

SECRETARIAT OF THE MONETARY BOARD

RESOLUTION JM-211-2007

Inserted in the First Point of Act 62-2007, corresponding to the session celebrated by the Monetary Board on December 27, 2007.

FIRST POINT: Monetary, Foreign Exchange Rate and Credit Policy: Evaluation to November 2007 and Proposal for 2008.

RESOLUTION JM-211-2007. Known through decrees CT-4/2007 and CT-5/2007 from the Technical Council from the *Banco de Guatemala*, which present, on the one hand, the Evaluation of the Monetary, Foreign Exchange Rate Credit Policy to November 2007 and, on the other hand, the Economic Perspectives for 2008-2009 and the Proposal for the Monetary, Foreign Exchange Rate and Credit Policy for 2008, respectively.

MONETARY BOARD:

WHEREAS: That this Board according to its legal mandate reiterated the importance of ensuring conditions that favor macroeconomic stability in the mid and long terms, that support a gradual inflation reduction process sustained that make their convergence viable toward inflationary levels similar to those prevailing in developing countries that operate under inflation targeting; **WHEREAS:** That in a regimen of inflation targeting, inflation targeting in the mid and long terms have the main purpose of constituting a nominal anchor for the monetary policy and, as such, effectively orient toward the policy actions as well as the economic agent expectations; **WHEREAS:** That the national economic activity has grown in a sustained manner, as a result of the dynamism of exportations, of the benefits generated by the free trade agreement (DR-CAFTA), of the increase of direct foreign investment and of the maintenance of the macroeconomic stability and that for 2007 foresees an economic growth rate 5.7%, percentage higher to the registered in 2006 (5.2%) as per population growth (2.5%), which shows a positive growth path for the country; **WHEREAS:** That to November 2007 the inflationary rhythm was located over the inflation goal of 5% (+/- 1 percentual point); **WHEREAS:** That from 2004 the behavior of the inflationary rhythm has been significantly influenced by the imported inflation, which to November 2007, explained 3.06 percentual points of the total inflationary rhythm (9.13%), of which 0.92 percentual points correspond to direct imported inflation and 2.14 percentual points to indirect imported inflation; **WHEREAS:** That although the increase of the inflationary rhythm on the inflation goal is fundamentally due to supply shocks derived of the persistent increase in the international prices of oil-derived

products, corn and wheat, which at the same time affected the prices of goods and services from the basic food basket that use them as consumer products; in some measure, it has also influenced the excess liquidity of the economy;

WHEREAS: That the Board, taking into account that the monetary policy has delayed action on inflation, and that its effects influence on present as well as future inflationary pressures, in a prudent and gradual framework, increased the leading interest rate of the monetary policy on six occasions;

WHEREAS: That during 2007 the performance of the monetary policy supported by the fiscal policy, which is evidenced in the fact that to November of said year, the fiscal deficit was at 1.1% of the Gross Domestic Product;

WHEREAS: That for 2008, this Board must take into account that adverse external factors could persist, such as: a) the behavior of the international oil derived products, corn and wheat prices; b) the effect of imported inflation; and, c) the deceleration foreseen of the world economic activity, particularly of the United States of America and that of the Eurozone; reason for which efforts must be made, in order that the inflationary rhythm in the country be reduced regarding the level registered in November 2007;

WHEREAS: That the economic growth forecast for 2008 (5.3%) was founded on the maintenance of macroeconomic stability, sustained in disciplined monetary and fiscal policies; in favorable expectations of the economic agents and in the sustainability of public and private investment in spite of a deceleration in the economic growth of the main commercial partners of the country;

WHEREAS: That the strengthening of public finance and disciplined management of the same, is fundamental to serve as permanent support of the conduction of the monetary policy and make possible the consecution of the inflation goal in the mid term;

WHEREAS: That the current flexibility exchange scheme in the country is a fundamental element for the perfecting of the inflation targeting scheme, therefore the participation of the *Banco de Guatemala* in the exchange market must be sustained in objective and transparent criteria that generate certainty for the participants in said market, in order to moderate the excess volatility in the nominal exchange rate, without affecting its tendency;

WHEREAS: That it is necessary that the Central Bank continue orienting the monetary policy to the consecution of the inflation goal, in a framework of effectiveness of transmission mechanisms of the same, therefore it is proceeding that the Central Bank, in the competency environment, adopt actions toward achieving development and deepening of the secondary market values, due to the fact that greater development of said market improves the operation mechanisms of transmission and increases the monetary policy effectiveness;

