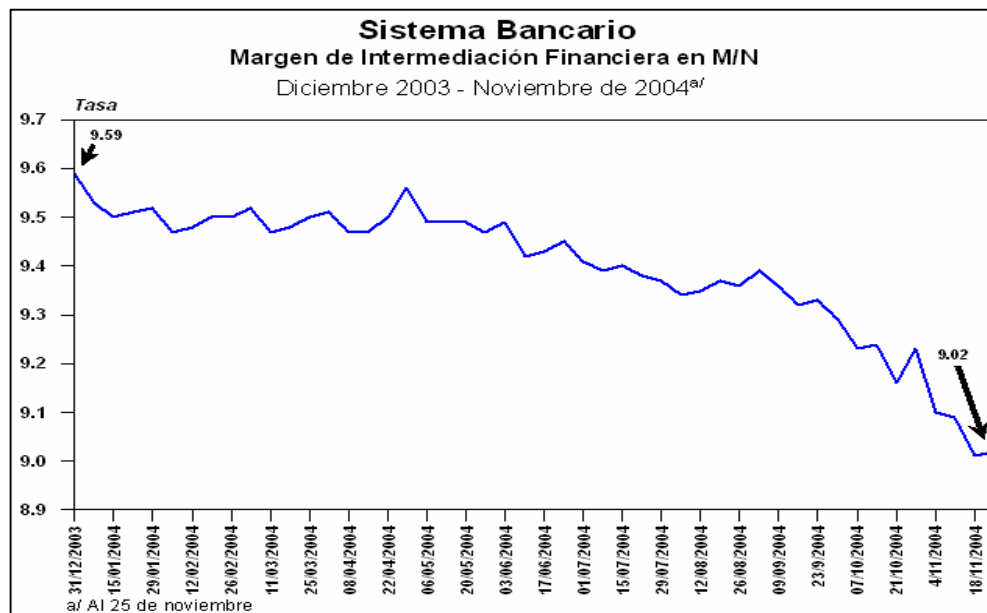
From January to November 2004, the interest rates, weighted average, continue showing stable behavior with a tendency toward the low. In effect, the asset interest rate, weighted average, at the end of November was at 13.56% annual, less by 0.55 percentage points to the observed at the end of December 2003 (14.11%); while the liable rate was at 4.54%, higher by 0.02 percentage points regarding the registered to December 31, 2003 (4.52%). It is worth mentioning that the level of referred interest rates is the lowest that has been registered since 1989, year in which the modernization and strengthening process began in the banking system.

(Banking System, Asset and Liabe Weighted Average Interest Rates in M/N  
January 2001 to November 2004)



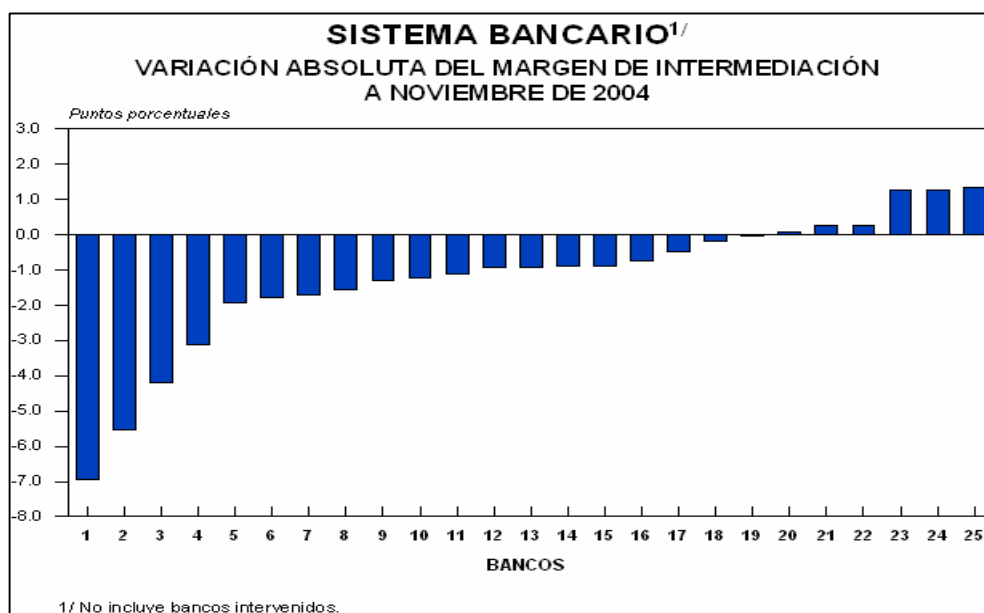
As a result of the tendency that registered the liable and asset interest rates, the financial intermediation margin was reduced during the period in 0.57 percentage points, when going from 9.59% (December 2003) to 9.02% (November 2004).

