INTERNATIONAL MONETARY FUND

IMF Country Report No. 21/111

GUATEMALA

2021 ARTICLE IV CONSULTATION—PRESS RELEASE; STAFF REPORT; AND STATEMENT BY THE EXECUTIVE DIRECTOR FOR GUATEMALA

June 2021

Under Article IV of the IMF's Articles of Agreement, the IMF holds bilateral discussions with members, usually every year. In the context of the 2021 Article IV consultation with Guatemala, the following documents have been released and are included in this package:

- A **Press Release** summarizing the views of the Executive Board as expressed during its June 9, 2021 consideration of the staff report that concluded the Article IV consultation with Guatemala.
- The **Staff Report** prepared by a staff team of the IMF for the Executive Board's consideration on June 9, 2021, following discussions that ended on May 4, 2021, with the officials of Guatemala on economic developments and policies. Based on information available at the time of these discussions, the staff report was completed on May 19, 2021.
- An **Informational Annex** prepared by the IMF staff.
- A **Statement by the Executive Director** for Guatemala.

The IMF's transparency policy allows for the deletion of market-sensitive information and premature disclosure of the authorities' policy intentions in published staff reports and other documents.

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International Monetary Fund
Washington, D.C.

IMF Executive Board Concludes 2021 Article IV Consultation with Guatemala

FOR IMMEDIATE RELEASE

Washington, DC – **June 11, 2021:** The Executive Board of the International Monetary Fund (IMF) concluded the 2021 Article IV consultation[1] with Guatemala on June 9, 2021.

The pandemic hit Guatemala at a time of macroeconomic stability and firming growth, with robust remittances, soaring investor confidence, and accommodative macroeconomic policies. The economic impact of the COVID-19 shock has been relatively limited given an early reopening of the economy, unprecedented policy support, and resilient remittances and exports. Large-scale government support notwithstanding, already weak social indicators—including on poverty and malnutrition—have further deteriorated following COVID-19 and the two major hurricanes that hit Guatemala in November 2020.

Real GDP is estimated to have contracted by 1½ percent in 2020, showing Guatemala's resilience in a regional comparison, amidst a favorable production and exports mix, resilient remittance inflows, and unprecedented monetary and fiscal policy support. Although temporary factors exercised upward pressures on headline inflation, inflation expectations have remained well-anchored throughout, reflecting soft demand conditions and core inflation. The current account balance increased significantly to 5½ percent of GDP in 2020 (from 2.4 percent in 2019), reflecting resilient remittances and a lower trade deficit due to stronger terms of trade, imports compression, and robust agriculture, food and chemical exports.

The authorities deployed an unprecedented set of macroeconomic policy measures to counter the impact of the pandemic. Fiscal policy promptly supported the economy and the most vulnerable, as the authorities drew on available fiscal space with an overall package of 2.3 percent of GDP to enhance healthcare capacity, secure lifelines, and sustain demand. The central bank lowered the policy rate by 100 basis points (to a historic low of 1¾ percent) and provided additional liquidity to support the payments systems and meet precautionary demand for cash. The monetary board temporarily eased credit risk regulations to facilitate the renegotiation of loans, and allowed banks to record interest from restructured loans on an accrual basis.

Economic activity is projected to expand by 4½ percent in 2021, with leading indicators showing a recovery in the key sectors of commerce, manufacturing, and construction, and a slower recovery in hospitality. The outlook will be supported by the U.S. recovery, powered by the vaccine and the *American Rescue Plan*, and improving prospects in remaining trade partners. Over the medium term, growth is projected to stabilize at its pre-COVID potential rate of 3½ percent by 2023. Near-term inflation is set to converge to the mid-point of the target band (4 +/-1 percent) as supply shocks wane, outweighing inflationary pressures from

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[1] Under Article IV of the IMF's Articles of Agreement, the IMF holds bilateral discussions with members, usually every year. A staff team visits the country, collects economic and financial information, and discusses with officials the country's economic developments and policies. On return to headquarters, the staff prepares a report, which forms the basis for discussion by the Executive Board.

diminishing economic slack. As the pandemic recedes, the current account balance is expected to deteriorate to -0.6 percent of GDP over the medium term due to lower exports growth, improving imports, and an increase in the FDI payout.

Risks to the outlook are tilted to the downside. Slower vaccine rollout and/or new virus strains could prolong the global and domestic recovery. Protracted worsening in poverty and malnutrition could trigger social discontent, and further natural disasters could weigh on the recovery and livelihoods. A premature withdrawal of the financial sector support measures might curtail banks' profitability and credit flow to the recovery. On the upside, a quick resolution to the pandemic, alongside faster-than-expected progress with business reforms, could further lift investment and growth.

Executive Board Assessment[2]

Directors commended the Guatemalan authorities for maintaining sound macroeconomic policies and for implementing a swift and unprecedented policy response to the COVID-19 pandemic, which allowed for an early reopening of the economy. Directors agreed that the near-term outlook is favorable although the recovery hinges on progress in vaccination. They recommended that macroeconomic policies remain supportive in the near term until the recovery takes hold, while guarding against any downside risks from the pandemic. Noting that the pandemic and recent hurricanes have exacerbated Guatemala's long-standing challenges, Directors emphasized the importance of securing more inclusive, sustainable growth, building resilience to natural disasters, and ensuring debt sustainability.

Directors recommended that, as the fiscal stimulus is gradually withdrawn, the authorities scale up much needed social programs and infrastructure expenditure, aimed at reducing poverty and boosting potential growth. To this end, enhancing revenue mobilization and spending efficiency is necessary to expand fiscal space. More specifically, Directors encouraged continued efforts to strengthen tax controls, tackle contraband, and reduce red tape and corruption. They also emphasized the importance of enhancing transparency, governance, the quality of public services, and procurement cost-effectiveness.

Directors agreed that accommodative monetary conditions should continue, provided inflation expectations remain well-anchored. They stressed the need to guard against any unintended consequences from last year's monetization of part of the fiscal deficit. Directors also encouraged the authorities to monitor banks' asset quality closely and remain vigilant to financial stability risks. They looked forward to the prompt passage of the banking law and the revised AML/CFT law, which would enhance financial stability and integrity.

Directors welcomed the authorities' reform agenda to lift potential growth and build resilience, noting that its expeditious implementation would help improve the business climate, foster employment opportunities, and facilitate external rebalancing. Given Guatemala's high risk to natural disasters, they recommended complementing past efforts on climate change mitigation and adaptation with an enhanced disaster risk management strategy and an effective implementation of the emission reduction programs.

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[2] At the conclusion of the discussion, the Managing Director, as Chairman of the Board, summarizes the views of Executive Directors, and this summary is transmitted to the country's authorities. An explanation of any qualifiers used in summings up can be found here: http://www.IMF.org/external/np/sec/misc/qualifiers.htm.

Guatemala: Selected Economic and Social Indicators

I. Social and Demographic Indicators

Population 2020 (millions)	17	Gini index (2014)	48
Percentage of indigenous population (2018)	44	Life expectancy at birth (2018)	74
Population below the poverty line (Percent, 2014)	59	Adult illiteracy rate (2014)	19
Rank in UNDP development index (2019; of 189)	127	GDP per capita (US$, 2020)	4,603

II. Economic Indicators

					Projections	
	2017	2018	2019	2020	2021	2022
	(Annual percent change, unless otherwise indicated)					
Income and Prices						
Real GDP	3.1	3.3	3.9	-1.5	4.5	4.0
Consumer prices (end of period)	5.7	2.3	3.4	4.8	4.5	3.6
Monetary Sector						
M2	8.4	9.4	9.6	18.9	7.8	6.3
Credit to the private sector	3.8	7.0	4.9	6.4	6.8	7.3
	(In percent of GDP, unless otherwise indicated)					
Saving and Investment						
Gross domestic investment	13.6	13.8	14.3	12.9	14.1	14.5
Private sector	12.5	12.2	12.4	12.2	13.4	13.9
Public sector	1.1	1.5	1.9	1.3	1.2	1.1
Gross national saving	14.7	14.6	16.6	18.4	16.5	16.2
Private sector	14.8	14.8	16.8	21.8	18.4	17.7
Public sector	-0.1	-0.2	-0.1	-3.4	-2.0	-1.5
External saving	-1.1	-0.9	-2.3	-5.5	-2.3	-1.7
External Sector						
Current account balance	1.1	0.9	2.3	5.5	2.3	1.7
Trade balance (goods)	-9.5	-10.9	-10.3	-7.6	-9.9	-10.4
Exports	13.5	13.2	12.9	13.5	13.3	12.7
Imports	23.0	24.1	23.2	21.2	23.2	23.1
Of which: oil & lubricants	3.5	4.0	3.8	2.5	3.4	3.2
Trade balance (services)	0.4	0.2	0.1	-0.3	-0.8	-1.0
Other (net)	10.2	11.5	12.6	13.4	13.0	13.1
Of which: remittances	11.4	12.7	13.6	14.6	14.6	14.8
Capital account balance	0.0	0.0	0.0	0.0	0.0	0.0
Financial account balance (Net lending (+))	0.6	0.4	1.3	4.4	2.3	1.7
Of which: FDI, net	-1.3	-1.1	-1.0	-0.9	-1.4	-1.4
Errors and omissions	-0.6	-0.5	-1.0	-1.0	0.0	0.0
Change in reserves assets (Increase (+))	3.6	1.3	2.3	4.1	0.0	0.0

Guatemala: Selected Economic and Social Indicators (Concluded)

Net International Reserves						
(Stock in months of next-year NFGS imports)	6.0	6.5	8.6	9.2	8.8	8.5
(Stock over short-term debt, residual maturity)	1.8	1.9	2.3	3.2	2.5	2.5
Public Finances						
Central Government						
Revenues	11.4	11.3	11.2	10.7	10.6	11.0
Expenditures	12.8	13.2	13.5	15.6	14.0	13.8
Current	10.5	10.6	10.7	12.6	11.2	11.2
Capital	2.3	2.6	2.7	3.0	2.8	2.6
Primary balance	0.1	-0.3	-0.6	-3.2	-1.5	-0.9
Overall balance	-1.4	-1.9	-2.2	-4.9	-3.4	-2.8
Financing of the central government balance	1.4	1.9	2.2	4.9	3.4	2.8
Net external financing	0.2	0.1	1.2	1.7	1.7	0.6
Net domestic financing	1.2	1.8	1.1	3.2	1.7	2.2
Central Government Debt	25.1	26.5	26.5	31.5	32.4	33.4
External	11.4	11.5	11.8	13.5	14.5	14.4
Domestic [1/]	13.7	15.0	14.7	18.0	17.9	19.0
Memorandum Items:						
GDP (US$ billions)	71.6	73.2	77.0	77.6	82.1	86.0
Output gap (% of GDP)	-0.1	-0.2	0.2	-2.1	-0.9	-0.4

Sources: Bank of Guatemala; Ministry of Finance; and Fund staff estimates and projections.

[1/] Does not include recapitalization of obligations to the central bank.

INTERNATIONAL MONETARY FUND

GUATEMALA

STAFF REPORT FOR THE 2021 ARTICLE IV CONSULTATION

May 19, 2021

KEY ISSUES

Context. Guatemala has managed to keep infections and deaths moderate during the pandemic. The economic impact of COVID-19 has been mild given an early reopening of the economy, unprecedented policy support, and resilient remittances and exports. However, despite large-scale government interventions to support households, poverty and malnutrition have deteriorated following COVID-19 and the two major hurricanes battering Guatemala last November.

Outlook and Risks. Real GDP is projected to have contracted by 1½ percent in 2020, followed by a strong recovery in 2021 to 4½ percent, and a stabilization at its pre-COVID potential rate of 3½ percent by 2023. However, the pandemic and recent natural disasters have accentuated Guatemala's social vulnerabilities. Inadequate health coverage, social protection, and employment opportunities have for long led to high poverty and migration rates.

Policy Recommendations. The authorities appropriately provided essential support to households and firms. Facilitating the recovery while fostering inclusive growth will require that:

- *Fiscal policy* scales up in the near-term cash transfers for health, education, and nutrition interventions commensurate with the deterioration in social indicators. Over the medium term, the authorities should create fiscal space to address sizable social and infrastructure needs through improved tax collections, spending efficiency, and disaster risks and debt management.
- *Monetary policy* stays accommodative provided inflation expectations remain anchored. Banguat should sterilize as warranted any excess liquidity from last year's partial monetization of the fiscal deficit.
- *Financial policy* remains supportive while closely monitoring financial stability risks and expediting the passing of the new banking law and AML/CFT bills.
- *Structural reforms* foster legal certainty to attract domestic and foreign investment, and support the recovery through e-commerce and digital services, part-time employment, and efficient insolvency procedures to facilitate firms' reorganization.
- *Disaster risk policies* continue to reduce vulnerability to natural disasters, with a focus on fiscal and infrastructure resilience.

Approved by:
Patricia Alonso-Gamo (WHD) and Anna Ilyina (SPR)

Discussions took place via conference calls during April 19 – May 4, 2021. The staff team comprised Esther Pérez Ruiz (Head), Aleksandra Babii, Jean François Clevy, Carlos Janada and Gonzalo Salinas (all WHD). Metodij Hadzi-Vaskov (Regional Resident Representative), Luis Carlos Ibanez Thomae (Resident Representative Office), Pablo Moreno and Edgar Cartagena (both OED) participated in the discussions. Cristhian Vera and Anaysa Delsid (both WHD) provided research assistance and document management, respectively. The mission held discussions with the President of Guatemala, the Central Bank Governor, the Minister of Finance, the Minister of Health, regulatory and supervisory bodies, other senior officials, private-sector representatives, representatives of diplomatic missions and international organizations, and academics.

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ANNEXES

RECENT DEVELOPMENTS AND OUTLOOK

A. The Pre-COVID-19 Landscape

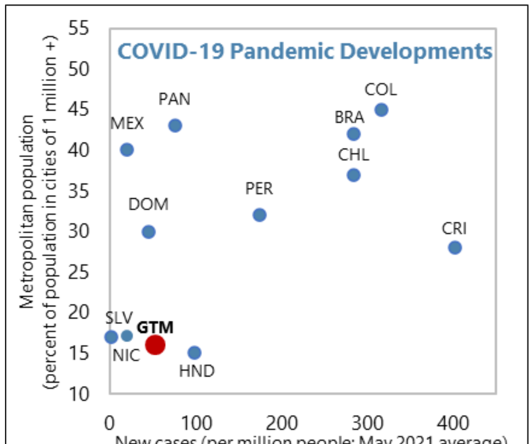
1. **COVID-19 came at a time of macroeconomic stability and firming growth.** Guatemala proved the steadiest economy in Latin America post-GFC (with an average growth of 3½ percent) and economic momentum was strong pre-pandemic. Robust remittances, soaring investor confidence upon the inauguration of Giammattei's administration (January 2020) and accommodative fiscal and monetary policies supported growth while keeping inflation expectations firmly anchored. The external position remained strong and the banking system liquid and well capitalized.

2. **Social development remained a significant challenge pre-COVID**. At 0.1 percent of GDP, social spending was dwarfed by social challenges. The poverty rate was close to 60 percent of the population and one out of five Guatemalans lived in extreme poverty. Basic healthcare covered just about 50 percent of Guatemalans, leaving the poor and rural populations (60 and 46 percent of Guatemalans, respectively) with minimal access to these services. Only 25 percent of the population had access to safe water and sanitation. At 46½ percent, and up to 70 percent in some departments, Guatemala's prevalence of stunting in children under 5 was one of the highest in the world.

3. **The *National Innovation and Economic Development Plan* (*PLANID*) rightly aimed at improving Guatemalans livelihoods.** Broad-based fiscal and business climate reforms pursued the modernization of the public sector for an expanded provision of health and education, and greater competitiveness and employment. And improved accountability and transparency would curb corruption.

B. The COVID-19 Shock

4. **Pandemic infections and deaths have remained relatively moderate despite an early reopening of the economy.** The swift declaration of the *State of Calamity* and associated country-wide curfew, border closures, and suspension of non-essential activities provided necessary containment at the early stages of the outbreak. The early reopening of the economy amid strict biosecurity protocols, effective mask use, and low incidence of megacities, allowed for the recovery to materialize while stabilizing infections, which have remained contained during the latest third wave.



Sources: Population Reference Bureau, John Hopkins University.

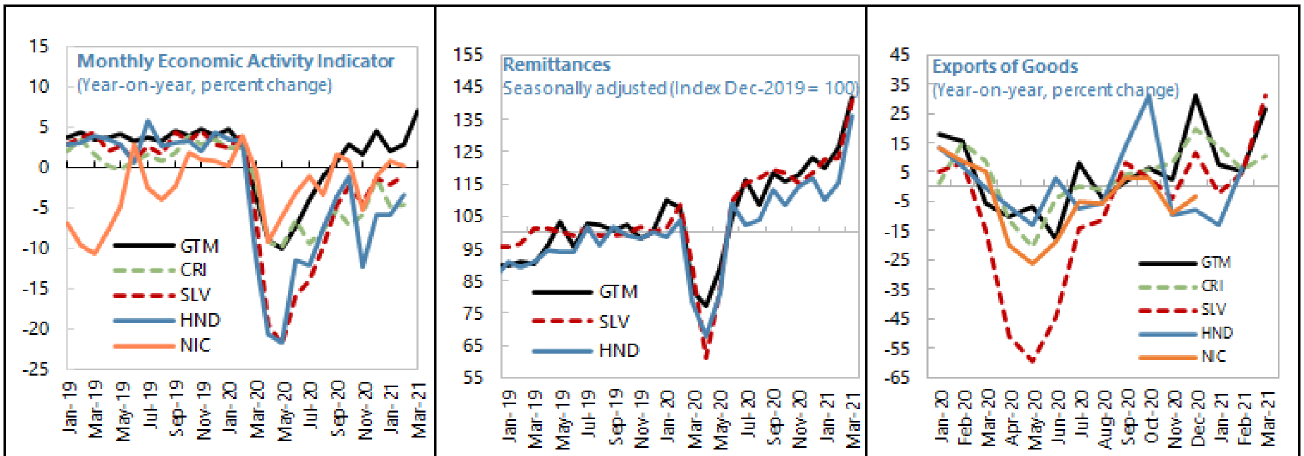
5. **2020 growth proved resilient in regional comparison.** A 4-month strict lockdown and the collapse of external demand weighed on private consumption, investment, and exports. Guatemala's recovery turned around in June and accelerated

during the summer in line with the reopening of the economy (complete by early October), with a jobs' recovery rate of 75 percent as of December 2020. Overall, GDP contracted by 1½ percent in 2020, versus 7.2 percent on average in CAPDR. Guatemala's resilience during the pandemic reflects:

- *A favorable production and exports mix* tilted towards essential agriculture, food and chemical activities—unaffected by lockdown measures and on high demand in international markets. As such, growth in nominal merchandise exports reached 14 percent (y/y) in 4Q2020.

- *Remittances' resilience*. After a sharp decline through May, remittances rebounded strongly posting an annual growth of 7.9 percent (Box 1). With remittances accounting for around 30 percent of households' income and private consumption standing at 85 percent of GDP, remittances helped support growth.

- *Unprecedented fiscal and monetary support*. Already laid out by March 19th, the *National Emergency and Economic Recovery Plan* entailed a comprehensive policy response (¶6, 8).



Sources: National authorities and IMF staff calculations.

6. Fiscal policy promptly supported the economy and the most vulnerable. The authorities drew on available fiscal space to enhance healthcare capacity, secure lifelines, and sustain demand. The scope of the government's interventions is commendable given very low levels of health coverage and social protection pre-COVID.

- *Saving lives and protecting livelihoods*. The authorities (i) ramped up temporary hospitals and medical equipment; (ii) deployed food support and emergency funding for SMEs; (iii) expedited relief to firms through tax credit refunds and the deferral of tax payments and social security contributions; (iv) provided targeted cash transfers (*Family Bonus*), salary subsidies (*Employment Protection Fund*) and firms' loans at favorable terms (*Working Capital Credit Fund*).

- *Unprecedented deployment of cash transfers.* The *Family Bonus* reached almost 80 percent of Guatemalan households, up from 5 percent covered by social transfers pre-COVID. Lacking a public registry of households, the government used electricity bills to identify beneficiaries, rolled out internet and phone platforms to register them, and channeled transfers digitally in a transparent and effective manner.

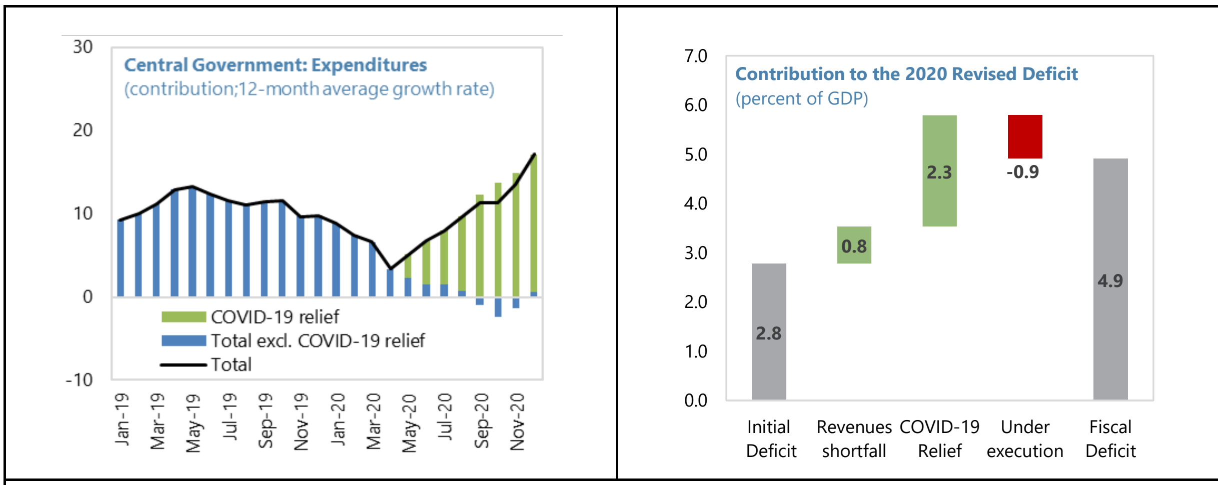
- *Financing swiftly mobilized.* MINFIN mobilized around US$1,900 million in domestic bonds, US$1,400 million in direct bond placements with Banguat, US$1,200 million in Eurobonds, and US$535 million in IFI loans. As a result, public debt increased from 26.5 percent of GDP to 31.6 percent.

Main Economic Measures to Mitigate COVID-19 Impacts

Program	Description
Family Bonus	- Cash transfers through bank account of US$780 million (1.0% of GDP). - Beneficiaries: 2.8 million heads of vulnerable households (electricity consumption below 200 kWh; poor households living with single parent, elderly or malnourished children get prioritized). - Benefits: 3 payments of up to 130 dollar each.
Employment Protection Fund	- Cash transfers to private-sector workers of US$240 million (0.3% of GDP). - Beneficiaries: 191,110 furloughed formal employees in firms with suspended labor contract and regular contribution records. - Benefits: US$10 per day of suspended work.
Working Capital Credit Fund	- Loans at favorable terms of US$300 million (0.4% of GDP). - Beneficiaries: SMEs. - Favorable terms: grace periods and below-market interest rates.
Food Support Program	- Delivering food assistance for around US$90 million (0.1% of GDP). - Beneficiaries: 700,000 households that did not benefit from other transfers. -Benefits: Baskets with 30-day supplies (food, hygiene) at around US$90 each.

Source: Staff based on First General Report of the Republic 2020.

- *Sizable fiscal impulse* of 2.3 percent of GDP due to relief spending and faltering revenues, only partly offset by budget underexecution from lockdown disruptions. In all, the fiscal deficit reached 4.9 percent of GDP.



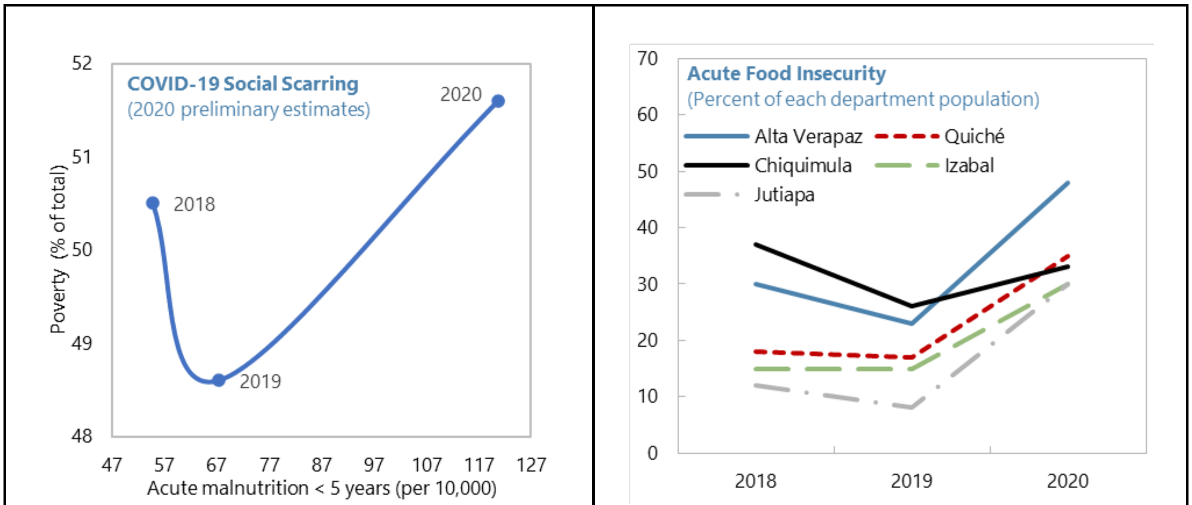
Sources: National authorities and IMF staff calculations.

7. Despite these unprecedented measures, social indicators have deteriorated. The pandemic and the two major hurricanes hitting Guatemala last November, *Eta* and *Iota*, have compounded long-standing social challenges.

- *The pandemic.* Job losses and labor income reductions are estimated to have increased poverty by 3 percentage points during 2020 (UN-ECLAC). Mobility restrictions reduced informal work, and rising food prices might have increased acute malnutrition sharply by 80 percent, to about

120 children under 5 per 10,000 population (preliminary data). In parallel, the pandemic has lowered the provision of basic health services.

- *The hurricanes.* While their growth impact is expected to be limited (0.2 percentage point at most in 2020), the overall infrastructure damage, foregone income and additional costs are estimated at almost 1 percent of GDP. Furthermore, the hurricanes battered the poorest regions with a large share of indigenous communities, overall affecting livelihoods of 311,000 people and fueling migration.

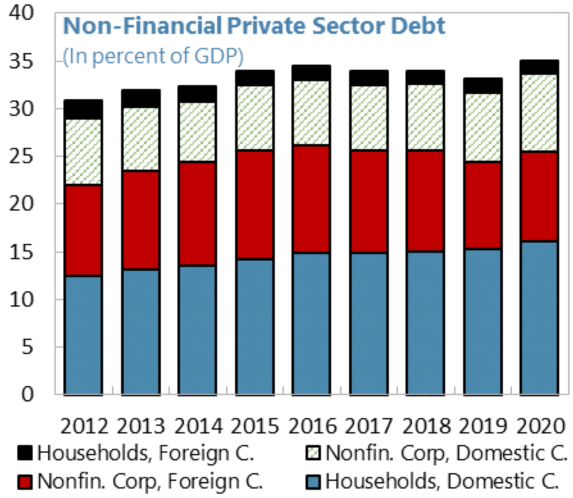


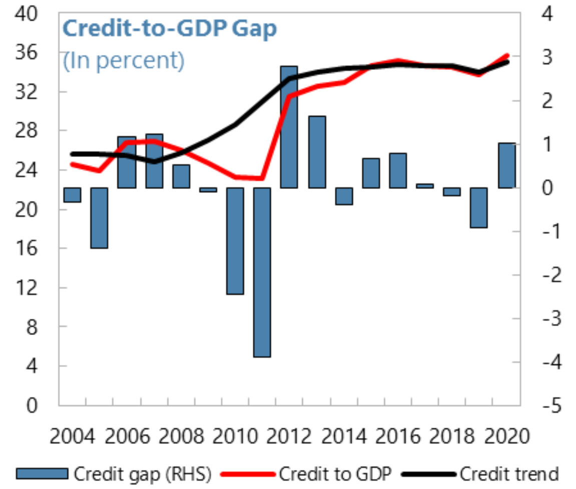
Sources: National authorities, ECLAC and IMF staff calculations.