WHEREAS: That for an adequate execution of the Monetary, Foreign Exchange Rate and Credit Policy in a changing macro-financial environment, it is indispensable that the same 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 clearly defined Money and Exchange markets, defended as those that offer greater effectiveness in the Central Bank's actions;

WHEREAS: That for 2008, it is necessary that the coordination between fiscal and monetary policy continue to be led through a work group from the *Banco de Guatemala – Ministerio de Finanzas*

Públicas [Roughly equivalent to the Department of the Treasury.], that according to the agreed by both entities, must get together periodically in order to make concrete efforts that allow the mentioned policies to fulfill their objectives; **WHEREAS:** That the Proposal of the Monetary, Foreign Exchange Rate and Credit Policy for 2008, presented to the Board for consideration, contains the main instruments and measures that make it coherent with the perfecting of the inflation targeting scheme, which would allow continuing the consolidation of 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 agreed 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*, and taking into account Decrees CT-4/2007 and CT-5/2007 from the Technical Council of the *Banco de Guatemala*,

RESOLVES:

- I. **TO HAVE THE MONETARY, FOREIGN EXCHANGE RATE AND CREDITIC POLICY OF 2007 AS EVALUATED:**
- II. **DETERMINE THE MONETARY, FOREIGN EXCHANGE RATE AND CREDITIC POLICY FOR 2008, IN THE FOLLOWING MANNER:**
 - A. **FUNDAMENTAL OBJECTIVE AND POLICY GOAL**

1. Fundamental Objective

Congruent with the fundamental objective of the *Banco de Guatemala*, regarding contributing to creating and maintaining the most favorable conditions for developing the national economy, for which it will propitiate the monetary, exchange rate and credit conditions that promote the general stability in the level of prices, the Monetary, Foreign Exchange Rate and Credit Policy is therefore determined in lieu of reaching said objective.

In support of achieving the fundamental objective, and with the purpose that in the mid term the internal inflation converge toward the observed levels in the developing economy that have applied inflation targeting scheme, the execution of the monetary policy is complemented by actions in the financial modernization environments and of the consolidation of public finance, in the framework of an integral and sustainable economic policy that promotes competitiveness and efficiency from the productive sector.

2. Policy goal

For total inflationary rhythm, measured by the inter-annual variation of the Consumer Price Index, for 2008 established a 5.5% goal with a tolerance margin of +/- 1.5 percentual point and for December 2009 a goal of 5.5% with a tolerance margin of +/- 1 percentual point.

B. INDICATIVE VARIABLES

In order to guide and orient the Monetary, Foreign Exchange Rate and Credit Policy, and evaluate in what measure the goal is being achieved, in order to opportunely detect the effects that exogenous events can have on the financial markets and therefore act opportunely, following up on these indicative variables:

1. Total Projected Inflationary Rhythm

Follow up will be given to the total projected inflationary rhythm for December 2008 and December 2009, comparing it to the inflation goal fixed for those same months.

2. Subjacent Projected Inflationary Rhythm

Follow up will be given to the subjacent projected inflationary rhythm (for December 2008 and December 2009), for which calculation the headings that have high variability, unexplained by monetary reasons, will be excluded from the CPI, comparing it to the fixed inflation goal for those months.

3. Parameter Interest Rate¹

In order to find Money market conditions that are compatible with achieving the inflation goal, follow up will be given to the parameter interest rate (adjusted Taylor Rate), comparing it to the level of the leading interest rate of the monetary policy.

4. Parity Liable Interest Rate

In order to evaluate the competitive conditions of the internal financial market regarding the foreign financial markets, follow up will be given to the parity liable rate, which will include a fluctuation margin of mean deviation standard.

5. Primary Liquidity

¹ It is the short term interest rate compatible with maintaining economic stability.

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

Primary liquidity is made up of the monetary issue and by the ample monetary base; therefore follow up will be given to the behavior of both variables.

As to monetary issue, according to the monetary program for 2008 (Annex 1), it is estimated that the demand of monetary issue increase in 11.9% regarding the closing level estimated in the monetary program of 2007, compatible with the expected growth rate of the Gross Domestic Product, in real terms, of 5.3% and with an inflation goal of 5.5%.

Regarding the ample monetary base, made up of circulating numerary, the banking reserve and the monetary stabilization operations balance in the short term, follow up will be given to its evolution regarding the programmed runner, whose tolerance margin corresponds to a standard deviation.