(Banking System, Financial Margin Intermediation in M/N, December 2003 to November 2004)



It is worth indicating that the reduction of the margin of financial intermediation was given in 19 banks, where in 6 it measured a slight increase. Said situation would be associated to the improvement of the efficiency and competitiveness of the banking institutions.

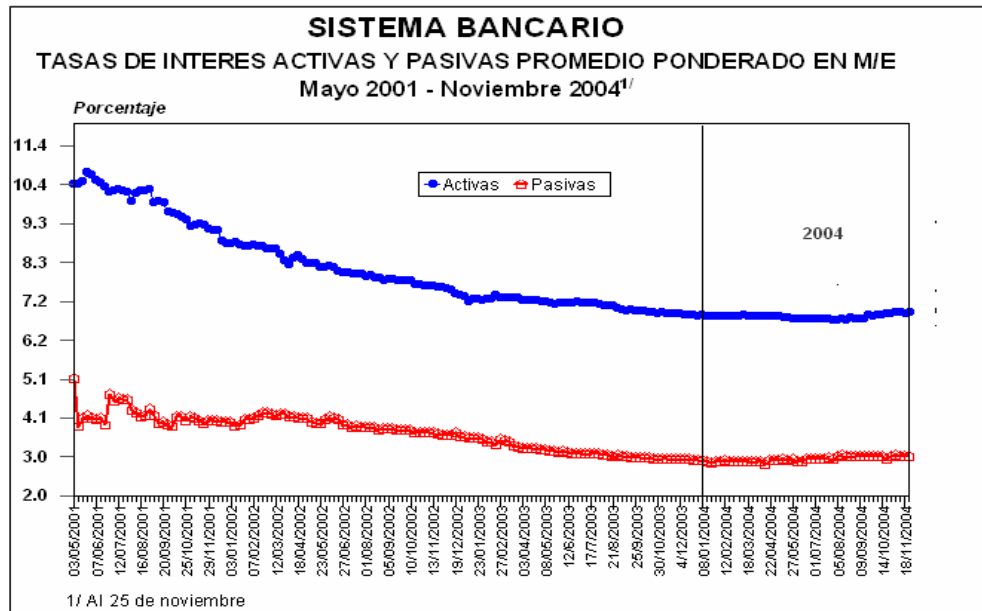
**(Banking System; Absolute Variation of the Intermediation margin to November 2004)**



**ii) In foreign currency**

The asset and liable interest rates, weighted average, in foreign currency during 2004 have showed stable behavior, but with a slight tendency to the rise. The asset interest rate for November 25 was at 6.91%, higher by 0.10 percentage points to the observed on December 31, 2003 (6.81%); while the liable interest rate showed an increase of 0.22 percentage points; until on November 25 it was at 3.06%.

(Banking System, Weighted Average Asset and Liabe Interest Rate in M/E, May 2001 to November 2004)



It is worth mentioning that as a result of the behavior of the asset and liabe interest rates, the financial intermediation margin, in foreign currency, was reduced by 0.01 percentage points, when going from 3.86% (December 2003) to 3.85% (November 2004).

## 7. Nominal Exchange rate

The Monetary, Exchange and Credit Policy for 2004 determines that the current exchange regimen must be flexible and, therefore, the exchange rate is determined by the interaction between offer and demand of foreign currency on the market. In that sense, the *Banco de Guatemala*, according to said policy, only participates in the exchange market with the purpose, on the one hand, of reducing the volatility of the exchange rate, and on the other hand, acquiring foreign currency required by the bank itself, the central government and other entities in the public sector to fulfill with their foreign commitments.

In that context, to November 30, the exchange rate registered an appreciation of 3.61% when going from Q8.04 for US\$1.00 on December 31, 2003 to Q7.75 for US\$1.00 on said date. The observed behavior in the exchange rate can be divided in two periods: the first, from January 1 to March 31, in which the exchange rate depreciated, whereas in the second, from April 1 to November 30, the exchange rate registered a marked tendency toward appreciation.

