

EXECUTION COMMITTEE

ACT NUMBER 40-2008

Session 40-2008 celebrated in the *Banco de Guatemala* building located at *séptima avenida número veintidós guión cero uno, zona uno* of this city, on Friday, August eighth, two thousand eight, at thirteen hours and seven minutes.

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

FIRST: Knowledge of the project of act number 39-2008 corresponding to the session celebrated on August 1, 2008.

CIRCULATE: project of act number 39-2008.

SECOND: Information on markets and monetary variables.

- a) Money Market
- b) Exchange Market
- c) Indicative Variables
- d) Estimated Monetization Flow
- e) Proposal of quotas for bids in term deposits

THIRD: Discussion and determination for quotas for the bidding of term deposits.

- a) Discussion
- b) Determination of quotas for bidding of term deposits

FOURTH: Other matters and reports.

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

FIRST: The coordinator submitted the projects of the corresponding acts for consideration.

Not having observations, the Committee approved Act number 39-2008.

SECOND: Information of markets and monetary variables.

The Coordinator requested the corresponding information be provided.

- a) The Sub-Director of the Department of Monetary Stabilization Operations, regarding the Money Market informed that during the period from August 1 to 7, 2008, registered a placements for LTD's of Q2,650.3 million and maturity for Q3,857.0 million, which gave as a result net maturities for Q1,206.7 million, associated to the operations made in bidding through commerce exchanges (net placements for Q34.0 million), in the Electronic Banking Money Table –MEBD- and in the *Bolsa de Valores*

Nacional, S. A. stock exchange (net maturities for Q1,165.0 million); and at the window (net maturity for Q75.7 million).

Regarding the DP fund-raising, it was indicated that during the period of August 1 to 7, 2008, for the biddings case, the same were made per due date and price, indicated that in the bidding made through the commerce exchanges, the cut price was of 93.9365% for maturities dated June 8, 2009, equivalent to a yield rate of 7.6495%; while for the direct bid there were no bids. In the MEBD and in the *Bolsa de Valores Nacional, S. A.* stock exchange, the fund-raising was held for a 7 day term, the leading interest rate was of 7.25%.

Regarding liquidity injecting operations it was reported that, during the period of August 1 to 7, 2008, operations for Q43.5 million for a 7 day term; at an interest rate of 8.75%. It was indicated that in the referred operations they received Representative Certificates of Treasury Bonds from the Republic of Guatemala expressed in quetzales and in US dollars as a guarantee.

As to the weighted average interest rates of total operations of repurchase agreements made in the stock exchange of the country, it was indicated that, during the August 1 to 7, 2008 period, the minimum was of 7.34% observed on August 5, 2008 and the maximum was of 7.47% registered on August 6, 2008. It also pointed out that the amounts negotiated were guaranteed with public titles and that the weighted average interest rate during said period was of 7.41%.

On the other hand, it was informed that on August 7 of this year, they had repurchase agreement operations in the exchange market and in the over the counter market, in the banks of the system and the financial stock companies, with term deposits from the *Banco de Guatemala* and Guatemalan Treasury Bonds for Q75.0 million with a weighted average yield of 7.3067%; as well as operations in the stock market for US\$2.8 million with an average weighted yield of 4.0000%.

Finally, regarding the placement of treasury bonds of the Republic of Guatemala, during the period of August 1 to 7, 2008, maturities were registered for Q33.2 million and US\$7.0 million.

b) The Sub-Director for the Monetary Stabilization Operations Department regarding the Institutional Market for foreign currency reported that during the period of July 31 to August 6, 2008, the average daily operations for purchase were of US\$75.3 million and the sale was of US\$84.2 million and that the weighted average exchange rates of the referred operations showed a tendency to fall. In effect, on Thursday, July

31 were of Q7.42488 per US\$1.00 for purchase and of Q7.43318 per US\$1.00 for sale; in that order, on Friday, August 1 was of Q7.40008 and Q7.42180; on Monday, August 4 were of Q7.38404 and Q7.41304; and on Tuesday, August 5 they were Q7.38101 and Q7.39891; and, on Wednesday, August 6 they were Q7.37609 and Q7.39676. Also, it was indicated that the current exchange reference rate for August 8, 9 and 10 of the current year is Q7.39054 per US\$1.00.