6. Payment Means

Congruent with the economic activity growth estimation, with the inflation goal and with the speed of Money circulation, it is estimated that the total payment means (M2) will grow at the end of 2008 within a range of 12% and 15%, in inter-annual terms. The follow up of this variable will be oriented toward observing if the evolution throughout the year is compatible with the referred estimation of inter-annual growth.

7. Banking Credit to the Private Sector

Consistent with the payment means growth, the total banking credit to the private sector growth at the end of 2008 will be between 18% and 21%, in inter-annual terms. The follow up of this variable is oriented toward evaluating if its 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 future behavior of the prices in the economy can, in determined circumstances, influence the tendency of the inflation rate that is finally observed in the period, therefore follow up will be given to the inflation forecast coming from the survey of expectations from the panel of private analysts.

9. Implied Inflation Expectations

The calculation of the implied inflation expectations constitutes an indirect manner of obtaining the perception on the expectations of the economic agents, and is obtained by estimating the gap 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 inflation expected by the economic agents. In that sense, the follow up of the referred variable will complement the measure of inflation expectations from the economic agents, which is fundamental in a scheme of inflation targeting.

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

Follow up will be given to the result of the inflation forecast in the mid term obtained from the four runnings of the Semi-structural Macroeconomic Model forecast for 2008.

C. PRINCIPILES FOR MARKET PARTICIPATION

In order to reach the fundamental objective of the *Banco de Guatemala* contemplated in article 3 of its organic law, it is considered convenient to make the rules that regulate its participation, explicit in the monetary and Exchange market.

1. Focus on the fundamental objective

Taking into account that within a scheme of explicit inflation targeting, the objective of the Central Bank is focused on reaching stability in the general level of prices; this must fit in with its monetary policy efforts in the creation and maintenance of the most favorable monetary, foreign exchange rate and credit conditions for the orderly development of the national economy.

2. Realization of the monetary stabilization operations of inflation targeting scheme

In the explicit inflation targeting scheme, the main instrument for the control of liquidity in the economy is constituted by making the monetary stabilization operations, that make up, among others, the reception of term deposits, as well as holding open market operations in the secondary values market, in market conditions, on behalf of the Central Bank, with financial, public and private non-financial sectors, in order to contract or expand monetary offer so that it moderates the behavior of aggregate demand in the economy and also influence the evolution of interest rates and in that manner contribute to achieving the fundamental objective of the Central Bank, referred to in article 3 of its organic law.

3. Exchange Flexibility

Although it is true that in a scheme of exchange flexibility the nominal exchange rate is determined by the interaction between supply and demand of foreign currency in the market, there are also reasons that justify the eventual participation of the Central Bank in the exchange market. For said effect, said participation must be sustained in objective and transparent criteria that generate certainty for the participants in the exchange market.

D. INSTRUMENTS FOR KEEPING MACRO-FINANCIAL STABILITY

1. Monetary market

a) Monetary Stabilization Operations

For 2008 the monetary stabilization operations will continue to be the main instrument for the control of money supply, given that it is the one that least distortions introduces in the financial market operations, reason for which it helps fulfill the fundamental objective of promoting stability in the general level of prices.

For 2008 participation will continue in the market through mechanisms that the *Banco de Guatemala* currently uses for receiving Term Deposits, which are:

i) Placement Mechanisms

- **Electronic Money Banking Table**
Through this mechanism negotiations with banks and financial stock companies are held daily, in 7 day terms, at the leading interest rate of the monetary policy.
- **Values System of the National Stock Exchange, S. A.**
Through this mechanism negotiations through the stock exchange are held, in 7 day terms, at the interest rate of the monetary policy.
- **Biddings**
Through this mechanism, term deposits will be received through the stock exchanges that operate in the country and directly, for which they will convene the biddings for maturity dates, with predetermined quotas, whose maturities are for up to a year.
- **Window**

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

ii) Framework for the monetary stabilization operations holding

- Continue using the leading interest rate of the monetary policy corresponding to the 7 day term operations.
- Continue with the reception of deposits with maturity from 7 days, up to a year, at interest rates that will be determined by the market.

Also, when the monetary spaces allow, the Central Bank will hold monetary stabilization operations, whose maturity will be greater than a year, so that the *Banco de Guatemala* will gradually get close to a less debtor or neutral position before the money market and, on the other hand, improve the management of monetary liability.