8. The authorities eased monetary policy, provided additional liquidity, and facilitated loan restructuring. Banguat lowered the policy rate by 100 basis points (to a historic low of 1¾ percent) and provided additional liquidity to support the payments systems and meet precautionary demand for cash. The monetary board temporarily eased regulations to facilitate the renegotiation of past-due loans (with no detriment to their credit risk classification), redefine default from 90 to 180 past-due days, and allow banks to record interest from restructured loans on an accrual basis.

9. Credit conditions turned moderately accommodative as a result. Private credit slightly accelerated to 6.4 percent (y/y) in 2020, from 4.9 percent (y/y) in 2019, bringing the credit-to-GDP *gap* to positive territory as nominal output shrank. By type of borrower, loans to large corporates, consumer loans, microcredits and mortgages all grew, whereas loans to small corporates contracted marginally. 26.2 percent of banks' credit portfolio (9.7 percent of GDP) were restructured under regulatory forbearance, of which 15.7 and 35.4 percent consumer loans and loans to corporates, respectively. Private sector debt levels remain moderate at about 38 percent at end-2020, with firms and households contributing to total debt in about equal proportions.

Guatemala: Total Credit and Private Sector Indebtedness





Sources: IMF Integrated Monetary Database, IMF Financial Access Survey, and IMF Staff estimates.

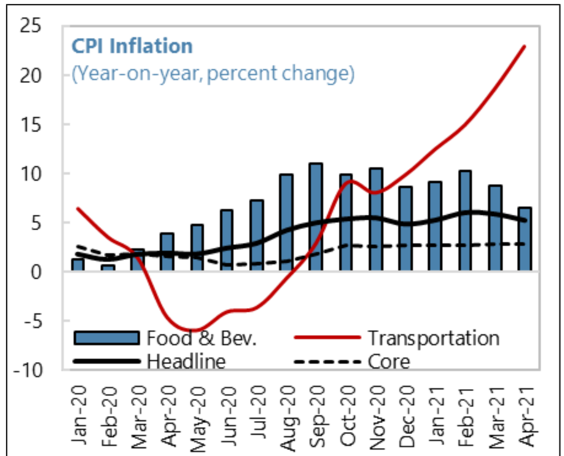
C. Outlook and Risks to the Recovery

10. The near-term outlook is positive. Staff projects growth of 4½ percent in 2021, with leading indicators showing a recovery in the key sectors of commerce, manufacturing, and construction, and a slower recovery in hospitality (accounting for just 3 percent of GDP). The outlook will be supported by the U.S.' recovery, powered by the vaccine and the *American Rescue Plan*, and improving prospects in remaining trade partners. Domestically, the continued recovery in employment, sustained monetary accommodation, and initially planned vaccination coverage of about 60 percent of the population this year, are expected to lift consumption and investment.

11. Efforts are needed to raise medium-term growth. Given Guatemala's relatively low exposure to contact-intensive industries, and resilient agro-industrial exports and remittances, growth is expected to stabilize at its *pre*-COVID potential rate of 3½ percent by 2023 (closing the output gap by 2025).[1] However, pre-existing social and infrastructure needs due to inadequate government revenue and business climate conditions, alongside the deterioration of poverty and malnutrition during the pandemic, underscore the need to lift potential growth through greater provision of public health and education and pro-business reforms that spur foreign and domestic investment—both declining as a share of GDP over the past decade.

[1] Staff's estimated GDP loss amounts to about 3½ percent by 2025 relative to pre-COVID levels.

12. Temporary inflationary pressures are expected to abate. Local supply constraints and precautionary hoarding of basic foods in early stages of the pandemic, higher transportation fares from costly biosecurity protocols, and logistic disruptions following *Eta* and *Iota,* pushed inflation to the upper bound of the target band for most of 2H2020. Inflation expectations have remained well anchored throughout, consistent with soft demand conditions and core inflation. Near-term inflation is set to converge to the mid-point of the target band (4 ± 1 percent) as supply shocks wane, outweighing inflationary pressures from diminishing economic slack. Staff's baseline scenario presumes, as intended by Banguat, the sterilization of any excess liquidity stemming from the partial monetization of the 2020 fiscal deficit.



Source: INE; staff calculations

13. The external position was substantially stronger than the level consistent with medium term fundamentals and desirable policies in 2020.

- *Current account (CA) recent developments*. The CA balance increased significantly to 5.5 percent of GDP in 2020 (from 2.4 percent in 2019) reflecting resilient remittances and a lower trade deficit from stronger terms of trade, imports compression, and robust agriculture, food and chemical exports. As the pandemic recedes, the CA is expected to deteriorate to -0.6 percent of GDP over the medium term due to lower exports growth, improving imports, and an increase in the FDI payout.

- *CA trend developments*. The REER has appreciated by 37 percent cumulatively over the past decade. In parallel: (i) growing remittances have outweighed the deterioration in the trade balance; (ii) exports and imports shares in GDP, and trade openness[2] have all declined; and (iii) the consumption (investment) share in GDP has fallen (increased).

- *EBA CA assessment*. The EBA CA methodology suggests a CA norm of -4.0 percent of GDP in 2020 reflecting Guatemala's relatively low output per worker and youth population. As in the 2019 AIV, staff estimates Guatemala's CA norm at -2 percent of GDP, once relatively weak security conditions discouraging investment are accounted for (Annex I). Even so, the CA norm remains below the debt stabilizing CA deficit of -0.9 percent, which would lead to the deterioration of the NFA position and build-up of external vulnerabilities, not least because the business climate is not conducive to FDI. The corresponding CA gap of 7.1 percent of GDP[3] implies a REER undervaluation of -69 to -49 percent (compared with -26 to -10 percent at the time of the 2019 AIV). While the REER appreciation may be effective at closing the CA

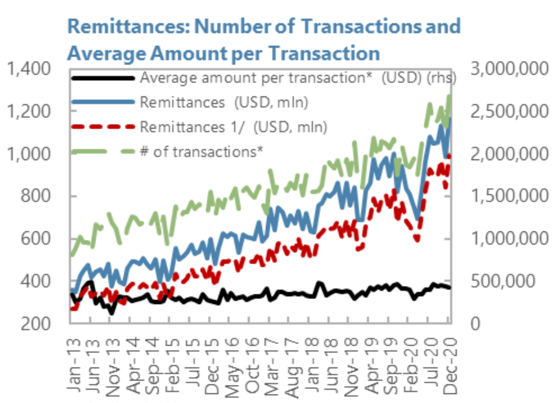
[2] Measured as a share of gross external trade in GDP.

[3] The estimate of CA gap incorporates cyclical contributions as well as COVID-19 related factors (Annex I).

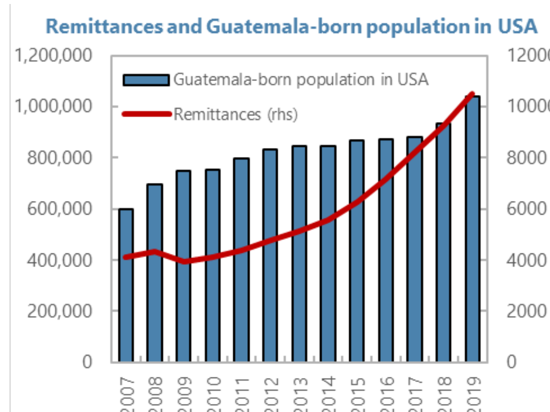
gap, it may further worsen the trade balance. In this context, structural and fiscal reforms that improve business conditions and increase productivity are essential to attract investment, decrease migration and remittances inflows, and support closure of the CA gap over the medium term.

Box 1. Remittances as a Stabilizing Source of Income During the Pandemic

Pre-COVID, remittances had been growing steadily in Guatemala, increasing from 8 percent of GDP in 2002 to 13.7 percent in 2019, overweighting the trade deficit and expanding the CA surplus. Mostly originating from migrants to the U.S., remittances have helped reduce inequality and poverty through investments in human and physical capital[1]. However, their impact on growth has likely been muted once REER appreciation effects and declining trade openness, are accounted for. Remittance growth was predominantly driven by a boost in the number of transactions—likely reflecting a growing flow of migrants from Guatemala to the U.S. over time—while the average amount remitted per transaction remained stable around US$333.



Source: National Authorities.
1/ Data covers four largest financial institution that transfer remittances.



Sources: ACS, Haver, and IMF staff calculations.

Remittances have proved resilient during the pandemic. Despite a sharp decline in remittances between March and May, remittances rebounded in the second half of the year and overall achieved a yearly growth of 7.9 percent in 2020, supported by a higher number of transactions while the average amount remitted remained, on average, below 2019 level.

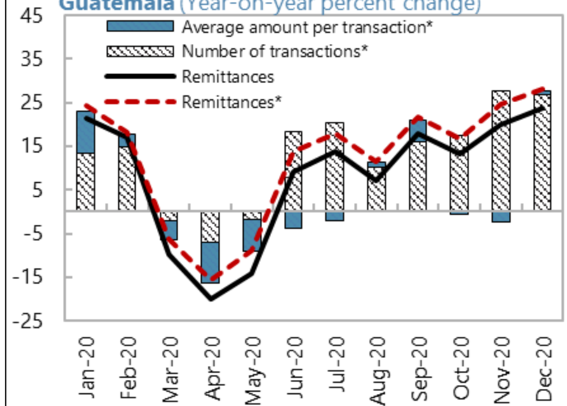
[1] Adams Jr, R. H., Cuecuecha, A. (2010). Remittances, household expenditure and investment in Guatemala. World Development, 38 (11), 1626-1641.

Box 1. Remittances as a Stabilizing Source of Income During the Pandemic (concluded)

Remittances' resilience reflects differing economic conditions in the U.S. and Guatemala and strengthened migrants' solidarity.

Historically, a 1 percent improvement in U.S. building permits (proxy for U.S. economic conditions given the large share of Guatemalan migrants working in the U.S. construction sector) is associated with an increase in remittances by 0.47 percent. A 1 percent worsening of agricultural activity in Guatemala (key employment sector in rural areas where most migrants come from) is associated with an increase in remittances flows by 0.57 percent. *Remittances developments in 2020* are broadly consistent with the model. Furthermore, there is some evidence that U.S. income relief measures under the CARES Act, and heightened solidarity of Guatemalan migrants to support the livelihood of their families, are behind remittances' strength during the COVID crisis.[2]

COVID-19 Pandemic and Remittances Inflow to Guatemala (Year-on-year percent change)



Source: National Authorities. * - data covers four largest financial institution that transfer remittances.

Dependent variable	Remittances
U.S. Hispanic unemployment rate	0.96
Building permits	0.47***
IMAE Agriculture	-0.57***
Remittances (lagged)	-0.28***

All variables are measured in m/m growth rates. Data from 2001M1 until 2019M12. Economic conditions are measured by building permits and Hispanic Unemployment in the U.S., and agriculture activity in Guatemala.

Remittances are expected to normalize in 2021 as temporary support factors in 2020 wear off. Such factors include: (i) the official U.S. pandemic support, (ii) higher transfers of funds to migrants' families as economic and health conditions deteriorate in Guatemala, (iii) transfers of migrants' savings to home countries due to the fear of repatriation.

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[2] IMF. (2019). Annex IV. External Adjustment to Terms-of-Trade Shocks Guatemala. 2019 Article IV Consultation – Press Release and Staff Report, 49-51.

14. **Risks to the outlook are tilted to the downside**. Slower vaccine rollout and/or new virus strains could draw out the global and domestic recovery. Protracted worsening in poverty and malnutrition could trigger social discontent, and further natural disasters could weigh on the recovery and Guatemalans' livelihoods. A premature withdrawal of the financial sector support measures (before the recovery firmly takes hold) might curtail banks' profitability and credit flow to the recovery. On the upside, a quick resolution to the pandemic, alongside faster-than-expected progress with business reforms, could further lift investment and growth (RAM Annex II).

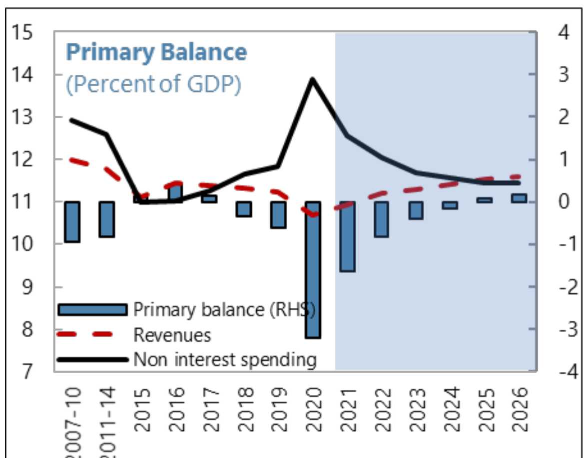
POLICY PRIORITIES

To support the recovery, staff recommends maintaining monetary accommodation and targeted fiscal support to tackle increased poverty and malnutrition, while gradually unwinding credit support measures. Over the medium term, the authorities should create fiscal space to durably raise social and infrastructure spending.

A. Fiscal Policy

15. The authorities are envisaging a gradual withdrawal of the fiscal stimulus. Amid lack of Congress approval of the 2021 Budget, the government is working with the 2020 nominal target for revenues, or 9.9 percent of GDP, and an envisaged spending envelop of 14 percent of GDP. Fiscal support will shift from providing lifelines during the lockdown and reopening phases to supporting the recovery and improving social indicators. The implied deficit of 3.4 percent of GDP deviates by about 1½ percentage points from the historical mark of 2 percent—to be attained gradually by 2026. Financing needs are expected to be met primarily with a mix of domestic bonds, Eurobonds, and IFIs loans.[4] Public debt is projected at 34 percent of GDP on average during 2021–26 and deemed sustainable (Annex III).

16. The overall fiscal stance in 2021 is appropriate and the authorities should persevere in their efforts to prioritize social and infrastructure spending. Ongoing efforts to reshuffle spending, given the lack of Congress approval of the 2021 Budget, should aim for (i) an increase in cash transfers (for education, health, and nutrition) commensurate with the deterioration in social indicators, drawing on improvements during the pandemic on targeting and enrollment (i.e., *Social Registry of Households*) while enhancing transparency via payments digitalization; (ii) enhanced provision of education through virtual or in-person learning, which is critical to prevent human capital losses; (iii) stepped up public investment that catalyzes private investment amidst prevailing uncertainties and the low-interest rate



Source: MINFIN; staff estimates.

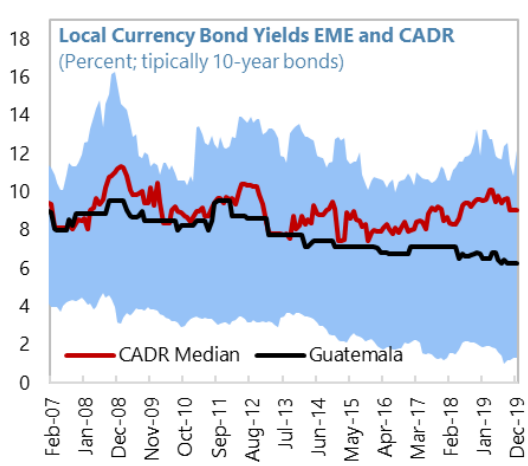
[4] Staff's baseline scenario excludes Guatemala's approved RFI of US$594 million. During the AIV mission, the authorities reiterated their intent to pursue Congress' approval to draw the RFI before it expires, although the likelihood of a purchase was deemed low. Delays with the processing of the RFI Law Initiative to comply with the national legislation, Guatemala's aversion to external debt, and available domestic financing, underly the undrawn RFI.

environment. Should social indicators worsen beyond expectations, staff recommends using the available fiscal space to expand the coverage of cash transfer programs (Annex III).

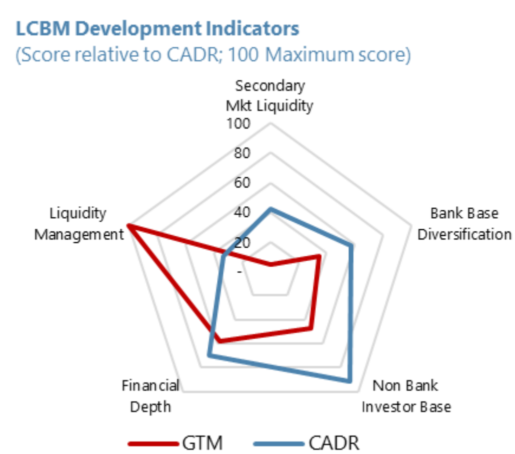
17. As the recovery becomes entrenched, the authorities should raise overdue social and infrastructure spending as a matter of social cohesion and economic success. Guatemala's low indebtedness provides fiscal space, although a narrow tax base somewhat limits debt carrying capacity. As the economy operates near its potential, fiscal policy should thus aim at a broadly stable debt-to-GDP ratio to guard against any unexpected shocks while raising necessary social and infrastructure spending. To reconcile these two goals, it is essential to enhance revenue mobilization and spending efficiency (¶18, 20), and more effectively manage natural disasters risks (Box 4) and public debt. Fostering the development of the domestic debt market is key to allow for more stable and cost-effective budgetary funding, especially amid volatile external financing conditions (Box 2).

Box 2. Financing the Recovery: Enhancing the Local Currency Bond Market (LCBM)

Guatemala's public debt metrics have benefitted from fiscal prudence. In 2020, the debt-to-GDP reached 32 percent, of which 18.3, 7 and 6.7 percent of GDP were domestic bonds, Eurobonds, and external bonds respectively. With external financing being, on average, 250 basis points cheaper than domestic financing, Guatemala has maintained a regular presence in international markets (EMBI spread of 263 in 2020) offering 10- to 30-year instruments. Domestically, the Ministry of Finance has sought to extend maturities from 1- to 3-year term instruments to 20-year treasury bonds, standardize and dematerialize securities, conduct regular auctions throughout the year, and coordinate with Banguat on amounts and maturity issued. Long-term domestic bond yields have steadily converged towards the emerging markets median.



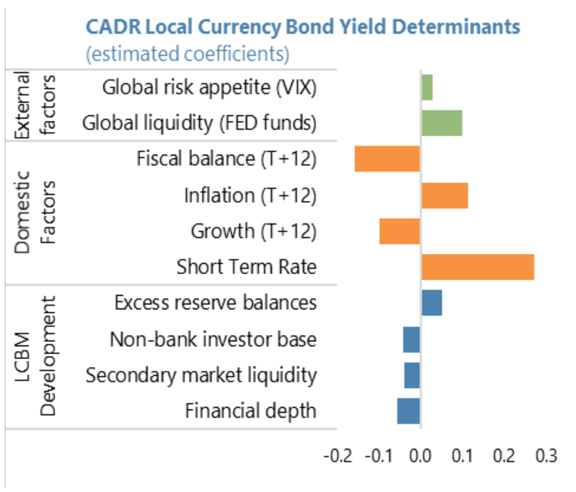
Sources: JP Morgan GB Index, SECMCA, staff calculations.
Note: Shading represents 10-90th percentile of the distribution of domestic bond yields in EMEs.



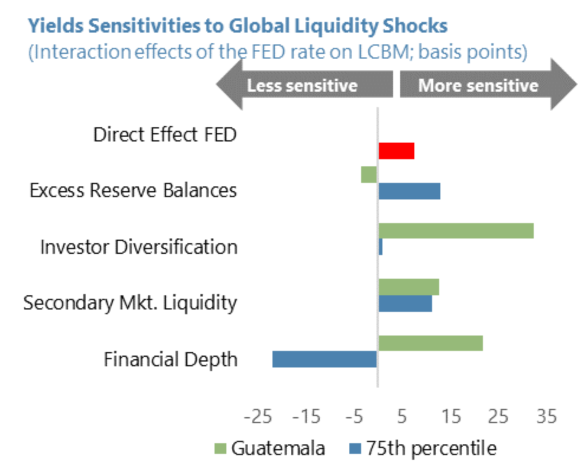
Sources: National authorities, staff calculations.

Box 2. Financing the Recovery: Enhancing the Local Currency Bond Market (LCBM) (concluded)

Enhancing the LCBM could lower borrowing costs and provide more stable budgetary resources. In line with available evidence for emerging market economies (e.g. GFSR, 2014), staff estimates based on panel data for the 6 CADR countries suggest that further financial deepening (larger and/or more diversified investor base) and liquidity in LCBM are associated with lower yields and exposure to global shocks.[1] On average, an increase in (i) financial depth of 1 percent of GDP reduces bond yields by 5 bps, (ii) traded volumes in the secondary market of 1 percent of the outstanding public debt reduces bond yields by 4 bps; (iii) the non-bank participation share of 1 percent reduces bond yields by 4 bps; and (iv) a decrease in banks' excess reserve balances of 1 percent of total deposits brings down financing costs by 5 bps. Staff also finds that greater investor base diversification and financial depth could save up to 30 and 45 basis points in treasury bond yields, respectively, following a 100 basis point increase in the Fed funds rate.[2]



Sources: SECMCA, EIU, Staff calculations.



Sources: SECMCA, EIU, Staff calculations.

The dataset compiles indicators of local currency bond market development in Costa Rica, Dominican Republic, El Salvador, Guatemala, Honduras and Nicaragua (monthly, 2007-2019). These indicators comprise the depth of the financial market (assets as percent of GDP), the liquidity of the secondary market (turnover ratio), the diversification of the investor base (non-bank investor base) and the excess liquidity in the money market (banks' excess reserve balances).

To capitalize on these benefits, the authorities should further develop the LCBM. Priorities include (i) passing the new Securities Market Law to modernize debt management and diversify the investor base; (ii) publish a Medium-Term Debt Strategy/Annual Borrowing Plan to enhance transparency and predictability; (iii) place instruments on a wide maturity spectrum to expand investment alternatives while using liability management to mitigate refinancing risks; (iv) further enhance coordination between debt management and monetary policy to reduce market segmentation, increase treasury bond liquidity, and secondary market trading.

[1] Control variables for domestic macroeconomic conditions (one-year-ahead expectations) and external environment (liquidity and risk appetite) resulted significant and with the expected signs.

[2] Panel estimation results using interaction effects on the Fed funds rate and LCBM indicators. Savings from benchmarking Guatemala's development indicators with those of the 75th percentile across the sample.

18. Spending efficiency and fiscal transparency efforts can help free up resources and enhance public finances. The authorities' intent to expand the provision of public services in a cost-effective manner is timely in the pandemic context. Welcome measures under the *PLANID* include an *e-government strategy* to reduce red tape and exposure to corruption and the recent approval by Congress of the *Administrative Simplification Law*. Ongoing efforts to improve fiscal transparency—via information portals on the use of COVID-related programs, external loans, NGOs, trusts—should be complemented with the financial strengthening of the Comptroller General's Office. The authorities should pursue long-awaited fiscal structural reforms, notably: (i) a reform of laws on civil service and salaries to align compensations with an effective provision of public services and to promote recruitment based on merit; (ii) an integral reform of the procurement law to reinforce transparency and accountability of public spending, and ensure an adequate balance between agility and competition; (iii) enhancing public investment management through multi-year budgeting; and (iv) strengthening results-based budget management with medium- and long-term planning.

19. The authorities should persevere in their anti-corruption efforts. Following the termination of UN-backed International Commission against Impunity in Guatemala (CICIG) in 2019, the authorities kept strengthening the Attorney General's Office (AGO), including through two IFIs loans of US$360 million, and extended its territorial coverage. There is also further scope to fortify the investigative and prosecutorial competences of the AGO, and to reduce the judicial backlog.

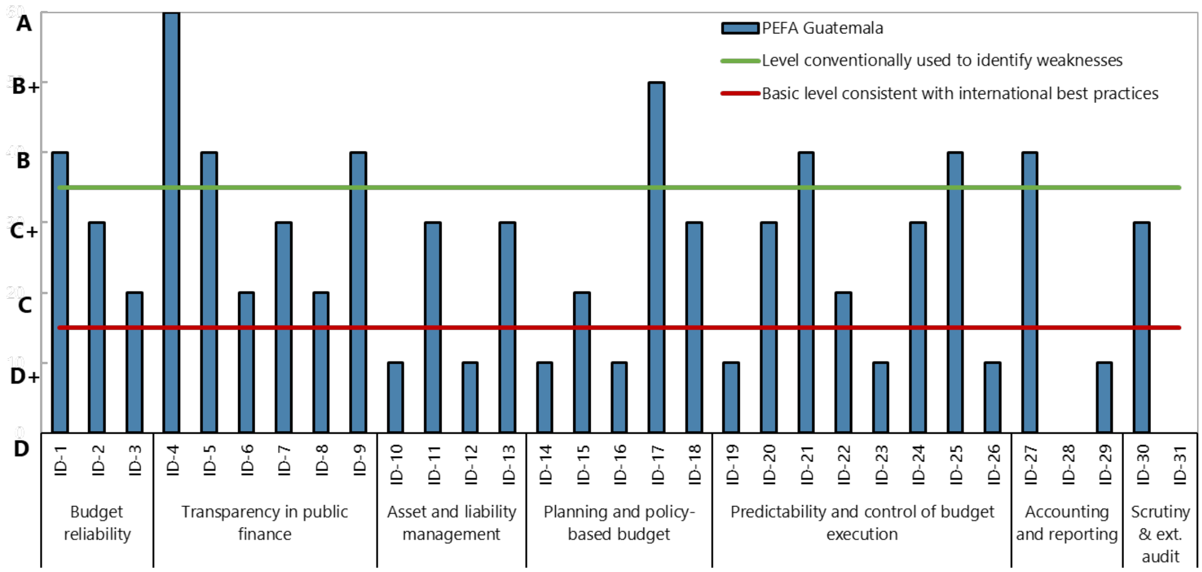
Box 3. Strengthening Public Finance Transparency and Governance

Guatemala's public finance management (PFM), which is broadly aligned with international good practices, needs to be further strengthened. About two thirds of indicators under the Public Expenditure and Financial Accountability (PEFA, 2018) Assessment are in line or above the basic levels required by international good practices. Nonetheless, the PEFA assessment highlights areas for improvements in about ¾ of its indicators, notably in the areas of (i) management of assets and liabilities (expansion of single Treasury account to decentralized institutions, automation of payments), (ii) control of budget execution, (iii) external scrutiny and auditing, (iv) accounting and reporting (automation of registration processes) and (iv) policy-based budgeting (availability of financial programming and forecasting model). The pandemic makes it more important to enhance transparency in the use of resources.

Building on progress in recent years, it is essential to keep enhancing control in budget execution, including public procurement (PEFA pillar V). While over 80 percent of the value of public procurement was contracted under non-competitive procurement practices a decade ago (such as single source or emergency procedures), the authorities have sought to improve efficiency, control and transparency through procurement reforms in recent years, resulting in over half of total procurement conducted competitively by 2018. Some of the major steps in this area included: (i) the use of reverse auction as procurement method; (ii) an increase in use of competitive procurement processes; (iii) the creation of a Vice Ministry for Transparency; (iv) the use of a centralized, web-based registry; and (v) improvements in the national procurement platform. There is a need to enhance the system for processing complaints and appeals related to public procurement, as highlighted by the latest PEFA.

Box 3. Strengthening Public Finance Transparency and Governance (concluded)

The authorities have taken several measures to enhance the transparent use of resources (PEFA pillar V), **including those related to Covid-19.** The Ministry of Finance publishes overall expenditures in a fiscal transparency portal (https://transparencia.minfin.gob.gt/), including open data (https://datos.minfin.gob.gt/). It also administers and regulates the State Procurement System through the *Guatecompras* portal (https://www.guatecompras.gt/), used to buy public goods and services, and to disseminate all procurement contracts, including Covid-19-related. *Guatecompras* provides details on all purchases by the general government, key information on competition rules and requirements, the list of awarded companies and the amounts paid. *Registro General de Adquisiciones del Estado* (https://rgae.gob.gt/) publishes the names of the beneficial owners of each awarded company. In addition, the Comptroller General is in charge of supervising the negotiations and the implementation of Covid-19 contracts (https://www.contraloria.gob.gt/).