In the operations of the electronic systems of negotiations of foreign currency administered by the *Bolsa de Valores Nacional, S.A.* (National Stock Exchange, S.A.), for the period of August 1 to 7, 2008, it was commented that the Private Institutional Foreign Currency System –SPID-, there were no operations. Regarding the Electronic Foreign Currency Negotiation System –SINEDI-, according to the established in the participation rules of the *Banco de Guatemala* in the institutional foreign currency market, did not convene any bids in US dollars.

On the other hand, they informed that the Future Foreign Currency Market that is operated by the National Stock Exchange, S.A., during the period of August 1 to 7, 2008, did not close operations and that on Thursday, August 7 there was no reference price for the market to settle in September 2008.

c) The Director for the Economic Studies Department presented the behavior of inflation to July 2008, according to the information from the National Statistics Institute –INE (For its acronym in Spanish) - indicating that the monthly inflation was of 1.25%, lower by 0.38 percentage points to that of July 2007. It was mentioned that in July 2008 they observed hikes in the median prices of the following goods and services: beans (11.97%); tomato (14.74%); tortilla products (3.01%); extra-urban transportation (9.82%); poultry meats (4.20%); potato (11.53%); other fruits and orchard products (8.79%); electricity (2.44%); gasoline (2.48%); and, ball shaped soap (4.69%). They also registered reductions in the median prices of the following goods and services: bread (1.59%); air transportation (11.76%); and, other fresh fruit (3.26%). The dynamic subjacent inflation registered a rhythm of 9.43%, higher by 0.34 percentage points to the observed in June 2008 (9.09%) and higher by 4.98 percentage points to the registered in July 2007 (4.45%). They also presented the information on the estimation of the imported and domestic components of the total inflation of the referred month. In that sense, it was indicated that of the total inflationary rhythm to July 2008 (14.16%), 5.64 percentage points are due to measurable imported inflation, associated to the direct and indirect effect of the increase of prices in the international

oil and its derivatives market, whereas 8.52 percentage points correspond to internal inflation.

The Committee also received reports from the technical departments on the econometric estimation for December 2008 and 2009 on the total and dynamic subjacent inflation rhythm, in which they incorporate the data observed to July 2008. According to said estimations the total inflationary rhythm as well as the dynamic subjacent inflation is located over the tolerance margin of the inflation target forecast for each one of those years. In that regard, the econometric projection of total inflation for December 2008, it was indicated that it is higher by 0.28 percentage points to the estimation made with data to June, when at 11.66%, percentage that is also over the tolerance margin of the inflation target determined by said year (5.5% +/- 1.5 percentage points). On the other hand, when evaluating the projection of total inflation for December 2009 (8.54%) regarding the determined inflation target for the end of the referred year, it was highlighted that said projection is higher by 0.05 percentage points to the estimation made with data to June, located over the tolerance margin of the inflation target (5.5% +/- 1 percentage point).

As to the econometric projection of dynamic subjacent inflation to December 2008, it was reported that it was at 8.77%, higher by 0.06 percentage points to the estimation made with data to June, located over the tolerance margin of the inflation target determined for said year (5.5% +/- 1.5 percentage points). When examining econometric estimation for December 2009 (7.35%) this was higher by 0.04 percentage points to the estimation of the previous month (7.31%), located over the tolerance margin of the inflation target (5.5% +/- 1 percentage point).

