

## EXECUTION COMMITTEE

### ACT NUMBER 26-2008

Session 26-2008 celebrated in the *Banco de Guatemala* building located at *séptima avenida número veintidós guión cero uno, zona uno* of this city, on Monday, May nineteenth, two thousand eight, at thirteen hours and twenty-five minutes.

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

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

**SECOND:** Inflation Risks Balance.

**THIRD:** Discussion

**FOURTH:** Other Matters.

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

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

The Committee deliberated on 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, May 21, 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 second running in 2008 of the Semi-structural Macroeconomic Model- MMS-.

It was indicated that the inter-annual inflation forecast for December 2008, generated in the second running of 2008 (8.62%), is greater by 1.35 percentage points to the generated forecast, for the same date, in the first running of 2008 (7.27%). Said increase in the inflation forecast is explained, mainly to changes in the following factors: the price of diesel (0.82%) and the short term inflation forecast (0.66%). It was also indicated that the inflation forecast for December 2009, generated in the second running of 2008 (6.44%), is greater by 0.74 percentage points to the generated forecast, for the same date, in the first running of 2008 (5.70%). In this

case, the increase in the forecast is mainly explained by the changes in the following factors: the price of diesel (0.82%) and the short term inflation forecast of (0.26%).

Regarding the leading interest rate, it was indicated that the average forecast of four quarters understood between the second and fourth quarters of 2008, generated in the second running of 2008 (7.47%) is higher by 68 basic points to the generated, for the same period, in the first running of 2008 (6.79%). This behavior is mainly explained by the changes in the following factors: the price of diesel (189 basic points), the short term inflation forecast (87 basic points) and the leading interest rate of the Monetary Policy (-84 basic points). On the other hand, the forecast of the average leading interest rate of the monetary policy, average for the seven quarters between the second of 2008 and the fourth of 2009, that was generated in the second running of 2008 (6.11%), is greater by 25 basic points to the average forecast generated, for the same period, in the first running of 2008 (5.86%). The increase of this average forecast is mainly explained by the changes in the following factors: the price of diesel (158 basic points), the short term inflation forecast (71 basic points) and the variation rate of the real balance exchange rate (-70 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 rate will be over the monetary policy target, whereas at the end of 2009 said rate will be within the corresponding monetary policy target.

Following, the risks balance of the MMS forecast and the corresponding fan graphs were presented. In that regard, it was indicated that, according to the forecast generated in the first running of 2008, there is a 37.97% probability that the inter-annual inflation rate is found within the policy margin for 2008, 54.73% of probability that the inflation rate be located over the target and 7.30% probability that the inflation rate be below the monetary policy target. Instead, according to the forecast generated in the second running of 2008, there is a 16.54% probability that the inter-annual inflation rate be found within the monetary policy target for December 2008, there is a 83.15% probability that the rate in question be over the target and 0.31% 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 first running of 2008, there is a 25.17% probability that the inter-annual inflation rate is within the

policy target for 2009, a 39.48% probability that the rate in question is over the target and a 35.35% probability that the inflation target is below the monetary policy target. But, according to the forecast generated in the second running of 2008, there is a 25.53% probability that the inter-annual inflation rate is within the monetary policy for December 2009, there is 48.91% probability that the rate in question is located over the target and a 26.56% 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 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 second running of 2008, going from an observed value of 6.50% in the first quarter of 2008 to 7.61% in the second quarter of 2008, and, then to 7.69% in the third quarter of 2008. Then as of the fourth quarter of 2008, there begins a descending trajectory that reaches 7.11% in said quarter and to 4.16% in the fourth quarter of 2009. Comparing the abovementioned trajectory with the trajectory that was prescribed by the first running of MMS in 2008, the policy interest rates prescribed in the second 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, From May 1 to 15, 2008, on average, was at US\$122.02 per barrel, which means an increase of US\$9.56 per barrel (8.50%) regarding the average price registered during April 2008 (US\$112.46 per barrel) and an increase of US\$30.28 per barrel, (33.01%) 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 May 15, 2008 was at US\$123.05 per barrel, higher by US\$32.08 per barrel (10.97%) to the registered price 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, which has stimulated the participation of investors in the futures market. As to supply factors, they mentioned that the Organization of Oil Exporting Countries –OPEC- in its last meeting (March 5, 2008), agreed to keep the current production level invariable at 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 news to affect oil production, which can influence the futures price of the same, as well as its derivatives.

