EXECUTION COMMITTEE

ACT NUMBER 14-2008

Session 14-2008 celebrated in the *Banco de Guatemala* building located at *séptima avenida número veintidós guión cero uno, zona uno* of this city, on Monday, March twenty-fourth, two thousand eight, at twelve hours and ten minutes.

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

FIRST: Information of the Indicative Variables.

SECOND: Monthly Report on the Inflation Risks Balance of the Semi-structural Macroeconomic Model.

THIRD: Inflation Risks Balance.

FOURTH: Discussion.

FIFTH: Other matters.

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

FIRST: Information of the Indicative Variables.

The Coordinator requested the corresponding information be provided.

The Director for the Economic Studies Department informed that, from March 13 and 18, 2008, according to preliminary numbers, the daily legal reserve of the banking system went from a position of Q935.5 million to one of Q396.2 million. They also mentioned that during said period they registered net placements of liquidity giving operations of the *Banco de Guatemala* for Q0.1 million. On the other hand, the average position of legal reserve in the mentioned period went from Q433.1 million to Q459.4 million.

The highlights during the period of March 13 to 19, 2008, the main monetizing factors of the monetary issue were the decrease in the balance of the legal banking reserve for Q604.3 million and the deposits of the Central Government in the *Banco de Guatemala* for Q231.1 million; while the main demonetizing factors were the decrease in the balance of the Net International Reserves for the equivalent in quetzales to Q278.4 million and the increase in the balance of the term deposits constituted in the

Central Bank for Q136.1 million and the deposits of the rest of the public sector in the Banco de Guatemala for Q60.4 million.

Regarding the indicative variables of the Monetary, Foreign Exchange Rate and Credit Policy they indicated that with data to February 2008, for December 2008 the total expected inflation estimated with a model of ordinary squared minimums is of 7.29% and with a softened exponential model of 6.92%; the simple average of both models is located at 7.11%, percentage which is found over the tolerance margin of the policy target (5.5% +/- 1.5 percentage point), which suggests a restrictive monetary policy; and, for December 2009 the total expected inflation, estimated with an ordinary squared minimum model, is of 6.54% and with a softened exponential model of 6.49%; the simple average of both models is at 6.52%, which is over the tolerance margin of the policy target (5.5% +/- 1 percentage point), which suggests a restrictive monetary policy.

Regarding the expected subjacent inflation for December 2008, with data up to February 2008, estimated with an integrated auto-regression model of mobile averages ARIMA was of 7.12%, whereas the estimated with a softened exponential model was of 6.63%; the simple average of both models is of 6.88%, which is over the tolerance margin for the policy target (5.5% +/- 1.5 percentage point), which suggests a moderately restrictive monetary policy; and, for December 2009 the estimated subjacent inflation with an integrated autoregressive model of mobile averages ARIMA, was of 6.62%, whereas the estimated softened exponential model was of 6.15%; the simple average of both models is of 6.39%, which is located over the punctual value of the inflation target and within the tolerance margin of the policy target (5.5% +/- 1 percentage point), which suggests a moderately restrictive monetary policy.

As to the parameter rate, it was reported to March 13, 2008, the lower limit was 7.54%, and the upper limit is 11.49%; while the leading interest rate of the monetary policy was at 6.50%, which is below the lower limit of the estimated tolerance margin for the parameter rate, situation that suggests restricting the monetary policy. When referring to the parity liable rate, they declared that up to March 13, 2008, the lower limit was 4.60% and the upper limit was 5.50%, and the weighted average rate of long term deposits of the banking system was of 7.32% which is located over the upper limit of the fluctuation margin of the parity liable rate, which suggests relaxing the monetary policy.

As to primary liquidity it was indicated that monetary issue observed to March 19, 2008, is found within the programmed runner for said variable, which would indicate an invariable monetary policy, whereas the base of a broad monetary base, on that same date, is at Q823.7 million below the lower limit of the programmed runner, which suggests a relaxed monetary policy. The weighted orientation of the deviation for the present week –Q411.9 million) would indicate relaxing the monetary policy.

