

## EXECUTION COMMITTEE

### ACT NUMBER 8-2008

Session 8-2008 celebrated in the *Banco de Guatemala* building located at *séptima avenida número veintidós guión cero uno, zona uno* of this city, on Monday, February eighteenth, two thousand eight, at fifteen hours.

The coordinator, with the corresponding quorum, for the consideration of the Execution Committee submitted the project for the order of the day.

**FIRST:** First running of the Semi-structural Macroeconomic Model of 2008.

**SECOND:** Inflation Risks Balance.

**THIRD:** Discussion.

**FOURTH:** Other matters.

Not having observations, the Committee approved the Order of the day.

**FIRST:** First running of the Semi-structural Macroeconomic Model –MMS- of 2008.

The Committee continued with the analysis on the level of the leading interest rate of the monetary policy that it must present to the Monetary Board in the session for Wednesday, February 20, 2008 session, in which said licensed body will decide the level of the leading interest rate of the monetary policy. For said effect, the technical departments presented the Execution Committee with the mid-term forecasts generated by the first running in 2008 of the Semi-structural Macroeconomic Model-MMS-, which was begun with a summary of the initial conditions of the running, followed by a presentation of a report of changes in the forecast of the inter-annual inflation rate and the interest rate of the monetary policy, regarding the forecast generated in the fourth running of the MMS in 2007 (made in November. In said report it was indicated that the inter-annual inflation forecast for December 2008, generated in the first running of 2008 (7.27%), is greater by 1.11 percentual points to the generated forecast, for the same date, in the fourth running of 2007 (6.16%). Said increase in the inflation forecast is explained, mainly to changes in the following factors: change in the monetary policy target (0.29%), the price of diesel (0.47%) and the forecast of short term inflation (0.20%). It was also indicated that the inflation

forecast for December 2009, generated in the first running of 2008 (5.70%), is greater by 1.54 percentage points to the generated forecast, for the same date, in the fourth running of 2007 (4.16%). In this case, the increase in the forecast is mainly explained by the changes in the following factors: change in the monetary policy target (0.80%), the price of diesel (0.33%) and the forecast of short term inflation (0.19%).

As to the leading interest rate, it was indicated that the average forecast of four quarters understood between the first and fourth quarters of 2008, generated in the fourth running of 2007 (6.29%). This behavior is mainly explained by the changes in the following factors: the price of diesel (62 basic points), the interest rate in the United States of America (-53 basic points) and the leading interest rate of the Monetary Policy (-29 basic points). On the other hand, the forecast of the average leading interest rate of the monetary policy, average for the eight quarters between the first of 2008 (6.00%), is greater by 3 basic points to the average forecast generated, for the same period, in the fourth running of 2007 (5.97%). The increase of this average forecast is explained, mainly, by the changes in the following factors: change in the monetary policy target (-60 basic points), the interest rate of the United States of America (-54 basic points) and the price of diesel (41 basic points).

Additionally, it was indicated that when comparing the inter-annual inflation forecast with the determined inflation target by the Monetary Board in resolution JM-211-2007, it is observed that for the end of 2008 the inter-annual inflation will be over the monetary policy target, whereas of the end of 2009 said rate will be within the corresponding monetary policy target.

Following, the risks balance were presented for the MMS and the corresponding fan graphs. In that regard, it was indicated that, according to the forecast generated in the fourth running of 2007, there is a 35.17% probability that the inter-annual inflation rate is found within the policy margin for 2008, 51.26% probability that the inflation rate be located over the target and 13.57% probability that the inflation rate be below the monetary policy target. Instead, according to the forecast generated in the first running of 2008, there is a 37.97% probability that the inter-annual inflation rate be found within the monetary policy target for December 2008, there is a 54.73% probability that the rate in question be over the target and 7.30% probability that the inflation rate be below the referred monetary policy target. Therefore, the risk of exceeding the inflation target by the end of 2008 increased.

