

MONETARY BOARD
RESOLUTION JM-185-2005

Inserted in the First Point of Act 57-2005, corresponding to the session celebrated by the Monetary Board on December 27, 2005.

FIRST CLAUSE: Monetary, exchange rate and credit policy: Evaluation to November 2005 and proposal for 2006.

RESOLUTION JM-185-2005. Known as Decree CT 4/2005 of the Technical Council of the *Banco de Guatemala*, where the evaluation of the Monetary, Exchange Rate and Credit policy to November 2005 and the proposal of the policy for 2006 is shown; and, WHEREAS: this Board estimated convenient to express its criterion on the importance of assuring the conditions that support the macroeconomic stability in the mid and long term, through the adoption of an economic policy, orientation that supports the fiscal and commercial fields and complement a sustainable process of inflation reduction that provides viability to its convergence toward inflationary rates similar to the ones prevailing in countries with higher development; WHEREAS: that the monetary scheme of explicit inflation goals constitute a reference outline through which the monetary policy reaches stabilization effectively in the general level of prices, in a flexible exchange rate environment, therefore the Board estimates that it is proceeding to continue with the transition process toward said scheme; WHEREAS: that in a regimen of explicit inflation goals, the mid and long-term inflation goals have as their main objective to constitute the nominal anchor of the monetary policy and, as such, to effectively orient the monetary policy assets as well as the expectations of the economic agents; WHEREAS: that the gradual convergence toward inflationary rates similar to the ones of the industrialized economies, requires that the inflation goals to be announced must be trustworthy and real, for that reason a favorable environment is essential that, among other aspects, privileges: a) The consolidation of the public finances in fulfillment of the Fiscal Pact; b) To continue advancing in the generation of an adequate climate for a more dynamic growth of the production activity, through the strengthening and deepening of the free trade agreements,

the improvement of the competitiveness and a higher participation of the small and mid-size companies in these processes; and, c) The maintenance of the macroeconomic discipline that propitiates the deficit reduction in the current account of the payment balance, the stability of the capital flow toward the country and the maintenance of a favorable external position; WHEREAS: That in 2005 the prevalence of adverse factors for the effectiveness of the monetary policy, mainly the impact of the imported inflation derived from the shock of international oil prices, was a determinant for the inflation to remain close to the rate registered at the end of 2004, located above the established goal for the Monetary, Exchange Rate and Credit Policy determined for 2005, given that the inflationary rhythm was at 9.25% to November 2005, corresponding 2.52 percentage points to the imported inflation and 6.73 percentage points to the domestic inflation, this last is somehow associated with surplus of primary liquidity; WHEREAS: in October the country was affected by tropical storm Stan, which caused the scarcity of some agricultural products and the temporary interruption of the products' distribution, which incremented the inflation during said month in 1.01 percentage points, increase, that although it was partially reinvested in November, negatively affected the expectations of the economic agents regarding the containment of the future inflation; WHEREAS: before the described phenomena, the need to take action on behalf of the monetary policy, on order to abate the inflationary expectations observed; WHEREAS: given the exogenous and temporary imported inflation and in order to maintain the most favorable conditions for the orderly development of the national economy, the monetary measures must have been executed with special prudence taking into account, that on one hand, that although the economic activity has been recovering, its growth rhythm is still insufficient to effectively contribute to the objective of development in the country and, on the other hand, that most of the year a behavior was registered in the nominal exchange rate toward the appreciation, which caused the volatility of said variable; therefore, the Central Bank participated in the currency market in order to moderate its behavior; WHEREAS: although it is estimated that the inflationary rhythm to December 2005 would be around 9.2% mainly due to the shock of international oil prices observed during 2006, due to the economic growth rhythm in the United States of America and People's Republic of China, and before the stability of the oil offer, the international oil prices would remain close to the rates currently observed;

