INTERNATIONAL MONETARY FUND

IMF Country Report No. 23/172

GUATEMALA

May 2023

2023 ARTICLE IV CONSULTATION—PRESS RELEASE; STAFF REPORT; AND STATEMENT BY THE EXECUTIVE DIRECTOR FOR GUATEMALA

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 2023 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 May 15, 2023, 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 May 15, 2023, following discussions that ended on March 13th, 2023, 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 April 28th, 2023.
- An **Informational Annex** prepared by the IMF staff.
- A **Statement by the Executive Director** for Guatemala.

The documents listed below have been or will be separately released.

Selected Issues

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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PRESS RELEASE

PR23/173

IMF Executive Board Concludes 2023 Article IV Consultation with Guatemala

FOR IMMEDIATE RELEASE

Washington, DC – May 24, 2023: The Executive Board of the International Monetary Fund (IMF) concluded the 2023 Article IV consultation[1] with Guatemala on May 15, 2023, and endorsed the staff appraisal.

Guatemala's solid track record of prudent macroeconomic policies and large remittance inflows provided the country with large buffers to weather a challenging global environment and tightened global financial conditions. In 2022, Guatemala's real GDP growth was 4.1 percent (3.4 percent projected in 2023), with the fiscal deficit below 2 percent of GDP—driven by tax collection overperformance and high import prices—and the stock of public debt below 30 percent of GDP. Domestic private demand continued to be strong, and bank credit to the private sector grew at double-digit rates.

Inflationary pressures remain high, with April 2023 headline inflation at 8.32 percent. The currency has remained stable and the external balances solid, despite a large import bill. The financial sector has proven resilient to global financial tightening conditions and domestic interest rate hikes.

The outlook continues to be broadly positive, but risks remain. Near-term risks relate to an abrupt global economic slowdown, including in the U.S., that could reduce remittance inflows and have knock-off effects on Guatemala's domestic demand and growth. Heightened global market volatility and uncertainty could fuel volatility in commodity prices and complicate the fight against inflationary pressures, affecting especially the most vulnerable. At the same time, the steady record of economic achievements and prudent policies has served the country well and, if continued, will help further reinforce the economy's resilience to shocks. Medium-term risks are domestically related, with structural weaknesses hindering development prospects.

Guatemala stays an economy with untapped opportunities. Scaling up the implementation of a transformative infrastructure agenda, fostering human capital and social policies, and enhancing legal certainty are critical to support a sustainable and inclusive medium-term growth model with higher potential growth. While the global outlook is challenging, the current conjuncture also offers ample opportunities to draw on the demographic dividend and to fast track reforms to improve the business climate environment and attract foreign investment.

Executive Board Assessment[2]

Executive Directors noted the resilience of the Guatemalan economy in the face of adverse external shocks and commended the authorities for maintaining sound macroeconomic policies. However, poverty and food insecurity remain high, inflationary pressures are elevated, and risks—both external and domestic—remain. Directors emphasized that continued policies targeted at increasing macroeconomic resilience, accompanied by further

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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.

[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.

progress on the structural reform agenda, will be key in promoting higher and more inclusive growth and building resilience to climate risks.

Directors highlighted the need for continued prudent fiscal policies and a strengthened medium-term fiscal framework. They emphasized that closing the existing infrastructure and social gaps will require enhancing revenue mobilization and spending efficiency. A comprehensive tax reform will be critical in this regard. Directors underscored the need to enhance the investment framework and looked forward to the PIMA/C-PIMA. They also supported establishing a medium-term debt management framework and developing a secondary market for sovereign debt.

Directors welcomed the recent decisions to increase the monetary policy rate. They noted that further data-driven increases could be necessary, stressing that monetary policy should continue to be focused on keeping inflation expectations anchored and bringing headline inflation back to the mid-point of the target range. Directors highlighted the need for further enhancements to the inflation targeting framework and the gradual transfer of market risk management to the private sector, which will support the exchange rate's role as a shock absorber.

Directors called for careful monitoring of financial sector risks and continued efforts toward strengthening its regulation and supervision. They looked forward to the prompt approval and implementation of the banking law and the revised AML/CFT law, in line with the Financial Action Task Force's standards.

Directors stressed the criticality of advancing the structural reform agenda to raise potential growth and reduce poverty. They emphasized the need to decrease informality and called for reinvigorating the longstanding infrastructure investment agenda and addressing social gaps. Directors underscored the importance of further efforts to improve governance and address corruption and welcomed the authorities' interest in undertaking a Fund governance diagnostic.

Table 1. Guatemala: Selected Economic and Financial Indicators

			Est.	Projections					
	2020	2021	2022	2023	2024	2025	2026	2027	2028
	(Annual percentage change, unless otherwise specified)								
Income and Prices									
Real GDP	-1.8	8.0	4.1	3.4	3.5	3.6	3.7	3.8	3.9
Consumer prices (average)	3.2	4.3	6.9	7.5	5.5	4.3	4.0	4.0	4.0
Consumer prices (end of period)	4.8	3.1	9.2	6.4	5.0	4.0	4.0	4.0	4.0
Money and Credit									
M2	18.9	11.6	14.5	11.2	8.5	7.6	7.3	7.4	7.4
Credit to the private sector	6.4	12.7	16.0	14.0	7.0	7.5	7.5	8.0	8.0
	(Percent of GDP, unless otherwise specified)								
Saving and Investment									
Gross domestic investment	13.5	16.9	16.7	16.1	15.5	15.2	14.8	14.4	14.0
Private sector	12.2	14.1	15.0	14.3	13.7	13.3	12.9	12.5	12.1
Public sector	1.3	1.7	1.8	1.7	1.8	1.9	1.9	1.9	1.9
Gross national saving	18.6	19.1	18.0	17.5	16.8	16.4	15.9	15.2	14.5
Private sector	21.0	17.8	17.5	17.0	16.3	15.9	15.5	14.8	14.1
Public sector	-2.4	1.3	0.6	0.5	0.5	0.5	0.4	0.4	0.4
External saving	-5.0	-2.2	-1.4	-1.5	-1.3	-1.2	-1.1	-0.8	-0.5
External Sector									
Current account balance	5.0	2.2	1.4	1.5	1.3	1.2	1.1	0.8	0.5
Trade balance (goods)	-8.1	-12.7	-14.9	-13.9	-13.5	-13.0	-12.7	-12.4	-12.2
Exports	13.0	14.4	15.0	14.0	13.1	12.5	12.1	11.6	11.3
Imports	21.2	27.1	30.0	27.9	26.6	25.6	24.7	24.0	23.4
Of which: oil & lubricants	3.1	5.2	6.6	5.5	5.1	4.8	4.5	4.3	4.1
Trade balance (services)	-0.3	-1.4	-1.7	-1.6	-1.2	-1.2	-1.2	-1.2	-1.2
Other (net)	13.5	16.3	18.0	16.9	16.0	15.4	14.9	14.4	13.8

Of which: remittances	14.6	17.8	19.0	18.2	17.2	16.6	16.1	15.5	15.0
Capital account balance	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Financial account balance (Net lending (+))	4.2	1.6	0.9	1.5	1.3	1.2	1.1	0.8	0.5
Of which: FDI, net	-1.0	-3.5	-1.0	-1.1	-1.1	-1.1	-1.1	-1.1	-1.1
Errors and omissions	0.0	-0.6	-0.5	0.0	0.0	0.0	0.0	0.0	0.0
Change in reserve assets (Increase (+))	4.1	3.3	0.0	0.5	0.9	0.8	0.8	0.7	0.7
Net International Reserves									
Net international reserves (US$ billion)	8.1	7.4	7.0	6.9	7.0	7.0	6.7	7.0	…
Stock in months of next-year NFGS imports	3.5	3.2	4.0	4.5	5.0	5.1	5.6	5.9	…
Central Government Finances									
Revenues	10.7	12.3	12.7	12.2	12.1	12.0	11.9	11.8	11.8
Expenditures	15.6	13.5	14.4	13.9	13.9	13.9	13.9	13.8	13.8
Current	12.6	11.2	11.9	11.4	11.4	11.2	11.2	11.1	11.1
Capital	3.0	2.4	2.5	2.5	2.5	2.7	2.7	2.7	2.7
Primary balance	-3.2	0.6	0.0	-0.1	-0.1	-0.3	-0.3	-0.3	-0.3
Overall balance	-4.9	-1.2	-1.7	-1.7	-1.8	-1.9	-2.0	-2.0	-2.0
Financing of the central government balance	4.9	1.2	1.7	1.7	1.8	1.9	2.0	2.0	2.0
Net external financing	-0.3	0.8	0.0	0.6	0.5	0.4	0.4	0.5	0.3
Net domestic financing	2.5	0.4	1.7	1.0	1.2	1.5	1.6	1.6	1.7
Central Government Debt	31.5	30.8	29.2	28.2	27.8	27.7	27.8	28.0	28.0
External	13.5	12.9	11.9	11.3	11.0	10.6	10.3	10.0	9.6
Domestic[1]	18.0	17.9	17.4	16.8	16.8	17.1	17.6	17.9	18.4
Memorandum items									
GDP (US$ billions)	77.7	86.0	95.0	103.8	112.6	121.2	130.1	139.7	150.1
Output gap (% of GDP)	-3.1	0.4	0.2	0.0	0.0	0.0	0.0	0.1	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.

GUATEMALA

STAFF REPORT FOR THE 2023 ARTICLE IV CONSULTATION

April 28, 2023

KEY ISSUES

Context. Guatemala has weathered many crises well. Its 's economy has proved resilient, building on a solid track-record of prudent policies—low fiscal deficits and debt-to-GDP ratio, and high international reserves—and strong remittance inflows. After a strong rebound in 2021, Guatemala's economy has been slowing down—with GDP growth halving to a solid 4.1 percent in 2022. Inflation increased in 2022 but peaked in February 2023 (9.9 percent, year-on-year) to drop to 8.71 percent in March 2023. At the same time, public investment tends to be under-executed, poverty remains high, and tax revenue is weak, while substantial institutional, investment, and social gaps and governance weaknesses hinder progress. Addressing these requires higher broad-based and inclusive growth and further progress in the reform agenda. The authorities' goal to attain investment grade and attract foreign investment could unlock opportunities. General elections are due June 25, 2023 (the second round on August 20, if needed).

Outlook and Risks. Growth is projected to decelerate to 3.4 percent in 2023, partly driven by the U.S. slowdown and tighter global financial conditions. High inflationary pressures are testing the Central Bank's ability to conduct effective monetary policy and rein in inflation back to the target in the coming months. The outlook remains favorable, albeit with downside risks also affecting other countries. Risks to the baseline include an abrupt slowdown or recession of the U.S. economy, which could result in lower-than-expected remittance inflows, a de-anchoring of inflation expectations, an acceleration of regional conflicts and high commodity price volatility with social implications, and natural disasters. Strong buffers should help surmount these challenges.

Main Policy Recommendations

Fiscal Policy. The fiscal stance should remain prudent as part of a Medium-Term (MT) strategy that incorporates pro-growth fiscal sustainability objectives. Obtaining higher tax revenue, required to finance the country's structural needs, would require comprehensive tax reform. A transformative MT strategic agenda, supported by streamlined processes, is required to address large investments in infrastructure, human capital, and social needs. The larger debt issuances to finance these needs should come with a clear communication strategy. A MT debt management strategy should also include the completion of the yield curve and the development of the secondary debt market.

Infrastructure-enabling legislation and the reform to the Private-Public Partnership Law should not be delayed.

Monetary and Exchange Rate Policy. The monetary policy stance will need to be tightened until inflationary pressures are reined in and inflation returns to the target band. A reform package to strengthen the operationalization of the IT framework would further help the policy rate to be more effective in pricing market liquidity and impacting the inflation rate. Measures include the recapitalization of the Central Bank and gradually transferring the management of market risks to the market users, letting the exchange rate be the shock absorber. The framework supporting the development of hedging tools to manage these risks should be operationalized.

Financial Sector Policies. Close monitoring of deposit-taking institutions should continue. The approval of the update to the 2002 Banking and Financial Groups Law, and the publication of banks' financial statements under international accounting standards and of the Financial Stability Report should not be delayed.

Other Policies. A draft AML/CFT Law containing key reforms to bring Guatemala's regime in line with the best Financial Action Task Force (FATF) standard should be approved by Parliament as soon as possible. An up-to-date medium-term roadmap of measures to address key governance and corruption vulnerabilities and perceptions is needed and has strong support from the authorities.

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

Discussions took place between November 2022 and March 13, 2023. The team comprised Maria A. Oliva (Head), Paula Beltran-Saavedra, Alexandre Nguyen-Duong, and Gonzalo Salinas (all WHD), Metodij Hadzi-Vaskov (Regional Resident Representative), and Luis Carlos Ibanez Thomae (Resident Representative Office), Alfonso Guerra and Valerie Lankester Campos (both OED) joined the discussions. Heidi Canelas, Eliana Porras, and Rozi Lamprakaki (all WHD) provided support. The mission met with the President of Guatemala, the President of the Bank of Guatemala, the Ministers of Finance, Economy, Foreign Affairs, Labor, the Controller General regulatory and supervisory bodies, senior government officials, private sector representatives, members of the international community (World Bank, IADB, UN agencies, Embassies), academics, and other stakeholders. A press conference has held at the end of the mission, on March 13.

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TABLES

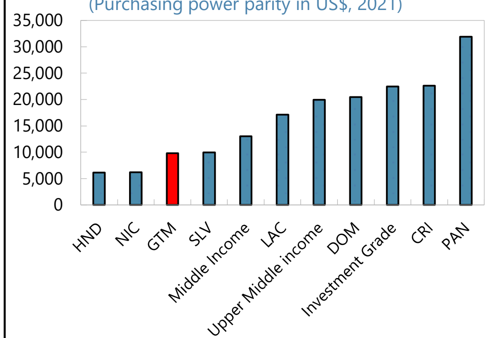
ANNEXES

CONTEXT

1. **Guatemala has built a strong track record of prudent macroeconomic, fiscal, and financial management over the years that explains its resilience to crises.** The 2012-2021 average growth rate was 3.5 percent and inflation remained mainly within the inflation target bands. In the past decade, on average, fiscal deficits remained solidly anchored below two percent of GDP and the public debt-to-GDP ratio kept below 30 percent of GDP. The gradual accumulation of international reserves (to cover seven months of imports in 2021-22) has also provided solid buffers and contributed to Guatemala's economic stability in past years. Banks continued to run traditional business models of limited complexity, with solid buffers at the aggregate. Guatemala is highly dependent on remittance inflows (20 percent of GDP in 2022).[1]

2. **At the same time, Guatemala suffers from long-standing gaps—infrastructure and education, social, and governance— that are hampering growth opportunities.** The GDP per capita ratio (US$9,800 at purchasing power parity in 2021) is low compared to middle-income peer economies and economies in investment grade (medium grade). Guatemala suffers from high poverty levels, food insecurity, and chronic infant malnutrition.[2] Potential growth (estimated at 3.5 percent) is also constrained by poor infrastructure, lack of human capital and legal certainty, key obstacles to doing business, further attracting foreign investment, and fully benefiting from trade. Despite important efforts in recent years, the reform agenda has moved slowly, partly due to significant delays in Congress approvals for key projects and cumbersome processes. Tax collection falls short of the level required to address the country's social deficit and infrastructure gaps. And perceptions of weak legal protection, high legal uncertainty, weak governance, and crime (albeit it has declined in the past years) are being addressed with efforts on data transparency and digitalization. But more is needed, to promote the country's development prospects.

GDP per Capita
(Purchasing power parity in US$, 2021)



Source: World Bank Indicators and IMF Staff estimates.
Note: Invetsment Grade is the simple average of 26 countrries ranked at Baa2,baa3 by Moodys ratings.

3. **General elections will be held on June 25 (and August 20, 2023, if needed).**[3] A new President and Vice-President, and all 160 Congress seats will be elected.

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[1] The bulk of remittances are transferred through banks and are spent on consumption and some construction.

