

MONETARY BOARD RESOLUTION JM-168-2006

Insert in the First Point of Act 66-2006, corresponding to session celebrated by the Monetary Board on December 28, 2006.

FIRST POINT: Monetary, Foreign Exchange and Credit Policy: Evaluation to November 2006 and Proposal for 2007.

RESOLUTION JM-168-2006. After having heard declarations CT-3/2006 and CT-4/2006 from the Technical Council from the *Banco de Guatemala*, in which they present, on the one hand, the Evaluation of the Monetary, Foreign Exchange and Credit Policy to November, 2006 and, on the other hand, the Economic Perspectives for 2007 and 2008 and the Proposal for 2007; and, WHEREAS: That this Board deemed it pertinent to express their criteria on the importance of ensuring conditions that favor macroeconomic stability in the mid and long terms, through the adoption of an orientation of economic policy that in the fiscal and commercial campus support the process sustained of inflation reduction that makes viable its convergence toward similar inflationary levels to the prevalent in developing countries that operate under the explicit inflation goals scheme; WHEREAS: That in an explicit inflation goals scheme, the mid and long term inflation goals have the main purpose of constituting the nominal anchor of the monetary policy and, as such, effectively orient the monetary policy actions as well as the expectations of the economic agents; WHEREAS: That during 2006 the performance of the monetary policy has been supported by the fiscal policy, through the maintenance of a level of deposits in the *Banco de Guatemala* over the programmed, in an environment in which the formation of positive expectations of economic growth prevails, on behalf of the economic agents, derived from the dynamic behavior of global economy, as well as the levels of public and private investment foreseen; WHEREAS: That the inflationary rhythm decelerated during the greater part of 2006, so much so that to November of this year the inflationary rhythm decreased 4.17 percentage points, when going from 8.75% in December 2005 to 4.40% in November 2006 due to, on the one hand, the reduction of the international oil prices and their derivatives, especially during the second semester of 2006 and, on the other hand, to the delayed effect coming from the increase in the leading interest rate of the monetary policy made in 2005 and in 2006; WHEREAS: That as a result of the reduction of the international oil prices, imported inflation decreased 1.57 percentage points in November 2006, which added to a deceleration of 2.60 percentage points in the internal inflation in the same period, a deceleration of 2.60 percentage points in the internal inflation in the same period, explains the decrease of 4.17 percentage points in the inflationary rhythm; WHEREAS: That according to the last projections, the inflationary rhythm to December 2006 would be at 4.9%, percentage lower to the fixed inflation goal for the monetary authority of 6% +/- 1 percentage point; WHEREAS: That in 2006 an economic growth rate