As to the total payment means, the inter-annual growth observed to March 13, 2008, ascended to 10.9%, which is below the lower limit of the estimated runner for said variable on the same date (11.6 to 14.6%), which suggests a relaxed monetary policy; in which the econometric estimation for the payment means for December 2008 is of 12.0%, which is below the expected range for December 2008 (12.0% to 15.0%), which suggests an invariable monetary policy. The average orientation of the deviation (-0.35%) therefore suggests relaxing the monetary policy. Also, up to said date, the inter-annual variation of banking credit of the private sector registered growth of 23.4%, which is within the upper limit of the estimated runner for March 13, 2008 (20.9% to 23.9%), which suggests an invariable monetary policy; on the other hand, the econometric estimation for the end of 2008 of the banking credit to the private sector is of 20.4%, which is within the expected range (18.0% to 21.0%), which suggests an invariable monetary policy. The average orientation of the deviations for the present week is of 0.00%, suggesting keeping an invariable monetary policy.

As to the inflation expectations of the panel of private analysts, it was indicated that, according to the survey made in February 2008, for December 2008 the inflation projection is at 7.88%, which is over the tolerance margin of the policy target (5.5%+/-1.5 percentual points), which suggests a restrictive monetary policy; and, for December 2009, the inflation projection will be at 7.41%, which is also over the tolerance margin estimated for said year (5.5%+/-1 percentual point), which suggests restricting the monetary policy. Also indicating that the implied inflation expectations variable with data to February 2008, showed an inflationary rhythm of 6.13%, which is over the punctual value of the inflation target and within the tolerance of the monetary policy target for 2008 (5.5% +/- 1.5 percentual points), which suggests a moderately restrictive monetary policy.

Regarding the Semi-structural Macroeconomic Model (MMS) used in February 2008 to forecast the total inflationary rhythm, projected an inflationary rhythm of 7.27% for December 2008, conditioned to gradual adjustments in the leading interest rate of the monetary policy until locating itself, on average, in the last quarter of said year at 6.33%, which suggests a restrictive monetary policy. Also the forecast for said model of a mid-term horizon projected an inflationary rhythm for December 2009 of 5.70%, conditioned to gradual adjustments to the leading interest rate of the monetary policy until it reached 4.78%, on average, in the last quarter of said year, which is suggesting a moderately restrictive monetary policy.

The Committee reported that the orientation of the indicative variables, regarding the previous week, remained unchanged. In that sense, it was reported that 33.83% of the same suggest a restrictive monetary policy orientation; 27.98% suggest a moderately restrictive monetary policy; 9.07% suggest an invariable monetary policy orientation; and, 29.12% suggest a relaxed monetary policy.

SECOND: Monthly report on Inflation Risks of the Semi-structural Model Macro-economic -MMS-.

The Committee deliberated on the analysis of the level of the leading interest rate of the monetary policy that it must present to the Monetary Board in the session for Wednesday, March 26, 2008, 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 Monthly Report on Inflation Risks of the Semi-structural Macroeconomic Model- MMS- to the Committee. In that sense, emphasis was made on that fact that in said report it indicates the direction in which the suggested data in the last month (February 11 to March 10, 2008) affect the risks that surround the forecast in the mid-term based on the first running of the MMS in 2008 (made in February). The generation of said report is based on the iterative and mechanical runnings of the MMS based on new data (historic and/or forecast) of the diverse variables that feed the data base of the model in question.

It was mentioned that the Monthly Inflation Risks Report does not constitute a new complete inflation forecast, since it does not incorporate the qualitative analysis inherent to the generation of the complete forecast that has been presented previously with a quarterly frequency. In that sense, the mentioned report is limited to presenting the result of processing new available data in a mechanical running of the MMS. Therefore, it was pointed out that the quantitative results presented in this type of report must not be interpreted literally, but only as indicative of the direction of risks based on the last quarterly forecast.