[2] Guatemala's population was 17.4 million in 2022. The poverty rate is estimated at 55 percent in 2022 (55.3 percent in 1998) and 43.1 percent of the population have access to basic services (INE 2022). Chronic malnutrition for infants under five years old is at 46.5 percent according to UNICEF data.

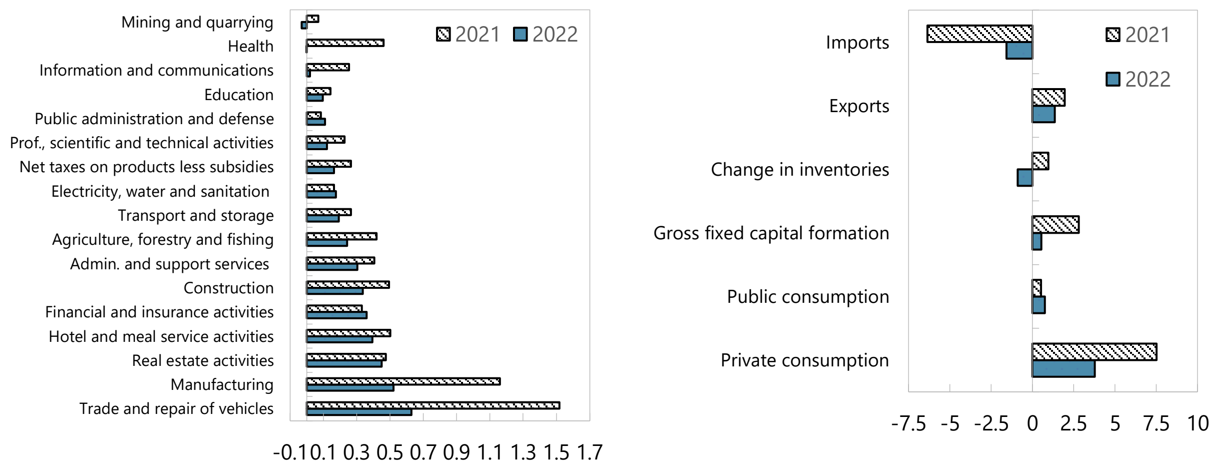
[3] Incumbent President Alejandro Giammattei is constitutionally bound to one four-year term. The election follows the runoff voting system. Key positions of the government were appointed (for four years) in early October 2022—the Central Bank President and Vice-President and the Superintendent of Banks.

RECENT DEVELOPMENTS

4. Guatemala's economy experienced a strong rebound after the pandemic, which moderated in 2022. GDP growth was 4.1 percent in 2022, driven mostly by trade, manufacturing, real estate, and accommodation and hospitality sectors. On the expenditure side, private consumption continued to largely support growth.

Contribution to Real GDP Growth

(Percentage points, 2021 and 2022)



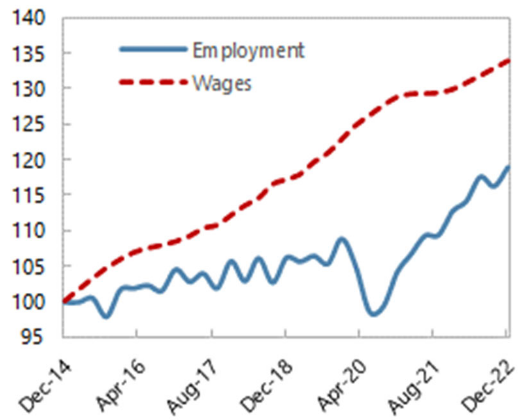
Source: Banguat and IMF staff estimates.

5. In 2022, unemployment remained low but above pre-pandemic levels. The 2022 National Survey on Employment and Income (NSIE) shows the 2022 overall participation rate was 60 percent (slightly above 2019 levels), with women accounting for 22.7 percent.[4] Unemployment remained low, at three percent, albeit higher than in 2017-2021 (with rates at 2.0-2.2 percent). In 2022, labor supply shortages in some sectors (notably agriculture and construction) started to materialize, in part, due to migration outflows, putting pressure on wages. In 2022, formal average monthly wages grew by 29 percent (y-o-y) and 17 percent relative to 2019 (NSIE 2022). For the first time, in 2023, the authorities adjusted the official wage rate to cost-of-living differentials, with a minimum wage increase for the Department of Guatemala of seven percent and four percent for the rest of the country. Informality remained high and stable at about 71 percent of the active population, with agriculture activities accounting for the largest share.[5]

[4] Economically active population (at least 15 years old) relative to the total working-age population. Rural employment continued to dominate, accounting for about 53 percent of the participation rate.

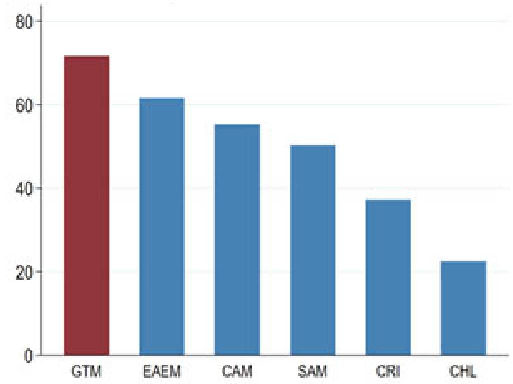
[5] The national estimate of informality does not include workers of firms with more than six workers that do not have formal contracts. ILO's informality data includes them; the ILO's informality rate for Guatemala is closer to 80 percent.

Employment and Wages
(Index 2014=100)



Source: IGGS Guatemala and IMF Staff estimates.
Note: IGGS's wage index includes formal waged received by social security contributors. INE's 2022 NSIE shows a stronger 2022 wage acceleration.

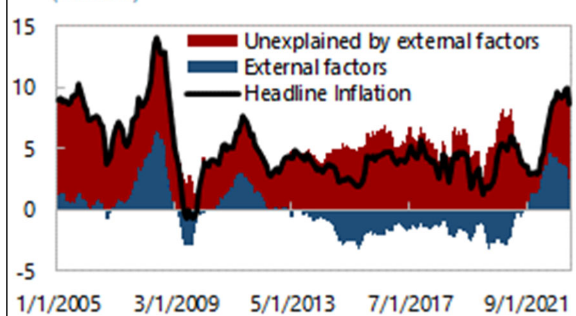
Informal Employment Rate
(Percent, 2016-19)



Source: ILO
Note: CAM= Central America and Mexico, EAEM= East Asia Emerging Markets.

6. Inflation and inflationary pressures intensified in mid-2022 and started to recede in March 2023. The headline and core inflation started surging in mid-2022 to reach 9.9 percent and 5.3 percent (y-o-y), respectively, in February 2023, before it started to revert in March (to 9.71 percent and 5.08 percent, respectively, y-o-y). Initially, imported inflation (import food and fuel prices) accounted for the bulk of the increase. Domestic factors (second-round effects and domestic demand and supply-led pressures) have been gaining steam and may show some inertia (see accompanying Selected Issues Paper, SIP).[6] March inflation points to food prices and services as key drivers. One-year ahead inflation expectations breached the target band (4 ± 1 percent) in August 2022, while two-year ahead expectations remain mostly anchored within the bands.

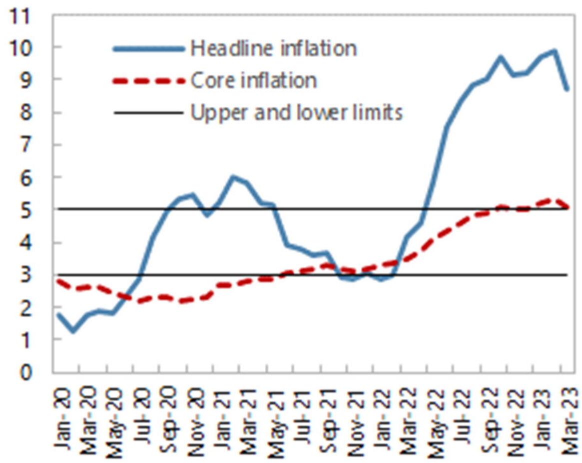
Contribution of External Factors to Inflation
(Percent)



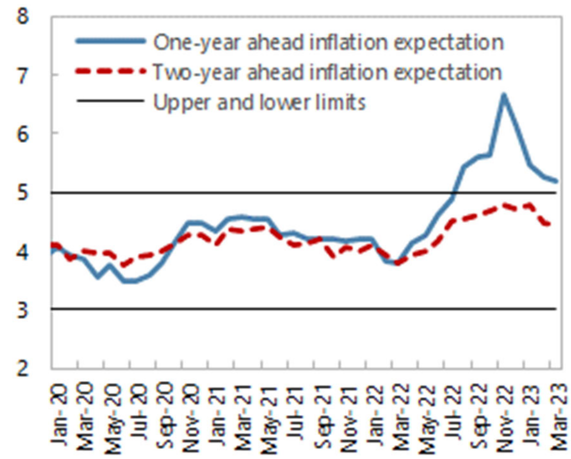
Source: Staff calculations based on PCA analysis on headline inflation.

[6] This was also observed in most past episodes in exchange rate-based stabilization regimes, as domestic prices and wages continued to increase even with a stable nominal exchange rate.

CPI Inflation
(Percent change y-o-y)



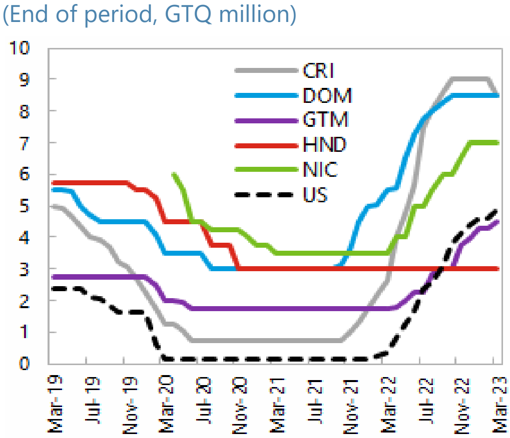
Inflation Expectations
(Percent change, y-o-y)



Source: INE Guatemala, Banguat, and IMF Staff estimates.

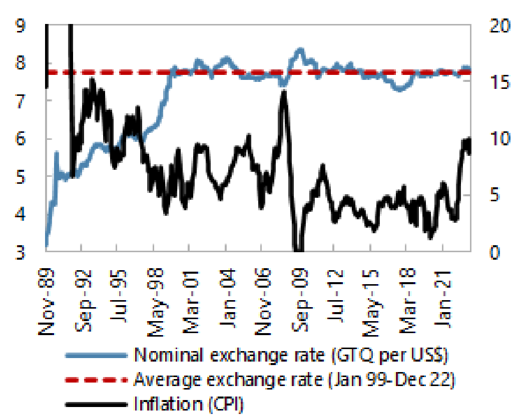
7. The monetary policy stance remains accommodative. Banguat gradually raised the policy rate by 300 bps to 4.75 percent between May 2022 and March 2023 in response to inflationary pressures.[7] However, monetary policy transmission largely relies on the expectations channel and forward guidance communication. Long lags affecting the policy rate transmission mechanism partly explain the limited impact of active monetary policy in curbing aggregate demand via the lending channel to date (see SIP). Large remittance inflows, treated as permanent, have added complexity to the monetary policy design and management, with one-sided pressures on the exchange rate and large and continued liquidity injections into the economy. Partial sterilization of domestic liquidity and the activation of Banguat's foreign exchange intervention rules have come at a cost to Banguat's balance sheet (see SIP).

Monetary Policy Rates
(End of period, GTQ million)



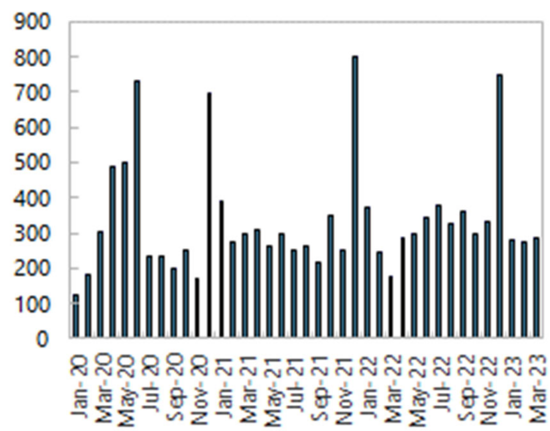
Source: Haver, Banguat, and IMF staff estimates.

Nominal Exchange Rate
(GTQ per $US dollar)

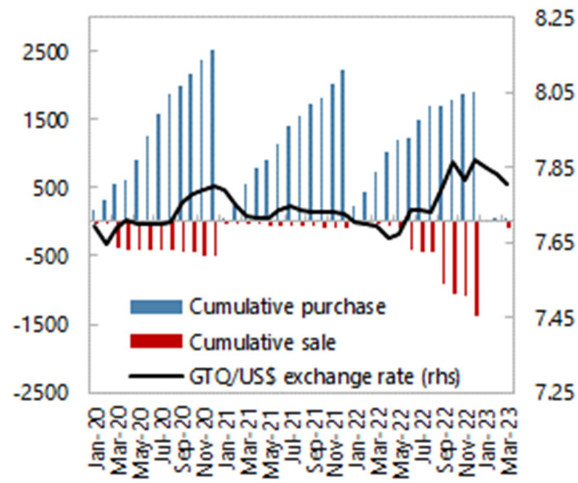


[7] The 75-bps policy rate increase in December 2022 and 50-bps in January 2023, approved by unanimity, sent a clear signal to the markets about Banguat's newcomer President (at the time) resolve to fight inflation.

Average Accumulated Bank Liquidity
(End of period, GTQ million)



Foreign Exchange Interventions
($US million)

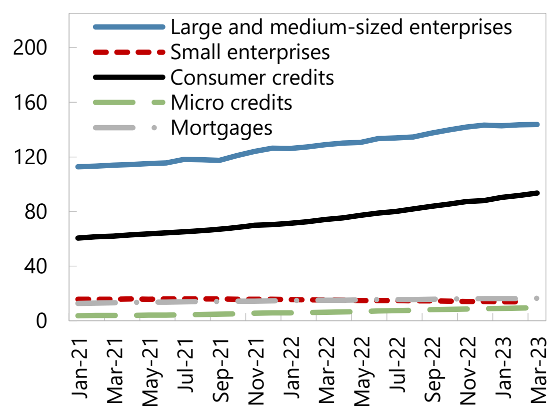


Source: Banguat and IMF staff estimates.

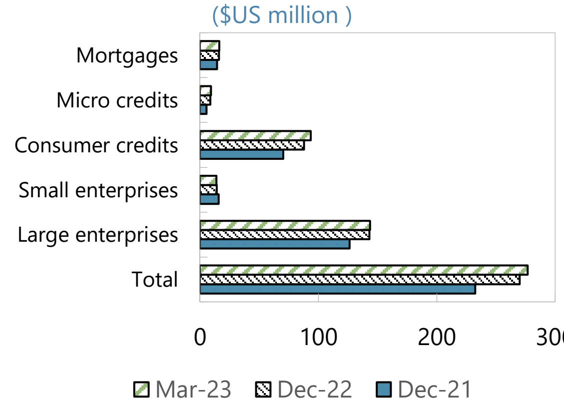
8. Bank credit to the private sector increased by double-digit rates (16 percent) while lending rates remained subdued. Bank credit to the private sector grew by 20 percent in domestic currency in 2022, with credit to consumption increasing by 25 percent (y-o-y). At the same time, most lending rates quoted in domestic currency continued to decline in 2022, except for consumer lending credit rates that gradually adjusted (by 100 basis points over March-December 2022) to 24.9 percent. U.S. dollar lending rates adjusted faster to the FED rate increases in all credit categories, especially for consumption and large business credit.

Selected Monetary Sector Indicators

Bank Lending Rates
(Percent)



Bank Lending by Sector
($US million)



Source: SIB and IMF staff estimates.