During the first trimester of 2004, the exchange rate registered a slight depreciation of 0.6% when going from Q8.04 for US\$1.00 on December 31, 2003 to Q8.09 for US\$1.00 on March 31, 2004, behavior that is associated with the seasonality of the referred variable. However, in the second period this behavior reverted as of the month of April, when registering an appreciation in said variable of Q0.34 (4.20%) going from Q8.09 for US\$1.00 on March 31, 2004 to Q7.75 for US\$1.00 on November 30, 2004. The appreciation of the exchange rate as of April is associated to the influence of various factors that have been presented simultaneously, among them are; the seasonality of the variable; the continuous increase of the foreign currency income due to family remittances; the increase in the flow of private capital for investment; the payment on the domestic market of Treasury Bonds expressed in foreign currency on behalf of the central government; and, the expectations on the part of the economic agents that exacerbated the referred appreciation. In the described context, in order to formulate conclusions of the monetary policy, it is precise to determine if the increase phenomenon in the offer of foreign currency is temporary or permanent. In that sense, the observations of the primary information are no concluding, therefore, for example, while the increase of foreign currency due to family remittances can be considered a mid term event, the increase in the offer caused by the flow of capital due to the existence of a positive differential in the yield could be considered as a short term<sup>42</sup>. Therefore, it was necessary to recur to the more complicated econometric

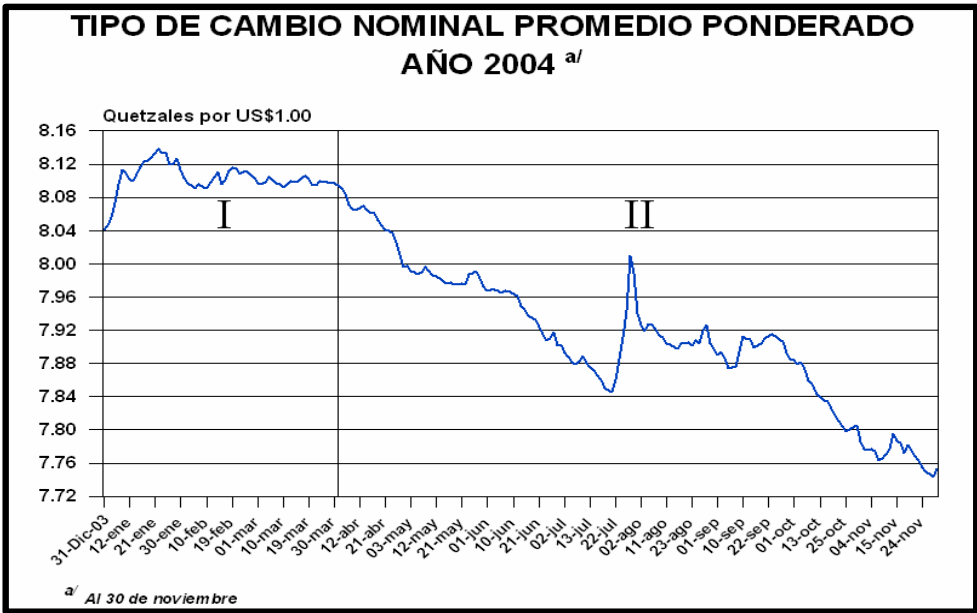
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<sup>42</sup> A complete discussion on the causes of exchange appreciation and the options of policy in the presence of an accelerated process of weakening of the dollar regarding the national currency are in the 'Report of the Monetary Policy to June, 2004', *Banco de Guatemala*, decree CT-2/2004, dated July, 2004 and in 'Considerations on the Monetary Policy, Capital Flow and



estimations. For the effect, in Annex 1 is the study on the nature of the flow of capital, which makes evident that these are temporary in nature, aspect which suggests that the actions on exchange matter that have been taken to date<sup>43</sup> are going in the right direction.

(Nominal, Average Weighted Exchange Rate for the Year 2004)



On the other hand, it can be mentioned that in 2004 the appreciation of the exchange rate regarding the US dollar is an internationally generalized phenomenon, as is shown in the following table.

the behavior or the nominal Exchange Rate Cooperation'. Memorandum CT-1/2004, dated August 17, 2004. Both documents are on the web page of the *Banco de Guatemala*.