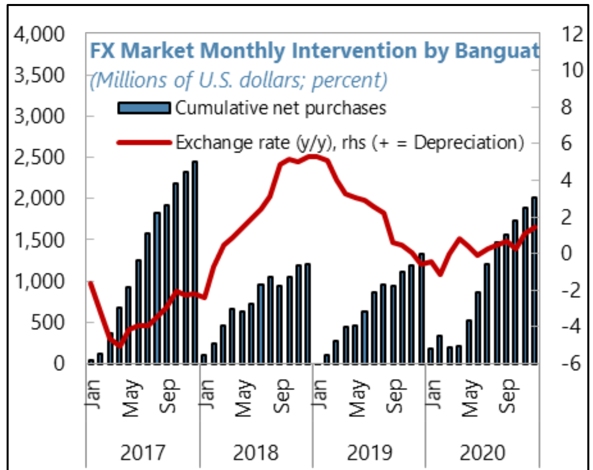


20. Revenue mobilization should be scaled up substantially post-pandemic. Significant imports compression, and related VAT receipts, explain most of the ½ percent of GDP decline in revenues last year, from an already historical low of 11.2 percent of GDP in 2019. Greater management continuity at the tax agency and improvements in voluntary compliance—through, e.g., a dispute resolution mechanism—are welcome. Improved interagency coordination against contraband is bearing fruit and should be underpinned by a robust regulatory framework. Priority areas for the tax agency include (i) rationalizing tax exemptions; (ii) strengthening the clearance process and imports valuation controls in customs; (iii) enhancing the control of medium and large tax payers, and those under special tax regimes; (iv) implementing a comprehensive plan on VAT credit control; (v) updating the taxpayer register; and (vi) automatizing core revenue administration processes.

B. Monetary Policy

21. Monetary policy should remain accommodative to guard against downside risks from the pandemic. At 1.75 percent, the monetary policy rate is about 220 basis points lower than what a neutral stance would imply. Unprecedented monetary easing should continue provided inflation expectations remain anchored. Under staff's baseline scenario, inflation is expected to ease as pandemic-related shocks wane (¶12), overweighing inflationary pressures from the normalization of oil prices and the output gap. Furthermore, inflationary risks are tilted to the downside given prevailing uncertainties about the recovery.

22. The current account surplus and FX intervention by Banguat improved reserve adequacy. Banguat's net purchases amounted to US$2,010 million in 2020 with a sizable acceleration between May and August 2020 and following decline towards the end of the year. This represents a sizable increase compared to US$1,329 million in 2019 (1.7/2.9 percent of GDP in 2019/2020). The FX measures taken by Banguat to improve reserve adequacy were appropriate given disorderly market conditions in the early stages of the pandemic, protracted uncertainty, and Guatemala's vulnerability to climate risks, as evidenced by two major hurricanes hitting the country last November. Nonetheless, the quetzal has been considerably more stable than other currencies in the CAPDR region in 2020, largely reflecting Banguat's intervention policy.[5] Allowing two-way FX flexibility is important to stimulate market finance development and support de-dollarization efforts.



Sources: Banguat and IMF staff calculations.

23. Banguat should remain vigilant to avoid any unintended consequences of last year's monetization. Potential credibility and inflationary risks from the partial monetization of the fiscal deficit in 2020 (¶6) have been contained thus far, as evidenced by well-anchored inflation expectations. The one-off nature of monetization to finance measures to protect the most vulnerable, and its compliance with Constitutional law for emergency circumstances, are likely behind this positive outcome. As in the rest of the CAPDR region, money growth accelerated significantly (to 18 percent y/y in December 2020, from 9½ percent on average over 2010–19), although active monetary operations by Banguat alongside increased precautionary savings have so far prevented inflationary pressures, with core inflation remaining consistently below 3 percent. Going forward, Banguat should continue to closely watch monetary aggregates and neutralize any excess liquidity as warranted.

C. Financial Sector Policy

24. The banking sector seems to have weathered the crisis so far. The banking system's capitalization remains above the regulatory level (16.1 and 10 percent of risk weighted assets, respectively) and liquid assets covered 72½ percent of short-term liabilities in 2020, compared to 71 percent in 2019. With over ¼ of banks' loan portfolio under credit moratoria, and a temporary shift from cash to accrual basis for interest payments, NPLs declined on aggregate (to 1.9 percent last

[5] Guatemala's *de facto* exchange rate arrangement is classified as crawl-like.

year from 2.2 percent in 2019) and across all borrower types. In parallel, ROE profitability was eroded (from 17.9 percent at end-2019 to 16.1 at end- 2020), reflecting cautious provisioning (194 percent at end-2020 versus 137.9 percent at-end 2019) in anticipation of possible deterioration of loans quality.

25. Banks may need to use their buffers as regulatory forbearance is phased out. Credit moratoria granted to impaired customers could mask the actual increase in NPLs, which might rise once these moratoria are lifted. The authorities' exit strategy foresees the gradual normalization through September of the default period (to 90 past-due days from 180 days currently), gradual recognition through September in expenses of all interests accrued but not paid, and a return to cash basis for interest revenues as of January 2020. As these exceptional measures started to be phased out in 1Q2021, NPLs remained broadly stable, and banks' capital positions and profitability healthy. Staff stress tests (Annex V) indicate that the banking sector is resilient to severe scenarios and could withstand significant shocks as normalization unfolds. Although staff overall deems risks to financial stability as moderate, the SIB should continue to closely monitor NPLs and engage with banks to ensure early intervention and maintain financial stability; even more so if downside risks materialized.

26. The adoption of FSAP recommendations would help enhance financial stability and integrity post-COVID. The adoption of the bill on banks and financial groups, currently in Congress, would align national legislation with Basel III standards for capital requirements and the bank resolution framework. The passage of the draft AML/CFT law, also in Congress, would align with FATF standards, notably on the adoption of a risk-based approach, a sound sanctioning regime for noncompliance, and greater protection for supervisors. Ensuring transparency on the ultimate beneficial ownership of corporate vehicles (by e.g. keeping up-to-date the corporate registry and facilitating its access) is also needed to tackle money laundering and corruption.

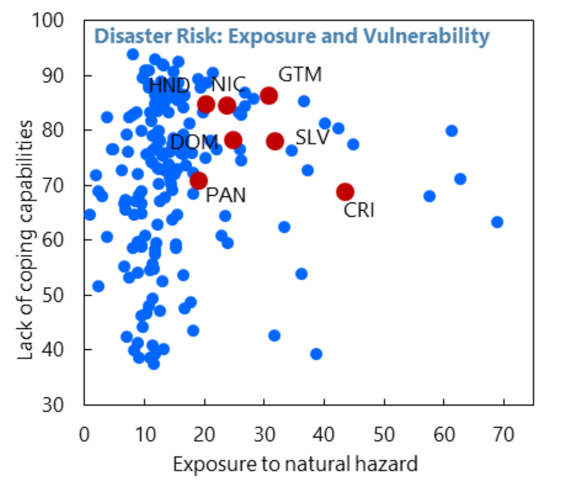
D. Unlocking Potential Growth and Building Resilience

27. Undertaking business and labor market reforms during the recovery would lift potential growth. The authorities' *Economic Recovery Plan* rightly aims at improving the business environment and labor market flexibility. To support the recovery, the authorities should prioritize measures to promote e-commerce and digital services, and new regulations to facilitate formal part-time employment and firms' reorganization through efficient insolvency procedures. A new legal framework to modernize road infrastructure management, catalyze private funding for connectivity and logistics, and increase legal certainty for large-scale projects, is key to stimulate domestic and foreign investment.

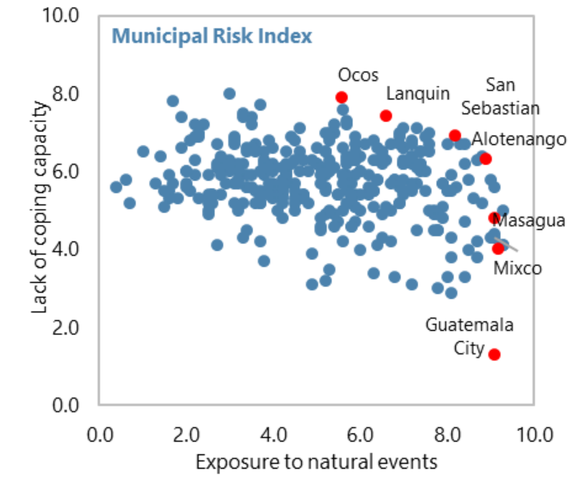
28. The recent major hurricanes *Eta* and *Iota* have brought to the fore the need to strengthen Disaster Risk Management. Highly exposed to climate events, natural disasters in Guatemala are macro-critical and disproportionately affect the most vulnerable (Box 4). The authorities' past efforts to lay the legal foundations for climate change mitigation and adaptation should be complemented by *i*) an effective implementation of its e*missions reduction programs*, and *ii*) a financial strategy to enhance fiscal and infrastructure resilience to natural disasters.

Box 4. Managing Climate Change Risks to Support Resilience and Sustainable Growth

Guatemala is highly vulnerable to climate risks and geophysical hazards. Situated in the conjuncture of three tectonic plates and in the inter-tropical convergence zone, the country is highly exposed to earthquakes, volcanic activity, hurricanes, floods, and other extreme weather events. Along its *Dry Corridor*, severe droughts are recurrent during *El Niño* phenomenon. As such, Guatemala is placed 10th in the world ranking[1] of countries most vulnerable to natural disasters, with climate change compounding its frequency and severity. The landfall of *Eta* and *Iota* in November 2020 is a case in point.

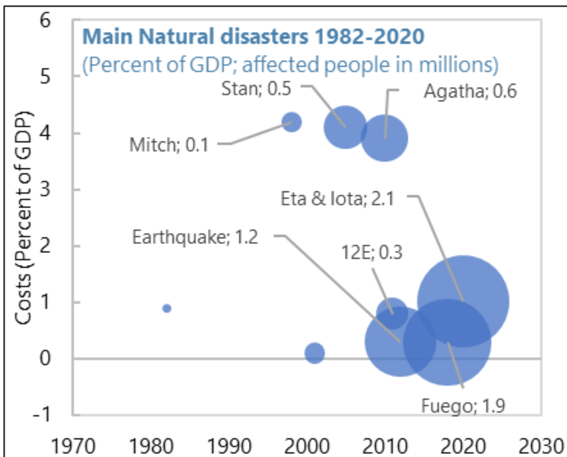


Source: UNU, Institute for Environment and Human Security.



Source: INFORM Guatemala (2017).

Climate risk is macro-critical for Guatemala, and disproportionately affects the poor. With an average cost of 1.7 percent of GDP per event over the past four decades, natural disasters have dented growth, depleted fiscal buffers, and crowded out scarce resources for social spending. Guatemala's dependence on agriculture (accounting for almost 24 percent of GDP and employing 72 percent of the population in extreme poverty, including economic linkages) makes it highly sensitive to climate change.[2] Furthermore, climate events disproportionately affect the vulnerable populations that usually live in high-risk, poor-infrastructure areas. For example, tropical storm *Agatha* reduced households' per capita consumption by 5½ percent and increased poverty and child labor force participation by 18 percent and 3.1 percentage points, respectively.[3]



Sources: ECLAC, World Bank.
Note: Bubble size represents affected people (also in labels).

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[1] 2020 WorldRiskReport.

[2] Sistema Guatemalteco de Ciencias del Cambio Climático, 2019, "Primer reporte de evaluación del conocimiento sobre cambio climático en Guatemala".

[3] Baez, J., L. Lucchetti, M. Genoni, M. Salazar, 2015, "Gone with the Storm: Rainfall Shocks and Household Well-Being in Guatemala", World Bank.

Box 4. Managing Climate Change Risks to Support Resilience and Sustainable Growth (concluded)

Efforts are ongoing to enhance climate change mitigation. While Guatemala's share of global greenhouse gas (GHG) production was small in 2005 (0.06 percent), *net* emissions had been increasing significantly during the 1990s and early 2000s. Deforestation explains the largest share of GHG emissions, followed by transportation, agriculture, livestock and the energy sector. To comply with the *Paris Agreement*, Guatemala foresees emission reductions of between 11.2 and 22.6 percent (unconditional and conditional, respectively) by 2030, relative to a no-policy-change scenario. Key actions include: i) promoting renewable energy through the *National Energy Plan*, ii) reducing emissions from deforestation and forest degradation, iii) implementing the *Low Emission Development Strategy*, and iv) facilitating the certification of emission reduction. Going forward, the authorities should reinforce Guatemala's *Environmental Fiscal Strategy* by considering (i) a tax proportional to the carbon content of domestically consumed fossil fuels, (ii) a vehicle taxation including an *ad valorem* component and a sliding scale of taxes/subsidies for relatively high/low emission rate vehicles, and (iii) pricing schemes that reduce hazardous products and manage the volume of solid waste.

Past adaptation efforts can be further enhanced.

- *Fiscal resilience*. The new DRM law (pending Congress approval) aims for improved financial resilience and transparency. To enhance capacity response while preserving fiscal resilience, the authorities are encouraged to supplement risk retention instruments (contingent credit lines, budgetary reserves) with larger risk transfer instruments (so far the Caribbean Catastrophe Risk Insurance Facility solely).
- *Infrastructure resilience*. Guatemala's estimated annual financing gap to meet its adaptation targets reaches 1.2 billion dollars over a 12-year period (or 1½ percent of GDP per annum, UNDP 2018). To close this gap, Guatemala should prioritize those investments generating the strongest externalities and with the highest potential for cost recovery; and devise a prudent financing strategy jointly with development partners and the private sector.

Authorities' Views

29. The authorities broadly concurred with staff's outlook. They emphasized that the effective 2020 policy response improved private sector expectations and investment prospects in 2021. While they see risks primarily tilted to the upside, they regard delays in the immunization process and the threat of new virus variants as important downside risks. The authorities agree with staff that the current account in 2020 was stronger than the level implied by fundamentals and desirable policies although they do not see any misalignment in the REER once temporary factors are accounted for and, unlike EBA, expect the REER to depreciate as temporary strong remittance inflows and terms of trade deteriorate. They noted that excessive FX inflows could not be smoothly absorbed by a small FX market and expressed concerns that they could have a significant impact on the real sector, which provided justification for their participation in the FX market. Nonetheless, they reiterated their desire to gradually allow more exchange rate flexibility.

30. The Ministry of Finance's priority is to sustain the recovery and strengthen social programs. They are confident that the ongoing budget reshuffling will allow to redirect resources towards necessary health, education, and public investment outlays, and have placed transparency at the heart of their fiscal strategy. To durably raise social spending and the provision of public services the authorities plan to strengthen tax revenues, building on substantial efforts deployed during the pandemic to curb tax evasion and contraband. The authorities concurred on the need to undertake comprehensive reforms to public procurement system and the civil service.

31. The authorities agree with the staff's assessment of the monetary stance. They concur there is room for monetary policy to maintain its accommodative stance and support the recovery, provided that inflation expectations remain well anchored. As extraordinary credit support measures are phased out, the authorities will continue to closely monitor financial stability risks, which are deemed moderate. To enhance financial stability and integrity, the authorities intend to pass the banking law and the revised AML/CFT law.

32. The authorities acknowledged the need for wide-ranging reforms to lift employment and increase resilience. As per their *Economic Recovery Plan*, they are aiming for business-climate-enhancing reforms to generate an investment push that creates employment opportunities and retains talent in Guatemala. To reduce their vulnerabilities to natural disasters, the Ministry of Finance is actively enhancing its disaster management strategy by scaling up their risk retention instruments and exploring new risk transfer instruments.

33. The authorities emphasized their recent efforts to improve transparency and governance. To reduce red tape and corruption, they have launched a suite of fiscal transparency portals and an e-government strategy under the General Government Policy 2020–24, and passed the *Administrative Simplification Law* initiative. They emphasized ongoing efforts to increase the financing of the Office of the Public Prosecutor, expand its territorial presence throughout the country, and fortify its investigative and prosecutorial competences. They recognized the need for further progress in this area and stand ready to pursue additional measures.

STAFF APPRAISAL

34. The near-term outlook is favorable although further efforts are needed to raise medium-term growth. After rebounding in 2021, underpinned by the strong U.S. recovery, growth is expected peak at 4½ percent in 2021, then to converge to its potential rate of 3½ percent by 2023. Inflation is set to reach the mid-point of the target band as supply shocks abate, offsetting any inflationary pressures from the closure of the output gap. The external position remains stronger than the level implied by medium-term fundamentals and desirable policies, but the gap is expected to narrow by 2026. Lifting potential growth through wide-ranging business climate reforms remains a priority given significant social and infrastructure challenges.

35. Fiscal and monetary policies should remain supportive in the near term until the recovery takes hold, guarding against any downside risks from the pandemic. As fiscal stimulus is gradually withdrawn, social and infrastructure spending should be scaled up while increasing efficiency. The accommodative monetary conditions should continue provided inflation expectations remain well-anchored. Banguat should remain vigilant to avoid any unintended consequences from last year's monetization. The SIB should closely monitor NPLs and any potential risks to financial stability.

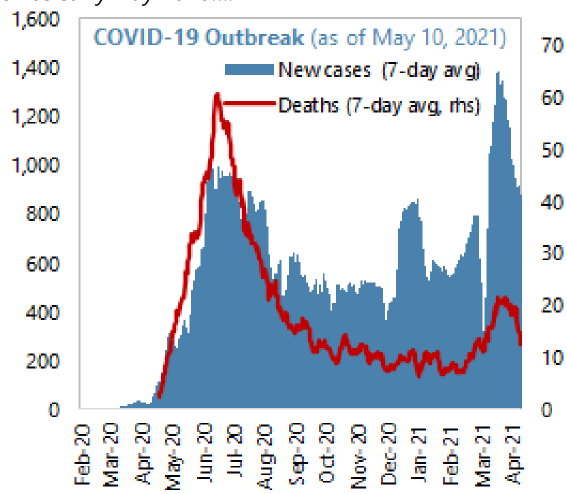
36. As the recovery firms up, the authorities should raise overdue social and infrastructure spending to raise potential growth and improve social cohesion. Enhancing revenue mobilization and spending efficiency is necessary to expand fiscal space. SAT should persevere in strengthening its tax controls and redouble efforts against contraband. Spending efficiency reforms should focus on increasing transparency and governance, while bolstering procurement cost-effectiveness and the quality of public services.

37. The authorities' reform agenda to lift potential growth and build resilience is commendable and should be expedited. The authorities' *Economic Recovery Plan* has rightly identified a set of legal initiatives to improve business climate and foster employment opportunities. As Guatemala is at high risk of natural disasters, past efforts on climate change mitigation and adaptation should be complemented with an enhanced disaster risk management strategy and the effective implementation of its emission reduction programs.

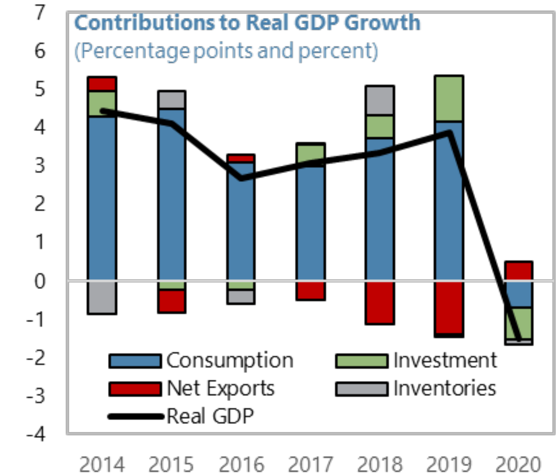
38. It is recommended that the next Article IV consultation with Guatemala be held on the standard 12-month cycle.

Figure 1. Guatemala: Recent Economic Developments

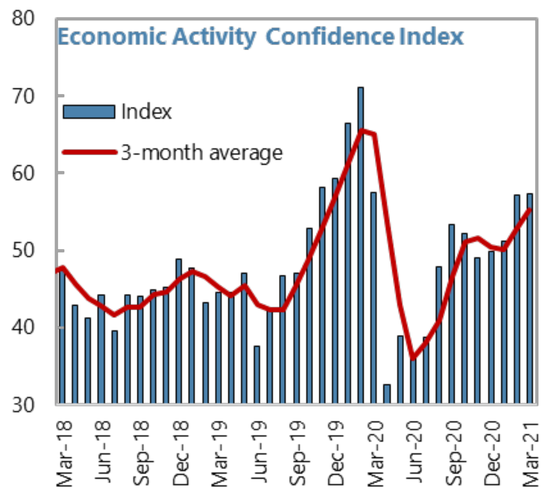
Despite the COVID-19 outbreak hitting hard Guatemala since early May 2020….



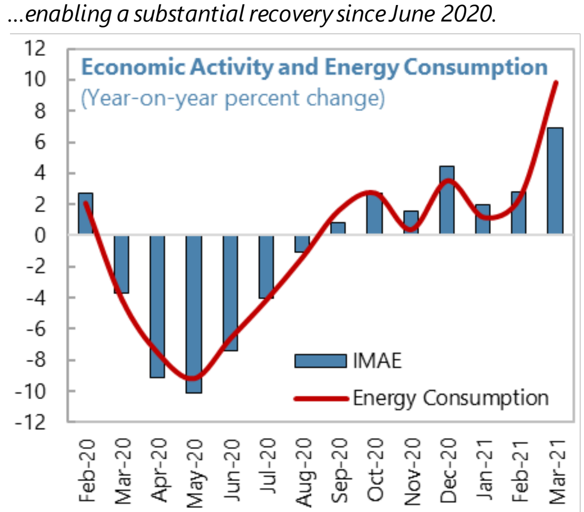
… the economy proved resilient, supported by swift policy response, favorable export mix and remittances.



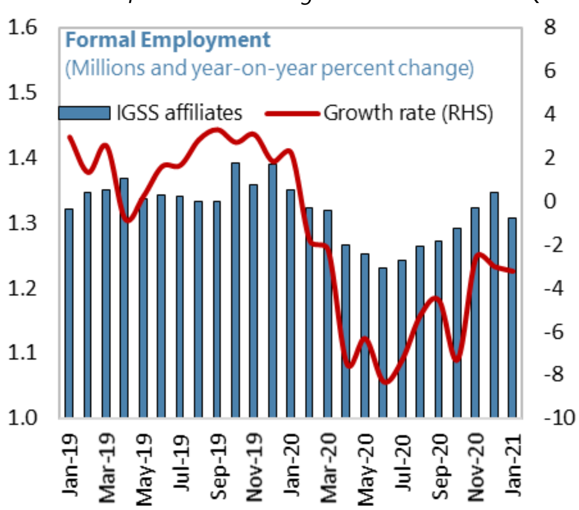
Confidence improved with the reopening of the economy…



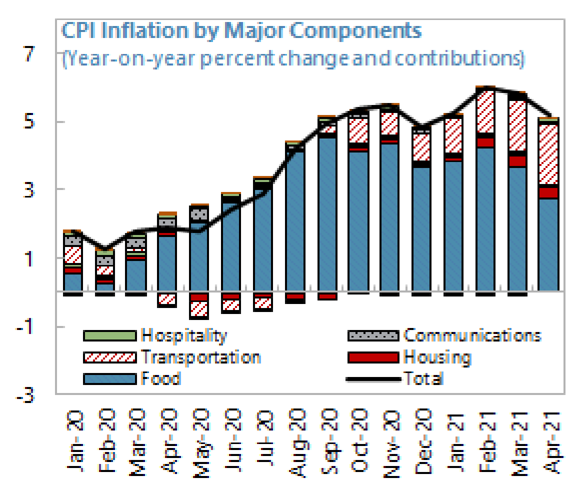
…enabling a substantial recovery since June 2020.



Job creation followed suit and gained traction in late Q3.



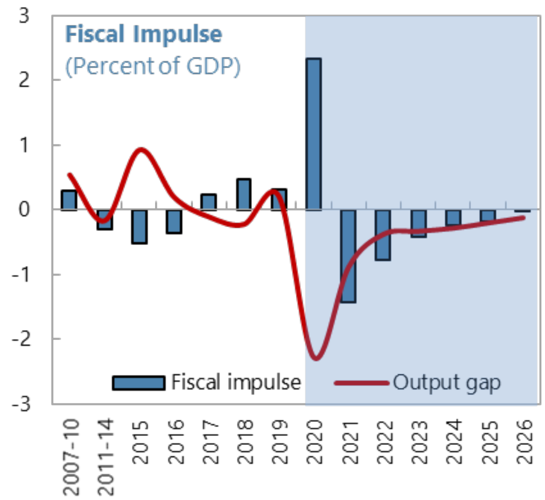
Pandemic-related supply shocks lifted inflation.



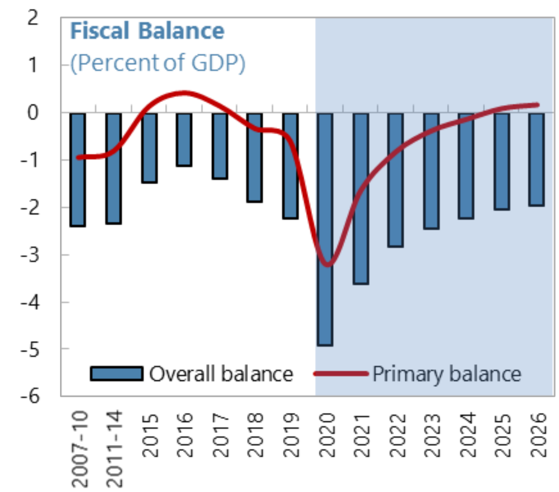
Sources: National authorities and IMF staff calculations.

Figure 2. Guatemala: Fiscal Sector Developments

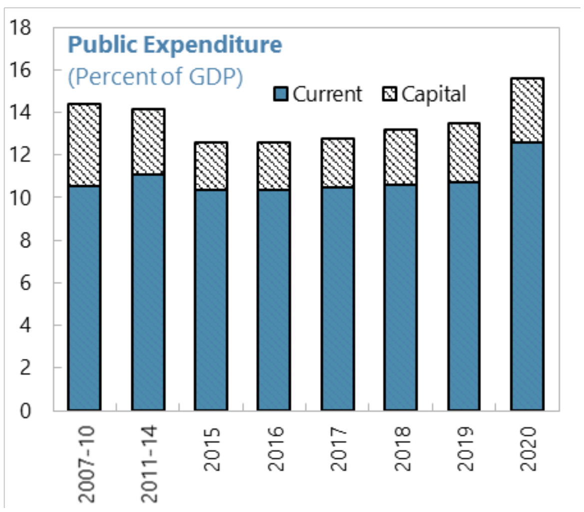
Fiscal impulse shored up aggregate demand…



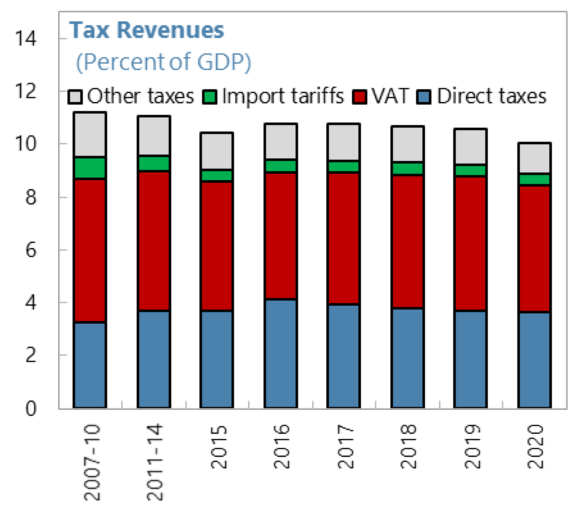
…. increasing the fiscal deficit above historic levels.