On the other hand, according to the forecast generated in the fourth running of 2007, there is a 21.86% probability that the inter-annual inflation rate is within the policy target for 2009, a 35.74% probability that the rate in question is over the target and a 42.40% probability that the inflation target is below the monetary policy target. But, according to the forecast generated in the first running of 2008, there is a 25.17% probability that the inter-annual inflation rate is within the monetary policy for December 2009, there is 39.48% probability that the rate in question is located over the target and a 35.35% probability that the inflation rate is below the referred monetary policy target. Therefore, the risk of exceeding the inflation target at the end of 2009 also increased.

It was indicated that the inflation forecasts abovementioned are conditioned to the Monetary Authority making a monetary policy that tries to achieve the consecution of the mid and long term inflation targets. In that sense, the leading interest rate is compatible with the MMS forecast generated in the first running of 2008 going from an observed value of 6.00% in the fourth quarter of 2007 to 6.00% in the fourth quarter of 2007 to one of 7.00% in the first quarter of 2008 and to 7.16% in the second quarter of 2008, then, as of the third quarter 2008, there begins a declining trajectory that reaches 6.33% in the fourth quarter of said year and 4.78% in the fourth quarter of 2009. Comparing the abovementioned trajectory with the trajectory that was prescribed by the third running of MMS in 2007, the policy interest rates prescribed in the first running of 2008 are greater for the five first quarters of the forecast horizon, which is consistent with the forecast of higher inflation rates.

**SECOND:** Inflation risks balance.

The technical departments presented the Execution Committee with the inflation risks balance, emphasizing the following aspects:

As to the external conditions, it was indicated that the international price of oil, to February 14, 2008, on average, was at US\$90.95 per barrel, which means a reduction of US\$0.79 per barrel (0.86%) regarding the average price registered during December 2007 (US\$91.74 per barrel). On the other hand, the price of crude oil for delivery in December 2008, according to Bloomberg, on February 14, 2008 was at US\$93.82 per barrel, higher by US\$2.85 per barrel (3.13%) regarding the price registered for the same position on December 31, 2007 that was of US\$90.97 per barrel. In that sense, according to reports by international experts, the referred

behavior in the price of crude oil is associated to supply and demand factors and to the speculation observed in the market. As to demand factors, they mentioned the higher expectations of greater deceleration in the economic growth of the United States of America, considering the higher oil consumption, which has produced a reduction in the projections of crude oil demand. As to supply factors, they mentioned that in the extraordinary meeting held on February 1, 2008, the Organization of Oil Exporting Countries –OPEC- agreed to keep the current crude oil production invariable (29.67 million barrels daily), which is considered insufficient to satisfy the current demand; and on the other hand, that according to the Department of Energy from the United States of America, the levels of the inventory of crude oil registered its fifth consecutive increase when at 301.1 million barrels, on February 8, 2008, although it remains below the registered levels in the same month the year before. As to market speculation, reference was made to the slim margin between world supply and demand of oil, which causes any oil production news to affect oil production, which can influence in a new increase in the futures price, as well as its derivatives.

As to the behavior of the international price of corn, it was reported that an important rise was registered when on February 14, 2008 it was located at US\$9.00 per quintal, higher by 18.89% to the observed at the end of 2007 (US\$7.57 per quintal), therefore its follow up in the risks balance is important as a supply factor.

As to the international price of wheat, they mentioned that it continues to rise, and of February 14, 2008, it was at US\$16.19 per quintal, which represents an increase of approximately 11.73% regarding the observed level at the end of December 2007 (US\$14.49 per quintal), which shows that it continues to be a source of inflationary pressure, especially if we consider that internally it is used as raw material in the production of flour, bread and pasta.

Regarding the composed inflation index of the main commercial partners of Guatemala, it was indicated that this fell slightly in December 2007, located at 5.07%, percentage which is over the value registered in December 2006 (3.43%). They added that in the case of inflationary rhythm in the United States of America, in December 2007 it was at 4.08%, lower to the observed in November 2007 (4.31%), but higher to the registered in December 2006 (2.54%); so taking into account that said country has the highest relative weight within the referred index, in this manner imported inflation risks persist.