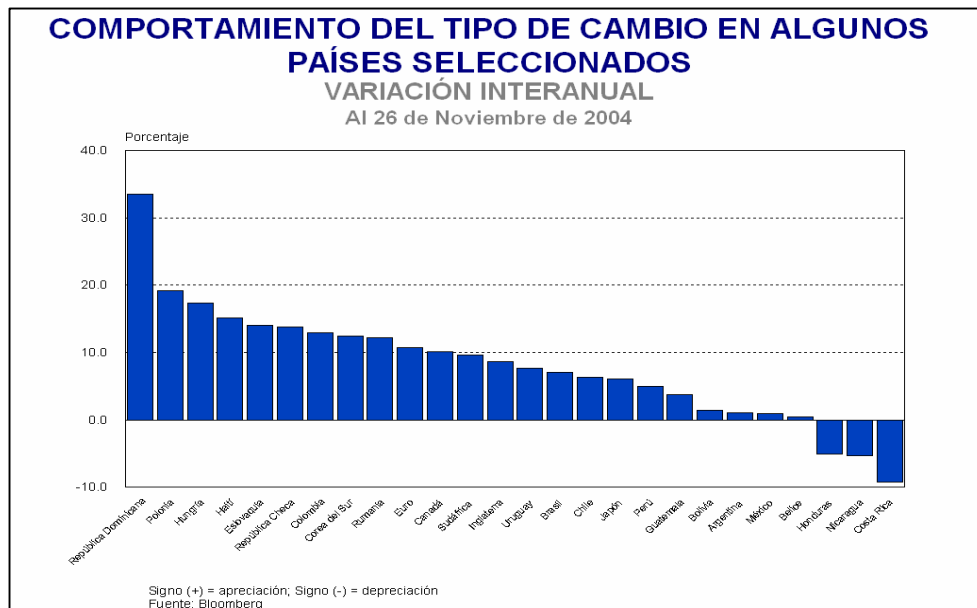
<sup>43</sup> Which have been: the elimination of LTDs for 28 day terms as a leading policy rate (and reduction of quota); coordination in placement of the MFP, authorization of the LTDs in US dollars; purchase of US dollars in order to moderate the volatility (sterilized intervention). This last one has allowed the purchase of foreign currency on the market for the advance payment of the debt of the *Banco de Guatemala*, as well as the advance purchase of foreign currency to take care of the payment of the Central Government's foreign debt programmed for the rest of 2004 and 2005.

**EXCHANGE RATE BEHAVIOR IN SOME  
SELECTED COUNTRIES  
INTER-ANNUAL VARIATION**

<b>COUNTRY Currency</b>		<b>November 26, 2003</b>	<b>November</b>	<b>Variation % + = deprec. - = aprec.</b>
<b>South America</b>				
Colombia	Peso	2,837.25	2,469.10	-12.98
Uruguay	Peso	29.01	26.78	-7.69
Brazil	Real	2.95	2.74	-7.07
Chile	Peso	625.83	586.24	-6.33
Peru	Nuevo Sol	3.48	3.31	-5.02
Bolivia	Boliviano	8.03	7.91	-1.47
Argentina	Peso	2.98	2.94	-1.14
<b>CENTRAL AMERICA</b>				
Guatemala	Quetzal	8.07	7.76	-3.78
Belize	Dollar	1.98	1.97	-0.50
Honduras	Lempira	17.69	18.58	5.04
Nicaragua	Cordoba	15.34	16.15	5.31
Costa Rica	Colon	415.50	453.61	9.17
<b>OTHER COUNTRIES</b>				
Dominican Republic	Peso	42.06	27.96	-33.53
Poland	Zloty	3.93	3.18	-19.14
Hungary	Florin	222.50	184.01	-17.30
Haiti	Gourde	41.35	35.10	-15.11
Slovakia	Corona	34.37	29.54	-14.04
Czech Republic	Corona	26.98	23.24	-13.85
South Korea	Won	1,196.72	1,047.23	-12.49
Rumania	Leu	33,688.32	29,568.39	-12.23
Euro	Euro	0.84	0.75	-10.71
Canada	Dollar	1.31	1.18	-10.13
South Africa	Rand	6.40	5.79	-9.64
England	Libra	0.58	0.53	-8.62
Japan	Yen	109.10	102.51	-6.04
Mexico	Peso	11.34	11.23	-0.96