is foreseen of 4.6%, greater to the registered in 2005, as a result, on the one hand, of the discipline of the fiscal and monetary policy and, on the other hand, of a better business climate, aspect that has been reflected in greater levels of private and public investment; WHEREAS: That the strength of an economy before economic and extra-economic shocks requires a disciplined monetary policy (with a defined nominal anchor and a type of flexible Exchange), a fiscal balanced policy, an adequate institutional and structural base, that constitutes a sustainable growth platform; WHEREAS: That to fulfill in 2007 with its fundamental objective, the policy in the external order should contemplate the persistent of diverse economic phenomena that could interfere in its effectiveness, such as: a) the adjustment of the deficit in current account of the United States of America payment balance; b) the flow of capital and monetary policy of the referred country; c) the behavior of the international price of oil; and, d) the evolution of the economic growth of the United States of America and the People's Republic of China; WHEREAS: That it is precise that the Central Bank continue orienting their monetary policy to the consecution of the inflation goal, in a frame of effectiveness of the transmission mechanisms of the same; WHEREAS: That the solidity of public finance is fundamental so it serves as permanent support to the monetary policy management and make possible the consecution of the mid term inflation goal; WHEREAS: That in the current exchange regimen, the nominal exchange rate is determined by the interaction between supply and demand of currency in the exchange market, which is consistent with the explicit inflation goals scheme, notwithstanding the measures that during 2006 were adopted to moderate the volatility of the nominal exchange rate, it is even precise to increase the certainty of the economic agents as to the participation of the Central Bank in the referred market, reason for which the flexible regimen exchange rate by which the determination of an explicit rule that orients the mentioned participation requires perfection, with the purpose of minimizing the referred volatility without affecting the tendency of the nominal exchange rate; WHEREAS: That derived from the lack of approval from the Congress of the Republic for the General Income and Expenditure Budget of the State for the 2007 Fiscal Year, the execution of public finance for the next year will be regulated by the 2006 budget, reason for which the monetary program will have to adjust to this last budget; WHEREAS: That according to the income and expenditure estimations from the *Ministerio de Finanzas Públicas* [Roughly equivalent to the Department of the Treasury.], for 2007, a budget execution is foreseen that would put the fiscal deficit at a level, that as a maximum, would reach 0.9% of the Gross Domestic Product, percentage lower to the fiscal deficit foreseen for 2006 (1.5%); WHEREAS: That if it is true that there is certainty as to the global income amounts, expense and finance, they should be observed as of next year, there is also no certainty as to the financial source that corresponds to the placement of Treasury Bonds, because that would also have to be approved by the Congress of the Republic, therefore there are no legal or regulatory decisions that indicate their characteristics; WHEREAS: That the economic growth rate foreseen of 5.1% for 2007 (4.6% in 2006) is based, in the external order, in a favorable environment of the evolution that the economy would experiment with the main commercial partners of Guatemala, as well as in the consolidation of the benefits of the Free Trade Agreement with the United States of America and, in the internal order, said growth is based on the maintenance of the

macroeconomic stability, as a result of the application of disciplined monetary and fiscal policies, in the best business climate and in the best expectations of the economic agents; WHEREAS: That for an adequate execution of the Monetary, Foreign Exchange and Credit Policy in a macro-financial changing environment and within a scheme of explicit inflation goals, it is necessary for the same to be founded in the application of instruments and measures that allow acting opportunely and that, at the same time, are based on participation principles in the monetary and exchange markets, clearly defined that allow greater clarity in the operations of the Central Bank; WHEREAS: That it is proceeding that the Central Bank, with its competition, adopt measures toward the achievement and deepening of the secondary values market, since greater development of said market improves the operation of the transmission mechanisms and increases the effectiveness of the monetary policy; WHEREAS: That during 2006, the coordination between the monetary and fiscal policies was being developed through the *Banco de Guatemala-Ministerio de Finanzas Públicas* Work Group that, according to both entities, is periodically reunited with the finality of materializing efforts that will allow the mentioned policies with their objectives; WHEREAS: That the Monetary, Foreign Exchange and Credit Policy for 2007, raised to consideration from this Board, contains the principles, the instruments and the measures that make it coherent with the efforts of going forward in the development of a scheme of explicit inflation goals, which allow continuing consolidating the trust of the economic agents in the referred scheme and, therefore, the stability in the main macroeconomic and financial variables;

THEREFORE:

Based on the considered, in the declared in articles 132 and 133 of the Political Constitution of the Republic of Guatemala, 3, 4, 13, 26 and 48 of the Organic Law of the *Banco de Guatemala*, as well as taking into account the declarations CT-3/2006 and CT-4/2006 of Technical Council of the *Banco de Guatemala*, and in the opinion of its members,

THE MONETARY BOARD RESOLVES:

- I. TO HAVE EVALUATED THE MONETARY, FOREIGN EXCHANGE AND CREDIT POLICY 2006**
- II. DETERMINE THE MONETARY, FOREIGN EXCHANGE AND CREDIT POLICY 2007, IN THE FOLLOWING MANNER:**
 - A. FUNDAMENTAL OBJECTIVE AND POLICY GOAL**
 - 1. Fundamental Objective**

Congruent with the mission corresponding to the Banco de Guatemala, the fundamental objective of the Monetary, Foreign Exchange and Credit Policy for 2007 is to create and maintain the most favorable conditions to the orderly development of the national economy, for which it will propitiate the Monetary, Foreign Exchange 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 internal inflation converges toward the observed levels in developing economies that have successfully applied the scheme of explicit inflation goals, the execution of the monetary policy must be complemented by the actions in the environment of the financial modernization and of the consolidation of public finance, in the frame of an integral economic and sustainable policy that propitiates competitiveness and efficiency of the productive sector.