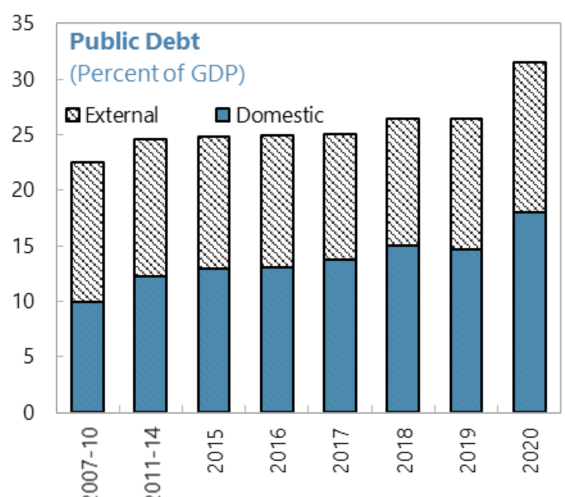
Spending provided lifelines to households and firms…



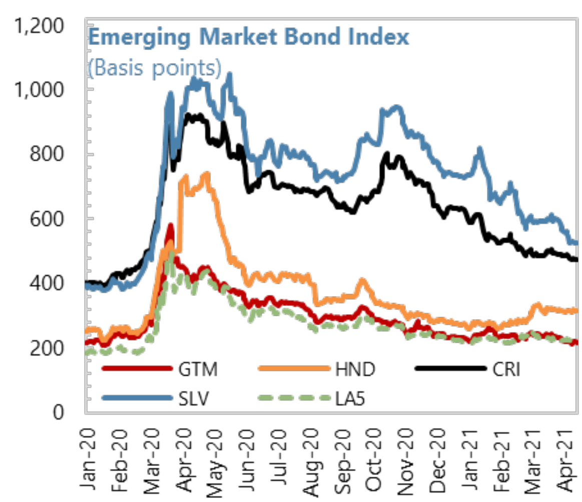
…while containment measures weakened tax revenues.



A hybrid financing strategy was swiftly deployed…



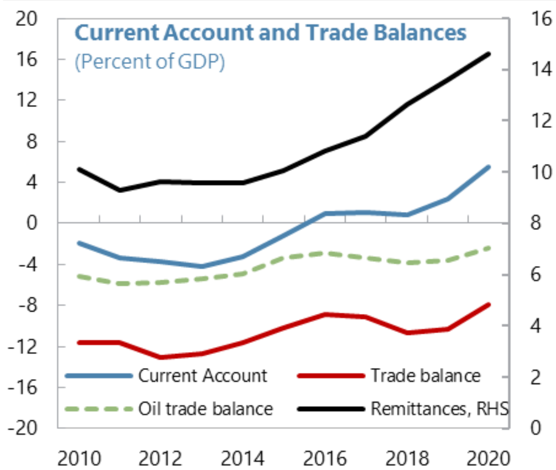
… amid relatively favorable financing conditions.



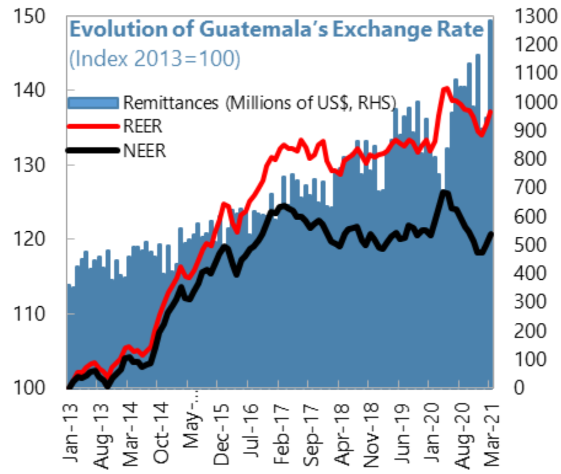
Sources: National authorities and IMF staff calculations.

Figure 3. Guatemala: External Developments

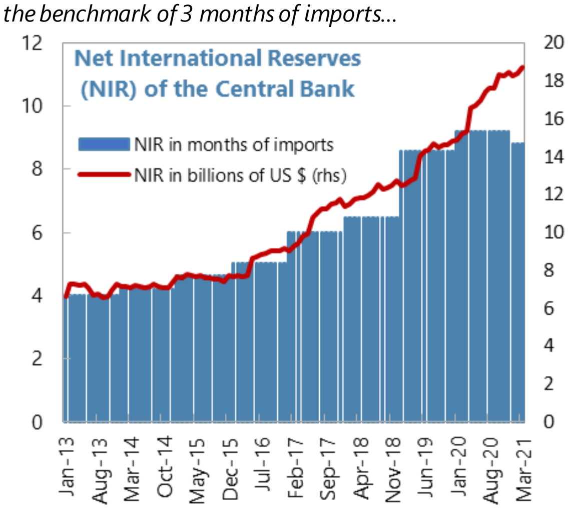
The current account surplus improved significantly in 2020 supported by remittances, a lower trade deficit...



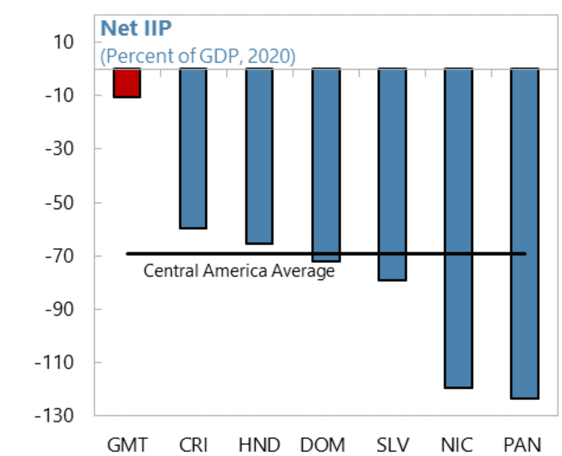
...and real effective exchange rate slightly appreciated in 2020.



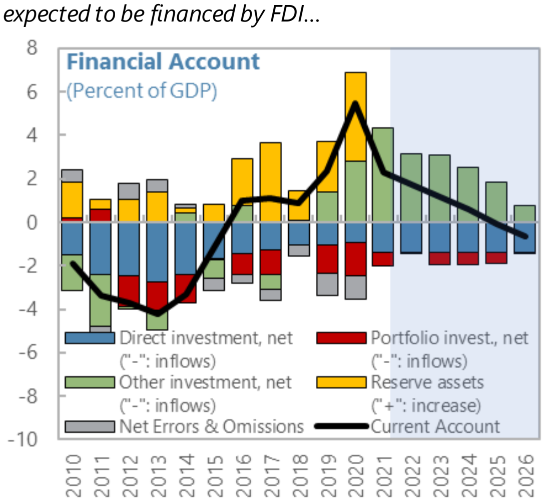
International reserves remain healthy and well above the benchmark of 3 months of imports...



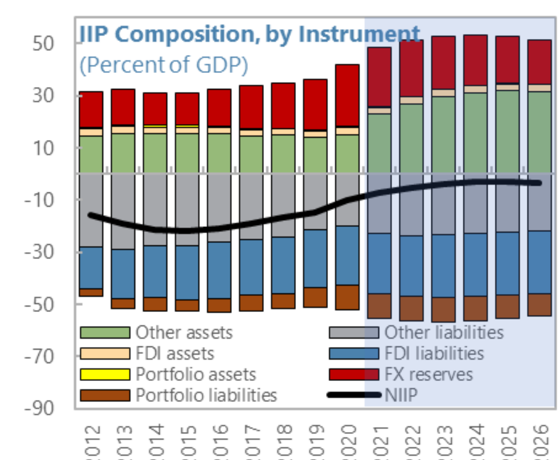
...and the net international investment position remains negative, though lower compared to regional peers.



The projected medium-term current account deficit is expected to be financed by FDI...



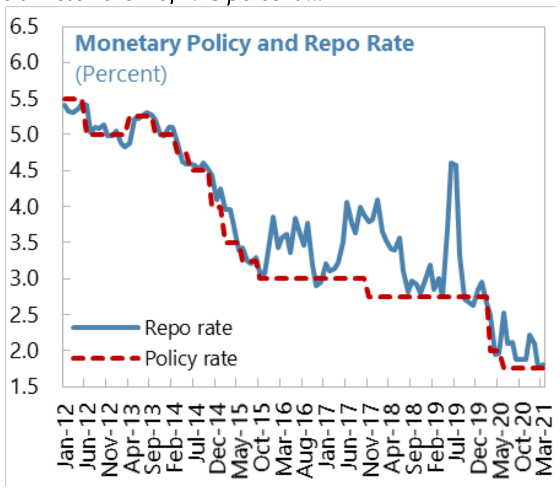
...and a large share of external liabilities constitutes non-debt creating FDI inflows.



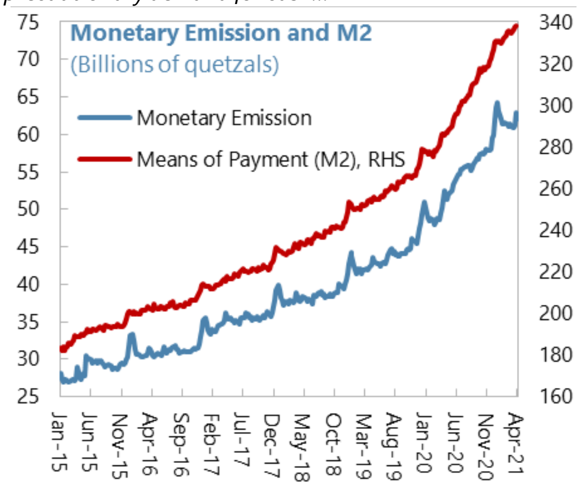
Sources: National authorities and IMF staff calculations.

Figure 4. Monetary Sector Developments

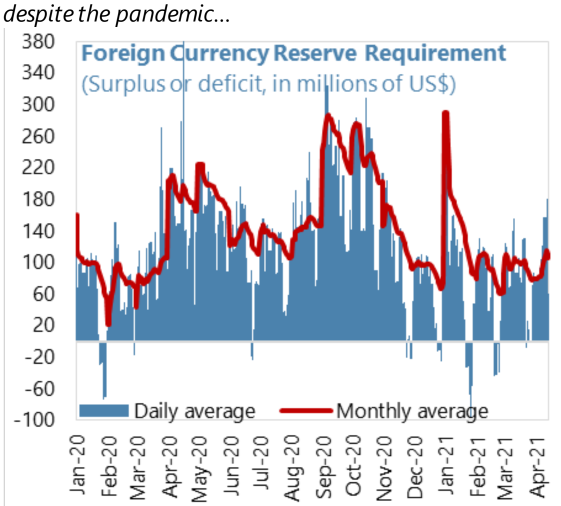
Banguat lowered the monetary policy rate pre-emptively to a historic low of 1.75 percent …



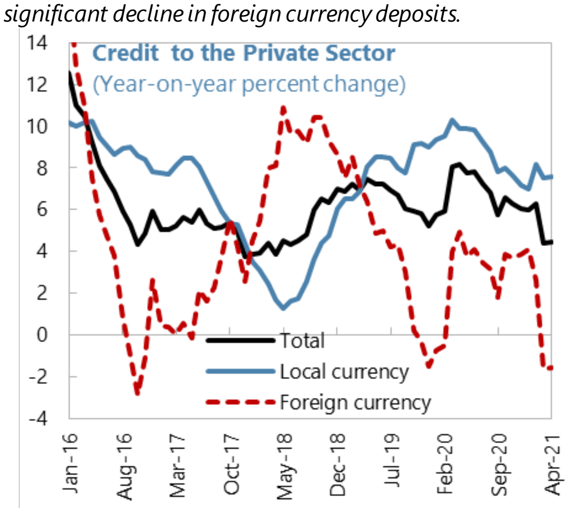
… and provided additional liquidity to meet increased precautionary demand for cash…



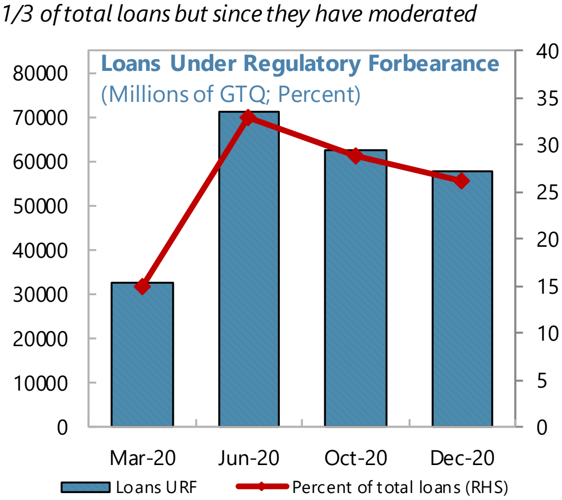
Timely regulatory forbearance supported credit expansion despite the pandemic…



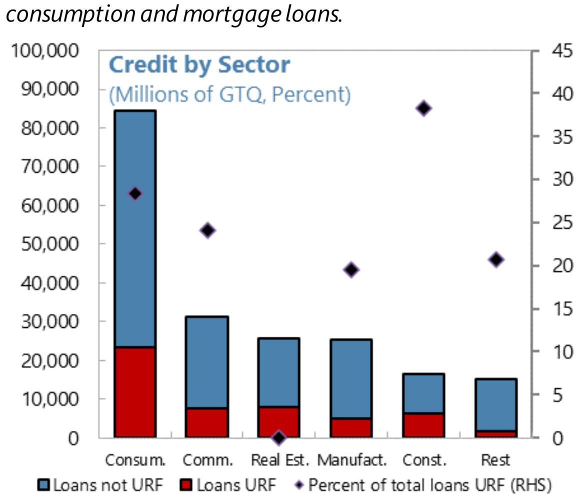
… and provided confidence in the financial system with no significant decline in foreign currency deposits.



Loans under regulatory forbearance spiked in June to over 1/3 of total loans but since they have moderated



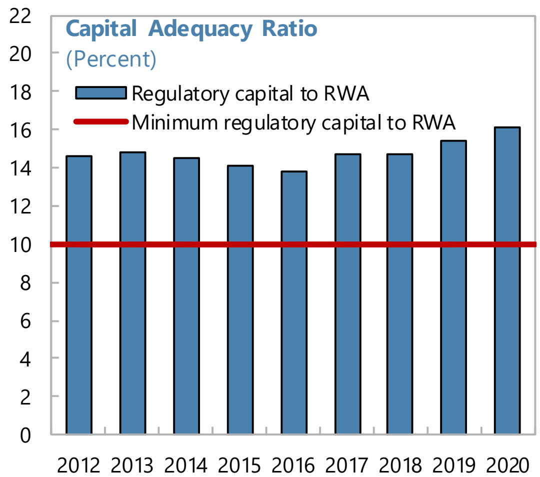
Half of the loans under regulatory forbearance are consumption and mortgage loans.



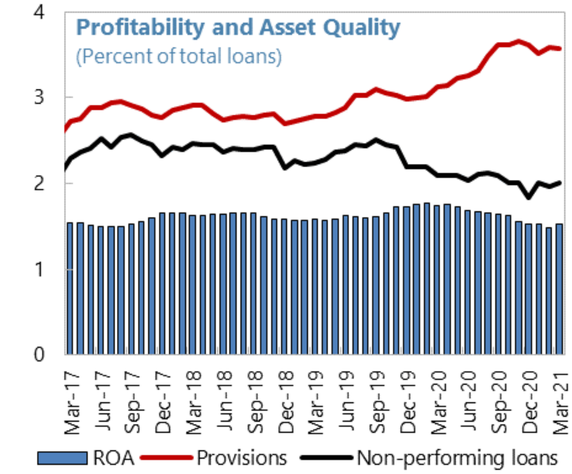
Sources: National authorities and IMF staff calculations.

Figure 5. Financial Sector Developments

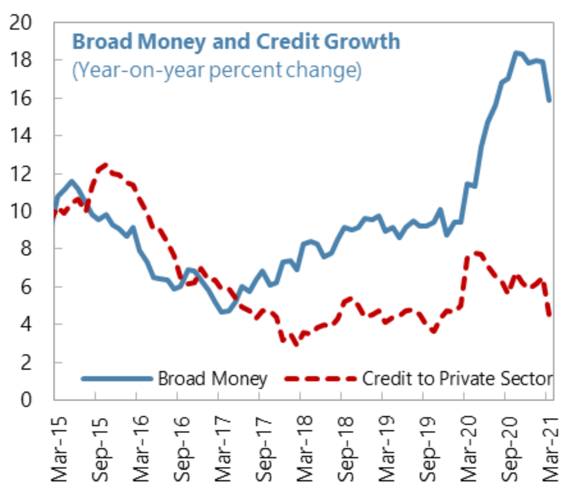
Banks' capital adequacy ratio increased in 2020



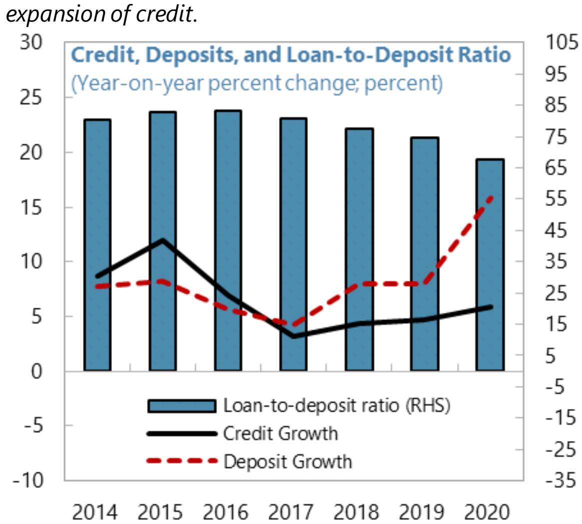
Amidst credit moratoria, non-performing loans declined, precautionary provisions rose, and ROA profitability fell.



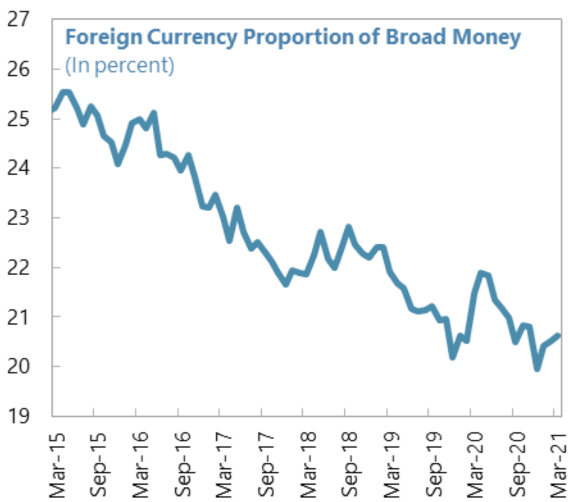
An unprecedent monetary stimulus...



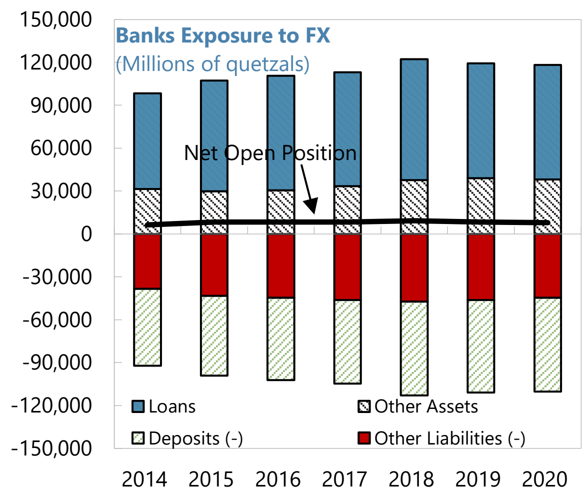
...alongside strong deposits growth helped support the expansion of credit.



The ratio of dollarization continued declining ...



...although banks' overall exposure to FX remains positive.



Sources: National authorities and IMF staff calculations.

Table 1. Guatemala: Selected Economic and Social Indicators

I. Social and Demographic Indicators

Population 2020 (millions)	17	Gini index (2014)	48
Percentage of indigenous population (2018)	44	Life expectancy at birth (2018)	74
Population below the poverty line (Percent, 2014)	59	Adult illiteracy rate (2014)	19
Rank in UNDP development index (2019; of 189)	127	GDP per capita (US$, 2020)	4,603

II. Economic Indicators

						Projections					
	2016	2017	2018	2019	2020	2021	2022	2023	2024	2025	2026
	(Annual percent change, unless otherwise indicated)										
Income and Prices											
Real GDP	2.7	3.1	3.3	3.9	-1.5	4.5	4.0	3.5	3.5	3.5	3.5
Consumer prices (end of period)	4.2	5.7	2.3	3.4	4.8	4.5	3.6	3.7	3.8	3.9	4.0
Monetary Sector											
M2	6.6	8.4	9.4	9.6	18.9	7.8	6.3	6.6	6.7	6.7	6.8
Credit to the private sector	5.9	3.8	7.0	4.9	6.4	6.8	7.3	7.2	7.2	7.2	7.2
	(In percent of GDP, unless otherwise indicated)										
Saving and Investment											
Gross domestic investment	13.9	13.6	13.8	14.3	12.9	14.1	14.5	14.8	14.9	14.7	14.5
Private sector	12.9	12.5	12.2	12.4	12.2	13.4	13.9	14.2	14.3	14.1	13.9
Public sector	1.0	1.1	1.5	1.9	1.3	1.2	1.1	1.1	1.0	1.0	1.0
Gross national saving	14.8	14.7	14.6	16.6	18.4	16.5	16.2	15.9	15.5	14.6	13.8
Private sector	14.8	14.8	14.8	16.8	21.8	18.4	17.7	17.1	16.5	15.6	14.8
Public sector	0.1	-0.1	-0.2	-0.1	-3.4	-2.0	-1.5	-1.1	-1.0	-1.0	-1.0
External saving	-1.0	-1.1	-0.9	-2.3	-5.5	-2.3	-1.7	-1.1	-0.6	0.1	0.6
External Sector											
Current account balance	1.0	1.1	0.9	2.3	5.5	2.3	1.7	1.1	0.6	-0.1	-0.6
Trade balance (goods)	-9.2	-9.5	-10.9	-10.3	-7.6	-9.9	-10.4	-10.6	-10.7	-10.8	-10.8
Exports	13.6	13.5	13.2	12.9	13.5	13.3	12.7	12.3	11.9	11.4	11.0
Imports	22.8	23.0	24.1	23.2	21.2	23.2	23.1	22.9	22.5	22.2	21.8
Of which: oil & lubricants	3.1	3.5	4.0	3.8	2.5	3.4	3.2	3.1	3.0	2.9	2.9
Trade balance (services)	0.3	0.4	0.2	0.1	-0.3	-0.8	-1.0	-1.0	-1.1	-1.1	-1.2
Other (net)	9.8	10.2	11.5	12.6	13.4	13.0	13.1	12.8	12.3	11.8	11.4
Of which: remittances	10.8	11.4	12.7	13.6	14.6	14.6	14.8	14.7	14.4	14.1	13.8
Capital account balance	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Financial account balance (Net lending (+))	0.6	0.6	0.4	1.3	4.4	2.3	1.7	1.1	0.6	-0.1	-0.6
Of which: FDI, net	-1.5	-1.3	-1.1	-1.0	-0.9	-1.4	-1.4	-1.4	-1.4	-1.4	-1.4
Errors and omissions	-0.4	-0.6	-0.5	-1.0	-1.0	0.0	0.0	0.0	0.0	0.0	0.0
Change in reserves assets (Increase (+))	2.2	3.6	1.3	2.3	4.1	0.0	0.0	0.0	0.0	0.0	0.0
Net International Reserves											
(Stock in months of next-year NFGS imports)	5.1	6.0	6.5	8.6	9.2	8.8	8.5	8.1	7.7	7.3	7.3
(Stock over short-term debt on residual maturity)	1.5	1.8	1.9	2.3	3.2	2.5	2.5	2.4	2.3	2.0	2.0
Public Finances											
Central Government											
Revenues	11.4	11.4	11.3	11.2	10.7	10.6	11.0	11.3	11.4	11.4	11.5
Expenditures	12.6	12.8	13.2	13.5	15.6	14.0	13.8	13.7	13.6	13.5	13.5
Current	10.4	10.5	10.6	10.7	12.6	11.2	11.2	11.2	11.2	11.2	11.2
Capital	2.2	2.3	2.6	2.7	3.0	2.8	2.6	2.4	2.4	2.3	2.3
Primary balance	0.4	0.1	-0.3	-0.6	-3.2	-1.5	-0.9	-0.5	-0.3	0.0	0.0
Overall balance	-1.1	-1.4	-1.9	-2.2	-4.9	-3.4	-2.8	-2.4	-2.2	-2.0	-2.0
Financing of the central government balance	1.1	1.4	1.9	2.2	4.9	3.4	2.8	2.4	2.2	2.0	2.0
Net external financing	0.8	0.2	0.1	1.2	1.7	1.7	0.6	0.5	0.3	0.4	-0.1
Net domestic financing	0.3	1.2	1.8	1.1	3.2	1.7	2.2	1.9	1.9	1.6	2.1
Of which : use of government deposits	-0.5	-0.1	-0.1	0.2	-0.5	0.5	0.1	-0.1	-0.1	-0.1	-0.1
Central Government Debt	25.0	25.1	26.5	26.5	31.5	32.4	33.4	34.0	34.2	34.2	34.0
External	11.9	11.4	11.5	11.8	13.5	14.5	14.4	14.2	13.6	13.2	12.3
Domestic 1/	13.0	13.7	15.0	14.7	18.0	17.9	19.0	19.8	20.5	20.9	21.7
Memorandum Items:											
GDP (US$ billions)	66.0	71.6	73.2	77.0	77.6	82.1	86.0	90.7	96.8	103.3	110.3
Output gap (% of GDP)	0.2	-0.1	-0.2	0.2	-2.1	-0.9	-0.4	-0.3	-0.3	-0.2	-0.1

Sources: Bank of Guatemala; Ministry of Finance; and Fund staff estimates and projections.

1/ Does not include recapitalization of obligations to the central bank.