Source: Bloomberg

(Behavior of the Exchange Rate in some select countries, Inter-annual variation to November 26, 2004)

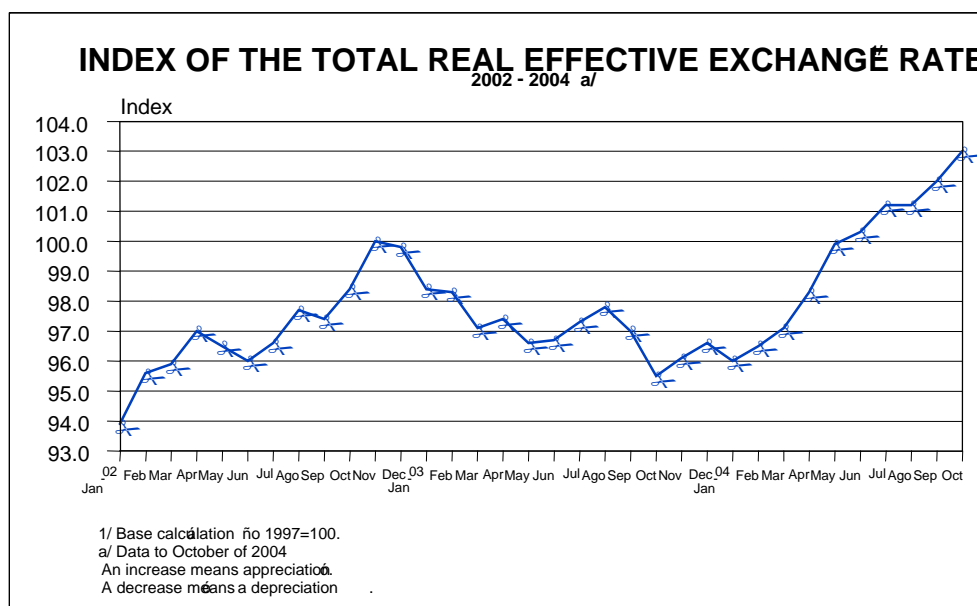


It is worth mentioning that the appreciation of the currency of some countries indicated regarding the US dollar are due to, among other causes, the surplus offer of dollars in the international markets due to the high fiscal deficit and the current account of the United States of America, which increased the expected depreciation of the dollar, therefore it reduced the demand of that currency in the international financial markets, and, therefore increased its offer. Particularly, the growing deficit in current account that is at US\$596.2 billion is basically explained by the elevated commercial deficit with the People's Republic of China (22.3%), the European Union (17.4%), Japan (12.2%), Canada (11.6%) and Mexico (7.8%). On the part of the fiscal deficit, it is situated above the 4% of the GNP, mainly provoked by the increase in the defense expense and the tax reduction program. Both deficits, as indicated, have generated an accumulation of US dollars in the hands of investors around the world, especially in the emerging market economies.

## 8. Index of the Real Effective Exchange Rate –ITCER (Acronym in Spanish)

This indicator measures the relation between the nominal exchange rate and the domestic inflation regarding the main commercial partners of the country and it is an approximate measure of the direction of change in the competitiveness of its exportations.

To October, the ITCER (acronym in Spanish) had an appreciation in inter-annual terms of 7.80%, contrary situation to the observed depreciation in the same period the year before (2.92%). Said behavior fundamentally reflects the fact that three of the main commercial partners that make up the basket of countries with which the ITCER is calculated (Costa Rica, Honduras y Mexico) had depreciations in their currency regarding the US dollar greater than that of Guatemala. Another factor that influences that behavior was a lower growth rhythm of prices in El Salvador, United States, European Union, Japan, and Mexico regarding Guatemalan inflation.