2. Policy Goal

For December 2007, the inflationary rhythm, measured by the inter-annual variation of the Consumer Price Index, CPI, should be located around 5% with a tolerance margin of +/- 1 percentage point and for December 2008 said rhythm should be around 4.5% with a tolerance margin of +/- 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 what measure the goal is being achieved, as well as opportunely detecting the effects that exogenous events can have on the financial markets and act, consequently, opportunely, the following variables will be given follow up:

1. Total Projected Inflationary Rhythm

Follow up will be given to the total projected inflationary rhythm for December 2007 and for December 2008, comparing it with the fixed inflation goal for these same months.

2. Subjacent Projected Inflationary Rhythm

Follow up will be given to the projected inflationary rhythm (for December 2007 as well as December 2008), for which calculation the headings that have a high variability will be excluded that are not applied due to monetary reasons.

3. Parameter Interest Rate*

For 2007, in order that the money market conditions are compatible with the achievement of the inflation goal, follow up will be given to the parameter interest rate (adjusted Taylor Rate), comparing it with the simple average between the weighted average interest rates of the repurchase agreements between 8 and 15 days and the weighted average interest rate of the monetary stabilization operations up to 91 days.

4. Parity Liab Interest Rate

In order to evaluate the competitiveness conditions of the internal financial markets regarding the external financial markets, will give follow up to the parity liab interest rate, which will include the fluctuation margin of median standard deviation.

5. Primary Liquidity

Primary liquidity in the economy is a fundamental element in the monetary theory, given that it represents the high power money concept, which is that that has a multiplying effect in the process of secondary money creation.

For the follow up of primary liquidity monetary issue and the ample monetary base will be used.

As to monetary issue, according to the monetary program for 2007 (Annex 1), it is estimated that the monetary issue demand will grow 11.2% regarding the estimated level of closing in the monetary program of 2006, compatible with an expected growth rate of the Gross Domestic Product, in real terms, of 5.1% and with the inflation goal of 5%.

En lo referente a la base monetaria amplia, compuesta por el numerario en circulación, la reserva bancaria y el saldo de operaciones de estabilización monetaria de corto plazo, se dará seguimiento a su evolución en relación con un corredor programado, cuyo margen de tolerancia corresponde a una desviación estándar.

6. Payment Means

Congruent with the growth estimation of economic activity, with the inflation goal and with the money circulation speed, it is estimated that the total payment means (M2) will grow toward the end of 2007 between 15% and 17%, in inter-annual terms. The follow up of said variable will be oriented toward evaluating if its observed evolution throughout the year is compatible with the referred estimation of inter-annual growth.

* Is the short term interest rate that is compatible with the support of economic stability.

7. Private Sector Banking Credit

Consistent with the growth of payment means, the growth of total banking credit to the private sector is expected to reach between 21% and 23% at the end of 2007, in inter-annual terms. The follow up of this variable will be oriented toward evaluating if the observed evolution throughout the year is compatible with the referred estimation of inter-annual growth.

8. Inflation Expectations from the Panel of Private Analysts

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

9. Implied Inflation Expectations

The calculation of the implied inflation constitutes an indirect manner of obtaining the perception on the economic agents expectations, and it is estimated by obtaining the breach between the long term interest rate and the short term interest rate, under the premise that the long term interest rate contains information on the expected inflation by the economic agents. In that sense, the follow up of the referred variable will complement the measure of the inflation expectations of the economic agents, which is fundamental in a scheme of implied inflation goals.

10. Mid-Term Inflation Prognosis of the Semi-structural Macroeconomic Model -MMS-

Follow up will be given to the result of the mid-term inflation prognosis obtained of the four runnings of the Semi-structural Macroeconomic Model foreseen for 2007.

C. PRINCIPLES FOR MARKET PARTICIPATION

With the purpose of reaching the fundamental objective of the Monetary, Foreign Exchange and Credit Policy for 2007, it is considered convenient to explain the principles that have regulated the participation of the Central Bank, in the monetary market as well as in the exchange market.