As to the behavior of the international price of corn, it was reported that a rise was registered when on May 15, 2008 it was located at US\$10.78 per quintal, higher by 1.70% to the observed at the end of April (US\$10.60 per quintal) and higher by 42.40% to the registered in December 2007 (US\$7.57 per quintal), therefore its follow up in the risks balance will continue to be relevant as a supply factor. Also reference was made to the fact that, according to the information of the National Statistics Institute –INE [For its acronym in Spanish]-, the internal price of white corn (with a weighting in the Consumer Price Index of 0.75%) increased 5.55% in April 2008, therefore taking into account said price increased for the second consecutive month and given its influence on other prices (particularly of the tortilla products and poultry meats), there are still inflationary risks in this manner.

As to the international price of wheat, they mentioned that it fell, and on May 15 it was at US\$11.33 per quintal, therefore representing a decrease of 11.69% regarding the level observed at the end of April 2008 (US\$12.83 per quintal), and a reduction of 21.81% regarding the level observed at the end of December 2007 (US\$14.49 per quintal). Notwithstanding this decrease, the referred price continues to be a source of inflationary pressure, due to the fact that it still remains over the levels registered during the first eight months of 2007, which influences the prices of derived products like flour, bread and pasta.

Regarding the composed inflation index of the main commercial partners of Guatemala, it was indicated that to April 2008 it was at 5.53%, over the value registered in December 2007 (5.07%). They added that the inflationary rhythm of the United States of America, in April 2008 was at 3.94%, lower to the observed in March (3.98%), but higher to the registered in April 2007 (2.57%); therefore, 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 April 2008 was at 1.40%, higher by 1.17 percentage points to the registered in April 2007 (0.23%) and higher by 0.77 percentage points to the average of registered variations in April during the last eight years (0.63%). On the other hand, total and dynamic subjacent inflationary rhythms to April 2008 (10.37% and 7.51%, respectively) registered an increase regarding the previous month, located over the tolerance margin of the inflation target determined by the Monetary Board for 2008 (5.5% +/- 1 percentage point). The econometric projections of total and subjacent inflationary rhythm (estimated based on the Subjacent Inflation Dynamic) for December 2008 and December 2009, they are over the punctual value of the inflation target for those years. As to the results of the survey to inflation expectations of the panel of private analysts made in April 2008, the same reveal that said panel projects an inflationary rhythm for the end of 2008, higher to the forecast made in March, while for the end of 2009, they projected a lower inflationary rhythm to the previous survey. Both projections are over the inflation target established for each one of the referred years.

Regarding the execution of public finance, it was indicated that according to preliminary number to April 2008, registered a surplus of Q2 132.7 million, equivalent to 0.7% of the GDP (surplus of Q390.9 million to April 2007, equivalent to 0.2% of the GDP). Also emphasis was made on the following aspects: a) that the surplus registered to April was due to less public expense and higher tributary collection levels; b) that the level of deposits of the Central Government in the *Banco de Guatemala* registered an increase between December 31, 2007 and April 30, 2008 of Q1,664.1 million; and, c) that to May 8, 2008, the Central Government had placed Treasury Bonds for Q1,096.3 million, of which 89.7% are for placements with the public sector and of 10.3% with the private sector, situation that is contrasts significantly with the observed on the same date the previous year, when the amount placed (Q1,865.0

million), 17.4% was with the public sector and the remaining 82.6% with the private sector.