9. The authorities maintained a prudent fiscal stance in 2022. The 2022 overall fiscal deficit was 1.7 percent of GDP (3.8 percent of GDP in the budget), with overperformance in tax collection—estimated tax revenue reached 12.0 percent of GDP (against the 10.5 percent of GDP included in the budget)[8]. Tax administration gains (customs, tax administration enforcement, and digitalization) and higher import prices helped strengthen the fiscal balance. Fiscal support to households and firms (0.7 percent of GDP) helped partially offset the sharp rise in the energy bill and address reconstruction needs associated with the natural disasters of 2022. Infrastructure spending remained below 1 percent of GDP.[9] The public debt-to-GDP ratio decreased to 29.2 percent of GDP in 2022.[10]

Fiscal Framework: Historical and 2022 Outourn

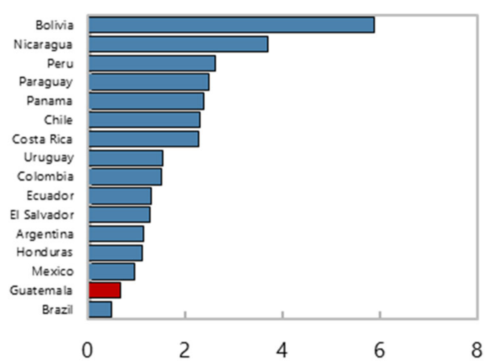
(Percent of GDP, 2019-2022)

	2019	2020	2021	2022	
				Budget[1]	Est.
Central government					
Total revenues	**11.2**	**10.7**	**12.3**	**11.1**	**12.7**
Tax revenues	10.5	10.0	11.7	10.4	12.0
Direct taxes	3.7	3.6	4.3	3.8	4.3
o/w					
PIT	2.9	2.8	3.5	2.8	3.5
Indirect taxes	6.8	6.4	7.4	6.6	7.7
o/w					
VAT	5.0	4.8	5.6	4.8	5.9
Domestic	2.5	2.4	2.5	2.2	2.5
On imports	2.6	2.3	3.0	2.6	3.4
Nontax revenues	0.7	0.6	0.6	0.7	0.6
Total expenditures	**13.4**	**15.6**	**13.5**	**14.9**	**14.4**
Current	10.7	12.6	11.2	12.1	11.9
Operating expenditures	9.1	10.9	9.4	10.5	10.2
Interest	1.6	1.7	1.7	1.7	1.7
Capital	2.7	3.0	2.4	2.8	2.5
Primary expenditures	11.8	13.9	11.8	13.3	12.7
Primary balance	**-0.6**	**-3.2**	**0.6**	**-2.2**	**0.0**
Fiscal balance	**-2.2**	**-4.9**	**-1.2**	**-3.8**	**-1.7**

Source: Ministry of Finance; and Fund staff calculations.
1/ The 2022 budget includes budget amendments of one percentage point of GDP (the initial budget envisaged a fiscal deficit of 2.8 percent of GDP)

Investment in Public Infrastructure

(Percent of GDP, Average 2015-2021)



Source: Infralatam.

Commodity Shock and Emergency Relief Measures

(Percent of GDP)

	2022
Energy subsidies	**0.42**
Gas subsidies	0.08
Fuel subsidies	0.32
Electricity subsidies	0.01
Agricultural subsidies	0.01
Emergency expenditures	**0.26**
Reconstruction expenditures	0.26

Source: Ministry of Finance

10. Guatemala's 2022 external position is stronger than the level consistent with the level implied by fundamentals and desirable policies. The undervaluation of the real effective exchange

[8] The tax revenue line in the budget approved by Congress is a floor level. Attaining this level allows for the possible continuity of the Superintendency of Tax Administration (SAT) management team in their roles.

[9] At less than one percent of GDP on average, Guatemala's public infrastructure investment is among the lowest in Latin America (two percent of GDP on average between 2014 and 2021 in Latin America).

[10] There are also pending balances to the IGSS admitted by the courts and Banguat (estimated at about 4.1 percent of GDP) not included in the stock of debt.

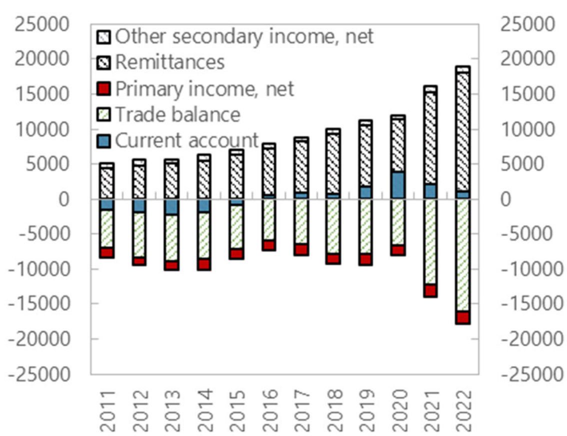
rate was smaller than in 2021 due to a higher elasticity of the CA balance with respect to REER (Annex I):

- *The trade balance deficit (about 17 percent of GDP in 2022) expanded and current account surplus (1.4 percent of GDP in 2022) weakened in 2022*. The strength in remittance inflows (19 percent of GDP in 2022) and exports offset the strong imports (driven by higher import prices).

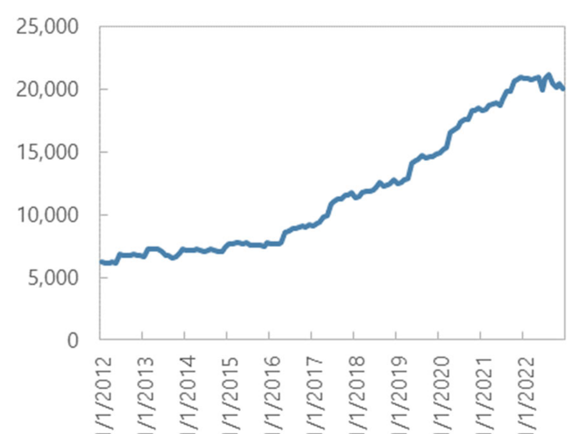
- *2022 net international reserves closed at US$20 billion, 4.4 percent (US$920 million) below the end-2021 level*. Temporary U.S. dollar liquidity needs were driven by a mix of factors: a large import bill, the closing of the four offshore banks by year-end, and the repayment of expensive US$-denominated debt held by some large banks.[11]

- *The nominal exchange rate remained stable around its historical mean*, but the real effective exchange rate appreciated somewhat (about three percent in 2022).[12]

Current Account
($US million)



Net International Reserves
($US million)



Source: Banguat; IMF staff calculations

11. Guatemala's financial sector is bank-centric; banks appear to be well prepared to absorb a range of shocks with available buffers. In 2022 Guatemala had 17 banks holding about 93 percent of the financial sector's assets (ten are part of a financial group); a new purely digital bank was licensed in December 2022. Banks' solvency ratios remained solid at end-2022, with capital

[11] Also, bank portfolio debt management was associated with the U.S. monetary policy tightening and limited U.S. dollar new lending–linked to the 2022 U.S. bank stress test exercises and individual U.S. banks' capital needs announced in October 2022. U.S. dollar needs were covered by Banguat through its repurchase agreements facility in U.S. dollars (with an overall limit of US$500 million to end-December 2022) and interbank transactions.

[12] In the first eight months of 2022, Foreign Exchange (FX) purchases eased appreciation pressures from strong remittance inflows (FX net purchases reached US$1.2 billion in August 2022), while depreciation pressures dominated in the last months of 2022, with FX net purchases falling to US$0.5 billion in December 2022. Since January 1, 2023, Banguat doubled the maximum daily amount of interventions to US$100 million.

ratios (16.5 percent) well above the regulatory minimum capital adequacy ratio (10 percent) and nonperforming loans reported at 1.3 percent. The system is also liquid, with short-term and MT liquidity ratios estimated at 20 percent and 48 percent, respectively. Banks' provisions exceeded 260 percent, and profitability has been increasing—with returns on assets at 2.3 percent and returns on equity above 24 percent (Table 5). The staff top-down stress test suggests banks continue to be well prepared to withstand a range of shocks with available buffers (Annex IV). However, there are pockets of vulnerability, driven, among others, by the rapid credit expansion in 2022-to date, especially towards consumption.

12. There has also been progress on the legislative front to improve the business climate. The approval of the leasing and insolvency laws, the law to encourage foreign investment, and the Free Zones Act are good examples. Draft legislation on Securities and Merchandise Market, Intellectual Property Rights, Public-Private Partnerships (PPPs), and Infrastructure are all pending in Congress. The Competition draft law, regulating monopolistic and anti-competitive behaviors, is expected to be approved by Congress soon.

13. Significant efforts are ongoing to strengthen data availability and its quality further. The 2022 Survey on Employment and Income was completed in February and published in April 2023. The National Household Survey on income and spending will be completed by the end of 2023, with the updated Consumer Price Index (CPI) data (with updated weights) published by January 2024. Banguat, jointly with the Ministry of Economy and the National Statistics Institute, has started a project to develop quarterly leading labor market indicators that help identify inflationary pressures in the future. Other projects involve measuring GDP by region, strengthening the environmental accounting system, advancing the monetary and financial sector statistics on non-bank financial institutions, and expanding the debt data to cover general government debt (including public entities).

OUTLOOK AND RISKS

14. Guatemala's growth rate is projected to moderate in 2023 and strengthen over the medium term. In 2023 real GDP growth rate is projected to decelerate to 3.4 percent, partly reflecting the U.S. economy slowdown. Nonetheless, the large remittance inflows –about US$19 billion in 2023—associated with exceptionally large migration outflows to the United States in recent years are expected to remain strong in the coming years,[13] and to continue supporting domestic consumption and imports. At the same time, demand is expected to respond to tighter global and domestic financial conditions, inflationary pressures, and higher production costs (driven by some labor market tightness and higher standards under the European Climate Law regulation

[13] The strong U.S. labor market in recent years and the large wage gap, security and crime, rural poverty, and climate-related events have driven migration flows. Babii et al. (2022) provide further insights into the regional dynamics of remittances.

on fertilizers, for example). The output gap should close by 2024, and inflation is expected to peak in Spring 2023 and gradually decline to the target band (center) by end-2024.

15. The fiscal stance is expected to remain prudent while monetary policy becomes less accommodative and the external sector balance shrinks. The 2023 budget, approved by Congress in November 2022, envisages an overall deficit of three percent of GDP (staff's deficit projection is 1.7 percent of GDP, after adjusting for a low spending execution rate and higher tax collection) and a decline in total expenditure of 0.5 percent of GDP. The MT fiscal deficit is expected not to exceed the two percent target, and monetary policy to continue helping tame inflationary pressures further in the near term. The current account balance is projected at 1.9 percent of GDP and only close over the medium term. In 2023 (to end-February), remittance inflows remained strong—12.6 percent higher than in 2022 (to end-March). Banguat's net FX purchases mounted to – US$53.8 million by April 10, 2023.

Fiscal Framework 2023

(Percent of GDP)

	2023		
	Budget 1/	Authorities' Proj	Staff's Proj.
Central government			
Total revenues	**11.3**	**12.5**	**12.2**
Tax revenues	10.7	11.9	11.6
Direct taxes	3.7	4.3	4.2
o/w			
PIT	2.9	3.5	3.4
Indirect taxes	6.6	7.7	7.4
o/w			
VAT	5.0	5.9	5.7
Domestic	2.2	2.5	2.6
On imports	2.8	3.3	3.1
Nontax revenues	0.6	0.6	0.6
Total expenditures	**14.2**	**14.0**	**13.9**
Current	11.7	11.6	11.4
Operating expenditures	10.1	10.0	9.9
Interest	1.6	1.6	1.6
Capital	2.6	2.4	2.5
Primary expenditures	12.6	12.4	12.3
Primary balance	**-1.4**	**0.1**	**-0.1**
Fiscal balance	**-3.0**	**-1.6**	**-1.7**

Source: Ministry of Finance; Bank of Guatemala; and Fund staff estimates and projections. 1/ The 2023 budget (2023, left column in the table) assumes inflation at 5% and real GDP growth of 2.5%. Staff projects nominal GDP growth at 10%

16. Risks to the outlook remain high (Annex II).

- ***Near-term risks*** are related to the external outlook and inflationary pressures and affect other economies too. An abrupt global slowdown or recession in the U.S. could trigger a slowdown (or contraction) in remittance inflows. An intensification of regional conflict(s) could heighten volatility and uncertainty and further impact commodity prices. Monetary policy miscalibration and high commodity price volatility could add further uncertainty and fuel social demands.

- ***Over the medium-term,*** Guatemala's persistent structural weaknesses continue to hinder its growth potential. Economic development will require significant improvements in the country's infrastructure, skilled labor supply, and decisive action to improve governance and legal certainty. Guatemala continues to be exposed to money laundering and terrorism financing (ML/TF) risks. The next AML/CFT evaluation, to be conducted by the FATF-style regional group ("Grupo de Acción Financiera international – GAFILAT") scheduled for 2027, will test both the level of technical compliance and effectiveness of Guatemala's AML/CFT regime. As such, the approval of the draft AML/CFT Law, aimed at strengthening the existing legal and regulatory framework in line with the FATF standard, will be critical to achieve a positive outcome. Such outcome will prevent correspondent banking relationships and credits with foreign financial institutions from being negatively impacted. Guatemala is also exposed to the effects of extreme events caused by climate change.

POLICY DISCUSSIONS

Guatemala's urgent challenges are to curb inflationary pressures and scale up the structural agenda. The country has built significant resilience against shocks with ample buffers but has operated under a low potential growth model for years, and development needs remain substantial. Fiscal policy should continue to be prudent while helping to cement a pro-growth agenda, with inclusion and productivity at its core. The implicit two percent fiscal deficit anchor and a low debt-to-GDP ratio have served the country well and should be maintained. In addition to a fiscal reform, a prudent increase in sovereign debt to cover much-needed infrastructure investments could be recommended if accompanied by a clear communication strategy and well-defined and vetted infrastructure projects. The monetary stance remains accommodative despite policy rate hikes and more policy tightening may be required to bring inflation back to the target. The further strengthening and deepening of the financial sector, and a roadmap to enhance governance perceptions should fare prominently in Guatemala's development strategy.

A. Monetary and Exchange Rate Policies: A New Opportunity to Strengthen Practices

17. The Banguat's data-driven policy rate increases remain appropriate. The recent policy rate increases (+300 basis points between May 2022 and March 2023) have helped keep inflation expectations anchored. However, the monetary stance remains accommodative, with private demand and bank credit to the private sector recording solid growth rates. The policy rate increases are to impact aggregate demand with significant lags. A tighter policy stance and adoption of further measures to offset demand and supply pressures may be required to quell inflation back to the inflation target band by 2024, especially if inflationary pressures show persistency. Tightening efforts should continue until inflation is back to the four percent target.

18. The current monetary policy challenges call for further strengthening Banguat's financial position, the Inflation-Targeting (IT) framework, and its toolkit. The 2005-adopted IT framework has served Guatemala well by supporting the authorities in safeguarding the country's macroeconomic and financial stability. However, current inflationary pressures are testing Guatemala's IT framework and evidencing the need for enhancements to further improve monetary policy effectiveness in taming inflationary pressures. Reforms include:

- *The recapitalization of Banguat* (following Article 9 of the Banguat Law) would ensure the Bank can use all its tools to manage supply and demand-driven pressures and the ability to fulfill its mandate in the future. Staff also recommended the publication of Banguat's financial statements using international accounting standards to enhance transparency and help maintain credibility.

- *The framework needs to continue transitioning towards a fully-fledged IT framework.* Further progress is required to: (i) adjust the governance framework to support the inflation-only objective; (ii) strengthen the Banguat's role as an operationally independent monetary authority; and (iii) modernize the monetary policy implementation framework (e.g., the policy rate operational framework, macroeconomic modeling capacity for monetary policy forecasting, and the reserves requirements practices). These reforms would further strengthen the effectiveness of the policy rate, better reconcile Banguat's main operations with the price of liquidity, facilitate the deepening of the interbank market, and foster the development of the monetary policy transmission mechanisms.