therefore, taking into account the behavior projections of crude oil prices in the futures market, it is estimated that in 2006 the inflationary rhythm would be decelerating regarding the observed levels in 2005; WHEREAS: in order to fulfill its fundamental objective in 2006, the monetary policy, in its internal order, should be oriented to the following aspects: i) the continuation of the coordination with the financial policy of the state, in the outline of the fulfillment of the fiscal goals determined for 2006; and, ii) the consolidation of the implementation of the financial legislation; WHEREAS: in order to fulfill its fundamental objective for 2006, the monetary policy, in its external order, must contemplate the persistence of diverse economic phenomena that could influence in its effectiveness, such as: a) the adjustment of the deficit in the current account of the payment balance of the United States of America; b) the capital flows and the monetary policy of the United States of America; c) the evolution of the international oil prices; and, d) the evolution of the economic growth of the United States of America and People's Republic of China; WHEREAS: according to the general income and expense budget of the state, approved by the Congress of the Republic, the fiscal deficit for 2006 might be at about 2.5% of the Gross Domestic Product, which makes it necessary to strengthen the coordination efforts of the fiscal and monetary policies through the work group *Banco de Guatemala – Ministerio de Finanzas Públicas* [Equivalent to the Department of the Treasury], with the purpose of materializing the efforts that allow the monetary and fiscal policies to fulfill their objectives; WHEREAS: a disciplined monetary policy, duly supported by the fiscal policy, will keep stability within the general level of prices, and keeping in mind the processes of reorganization and transparency of the public finances and the acquisition of a sustainable external position are factors that favor the positive expectations of the economic agents, regarding future performance of the Guatemalan economy in the mid and long terms; WHEREAS: the proposal of the Monetary, Exchange Rate and Credit policy for 2006 presented to this board contains principles, instruments and measures that make it coherent with the efforts of advancing the adoption of a complete monetary scheme with explicit inflation goals, which will allow the consolidation of the stability and confidence in the main macroeconomic and financial variables; WHEREAS: in the current exchange regimen, the exchange rate is determined by the interaction of the offer and demand of foreign currency in the market, which is consistent with the monetary scheme of explicit

inflation goals; but even so, the measures that were adopted during 2005 to moderate the volatility of the exchange rate, it is still necessary to give certainty to the economic agents as to the participation of the Central Bank in the referred market, therefore, it requires moving on to a more flexible exchange regimen through the determination of explicit rules that avoid volatility without affecting its tendency; WHEREAS: the deficit in current account of the payment balance of Guatemala remains at relatively high levels in comparison with the size of the economy; therefore, it is important to continue promoting a disciplined monetary policy, with the necessary support of the fiscal policy and in coordination with an integral economic policy, it will allow not only the strengthening ability of the country to absorb external shock, but also to establish the basis for the achievement of a more dynamic and sustainable economic growth;

THEREFORE:

Based on the considered, in the agreement in articles 132 and 133 of the Political Constitution of the Republic of Guatemala 3, 4, 13, 26 y 48 of the Organic Law of the *Banco de Guatemala*, as well as considering the Sentence CT 4/2005 of the Technical Council of the *Banco de Guatemala*, and in the opinion of its members,

THE MONETARY BOARD RESOLVES:

I. CONSIDER HAVING EVALUATED THE MONETARY, EXCHANGE RATE AND CREDIT POLICY OF 2005.

II. HAVING DETERMINED THE MONETARY, EXCHANGE RATE AND CREDIT POLICY FOR 2006, IN THE FOLLOWING:

A. FUNDAMENTAL OBJECTIVE AND POLICY GOAL. 1. Fundamental objective.

Congruent with the mission that corresponds to the *Banco de Guatemala*, the fundamental objective of the Monetary, Exchange Rate and Credit policy for 2006 is to create and maintain the most favorable conditions for orderly development of the national economy,

for that reason it will propitiate the monetary, exchange rate and credit conditions that promote stability in the general level of prices.

In support of the achievement of the fundamental objective, and with the purpose that in the mid term, the domestic inflation converges toward the observed levels in the industrialized economies, the application of the monetary policy must be complemented by actions in the financial modernization and consolidation of fiscal equilibrium ambits, in the frame of the integral economic and sustainable programs that propitiate competitiveness and effectiveness of the productive sector.

2. Policy goal. For December 2006 the inflationary rhythm, measured by the inter-annual variation of the Consumer Price Index -IPC-[Acronym in Spanish], must be at 6%, +/- 1 percentage point and for December 2007 said rhythm must be at 5%, +/- 1 percentage point.

B. INDICATIVE VARIABLES.

With the purpose of guiding and orienting the actions of the Monetary, Exchange rate and Credit policy and evaluating in which measure the goal is being achieved, as well as with the finality of opportunely detecting the effects that exogenous events can have over the financial markets and consequently, act accordingly; the following indicative variables will be follow up on:

1. Expected inflation.

Follow up will be given to the fixed inflationary goal for December 2006 and for December 2007, comparing it to the inter-annual inflationary rhythm projected for those same periods. Besides, follow up will be given to the expected subjacent inflationary rhythm (for December 2006 as well as for December 2007), for said calculation the sectors that have an elevated variability that is not explained with monetary reasons will be excluded from the IPC.