1. Focus on the Fundamental Objective

Taking into account that within the scheme of explicit inflation goals, the objective of the Central Bank is circumscribed to reaching stability in the general level of

prices, this must channel efforts of the monetary policy in the creation and maintenance of the most favorable Monetary, Foreign Exchange and credit conditions for the orderly development of the national economy.

2. Use of the monetary stabilization operations in a scheme of explicit inflation goals

In the scheme of explicit inflation goal, the main instrument for the control of liquidity in the economy is constituted with making monetary stabilization operations, that make up, among others, the reception of term deposits, as well as open market operations in the secondary values market, in market conditions, on behalf of the Central Bank, with the financial sectors, non-financial public and private, with the end of contracting or expanding the monetary offer so that, on the one hand, the behavior of aggregate demand in the economy is moderated, and, on the other hand, influence on the evolution of the interest rates and in that manner contribute to achieving the fundamental objective of the monetary policy, as well as the stability in the general level of prices.

3. Flexibility Exchange

Even though the current exchange regimen is free and the nominal exchange rate is determined by the interaction between supply and demand of foreign currency in the market, there are reasons that justify the current participation of the Central Bank in the exchange market. In the first place, in an open economy, the nominal exchange rate affects the relative price between the internal and external commodities, which at the same time, affects the internal and external demand of locally produced goods, and therefore, influences the behavior of the aggregate demand and inflation. In second place, there is also a direct channel by which the nominal exchange rate affects the price in local currency of imported goods, so high exchange volatility can distort messages to the relative internal prices to the market. In third place, the Central Bank would participate in the exchange market with the purpose of acquiring foreign currency that require, on the one hand, the bank itself and, on the other hand, the central government and other entities of the public sector.

D. INSTRUMENTS TO MAINTAIN MACRO-FINANCIAL STABILITY

1. Monetary market

a) Monetary Stabilization Operations

For 2007 the monetary stabilization operations will continue to be the central instrument for the control of money supply, given that it is the one that least distorts in the operation of the financial market, reason for which it cooperates fulfilling the fundamental objective to promote stability in the general level of prices.

For 2007 participation will be continued in the market through the mechanisms that currently use the *Banco de Guatemala* for the reception of Term Deposits -DPs-, these are:

i) Placement for Mechanisms

- **Money Banking Electronic Table**

Through this mechanism negotiations will be made with banks and financial societies, daily, for 7 day terms, of the leading interest rate of the monetary policy.

- **Values System of the National Stock Exchange, S. A.**

Through this mechanism, daily negotiations will be made with the financial sector in the National Stock Exchange, S. A., for 7 day terms, of the leading interest rate of the monetary policy.

- **Bidding**

Through this mechanism, through stock exchanges that operate in the country, the convening of the biddings of those terms that are made for pre-determined quotas for the terms of up to a year.

- **Window**

In this mechanism the *Banco de Guatemala* will receive term deposits, daily, directly from the non-financial private and public sector.

ii) Framework for monetary stabilization operations

- Continue using 7 day term operations as the leading interest rate of the monetary policy.
- Continue the reception of term deposits greater to seven days, at interest rates that will be determined by the markets.
- Watch over the stability of the short term interest rates without a lack of appreciation of the fundamental

objective. Watch that the stability of the short term interest rates not fluctuate abruptly, so that the *Banco de Guatemala* may participate in the Electronic Banking Money Table or in the stock exchanges injecting or retiring liquidity when volatility is observed in the money market.

- Continue with the best in the operational scheme for its operation, especially in the following aspects:

Ü Placement of Term Deposits, in quetzales, according to maturity dates

The *Banco de Guatemala* could place Term Deposit Certificates, in quetzales, according to maturity date, so that they strengthen the secondary market and propitiate the formation of a yield curve of the interest rates that reflect the best behavior of the market.

Ü Improve the transmission mechanism of the leading interest rate

To improve the effectiveness of the monetary stabilization operations, in the sense that the movements of the leading interest rates are reflected in the interest rates of the other fund-raising terms, the Execution Committee of the *Banco de Guatemala*, based on the analysis of the technical bodies, will evaluate the criteria that allow improving the mechanisms of transmission of the leading interest rate, including the relative of the determination of quotas, as well as the manner of estimation of the reference interest rate for the awarding.