The tendency toward appreciation that has been registered by the nominal exchange rate activated the participation rule of the *Banco de Guatemala* in the exchange market. They highlighted that said participation occurred at a moment of scarce liquidity in national currency.

Regarding the indicative variables, when comparing their situation to date regarding the observed the month before, 47.45% of the variables advised a restrictive monetary policy (36.54% the month before), 16.28% suggest a moderately restrictive monetary policy (15.93% the month before); 18.41% suggest an invariable monetary policy (29.67% the month before); and 17.86% advise a relaxed monetary policy (equal percentage the month before).

The primary liquidity (monetary issue and broad monetary base), based on the approved runners for the Monetary Board in the May 16, 2008 session, shows an average deviation of Q214.7 million. As to the inter-annual variation of payment means is located below the lower limit of the estimated runner and the inter-annual variation of the banking credit to the private sector has been decelerating, located within the estimated runner for 2008.

**THIRD:** Discussion.

The technical departments of the *Banco de Guatemala*, after having presented the elements that make up the inflation risks balance, the second running of the MMS model, as well as the behavior of the indicative variables of the monetary policy, came to the conclusion that although the factors that suggest restricting the monetary conditions, the inflation risks balance on this occasion is more complex than that of the previous month, so under those circumstances, we advise caution, and to keep the leading interest rate invariable.

Based on the presentations made by 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 with 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 May 21 of this year.

Regarding the behavior of inflation to April 2008, the Committee referred to the fact that the total inflationary rhythm increased for the third consecutive month when at

10.37% (8.76% in February and 9.10% in March 2008), situation that could have been exacerbated by the inflation expectations of the economic agents. When making a prospective analysis of the behavior of inflation, it was indicated that the projections of the total inflationary rhythm for the end of 2008 coming from the arithmetic average of the two econometric models that are being used, point toward an inflationary rhythm of 8.76%, higher to the inflation target of this year. For the end of 2009 they also project a total inflationary rhythm of 7.29%, percentage that is also over the inflation target determined for said year.

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

In the Committee, someone mentioned that the payment means have been below the estimated runner, aspect that has influenced in a relative scarcity of liquidity for the active banking operations and in an appreciation of the nominal exchange rate, which activated the participation rule of the Central Bank in the exchange market.

In the described context, in the Committee they declared that an integral analysis of the macroeconomic variables and indicators indicated that it is important to take into account the elements that advise restricting the monetary conditions as well as those elements that advise restricting the monetary conditions and those elements that recommend keeping them invariable. The restricting factors are the following: a) That the econometric projections of total inflation for December 2008 (8.76%) and of 2009 (7.29%), are located over the inflation target determined for each one of those years; b) That according to the MMS, inflation registered a high tendency value; c) That the supply shocks associated to the rise in international oil, corn and wheat prices, continue to represent inflationary risks, so it is necessary to keep close follow up of the second round effects and of the inflation expectations of the economic agents; and, d) That the inflation expectations of the Panel of Private Analysts is over the inflation target for 2008 as well as for 2009.

As to the factors that recommend keeping the monetary conditions invariable, the following were mentioned: a) that although the orientation of the indicative variables continues leaning toward the convenience of restricting the monetary policy, the banking credit to the private sector is within the estimated runner and the payment means is below the lower limit of its own runner; b) that to April 2008, public finance registered a surplus of Q2,132.7 million, equivalent to 0.7% of the GDP; c) That recently a period of liquidity scarcity has been experienced for the asset operations; and, d) That the product gap and the real exchange rate was reduced in the second running of the MMS in 2008, which could reflect less inflationary pressure on behalf of aggregate demand.

As a result of the discussion and analysis, in the heart of the Committee the criteria that it is advisable at this time to keep the level of the leading interest rate of the monetary policy invariable at 6.75% prevailed; and, that the evolution of the inflation risks balance and next month's orientation will be observed, so it is important to give close follow up to the main macroeconomic variables and indicators, both internal as well as external.

**FOURTH:** Other matters.

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