- *The gradual transfer of market risk management to FX users* should support the exchange rate's role as a shock absorber.[14] Guatemala is an open economy that relies on FX flows (through the trade balance and large remittance inflows). An FX risk management toolkit (including FX risk management and macroprudential FX tools) and a plan to gradually transfer the FX risks, now absorbed by Banguat, to the market should help FX users prepare to manage FX risks as the FX rate gradually adjusts flexibly to demand and supply shocks consistent with the external balance. The mission encouraged synchronizing the gradual transfer of FX risk management with the operationalization of the hedging market regulatory framework and adopting a well-designed communication strategy that guides market expectations throughout the process. Letting the exchange rate assume a more important role as the shock absorber would also facilitate the deepening and strengthening of the FX market, the lessening of frictions and potential balance

[14] As an income account item, remittances fall outside the institutional view captured under the Integrated Policy Framework (IPF). Also, non-IPF frictions include: the bid-ask spread is relatively narrow (less than ten basis points), the uncovered interest parity deviations are relatively small, capital flows are tiny in Guatemala, and net FX exposures in the banking sector are subject to regulatory mismatch limits supervised by the authorities.

sheet vulnerabilities, and allow the Bank to only intervene in the FX market to address disruptive shocks. In addition, given the permanent nature of remittance inflows, staff encouraged the adoption of structural pro-growth and productivity-enhancing reforms that increase the absorption capacity of large FX inflows.

Authorities' Views

19. The authorities expect inflation to return to the target band by the end of 2023 and be at the mid-point of the band by 2024. At the same time, they acknowledged considerable uncertainty affecting food prices, wage adjustments, and inflation persistence effects. They expressed confidence in the effectiveness of a mix of factors, including base effects and stable inflation expectations, easing external pressures, and some policy action, as needed. They expect the current account surplus to close in two years, owing to higher imports and further moderation in remittance inflows growth rate. The authorities have accumulated large buffers in the form of international reserves, part of which has a precautionary function. The authorities believe that the current environment of protracted high uncertainty justifies higher reserve buffers than previously deemed adequate.

B. Fiscal Policy: Prudence for Longer and a Medium-Term Strategy

20. The authorities' commitment to a prudent fiscal stance has served them well and continues to be appropriate. The 2022 budget had a 96 percent execution rate, above past years, yet the fiscal deficit stayed well below the projected deficit in the approved budget, with revenue overperforming. The 2023 approved budget kept the prudent fiscal policy stance of past budgets and was also designed under the base scenario of fiscal prudency beyond 2023, with low fiscal deficits (below 2 percent) and a low debt-to-GDP ratio (below 30 percent of GDP).

21. A multi-year, medium-term, more flexible budget is urgently needed to support a sustainable, inclusive growth model and expand Guatemala's potential growth. The authorities faulted the rigidities in the legal framework and cumbersome approval processes as the limiting factors to an expansion of much-needed capital spending, the residual item in the budget.[15] They also recognized that further flexibility in the annual budget and aligning the multi-year fiscal revenue and spending targets with a MT debt strategy would be welcomed. The inclusion of the MT fiscal framework as part of the annual budget discussion at Congress and the publication of multi-year plans and targets as part of the budget process could help communicate the administration's budgetary priorities, assess the impact of current and proposed policies over several years, and ultimately help achieve better allocation, control, and execution of public expenditure and borrowing.

[15] Over 90 percent of the budget is estimated to be earmarked against wages, debt service payments, and transfers to entities determined by the Constitution—e.g., municipalities, the University of San Carlos, the Constitutional Court, and Development Counsels.

22. At the same time, tax collection needs to increase to be able to finance the much-needed investments in the country. 2022 was a strong tax collection year, with revenues estimated at 12 percent of GDP. Reform continuity guided by management continuity at the Superintendence of Tax Administration played an important role in achieving these outcomes. In addition, maintaining this achievement will also require of additional administrative tax measures to offset possible import prices declines and continued improvements in compliance. Increasing the tax revenue objective to at least 15 percent of GDP is an ambitious but realistic objective that would require the approval of a comprehensive tax reform. Measures already considered in past fiscal reforms that did not materialize (or failed in Congress) but should be considered include broadening the tax base, a structural increase in domestic VAT and personal income tax rates, streamlining exemptions, and enhancing compliance (e.g., via tax audit functions), among others (Annex V).

23. Pro-growth spending needs to increase to cover the gaps in investment, institutional capacity, and social needs. Efforts are ongoing but

a. *Infrastructure gaps put a major brake on Guatemala's growth prospects* (Annex VI). The authorities agree on the need to accelerate the implementation (and evaluation) of critical transformative infrastructure projects required to enhance connectivity throughout the country and cost-efficiencies. The top-down *Guatemala no se detiene* strategy is an important public-private sector collaborative effort; nonetheless, its execution requires consistency with: (i) the bottom-up national investment plan; and (ii) the administration's broader development MT goals. Further agility in implementation could be attained by strengthening project appraisals and procurement, portfolio management and implementation, and risk management functions—including risk assessments and insurance instruments to mitigate climate–related hazards. An IMF-led Public Investment Management Assessment (PIMA/Climate-PIMA), scheduled for June 2023 and with World Bank participation, will propose a roadmap of reforms to streamline overly cumbersome processes.[16] It is also critical that the first Public-Private Partnership (PPP) project is completed and the PPP legal framework's reform simplifying some of the processes is adopted. Approving legislation on infrastructure encompassing roads, airports, and ports would be a key step forward. Given the import-intensive component in investment projects, these efforts will also continue to help reduce the current account gap and further enhance Guatemala's growth model.

b. *Access to qualified labor force and addressing institutional capacity gaps remain a constraint, despite recent efforts.* The government has put in place some initiatives to address educational gaps. For example, Guatemala's INDECAP has served as the platform to train groups of workers needed for specific work projects. Since 2020, the Ministry of Education has launched a scholarship program to study English. At the same time, the education budget is largely

[16] The PIMA/C-PIMA will build on the IMF's Fiscal Transparency Evaluation update (September 2022). Among other recommendations, this evaluation proposed strengthening the assessment of funding allocated to mitigating and preventing natural disasters. The Climate-PIMA will provide a roadmap to enhance resilience to climate risks, strengthen the capital project appraisal process, and develop a standardized methodology for assessing the climate impact of new projects and their exposure to climate events.

assigned to wages and there are some indications of brain drain migration due to wage differentials with the U.S. Also, the quality of public sector services needs to be strengthened, with meritocracy, institutional efficiency, and competitive and effective procurement services being at the core of the civil service law reform efforts.

c. *Social spending needs to be better targeted and increased.* The completion of the national household survey (due by late 2023/early 2024) should help close information gaps on vulnerable populations, enable more efficient temporary targeting of these segments, and record a stronger impact. At the same time, scaling up temporary targeted support to education and health would help close gaps.[17] Accumulated cash balances due to budgetary underspending (e.g., about 0.6 percent of GDP from 2022 and the first two months of 2023) could be used to support the most vulnerable groups.

24. Guatemala is well-placed to develop its MT debt management framework that supports the country's development needs. The mission stressed the benefits for the government and the private sector of issuing debt instruments along the whole spectrum of the yield curve according to a pre-announced debt issuance annual plan[18] and market conditions. Staff supported that, given the criticality of large investments to ensure a MT sustainable growth model, a slightly higher debt-to-GDP ratio could be appropriate if clearly articulated in a communication strategy that explains the criticality of the project vetted and the associated timeline. Improvements in the MT debt management strategy and annual budgeting and borrowing, consistent with the government's MT spending and revenue collection plans, is much needed. It would bring efficiency gains and reduce spending lags. Also, developing the secondary market for sovereign debt and the domestic capital market as a whole and broadening the investor base (e.g., insurance markets) would help reduce funding costs and improve access over time.

Authorities' Views

25. The authorities reiterated the new administration should build on the progress made and broadly agreed with the staff recommendations. They emphasized the results of their efforts on tax administration (e.g., digitalization, transparency, and streamlining of bureaucratic procedures) in achieving a solid outturn. Their commitment to fiscal transparency yielded improvements in the recently conducted Fiscal Transparency Evaluation (FTE). They underscored the progress made in this regard (digital procurement platform, budget transparency, procurement law, updated procurement regulation, and continued efforts on consolidated statistics for the NFPS) and continued efforts for 2023. The authorities recognize the need to increase tax revenue further if the longstanding social and infrastructure gaps are to be addressed. At the same time continuity of the management team

[17] Targeted cash transfers funded by multilateral debt is not possible in Guatemala. Congress has also been limiting the approval of multilateral projects on education and health. Temporary energy subsidies (as implemented in 2022 and extended for three months in 2023) would be the second-best option when targeted cash transfers are not an option.

[18] The authorities publish the issuance dates for the fiscal year in January, but the calendar does not disclose the amounts to be issued. In practice, the budget guides investors.

and legal protection to tax inspectors in exercise of their duties would help. The authorities agree building broad-based consensus for the design and adoption of a tax reform may require improving spending quality. They also reiterated

- *Their longstanding commitment to prudent fiscal policies*. These resulted in low debt levels and a deficit below the anchor for two consecutive years. Their current MT Framework guides these conservative policies. Yet, they agreed it could be better anchored to close infrastructure and social gaps and are interested in exploring mechanisms to improve it further. The authorities recognized the benefits of adopting a MT fiscal and debt framework but also stressed the officialization of this approach would require Congress approval. Also, the authorities pointed to the cost of the debt as a challenge and favored benefiting from market conditions.

- A comprehensive fiscal reform would be needed to achieve a 15 percent of GDP target, but it should be taken by the next administration.

- Their efforts to support the most vulnerable. They indicated the renewal of social support to alleviate poverty and inflationary pressures by extending targeted and temporary subsidies and raising social spending in 2023. They will also reduce the information gaps to target social spending by using the household survey in the field, expected by 2024.

26. The authorities appreciated the FTE and welcomed the PIMA/Climate-PIMA evaluation as a first step to identify the main steps moving forward on streamlining processes. They agreed they could enhance their public investment framework and its resilience to climate events.

27. The Ministry of Finance does not recognize the debt claimed by IGGS, and some judicial processes are in Courts for resolution; the Law to cover the employer's contribution to social security must respond to a new tax (which was never promulgated by the Congress of the Republic) to cover these expenses. In addition, regarding the deficiencies of Banguat, the notes to the Financial Statements reflect that it requires authorization from Congress and that situation is pending, the Ministry having made the proposals before said entity as appropriate both in the annual budget projects and in the long-term term

C. Financial Sector Policies

28. The accounting and regulatory framework underpinning Guatemala's banking sector needs to advance. Staff stressed the importance of maintaining close oversight and fast-tracking the pending accounting reform to ensure the banks' disclosure of their financial statements using international accounting standards. These efforts should help further monitor evolving risks (related to monetary policy tightening and credit to consumption), add transparency, and result in lower external funding costs. Also, Congress' approval of the 2002 Banking Law and Financial Groups update, aligning regulatory and supervisory practices to international standards and ensuring supervisors are equipped with up-to-date tools to monitor risks (credit, market, and operational) is urgently needed. The Law would equip supervisors with a mandate to evaluate and act upon risks and vulnerabilities that could affect Guatemala's financial system.[19] The publication of the Financial Stability Report would provide a stocktaking of the Guatemalan financial sector's financial stability risks based on bottom-up and top-down stress testing assessments and foster communication with market participants. Staff also recommended strengthening carbon footprint data collection from the banking sector and better understanding the potential impact of climate risks in the financial sector, by also partnering with other regional bodies.

29. The financial sector could further support Guatemala's development. Guatemala's financial sector remains small, with a traditional bank-centric structure. The insurance sector needs to grow, deepen significantly in the life and non-life segments,[20] and support the work on climate-risk management. Reconstruction costs could be lowered and economic opportunities in areas affected by climate-hazards expanded by providing prevention tools that foster sustainable investments. Also, the digitalization of financial services could provide the platform to propel the inclusion of the large informal sector.

Authorities' Views

30. The authorities consider the banking sector is sound and agree that the financial sector needs to support Guatemala's development further. The approval of the Banking and Financial Groups Law reform is important to support these efforts further. Still, they consider that the Financial Stability Report publication should only take place in the medium term.

D. Governance Agenda

31. The implementation of the governance and anti-corruption reform agenda has seen some progress. The IMF FTE, conducted at the request of the authorities, reflects ongoing efforts to enhance transparency and the digitalization of processes. The evaluation shows significant progress relative to the 2016 Evaluation, with major advances identified in fiscal reporting and fiscal risks. Further work is needed in the budgetary and fiscal projections areas. Also, the authorities have been making efforts to enhance transparency via the development of technological tools and mechanisms to improve access to information on public resource management (e.g., portals on expenditure and budget execution), the implementation of the General Registry of State Acquisitions since January 2020 to cross-check procurement transactions information and identify conflict of interests, among others, and the establishment of a technical sub-commission in August 2021 to follow up on commitments and obligations arising from conventions ratified by the government. Closing the remaining four offshore banks was also a good step forward.

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[19] The current draft law (pending Congress approval) would benefit from updates to align regulation to Basel Principles (market risks and operational risks, for example) to new advances on consolidated supervision, among others.

[20] The penetration index (insurance premiums to GDP), density index (insurance premium per capita), and deepening index (life premium share to premium).

32. There have also been some setbacks in the fight against corruption. The announcement on January 16, 2023, that a Guatemalan court was initiating legal action against the former head of the U.N.'s international commission against impunity in Guatemala (CICIG) and against former staff of the commission In January and end-March 2023, lead to adverse international community reactions. The 2022 Sustainable Development Report shows progress in property rights and reducing crime but a deterioration in corruption perception and press freedom index. Undertaking a diagnostic governance assessment would be important to provide a roadmap of reforms with a timeline. This roadmap will help scale up efforts in this area, improve the business climate, and help attract FDI.

33. The approval of the pending draft AML/CFT Law and further implementation of the new reforms enhancing Guatemala's legal framework in line with the FATF standard is very urgent. Adopting and implementing a sound and robust AML/CFT law is crucial in preventing the misuse of legal institutions to launder the proceeds of criminal acts, reduce corruption vulnerabilities, maintaining financial stability, and safeguarding the financial sector. The draft law has been in Congress for approval for several years now. GAFILAT postponed the next assessment until 2027 (initially planned for 2024). In a joint collaborative effort with the World Bank, the Inter-American Development Bank, and the Organization of American States, Fund staff is coordinating AML/CFT-related institutional capacity building and training addressing the AML/CFT legal and regulatory framework in Guatemala. Further support would be expected to raise awareness on the revised AML/CFT Law once approved by Congress, as well as the updating of implementing regulations.

Authorities' Views

34. The authorities consider strengthening the institutional capacity for AML/CFT as a core prerequisite to the approval and implementation of the AML/CFT Law that addresses gaps and aligns Guatemala's regime with the FATF standards. Also, the authorities expressed strong interest in undertaking the IMF governance diagnostic to demonstrate their progress in their fight against corruption and have a roadmap of reforms for the medium term. The formal request will require the new government's approval and the timeline agreed with the authorities.

E. Supply Side Reform Agenda

35. Guatemala should benefit from an enhanced results-based framework linking initiatives to outcomes within an overall MT strategy. The approval of the insolvency framework and foreign direct investment law are good steps forward. The signature of new bilateral trade agreements and FDI promotion are also important steps. Increasing access to technology and innovation, lowering electricity costs, and increasing the skilled labor supply would improve structural competitiveness**.** International institutions' continued collaboration in the structural agenda should benefit from further implementation efforts and the passing of reforms streamlining processes.[21]

36. Reducing informality in Guatemala would require an integral labor market formalization strategy (see SIP). The strategy should include strengthening education and governance, reducing labor market rigidities, and to cope with informality are necessary.[22] The flexibilization of the labor market would require rationalizing severance payments, linking the minimum wage to productivity, and adjusting the regulations and procedures to incorporate rural labor market features such as agricultural seasonality. Other measures include enhancing oversight and designing formalization benefits (e.g., streamlined taxation requirements, access to credit, SME hiring policies, and part-time arrangements).