Ü Transfer of Title holding of Term Deposit Certificates in custody of the *Banco de Guatemala*

With the purpose of contributing to the development of an agile and secure secondary market, will continue with the process of implementation of measures oriented toward a transfer of title holding of Term Deposit Certificates in custody of the *Banco de Guatemala*.

Ü Strategy for the Development and Deepening of the secondary values market

The *Banco de Guatemala* will request technical assistance to international financial organisms, with the purpose of designing a mid-term strategy that will allow developing and deepening secondary values markets.

iii) Fund-raising of term deposits in US dollars

In 2007 the *Banco de Guatemala* will have the instrument available that will allow picking up liquidity in foreign currency, through the fund-raising of term deposits in US dollars, with the objective of, if the circumstances merit them, soften the behavior of the nominal exchange rate, according to the established in resolution JM-99-2004 dated September 8, 2004.

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

b) Other instruments

i) Banking Legal Reserve

The banking legal reserve remains current at 14.6%, in national as well as foreign currency.

ii) Last Instance Loan Shark

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

2. Exchange market

a) Participation Regulation

With the purpose of the participation of the *Banco de Guatemala* being sustained by objective criteria known by the market, will use one rule for participation of it in the exchange market, in order to moderate the volatility of the nominal exchange rate, without affecting its tendency (Annex 2).

E. MEASURES THAT CONTRIBUTE TO THE EFFECTIVENESS OF THE MONETARY POLICY

1. Coordination with the fiscal policy

In order to consolidate the efficacy and credibility of the macroeconomic policy, it is necessary to continue strengthening the institutional coordinating through the *Banco de Guatemala - Ministerio de Finanzas Públicas* Work Group, created in 2002 for both entities, in order to materialize efforts that will allow the monetary and fiscal policies to fulfill their objectives in matters of macroeconomic stability.

2. Transparency and Accountability of the *Banco de Guatemala*

For the strengthening of accountability as to the actions of the Central Bank it is necessary that, besides making up different reports and publications that it must do, according to the declared in the organic law, the *Banco de Guatemala* must let the public know about, on the one hand, the design and orientation of the monetary policy and, on the other hand, the actions taken for the execution of said policy for the achievement of the fundamental objective of the Central Bank, which is the stability in the general level of prices. Also, in order to generate certainty in the economic agents for decision making, in Annex 3 is the annual calendar for the sessions in which the Board will make decisions regarding the leading interest rate of the monetary policy.

3. Improvement in the economic-finance statistics information

The *Banco de Guatemala* must continue the process of adopting the manuals and methodology used currently in matters of National Accounts, Payment Balance and Monetary Accounts.

4. Strengthening of the prudential norms and of the preventive supervision

Without discrediting what is established in literal u) of article 3 of the Law of Financial Supervision, the Superintendence of Banks is instructed to continue advancing with the adoption of actions and measures oriented toward the strengthening of the prudential normative and of preventive supervision and, if necessary, to present the proposals deemed pertinent before the Board.

III. KEEP CURRENT THE OTHER DECLARATIONS OF THE MONETARY, FOREIGN EXCHANGE AND CREDIT POLICY THAT DO NOT OPPOSE THOSE CONTAINED IN THE PRESENT RESOLUTION.

IV. AUTHORIZE THE SECRETARY OF THE BOARD SO THEY PUBLISH THE PRESENT RESOLUTION, WHICH WILL BE ENFORCED AS OF JANUARY 1, 2007.