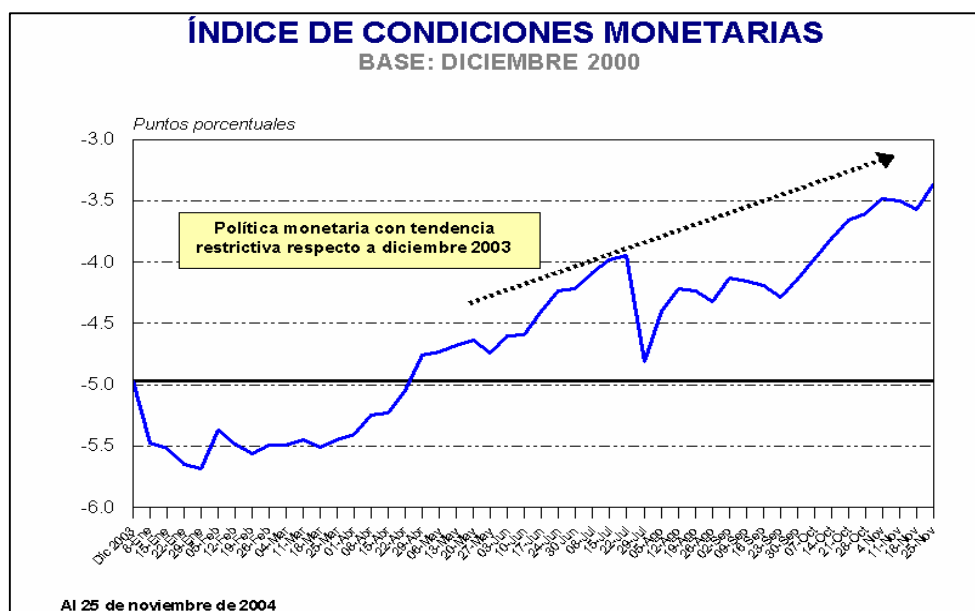


## 9. Index of Monetary Conditions -ICM (Acronym in Spanish)

The Monetary Conditions Index, ICM (for its acronym in Spanish) is an indicator that is calculated taking into account the changes that experiment the interest rate and the exchange rate regarding a predetermined base year. The interpretation of the ICM based in the concept that the relation between the exchange rate and the interest rate can indicate if the monetary policy needs to be more or less restrictive.

When observing the behavior of the ICM from December 2003 to November 25, 2004, the nominal appreciation of the exchange rate not compensated by a decrease in the interest rate, implying that the monetary policy was restrictive in the long analysis period should be highlighted.

**INDEX OF MONETARY CONDITIONS, BASE: December 2000 (Monetary policy with a restrictive tendency regarding December 2003.**



For the review of the monetary program closing of the current year it is necessary to first analyze the deviations evidenced between the numbers of the program and the observed at the end of the third trimester. To September 30 of the current year the net international monetary reserves increased US\$64.0 million registering a deficiency of US\$203.0 million regarding the proposed goal. Said deficiency was mainly due to the fact that during the third trimester US\$300.0 million in bonuses from the central government were programmed to be placed in the international financial market, event that took place until October 2004.

**MONETARY PROGRAM OF THE BANCO DE GUATEMALA 2004**  
**To September 30, 2004**  
Flow in millions of quetzales

CONCEPT	OBSERVED A	PROGRAMMED B	DEVIATION B-A
<b>I. NET INTERNATIONAL RESERVES</b>	513	2141	1628
US\$	64	268	203
<b>II. NET INTERNAL ASSETS OS</b>	-1392	-3666	-2274
1. Position with the Consolidated Public	-1561	-2396	-835
1.1. Central Government	-1090	-2205	-1116
1.2. Rest of public sector	-471	-191	281
2. Position with banks and finance Co	-585	-181	404
2.1. Credit to banks and finance	-3	-3	0
2.2. Remunerated float and non remunerat	-581	-178	404
3. Other assets and nets	851	1059	208
3.1. Expense and product	845	811	-34
3.2. Net assets not classified	6	248	242
4. Open market operations	-97	130	227
5. Excess (-) or lacking (+) liquidity	0	-2278	-2278
<b>III. DEMAND of monetary issue</b>	-879	-1526	-646

On the other hand, the net internal assets (AIN, acronym in Spanish) of the *Banco de Guatemala* decreased Q1, 392.0 million, and are less than the programmed goal of Q2, 274.0 million. The main factor that influenced so the goal would not be reached is related to the counterpart, because of its equivalent in *quetzales*, of the placement of US\$330.0 million in the international financial market (Q2, 640.0 million).