Authorities' Views

37. The authorities recognize the importance of lowering informality. This year the authorities approved two increases to minimum wages (7 percent in the Department of Guatemala City and 4 percent in other regions) to better align the salary scale to productivity in each area and have recently approved ILO-backed regulation to facilitate partial-time hiring. The authorities also expect to ease formalization through electronic invoicing, digitalizing public sector procedures, and further implementing *the Tax Simplification, Update, and Incorporation Law*.

STAFF APPRAISAL

38. Guatemala's economy continues to benefit from a broadly positive outlook thanks to the authorities' prudent macroeconomic policies, but risks are tilted to the downside. Guatemala's prudent policies have helped shelter the economy from the challenging global environment and tightened global financial conditions. The 2022 slowdown in growth (to 4.1 percent) is expected to continue further (to 3.4 percent) in 2023 but remain close to potential. Large remittance inflows are expected to continue supporting a robust external position and domestic private demand. Inflationary pressures and uncertainty will continue to pose challenges on the horizon, with domestic factors (demand and supply pressures and so-called second-round effects) risking outpacing external factors in explaining inflation.

39. The unanimous decisions to hike the policy rate in the past months sent a strong message from the Bank of Guatemala, in the resolve to fight Inflation consistent with its Inflation Targeting (IT) framework. The decline in U.S. inflation and base effects from April 2023 will help tame pressures. However, continued monetary policy efforts will be required. Banguat

[21] The World Bank engagement covers poverty, social gaps, revenue mobilization, and inclusion, among others. The IADB's extensive engagement with Guatemala covers institutional strengthening, provision of basic services, private sector development, climate, gender, and digital transformation, among others.

[22] Measures also supported by the World Bank to add flexibility to the labor market include allowing factors of production to move freely across firms and sectors, apprenticeship programs, part-time and flexible labor contracts, that remove barriers and incentivize female labor force participation, among others.

should stay ready to fight inflation persistence by further tightening its stance and reversing its still widely accommodative stance as needed. Also, further strengthening the IT framework and practices in monetary operations would help the policy rate be a more effective tool. The adoption of a mix of technical measures related to the monetary and operational framework is required to further enhance the effectiveness of the policy rate and the monetary policy transmission mechanisms. The gradual transfer of market risk management to the private sector will support the foreign exchange rate's role as a shock absorber and help deepen the interbank market. Other urgent measures to help Banguat further improve the effectiveness of monetary policy include the recapitalization of the Banguat and the development of hedging tools for the private sector to manage foreign exchange volatility.

40. The sustained track record of prudent fiscal policies and low debt-to-GDP ratios is expected to remain in place. The 2022 boosting of tax collection due to tax administration reform efforts (customs, tax administration enforcement, and digitalization), but also high import prices, is welcomed. These are the proper steps to address the country's investment needs—i.e., social programs, infrastructure, and education and health spending, among others. The continuity of the Superintendence of Tax Administration management team played an important role in achieving these outcomes, and the reappointment of these posts based on effort result-based assessments to achieve the MT strategic objectives towards properly planning the multi-annual budget should be considered. Also, there should be continued efforts to identify and correct factors limiting VAT collection and streamlining tax exemptions. But a much-needed structural increase in tax collection—necessary to attain the country's spending needs and development targets— will require adopting a comprehensive fiscal reform that embeds a framework of MT, multi-year, and pro-growth fiscal budgets. Steps to put the bases for this reform effort are welcomed.

41. At the same time, Guatemala needs to invest heavily in quality and sustainable infrastructure, human capital investment, and social spending. A MT, multi-year planning and implementation approach is urgently needed to support the MT transformative pro-growth, pro-productivity spending agenda. The strategy *Guatemala no se detiene* is a good step in planning MT. However, closing existing gaps, implementing the infrastructure plan that incorporates resilience to natural shocks in the design, ensures connectivity and cost efficiencies, and avoids further implementation delays will require a strategic vision, streamlining processes, and reducing inefficiencies. For instance, the budget should be flexible enough for a multi-year ambitious infrastructure investment agenda consistent with the authorities' MT targets. Also, the budget should link national, subnational, and sectoral planning. Project appraisals and PPP procedures should be rationalized to reduce unnecessary implementation lags. Portfolio management and implementation with clear timelines and specific delivery targets would help fast-track projects. The IMF PIMA/C-PIMA (starting late May 2023 with also World Bank collaboration) is geared towards identifying gaps in the investment governance framework to increase high-quality investments and achieve sustainable, inclusive development.

42. Guatemala's debt-to-GDP ratio is low, and the country's risk premium has remained stable and low. The development of the secondary debt markets and completion of the yield curve should not only further help secure low-risk, lower-rates financing but also facilitate private sector access to external financing at lower rates. The latter is particularly relevant to the efforts of Guatemala's private sector to expand further.

43. The financial sector has proven to be resilient but close monitoring is justified. Guatemala's banking sector has proven resilient to shocks, but global headwinds call for caution. Close oversight and following up on banks' preparedness to weather shocks and manage a potential deterioration of credit quality would be necessary. The approval of the 2002 Banking Law and Financial Groups update, aligning regulatory and supervisory practices to international standards, and equipping supervisors with up-to-date tools to monitor risks and vulnerabilities in the industry and respond, if needed, is also very necessary now. The adoption of international accounting standards in the disclosure of banks' financial statements and the publication of the Financial Stability Report should not be further delayed.

44. Guatemala is at a critical juncture and advancing in the implementation of the structural agenda will prove defining. Guatemala has made important strides in reinvigorating opportunities for the private sector with the approval of several legislations—the leasing and insolvency laws, the law to simplify requirements and administrative procedures, and the law encouraging foreign investment. However, the approval of draft laws on civil service reform and infrastructure is urgently needed, and the financial sector should further deepen, with the insurance sector playing a role in managing climate-related risks. The implementation of approved projects, funded by international development agencies, should be spearheaded. The country should also complement these efforts and:

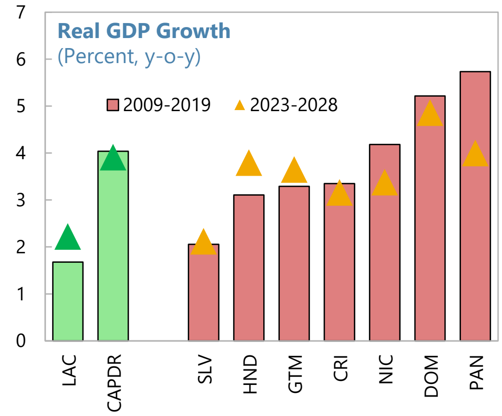
- Expand the formal labor market further, strengthen productivity, and attract investment by widening access to technology and innovation, investing in human capital, and reducing regulatory uncertainty.

- Scale up efforts to improve governance and legal certainty, reduce corruption vulnerabilities, and guarantee responsible and independent anti-corruption institutions, essential for enhancing the business climate and attracting more investment. The authorities' strong interest in completing a governance diagnostic that provides a roadmap of reforms is an important step forward.

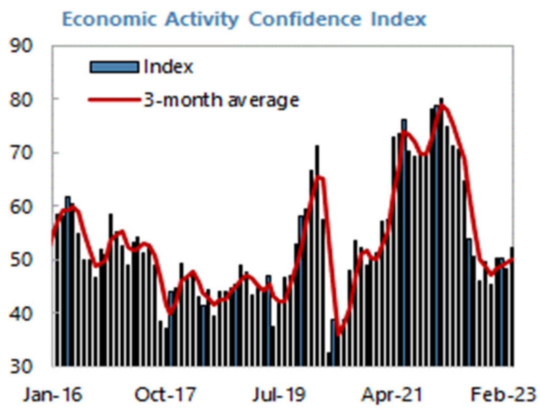
45. Staff recommends that the next Article IV consultation take place on the standard 12-month cycle.

Figure 1. Guatemala: Recent Economic Developments

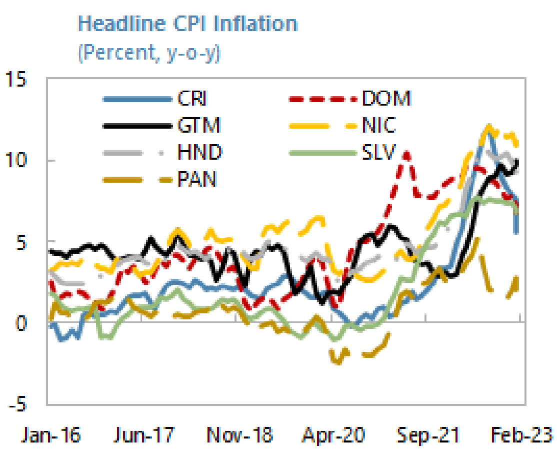
The Guatemala's MT growth outlook remains broadly unchanged.



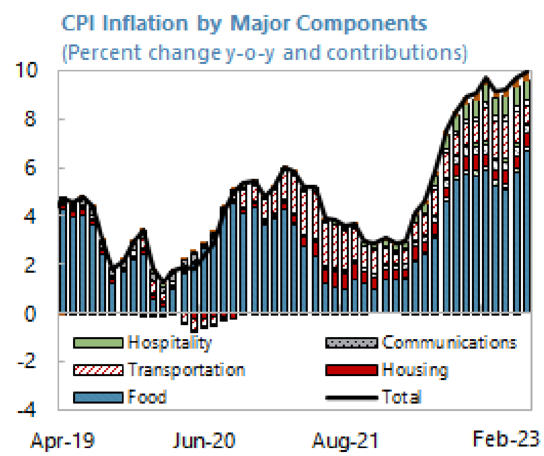
The confidence index shows a recovery.



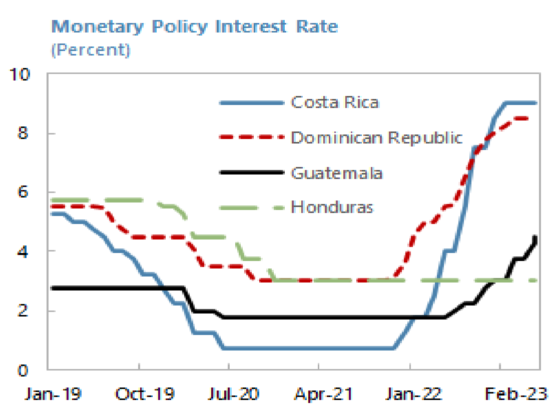
Inflation remains high and shows signs of stickiness…



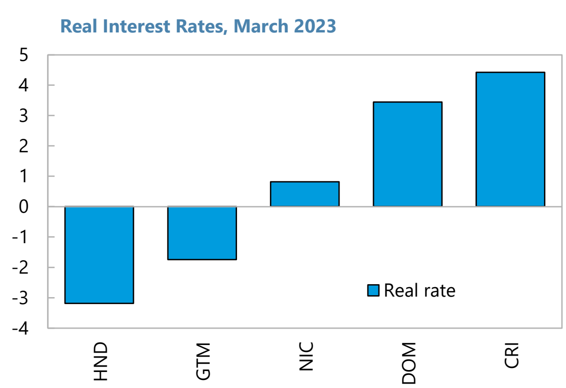
…with food inflation playing a major role.



And while the policy rate has increased ….



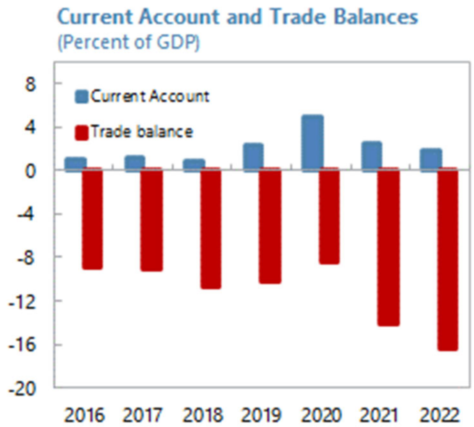
… it remains in negative real terms territory.



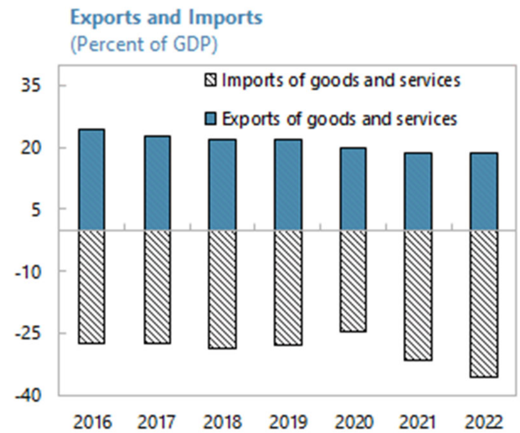
Source: National Authorities and IMF Staff Calculations.

Figure 2. Guatemala: External Developments

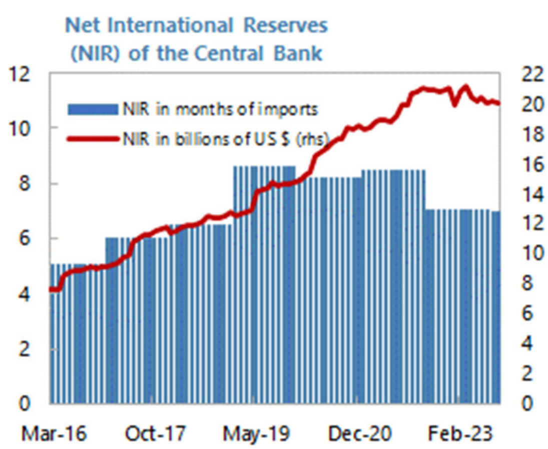
The CA surplus has been shrinking ….



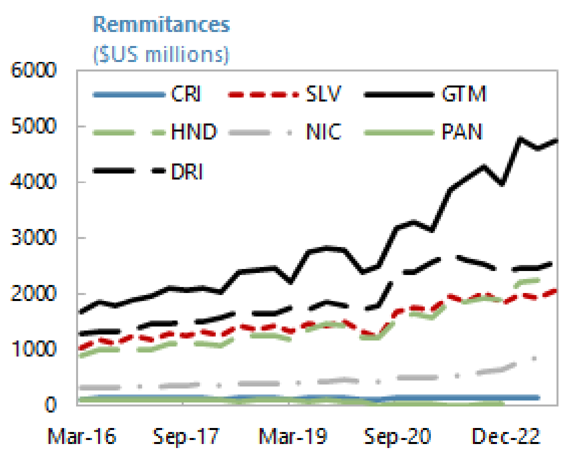
…. with the surge in import prices.



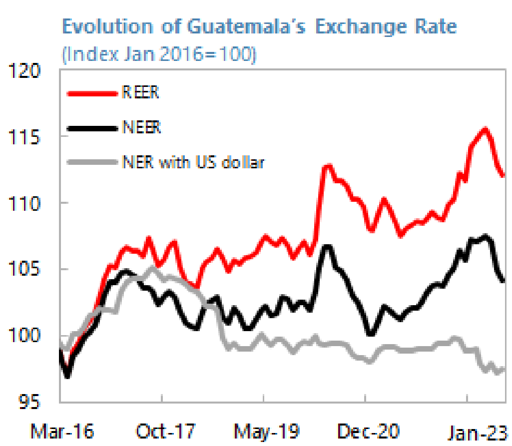
International reserves remain solid …



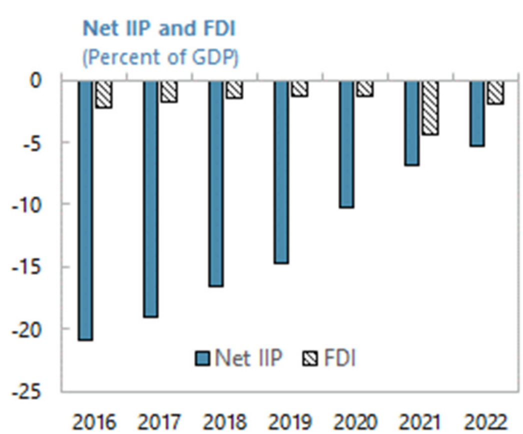
with remittances growing fast …



and adding pressure to the exchange rate.