Armando Felipe García Salas Alvarado
Secretary
Monetary Board

ANNEX 1

MONETARY AND FISCAL PROGRAM 2007
Millions of quetzales

Concept	I TRIM	II TRIM	III TRIM	IV TRIM	TOTAL
FISCAL ACCOUNTS					
Income	7571	7698	8210	8271	31750
Expenditure	7052	7266	9404	10791	34513
Current	5389	5245	6567	6163	23364
Capital	1663	2021	2836	4629	11149
Deficit	-519	-432	1194	2520	2763
(% del GDP)					0.9
Net external financing	235	1655	-952	-79	860
Net internal financing	0	0	0	0	0
Till variation	-755	-2088	2146	2599	1903
A. MONETIZING (+) AND DEMONETIZING (-) FACTORS					
I. Net International Monetary Reserves	102	1335	-272	-365	800
In US\$	13	167	-34	-46	100
II. Net internal assets	510	-1103	2477	2646	3876
1. Central government	-755	-2088	2146	2599	1903
2. Rest of the public sector	-564	-96	-108	284	-484
3. Position with banks	-302	-298	-287	-843	-1730
Credit to banks	0	0	0	0	0
Banking Reserve	-302	-298	-287	-843	-1730
4. Other Net Assets	248	-8	43	241	525
Expense and products	126	81	14	57	278
Others	122	-89	29	184	246
5. Maturity of MSOs	1883	1386	683	365	3662
III. CREATION OF LIQUIDITY	612	231	2205	2281	4676
B. DEMAND OF MONETARY ISSUE	-134	257	-56	1717	1785
C. EXCESS (-) OR SHORTAGE (+) OF LIQUIDITY (B-III)	-746	26	-2261	-564	-2891
D. PLACEMENT OF MSOs	746	-26	2261	564	2891
E. PLACEMENT OF NET MSOs	1136	1412	-1578	-199	771
(-) increase (+) decrease					

ANNEX 2

REGULATION OF THE PARTICIPATION OF THE BANCO DE GUATEMALA IN THE EXCHANGE MARKET

Criteria for purchase:

1. The rule for purchase will be actively open permanently.
2. In case the reference exchange rate is equal to or less than the mobile average in the last five working days of the reference exchange rate minus a fluctuation margin of 0.5%, the Central Bank will convene the entities that constitute the Institutional Market of Foreign Currency in a dollar purchase auction, for the maximum amount of US\$8.0 million.
3. In case the auctioned amount is awarded, the *Banco de Guatemala* will convene additional auctions, for an amount and a period of time, to present bids, equal to those of the first bid, but without exceeding the amount of the three maximum purchase bids of foreign currency of the day.
4. In case the reference exchange rate is equal to or less than Q7.60, the fluctuation margin will be of 0.1%, the rest of the decisions for purchase remaining invariable.

Criteria for sale:

1. The regulation for sale will be activated when the reference exchange rate is equal to or greater than Q7.81500.
2. In case the reference exchange rate is equal to or greater than the mobile average of the last five working days of the reference exchange rate plus a fluctuation margin of 1.0%, the Central Bank will convene the entities that make up the Institutional Market of Foreign Currency to an auction for the sale of dollars, for a maximum amount of US\$8.0 million.
3. In case an auctioned amount is awarded, the *Banco de Guatemala* will convene additional auctions, for an amount and a period of time, for presenting bids, equal to the first bid, but without exceeding a maximum of three foreign currency sale auctions per day.
4. In case the reference exchange rate is equal to or greater than Q8.05, the fluctuation margin will be 0.5%, the rest of the decisions for sale remaining invariable. As of

said value the rule of participation for foreign currency sale will be symmetric with the established for the purchase of foreign currency.

General Decisions:

The sale and purchase auctions for foreign currency will be made through the Foreign Currency Electronic Negotiation System, as of the schedule to begin said operations in said system, for which the *Banco de Guatemala* must observe the established criteria in the present annex.

The liquidation operations for sale and purchase of foreign currency, made according to the mentioned criteria, will be made immediately after the awarding of each one of the auction events, through the Real Time Gross Settlement System.

The participation regulation of the *Banco de Guatemala* in the exchange market will be revised periodically, in order to maintain market conditions.

ANNEX 3**CALENDAR OF THE SESSIONS IN WHICH THE MONETARY POLICY WILL
MAKE THE DECISION REGARDING THE LEADING INTEREST RATE OF THE
MONETARY POLICY FOR 2007**

MONTH	DATE
January	31
February	28
March	28
April	25
May	30
June	27
July	25
August	29
September	26
October	31
November	28
December	26