Regarding the effect of new available data in the forecast of inter-annual inflation, it was indicated that said effect will point to an increase of inflation risk, since the trajectory generated by the mechanical running of the MMS made in March is translated to higher rates in comparison to the trajectory generated in February by the forecast of the first running of the MMS in 2008. Congruent with the above, it was pointed out that the new data imply a trajectory for the leading interest rate of the monetary policy in levels higher regarding the corresponding trajectory of the first running of the MMS in 2008 for the four quarters of 2008 and for the first quarter of 2009, although slightly lower for the last three quarters of 2009.

Then, the technical departments presented the decomposition of the effects of the new data on the forecast of the MMS generated in the first running of 2008 (made in February), for the fourth quarter of 2008. In terms of inter-annual inflation, it was indicated that the projection for the fourth quarter of 2008 increased by 0.10 percentage points, when going from 7.27% (in the forecast of the first running of 2008) to 7.37% (in the mechanical running that incorporates the new data). Said behavior is explained by the new forecast on the price of diesel (13 hundredths of a point toward the rise), by the new forecast of the interest rate of the United States of America (5 hundredths of a point toward decline), by the data of the Monthly Economic Activity Index of domestic demand (6 hundredths of a point toward the decline), by the new inflation data (6 hundredths of a point toward the rise), and by the new inflation data of the nominal exchange rate (2 hundredths of a point toward the rise).

As to the leading interest rate, the average of said variable for the quarters between the first and fourth quarters of 2008, increased by 9 basic points, when going from 6.84% (in the forecast of the first running of 2008) to 6.93% (in the mechanical running that incorporate the new data). Said increase is explained by the effect of the new forecast of the price of diesel (15 basic points toward the rise), by the new forecast of inflation from the United States of America (1 basic point toward the rise), by the new forecast of the interest rate in the United States of America (19 basic points toward the decline), by the new IMAE data of domestic demand (9 basic points toward the decline), by the new inflation data (7 basic points toward the rise) and by the new data of the nominal exchange rate (14 basic points toward the rise).

In terms of the leading interest rate of the monetary policy, the average of said variable for the quarters, between the first and fourth 2008, increase by 9 basic points, when going from 6.84% (in the forecast of the first running of 2008) to 6.93% (in the mechanical running that incorporates the new data). Said increase is explained by the effect of new forecasts of the price of diesel (15 basic points toward the rise), by the new forecast of the US inflation (1 basic point toward the rise), by the forecast of the US interest rate (19 basic points toward the decline), by the new IMAE data of domestic demand (9 basic points toward the decline), by the new inflation data (7 basic points toward the rise) and by the new data of the nominal exchange rate (14 basic points toward the rise).

As to the breakdown of the effect of the new data on the forecast of the MMS generated in the first running of 2008 (made in February) for the fourth quarter of 2009, it was indicated that, in terms of inter-annual inflation, the projection for the fourth quarter of 2009 increase by 0.06 percentage points, when going from 5.70% (in the first running of 2008) to 5.76% (in the mechanical running that incorporates the new data). Said increase is explained by the new forecast of the price of diesel (6 hundredths of a percentage point toward the rise), by the new forecast of the US interest rate (8 hundredths of a percentage point toward the decline), by the new data of the IMAE of domestic demand (2 hundredths of a percentage point toward the fall), by the new inflation data (4 hundredths of a percentage point toward the rise) and the new data of the new nominal exchange (6 hundredths of a percentage point toward the rise).

As to the leading interest rate of the monetary policy, it was pointed out that the average of said variable, for the eight quarters understood as those between the first of 2008 and fourth quarter of 2009, increase by 4 basic points, when going from 6.00% (in the forecast of the first running of 2008) to 6.04% (in the mechanical running that incorporates new data). Said behavior is explained by the new forecast in the price of diesel (10 basic points toward the rise), by the new US inflation forecast (1 basic point toward the rise), by the new interest rate in the United States of America (1 basic point toward the rise), by the new forecast of the US interest rate (17 basic points toward the decline), by the new data of the IMAE of domestic demand (7 basic points toward the fall), by the new inflation data (5 basic points toward the rise) and by the new data of the new nominal exchange (12 basic points toward the rise).