2. Interest rates.

For 2006, with the finality of finding the money market conditions with the achieved inflation goal, follow up will be given to the parameter rate (adjusted Taylor rate), comparing it with the weighted average interest rate of the repurchase agreement operations between 8 and 15 days, as well as the weighted average interest rate of the monetary stabilization operations to 91 days. Besides, with the goal of evaluating the competitiveness conditions of the internal financial market regarding foreign financial markets, follow up will be continued on the liable parity interest rate, which will be compared with a fluctuation margin of a standard deviation.

3. Monetary Issue

According to the monetary program for 2006 (Annex 1), it is estimated that the demand of the monetary issue will grow by about 10% regarding the estimated closing level in the monetary program of 2005, compatible with an expected growth rate of the Gross Domestic Product, in real terms, of about 4.4% and with an inflation goal of 6%.

4. Payment means

Congruent with the growth estimation of the economic activity, with the inflation goal and with the circulation speed of money, it is estimated that the total payment means (M2) will grow between 13% and 15%, in inter-annual terms.

5. Banking Credit to the Private Sector

Consistent with the growth of payment means, it is expected that the growth of the total banking credit to the private sector increases between 16% and 18%, in inter-annual terms.

6. Inflation Expectations by Private Analysts

The expectations of future behavior of the prices in the economy can, in determined circumstances, influence the tendency of the inflation rate that will finally be observed in the period, therefore, it must be given follow up; the prognosis of inflation comes from survey to the private analyst panel on inflation expectations.

7. Explicit Inflation expectations

The calculation of the explicit inflation expectations constitutes an indirect way of obtaining the perception on the economic agent expectations, and it is obtained from estimating the gap between the long-term interest rate and short-term interest rate, under the premise that the long-term interest rate contains information on the inflation expected by the economic agents. In that case, the follow up of the referred variable will complement the measurement of the inflation expectations of the economic agents, which is fundamental in a scheme of explicit inflation goals.

8. Monetary Conditions Index –ICM [Acronyms in Spanish]

The Monetary Conditions Index will be followed up, which measures the interrelation between the changes in the interest rate and in the nominal exchange rate regarding a date in time. For its follow up, an agent whose central focus will be the ICM value for 2000 (base year) will be established and its ceiling and floor values will be at about 0.8 percentage points, regarding the central value indicated; an ICM value higher than the indicated agent will be interpreted as the presence of a restrictive monetary policy regarding said base, while a value lower than the agent will be interpreted as the presence of an expansive policy regarding said base.

C. MEASURES OF MONETARY, EXCHANGE RATE AND CREDIT POLICY

1. Principles for market participation

In order to reach the fundamental objective of the Monetary, Exchange Rate and Credit Policy for 2006, it is considered convenient to explain the principles that regulate the participation of the Central Bank in the monetary market as well as in the exchange market:

a) Coordination with the fiscal policy

In order to consolidate the efficiency and credibility of the macroeconomic policy, it is important to continue strengthening the institutional coordination through the work group of the *Banco de Guatemala - Ministerio de Finanzas Públicas* [Equivalent to the Department of Treasury.], constituted since 2002 by both entities, with the goal of materializing the efforts that could allow the monetary and fiscal policy to fulfill the objective in matters of macroeconomic stability. Particularly, they must coordinate conditions in which they will issue Treasury Bonds that, in fulfillment with the established in article 9 of the Organic Law of the *Banco de Guatemala*, the income and expense budget of the state for the 2006 Fiscal Year, in order to effectively use them in support of the monetary policy.

b) Use of the monetary stabilization operations in market conditions

The monetary scheme of explicit inflation goals requires an operational frame based on the operating of monetary stabilization operations market conditions, that not only promote the efficiency of the primary market of public titles, but also, at the same time promote the development and deepening of a secondary market for said titles, so that the Central Bank sends clear and explicit signals to the monetary market on the orientation of its policy, as well as to receive from this, the information that allows it to depend on the additional elements for decision making.

For this, the operations of monetary stabilization will be carried out according to the following frame, consistent with the scheme of explicit inflation goals:

- i) **To continue using the 7 day-term as the monetary policy's leading interest rate for the monetary stabilization in the short-term.** The operations will be oriented to influencing conditions and expectations of the market, with the purpose of achieving the inflationary goal. The decisions in the determination of the monetary policy's leading interest rate will be adopted by the Monetary Board, based on the analysis that the Execution Committee will perform, related to the Prognosis and Analysis System of the Monetary Policy and the follow up of the indicative variables of said policy. With the purpose that the markets may adequately adapt to said decisions and, therefore, increase the efficiency of the monetary policy transmission, the Monetary Board will decide monthly on the changes of the monetary policy's leading interest rate according to an annual session calendar, which is attached to the present resolution (Annex 2); after each decision and with a delay of one month, a summary of the arguments that the Monetary Board has considered will be published, according to the stipulated in article 63 of the Organic Law of the *Banco de Guatemala*.
- ii) **ii) To continue with the reception of deposits for terms longer than seven days, according to the interest rates determined by the market.** Taking into account the importance that in a scheme of explicit inflation goals the Central Bank exhibits, in mid term, a neutral position before the currency market; operations of monetary stabilization for terms up to two years will be performed, and when the market advises it, they will also be able to make these operations for terms of more than two years. In operations made through bids, the interest rates will be the result of the lower positions of each term in each bid.
- iii) **iii) Without discredit to the inflationary objective achieved, watch over the stability of the short-term interest rates.** It will be pursued that the short-term

interest rates (represented mainly by the rates in the repurchase agreement markets) do not fluctuate abruptly, so that the Central Bank could participate in the Electronic Banking Table of Money or in the Stock Exchange- giving liquidity to the market or retiring liquidity in the moment when it observes volatility in the market.

***❖☒ To continue with the improvement of the operational scheme to carry out the monetary stabilization operations**, consistent with a scheme of explicit inflation goals, particularly in the following aspects: **Issue of Term Deposit certificates per expiration date**. The *Banco de Guatemala* can issue Term Deposits Certificates, concentrated in determined expiration dates.

Title transference of the Term Deposit Certificates under the custody of the Banco de Guatemala. During the first trimester of 2006 the necessary steps will be made, which tend to the following: a) That the term deposit certificates can be registered under the custody of the Central Bank; b) That the change of title of the registered Term Deposit Certificates or that can be registered in the future under the custody of the *Banco de Guatemala*; and, c) That the Term Deposit Certificates issued physically, in movement, might be registered under the custody of the *Banco de Guatemala*.

c) Exchange flexibility

In order to increase the efficiency of the mechanism through which the *Banco de Guatemala* participates in the exchange market, gradual modifications will be introduced to said mechanism, in order to fulfill the following principles that allow the explicit inflation goals:

- i) to be consistent with a monetary scheme of explicit inflation goals;
- ii) to be based on explicit rules, transparent and comprehensible regulations for the markets;

- iii) to eliminate the discretionary participation of the *Banco de Guatemala*; and,
- iv) to minimize the volatility of the exchange rate, without affecting its tendency.

For that reason, the *Banco de Guatemala* should participate in the Currency Institutional Market observing the procedure approved by the Monetary Board.

Besides, the *Banco de Guatemala* can participate in the exchange market with the exclusive purpose of acquiring the currency needed by the Bank itself, the central government and other entities of the public sector, in market conditions, in order to cover their obligations in foreign currency.

2. Instruments to maintain the macro-financial stability

a) Monetary Stabilization Operations

For 2006 the monetary stabilization operation, for giving or retiring liquidity, will be made according to the principles of participation indicated in section II.C.1.b) of the present resolution.

b) Fund raising of term deposits in US dollars

In 2006 the *Banco de Guatemala* will have the instrument available that will allow picking up the liquidity in the market in foreign currency through fund raising with term deposits in US dollars, in order to, if the circumstances allow, soften the behavior of the exchange rate, according to the established in resolution JM-99-2004 dated September 8, 2004.

The amounts to be raised in funds and the terms of the proposed operations will continue to be determined by the Execution Committee of the *Banco de Guatemala*, regarding the evolution of the exchange market.

d) Till money

The till money rate remains at 14.6%.

e) Last Instance Loans

The credit assistance of the Central Bank to the system's banks, according to the established in article 48 of the Organic Law of the *Banco de Guatemala* and in resolution JM-50-2005 dated March 2 of the current year, will be oriented only to solving temporal liquidity deficiencies.

3. Measures to support the effectiveness of the monetary policy

a) To continue with the modernization of the payment system

With the purpose of procuring the functioning of the Gross Liquidation System in Real Time -LBTR-, and to continue with the adoption of the assets contained in the Main Modernization of the Payment System, approved by the Monetary Board in resolution JM-140-2004 dated November 17, 2004.

b) Transparency and rendition of accounts of *Banco de Guatemala*.

To continue the strengthening of the transparency and rendering of accounts in the actions of the Central Bank, they will opportunely fulfill the elaboration of the different reports and publications contained in the organic law, and in other dispositions of the Monetary Board, according to Annex 3 of the present resolution.

c) Improvement of the national statistics system.

The *Banco de Guatemala* must continue with the adoption process of manuals and methodologies updated in National Accounts, Payment Balance and Monetary Accounts.