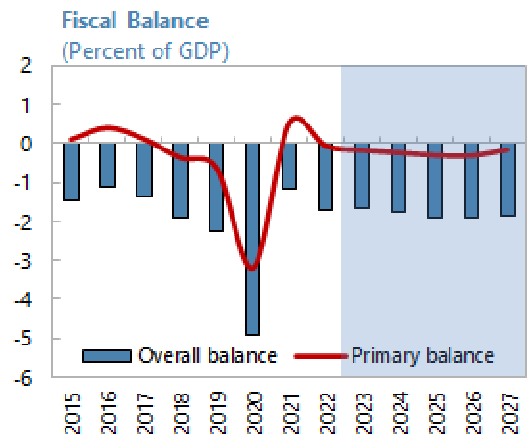
FDI has dropped from 2021 but is above previous years.



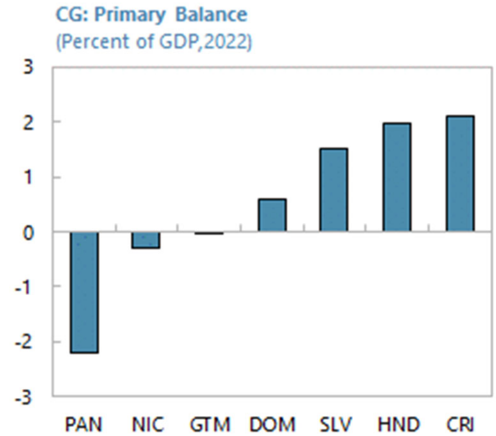
Source: National Authorities and IMF Staff Calculations.

Figure 3. Guatemala: Fiscal Sector Developments

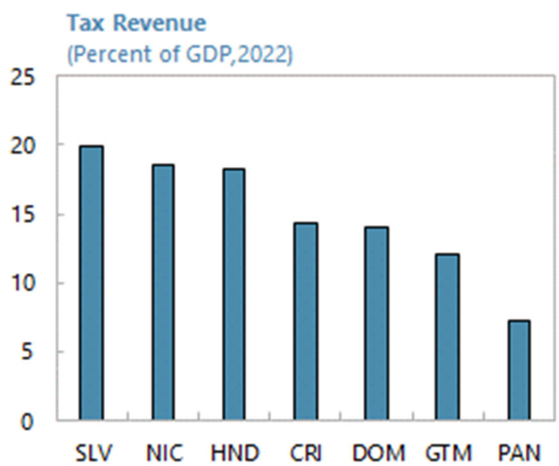
The overall fiscal balance closed in surplus...



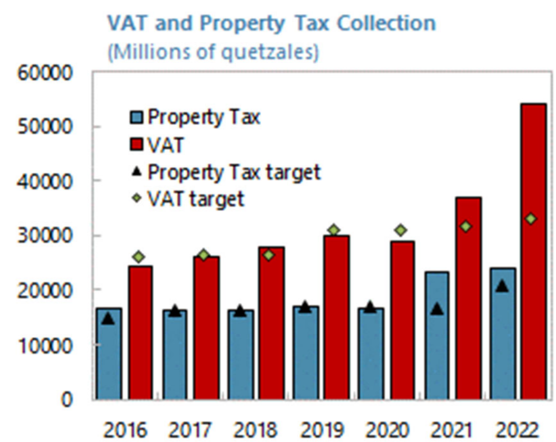
.... with a balanced primary budget ....



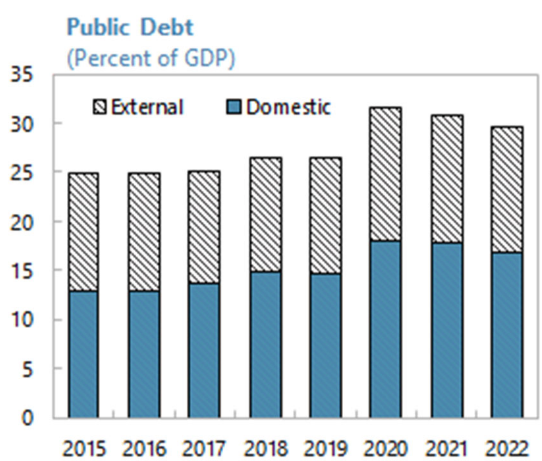
...despite tax collection remained amongst the lowest.



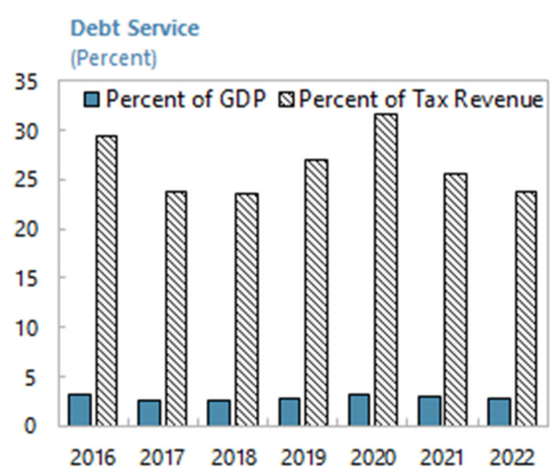
Tax collection targets continue to be overperformed.



Guatemala maintains low debt to GDP levels...



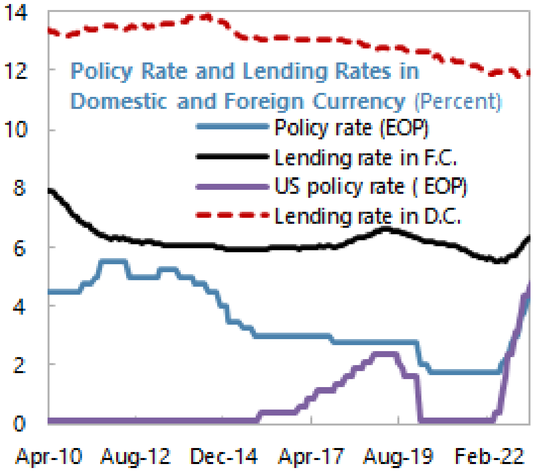
... with debt service to tax revenue declining.



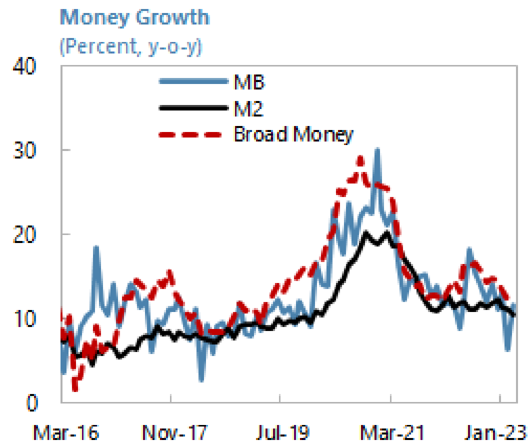
Source: National Authorities and IMF Staff Calculations.

Figure 4. Guatemala: Monetary Policy and Financial Sector Developments

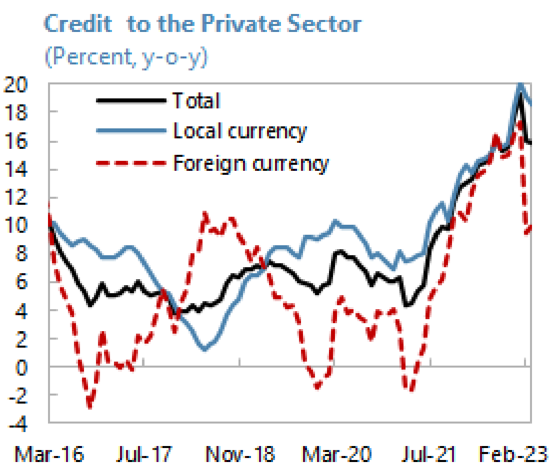
Banguat increased the policy rate, but it is not yet fully adjusting to the lending rates, especially in quetzal



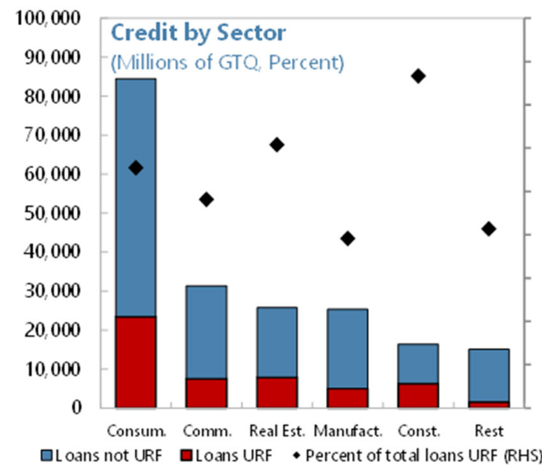
...and liquidity growth in the system is adjusting ...



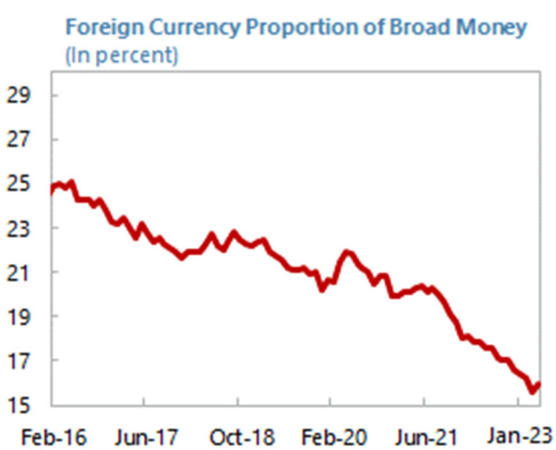
...continuing supporting credit in quetzal...



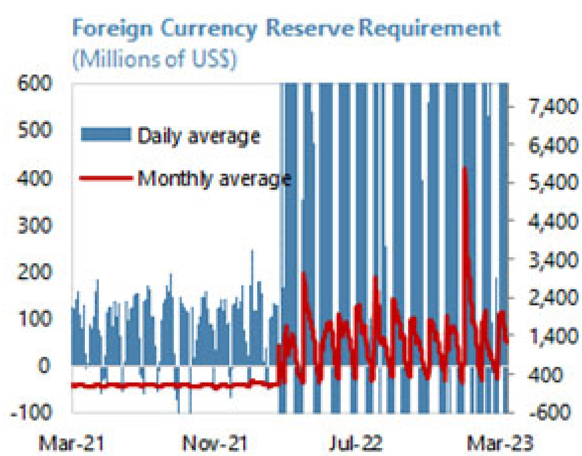
... especially for consumption...



FX liquidity has been declining, but not in quetzal...



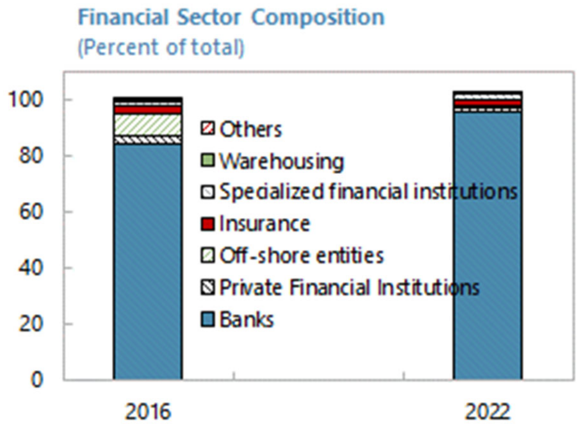
...showing some pressure in the last quarter of 2022.



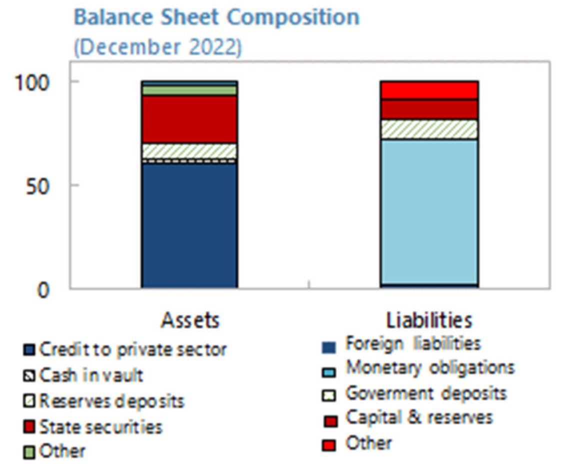
Source: National Authorities and IMF Staff Calculations.

Figure 5. Guatemala: Financial Sector Developments

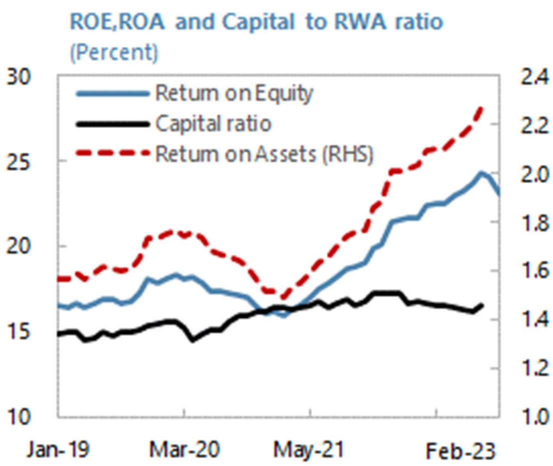
The financial system is even more bank-centric…



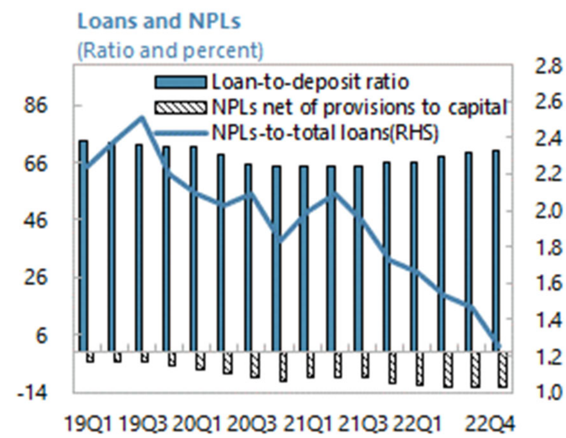
…with a traditional business model…



…that is profitable …



…conservative and with apparent low credit risk exposures.