In summary the technical departments indicated that, regarding the first running of the MMS in 2008 (made in February), the mechanical running of March 2008 indicate a trajectory of higher inflation rates, over the current target of the monetary policy established for 2008, but within the current established monetary policy target of 2009, as well as with a trajectory for the highest leading interest rate of the monetary policy in the first five quarters of the forecast horizon.

Additionally, the technical departments presented a simulation where the values for the US interest rates fall by 75 basic points, regarding the forecast in the mechanical running of March. In that sense, the technical departments indicated that the effect of such modification is a very slight reduction in the inflation forecasts and a more pronounced reduction in the trajectory of the leading interest rate of the monetary policy.

THIRD: 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 March 20, 2008, on average, was at US$106.12 per barrel, which means an increase of US$14.38 per barrel (15.67%) 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 March 20, 2008 was at US$98.14 per barrel, higher by US$7.17 per barrel (7.88%) 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 weakening US dollar regarding other currencies, particularly the Euro, which has caused a greater participation of investors in the crude oil market. As to supply factors, they mentioned that in the extraordinary meeting held on March 5, 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. 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 March 20, 2008 it was located at US$9.76 per quintal, higher by 28.93% 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 March 20, 2008, it was at US$18.16 per quintal, which represents an increase of approximately 25.33% 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 it increased considerably in February 2008, located at 5.37%, percentage which is over the value registered in December 2007 (5.07%). They added that in the case of inflationary rhythm in the United States of America, in February 2008 it was at 4.03%, lower to the observed in January 2008 (4.28%), but higher to the registered in February 2007 (2.42%); 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 February 2008 was at 0.69%, higher by 0.34 percentage points to the registered in February 2007 (0.35%) and higher by 0.09 percentage points to the average of registered variations in February during the last eight years (0.60%). On the other hand, total and subjacent inflationary rhythms observed in February 2008 (8.76% and 8.96%, respectively), although they registered an increase regarding the previous month, and continue to be over the tolerance margin of the inflation target determined by the Monetary Board for 2008 (5.5% +/- 1.5 percentage point).

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

Regarding the execution of public finance, it was indicated that according to preliminary number to February, 2008, registered a surplus of Q1,046.5 million, equivalent to 0.4% of the GDP (surplus of Q827.8 million to February 2007, equivalent to 0.3% of the GDP). Notwithstanding, it was mentioned March 19, 2008 the level of deposits of the Central Government in the *Banco de Guatemala*, on average, were around Q1,181.0 million below the programmed in the monetary and fiscal programs for 2008. In addition, it was indicated that the monetary stabilization operations with the private sector, to date have been, on average, at approximately Q765.0 million below the programmed level. They pointed out that in contrast to the monetizing effect in the deposits of the Central Government 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 Q1,141.0 million, due to the banking legal reserve in national currency which has been over the programmed levels.

Regarding the indicative variables, when comparing their situation to date regarding the observed the month before, 33.83% of the variables advised a restrictive monetary policy (31.10% the month before), 27.98% suggest a moderately restrictive monetary policy (39.78% the month before); 9.07% suggest an invariable monetary policy (8.79% the month before); and the remaining 29.12% advise a relaxed monetary policy (20.33% the month before). They also mentioned that the inter-annual growth rhythm of the banking credit to the private sector has been decelerating gradually, located during the last two weeks within the estimated runner.

Last, the total payment means have been below the lower limit of the estimated runner in the last four weeks.

FOURTH: Discussion

The technical departments of the *Banco de Guatemala*, after having presented the elements that make up the inflation risks balance, the monthly report of inflation risks derived from the Semi-structural Macroeconomic Model, as well as the behavior of the indicative variables of the monetary policy, arrived at the conclusion that the factors that advise restricting the monetary policy prevailed, so a rise in the leading interest rate of the monetary policy could contribute to moderating the inflationary expectations of the economic agents, and could also strengthen the credibility of commitment of the monetary authority in keeping the general level of prices stable, aspects of special importance to contribute to conditions of stable and sustained economic growth.