As to internal conditions, it was indicated that inter-monthly inflation in January 2008 was at 0.99%, lower by 0.33 percentage points to the registered in January 2007 (1.32%) and lower by 0.26 percentage points to the average of registered variations in January during the last eight years (1.25%). On the other hand, total and subjacent inflationary rhythms observed in January 2008 (8.39% and 8.67%, respectively), although they registered a fall regarding the previous month, were located over the tolerance margin of the inflation target determined by the Monetary Board for 2008 (5.5% +/- 1 percentage point).

As to econometric projections of total and subjacent inflation for December 2008 and December 2009, they are over the punctual value of the inflation target for both years, but within the respective tolerance margin of the inflation target for the referred years. As to the results of the survey to inflation expectations of the panel of private analysts made in January 2008, the same reveal that said panel projects an inflationary rhythm for the end of 2008, higher to the forecast in December 2007.

Regarding the execution of public finance, it was indicated that according to preliminary number to January 31, 2008, registered a surplus of Q531.8 million, equivalent to 0.2% of the GDP (surplus of Q855.6 million to January 2007, equivalent to 0.3% of the GDP). Notwithstanding, it was mentioned February 14, 2008 the level of deposits of the Central Government in the *Banco de Guatemala*, on average, were around Q1,350.0 million below the programmed in the current Monetary, Foreign Exchange Rate and Credit Policy. In addition, there is certain fiscal uncertainty, especially if we take into account that the floating debt still does not have a concrete financing source.

The monetary stabilization operations with the private sector, to date, on average, have been at approximately Q152.0 million below the programmed runner. They highlighted that the monetizing effect in Central Government deposits in the *Banco de Guatemala* as well as the monetary stabilization operations with the private sector, the position with banks and financial companies in national currency have had a demonetizing effect, on average, of Q925.0 million, due to fact that the legal banking reserve in national currency has been over the programmed levels. It was also indicated that the monetary issue registered a falling deviation to January 31, 2008 (around Q257.0 million), located in the last two weeks within the programmed runner.

Regarding the indicative variables, when comparing their situation to date regarding the observed the month before, 31.10% of the variables advised a restrictive monetary policy (57.69% the month before), 39.78% suggest a moderately restrictive monetary policy (24.45% the month before); 8.79% suggest an invariable monetary policy (equal percentage the month before); and the remaining 20.33% advise a relaxed monetary policy (9.07% the month before). They also mentioned that the inter-annual growth rhythm of the banking credit to the private sector, if it continues to be over the programmed values for 2008, has been gradually decelerating and the deviation regarding the referred runner is less than the registered in January. On their part, the total payment means continue to be below the estimated runner for 2008.

**THIRD:** Discussion.

Based on the presentations of the technical departments regarding the inflation risks balance, the results of the first running in 2008 of the Semi-structural Macroeconomic Model, as well as the behavior of the indicative variables of the monetary policy, the Committee deliberated on the content of the same with the purpose of presenting the Monetary Board the elements of analysis, as well as the considerations and conclusions that could be useful in the session of said licensed body, when they will decide the level of the leading interest rate of the monetary policy, programmed for February 20, 2008.

Regarding the inflation behavior to January 2008, in the Committee reference was made to the fact that the total inflationary rhythm was at 8.39%, which is lower by 0.36 percentual points regarding the registered in December 2007. Added to that, when making a prospective analysis of the inflation behavior, it was indicated that the projections of total inflationary rhythm for the end of 2008 coming from the arithmetic average of the two econometric models that have been used, mark an inflationary rhythm of 6.91%, which is over the punctual value of the inflation target (5.5%), but within the tolerance margin of +/- 1.5 percentage points, whereas for the end of 2009 an inflationary rhythm of 6.47% was projected, which is over the punctual value of the inflation target determined for said year (5.5%), but within the tolerance margin of +/- 1 percentage point.

As to the subjacent inflationary rhythm projections, it was mentioned that the projection for December 2008 (6.59%) as well as the projection for December 2009

(6.21%), are located over the punctual value of the inflation target established for these years (5.5%), but within the respective tolerance margins.