Table 2. Guatemala: Statement of the Central Government Operations and Financial Balance, GFSM 2001 Classification

						Projections					
	2016	2017	2018	2019	2020	2021	2022	2023	2024	2025	2026
				(In millions of quetzales)							
Central government operations											
Revenue	**57,413**	**59,984**	**62,339**	**66,551**	**64,063**	**68,408**	**75,268**	**82,526**	**88,858**	**95,568**	**102,931**
Taxes	54,109	56,477	58,513	62,415	60,162	63,866	70,372	77,303	83,362	89,787	96,846
Other revenue	3,304	3,506	3,826	4,136	3,902	4,542	4,897	5,223	5,496	5,781	6,085
Expenditure	**63,076**	**67,271**	**72,708**	**79,833**	**93,527**	**90,517**	**94,645**	**100,099**	**106,333**	**112,499**	**120,657**
Expense	**61,800**	**65,183**	**68,825**	**74,868**	**90,601**	**84,779**	**88,614**	**93,665**	**99,857**	**105,839**	**113,388**
Compensation of employees	21,028	22,328	23,295	26,036	27,677	29,185	30,751	32,799	35,005	37,353	39,895
Use of goods and services	7,686	7,205	8,482	8,753	9,993	10,997	11,457	12,036	12,460	13,030	13,639
Interest	7,724	8,003	8,484	9,690	10,331	12,252	12,935	14,227	15,460	16,713	17,906
Other expense	25,361	27,647	28,564	30,390	42,600	32,345	33,471	34,603	36,932	38,743	41,948
Net acquisition of nonfinancial assets	**1,276**	**2,089**	**3,883**	**4,964**	**2,926**	**5,738**	**6,032**	**6,434**	**6,476**	**6,660**	**7,269**
Gross Operating Balance	**-4,387**	**-5,199**	**-6,486**	**-8,317**	**-26,538**	**-16,371**	**-13,345**	**-11,139**	**-11,000**	**-10,271**	**-10,457**
Net lending (+)/borrowing (–)	**-5,663**	**-7,288**	**-10,369**	**-13,281**	**-29,463**	**-22,109**	**-19,377**	**-17,573**	**-17,476**	**-16,931**	**-17,726**
Net acquisition of financial assets	**2,561**	**1,201**	**357**	**-1,028**	**3,146**	**-3,379**	**-370**	**786**	**686**	**686**	**686**
Net incurrence of liabilities	**8,143**	**8,313**	**10,164**	**11,779**	**30,725**	**18,730**	**19,007**	**18,359**	**18,161**	**17,617**	**18,412**
Financial Balance 1/											
Net financial worth 2/	**-91,048**	**-91,950**	**-102,520**	**-114,665**	**-140,568**	**-164,465**	**-185,029**	**-204,053**	**-221,789**	**-239,535**	**-258,249**
Financial assets	**34,231**	**40,164**	**43,207**	**42,334**	**48,341**	**44,946**	**44,528**	**45,183**	**45,624**	**45,516**	**45,204**
Domestic	**34,231**	**40,164**	**43,207**	**42,334**	**48,341**	**44,946**	**44,528**	**45,183**	**45,624**	**45,516**	**45,204**
Currency and deposits	34,231	40,164	43,207	42,334	48,341	44,946	44,528	45,183	45,624	45,516	45,204
Foreign	**0**	**0**	**0**	**0**	**0**	**0**	**0**	**0**	**0**	**0**	**0**
Net incurrence of liabilities	**125,279**	**132,115**	**145,728**	**156,999**	**188,908**	**209,411**	**229,556**	**249,236**	**267,413**	**285,051**	**303,453**
Domestic 3/	**65,382**	**72,346**	**82,387**	**87,222**	**107,744**	**115,727**	**130,393**	**145,050**	**160,670**	**174,854**	**193,862**
Debt securities	65,382	72,346	82,387	87,222	107,744	115,727	130,393	145,050	160,670	174,854	193,862
Foreign	**59,897**	**59,769**	**63,341**	**69,777**	**81,165**	**93,685**	**99,164**	**104,186**	**106,743**	**110,197**	**109,592**
Debt securities	18,364	21,606	22,760	31,796	41,541	50,283	50,852	55,555	59,622	63,689	63,689
Loans	41,533	38,163	40,581	37,981	39,623	43,401	48,312	48,632	47,121	46,508	45,903
				(In percent of GDP)							
Central Government Operations											
Revenue	**11.4**	**11.4**	**11.3**	**11.2**	**10.7**	**10.6**	**11.0**	**11.3**	**11.4**	**11.4**	**11.5**
Taxes	10.8	10.7	10.6	10.5	10.0	9.9	10.2	10.5	10.7	10.8	10.9
Other revenue	0.7	0.7	0.7	0.7	0.7	0.7	0.7	0.7	0.7	0.7	0.7
Expenditure	**12.6**	**12.8**	**13.2**	**13.5**	**15.6**	**14.0**	**13.8**	**13.7**	**13.6**	**13.5**	**13.5**
Expense	**12.3**	**12.4**	**12.5**	**12.6**	**15.1**	**13.1**	**12.9**	**12.8**	**12.8**	**12.7**	**12.7**
Compensation of employees	4.2	4.2	4.2	4.4	4.6	4.5	4.5	4.5	4.5	4.5	4.5
Use of goods and services	1.5	1.4	1.5	1.5	1.7	1.7	1.7	1.6	1.6	1.6	1.5
Interest	1.5	1.5	1.5	1.6	1.7	1.9	1.9	1.9	2.0	2.0	2.0
Other expense	5.1	5.3	5.2	5.1	7.1	5.0	4.9	4.7	4.7	4.6	4.7
Net acquisition of nonfinancial assets	**0.3**	**0.4**	**0.7**	**0.8**	**0.5**	**0.9**	**0.9**	**0.9**	**0.8**	**0.8**	**0.8**
Gross Operating Balance	**-0.9**	**-1.0**	**-1.2**	**-1.4**	**-4.4**	**-2.5**	**-1.9**	**-1.5**	**-1.4**	**-1.2**	**-1.2**
Net lending (+)/borrowing (–)	**-1.1**	**-1.4**	**-1.9**	**-2.2**	**-4.9**	**-3.4**	**-2.8**	**-2.4**	**-2.2**	**-2.0**	**-2.0**
Net acquisition of financial assets	**0.5**	**0.2**	**0.1**	**-0.2**	**0.5**	**-0.5**	**-0.1**	**0.1**	**0.1**	**0.1**	**0.1**
Net incurrence of liabilities	**1.6**	**1.6**	**1.8**	**2.0**	**5.1**	**2.9**	**2.8**	**2.5**	**2.3**	**2.1**	**2.1**
Financial Balance 1/											
Net financial worth 2/	**-18.1**	**-17.5**	**-18.6**	**-19.3**	**-23.5**	**-25.4**	**-26.9**	**-27.8**	**-28.4**	**-28.7**	**-29.0**
Financial assets	**6.8**	**7.6**	**7.8**	**7.1**	**8.1**	**7.0**	**6.5**	**6.2**	**5.8**	**5.5**	**5.1**
Domestic	**6.8**	**7.6**	**7.8**	**7.1**	**8.1**	**7.0**	**6.5**	**6.2**	**5.8**	**5.5**	**5.1**
Currency and deposits	6.8	7.6	7.8	7.1	8.1	7.0	6.5	6.2	5.8	5.5	5.1
Foreign	**0.0**	**0.0**	**0.0**	**0.0**	**0.0**	**0.0**	**0.0**	**0.0**	**0.0**	**0.0**	**0.0**
Net incurrence of liabilities	**25.0**	**25.1**	**26.5**	**26.5**	**31.5**	**32.4**	**33.4**	**34.0**	**34.2**	**34.2**	**34.0**
Domestic 3/	**13.0**	**13.7**	**15.0**	**14.7**	**18.0**	**17.9**	**19.0**	**19.8**	**20.5**	**20.9**	**21.7**
Debt securities	13.0	13.7	15.0	14.7	18.0	17.9	19.0	19.8	20.5	20.9	21.7
Foreign	**11.9**	**11.4**	**11.5**	**11.8**	**13.5**	**14.5**	**14.4**	**14.2**	**13.6**	**13.2**	**12.3**
Debt securities	3.7	4.1	4.1	5.4	6.9	7.8	7.4	7.6	7.6	7.6	7.1
Loans	8.3	7.2	7.4	6.4	6.6	6.7	7.0	6.6	6.0	5.6	5.1

Sources: Ministry of Finance; Bank of Guatemala; and Fund staff estimates and projections.

1/ Based on available stock elements.

2/ Changes in net financial worth do not equal net lending due to valuation adjustments and statistical discrepancies.

3/ Does not include recapitilization obligations to the central bank.

Table 3. Guatemala: Summary Balance of Payments

	2016	2017	2018	2019	2020	2021	2022	2023	2024	2025	2026
						Projections					
				(In millions of U.S. dollars)							
Current account balance	**637**	**804**	**622**	**1,791**	**4,249**	**1,907**	**1,493**	**1,034**	**562**	**-66**	**-716**
Trade balance (goods)	-6,077	-6,810	-7,985	-7,967	-5,927	-8,166	-8,959	-9,585	-10,313	-11,118	-11,948
Exports, f.o.b.	8,973	9,651	9,644	9,919	10,514	10,927	10,949	11,165	11,483	11,807	12,125
Imports, f.o.b.	15,050	16,461	17,629	17,885	16,441	19,093	19,908	20,750	21,796	22,924	24,073
Of which : oil & lubricants	2,027	2,501	2,901	2,911	1,919	2,765	2,792	2,840	2,927	3,046	3,189
Net services	222	290	166	49	-250	-633	-845	-943	-1,053	-1,176	-1,304
Net income	-1,425	-1,501	-1,507	-1,412	-1,398	-1,950	-2,103	-2,482	-2,759	-3,141	-3,551
Net transfers	7,917	8,824	9,948	11,120	11,824	12,657	13,399	14,044	14,687	15,369	16,086
Of which: remittances	7,144	8,168	9,272	10,494	11,326	11,988	12,699	13,307	13,899	14,528	15,189
Capital account balance	0	0	1	1	0	0	0	0	0	0	0
Financial account balance	**366**	**406**	**260**	**1,028**	**3,439**	**1,907**	**1,493**	**1,034**	**562**	**-66**	**-716**
Foreign direct investment	-965	-934	-778	-799	-704	-1,156	-1,211	-1,276	-1,362	-1,454	-1,553
Net acquisition of financial assets	-119	64	145	370	103	109	114	120	128	136	146
Net incurrence of liabilities	846	998	922	1,169	807	1,265	1,325	1,396	1,490	1,590	1,698
Portfolio investment	-610	-804	19	-1,027	-1,213	-1,013	-13	-513	-513	-513	-13
Net acquisition of financial assets	8	-6	-30	20	-12	-12	-12	-12	-12	-12	-12
Net incurrence of liabilities	619	798	-49	1,047	1,201	1,001	1	501	501	501	1
Of which: government bonds	622	465	-50	1,047	1,200	1,000	0	500	500	500	0
Financial derivatives	0	0	0	0	0	0	0	0	0	0	0
Other investment	518	-457	31	1,057	2,168	4,077	2,717	2,823	2,437	1,900	850
Change in reserve assets	1,424	2,600	988	1,798	3,189	0	0	0	0	0	0
Errors and omissions	**-271**	**-398**	**-363**	**-764**	**-810**	**0**	**0**	**0**	**0**	**0**	**0**
				(In percent of GDP)							
Current account balance	**1.0**	**1.1**	**0.9**	**2.3**	**5.5**	**2.3**	**1.7**	**1.1**	**0.6**	**-0.1**	**-0.6**
Trade balance (goods)	-9.2	-9.5	-10.9	-10.3	-7.6	-9.9	-10.4	-10.6	-10.7	-10.8	-10.8
Exports, f.o.b.	13.6	13.5	13.2	12.9	13.5	13.3	12.7	12.3	11.9	11.4	11.0
Imports, f.o.b.	22.8	23.0	24.1	23.2	21.2	23.2	23.1	22.9	22.5	22.2	21.8
Of which : oil & lubricants	3.1	3.5	4.0	3.8	2.5	3.4	3.2	3.1	3.0	2.9	2.9
Net services	0.3	0.4	0.2	0.1	-0.3	-0.8	-1.0	-1.0	-1.1	-1.1	-1.2
Net income	-2.2	-2.1	-2.1	-1.8	-1.8	-2.4	-2.4	-2.7	-2.9	-3.0	-3.2
Net transfers	12.0	12.3	13.6	14.4	15.2	15.4	15.6	15.5	15.2	14.9	14.6
Of which: remittances	10.8	11.4	12.7	13.6	14.6	14.6	14.8	14.7	14.4	14.1	13.8
Capital account balance	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Financial account balance	**0.6**	**0.6**	**0.4**	**1.3**	**4.4**	**2.3**	**1.7**	**1.1**	**0.6**	**-0.1**	**-0.6**
Foreign direct investment	-1.5	-1.3	-1.1	-1.0	-0.9	-1.4	-1.4	-1.4	-1.4	-1.4	-1.4
Net acquisition of financial assets	-0.2	0.1	0.2	0.5	0.1	0.1	0.1	0.1	0.1	0.1	0.1
Net incurrence of liabilities	1.3	1.4	1.3	1.5	1.0	1.5	1.5	1.5	1.5	1.5	1.5
Portfolio investment	-0.9	-1.1	0.0	-1.3	-1.6	-1.2	0.0	-0.6	-0.5	-0.5	0.0
Net acquisition of financial assets	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Net incurrence of liabilities	0.9	1.1	-0.1	1.4	1.5	1.2	0.0	0.6	0.5	0.5	0.0
Of which: government bonds	0.9	0.6	-0.1	1.4	1.5	1.2	0.0	0.6	0.5	0.5	0.0
Financial derivatives	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Other investment	0.8	-0.6	0.0	1.4	2.8	5.0	3.2	3.1	2.5	1.8	0.8
Change in reserve assets	2.2	3.6	1.3	2.3	4.1	0.0	0.0	0.0	0.0	0.0	0.0
Errors and omissions	**-0.4**	**-0.6**	**-0.5**	**-1.0**	**-1.0**	**0.0**	**0.0**	**0.0**	**0.0**	**0.0**	**0.0**
Memorandum items:											
Value of exports, f.o.b. (percentage change)	-1.2	7.6	-0.1	2.8	6.0	3.9	0.2	2.0	2.8	2.8	2.7
Value of imports, f.o.b. (percentage change)	-3.1	9.4	7.1	1.5	-8.1	16.1	4.3	4.2	5.0	5.2	5.0
Remittances (percentage change)	14.0	14.3	13.5	13.2	7.9	5.9	5.9	4.8	4.5	4.5	4.5
Stock of NIR (in millions of U.S. dollars) 1/	8,321	10,578	11,617	13,769	17,285	17,285	17,285	17,285	17,285	17,285	17,285
NIR in months of next-year NFGS imports	5.1	6.0	6.5	8.6	9.2	8.8	8.5	8.1	7.7	7.3	7.3
NIR in ARA metric under stabilized regime (percent)	93.0	108.9	119.7	135.4	159.5	143.4	137.5	131.1	125.0	118.2	113.3
NIR over short-term debt on residual maturity	1.5	1.8	1.9	2.3	3.2	2.5	2.5	2.4	2.3	2.0	2.0
Nominal GDP (in billions of U.S. dollars)	66.0	71.6	73.2	77.0	77.6	82.1	86.0	90.7	96.8	103.3	110.3

Sources: Bank of Guatemala; Ministry of Finance; and Fund staff estimates and projections.

1/ Includes 2009 SDR allocations of US$271 million.

Table 4. Guatemala: Monetary Sector Survey

						Projections					
	2016	2017	2018	2019	2020	2021	2022	2023	2024	2025	2026
					(In millions of quetzales)						
Bank of Guatemala (BOG)											
Net international reserves 1/	**62,589**	**77,690**	**89,877**	**106,007**	**134,719**	**137,309**	**138,861**	**140,598**	**140,598**	**140,598**	**140,598**
(In millions of U.S. dollars) 1/	8,321	10,578	11,617	13,769	17,285	17,285	17,285	17,285	17,285	17,285	17,285
Net domestic assets	**-33,191**	**-44,095**	**-51,854**	**-61,992**	**-78,476**	**-76,808**	**-74,744**	**-72,423**	**-68,065**	**-63,442**	**-58,448**
Net claims on nonfinancial public sector	-15,290	-20,996	-26,794	-28,701	-20,875	-17,473	-17,030	-17,619	-17,939	-17,434	-16,623
Central government (CG)	-6,697	-9,532	-10,633	-8,489	-636	2,744	3,114	2,328	1,642	957	271
Rest of nonfinancial public sector	-8,593	-11,464	-16,160	-20,212	-20,239	-20,216	-20,144	-19,947	-19,581	-18,391	-16,894
Bank of Guatemala losses	23,586	25,022	25,711	25,493	26,692	27,891	29,090	30,289	31,488	32,687	33,886
Net credit to banks	-33,180	-37,082	-38,550	-39,793	-46,652	-50,624	-52,078	-53,691	-55,313	-56,892	-58,481
Of which: legal reserves	-35,239	-39,140	-40,608	-41,851	-48,710	-52,682	-54,136	-55,749	-57,372	-58,950	-60,540
Open market operations 2/	-15,991	-22,745	-19,239	-24,446	-42,363	-40,295	-39,456	-35,948	-32,584	-28,086	-23,513
Other assets (net)	7,685	11,707	7,018	6,724	4,722	3,693	4,731	4,546	6,283	6,283	6,283
Currency in circulation	29,398	33,595	38,023	44,016	56,243	60,501	64,117	68,175	72,533	77,156	82,150
Banking sector											
Net foreign position	**-34,924**	**-37,419**	**-36,272**	**-35,417**	**-31,666**	**-41,028**	**-42,507**	**-44,093**	**-45,315**	**-46,517**	**-47,705**
(in millions of U.S. Dollars)	-4,643	-5,095	-4,688	-4,600	-4,063	-5,165	-5,291	-5,421	-5,571	-5,719	-5,865
Net claims on Bank of Guatemala	**46,960**	**56,235**	**58,668**	**60,793**	**71,149**	**85,658**	**86,382**	**84,946**	**83,644**	**81,313**	**78,927**
Legal reserves	35,239	39,140	40,608	41,851	48,415	52,682	54,136	55,749	57,372	58,950	60,540
BOG securities	13,773	19,146	20,111	20,993	24,786	35,027	34,297	31,248	28,324	24,413	20,439
Liabilities to BOG	-2,052	-2,051	-2,051	-2,051	-2,051	-2,051	-2,051	-2,051	-2,051	-2,051	-2,051
Net domestic assets	**194,270**	**203,446**	**219,425**	**237,162**	**266,767**	**285,066**	**306,662**	**332,751**	**360,119**	**389,949**	**422,136**
Net credit to the NFPS	8,653	10,331	19,189	23,673	33,456	37,408	44,762	52,193	60,248	68,133	78,638
Official capital and reserves	-5,943	-6,283	-6,732	-7,802	-8,130	-8,621	-9,178	-9,714	-10,290	-10,863	-11,520
Credit to the private sector	182,199	189,043	202,221	212,195	225,715	241,029	258,624	277,245	297,207	318,606	341,546
Other items net	9,362	10,355	4,748	9,096	15,726	15,250	12,454	13,026	12,954	14,073	13,472
Medium and long-term foreign liabilities	**1,667**	**1,591**	**1,658**	**1,919**	**1,888**	**2,037**	**2,165**	**2,309**	**2,465**	**2,630**	**2,809**
Liabilities to private sector	**204,639**	**220,671**	**240,164**	**260,619**	**304,363**	**327,659**	**348,372**	**371,294**	**395,983**	**422,114**	**450,548**
Demand deposits	67,722	71,601	75,347	81,343	102,310	110,361	117,320	125,133	133,549	142,507	152,208
Time and savings deposits, and Securities	114,270	123,583	137,747	150,000	169,230	182,547	194,059	206,982	220,903	235,720	251,767
Capital and reserves (private banks)	19,904	22,215	24,400	26,506	29,817	31,617	33,660	35,624	37,738	39,840	42,250
Monetary survey											
Net foreign assets	**27,664**	**40,270**	**53,605**	**70,590**	**103,053**	**96,281**	**96,353**	**96,505**	**95,283**	**94,080**	**92,892**
(In millions of U.S. dollars)	3,678	5,483	6,928	9,169	13,222	12,120	11,994	11,864	11,714	11,566	11,420
Net domestic assets	**205,296**	**212,314**	**223,570**	**233,192**	**256,434**	**290,781**	**314,969**	**341,719**	**371,905**	**403,772**	**438,291**
Net claims on nonfinancial public sector	-6,637	-10,665	-7,605	-5,028	12,581	19,935	27,732	34,574	42,309	50,699	62,015
Bank of Guatemala losses	23,586	25,022	25,711	25,493	26,692	27,891	29,090	30,289	31,488	32,687	33,886
Credit to private sector	182,199	189,043	202,221	212,195	225,715	241,029	258,624	277,245	297,207	318,606	341,546
Other assets (net)	6,148	8,915	3,243	532	-8,554	1,925	-478	-389	900	1,780	844
Medium and long-term foreign liabilities	**1,667**	**1,591**	**1,658**	**1,919**	**1,888**	**2,037**	**2,165**	**2,309**	**2,465**	**2,630**	**2,809**
Liabilities to the private sector	**231,293**	**250,994**	**275,517**	**301,864**	**357,600**	**385,025**	**409,157**	**435,915**	**464,723**	**495,222**	**528,375**
Of which: Money	97,119	105,196	113,370	125,358	158,553	170,862	181,438	193,308	206,082	219,663	234,358
Of which: Quasi-money	114,270	123,583	137,747	150,000	169,230	182,547	194,059	206,982	220,903	235,720	251,767
Memorandum items:					(Percent change)						
Currency in circulation	8.3	14.3	13.2	15.8	27.8	7.6	6.0	6.3	6.4	6.4	6.5
M2	6.6	8.4	9.4	9.6	18.9	7.8	6.3	6.6	6.7	6.7	6.8
Credit to private sector	5.9	3.8	7.0	4.9	6.4	6.8	7.3	7.2	7.2	7.2	7.2
					(In percent of GDP)						
Currency in circulation	5.9	6.4	6.9	7.4	9.4	9.4	9.3	9.3	9.3	9.2	9.2
M2	42.7	44.1	46.1	46.9	55.2	55.2	55.1	55.1	55.1	55.0	55.0
Net credit of the banking sector to the CG	1.7	2.0	3.5	4.0	5.6	5.8	6.5	7.1	7.7	8.2	8.8
Credit to private sector	36.3	35.9	36.7	35.8	37.7	37.3	37.6	37.8	38.0	38.2	38.3
					(In percent of bank liabilities to the private sector)						
Banks' liquid assets	41.6	45.0	46.8	46.2	47.1	49.4	48.8	47.3	46.0	44.3	43.1
Demand deposits	33.1	32.4	31.4	31.2	33.6	33.7	33.7	33.7	33.7	33.8	33.8
Time and savings deposits	55.8	56.0	57.4	57.6	55.6	55.7	55.7	55.7	55.8	55.8	55.9
Capital and reserves (private banks)	9.7	10.1	10.2	10.2	9.8	9.6	9.7	9.6	9.5	9.4	9.4

Sources: Bank of Guatemala; and Fund staff estimates and projections.

1/ Excludes foreign currency liabilities of the central bank to financial institutions.

2/ Includes open market placements with the private sector (financial and nonfinancial).

Table 5. Guatemala: Financial Soundness Indicators

	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020
On-shore banks											
Reserves as a percentage of Deposits, in NC	14.6	14.6	14.5	14.5	14.6	14.5	14.8	15.0	14.9	14.9	14.9
Reserves as a percentage of Deposits, in FC	18.6	16.2	16.8	20.8	17.1	15.9	16.7	16.3	16.2	15.9	15.8
Short-term liquidity	20.3	21.6	21.6	21.9	20.7	18.9	20.5	21.2	20.6	19.0	21.2
Liquid asset to total asset ratio	28.4	29.0	27.5	28.1	28.8	26.9	27.7	28.4	29.6	29.3	32.7
Liquidity ratio	24.5	24.2	23.6	24.5	25.5	24.5	25.1	25.7	27.0	27.1	30.6
Regulatory capital to risk-weighted assets	15.2	15.3	14.7	14.8	14.6	14.1	13.8	14.7	14.8	15.5	16.1
Nonperforming loans to total gross loans	2.1	1.6	1.3	1.2	1.3	1.4	2.1	2.3	2.2	2.2	1.8
Provisions to non-performing loans	115.3	126.2	143.4	157.6	151.9	138.4	120.4	119.6	123.4	135.9	197.4
Cash to total deposits	20.3	21.6	21.6	21.9	20.7	18.9	20.5	21.2	20.6	19.0	21.2
Return on assets	1.7	1.7	1.6	1.5	1.5	1.5	1.6	1.7	1.6	1.7	1.5
Return on equity	16.3	18.5	17.2	16.0	16.6	16.3	16.9	17.8	16.7	17.9	16.1
Foreign currency-denominated loans to total loans	30.2	34.0	35.2	36.7	38.5	39.9	39.0	38.6	39.2	36.8	36.1
Foreign currency-denominated liabilities to total liabilities	24.6	27.5	28.6	30.3	31.1	30.8	29.8	29.1	29.5	27.7	26.4
Off-shore banks											
Statutory capital to risk-weighted assets	18.5	16.2	16.8	15.8	15.6	14.5	14.8	15.3	15.2	17.4	20.0
Nonperforming loans to total gross loans	2.1	1.7	1.2	0.8	0.9	1.2	1.2	1.7	2.1	2.2	2.1
Provisions to non-performing loans	110.7	143.0	172.4	229.4	178.4	148.8	138.3	114.9	116.8	135.9	149.4
Return on assets	1.4	1.8	1.8	1.4	1.5	1.2	1.5	1.6	1.4	1.7	1.2
Return on equity	12.6	16.0	15.6	12.8	13.8	12.0	14.9	15.3	16.9	17.9	12.1
Total assets off-shore banks to total assets on-shore banks	14.3	12.7	12.2	11.7	10.7	9.6	9.1	8.0	7.8	7.0	6.4

Source: Superintendency of Banks.

Table 6. Guatemala: Financial Soundness Indicators Heat Map

Guatemala	2018Q2	2018Q3	2018Q4	2019Q1	2019Q2	2019Q3	2019Q4	2020Q1	2020Q2	2020Q3	2020Q4	Latest
Overall Financial Sector Rating	M	M	M	M	M	M	M	M	M	M	M	M
Credit cycle	L	L	L	L	L	L	L	L	L	L	n.a.	L
Change in credit / GDP ratio (pp, annual)	-0.2	0.2	0.0	-0.3	-0.3	-0.8	-0.9	0.2	1.2	1.4	n.a.	1.4
Growth of credit / GDP (%, annual)	-0.6	-0.5	-0.1	-0.9	-0.9	-0.8	-2.4	0.5	0.5	3.5	n.a.	3.5
Credit-to-GDP gap (st. dev)	0.6	0.9	1.0	0.8	0.7	0.4	-0.1	1.7	3.0	2.0	n.a.	2.0
Balance Sheet Soundness	M	M	M	M	M	M	M	M	M	M	M	M
Balance Sheet Structural Risk	M	M	M	M	M	M	M	M	M	M	M	M
Deposit-to-loan ratio	132.1	132.7	133.6	134.1	134.4	135.6	136.7	136.7	141.7	148.1	149.5	149.5
FX liabilities % (of total liabilities)	29.3	29.8	29.5	28.9	28.4	28.8	27.7	29.6	27.7	26.8	26.4	26.4
FX loans % (of total loans)	39.5	39.5	39.2	39.1	38.5	38.1	36.8	37.3	37.3	36.8	36.1	36.1
Balance Sheet Buffers	L	L	L	L	L	L	L	L	L	L	L	L
Leverage	L	L	L	L	L	L	M	M	M	M	M	M
Leverage ratio (%)	7.4	7.3	7.1	7.4	7.3	7.1	6.9	6.9	6.8	6.7	6.5	6.5
Profitability	L	L	L	L	L	L	L	L	L	L	L	L
ROA	1.6	1.7	1.6	1.6	1.6	1.6	1.7	1.7	1.7	1.6	1.5	1.5
ROE	17.5	17.5	16.7	16.7	16.9	16.7	17.9	18.0	17.4	17.2	16.1	16.1
Asset quality	L	L	L	L	L	M	L	L	L	L	L	L
NPL ratio	2.4	2.4	2.2	2.2	2.4	2.5	2.2	2.1	2.0	2.1	1.8	1.8
NPL ratio change (%, annual)	-6.1	-6.9	-6.4	-9.2	0.7	5.2	1.2	-6.5	-14.5	-16.9	-16.9	-16.9

Source: IMF FSI database; and Fund staff calculations.

Annex I. External Sector Assessment

The trade deficit declined in 2020 due to exports resilience and significant imports compression, which combined with strong remittances inflows resulted in substantial widening of the current account (CA) surplus. Reserves continued to increase, and the net international investment position remained healthy. Staff estimates based on the EBA CA methodology suggest that the external position is substantially stronger than the level implied by fundamentals and medium-term desirable policies. Structural reforms that improve the business climate, enhance productivity and labor market conditions would help close the CA gap over the medium to long term while mitigating REER appreciation and a worsening of the trade deficit.

A. Recent Developments

1. The CA surplus increased significantly in 2020 supported by a decline in the trade deficit and resilient remittances. The CA surplus broadened to 5.5 percent of GDP in 2020 from 2.3 percent in 2019. A decline in exports from the contraction in external demand, particularly for tourism and travel services, was tempered by a favorable export mix of agro-industrial products (cardamom, vegetable oils, among others) and pandemic-related manufacturing products (chemical supplies and disinfectants). Moreover, the overall contraction in exports was overweighted by strong imports compression, including due to lower fuel prices. Despite a severe drop between March and May 2020, remittances experienced a strong rebound in the second half of the year and achieved an annual growth of 7.9 percent, reaching 14.6 percent of GDP, up from 13.7 percent in 2019. In the short run, the CA surplus as a share of GDP is expected to decrease on the back of recovery of imports (including due to rising fuel prices) and of nominal GDP.

2. The real effective exchange rate (REER) appreciated slightly in 2020. Supported by robust remittances inflows, the REER experienced a steady appreciation over the last decade by 37 percent cumulatively. In 2020, the real and nominal effective exchange rates continued to appreciate by 1.3 and 1.8 percent respectively. The quetzal remained relatively stable and depreciated by 1.2 percent relative to the US dollar.