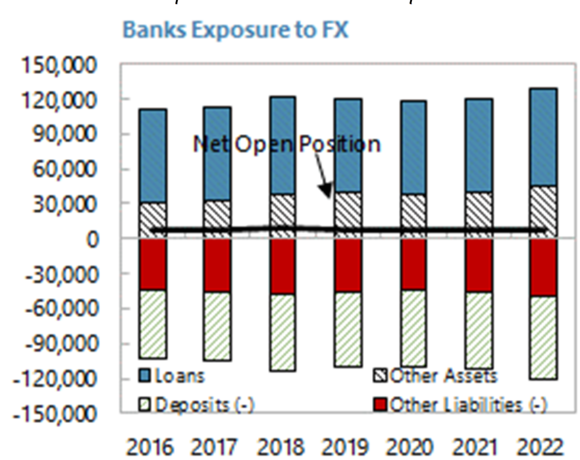
Banks are the sovereign bond holders

Bank-Sovereign Nexus, September 2022

(as % of banks' assets per group

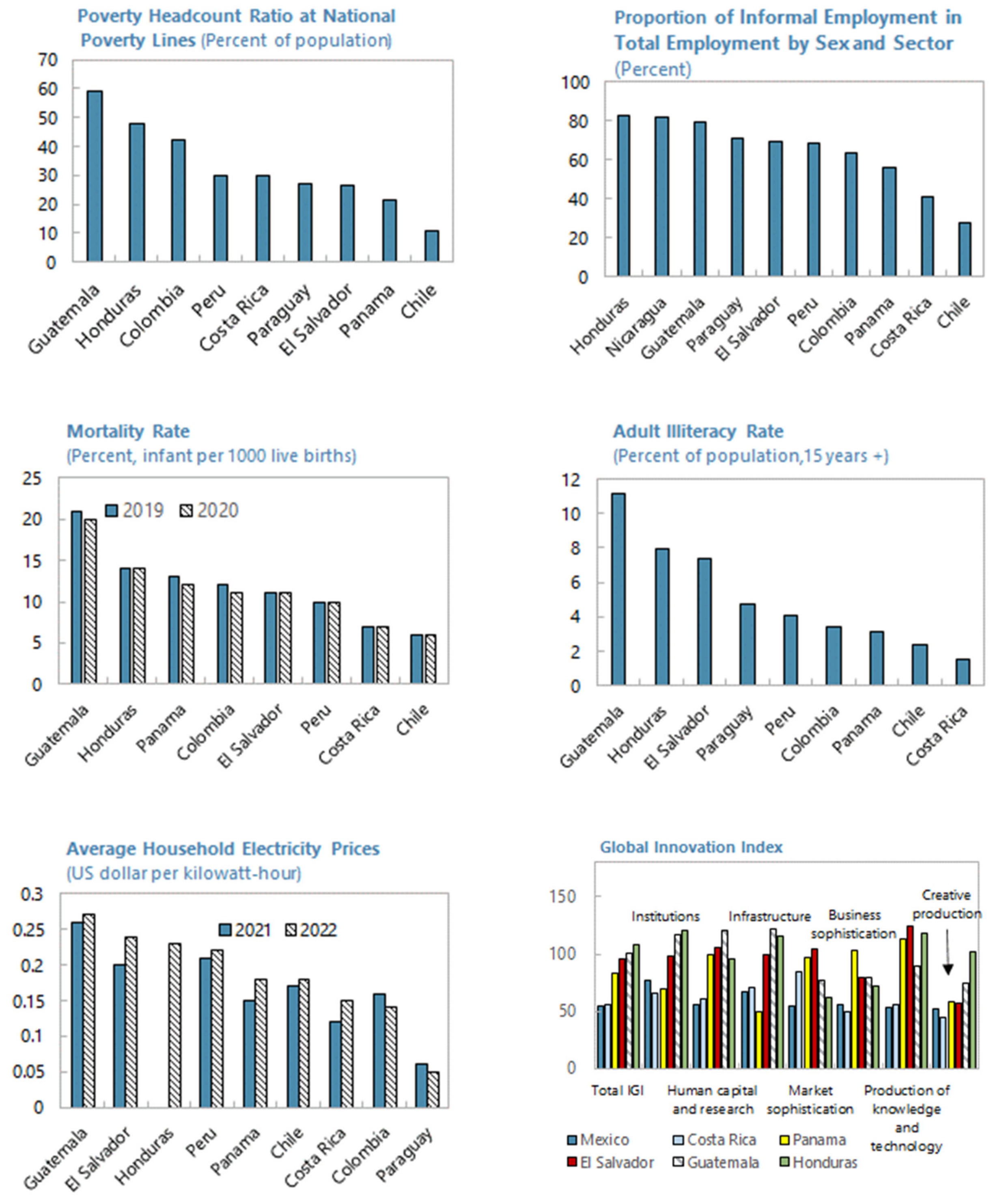
	All banks	Large banks	Medium-sized banks	Small banks
Sovereign instruments o/w	25%	28%	14%	21%
in domestic currency				
Traded	0%	0%	0%	0%
For sale	12%	13%	10%	11%
Held to maturity	10%	12%	2%	9%
in foreign currency				
Traded	0%	0%	0%	0%
For sale	1%	1%	2%	0%
Held to maturity	1%	2%	0%	0%

…. And maintain positive albeit low FX exposures.



Source: National Authorities and IMF Staff Calculations.

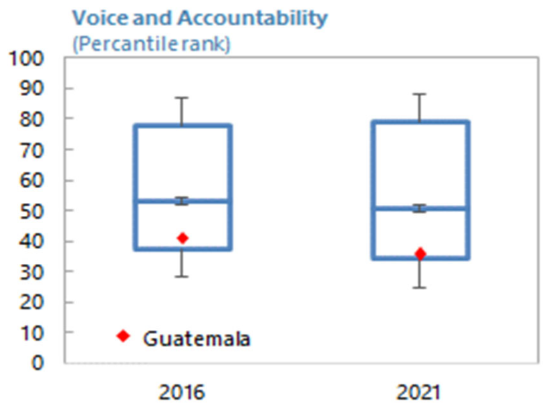
Figure 6. Guatemala: Social Indicators[1]



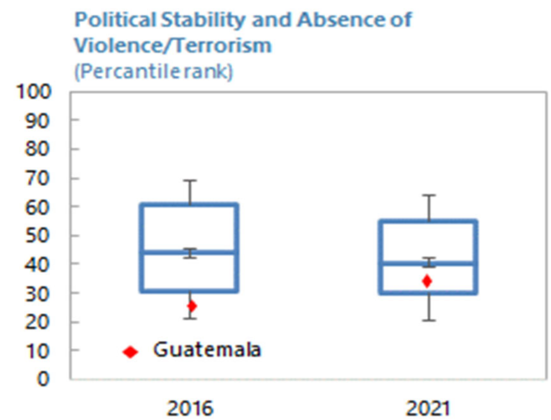
[1] Latest available year reported
Source: World Development Indicators, ILOSTAT, UNESCO, and IMF Staff Calculations.

Figure 7. Guatemala: Worldwide Governance Indicators

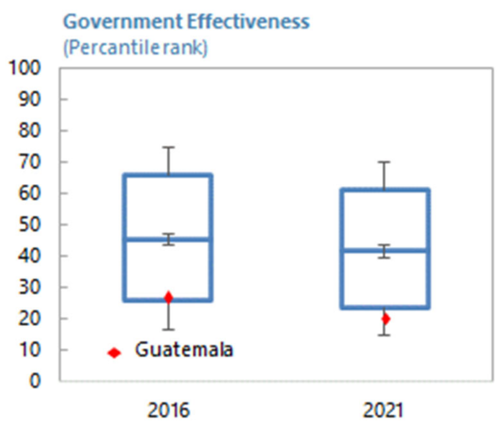
Reflects perceptions of whether citizens are able to participate in selecting their government, freedom of expression, freedom of association and media



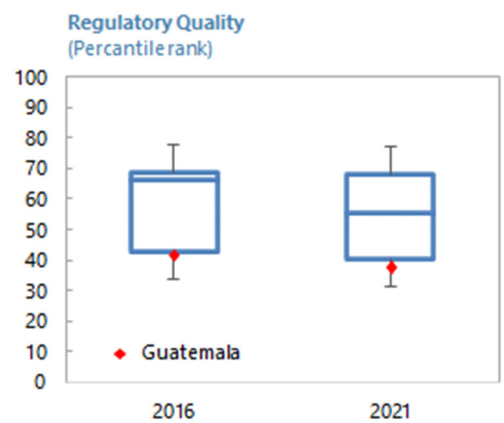
Political Stability and Absence of Violence/Terrorism measures the likelihood of political instability and/or politically motivated violence, including terrorism.



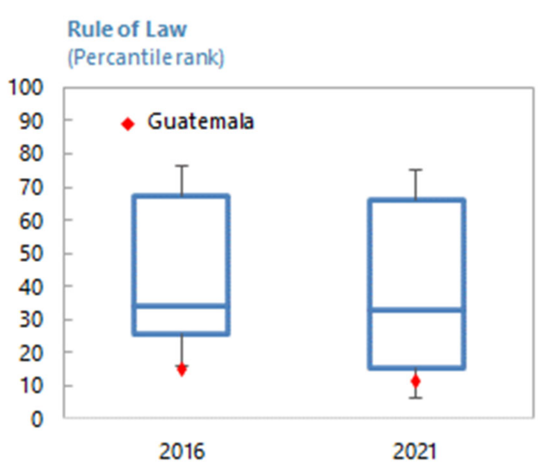
Reflects perceptions of the quality of public services, and the degree of its independence from political pressures.



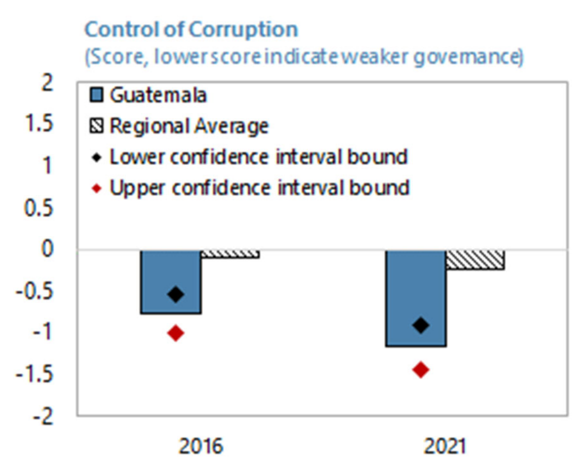
Reflects perceptions of the ability of the government to implement sound regulations for private sector development.



Reflects perceptions of the extent to which agents have confidence in and abide by the rules of society.



Reflects perceptions of the extent to which public power is exercised for private gain.



Source: The Worldwide Governance Indicators, World Bank Group.

Table 1. Guatemala: Selected Economic and Social Indicators

	2018	2019	2020	2021	2022	2023	2024	Projections 2025	2026	2027	2028
				(Annual percent change, unless otherwise indicated)							
Income and Prices											
Real GDP	3.4	4.0	-1.8	8.0	4.1	3.4	3.5	3.6	3.7	3.8	3.9
Consumer prices (average)	3.8	3.7	3.2	4.3	6.9	7.5	5.5	4.3	4.0	4.0	4.0
Consumer prices (end of period)	2.3	3.4	4.8	3.1	9.2	6.4	5.0	4.0	4.0	4.0	4.0
Monetary Sector											
M2	9.4	9.6	18.9	11.6	14.5	11.2	8.5	7.6	7.3	7.4	7.4
Credit to the private sector	7.0	4.9	6.4	12.7	16.0	14.0	7.0	7.5	7.5	8.0	8.0
				(In percent of GDP, unless otherwise indicated)							
Saving and Investment											
Gross domestic investment	13.8	14.3	13.5	16.9	16.7	16.1	15.5	15.2	14.8	14.4	14.0
Private sector	12.2	12.4	12.2	14.1	15.0	14.3	13.7	13.3	12.9	12.5	12.1
Public sector	1.5	1.9	1.3	1.7	1.8	1.7	1.8	1.9	1.9	1.9	1.9
Gross national saving	14.7	16.7	18.6	19.1	18.0	17.5	16.8	16.4	15.9	15.2	14.5
Private sector	14.1	16.6	21.0	17.8	17.5	17.0	16.3	15.9	15.5	14.8	14.1
Public sector	0.6	0.1	-2.4	1.3	0.6	0.5	0.5	0.5	0.4	0.4	0.4
External saving	-0.9	-2.4	-5.0	-2.2	-1.4	-1.5	-1.3	-1.2	-1.1	-0.8	-0.5
External Sector											
Current account balance	0.9	2.4	5.0	2.2	1.4	1.5	1.3	1.2	1.1	0.8	0.5
Trade balance (goods)	-10.9	-10.3	-8.1	-12.7	-14.9	-13.9	-13.5	-13.0	-12.7	-12.4	-12.2
Exports	13.2	12.9	13.0	14.4	15.0	14.0	13.1	12.5	12.1	11.6	11.3
Imports	24.0	23.2	21.2	27.1	30.0	27.9	26.6	25.6	24.7	24.0	23.4
Of which: oil & lubricants	4.0	3.8	3.1	5.2	6.6	5.5	5.1	4.8	4.5	4.3	4.1
Trade balance (services)	0.2	0.0	-0.3	-1.4	-1.7	-1.6	-1.2	-1.2	-1.2	-1.2	-1.2
Other (net)	11.5	12.6	13.5	16.3	18.0	16.9	16.0	15.4	14.9	14.4	13.8
Of which: remittances	12.6	13.6	14.6	17.8	19.0	18.2	17.2	16.6	16.1	15.5	15.0
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 (+))	0.5	1.8	4.2	1.6	0.9	1.5	1.3	1.2	1.1	0.8	0.5
Of which: FDI, net	-1.1	-1.0	-1.0	-3.5	-1.0	-1.1	-1.1	-1.1	-1.1	-1.1	-1.1
Errors and omissions	-0.4	-0.6	0.0	-0.6	-0.5	0.0	0.0	0.0	0.0	0.0	0.0
Change in reserve assets (Increase (+))	1.3	2.3	4.1	3.3	0.0	0.5	0.9	0.8	0.8	0.7	0.7
Net International Reserves											
(Stock in months of next-year NFGS imports)	6.5	8.6	8.1	7.4	7.0	6.9	7.0	7.0	6.7	7.0	
(Stock over short-term debt on residual maturity)	1.9	2.4	3.5	3.2	4.0	4.5	5.0	5.1	5.6	5.9	
Public Finances											
Central Government											
Revenues	11.3	11.2	10.7	12.3	12.7	12.2	12.1	12.0	11.9	11.8	11.8
Expenditures	13.2	13.4	15.6	13.5	14.4	13.9	13.9	13.9	13.9	13.8	13.8
Current	10.6	10.7	12.6	11.2	11.9	11.4	11.4	11.2	11.2	11.1	11.1
Capital	2.6	2.7	3.0	2.4	2.5	2.5	2.5	2.7	2.7	2.7	2.7
Primary balance	-0.3	-0.6	-3.2	0.6	0.0	-0.1	-0.1	-0.3	-0.3	-0.3	-0.3
Overall balance	-1.9	-2.2	-4.9	-1.2	-1.7	-1.7	-1.8	-1.9	-2.0	-2.0	-2.0
Financing of the central government balance	1.9	2.2	4.9	1.2	1.7	1.7	1.8	1.9	2.0	2.0	2.0
Net external financing	0.1	1.2	-0.3	0.8	0.0	0.6	0.5	0.4	0.4	0.5	0.3
Net domestic financing	1.8	1.1	2.5	0.4	1.7	1.0	1.2	1.5	1.6	1.6	1.7
Central Government Debt	26.4	26.4	31.5	30.8	29.2	28.2	27.8	27.7	27.8	28.0	28.0
External	11.5	11.7	13.5	12.9	11.9	11.3	11.0	10.6	10.3	10.0	9.6
Domestic 1/	14.9	14.7	18.0	17.9	17.4	16.8	16.8	17.1	17.6	17.9	18.4
Memorandum Items:											
GDP (US$ billions)	73.3	77.2	77.7	86.0	95.0	103.8	112.6	121.2	130.1	139.7	150.1
Output gap (% of GDP)	-0.1	0.0	-3.1	0.4	0.2	0.0	0.0	0.0	0.0	0.1	0.1