In the described context, the Committee declared its concern for the result of inflation to July 2008, due to the tendency to rise that has been registered. It was highlighted that the inflation registered to July 2008 was higher to the average of the inflation of July in the last eight years. Notwithstanding, the committee observed that the inter-monthly inflation decelerated in July regarding the previous months, situation that influenced in that the inflationary rhythm accelerated in less magnitude regarding the four previous months. In that sense, in the heart of the Committee they discussed the demand, supply and external factors that influenced the behavior of inflation to July 2008. Among the demand factors, the case of beans was mentioned, which registered a significant increase in its price (11.97%), associated to the increase in the demand in the internal market. As to supply factors, they highlighted the fact that the inflation in

said month reflects important increases in the price of various products, according to the *Ministerio de Agricultura, Ganadería y Alimentación* [Roughly equivalent to the Department of Agriculture.], which were affected by climate conditions, like the intense rains registered in July, such is the case of tomato (increase of 14.74%), onion (increase of 16.02%) and other vegetables (increase of 8.79%). Among the external factors, the decrease of imported inflation of 5.84 percentage points in June 2008 to 5.64 percentage points in July 2008, which reflects the deceleration observed in July in the international price of oil, corn and wheat.

d) The Director of the Department of Economic Studies reported that between July 31 and August 7, 2008, according to preliminary numbers, the daily position of legal banking reserve went from a negative position of Q58.5 million to a positive one of Q566.2 million, while the balance of investment in DP for a 7 day term period, varied from Q3,548.0 million to Q2,383.0 million, so the amount of liquid resources of the banking system (daily position of the legal reserve added to DP investments for 7 day term) went from Q3,489.5 million on July 31 to Q2,949.2 on August 7, 2008. They also mentioned that during said period they registered placements and maturities of liquidity giving operations of the *Banco de Guatemala* for Q63.4 million.

The highlights during the period of July 31 to August 7, 2008, of the main monetizing factors of the monetary issue were the decrease in the balance of the monetary stabilization operations for Q1,206.7 million and of the deposits of the rest of the public sector in the Central Bank for Q79.7 million; while the main demonetizing factors were the increase in the balance of the term deposits constituted by the Central Government in the Central Bank for Q784.5 million and the legal banking reserve for Q724.4 million.

Regarding the indicative variables of the Monetary, Foreign Exchange Rate and Credit Policy they indicated that with data to July 2008, for December 2008 the total expected inflation estimated with a model of ordinary squared minimums is of 11.17% and with a softened exponential model of 12.14% the simple average of both models is located at 11.66%, 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 8.98% and with a softened exponential model of 8.10%; the simple average of both models is at 8.54%, 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 July 2008, estimated with an integrated auto-regression model of mobile averages ARIMA was of 8.83%, whereas the estimated with a softened exponential model was of 8.71%; the simple average of both models is of 8.77%, which is over the punctual value of the inflation target and within the tolerance margin of the same (5.5% +/- 1.5 percentage point), which suggests a restrictive monetary policy; and, for December 2009 the estimated subjacent inflation with an integrated autoregressive model of mobile averages ARIMA, was of 7.72%, whereas the estimated softened exponential model was of 6.97%; the simple average of both models is of 7.35%, which is located over the tolerance margin of the same (5.5% +/- 1 percentage point), which suggests a restrictive monetary policy.

As to the parameter rate, it was reported to July 31, 2008, the lower limit was 7.12%, and the upper limit is 11.07%; while the leading interest rate of the monetary policy was at 7.25%, which is below the lower limit of the tolerance margin estimated for the parameter rate, situation that suggests a restrictive monetary policy. When referring to the parity liable rate, they declared that up to July 31, 2008, the lower limit was 4.80% and the upper limit was 5.70%, and the weighted average rate of long term deposits of the banking system was of 7.55% 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 August 7, 2008, is found Q462.1 below the lower limit of the programmed runner, which would indicate relaxing the monetary policy, whereas the broad monetary base, on that same date, is within the programmed runner at Q732.2 million over the upper limit of the programmed runner, which suggests a restrictive monetary policy. The average orientation of the deviation for the present week (Q135.1 million) would indicate restricting the monetary policy.

As to the total payment means, the inter-annual variation observed to July 31, 2008, rose to 6.4%, which is below the lower limit of the estimated runner for said variable on the same date (10.8% to 13.8%), which suggests relaxing the monetary policy; whereas, the econometric estimation of the payment means for December 2008 is of 9.8%, which is below the lower limit of the expected range for December 2008

(11.0% to 14.0%), which suggest relaxing the monetary policy. The average orientation of the deviation (-2.80%) 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 18.0%, which is below the lower limit of the estimated runner for July 31, 2008 (19.9% to 22.9%), which suggests a relaxed monetary policy; on the other hand, the econometric estimation for the end of 2008 of the banking credit to the private sector is 14.9%, which is below the expected range (17.0% to 20.0%), which suggests a relaxed monetary policy. The average orientation of the deviations for the present week of -2.00%, therefore suggests a relaxed monetary policy.