Based on the presentations of the technical departments, the Committee deliberated on the content of the same with the purpose of presenting the Monetary Board the main elements of analysis, as well as the reflections and conclusions that considerations and conclusions that could be considered in the decision regarding the level of the leading interest rate of the monetary policy programmed for Wednesday, March 26 of this year.

Regarding the inflation behavior to February 2008, in the Committee reference was made to the fact that the total inflationary rhythm was at 8.76%, (8.39 in January). In that regard, when making a prospective analysis of 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 7.11%, which is over the punctual value of the inflation target (5.5%), but within the tolerance margin of +/- 1.5 percentage points. In the same manner for the end of 2009 an inflationary rhythm of 6.52% 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 (6.88%) as well as the projection for December 2009 (6.39%), 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 inflation risks balance.

As to internal conditions, it was indicated that the inter-monthly inflation in February 2008 as at 0.69%, higher by 0.34 percentage points to the registered in February 2007 (0.35%) and higher by 0.09 percentage points to the average of variations registered in February during the last eight years (0.60%).

In the described context, a member of the Committee declared that a broader and more integral analysis of variables and macroeconomic indicators indicate that it was important to take into account the elements that advise restricting as well as the elements that recommend keeping the monetary conditions invariable. As to the factors that advise restricting, the following were mentioned: a) that the monthly report of inflation risks derived from the Semi-structural Macroeconomic Model indicated that the inflation is over the established target for the monetary authority for the end of 2008; b) that the total projections inflation for December 2008 and 2009 are located over the tolerance margin of the established inflation target by the monetary authority for each year; c) that the relative weight of the indicative variables segment that suggest restricting the monetary conditions, although they were reduced 70.88% (31.10% restrictive monetary policy and 27.98% moderately restrictive monetary policy) to 61.81% (33.83% restrictive monetary policy and 27.98% moderately restrictive monetary policy), is still an important percentage that indicates the convenience of restricting the monetary conditions; d) that the total inflationary rhythm of February increased to 8.76%, percentage that, on the one hand, constitutes a reversion of the deceleration registered in the two previous months and, on the other, represents a high value historically that influences in the inflationary expectations over the inflation target and exacerbates it in the following months; e) that the supply shocks associated to rises in the international oil price, wheat and corn, continue to be present, which advises attention to moderate the second round effects in a framework of caution and gradualness; f) that the inflation expectations of the panel of private analysts remain over the upper limit of the inflation target determined for 2008 as well as for 2009, with the risk that they deteriorate in the near future, and, g) that in order to promote orderly and sustained economic growth it is vital that macroeconomic stability remain that allows better decision making in matters of savings, investment and employment.

As to the factors that recommend keeping the monetary conditions invariable, the following were mentioned: a) that the relative monetary variables to primary liquidity and the payment means keep congruent behavior with the programmed values; and, b) that the banking credit to the private sector has decelerated in 2008, in the last two weeks having been within the programmed runner.

As a result of the discussion and analysis, the members of the Committee coincided in that the current situation is more complex in this month, regarding February, not only because the inflationary risks are present, but because the international context is changing constantly, which keeps the uncertainty margins and the lack of trust, situation that has given origin to very active measures on behalf of the US Federal Reserve, reason for which the inflation risks balance is more complicated this month, but still within this complexity, it is considered that an adjustment in the leading interest rate of 25 basic points is advisable, given that it would be a moderate raise.

On the other hand, the Committee emphasized that although the credit to the private sector has reduced its growth rhythm, congruent with the monetary policy decisions; its growth is within the estimated programmed runner based on the inflation target and to an estimation of economic growth of around 5.0%. It was also indicated that the monetary policy must operate with a mid-term vision in order to help in the path of orderly and sustainable economic growth in time, which necessarily requires, among other factors, an environment of price stability.

In the described context, there was consensus in that an increase of the leading interest rate, as was indicated, must be moderate (25 basic points) in order to promote a positive environment among economic agents and favor the sustainability of economic growth in the mid-term and, on the other hand, a moderation of inflationary expectations.

FIFTH: Other matters.

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