

EXECUTION COMMITTEE

ACT NUMBER 20-2008

Session 20-2008 celebrated in the *Banco de Guatemala* building located at *séptima avenida número veintidós guión cero uno, zona uno* of this city, on Tuesday, April twenty-second, two thousand eight, at twelve hours and fifty minutes.

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

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

SECOND: Inflation Risks Balance.

THIRD: Discussion.

FOURTH: Other matters.

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

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

The Committee deliberated on the analysis on the level of the leading interest rate of the monetary policy that must be presented to the Monetary Board on its Wednesday, April 23, 2008 session, date in which said licensed body will decide regarding the level of said interest rate. For said effect, the technical departments presented the Monthly Report of the Inflation Risks of the Semi-structural Macroeconomic Model to the Committee. Said report indicates the direction in which the data that came up the month before affects the risks that surround the forecast of the mid-term based on the first running of the MMS in 2008 (from February). The generation of the mentioned report is based on the iterative and mechanical running 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 Report of the Inflation Risk does not constitute a complete inflation forecast, since it does not incorporate the qualitative inherent analysis to the generation of a complete forecast as the one that has been presented quarterly. In that sense, said report is limited to presenting the result of processing the 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 the risks based on the last quarterly forecast.

Regarding the effect of the new available data on the inter-annual inflation forecast, it was indicated that said effect will point toward an increase of the inflation risk, since the trajectory generated by the mechanical running of the MMS made in April is moved 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 to those regarding the corresponding trajectory of the first running of the MMS in 2008 for the forecast horizon.

Then, the technical departments presented the break down 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 0.70 percentage points, when going from 7.27% (in the forecast of the first running of 2008) to 7.97% (in the mechanical running that incorporates the new data). Said behavior is explained by the new forecast on the price of diesel (63 hundredths of a point toward the rise), by the new forecast of the inflation of the United States of America (3 hundredths of a point toward the rise), by the new forecast of the interest rate of the United States of America (9 hundredths of a point toward the fall), by the data of the Monthly Economic Activity Index of domestic demand (1 hundredth of a point toward the decline), by the new inflation data (10 hundredths of a point toward the rise), and by the new data of the nominal exchange rate (4 hundredths of a point 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 quarters of 2008, increased by 84 basic points, when going from 6.84% (in the forecast of the first running of 2008) to 7.68% (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 (89 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 (36 basic points toward the decline), by the new IMAE data of domestic demand (2 basic points toward the decline), by the new inflation data (20

basic points toward the rise) and by the new data of the nominal exchange rate (12 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 0.36 percentage points, when going from 5.70% (in the first running of 2008) to 6.06% (in the mechanical running that incorporates the new data). Said increase is explained by the new forecast of the price of diesel (38 hundredths of a percentage point toward the rise), by the new forecast of the US interest rate (15 hundredths of a percentage point toward the decline), by the new inflation data (11 hundredths of a percentage point toward the rise) and the new data of the new nominal exchange (2 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 63 basic points, when going from 6.00% (in the forecast of the first running of 2008) to 6.63% (in the mechanical running that incorporates new data). Said behavior is explained by the new forecast in the price of diesel (74 basic points toward the rise), by the new US inflation forecast (36 basic point toward the fall), by the new data of the IMAE of domestic demand (1 basic points toward the fall), by the new inflation data (19 basic points toward the rise) and by the new data of the new nominal exchange (7 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 April 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 a higher trajectory for the leading interest rate of the monetary policy in the forecast horizon.

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 from April 1 to 17, 2008, the international price of oil, on average, was at US\$109.22 per barrel, which means an increase of US\$3.80 per barrel (3.60%) regarding the average price registered in

March 2008 (US\$105.42 per barrel) and an increase of US\$17.48 per barrel (19.05%) 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 April 17, 2008 was at US\$110.89 per barrel, higher by US\$19.92 per barrel (21.90%) 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; and on the other hand, the fact that according to information from the US Department of Energy, the level of oil reserves of that country showed a falling behavior for the second consecutive week, when it was at 313.7 million barrels, to April 11, 2008. 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 April 17, 2008 it was located at US\$10.64 per quintal, higher by 8.79% to the observed at the end of March (US\$9.78 per quintal) and higher by 40.55% to the observed in December 2007 (US\$4.57 per quintal), therefore its follow up in the risks balance is important as a supply factor. Reference was also made to the fact that, according to information from the National Statistics Institute, the internal prices of yellow and white corn (with weightings from the CPI of 0.07% and 0.75%, respectively) in March 2008, reverted their falling tendency, that had remained since August 2007, therefore inflationary risks from this still remain.

As to the international price of wheat, they mentioned that it fell, and of April 17, 2008, it was at US\$13.61 per quintal, which represents a decrease of approximately 21.06% regarding the observed level at the end of March 2008 (US\$17.29 per quintal), and a reduction of 6.07% regarding the observed level at the end of December 2007

(\$14.49 per quintal), it is worth indicating that, notwithstanding the reduction observed in its prices, this continues to be a source of inflationary pressure, due to the fact that it still remains over the registered levels during the greater part of 2007 which continues to influence in the prices of derived products, such as flour, bread and pasta.

Regarding the composed inflation index of the main commercial partners of Guatemala, it was indicated that in March 2008 it was at 5.45%, 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 March 2008 it was at 3.98%, lower to the observed in February 2008 (4.03%), but higher to the registered in March 2007 (2.78%); 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 March 2008 was at 1.18%, higher by 0.32 percentage points to the registered in March 2007 (0.86%) and higher by 0.51 percentage points to the average of registered variations in March during the last eight years (0.67%). On the other hand, total and subjacent inflationary rhythms observed in March 2008 (9.10% and 9.13%, respectively), 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 and the subjacent inflation for December 2008 are over the punctual target of the inflation target for both years. The econometric projection of subjacent inflation for December 2009, is over the punctual value of the inflation target, but within the respective tolerance margin determined for the referred year. As to the results of the survey to inflation expectations of the panel of private analysts made in March 2008, reveal that said panel projects an inflationary rhythm for the end of 2008 and 2009, higher to the forecast in the survey made in February.