As to the inflation expectations of the panel of private analysts, it was indicated that, according to the survey made in July 2008, for December 2008 the inflation projection is at 12.42%, which is over the tolerance margin of the policy target (5.5%+/- 1.5 percentage points), which suggests a restrictive monetary policy; and, for December 2009, the inflation projection will be at 9.29%, which is also over the tolerance margin of the inflation target (5.5%+/-1 percentage point), which suggests restricting the monetary policy. Also indicating that the implied inflation expectations variable with data to July 2008, showed an inflationary rhythm of 6.29%, 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 percentage points), which suggests a moderately restrictive monetary policy.

Regarding the Semi-structural Macroeconomic Model (MMS) used in May 2008 to forecast the total inflationary rhythm, this is projected for December 2008 at an inflationary rhythm of 8.62%, 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 7.11%. Also the forecast for said model of a mid-term horizon projected an inflationary rhythm for December 2009 of 6.44%, conditioned to gradual adjustments to the leading interest rate, in the last year at 4.16%.

As to the orientation of the indicative variables, regarding the previous week, it was indicated that the "Parameter Interest Rate" variable went from suggesting a restrictive monetary policy to advising the same be invariable. In that sense, according to the relative weight assigned to the indicative variables, it was reported that 46.15% of the same suggest a restrictive monetary policy orientation (55.97% the previous week), 17.58% a moderately restrictive monetary policy orientation (17.10% the previous week); 9.34% suggest a moderately restrictive monetary policy orientation

(0% the previous week); and 26.93% suggest a relaxed monetary policy orientation (equal percentage the previous week).

On the other hand, they indicated that regarding the behavior of the nominal exchange rate, the upper and lower limits for the estimated runner (according to its seasonality) for the week of August 4 to 8, 2008 were of Q7.757 and Q7.637 per US\$1.00, respectively; and the observed level (calculated as the average of the exchange rate in the Institutional Market of Foreign Currency for the period between August 4 and 7) was of Q7.396 per US\$1.00; with which the observed value of the nominal exchange rate is located below the lower limit of the referred runner.

e) The Director of the Department of Economic Studies informed the Committee of the monetizing and demonetizing factors forecast in the Estimated Monetization Flow for the week of August 8 to 14, 2008, which indicate an excess of primary liquidity for Q2,501.1 million mainly due to the maturity of CDs; if we add the daily banking liquidity position for Q588.5 million and the deviation observed in negative monetary issue for Q462.1 million, resulting in excess aggregate liquidity estimated for the referred period of Q2,627.5 million; if these factors are given, to make a compatible issue offer with the programmed demand, it would be necessary for the CDs that mature during the period (Q2,620.8 million; according to the registry to August 7, 2008) and fund-raise additionally for around Q6.7 million.

f) The Sub-Director of the Department of Monetary Stabilization Operations based on the estimated monetization flow and on the guidelines established for the determination of the quotas for the bidding of term deposits through the commodity exchanges, proposed to the Execution Committee that they be Q10.0 million, Q10.0 million, Q20.0 million and of Q30.0 million for the following maturity dates: September 8, 2008 and December 8, 2008, March 9, 2009 and June 8, 2009, respectively; and the due date of June 7, 2010, without a pre-established quota.