The Committee also analyzed the environmental risks in which the monetary policy is currently executed. As to the risks associated to the external environment, they discussed the evolution in the international price of oil, corn and wheat, as well as the recent behavior in the inflation of the main commercial partners of the country. In that regard, they highlighted that the evolution of the mentioned variables continues to reflect the persistence of the inflationary risks, so their close follow up is relevant in the balance of inflation risks.

In the described context, a member of the Committee pointed out that even when the current context is complex, he considered it convenient to make an adjustment to the rise in the leading interest rate, founded in the following aspects: a) the relative weight of the indicative variables, segment that suggest restricting the monetary conditions was reduced from 57.69% to 31.10%, while the percentage of variables that suggest a moderately restrictive monetary policy increased from 24.45% to 39.78%. These last percentages are still important; b) although the total inflationary rhythm has decelerated in the last two months, its level of 8.39% is still considered a historically high inflationary rhythm, aspect that could keep the inflationary expectations over the inflation target; c) in public finance uncertainty has been generated, especially if we take into account that the floating debt has still not found a concrete financing source; and, d) the supply shocks associated to the rise in the international oil prices, of wheat and corn, continue present, which shows that it must be ready to gradually and in a prudent framework, moderate the second round effects. Based on the presented, it was indicated that he considered that in terms of the monetary policy it is important to take action at the beginning of the year, directed toward achieving the inflation target fixed in the monetary policy for 2008 and with that the moderation of the inflation expectations of economic agents, so he was of the opinion that they suggest a 25 basic points adjustment to the leading interest rate.

A member of the Committee indicated that according to information provided by the *Ministerio de Finanzas Públicas* [Roughly equivalent to the US Department of the Treasury], in the framework of the coordination of the monetary and fiscal policies, the decision of said ministry is to establish the financing source for the floating debt, in order that it not generate monetary impact or that it be minimum.

Other members of the committee declared that given the complex nature, it is convenient to analyze the macroeconomic variables and indicators that are usually used to determine the pertinence of the adjustment in the leading interest rate. In that regard, it was indicated that it is fundamental to take into account the elements that advise restricting the monetary policy as well as the elements that advise keeping the monetary policy invariable. As to the factors that advise keeping the monetary conditions invariable, the following were mentioned: a) the econometric projections of total inflation for December 2008 (6.91%) and of 2009 (6.47%) are located over the punctual value of the inflation target for each one of those years, but within the respective tolerance margins; b) the total as well as the subjacent inflationary rhythm decelerated in December 2007 and in January 2008; c) the segment of indicative variables that suggest restricting the monetary policy, decreased; d) the relative monetary variables of primary liquidity and the payment means continue with congruent behavior with the programmed values; and, e) the banking credit to the private sector shows a falling tendency.

On the other hand, it was pointed out that among the factors that advise restricting the monetary policy, the following are highlighted: a) the persistence of external supply shocks, which continue to represent inflationary risks (international oil prices, corn and wheat), so it is important to counteract the second round effects; b) the inflation projections derived from econometric methods and the forecasts coming from the Semi-structural Macroeconomic Model, are located over the punctual value of the inflation targets determined for 2008 as well as 2009; and, c) the inflation expectations of the panel of private analysts are over the upper limit of the inflation target determined for 2008 as well as for 2009.

As a result of the discussion and analysis and after the ample deliberations, in the heart of the Committee the criteria that it is advisable that in this opportunity they make a pause in the monetary restriction measures and observe the evolution of the inflation risks balance in order to establish the changes and orientation in the next month prevailed, therefore what is important is to give follow up to the small gap between the main variables and macroeconomic indicators. In the described context, the Execution Committee arrived at the conclusion that it is pertinent to recommend that the Monetary Board, on this occasion, kept the level of the leading interest rate of the monetary policy invariable.



**FOURTH:** Other matters.

Not having other matters to discuss, the session ended at nineteen hours and thirty minutes, in the same place and on the same date indicated, the participants signed in agreement.