3. FDI has been falling steadily over time. FDI inflows have decreased from 2.9 percent of GDP in 2013 to 1.5 percent in 2019. This reflects weak infrastructure, relatively high levels of crime and other factors discouraging investment. Portfolio investment and other investment contributions to net inward capital flows remain volatile. FDI inflow is estimated to have shrunk to 1 percent of GDP due to the pandemic shock in 2020, while an increase in projected portfolio inflows reflects a Eurobond issuance of US$1.2 billion in April 2020. In the medium term, FDI is expected to remain stable around 2019 level and finance CA deficit.

Table I.1. EBA External Sector Assessment

		2018 1/	2020
EBA CA methodology		*Percent of GDP (except for REER Gap)*	
CA-Actual	(A)	**0.8**	**5.5**
Cyclical contributions /2	(B)	0.1	-0.3
COVID-19 Adjustments	('C)		0.7
of which: Oil adjustor			0.9
Tourism adjustor			-0.4
Remittances adjustor			0.2
Adjusted CA	(D = A-B-C)	**0.7**	**5.1**
CA Norm /2	('E)	**-4.2 +/- 1.3**	**-4.0 +/- 1.2**
Adjustments to the norm /3	(F)	-2.0	-2.0
Adjusted CA norm	(G = E-F)	**-2.2 +/- 1.3**	**-2.0 +/- 1.2**
CA gap	(H = D - G)	**2.9 +/- 1.3**	**7.1 +/- 1.2**
Contribution of identified policy gaps /2,4		0.8	2.0
Elasticity /2	(J)	0.16	0.12
REER Gap (percent) /5	**(K=H/J)**	**[-26,-10]**	**[-69,-49]**

Source: IMF staff estimates.

1/ Data featured in the previous Article IV consultation in 2019.

2/ Estimates from the EBA CA model. The standard error of the CA norm is 1.2 percent of GDP for Guatemala in 2020.

3/ Adjustment to the norm upward reflects the negative impact of Guatemala's security conditions on investment which is not captured by the EBA CA model.

4/ Of which, 1.7 percent owes to lower fiscal deficit and 0.5 percent owes to lower health spending than desirable policies.

5/ "-" indicates undervaluation

4. **External liabilities remain at low levels, as desired given Guatemala's weak investment climate.** The net international investment position (NIIP) has been declining over the last 5 years to -15.8 percent of GDP in 2019 and further to -10.3 percent in 2020 remains much stronger than the average for Central America countries of -69 percent of GDP. External liabilities are divided among 43 percent of FDI, 19percent of portfolio investment and 38 percent of other investment. Public external debt comprised around 16 percent of external liabilities in 2020 or around 13.5 percent of GDP.

B. External Sector Assessment

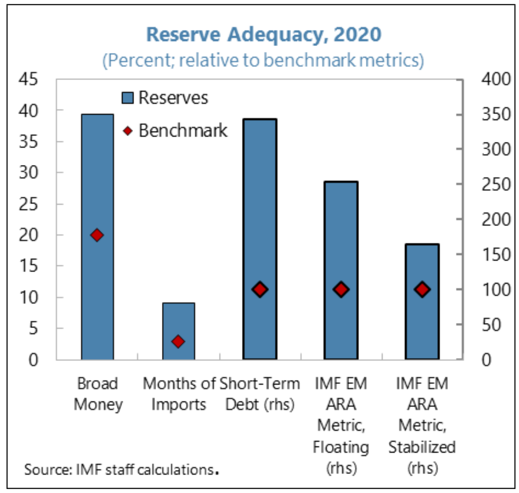
5. **The external balance assessment (EBA) methodology suggests that the external position in 2020 was [substantially stronger] than the level consistent with fundamentals and desirable medium-term policies.** The EBA model in 2020 includes the additional adjustors to the CA that capture the temporary impacts of the COVID-19 pandemic through a decline in tourists flows and oil prices. The EBA assessment for Guatemala further includes the adjustor for remittances' resilience (as a share of GDP). The CA norm is estimated at -4 percent. However, as in the 2019 Article IV, the CA norm is revised up by staff to -2 percent of GDP to account for relatively poor security conditions negatively impacting investment and that are not captured by the ICRG index.

6. **The estimated CA gap is large at 5.9 to 8.3 percent of GDP once estimation uncertainty is accounted for.** Under the assumption that the CA gap will be closed by an

adjustment in the trade balance, the EBA model implies that REER undervaluation in the range of -69 to -49 percent once uncertainty around estimates is considered.[1] Policy gaps account for about 30 percent of the CA gap and reflect lower fiscal deficit and health spending than desirable. In the short run, the CA gap is expected to decrease on the back of weaker CA surplus following recovery of imports and nominal GDP.[2] In the medium-term, business climate reforms and spending on infrastructure, including those envisaged under the government's Plan for Economic Recovery, should facilitate investment, improve labor conditions, and abate migration and remittances—hence mitigating the scale of REER appreciation needed to close the large CA gap.

C. Reserve Adequacy Assessment

7. Reserves continue to increase in line with a stronger CA balance and crisis uncertainty. End-of-year net international reserves (NIR) under the IMF definition increased by US$3.5 billion and reached the level of around US$17.3 billion in 2020, or 165 percent of the IMF's metric for Assessing Reserve Adequacy (ARA metric) for countries with stabilized exchange rates. Reserves continue being above other traditional metrics and cover more than 9 months of next year's imports, 39 percent of broad money, and 343 percent of short-term external debt.



[1] The EBA REER index model indicates that REER is over-valued by about 38 percent in 2020. The staff assessment is based on the EBA CA model because Guatemala is not included in the EBA REER index model so the model's estimate relies on imputed values for the missing data, such as country fixed effect.

[2] Similarly, CA increased in 2009 during the global financial crisis due to import compression followed by a normalization in 2010.

Annex II. Risk Assessment Matrix [1/]

Risks		Policy Response
External		
Unexpected shift in the Covid-19 pandemic. The disease proves harder to eradicate (e.g., due to new virus strains, short effectiveness of vaccines, or widespread unwillingness to take them), requiring costly containment efforts and prompting persistent behavioral changes rendering many activities unviable.	Medium Likelihood High Impact	Delay the withdrawal of fiscal support to guard against downside risks, and step up public investment. Prolong expansionary monetary policy, coupled with exchange rate flexibility to help absorb external shocks.
Intensified geopolitical tensions and security risks. (Geo)political tensions in selected countries/regions (e.g., Middle East) cause economic/political disruption, disorderly migration, higher volatility in commodity prices (if supply is disrupted), and lower confidence.	High Likelihood Medium Impact	Coordinate closely with regional authorities on sanitary protocols to avoid interruptions of trade flows; and continue enhancing COVID-19 tracing capabilities, including among migrant workers, to contain community transmission.
Sharp rise in global risk premia exposes financial and fiscal vulnerabilities. A reassessment of market fundamentals triggers a widespread risk-off event. Higher risk premia generate financing difficulties for leveraged firms and households, and a wave of bankruptcies erode banks' capital buffers. Financing difficulties extend to sovereigns with excessive public debt, leading to cascading debt defaults.	Medium Likelihood Low Impact	Enhance fiscal risks management and promote the development of the domestic bond market to mitigate external volatility. Strict vigilance of firms' and households' levels of indebtedness and banks' credit exposures, and adjust loan provisions and capital buffers as warranted.
Domestic		
Higher frequency and severity of natural disasters. Climate related natural disasters take a deep toll on growth prospects and erode fiscal cushions, and reconstruction costs crowd out scarce resources for health, education, and social spending.	Medium Likelihood Medium Impact	Supplement risk retention instruments with risk transfer instruments to expand response capacity while preserving fiscal resilience. Prioritize investments for infrastructure resilience.
Social discontent and political instability. Persistent increases in poverty and malnutrition could trigger social discontent. Growing political instability weakens policy effectiveness and confidence.	High Likelihood Medium Impact	Scale up conditional cash transfers and nutrition programs. Enhance spending efficiency and transparency to broaden the provision of public services and limit exposure to corruption. Advance structural reforms to lift potential growth, employment, and living standards.
Deterioration of credit portfolio quality. Exit from regulatory forbearance measures could pressure banks' asset quality and capital provisioning requirement, curtailing the financing for the recovery.	Medium Likelihood Low Impact	Intensify the monitoring of credit exposures, NPL classification, potential losses, and credit risk management practices.
Tax revenue shortfall. Failure to restore tax collection post-pandemic could put at risk the fiscal support for the recovery and for social programs.	Medium Likelihood Medium Impact	Step up efforts to strengthen tax administration focusing on VAT and customs controls. Improve spending efficiency through implementation of structural fiscal reforms.
Business climate reforms. Faster than expected progress with structural reforms provides an enabling environment for investment and lift potential growth.	Medium Likelihood Medium Impact	Take advantage of favorable conditions to advance fiscal structural reforms and to increase the provision of public services.

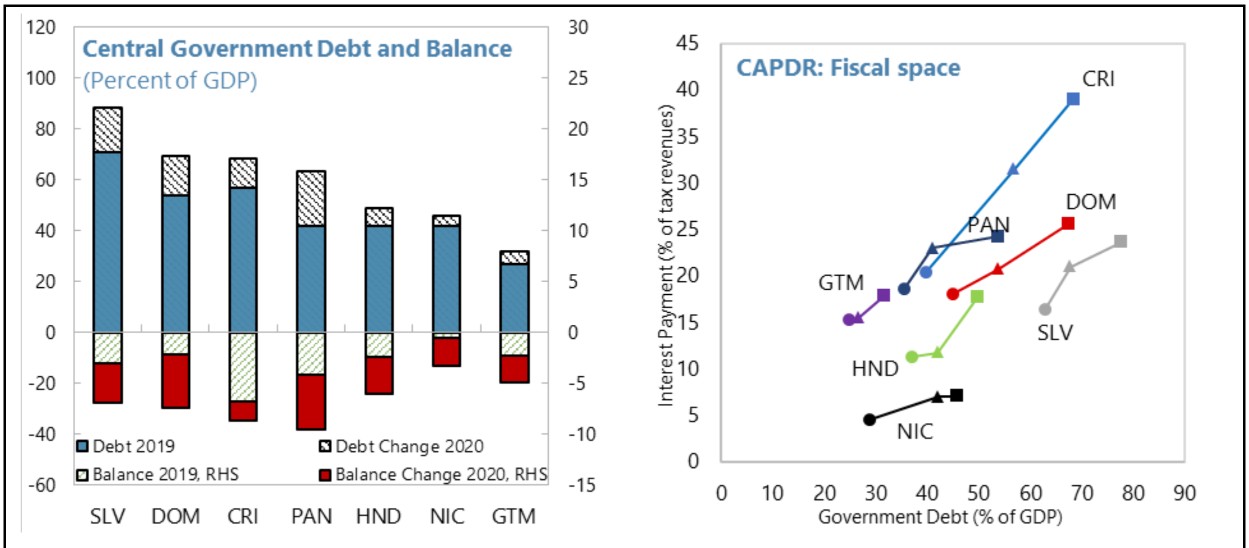
[1] The Risk Assessment Matrix (RAM) shows events that could materially alter the baseline path. The relative likelihood is the staff's subjective assessment of the risks surrounding the baseline ("low" is meant to indicate a probability below 10 percent, "medium" a probability between 10 and 30 percent, and "high" a probability between 30 and 50 percent). The RAM reflects staff views on the source of risks and overall level of concern as of the time of discussions with the authorities. Non-mutually exclusive risks may interact and materialize jointly.

Annex III. Public Debt Sustainability Analysis

This annex presents an assessment of Guatemala's medium-term debt sustainability. The results suggest that central government debt is sustainable at 34 percent of GDP under the current policies. Public debt is resilient to short-term shocks as debt-to-GDP ratios remain below 40 percent in all standardized macro-fiscal stress tests. The sustainability of public finances was also secured under two severe alternative scenarios. The first one assumes that the outbreak lasts longer than in the baseline, hampering the recovery and delaying the withdrawal of fiscal support. The second one assumes additional social spending to mitigate the impacts of the protracted pandemic. Both scenarios assumed a 20 percent exchange rate depreciation in 2021. Even under these stringent scenarios, debt stabilizes below 45 percent of GDP, while gross financing needs converge to below 5 percent of GDP.

A. Introduction

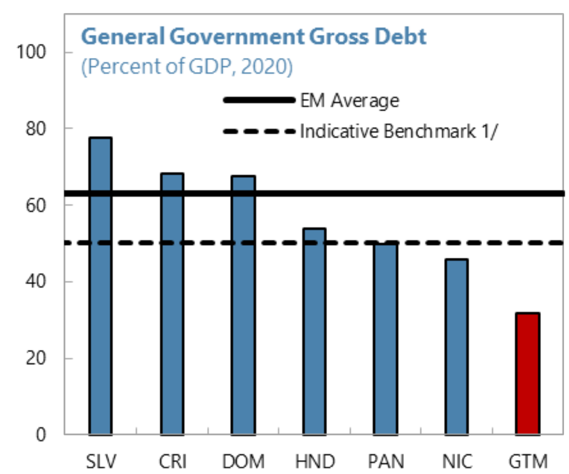
1. **In 2020, Guatemala drew on its fiscal space to protect lives and livelihoods.** With an average primary deficit around 0.5 percent of GDP and interest payments at 1½ percent of GDP during the last decade, Guatemala entered the pandemic with ample fiscal space. The government's steadfast policy response delivered an unprecedented fiscal impulse of 2.3 percent of GDP, widening the fiscal deficit to 4.9 percent of GDP (2.1 percent over the last decade). To secure its gross financing needs, MINFIN deployed a hybrid financing strategy, mobilizing around US$1,900 million through domestic bond placements, US$1,400 million through direct bond placements with the central bank, US$1,200 million in Eurobonds, and US$535 million in IFI loans (comprising a US$200 million WB loan for disaster relief and US$271 million IADB loans, primarily for budget support). Guatemala's financing conditions have remained relatively favorable. As such, yields of the Eurobonds issued in April 2020 were similar or lower than those issued in 2019. In the domestic market treasury bond yields also presented a downward trend in 2020, owing to the increased financial system liquidity.

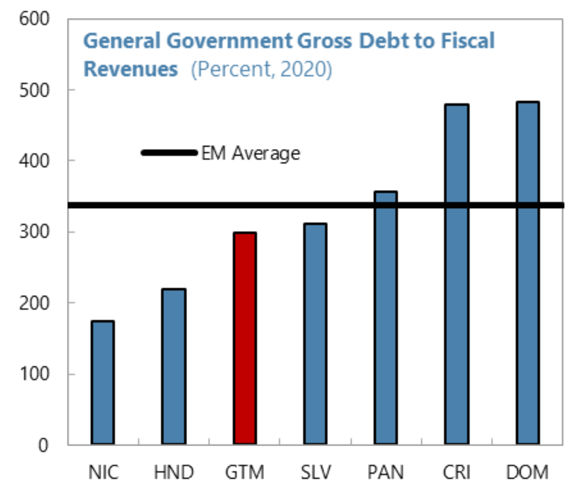


Sources: WEO, and IMF staff estimates.

2. Guatemala's tax burden, the lowest in the region, somewhat limits debt affordability. Despite the massive policy support, public debt stood at 31.5 percent of GDP in 2020, well below the indicative benchmark of 60 percent of GDP for countries with market access and one of the lowest ratios in the region and across emerging market peers.[1]

3. Guatemala's low indebtedness, coupled with a track record of prudent economic policies, has proved attractive to investors especially in international markets. However, these strengths are somewhat offset by a narrow tax base that limits productive spending and debt carrying capacity. As a share of revenues, Guatemala's public debt (around 300 percent) has converged to the average of emerging markets, reflecting its low tax revenues in global comparison. In 2020, domestic debt stood at 18 percent of GDP, accounting for almost 57 percent of total debt, while external public debt stood at 13.5 percent of GDP.





Sources: WEO, and IMF staff estimates.
1/ Indicative benchmark of 50 percent of GDP for emerging market countries beyond which higher scrutiny and a deeper assessment of risks is required.

B. Assessing Debt Dynamics and Fiscal Sustainability

4. The sustainability of public finances was analyzed under a baseline scenario and two alternative scenarios. The baseline scenario draws upon the 2021 budget setting with an overall deficit of 3.4 percent of GDP and a negative fiscal impulse of 1½ percent of GDP. From 2022 to 2026, the baseline fiscal deficit gradually improves from 2.8 percent of GDP to 2.0 percent of GDP. The first alternative scenario assumes that the virus surge (including from new variants) proves difficult to contain, infections and deaths mount rapidly before vaccines are widely available, and voluntary distancing proves stronger than anticipated. This leads to a lower-than-expected GDP growth by 1 percentage points in 2022, increased support to firms and households in 2021, and an

[1] See Annex II of the IMF "Staff Guidance Note for Public Debt Sustainability Analysis in Market Access Countries," 2013 at https://www.imf.org/external/np/pp/eng/2013/050913.pdf.

overall deficit of 2¾ percent of GDP, on average, over 2021-26. The second alternative scenario assumes, in addition to the response in the previous scenario, upscaled social programs[2] of 0.9 percent of GDP and a fiscal deficit of 3.6 percent of GDP per year during 2022-26, to mitigate the social scars from a protracted pandemic.

5. The fiscal position remains sustainable in the medium-term under all three scenarios. In the baseline scenario the debt-to-GDP ratio stabilizes at 34 percent of GDP in 2026 while the debt-to-revenue ratio remains at around 300 percent. In the first alternative scenario, the debt-to-GDP ratio rises slightly in the short term and stabilizes at 39 percent of GDP in 2026, with debt-to-revenue ratio reaching 340 percent. Under the second alternative scenario, the debt-to-GDP ratio stabilizes at 43 percent of GDP, with the debt-to-revenue ratio reaching 370 percent. Under all three scenarios the debt-to-GDP does not exceed the 60 percent indicative benchmark for countries with market access.

6. The sensitivity analysis suggests that Guatemala's debt burden indicators are resilient to short-term macroeconomic shocks. Five sensitivity tests are considered, including shocks to the primary balance, the real GDP growth, the real interest rate, the real exchange rate, as well as a shock combining all of the above. The size of each shock was based on the historical standard deviations of the corresponding variables.

- *Real GDP Growth Shock*. GDP growth rate is reduced by 1 standard deviation for 2 consecutive years, dropping growth rate to 2 and 1½ percent in 2022 and 2023, respectively. The decline in growth leads to lower inflation (0.25 percentage points per 1 percentage point decrease in GDP growth).
- *Primary Surplus Shock*. The portrayed shock is equivalent to 0.6 percent of GDP (half of the 10-year historical standard deviation). The shock triggers an increase in interest rates of 25 basis points for every percentage point of GDP worsening in the primary balance.
- *Interest Rate Shock*. The interest rate increases by 200 basis points relative to the baseline.
- *Real Exchange Rate Shock*. The shock translates to a nominal exchange rate depreciation of 10 percent with a pass-through elasticity to inflation of 0.25.

[2] Based on an UNDP costing exercise for Guatemala "Social Protection for Post-COVID-19 Recovery". Assumes that an average of 880,000 households receive a monthly cash transfer of 64 dollars, covering 1¼ times the extreme poverty line, with an equivalent annual cost of 0.87 percent of GDP.

Figure III.1. Guatemala Public Sector Debt Sustainability Analysis (DSA) – Baseline Scenario

(In percent of GDP unless otherwise indicated)

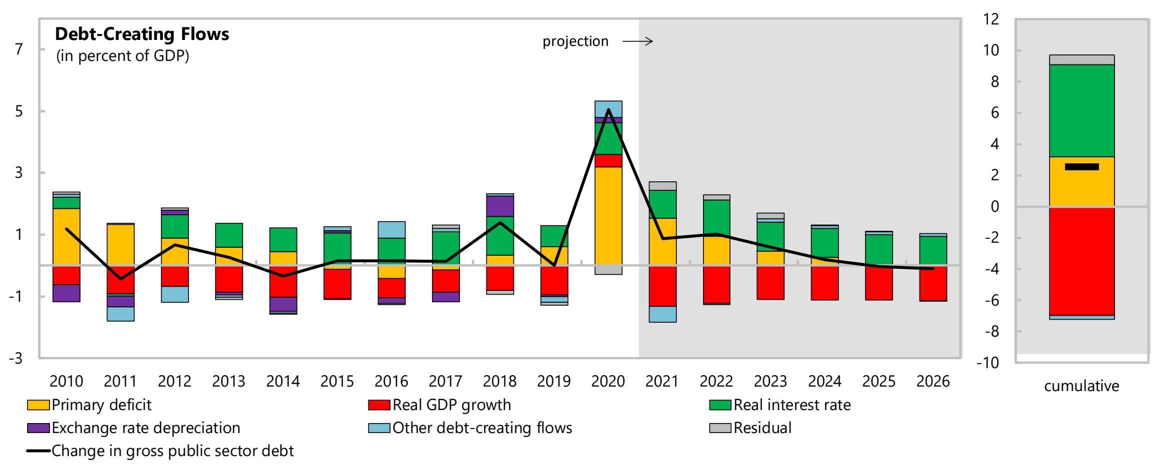
Debt, Economic and Market Indicators 1/

	Actual 2010-2018 2/	Actual 2019	Actual 2020	Projections 2021	2022	2023	2024	2025	2026
Nominal gross public debt	24.9	26.5	31.5	32.4	33.4	34.0	34.2	34.2	34.0
Public gross financing needs	3.3	3.5	6.4	4.7	4.1	3.4	3.7	3.3	3.8
Real GDP growth (in percent)	3.5	3.9	-1.5	4.5	4.0	3.5	3.5	3.5	3.5
Inflation (GDP deflator, in percent)	3.3	3.7	2.6	3.2	2.2	3.1	3.1	3.1	3.2
Nominal GDP growth (in percent)	6.9	7.7	1.1	7.9	6.3	6.7	6.7	6.7	6.8
Effective interest rate (in percent) 4/	6.7	6.6	6.6	6.5	6.2	6.2	6.2	6.2	6.3

As of December 31, 2020		
Sovereign Spreads		
EMBIG (bp) 3/		232
5Y CDS (bp)		N/A
Ratings	Foreign	Local
Moody's	Ba1	Ba1
S&Ps	BB-	BB-
Fitch	BB-	BB-

Contribution to Changes in Public Debt

	Actual 2010-2018	Actual 2019	Actual 2020	Projections 2021	2022	2023	2024	2025	2026	cumulative	debt-stabilizing primary balance 9/
Change in gross public sector debt	0.4	0.0	5.0	0.9	1.0	0.6	0.2	0.0	-0.1	2.5	
Identified debt-creating flows	0.4	0.1	5.3	0.6	0.8	0.4	0.2	0.0	-0.1	1.9	
Primary deficit	0.5	0.6	3.2	1.5	0.9	0.5	0.3	0.0	0.0	3.2	-0.1
Primary (noninterest) revenue and grants	11.5	11.2	10.7	10.6	11.0	11.3	11.4	11.4	11.5	67.2	
Primary (noninterest) expenditure	12.1	11.8	13.9	12.1	11.9	11.7	11.6	11.5	11.5	70.3	
Automatic debt dynamics 5/	-0.2	-0.3	1.6	-0.4	0.0	-0.1	-0.2	-0.1	-0.2	-1.1	
Interest rate/growth differential 6/	0.0	-0.3	1.4	-0.4	0.0	-0.1	-0.2	-0.1	-0.2	-1.1	
Of which: real interest rate	0.8	0.7	1.0	0.9	1.2	1.0	0.9	1.0	1.0	5.9	
Of which: real GDP growth	-0.8	-1.0	0.4	-1.3	-1.2	-1.1	-1.1	-1.1	-1.1	-7.0	
Exchange rate depreciation 7/	-0.1	-0.1	0.2	…	…	…	…	…	…	…	
Other identified debt-creating flows	0.0	-0.2	0.5	-0.5	-0.1	0.1	0.1	0.1	0.1	-0.2	
Use of deposits	0.0	-0.2	0.5	-0.5	-0.1	0.1	0.1	0.1	0.1	-0.2	
Contingent liabilities	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	
Privatization receipts (+ reduces financing needs)	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	
Residual, including asset changes 8/	0.0	-0.1	-0.3	0.3	0.2	0.2	0.0	0.0	0.0	0.6	



Source: IMF staff.

1/ Public sector is defined as central government.

2/ Based on available data.

3/ EMBIG.

4/ Defined as interest payments divided by debt stock (excluding guarantees) at the end of previous year.

5/ Derived as [(r - π(1+g) - g + ae(1+r)]/(1+g+π+gπ)) times previous period debt ratio, with r = interest rate; π = growth rate of GDP deflator; g = real GDP growth rate; a = share of foreign-currency denominated debt; and e = nominal exchange rate depreciation (measured by increase in local currency value of U.S. dollar).

6/ The real interest rate contribution is derived from the numerator in footnote 5 as r - π (1+g) and the real growth contribution as -g.

7/ The exchange rate contribution is derived from the numerator in footnote 5 as ae(1+r).

8/ Includes asset changes and interest revenues (if any). For projections, includes exchange rate changes during the projection period.

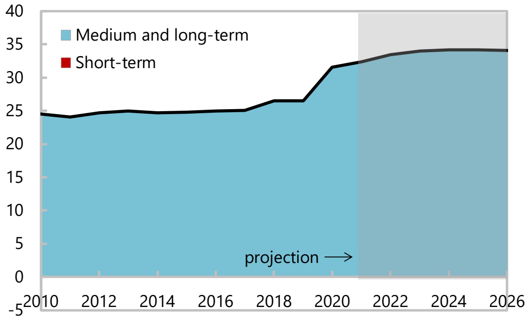
9/ Assumes that key variables (real GDP growth, real interest rate, and other identified debt-creating flows) remain at the level of the last projection year.