THIRD: Discussion and determination of quotas for Term Deposits.

a) Discussion

The Committee began the discussion of the analysis that must be presented to the Monetary Board in Wednesday, August 20 session when, according to the annual calendar, said licensed body would decide on the level of the leading interest rate of the monetary policy. It was mentioned that the inflationary panorama has become more and more complex. In that sense, in the world economy, although the risks for financial instability and economic deceleration continue latent, the greater risk and

concern is the increase of inflation. The Committee discussed some of the specific factors that could be considered in the balance of inflation risks that the technical departments will present in the next Committee meeting, which are described as follows:

- i. The international price of oil, from August 1 to 7, 2008, on average, was at US\$120.86 per barrel, which means a reduction of US\$12.62 per barrel (9.45%) regarding the average price registered during July 2008 (US\$133.48 per barrel) and an increase of US\$29.12 per barrel (31.74%) regarding the average price to December 2007 (US\$91.74 per barrel). Additionally according to Bloomberg, the price of crude oil for delivery in December 2008 was at US\$119.82 per barrel, on August 7, lower by US\$11.70 per barrel (8.90%) regarding the price prevalent for the same position to July 17, 2008 (US\$131.52 per barrel).
- ii. The international price of corn and wheat continues to be over the levels observed in 2007, so their follow up continues to be relevant in the evaluation for the inflation risks balance. It was indicated that the price of corn reverted its tendency to rise when located at US\$9.84 per quintal on August 7, which means a reduction of US\$2.04 per quintal regarding the price registered during July 2008 (US\$11.88 per quintal) and an increase of US\$2.27 per quintal regarding the price in December 2007 (US\$7.57 per quintal), while the price of wheat on the same date was at US\$10.82 per quintal, representing a decrease of US\$0.72 per quintal regarding the price registered during July 2008 (US\$11.54 per quintal) and of US\$3.67 per quintal regarding that of December 2007 (US\$14.49 per quintal).
- iii. The total inflationary rhythm (14.16%), the subjacent inflationary rhythm (12.32%) and the dynamic subjacent inflationary rhythm (9.43%) to July 2008, continued to be over the upper limit of the tolerance margin determined by the Monetary Board for 2008 (5.5% +/- 1.5 percentage points).
- iv. The econometric projections of total inflation for December 2008 and for December 2009 (11.66% and 8.54%, in that order), as well as with the econometric projections of the dynamic subjacent inflation for December 2008 and December 2009 (8.77% and 7.35%, respectively), are located over the tolerance margin of the inflation target for both years.

- v. The inflation expectations of the panel of private analysts, according to the survey made in July, indicate that the total inflationary rhythm for the end of 2008 and 2009 would be at 12.42% and 9.29%, respectively. They highlighted that although both projections are over the upper limit of the tolerance margin of the inflation target determined for each one of the referred years, the projection for the end of 2008 increased in lesser magnitude regarding the previous months, while for 2009, it decreased regarding the previous month. Said situation could evidence the increase of a moderation period for the inflation expectations.
 - vi. The liquidity conditions in the banking system are positive, situation that is reflected in the amount of liquid resources available (daily position of legal reserve plus the balance of the monetary stabilization operations at 7 day terms), which to August 7, 2008 were located at around Q2,950,0 million.
 - vii. The inter-annual variation of banking credit to the privates sector and of the payment means has been decelerating, located below the lower limit of the estimated runner.
 - viii. The average orientation of the monetary issue and of the broad monetary base (primary liquidity) suggests a restrictive monetary stabilization.
 - ix. The fiscal surplus to July 2008, according to preliminary numbers of the *Ministerio de Finanzas Públicas*, [Roughly equivalent to the Department of State.], was at Q1,364.2 million (equivalent to 0.5% of the GDP), as a result of the increase of total income of 10.6% and of a decrease in total expenses of 1.7%, regarding the same period the year before.
- b) Determination of the quotas for term deposit bidding

Regarding the determination of quotas for bidding on August 4, 2008, the proposal from the Department of Monetary Stabilization Operations was taken into account, that includes the information that provides the estimated monetization flow for the following week and, on the other hand, the guidelines to keep the number of weekly bids. Based on this, the Committee approved the proposal of the technical departments and, therefore, agreed to establish the fund-raising quotas in the following manner: for September 8, 2008, Q10.0 million; for December 8, 2008, Q10.0 million; and, for March 9, 2009, Q20.0 million; June 8, 2009, Q30.0 million; as well as the due date of June 7, 2010, without a pre-established quotas.

FOURTH: Other Matters and Reports.

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