Regarding the execution of public finance, it was indicated that according to preliminary number to March 2008, registered a surplus of Q1,358.5 million, equivalent to 0.5% of the GDP (surplus of Q164.9 million to March 2007, equivalent to 0.1% of the GDP). Emphasis was made on the following aspects: a) it was estimated by the

monetary and fiscal program that during the first quarter of 2008 the level of placements of Treasury Bonds rose to Q1, 263.7 million, while a level of Q838.8 million was observed; b) according to the referred program, the level of disbursements of external public debt must rise to Q349.0 million, registering only an amount of Q14.6 million; c) the level of Central Government deposits in the *Banco de Guatemala* registered an increase between December 31, 2008 and March 31, 2008 of Q75.7 million, when the programmed value was of Q1,320.4 million; d) between March 31 and April 17, 2008, the level of deposits of the Central Government increased Q1,500.0 million, associated to an increase in the tributary collection, situation that has reduced the deviation of said deposits regarding the programmed; and, e) to April 18, 2008, the Central Government has placed Treasury Bonds for Q935.2 million, of which 90.2% corresponded to placements with the public sector and of 9.8% with the private sector, situation that contrasts significantly with the observed on the same date the previous year, when the amount placed (Q1,118.7 million), 10.7% was with the public sector and the remaining 89.3% with the private sector.

On the other hand, it was mentioned that the tendency of the appreciation that has been registered in the nominal exchange rate, activated the participation regulation of the *Banco de Guatemala* in the exchange market, and in that regard, it was emphasized that said participation, given its monetizing effect, is compatible with the fulfillment of the inflation target.

Regarding the indicative variables, when comparing their situation to date regarding the observed the month before, 38.46% of the variables advised a restrictive monetary policy (33.83% the month before), 23.35% suggest a moderately restrictive monetary policy (27.98% the month before); 9.07% suggest an invariable monetary policy (same the month before); and the remaining 29.12% advise a relaxed monetary policy (same as the month before).

They also mentioned that the inter-annual growth rhythm of the banking credit to the private sector is within the programmed runner. The primary liquidity (monetary issue and broad monetary base) shows a behavior toward the fall, whereas the payment means are located below the lower limit of the estimated runner.

THIRD: Discussion

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 with the main analysis elements, as well as the thoughts and conclusions that could be considered in the decision regarding the level of the leading interest rate of the monetary policy, programmed for April 23 of this year.

Regarding the behavior of inflation to March 2008, in the Committee reference was made to the fact that the total inflationary rhythm increased for the second consecutive month at 9.10% (8.76% in February 2008), situation that could exacerbate the inflation expectations of the economic agents. 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, point toward an inflationary rhythm of 7.44%, higher to the inflation target of this year. Also, for the end of 2009 a total inflationary rhythm of 6.62% is projected, percentage that is also over the inflation target determined for said year.

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

Within this context and taking into account other variables of the monetary program, it was indicated that the monetary stabilization operations, between December 31, 2007 and April 17, 2008, although, on average, they have been below the programmed levels, said deviation, as in the case of deposits from the central government in the *Banco de Guatemala*, reduced in April. On the other hand, it was highlighted that, to date in 2008, on average, the position of the banks in the system in the *Banco de Guatemala* has been demonetizing by around Q1,125.0 million, notwithstanding they highlighted that in April said effect was less demonetizing, situation that in part is associated to a relative gap in banking liquidity during this month, which is, at the same time, coming from a temporary surplus of public finance.

In the Committee they mentioned that the tendency toward appreciation that the nominal exchange rate has been registering activated the participation rules of the *Banco de Guatemala* in the exchange market. In that regard, it was stressed that said

participation, given its monetizing effect, is incompatible with the efforts of fulfillment of the determined inflation targets by the Monetary Authority, therefore it would be opportune to analyze the convenience of bending the mentioned participation rules.

In the described context, the committee declared that an integral analysis of macroeconomic variables and indicators indicate that it was important to take into account the elements that advise restricting the monetary conditions as well as those elements that recommend keeping them invariable. As to the factors that advise restricting, the following were mentioned: a) That the econometric projections of total inflation for December 2008 (7.44%) and 2009 (6.62%), are located over the inflation target determined for each of those years; b) That the relative weight of the segment of indicative variables that suggest restricting the monetary conditions remain at (61.81%); and, c) That the supply shocks associated to the rise in the international prices oil, corn and wheat, continue to be present, constituting a source of future inflationary pressures.

As to factors that recommend keeping the monetary conditions invariable, the following were mentioned: a) That the relative monetary variables to primary liquidity and payment means keep congruent behavior with the programmed values; b) that the banking credit to the private sector have been decelerating in 2008, located in the last six weeks within the estimated runner; c) that to March 2008, public finances registered a surplus of Q1,358.5 million, equivalent to 0.5% of the GDP; d) That the appreciation of the nominal exchange rate activated the participation rule of the *Banco de Guatemala* and, at the same time, have implied interventions of the same.

As a result of the discussion and analysis, in the heart of the Committee the criteria that it is advisable that at this time there be 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 following month, so it is important to offer close follow up of the main variables and macroeconomic indicators, both internal and external. In the described context, the Execution Committee came to the conclusion that it is pertinent to recommend that the Monetary Board, at this time, keep the leading interest rate of the monetary policy invariable at 6.75%.

FOURTH: Other matters and reports.

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