Figure III.2. Guatemala Public DSA – Composition of Public Debt and Alternative Scenarios

Composition of Public Debt

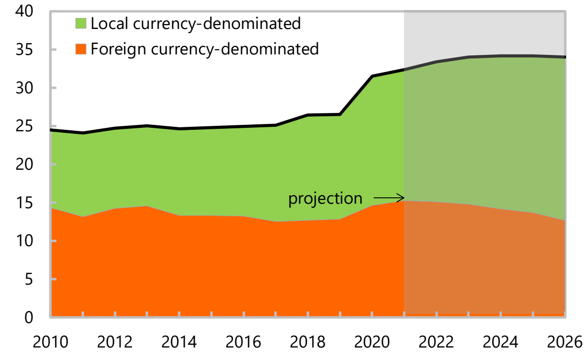
By Maturity

(In percent of GDP)



By Currency

(In percent of GDP)

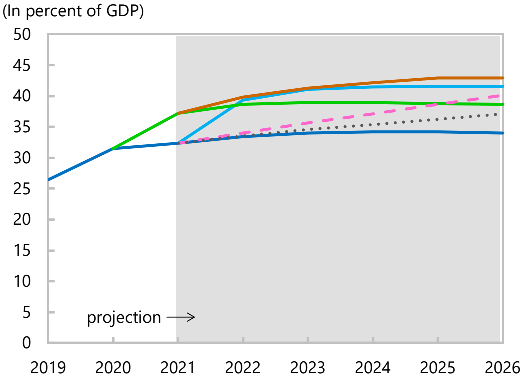


Alternative Scenarios

Baseline
Historical
Constant Primary Balance
Contingent Liability Shock
Protracted Outbreak 2021
Outbreak 2021 and social programs

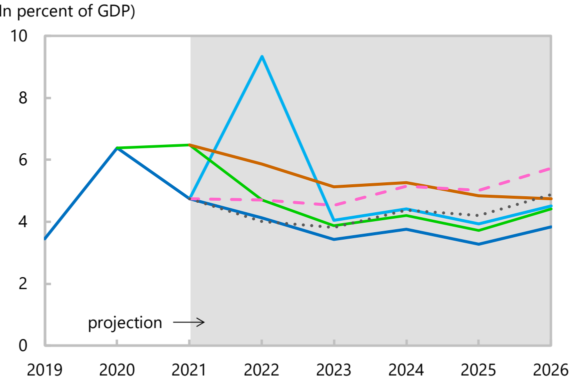
Gross Nominal Public Debt

(In percent of GDP)



Public Gross Financing Needs

(In percent of GDP)



Underlying Assumptions

(In percent)

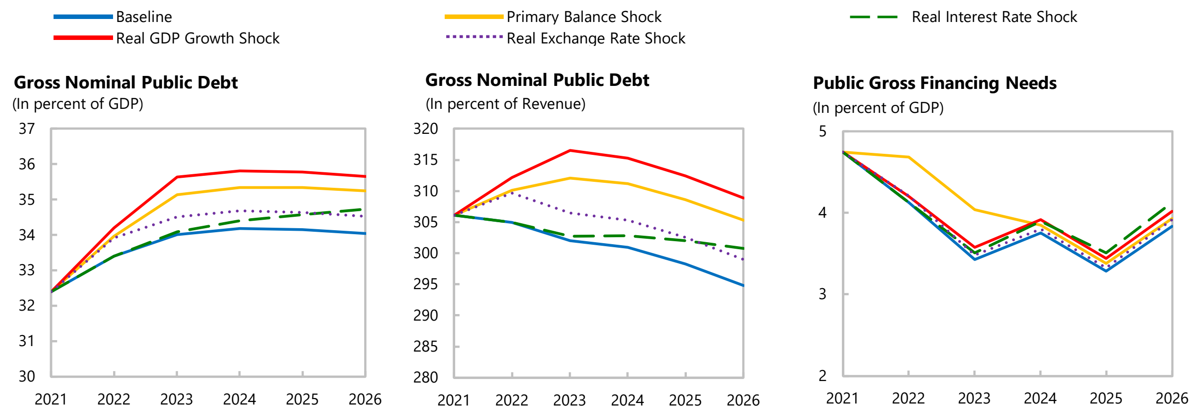
Baseline Scenario	2021	2022	2023	2024	2025	2026
Real GDP growth	4.5	4.0	3.5	3.5	3.5	3.5
Inflation	3.2	2.2	3.1	3.1	3.1	3.2
Primary Balance	-1.5	-0.9	-0.5	-0.3	0.0	0.0
Effective interest rate	6.5	6.2	6.2	6.2	6.2	6.3
Constant Primary Balance Scenario						
Real GDP growth	4.5	4.0	3.5	3.5	3.5	3.5
Inflation	3.2	2.2	3.1	3.1	3.1	3.2
Primary Balance	-1.5	-1.5	-1.5	-1.5	-1.5	-1.5
Effective interest rate	6.5	6.2	6.2	6.3	6.4	6.5
Protracted Outbreak 2021						
Real GDP growth	3.0	3.0	3.7	4.0	3.9	3.5
Inflation	3.2	2.2	3.1	3.1	3.1	3.2
Primary Balance	-1.5	-0.9	-0.5	-0.3	0.0	0.0
Effective interest rate	6.5	6.1	6.2	6.2	6.3	6.4

Historical Scenario	2021	2022	2023	2024	2025	2026
Real GDP growth	4.5	3.3	3.3	3.3	3.3	3.3
Inflation	3.2	2.2	3.1	3.1	3.1	3.2
Primary Balance	-1.5	-0.8	-0.8	-0.8	-0.8	-0.8
Effective interest rate	6.5	6.2	6.2	6.3	6.4	6.5
Contingent Liability Shock						
Real GDP growth	4.5	2.0	1.5	3.5	3.5	3.5
Inflation	3.2	1.7	2.6	3.1	3.1	3.2
Primary Balance	-1.5	-5.8	-0.5	-0.3	0.0	0.0
Effective interest rate	6.5	7.2	6.7	6.6	6.7	6.7
Outbreak 2021 and social programs						
Real GDP growth	3.0	3.0	3.7	4.0	3.9	3.5
Inflation	3.2	2.2	3.1	3.1	3.1	3.2
Primary Balance	-1.5	-2.1	-1.6	-1.1	-0.9	0.0
Effective interest rate	6.5	6.1	6.2	6.4	6.5	6.6

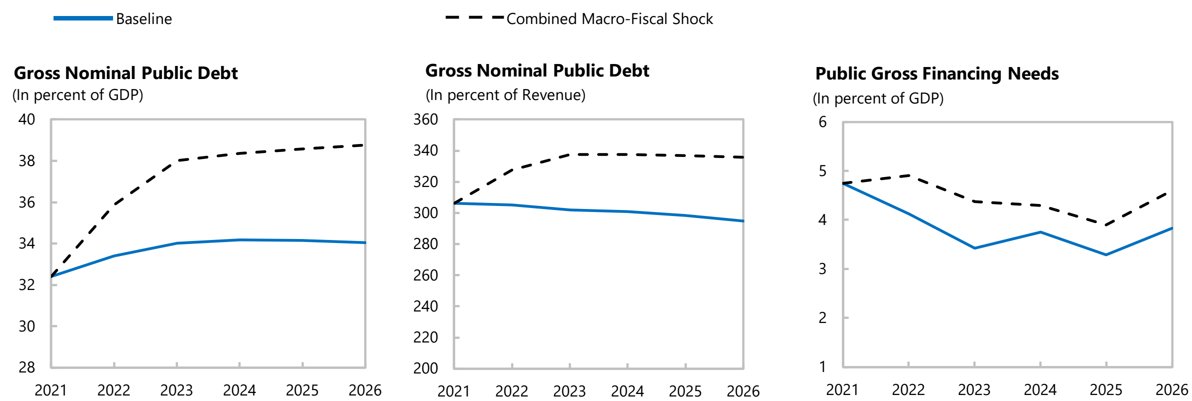
Source: IMF staff estimates.

Figure III.3 Guatemala Public DSA – Stress Test

Macro-Fiscal Stress Tests



Additional Stress Tests



Underlying Assumptions

(In percent)

	2021	2022	2023	2024	2025	2026
Primary Balance Shock						
Real GDP growth	4.5	4.0	3.5	3.5	3.5	3.5
Inflation	3.2	2.2	3.1	3.1	3.1	3.2
Primary balance	-1.5	-1.5	-1.0	-0.3	0.0	0.0
Effective interest rate	6.5	6.2	6.2	6.3	6.3	6.4
Real Interest Rate Shock						
Real GDP growth	4.5	4.0	3.5	3.5	3.5	3.5
Inflation	3.2	2.2	3.1	3.1	3.1	3.2
Primary balance	-1.5	-0.9	-0.5	-0.3	0.0	0.0
Effective interest rate	6.5	6.2	6.4	6.6	6.9	7.1
Combined Shock						
Real GDP growth	4.5	2.0	1.5	3.5	3.5	3.5
Inflation	3.2	1.7	2.6	3.1	3.1	3.2
Primary balance	-1.5	-1.5	-1.0	-0.3	0.0	0.0
Effective interest rate	6.5	6.3	6.5	6.7	7.0	7.2

	2021	2022	2023	2024	2025	2026
Real GDP Growth Shock						
Real GDP growth	4.5	2.0	1.5	3.5	3.5	3.5
Inflation	3.2	1.7	2.6	3.1	3.1	3.2
Primary balance	-1.5	-0.9	-0.5	-0.3	0.0	0.0
Effective interest rate	6.5	6.2	6.2	6.2	6.2	6.3
Real Exchange Rate Shock						
Real GDP growth	4.5	4.0	3.5	3.5	3.5	3.5
Inflation	3.2	4.0	3.1	3.1	3.1	3.2
Primary balance	-1.5	-0.9	-0.5	-0.3	0.0	0.0
Effective interest rate	6.5	6.3	6.2	6.2	6.2	6.3

Source: IMF staff estimates.

Annex IV. External Debt Sustainability

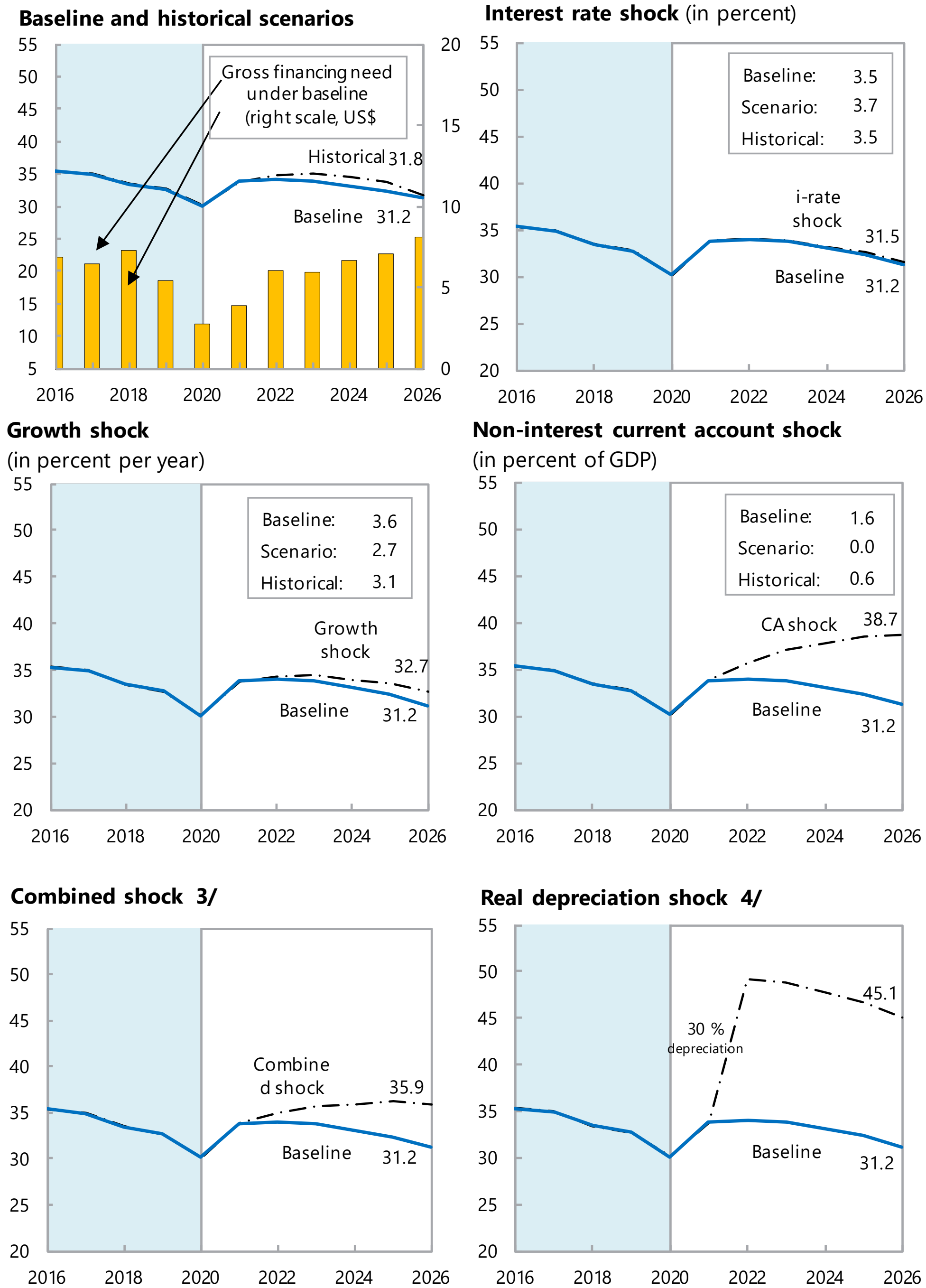
Table IV.1. Guatemala: External Debt Sustainability Framework, 2016-26
(In percent of GDP, unless otherwise indicated)

	Actual							Projections						
	2016	2017	2018	2019	2020			2021	2022	2023	2024	2025	2026	Debt-stabilizing non-interest current account 6/
Baseline: External debt	35.3	34.9	33.4	32.7	30.1			**33.8**	**34.0**	**33.8**	**33.0**	**32.3**	**31.2**	**-2.1**
Change in external debt	-0.4	-0.4	-1.5	-0.8	-2.6			3.7	0.2	-0.2	-0.8	-0.7	-1.1	
Identified external debt-creating flows (4+8+9)	-4.5	-5.2	-2.6	-5.0	-5.8			-4.6	-4.0	-3.3	-2.7	-2.1	-1.5	
Current account deficit, excluding interest payments	-2.1	-2.3	-2.1	-3.7	-6.3			-3.5	-2.9	-2.3	-1.6	-1.0	-0.4	
Deficit in balance of goods and services	8.9	9.1	10.7	10.5	8.5			11.2	11.8	12.0	12.2	12.3	12.4	
Exports	18.8	18.5	18.3	17.7	16.7			16.6	16.1	15.6	15.0	14.5	13.9	
Imports	27.6	27.6	29.0	28.2	25.2			27.8	27.9	27.6	27.2	26.8	26.3	
Net non-debt creating capital inflows (negative)	-1.5	-1.3	-1.1	-1.1	-0.6			-1.1	-1.1	-1.1	-1.1	-1.1	-1.1	
Automatic debt dynamics 1/	-1.0	-1.6	0.6	-0.3	1.1			0.0	-0.1	0.0	0.0	0.0	0.0	
Contribution from nominal interest rate	1.1	1.2	1.3	1.3	1.3			1.2	1.2	1.2	1.1	1.1	1.0	
Contribution from real GDP growth	-0.9	-1.0	-1.1	-1.2	0.5			-1.3	-1.3	-1.1	-1.1	-1.1	-1.1	
Contribution from price and exchange rate changes 2/	-1.2	-1.8	0.4	-0.3	-0.6			...	...	...	...	...	...	
Residual, incl. change in gross foreign assets (2-3) 3/	4.1	4.7	1.2	4.3	3.2			8.3	4.2	3.1	1.9	1.4	0.4	
External debt-to-exports ratio (in percent)	188.4	188.5	183.2	184.6	179.7			203.2	211.5	216.9	219.8	223.5	224.2	
Gross external financing need (in billions of US dollars) 4/	4.5	4.6	5.3	4.2	2.1			3.2	5.1	5.3	6.3	7.1	8.8	
in percent of GDP	6.9	6.4	7.2	5.4	2.7	10-Year	10-Year	3.9	6.1	5.9	6.6	7.0	8.1	
Scenario with key variables at their historical averages 5/								**33.8**	**34.8**	**35.1**	**34.6**	**33.7**	**31.8**	**-2.6**
Key Macroeconomic Assumptions Underlying Baseline						Historical Average	Standard Deviation							
Real GDP growth (in percent)	2.7	3.0	3.2	3.8	-1.5	3.1	1.7	4.5	4.0	3.5	3.5	3.5	3.5	
GDP deflator in US dollars (change in percent)	3.4	5.2	-1.0	1.0	2.0	3.2	2.8	1.1	0.3	1.7	3.1	3.1	3.1	
Nominal external interest rate (in percent)	3.4	3.6	3.8	4.0	4.0	3.5	0.3	4.3	3.7	3.6	3.5	3.4	3.3	
Growth of exports (US dollar terms, in percent)	0.5	7.0	0.8	1.7	-5.0	3.2	7.2	4.9	0.8	2.0	2.8	2.8	2.7	
Growth of imports (US dollar terms, in percent)	-2.4	8.4	7.1	2.0	-10.1	3.3	7.7	16.5	4.6	4.2	5.0	5.2	5.0	
Current account balance, excluding interest payments	2.1	2.3	2.1	3.7	6.3	0.6	3.2	3.5	2.9	2.3	1.6	1.0	0.4	
Net non-debt creating capital inflows	1.5	1.3	1.1	1.1	0.6	1.7	0.7	1.1	1.1	1.1	1.1	1.1	1.1	

1/ Derived as [r - g - r(1+g) + ea(1+r)]/(1+g+r+gr) times previous period debt stock, with r = nominal effective interest rate on external debt; r = change in domestic GDP deflator in US dollar terms, g = real GDP growth rate,
e = nominal appreciation (increase in dollar value of domestic currency), and a = share of domestic-currency denominated debt in total external debt.
2/ The contribution from price and exchange rate changes is defined as [-r(1+g) + ea(1+r)]/(1+g+r+gr) times previous period debt stock. r increases with an appreciating domestic currency (e > 0) and rising inflation (based on GDP deflator).
3/ For projection, line includes the impact of price and exchange rate changes.
4/ Defined as current account deficit, plus amortization on medium- and long-term debt, plus short-term debt at end of previous period.
5/ The key variables include real GDP growth; nominal interest rate; dollar deflator growth; and both non-interest current account and non-debt inflows in percent of GDP.
6/ Long-run, constant balance that stabilizes the debt ratio assuming that key variables (real GDP growth, nominal interest rate, dollar deflator growth, and non-debt inflows in percent of GDP) remain at their levels of the last projection year.

Figure IV.1. Guatemala: External Debt Sustainability: Bound Tests 1/ 2/

(External debt in percent of GDP)



Sources: International Monetary Fund, Country desk data, and staff estimates.
1/ Shaded areas represent actual data. Individual shocks are permanent one-half standard deviation shocks. Figures in the boxes represent average projections for the respective variables in the baseline and scenario being presented. Ten-year historical average for the variable is also shown.
2/ For historical scenarios, the historical averages are calculated over the ten-year period, and the information is used to project debt dynamics five years ahead.
3/ Permanent 1/4 standard deviation shocks applied to real interest rate, growth rate, and current account balance.
4/ One-time real depreciation of 30 percent occurs in 2019.

Annex V. Banking System Vulnerabilities and Stress Tests[1]

Stress tests are conducted on the Guatemalan banking system to assess both the solvency and liquidity stance of banks in the face of potential shocks. Results suggest that the banks are well prepared to absorb a range of shocks with available buffers, including the possible materialization of a substantial increase in impaired loans as regulatory forbearance is phased out.

A. Soundness of the Banking System and Risks

1. **Guatemala's banking system remains highly concentrated**. Over 80 percent of total assets are concentrated in the largest five banks (out of 17) and the top two banks account for nearly 50 percent of market share.

2. **The banking sector seems to have weathered the crisis so far.** The capital adequacy ratio (CAR) for the banking system was 15.6 percent as of December 2020, significantly higher than the minimum 10 percent threshold required by the regulatory authorities. For the banking system, a low 1.9 percent of total loans was impaired at end-2020 (Table 1). However, given the gradual phasing out of regulatory forbearance through September 2021, measured impaired loans might underestimate the true state of the loans portfolio. Relatedly, banks' provisions increased to more than 190 percent at end-2020, from less than 140 percent at end-2019, in anticipation of possible deterioration in loans quality.

3. **Deposits continued to be banks' main source of funding.** Deposits represented over three fourths of total liabilities at end-2020 and liquid assets covered over two-thirds of short-term liabilities. The deposit-to-loans ratio remains well above 100 for the system and individual institutions.

4. **Most potential losses and risks to solvency are likely to originate from credit risks in the loan book.** Loans represent about half of the banks' asset portfolio, the rest comprising long-term government bonds and central bank paper (about three tenths and expanding at a fast pace over the last three years)[2], cash and T-bills (around one sixth), and other assets (less than one twentieth of the total). Given the composition of banks' balance sheets, most potential losses and risks to solvency are likely to come from direct and indirect credit risks in the loan book. In addition, foreign-exchange long-term government bonds are affected by changes in their prices in international markets.

5. **Although declining over the past few years, dollarization continues to expose the system to FX risks**. Dollarization of both assets and liabilities has been recently declining but remains a source of risk to the banking system. Nearly 37 percent of banks loans are denominated

[1] We are grateful to Guatemala's Superintendency of Banks for providing the data necessary for this analysis.

[2] The share of investments in government bonds and central bank paper has expanded nearly GTQ 40 billion while loan portfolio has grown GTQ 31 billion over the last three years.

in foreign currency, and 39 percent of them have been extended to un-hedged borrowers, exposing the system to FX risk through credit risk.[3]

B. Solvency Stress Test

6. The stress test covers the main risks to solvency and liquidity faced by the banking system. The top-down solvency stress test includes: (i) credit risk, through an aggregate NPL shock as well as differentiated sectoral shocks; (ii) market risk, through interest and exchange rate risk; (iii) contagion risk through interbank exposure; and (iv) a set of reverse tests. The liquidity stress test models a simple liquidity drain that affects all banks in the system proportionally to each bank's liquidity holdings.

7. The impact of individual shocks to solvency is moderate and could be handled by existing buffers (Figure 1 and Table 2):

- The *credit risk shock* is modeled as a system-wide proportional increase in NPLs to 3.3 percent of total loans (the highest NPLs rate over the last 12 years); and sectoral shocks of 10 percent in the manufacturing, trade and non-bank financial sectors—which account for almost two fifths of loans. Results suggest that credit risk losses from a credit shock, both system-wide and sectoral, would materially affect banks capital adequacy, but losses would be measured in most cases. The CAR for the system would fall by 1.4 and 1.6 percent, to 14.2 and 14 percent, respectively. The CAR of two banks would decline slightly below the 10 percent minimum in the former case, and one bank's CAR would fall below 9 percent in the latter case.

Table V.1. Guatemala Selected Banking System Soundness Indicators
(Percent, December 2020)

	Banking System 1/
Capital Adequacy Ratio	
Capital / Risk Weighted Assets 2/	15.6
Asset Quality	
Non-Performing Loans / Total Loans	1.9
Provisions / NPLs	191.8
FX Loans / Total Loans	36.8
Funding	
Deposits / Total Liabilities	90.7
Deposits / Total Loans	174.0
Profitability	
ROA	1.5
ROE	16.1
Liquidity	
Liquid Assets / Total Assets	34.3
Liquid Assets / ST Liabilities	72.5
Sensitivity to Market Risk	
Net FX Exposure / Capital	15.7

Sources: SIB; and IMF staff calculations.

1/ Including: El Credito Hipotecario Nacional de Guatemala, Banco Inmobiliario, Banco de los Trabajadores, Banco Industrial, Banco de Desarrollo, Banco Internacional, Citibank, Vivibanco, Banco Ficohsa, Banco Promerica, Banco de Antigua, Banco de America Central, Banco Agromercantil, Banco G&T Continental, Banco Azteca, Banco INV & Banco Credicorp.

2/ Regulatory Capital (Assets minus Liabilities) is used in the calculation of the CAR.

- *Additional credit risk shocks* are conducted where the NPLs for regular loans remains at its baseline level of 1.8 percent whereas 1/8th, 1/4th and 3/8th of those loans under regulatory forbearance in 2020 fall into arrears (low, medium, high impact scenarios). For the latter, the

[3] However, to offset the additional FX risk, un-hedged borrowers must comply with a capital increase of 40 percentage points.

shock distribution across sectors is made proportional to the regulatory forbearance loans distribution. In all cases, the CARs post-shock still remains above the 10-percent regulatory minimum.

- The *interest rate risk shock* assumes an increase of 150 basis points, which affects both flows and stocks: (i) the flow impact from the gap between interest-sensitive assets and liabilities; and (ii) the stock impact from bond repricing as interest rates rise. While the simulated increase in interest rates would result in a marginal gain in interest income, valuation losses on sovereign bond holdings would reduce the system-wide CAR by four fifths of a percentage point, with the CAR of one bank falling slightly below the minimum 10 percent.

- The *FX risk shock* assumes a 20 percent nominal depreciation of the bilateral exchange rate with the US dollar, calibrated to match the highest depreciation rate (year-over-year) since the mid-1990s, and looks at: (i) the direct exchange rate risk effect on FX exposures; and (ii) the indirect effect through credit risk considering that 39 percent of loans denominated in foreign currency were extended to borrowers without natural edges. Results indicate that the hypothetical FX depreciation would lower banks capitalization both directly through the exchange rate risk and indirectly through higher credit risk. Overall, the CAR for the whole system would decline by four fifths of a percentage point to 14.8 percent, and below the regulatory minimum for just one single bank.

8. **A combined solvency shock would require recapitalization of some banks, although the system would still meet the minimum CAR requirement.** The combined shock includes the effects from: (i) credit risk following the proportional increase in NPLs; (ii) interest rate risk; and (iii) FX risk. Such a combined shock represents a very extreme scenario with a low probability of materialization. Results show that, even under these extreme assumptions, the CAR would fall by 2.9 percentage points to 12.7 percent, thereby still complying with the 10 percent regulatory minimum. However, four individual banks would fall short of the minimum regulatory CAR thus requiring recapitalization. However, the identified capital shortfalls would amount to just 0.2 percent of GDP (Figure 1 and Table 2).

9. **Contagion risks stemming from domestic interbank exposures are limited and there is no second-round effect following the combined macro-shock.** Contagion risks are assessed using a matrix of interbank exposures containing, for each bank, the net credit to every other bank in the system. Intuitively, the higher the obligation, the stronger the impact. This exercise illustrates what happens to other banks when one bank fails to repay its obligations in the interbank market because of the combined shock. Results show that there is no contagion stemming from domestic interbank exposures through second-round effects. This is because interbank lending in Guatemala is very narrow.

10. **The reverse test suggests that NPLs would need to increase substantially for the system CAR to fall below minimum requirement.** The reverse stress test answers what would have to be the NPL increase necessary for: (i) the system-wide CAR, (ii) the CAR of at least nine banks (half of total), and (iii) the CAR for 50 percent of the total market share, to fall below the

regulatory minimum of 10 percent. While an NPL increase to 13.1 percent would be necessary for the system-wide CAR to fall below 10 percent, NPLs would need to increase to 23.5 and 7.8 percent of currently performing loans, respectively, for nine banks or half of the total market share to fall below the 10 percent regulatory minimum (Figure 1 and Table 2).

11. The liquidity stress test suggests that liquidity shortfalls following a short-lived drain on deposits would be manageable. The liquidity stress test assumes a widespread liquidity drain of 10 and 3 percent per day of demand and time deposits respectively, affecting all banks in the system proportionally, without liquidity contagion. Results indicates that, although the share of liquid assets would tumble, all banks would remain liquid after 5 days, with no need for outside liquidity support (from other banks or the central bank) mainly because of maturing assets being rolled off and converted into new cash inflows (Figure 1 and Table 2).

Table V.2. Guatemala: Stress Tests

(December 2020)

		Post-Shock CAR (percent)	CAR change (percentage points)
Capital Adequacy Ratio (CAR) pre-shock	15.6		
Credit Risk 1/			
1. System-wide proportional increase in NPLs		14.2	-1.4
2. Sectoral Shock		14.0	-1.6
3. Sectoral Shock: Proportional to their share in loans under regulatory forbearance 2/			
Low		15.2	-0.4
Medium		14.5	-1.1
High		13.3	-2.2
Interest rate Risk 3/			
1. Net Interest Income (NII) impact		15.7	0.1
2. Repricing impact		14.8	-0.8
Overall change in CAR (NII and repricing)			-0.8
FX Risk 4/			
1. Direct FX impact		15.5	-0.1
2. Indirect FX impact (through credit risk)		14.8	-0.6
Overall change in CAR (direct and indirect)			-0.7
Combined Shock 5/		12.7	-2.9
Interbank Contagion			
CAR after macro-shocks		12.7	-2.9
CAR after contagion		12.7	-2.9
Reverse Stress Test (implied increase in NPLs, percent of total loans)			
System CAR < 10	13.1		
9 banks with CAR <10	23.5		
1/2 market share with CAR <10	7.8		
Liquidity 6/ (ratios in percent, except for the last one)			
Post-shock liquid assets / total assets	13.4		
Post shock liquid assets / short-term liabilities	39.0		
# of liquid banks after five days	17		

Source: SIB; and IMF staff estimates.

1/ Assumes NPLs of 3.3 percent of total loans in the system-wide shock and of 10 percent in the sectoral shock to the manufacturing, trade, and non-bank financial sectors.

2/ Assumes that a fraction of the loans granted during regulatory forbearance (26.2 percent of total loans on end-2020) become non-performing. The fractions used to define low, medium and high impact scenarios were 1/8th, 1/4th, and 3/8th, respectively. Sectoral shocks are propotional to their share in loans granted under regulatory finance.