- Oversee that the short term does not fluctuate abruptly, for which the *Banco de Guatemala* could participate in the Electronic Money Banking Table or in the stock exchanges, giving or withdrawing liquidity when there is volatility in the money market..

iii) Fund Raising of term deposits in US dollars

In 2008 the *Banco de Guatemala* will have the instrument that will allow picking up liquidity in foreign currency, through fund raising in term deposits in US dollars, at interest rates that do not induce arbitrage, with the objective of, if circumstances merit it, softening the behavior of the nominal exchange rate, according to the established in resolution JM-99-2004, dated September 8, 2004. This measure also helps moderate the banking credit to the private sector expansion in foreign currency.

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

b) Secondary Values Market

i) Consolidation of the information of inter-banking operations in the secondary values market

An important element in the development and deepening of the secondary values market constitutes the information and transparency of the operations in said market. For said effect, the banks in the system and financial stock markets are instructed to inform the *Banco de Guatemala* of the financial characteristics of the transactions made with term deposits and with treasury bonds or with certificates representative of such bonds in the stock and over the counter markets, in the manner and periodicity established by the Central Bank.

c) Other instruments

i) Legal Banking Reserve

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

ii) Last instance lender

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

2. Exchange Market

a) Participation Regulation

So that the participation of the *Banco de Guatemala* be sustained in objective and transparent criteria that be made known fully by the

market, will use the current exchange rule, in order to moderate the volatility of the nominal exchange rate, without affecting its tendency.

E. MEASURES TO 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 strengthen institutional coordination through the Work Group of the *Banco de Guatemala – Ministerio de Finanzas Públicas* [Roughly equivalent to the Department of the Treasury.], created since 2002 by both entities, with the purpose of allowing the monetary and fiscal policies to fulfill their objectives in matter of macroeconomic stability.

2. Strategy for developing and deepening secondary values market

The *Banco de Guatemala* will continue with efforts to design a mid-term strategy that allows developing, deepening and strengthening the secondary values market, with the support of international financial organisms.

3. Transparency and account rendering of the *Banco de Guatemala*

For the strengthening of account rendering and actions taken by the Central Bank it is necessary that, added to writing different reports and publications, according to the declared in its organic law, the *Banco de Guatemala* must make the design and orientation of the monetary policy public and also, the steps taken for the execution of said policy in order to achieve 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 to make decisions, in Annex 2 is the annual calendar of sessions in which the Board will make decisions regarding the leading interest rate of the monetary policy.

4. Improve the analytical framework of the monetary policy

a) Identification and quantification of the different mechanisms of monetary policy transmission

The technical departments of the *Banco de Guatemala* are instructed to begin the task of identification and quantification of the transmission mechanisms of the monetary policy.

b) Structural Macroeconomic Model -MME-

In 2008, the construction of a Structural Macroeconomic Model will begin - MME- in order to forecast inflation, which incorporates microeconomic level bases, a common tool in central banks that have implemented explicit inflation targeting. Said model will complement the inflation forecasts in the mid-term that are currently obtained in the Semi-structural Macroeconomic Model -MMS-.

5. Improvement of the Statistical System in 2008

The *Banco de Guatemala* will adopt recent manuals and better international practices in matters of: a) Quarterly National Accounts, no later than the end of the second semester of 2008; and, b) Payments Balance, no later than the end of the first semester of 2008.

6. Strengthening of the prudential normative and preventive supervision

Without discrediting the established in clause u) of article 3 of the Law of Financial Supervision, the Superintendence of Banks is instructed to continue advancing in the adoption of actions and measures oriented toward strengthening the prudential normative and preventive supervision and, if necessary, present what it deems pertinent to the Board for consideration.

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

IV. AUTHORIZE THE SECRETARY OF THIS BOARD TO PUBLISH THE PRESENT RESOLUTION, WHICH WILL BE CURRENT AS OF JANUARY 1, 2008.

Armando Felipe García Salas Alvarado
Secretary
Monetary Board

ANNEX 2**CALENDAR OF THE SESSIONS IN WHICH
THE MONETARY BOARD MADE DECISIONS
REGARDING THE LEADING INTEREST RATE
OF THE MONETARY POLICY**

DATE
February 20, 2008
March 26, 2008
April 23, 2008
May 21, 2008
June 18, 2008
July 23, 2008
August 20, 2008
September 17, 2008
October 22, 2008
November 19, 2008
December 17, 2008