Again, support is expressed to the Executive Branch in its efforts to consolidate the National Statistics System, which will allow it to count on efficient, trustworthy and opportune statistics that will ease the decision making.

III. TO ENFORCE THE OTHER AGREEMENTS OF THE MONETARY, EXCHANGE RATE AND CREDIT POLICY, WHICH DO NOT OPPOSE THE CONTENTS OF THE PRESENT RESOLUTION.

IV. TO AUTHORIZE THE SECRETARY OF THIS BOARD TO PUBLISH THE PRESENT RESOLUTION THAT WILL BE CURRENT AS OF JANUARY 1, 2006.

Armando Felipe García Salas Alvarado,
Secretary
Monetary Board

ANNEX 1

MONETARY AND FISCAL PROGRAM 2006
In million of Q.

Concept	I TRIM	II TRIM	III TRIM	IV TRIM	TOTAL
FISCAL ACCOUNTS					
Income	6535	6950	7034	7786	28304
Expenditure	8404	7225	9293	9820	34742
Current	5415	5229	6454	6234	23332
Capital	2989	1996	2839	3587	11410
Deficit (% of GDP)	1870	275	2259	2035	6438 2.5
Net Foreign Financing	2568	109	37	41	2754
NET Domestic Financing	222	428	969	984	2603
Till variation	-920	-263	1254	1009	1080
A. MONETIZING (+) AND DESMONETIZING FACTORS (-)					
I. Net International Reserves	2078	-15	-453	-210	1400
RIN US\$	260	-2	-57	-26	175
II. Net Domestic Assets	2804	727	1729	1257	6517
1. Central Government	-920	-263	1254	1009	1080
2. Rest of the Public Sector	-227	-100	-389	-191	-907
3. Position with banks	325	41	-90	-1074	-798
Credit to banks	0	0	0	0	0
Banking reserve	325	41	-90	-1074	-798
4. Other net assets	135	-192	142	429	514
Expenses and products	158	16	66	50	290
Others	-23	-208	75	379	223
5. Maturity of OEMs	3491	1240	814	1084	6628
III. CREATION OF LIQUIDITY	4882	712	1277	1047	7917
B. DEMAND OF MONETARY ISSUE	-913	448	-98	1959	1397
C. SURPLUS (-) ÓR MISSING (+) LIQUIDITY (B-III)	-5795	-264	-1374	913	-6520
D. PLACEMENT OF OEMs	5795	264	1374	-913	6520
E. NET PLACEMENTS (-) OEMs	-2304	977	-561	1996	108

ANNEX 2

CALENDAR SESSION IN WHICH THE MONETARY BOARD WILL MAKE DECISIONS ON THE LEADING INTEREST RATE OF THE MONETARY POLICY FOR 2006

SESSION	DAY
January	25
February	22
March	22
April	26
May	24
June	21
July	26
August	23
September	27
October	25
November	22
December	27

ANNEX 3

CALENDAR FOR THE PRESENTATION OF STRATEGIC TOPICS OF THE *BANCO DE GUATEMALA* TO THE MONETARY BOARD DURING 2006

No.	TOPIC	JANUARY		FEBRUARY		MARCH		APRIL		MAY		JUNE		JULY		AUGUST		SEPTEMBER		OCTOBER		NOVEMBER		DECEMBER	
		quincena 1a.	quincena 2a.																						
1	Evaluations a) Of the execution of the Monetary Policy b) Report of Monetary Policy		X					X							X										X
2	Proposal of Monetary Policy																								X
3	Work Memory, previous year							X																	
4	Study of the National Economy									X															
5	Annual Financial statements, previous year		X																						
6	Report of External Audit					X																			
7	Reports a) Monthly of operations b) Of operations of the Fiduciary Fund of Banking capitalization c) Monthly about the Budget execution		X	X	X	X	X	X	X	X	X	X	X	X	X	X	X	X	X	X	X	X	X	X	X
8	Financial statements of the Fund for the Protection of the Savings (FOPA)		X	X	X	X	X	X	X	X	X	X	X	X	X	X	X	X	X	X	X	X	X	X	X
9	Quarterly operations report of the Fund For the Protection of the savings (FOPA)		X					X						X						X					
10	Investment policy of the Fund for the Protection of the saving (FOPA)																								X
11	Expenditure budget of the fund for the Protection of the savings (FOPA)																								X
12	Reports a) Financial of the RMI b) Of risk analysis of the RMI c) Of Control and Supervision of the RMI		X					X						X						X					
13	Revision of the Investment policy of the RMI																								X
14	Annual budget project																								X
15	Analytic Revision of the budget							X						X						X					X