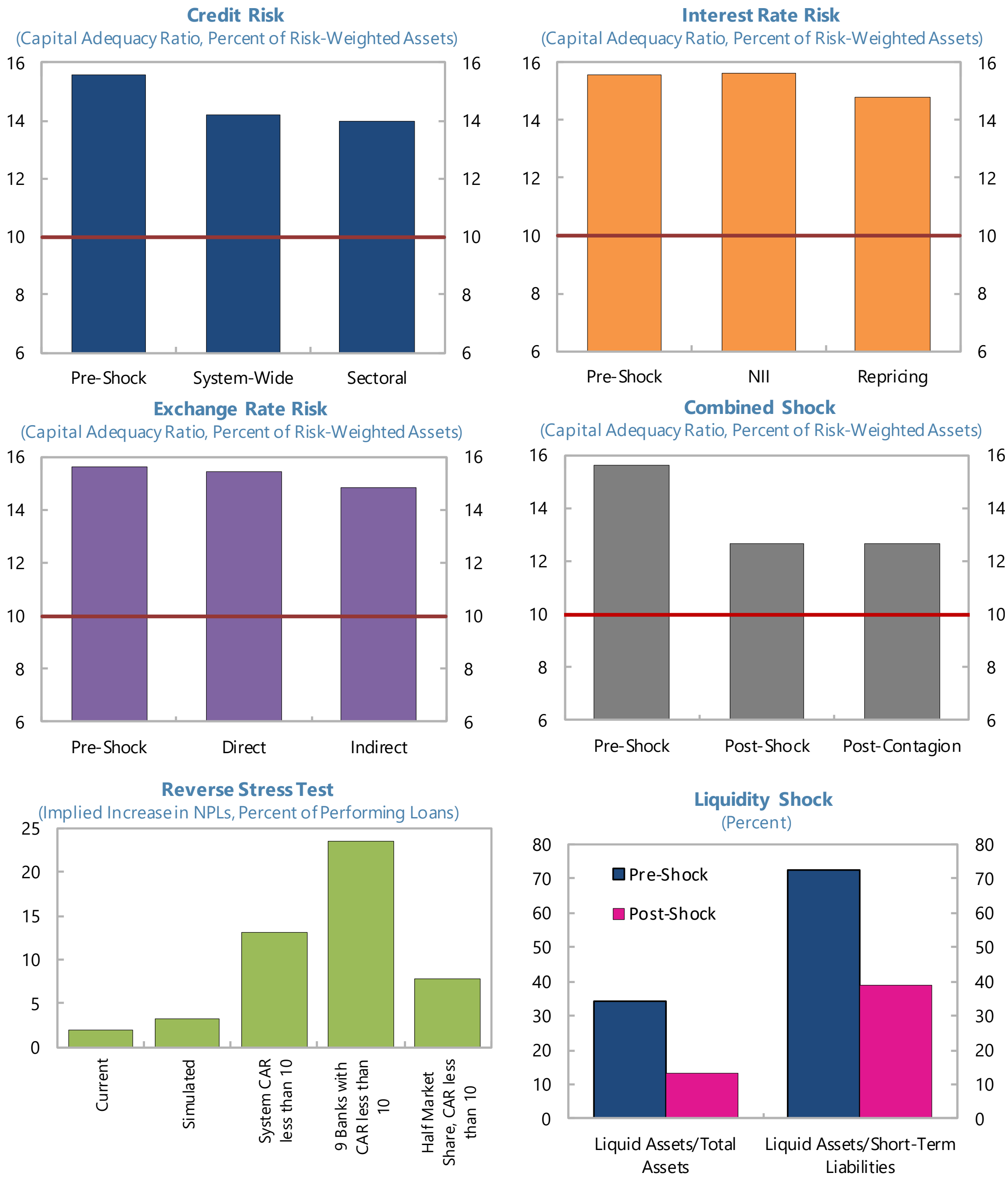
3/ Assumes a 150 basis points increase in nominal interest rates.

4/ Assumes a 20 percent depreciation of the bilateral USD exchange rate.

5/ Combines the system-wide credit shock, the interest rate, and the FX shocks.

6/ Assumes a 10 and 3 percent per day withdrawal of demand and time deposits, respectively.

Figure V.1. Guatemala: Stress Tests 1/



Sources: SIB; and IMF staff estimates.

1/ The credit risk assumes 3.3 percent of performing loans becoming non-performing in the system-wide shock and 10 percent on the sectoral shock to the manufacturing, trade, and non-bank financial sectors. The interest rate risk assumes a 150 basis points increase in the nominal interest rates. The exchange rate risk assumes a 20 percent depreciation of the bilateral USD exchange rate. the combined shock assumes all of the above. The liquidity shock assumes a 10 percent per day withdrawal of demand deposits and a 3 percent per day withdrawal of time deposits.

INTERNATIONAL MONETARY FUND

GUATEMALA

May 19, 2021

STAFF REPORT FOR THE 2021 ARTICLE IV CONSULTATION—INFORMATIONAL ANNEX

Prepared by: Western Hemisphere Department

CONTENTS

FUND RELATIONS

(As of April 30, 2021)

Membership Status: Joined: December 28, 1945, Article VIII

General Resources Account:	**SDR Million**	**Percentage of Quota**
Quota	428.60	100.00
Fund holdings of currency	373.97	87.25
Reserve Tranche Position	54.60	12.76

SDR Department:	**SDR Million**	**Percentage of Allocation**
Net cumulative allocation	200.91	100.00
Holdings	120.08	59.77

Outstanding Purchases and Loans:

None

Latest Financial Commitments:

Arrangements:

Type	**Date of Arrangement**	**Expiration Date**	**Amount Approved (SDR Million)**	**Amount Drawn (SDR Million)**
Stand-By	04/22/09	10/21/10	630.60	0.00
Stand-By	06/18/03	03/15/04	84.00	0.00
Stand-By	04/01/02	03/31/03	84.00	0.00

Outright Loans:

Type	**Date of Commitment**	**Date Drawn**	**Amount Approved (SDR Million)**	**Amount Drawn (SDR Million)**
RFI	06/10/20	NA	428.60	0.00

Projected Payments to Fund[1]

(SDR Million; based on existing use of resources and present holdings of SDRs):

	Forthcoming				
	2021	2022	2023	2024	2025
Principal					
Charges/Interest	0.03	0.04	0.04	0.04	0.04
Total	**0.03**	**0.04**	**0.04**	**0.04**	**0.04**

[1] When a member has overdue financial obligations outstanding for more than three months, the amount of such arrears will be shown in this section.

Safeguards Assessment. Under the Fund's safeguards assessment policy, the Bank of Guatemala was subject to an assessment with respect to the Stand-By Arrangement approved on April 22, 2009 (IMF Country Report No: 09/143). The assessment, which was completed in September 2009, found that the Bank of Guatemala has strengthened safeguards in the areas of transparency of financial reporting and the management of foreign exchange reserves. Recommendations were made to further strengthen the bank's governance and independence.

Exchange Rate Arrangement. Since March 1994, Guatemala has had an arrangement based on an interbank foreign exchange market in which authorized financial institutions buy and sell foreign exchange at market-determined rates. Financial institutions authorized to operate in the foreign exchange market include commercial banks, finance companies, and exchange houses. Guatemala has a *de jure* floating exchange rate arrangement, although the Bank of Guatemala (Banguat) may intervene to limit volatility in the nominal exchange rate without affecting its trend. Banguat intervenes through foreign exchange auctions based on a symmetric and public rule that limits daily volatility. Effective January 1st, 2021, the fluctuation margin (added to or subtracted from the five-day moving average of the exchange rate) that determines whether Banguat may intervene was increased to 0.85 percent (previously 0.8 percent) as part of Banguat's commitment to increase exchange rate flexibility. Banguat may also intervene outside the scope of this rule whenever the nominal exchange rate shows unusual volatility. After a period of stability since September 2018, the exchange rate depreciated against the U.S. dollar in the aftermath of the Covid-19 shock up until the start of 2021, when it reversed to an appreciating trend. Banguat's net purchases to avoid further appreciation amounted to US$2,010 million in 2020, a sizable increase compared to US$1,329 million in 2019. Therefore, the *de facto* exchange rate arrangement remains classified as "stabilized" (it was reclassified to "stabilized" from "crawl-like" in September 26, 2018). As of April 30, 2021, the reference exchange rate was Q7.71 per U.S. dollar. Guatemala has accepted the obligations of Article VIII, Sections 2, 3 and 4, and its exchange system is free of restrictions on the making of payments and transfers for current transactions.

FSAP Participation. An FSAP Update was carried out during March 18-April 1, 2014, and the Financial System Stability Assessment was discussed by the Executive Board on September 12, 2014, at the time of the 2014 Article IV consultation.

Article IV Consultation. The last Article IV consultation was concluded by the Executive Board on June 10, 2019.

Resident Representative. Mr. Metodij Hadzi-Vaskov is the Regional Resident Representative for Central America, Panama, and the Dominican Republic, and is based in Guatemala.

Technical Assistance 2011–21 (updated May 2021)

Department	Date of Delivery	Purpose
FAD, CAPTAC	2021	Budget: Economic Forecasts; Budget: Medium Term Fiscal Framework; Treasury Management; Fiscal Risks: Specific Risks
	2021	Implementing a new model for controlling special procedures operations; Post clearance audit program; Defining of a Customs Digitalization action plan
	2020	Improving cargo and clearance processes; Strategic Planning: Business Continuity Plan for Customs
	2020	Modernizing Treasury Management
	2020	Designing and implementing a comprehensive Business Continuity Plan
	2020	Strengthening the administration and control of special regimes based on risk management
	2020	Budget - Financial Programming
	2019	Strengthening Risk Management
	2019	Implementing the Integral Load Control Plan; Strengthening post clearance audits
	2019	Analyzing the design and implementation of risk management; Managing compliance risks for VAT refunds
	2019	Workshop: improving SAT's governance through close monitoring of results, and a focus on priority actions
	2019	Accounting- Account consolidation; Fiscal Risk; Treasury – Payment Policy; Budget; Strengthening tax administration management; Post Clearance Audit (special Procedures); Improving Customs Process
	2018	Fees and License Rights; Risk-Based Trade Operators; Improving Main Customs Processes; Load Control Plan; Strengthening Management of Tax Administration; Taxpayer Service; Audit Area; Accounting Consolidation; Cash Planning; System Requirements; Financial Programming; Macroeconomic Risks
	2018, 2017	Trade Operators Based on Risk; Integral Load Control Plan; Customs Administration Process; VAT Credit Control; Cash Planning in Treasury
	2017	System Requirements in Treasury; Fiscal Risks; Treasury Single Account
	2016	Improving Collection with Equity and Efficiency (tax policy mission)

	2016	Revenue administration mission. Defining define short- and medium-term strategy to reform tax and customs administration
	2016	Fiscal Transparency Evaluation
	2015, 2014	Supporting the tax control strategy with emphasis on mass control
	2014	Establishing tax payers' profiles and data to measure effectiveness of actions
	2015, 2014, 2013, 2012, 2011	Revenue administration (multiple missions)
	2014	Integrated control on VAT Credit; Tax and Customs Compliance Improvement Program; Information based Integrated Control Model
	2013, 2012, 2011	Treasury single account (multiple missions)
	2013, 2012, 2011	Customs administration (multiple missions)
	2012	Control of budgetary execution
	2011	Debt management strategy
	2011	Revenue forecasting
	2011	Government cash flow and financial planning

Department	Date of Delivery	Purpose
MCM, CAPTAC	2021	Data governance
	2020	Financial groups regulation
	2020	Cybersecurity Risk Supervision
	2019	Strengthen regulatory framework on supervision of financial groups
	2019	Credit risk regulation; Insurance Catastrophic Risk
	2018	Market Risk Regulation; Supervisory Reporting; Insurance Catastrophic Risks; Operational Risk Supervision
	2018	Equilibrium Real Exchange Rate Model
	2017	Operational Risk Data Base; Market Risk Regulation; Supervisory Reporting; Insurance Catastrophic Risk; Operational Risk Supervision
	2017	International Financial Reporting Standards (IFRS); Central Bank´s Capacities for Financial Stability Analysis
	2016	Central Securities Depository for Government Securities
	2016, 2015, 2014	Strengthening the central bank's structural model with financial sector frictions Developing a yield curve of public financial instruments Improving the structural liquidity forecast Developing a model to quantify the monetary policy transmission mechanism
	2015	Debt Management
	2014	Enhancing monetary operations Extending and reviewing the Central Bank macroeconomic structural model Strengthening Central Bank macro-modeling including for fiscal sustainability analysis Stress testing model for banking supervision as well as monetary stability purposes
	2014	Development of supervision credit risk models
	2014	Recommendations for market risk regulatory framework
	2013, 2012, 2011	Risk-based bank supervision (multiple missions)
	2013, 2012, 2011	Monetary operations, forecasting and liquidity administration (multiple missions)
	2011	Capital market development (multiple missions); Application of international financial reporting standards in the banking system

Department	Date of Delivery	Purpose
STA, CAPTAC	2021	General Government GFS and PSDS Data Expansion
	2020	National Accounts: Sources and methods to include the COVID-19 impact in quarterly NA
	2020	Applied Sampling Techniques
	2020	Data dissemination e-GDDS
	2019	GFS broadening institutional coverage
	2019	Assessment for the Consumer Price Index update
	2019	Public Sector Debt Statistics, Consumer Price Index, Producer Price Index
	2018	Sectorization of the Public Sector and Disclosure of Fiscal Data; Surveys; Government Finance Statistics Implementation Strategy
	2017, 2016, 2015, 2014, 2013, 2012, 2011	National accounts statistics (multiple missions)
	2019, 2016, 2015, 2014, 2013, 2012	Producer price index (multiple missions)
	2016, 2015, 2014, 2013, 2012, 2011	Export and import price indices (multiple missions)
	2016, 2015, 2014, 2013, 2012, 2011	Balance of Payments Statistics and IIP
	2015	Training and CD: Financial Accounts
	2014	Coordinated FDI and Portfolio Surveys
	2014	Regional National Accounts
	2013, 2012, 2011	Monthly Index of Economic Activity
	2013	Training: Balance of Payments Statistics
	2013	Balance of Payments Statistics

STATISTICAL ISSUES

(As of May 10, 2021)

I. Assessment of Data Adequacy for Surveillance
General: Data provision has some shortcomings but is broadly adequate for surveillance.
National accounts: The Bank of Guatemala (Banguat) publishes annual and quarterly national accounts consistent with the *System of National Accounts 2008* (*2008 SNA*), with 2013 as the base year. The annual compilation of GDP is elaborated by the three approaches of production, expenditure and income. The supply and use tables are prepared for 143 economic activities, and 217 products defined in the product nomenclature for Guatemala in current values and chained-linked volume measures reference year 2013. The compilation of the quarterly national accounts (QNA) is performed by the production and spending approaches. In addition, a monthly index of economic activity consistent with the quarterly and annual accounts is disseminated on a regular basis.
Consumer prices and unemployment: The National Statistics Institute (INE) prepares and disseminates monthly the consumer price index (CPI), using weights from 2009–10, based on the National Household Income and Expenditure Survey (ENIGFAM), conducted between July 2009 and July 2010. The CPI is compiled at national level and for eight regions. A producer price index (PPI) is currently not disseminated and technical assistance to improve the compilation method is being provided. Unemployment is estimated only on a biannual basis.
Government finance statistics: For surveillance purposes, the Ministry of Finance (MINFIN) provides monthly fiscal data (national methodology for policy purposes) with institutional coverage of Budgetary Central Government. Revenue, expenditure, and financing statistics for social security agencies, local governments, and nonfinancial public enterprises are not reported on a monthly basis, hindering the calculation of a consolidated operations statement and balance sheet for the nonfinancial public sector. On a yearly basis (2013-2020) MINFIN publishes detailed statistics for the non-financial public sector. The coverage and periodicity of data on Budgetary central government financing and debt is adequate. With the support of STAGO/CAPTAC-DR, MINFIN has made great strides into publishing monthly budgetary central government fiscal data according to the Government Finance Statistics Manual 2014 (international standard). The publication corresponds to information on incomes, expenses, assets and liabilities, classification of expenditure by functions of government according to divisions and groups, and the statement of operation of the Central Government, which includes the Budgetary and Extrabudgetary entities. MINFIN is advancing towards the compilation of local governments and social security statistics to broaden their GFS to General Government during the course of 2021. **Monetary and financial statistics:** Monetary and financial statistics are reported on a regular monthly basis to STA using the standardized report forms (SRFs) for the central bank, other

depository corporations, and other financial corporations (OFCs). OFCs comprise insurance companies, warehouses, and exchange houses. Monetary data exclude credit card companies, securities dealers, other financial intermediaries, and other financial auxiliaries. Guatemala reports data on some key series and indicators of the Financial Access Survey (FAS), including mobile money and the two indicators adopted by the UN to monitor Target 8.10.1 of the Sustainable Development Goals (SDGs). **Financial sector surveillance:** The authorities report on monthly basis all twelve core financial soundness indicators (FSIs) and ten (out of thirteen) of the encouraged set for the deposit taking sector. The authorities are working on expanding the FSI coverage of the OFCs sector.
External sector statistics: Guatemala has made significant progress on the prerequisites for data quality as well as on methodological soundness of concepts and definitions, scope, classification, and basis for recording. The legislation on the obligation of the private sector to provide information to the Bank of Guatemala for statistical purposes is still pending, which affects the response rate to balance of payments surveys and limits the availability of the required information. On dissemination of external sector statistics, Guatemala has successfully: (1) migrated to the sixth edition of the *Balance of Payments and International Investment Position Manual* (*BPM6*); (2) disseminated the Reserves Data Template; (3) disseminated comprehensive inward/outward data on the Coordinated Direct Investment Survey (CDIS), and; (4) provided total external debt statistics by sector on the World Bank's website. Compilers at the Central Bank should be encouraged to participate in the Coordinated Portfolio Investment Survey (CPIS).
II. Data Standards and Quality
Guatemala has implemented the recommendations of the IMF's Enhanced General Data Dissemination System (e-GDDS) by publishing essential data through the National Summary Data Page (NSDP). Guatemala completed the implementation of the e-GDDS while making remarkable efforts to cope with the effects of the covid-19 pandemic on data dissemination.

Table of Common Indicators Required for Surveillance

(As of May 10, 2021)

	Date of latest observation	Date received	Frequency of Data [7]	Frequency of Reporting [7]	Frequency of Publication [7]
Exchange Rates	5/7/2021	5/10/2021	D	D	D
International Reserve Assets and Reserve Liabilities of the Monetary Authorities [1]	March 2021	April 2021	M	M	M
Reserve/Base Money	April 2021	May 2021	W	W	W
Broad Money	April 2021	May 2021	W	W	W
Central Bank Balance Sheet	5/7/2021	5/10/2021	D	D	D
Consolidated Balance Sheet of the Banking System	Mar 2021	April 2021	M	M	M
Interest Rates [2]	April 2021	May 2021	W	W	W
Consumer Price Index	April 2021	May 2021	M	M	M
Revenue, Expenditure, Balance and Composition of Financing [3]- Central Government	Dec. 2020	Jan. 2021	M	M	M
Revenue, Expenditure, Balance and Composition of Financing [4]- General Government			N/A	N/A	N/A
Stocks of Central Government and Central Government-Guaranteed Debt [5]	Dec. 2020	Jan. 2021	M	M	M
External Current Account Balance	Q4/2020	April 2021	Q	Q	Q
Exports and Imports of Goods and Services	Q4/2020	April 2021	Q	Q	Q
GDP/GNP	Q4/2020	April 2021	Q	Q	Q
Gross External Debt	Q4/2020	April 2021	Q	Q	Q
International Investment Position [6]	Q4/2020	April 2021	Q	Q	Q

[1] Includes reserve assets pledged or otherwise encumbered as well as net derivative positions.

[2] Both market-based and officially determined, including discount rates, money market rates, rates on treasury bills, notes and bonds.

[3] Foreign, domestic bank, and domestic nonbank financing.

[4] The general government consists of the central government (budgetary funds, extra budgetary funds, and social security funds) and state and local governments. Provision of this data is hampered by lack of capacity while ongoing efforts, including the recently requested TA advice from the Fund on fiscal transparency, are made to strengthen it. Certain progress has been made in the following areas: defining an action plan to improve fiscal transparency; taking the decision to implement the GFSM 2014 as part of the fiscal transparency effort and designing an action plan for its implementation; creating the open government data portal (https://datos.minfin.gob.gt/) with data on budget formulation and execution, grants to municipalities; publication of fiscal risks as an appendix of Budgets 2017 and 2018; and working on a national publication of consolidated nonfinancial public sector (on a GFSM 1986 format): www.minfin.gob.gt.

[5] Including currency and maturity composition.

[6] Includes external gross financial asset and liability positions vis-à-vis nonresidents.

[7] Daily (D); weekly (W); monthly (M); quarterly (Q); annually (A); irregular (I); and not available (NA).

Statement by Mr. Moreno, Executive Director and Mr. Cartagena Guardado, Advisor to the Executive Director on Guatemala
June 9, 2021

On behalf of our Guatemalan authorities, we would like to thank Mrs. Perez Ruiz and her team for their open and candid discussions during the mission, their proactive engagement, and the comprehensive and well-balanced report. Our authorities broadly share the staff's assessment.

Background information

Guatemala has enjoyed a prolonged record of macroeconomic stability. Before the COVID-19 pandemic hit the country in 2020, Guatemala had built a strong economy, resilient to external and domestic shocks, underpinned by a prudent fiscal stance and a credible monetary policy. This was reflected by a steady economic growth of 3.5 percent between 1999-2019, stable exchange and interest rates, low and stable inflation (4.2 percent average between 2010-2020), low fiscal deficit (2.0 percent of GDP, average between 1999-2019), and a sound and liquid banking system. Guatemala's public debt levels have remained among the lowest shares of GDP in the Latin American region, also with the lowest weighted spreads (Averages December 2019: 182 basis points; December 2020: 184 bp; May 2020: 184 bp), according to the IMF's Sovereign Spread Monitor Report. Guatemala has also been addressing longstanding structural vulnerabilities, including fostering inclusion, reducing poverty, and addressing the informality of labor markets. These challenges have been tightened as a consequence of the pandemic.

The policy response to the pandemic

Guatemala adopted swift fiscal measures to protect human life and to reduce the negative impact caused by the pandemic shock. The fiscal impulse boosted by the authorities during the pandemic year elevated the fiscal deficit to 4.9 percent of GDP, one of the largest in the country's recent economic history. The countercyclical fiscal measures included family bonus for vulnerable households (1.0 percent of GDP), the employment protection fund (0.3 percent of GDP), working capital fund (0.4 percent of GDP) and a food support program (0.1 percent of GDP). According to Central Banks´ (Banguat) estimates, the economic contraction could have been 2.5 percentage points higher without these fiscal measures.

The fiscal impulse was accompanied by monetary easing, additional liquidity and debt relief in the financial sector. Given the extraordinary nature of the pandemic, and the need to swiftly support the financing needs, Banguat monetized part of the fiscal deficit in April 2020, following Congress' approval and invoking the extraordinary provision in Article 133 of the Constitution, given the fact that it is forbidden for the Central Bank to provide credit to the government. Banguat sterilized the monetary surpluses originated from the injection of primary liquidity to avoid pressure on the main macroeconomic prices. In the financial sector, the authorities introduced additional liquidity measures, such as flexibilization of the liquidity requirements for banks during the pandemic emergency and the easing of credit conditions, which helped keep the flow of resources to businesses and households and preserved the proper functioning of the payments system.

Outlook and policy priorities

Guatemala's economic contraction was one of the lowest in Latin America in 2020 and the authorities expect to restore GDP growth close to the pre-COVID average in 2021. The effective countercyclical measures have helped Guatemala to soften the economic impact of the crisis. In 2020, GDP growth has contracted by only 1.5 percent (the first negative GDP growth since 1983), which is the second lowest contraction among all the Latin American countries (according to last April´s WEO). In 2021, the authorities anticipate that the economy will reach a GDP growth above 3 percent (with a central scenario of 4 percent), which could improve up to 5 percent, depending on the acceleration of the vaccination process and the materialization of other upside risks. The authorities are projecting a positive trend in all economic sectors, which is being confirmed by the latest figures of short-term economic indicators, including the Monthly Index of Economic Activity, the Confidence Index Economic Activity, the high growth of family remittances, the higher external demand, and an increase in imports.

The slow vaccination process is one of the drivers of downside risks. With around 3.3 doses per 100 habitants up to Jun 1st, 2021, Guatemala is facing an important challenge vaccinating its population. The scarcity of supply is the main reason for the low vaccination rate. Although the government has contracted and preordered vaccines for a substantial share of the population, the supply received is considerably low. As many international instances have urged, it will be important that the international community make an additional effort to ensure a more equitable global vaccine distribution. On the positive side, COVID-19 contagion remains low following an effective policy on social distancing, use of facemasks, and cleaning protocol measures.

The authorities remain fully committed to ensuring fiscal stability and debt sustainability, as well as maintaining their good debt servicing track record. The fiscal deficit, that reached 4.9 percent of GDP in 2020 following the necessary countercyclical measures, is already expected to start a reducing trend from 2021, reaching levels closer to its historical average of 2 percent of GDP in the following years. The staff's debt analysis confirms the medium-term sustainability of debt levels, with the debt-to-GDP ratio increasing only by 5 percentage points in 2020, caused by the pandemic, up to 31.6 percent in 2020 (2019: 26.5 percent). The debt-to-GDP ratio is also expected to stabilize in the medium term at around 34 percent. Authorities concur that more progress is required on the revenue side, strengthening the capacity of the tax administration and gradually broadening the tax base to gain fiscal space to foster growth and reduce poverty over the medium term. Current efforts of the tax administration have prospered, and Guatemala is experiencing a double-digit increase in revenues, which can be associated not only to the economic recovery, but also with improvements in the tax administration.

Guatemala's monetary policy will remain accommodative as inflation remains under Banguat' s target. The monetary policy has been consistent with a policy mix to support the economy through the pandemic, while inflation has remained under the inflation target. The monetary policy´s interest rate was reduced to a historic low of 1.75 percent in June 2020 and has been kept at this level according to the last revision from May 26th. This policy rate is negative in real terms and well-below Guatemala's neutral interest rate. The monetary authorities will closely monitor inflation expectations as well as the balance of inflation risks steaming from both the external and domestic economic conditions. Inflation forecasts and expectations for the current year and the next, anticipate that inflation will remain within target (4.0% +/- 1 percentage point). The average inflation rate for this year (April 2021: 5.6 percent) shows the effect of both a comparison base effect and some supply shocks, particularly in transportation and food.

Temporary measures have helped to maintain exchange rate expectations more stable. Authorities concur that the international reserve accumulation mechanism is a transitory measure that has helped to keep exchange rate expectations stable and it has avoided abrupt capital outflows or reductions of external foreign currency financing. Building on the gains already achieved in the macroeconomic soundness, the authorities acknowledge that more progress towards greater exchange rate flexibility is needed. However, a gradual process is preferred as it fosters a competitive and transparent foreign exchange market. While the authorities concur that the current account surplus has been stronger than anticipated, they don't see a significant misalignment with fundamentals once temporary factors are accounted for. It has been boosted by the net current transfers, mainly family remittances, that have more than compensated for the deficit of the goods and services balance. Authorities expect the real exchange rate to depreciate as temporary strong remittance inflows normalize and terms of trade deteriorate.

The financial system remains resilient. Despite the challenges posed by the pandemic, the banking system has remained sound and has continued to finance the economic recovery. Credit to the private sector has increased (2020: 6.1 percent; May 20th, 2021: 5.0 percent), financed by the growth in customer deposits (2020: 15.4 percent; April 2021: 16.2 percent), which benefited from the easing of the monetary policy and the significant growth in family remittances (2020: 7.2 percent; May2021: 43.1 percent). The banking system maintains sound with solvency rates well above the regulatory levels (2020: 16.1 percent; April 2021: 16.4 percent; regulatory requirement: 10 percent), and sound profitability. (ROA April 2021: 1.6 percent and ROE: 16.6 percent). The liquidity of the banking system remains adequate.

Guatemala's authorities remain committed to strengthening the structural reforms on fiscal transparency and governance benefiting from the Fund's technical assistance. The authorities are also assessing policies to improve the business climate, address labor market informality and strengthen resilience to climate change.