However, the rest of the official entities, when keeping their deposits and investments in the central bank at a level higher to the programmed, contributed to the demonetization in Q281.0 million. Other factors of monetary contraction were the remunerated and the non-remunerated float of the banks, which was at Q404.0 million higher than the expected, as well as the open market operations with the private sector, that were located at Q227.0 million above the programmed.

Last, it is worth indicating that the monetary issue observed was deviated to the programmed in Q646.0 million, which was mainly the product, of the least open market operations, aspect that does not allow the total neutralization of primary liquidity excess.

Taking into account the monetary variable behavior observed to November, the estimation of the evolution of the real sector, as well as the tendency of the fiscal variables and the external sector, the estimation for the last trimester of 2004 is presented in the following as well as the closing of the year, considering that the first three trimesters correspond to the observed numbers.

**MONETARY PROGRAM 2004**  
**FLOW IN MILLIONS OF QUETZALES**

C O N C E P T	TRIMESTERS 2004				Total 2004
	I	II	III	IV	
<b>I. NET INTERNATIONAL RESERVES</b>	246	33	234	3487	4000
US\$	31	4	29	436	500
<b>II. NET INTERNAL ASSETS</b>	-999	-142	-251	-1787	-3179
1. Position with the Consolidated Public Sector	-1707	215	-68	36	-1525
1.1. Central Government	-863	149	-376	-485	-1574
1.2. Rest of the public sector	-844	65	308	521	49
2. Position with banks and financial comp.	-362	230	-512	2	-642
2.1. Credit to banks and financial comp.	-2	-1	0	0	-4
2.2. Remunerated and non remunerated float	-360	231	-511	2	-638
3. Other net assets	178	338	394	483	1393
3.1. Expenses and products	203	251	391	206	1051
3.2. Non-classified net assets	-25	86	3	278	342
4. Open market operations	892	-924	-65	0.0	-97
<b>5. EXCESS (-) OR LACKING (+) LIQUIDITY</b>	0	0	0	-2308	-2308
<b>III. DEMAND OF MONETARY ISSUE</b>	-754	-109	-17	1700	821

As is seen in the above table, in the fourth trimester the RIN is expected to increase by US\$436.0 million, due to the income of resources of placement of public bonds in the international financial market and the purchase of foreign currency made by the *Banco de Guatemala* in the SINEDI in order to moderate the volatile behavior of the exchange rate and to obtain the foreign currency to pay in advance part of the external debt of the *Banco de Guatemala*. Given observed numbers are of the first three trimesters, at the end of the year increases of RIN for around US\$500.0 million, with which the position of the external sector of the country would be consolidating itself.

Consistent with the behavior of RIN and the demand of monetary issue, the AIN of the *Banco de Guatemala* would demonetize by Q1, 787.0 million in the fourth trimester, while it would be expected that these would close the year monetizing in Q3, 179.0 million.

Considering the balance of the deposits to the central government at the end of the third trimester, as well as with the placement of public bonds in the international financial market during the fourth trimester, the government is expected to increase its deposits in Q485.0 million in the *Banco de Guatemala*. Of that account, at the end of the year, the demonetization generated by the central government would be Q1, 574.0 million. On the contrary, at the end of the year, the public entities are expected to have monetized Q49.0 million, with which the contraction generated by the consolidated public non financial sector would be Q1, 525.0 million.

As to the position of the banks of the system, the fourth trimester to end said entities there is a slight decrease of the deposits in the central bank, that due to the trajectory that could be observed in the credit to the private sector in the last trimester. However, the banks at the end of the year are expected to have generated a demonetization of Q638.0 million.



Taking into account the amount and the interest rate of the Open market operations and of the RIN investments, during the fourth trimester, the cost of the monetary, exchange and credit policy will reach Q206.0 million, which would add an accumulated cost of Q1, 051.0 million at the end of the year.

Consistent with the demand of the monetary issue of Q1, 700.0 million, with the monetization originated abroad for the equivalent to Q3, 487.0 million and with the monetizing effect it would have on the other headings that integrate the AIN of the *Banco de Guatemala*, in the fourth trimester it would be necessary to neutralize the liquidity for Q2, 308.0 million which would mean the balance of the OMAs would have an increase for that amount. In that sense, at the end of the year the total balance of the open market operations would be at Q17, 665.0 million, of which Q13, 201.0 million correspond to monetary operations made in the private sector.