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

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

Table 2a. Guatemala: Public Sector Balance in Millions of Quetzales

				Estimate	Projections					
	2019	2020	2021	2022	2023	2024	2025	2026	2027	2028
	(In millions of quetzales)									
Central Government										
Total revenues	**66,555**	**64,066**	**82,186**	**93,155**	**98,700**	**106,565**	**113,370**	**120,236**	**128,094**	**137,519**
Tax revenues	62,594	60,279	78,019	88,574	94,144	100,836	107,206	113,624	121,101	130,008
Direct Taxes	21,972	21,833	28,716	31,824	34,000	37,318	40,355	42,992	45,411	48,771
Indirect Taxes	40,622	38,446	49,303	56,750	60,144	63,518	66,851	70,631	75,690	81,238
Nontax revenues	3,961	3,786	4,167	4,581	4,556	5,729	6,163	6,613	6,993	7,510
Total expenditures	**79,836**	**93,529**	**90,066**	**105,726**	**112,418**	**121,986**	**131,512**	**140,531**	**150,399**	**160,981**
Current	63,551	75,569	74,258	87,281	92,598	100,050	106,012	113,072	121,017	129,426
Wages	26,036	27,677	28,675	29,989	33,574	36,677	39,666	43,063	46,793	50,255
Goods & services	8,753	9,993	13,759	17,635	17,443	17,783	19,141	19,570	20,283	20,912
Social security benefits	5,177	5,202	5,363	5,778	6,877	7,458	8,028	8,613	9,141	9,817
Interest	9,690	10,331	11,546	12,272	12,823	14,398	15,652	17,099	18,506	20,090
Transfers	13,709	22,244	14,784	21,363	21,619	23,447	23,218	24,412	25,956	27,988
Other	187	121	133	243	263	286	308	315	339	364
Capital	16,286	17,960	15,807	18,445	19,821	21,936	25,499	27,459	29,382	31,555
Primary expenditures	70,147	83,198	78,520	93,454	99,595	107,587	115,859	123,432	131,893	140,891
Primary balance	**-3,592**	**-19,132**	**3,666**	**-299**	**-895**	**-1,023**	**-2,490**	**-3,195**	**-3,799**	**-3,372**
Overall balance	**-13,281**	**-29,463**	**-7,880**	**-12,571**	**-13,718**	**-15,421**	**-18,142**	**-20,295**	**-22,305**	**-23,462**
Financing	**13,281**	**29,463**	**7,880**	**12,571**	**13,718**	**15,421**	**18,142**	**20,295**	**22,305**	**23,462**
Net external financing	6,913	10,337	5,236	110	5,246	4,492	3,878	4,022	4,980	3,772
Loans	-2,354	1,083	-2,496	1,724	1,349	595	-19	1,684	3,421	2,213
Bonds	9,267	9,255	7,732	-1,614	3,897	3,897	3,897	2,338	1,559	1,559
Net domestic financing	6,368	19,126	2,644	12,461	8,472	10,929	14,263	16,272	17,325	19,691
Net issuance of bonds	4,866	20,388	11,316	8,562	8,472	11,129	14,263	16,272	17,325	19,691
Other	-474	-1,884	-3,137	-6	0	0	0	0	0	0
Use of government deposits	1,028	-3,146	-11,809	3,893	0	-200	0	0	0	0
Rest of nonfinancial public sector balance	**2,782**	**6,958**	**4,904**	**3,681**	**4,045**	**4,387**	**4,722**	**5,066**	**5,441**	**5,844**
Consolidated nonfinancial public sector										
Primary balance	-2,027	-13,361	7,361	3,382	3,150	3,364	2,232	1,871	1,642	2,471
Interest	8,473	9,144	10,336	12,272	12,823	14,398	15,652	17,099	18,506	20,090
Overall balance	**-10,500**	**-22,505**	**-2,976**	**-8,890**	**-9,673**	**-11,034**	**-13,420**	**-15,229**	**-16,864**	**-17,619**
Central bank balance	**-1,199**	**-1,199**	**-1,505**	**-2,327**	**-2,327**	**-2,327**	**-2,327**	**-2,327**	**-2,327**	**-2,327**
Memorandum items:										
Central Government debt	156,999	188,908	204,666	215,106	227,940	243,545	261,687	281,923	304,247	327,708
External	69,777	81,165	85,660	87,271	91,687	96,162	100,039	104,000	108,996	112,765
Domestic 1/	87,222	107,744	119,006	127,835	136,253	147,383	161,647	177,923	195,251	214,944
Consolidated NFPS debt	141,081	172,776	186,463	194,974	205,814	219,564	235,874	254,286	274,541	295,802
Central government gross borrowing requirement	20,472	38,217	16,250	21,274	21,419	25,985	28,360	33,299	34,490	36,247
Social spending	32,436	29,580	32,808	36,285	39,878	43,252	46,553	49,946	53,641	57,609
GDP	593,972	600,089	665,568	736,109	809,005	877,440	944,419	1,013,247	1,088,208	1,169,206

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

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

Table 2b. Guatemala: Public Sector Balance in Percent of GDP

	2019	2020	2021	2022	2023	2024	2025	2026	2027	2028
				Projections						
		(In percent of GDP)								
Central government										
Total revenues	**11.2**	**10.7**	**12.3**	**12.7**	**12.2**	**12.1**	**12.0**	**11.9**	**11.8**	**11.8**
Tax revenues	10.5	10.0	11.7	12.0	11.6	11.5	11.4	11.2	11.1	11.1
Direct taxes	3.7	3.6	4.3	4.3	4.2	4.3	4.3	4.2	4.2	4.2
Indirect taxes	6.8	6.4	7.4	7.7	7.4	7.2	7.1	7.0	7.0	6.9
Nontax revenues	0.7	0.6	0.6	0.6	0.6	0.7	0.7	0.7	0.6	0.6
Total expenditures	**13.4**	**15.6**	**13.5**	**14.4**	**13.9**	**13.9**	**13.9**	**13.9**	**13.8**	**13.8**
Current	10.7	12.6	11.2	11.9	11.4	11.4	11.2	11.2	11.1	11.1
Wages	4.4	4.6	4.3	4.1	4.2	4.2	4.2	4.3	4.3	4.3
Goods & services	1.5	1.7	2.1	2.4	2.2	2.0	2.0	1.9	1.9	1.8
Social security benefits	0.9	0.9	0.8	0.8	0.9	0.9	0.9	0.9	0.8	0.8
Interest	1.6	1.7	1.7	1.7	1.6	1.6	1.7	1.7	1.7	1.7
Transfers	2.3	3.7	2.2	2.9	2.7	2.7	2.5	2.4	2.4	2.4
Other	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Capital	2.7	3.0	2.4	2.5	2.5	2.5	2.7	2.7	2.7	2.7
Primary expenditures	11.8	13.9	11.8	12.7	12.3	12.3	12.3	12.2	12.1	12.1
Primary balance	**-0.6**	**-3.2**	**0.6**	**0.0**	**-0.1**	**-0.1**	**-0.3**	**-0.3**	**-0.3**	**-0.3**
Overall balance	**-2.2**	**-4.9**	**-1.2**	**-1.7**	**-1.7**	**-1.8**	**-1.9**	**-2.0**	**-2.0**	**-2.0**
Financing	**2.2**	**4.9**	**1.2**	**1.7**	**1.7**	**1.8**	**1.9**	**2.0**	**2.0**	**2.0**
Net external financing	1.2	1.7	0.8	0.0	0.6	0.5	0.4	0.4	0.5	0.3
Loans	-0.4	0.2	-0.4	0.2	0.2	0.1	0.0	0.2	0.3	0.2
Bonds	1.6	1.5	1.2	-0.2	0.5	0.4	0.4	0.2	0.1	0.1
Net domestic financing	1.1	3.2	0.4	1.7	1.0	1.2	1.5	1.6	1.6	1.7
Net issuance of bonds	0.8	3.4	1.7	1.2	1.0	1.3	1.5	1.6	1.6	1.7
Other	-0.1	-0.3	-0.5	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Use of government deposits	0.2	-0.5	-1.8	0.5	0.0	0.0	0.0	0.0	0.0	0.0
Rest of nonfinancial public sector balance	**0.5**	**1.2**	**0.7**	**0.5**	**0.5**	**0.5**	**0.5**	**0.5**	**0.5**	**0.5**
Consolidated nonfinancial public sector										
Primary balance	-0.3	-2.2	1.1	0.5	0.4	0.4	0.2	0.2	0.2	0.2
Interest	1.4	1.5	1.6	1.7	1.6	1.6	1.7	1.7	1.7	1.7
Overall balance	**-1.8**	**-3.8**	**-0.4**	**-1.2**	**-1.2**	**-1.3**	**-1.4**	**-1.5**	**-1.5**	**-1.5**
Central bank balance	**-0.2**	**-0.2**	**-0.2**	**-0.3**	**-0.3**	**-0.3**	**-0.2**	**-0.2**	**-0.2**	**-0.2**
Memorandum items:										
Central Government debt	**26.4**	**31.5**	**30.8**	**29.2**	**28.2**	**27.8**	**27.7**	**27.8**	**28.0**	**28.0**
External	11.7	13.5	12.9	11.9	11.3	11.0	10.6	10.3	10.0	9.6
Domestic 1/	14.7	18.0	17.9	17.4	16.8	16.8	17.1	17.6	17.9	18.4

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

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

Table 3. Guatemala: Summary Balance of Payments

						Projections					
	2018	2019	2020	2021	2022	2023	2024	2025	2026	2027	2028
					(In millions of U.S. dollars)						
Current account balance	**650**	**1,822**	**3,924**	**1,892**	**1,319**	**1,524**	**1,430**	**1,456**	**1,416**	**1,169**	**762**
Trade balance (goods)	-7,985	-7,967	-6,314	-10,928	-14,186	-14,392	-15,209	-15,796	-16,467	-17,293	-18,280
Exports, f.o.b.	9,644	9,919	10,127	12,361	14,282	14,545	14,787	15,183	15,694	16,269	16,907
Imports, f.o.b.	17,629	17,885	16,441	23,289	28,468	28,937	29,996	30,979	32,161	33,563	35,187
Of which : oil & lubricants	2,901	2,911	2,444	4,496	6,252	5,712	5,741	5,788	5,889	6,028	6,201
Net services	166	38	-236	-1,169	-1,603	-1,619	-1,396	-1,462	-1,533	-1,624	-1,736
Net income	-1,502	-1,404	-1,404	-2,126	-1,853	-2,356	-2,471	-2,606	-2,772	-2,962	-3,166
Net transfers	9,971	11,155	11,878	16,115	18,961	19,892	20,506	21,320	22,189	23,048	23,943
Of which: remittances	9,272	10,494	11,326	15,279	18,021	18,864	19,391	20,120	20,901	21,665	22,457
Capital account balance	3	1	1	2	0	0	0	0	0	0	0
Financial account balance	**384**	**1,397**	**3,264**	**1,373**	**863**	**1,524**	**1,430**	**1,456**	**1,416**	**1,169**	**762**
Foreign direct investment	-780	-796	-786	-2,986	-963	-1,145	-1,242	-1,337	-1,435	-1,541	-1,656
Net acquisition of financial assets	142	374	222	641	375	389	422	454	487	523	562
Net incurrence of liabilities	922	1,171	1,007	3,626	1,338	1,534	1,664	1,791	1,923	2,064	2,218
Portfolio investment	94	-667	-241	-1,660	-491	-43	4	56	302	456	496
Net acquisition of financial assets	-30	19	1	97	102	39	50	68	78	93	92
Net incurrence of liabilities	-124	686	242	1,757	592	82	46	12	-224	-363	-405
Of which: government bonds	-125	1,036	1,042	759	-312	500	500	500	300	200	200
Financial derivatives	0	0	0	0	0	0	0	0	0	0	0
Other investment	83	1,062	1,103	3,210	2,284	2,212	1,669	1,737	1,549	1,254	921
Change in reserve assets	988	1,798	3,189	2,809	33	500	1,000	1,000	1,000	1,000	1,000
Errors and omissions	**-268**	**-425**	**-661**	**-521**	**-456**	**0**	**0**	**0**	**0**	**0**	**0**
					(In percent of GDP)						
Current account balance	**0.9**	**2.4**	**5.0**	**2.2**	**1.4**	**1.5**	**1.3**	**1.2**	**1.1**	**0.8**	**0.5**
Trade balance (goods)	-10.9	-10.3	-8.1	-12.7	-14.9	-13.9	-13.5	-13.0	-12.7	-12.4	-12.2
Exports, f.o.b.	13.2	12.9	13.0	14.4	15.0	14.0	13.1	12.5	12.1	11.6	11.3
Imports, f.o.b.	24.0	23.2	21.2	27.1	30.0	27.9	26.6	25.6	24.7	24.0	23.4
Of which : oil & lubricants	4.0	3.8	3.1	5.2	6.6	5.5	5.1	4.8	4.5	4.3	4.1
Net services	0.2	0.0	-0.3	-1.4	-1.7	-1.6	-1.2	-1.2	-1.2	-1.2	-1.2
Net income	-2.0	-1.8	-1.8	-2.5	-1.9	-2.3	-2.2	-2.2	-2.1	-2.1	-2.1
Net transfers	13.6	14.5	15.3	18.7	20.0	19.2	18.2	17.6	17.1	16.5	16.0
Of which: remittances	12.6	13.6	14.6	17.8	19.0	18.2	17.2	16.6	16.1	15.5	15.0
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	**0.5**	**1.8**	**4.2**	**1.6**	**0.9**	**1.5**	**1.3**	**1.2**	**1.1**	**0.8**	**0.5**
Foreign direct investment	-1.1	-1.0	-1.0	-3.5	-1.0	-1.1	-1.1	-1.1	-1.1	-1.1	-1.1
Net acquisition of financial assets	0.2	0.5	0.3	0.7	0.4	0.4	0.4	0.4	0.4	0.4	0.4
Net incurrence of liabilities	1.3	1.5	1.3	4.2	1.4	1.5	1.5	1.5	1.5	1.5	1.5
Portfolio investment	0.1	-0.9	-0.3	-1.9	-0.5	0.0	0.0	0.0	0.2	0.3	0.3
Net acquisition of financial assets	0.0	0.0	0.0	0.1	0.1	0.0	0.0	0.1	0.1	0.1	0.1
Net incurrence of liabilities	-0.2	0.9	0.3	2.0	0.6	0.1	0.0	0.0	-0.2	-0.3	-0.3
Of which: government bonds	-0.2	1.3	1.3	0.9	-0.3	0.5	0.4	0.4	0.2	0.1	0.1
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	0.1	1.4	1.4	3.7	2.4	2.1	1.5	1.4	1.2	0.9	0.6
Change in reserve assets	1.3	2.3	4.1	3.3	0.0	0.5	0.9	0.8	0.8	0.7	0.7
Errors and omissions	**-0.4**	**-0.6**	**-0.9**	**-0.6**	**-0.5**	**0.0**	**0.0**	**0.0**	**0.0**	**0.0**	**0.0**
Memorandum items:											
Value of exports, f.o.b. (percentage change)	-0.1	2.8	2.1	22.1	15.5	1.8	1.7	2.7	3.4	3.7	3.9
Value of imports, f.o.b. (percentage change)	7.2	1.5	-8.1	41.7	22.2	1.6	3.7	3.3	3.8	4.4	4.8
Remittances (percentage change)	13.5	13.2	7.9	34.9	17.9	4.7	2.8	3.8	3.9	3.7	3.7
Stock of NIR (in millions of U.S. dollars) 1/	11,617	13,769	18,468	20,940	20,020	20,520	21,520	22,520	23,520	24,520	25,520
NIR in months of next-year NFGS imports	6.5	8.6	8.1	7.4	7.0	6.9	7.0	7.0	6.7	7.0	N.A.
NIR in ARA metric under stabilized regime (percent)	119.6	136.8	173.2	176.4	163.3	160.4	161.9	162.9	163.5	162.4	162.8
NIR over short-term debt on residual maturity	1.9	2.4	3.5	3.2	4.0	4.5	5.0	5.1	5.6	5.9	22.6
Nominal GDP (in billions of U.S. dollars)	73.3	77.2	77.7	86.0	95.0	103.8	112.6	121.2	130.1	139.7	150.1

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

1/ Includes 2009 SDR allocations of US$271 million and 2021 SDR allocations of US$586 million.

Table 4. Guatemala: Monetary Sector Survey

									Projections			
	2017	2018	2019	2020	2021	2022	2023	2024	2025	2026	2027	2028
					(In millions of quetzales)							
Bank of Guatemala (BOG)												
Net international reserves 1/	**77,690**	**89,877**	**106,007**	**143,938**	**161,635**	**157,536**	**159,935**	**167,700**	**167,700**	**167,606**	**167,636**	**167,634**
(In millions of U.S. dollars) 1/	10,578	11,617	13,769	18,468	20,940	20,020	20,520	21,520	21,520	21,520	21,520	21,520
Net domestic assets	**-44,095**	**-51,854**	**-61,992**	**-87,695**	**-98,218**	**-87,397**	**-82,850**	**-84,095**	**-77,713**	**-71,061**	**-63,948**	**-56,229**
Net claims on nonfinancial public sector	-20,996	-26,794	-28,701	-25,117	-33,867	-31,644	-33,362	-35,159	-36,797	-38,507	-40,380	-42,317
Central government (CG)	-9,532	-10,633	-8,489	-1,721	-13,499	-9,607	-9,607	-9,807	-9,807	-9,807	-9,807	-9,807
Rest of nonfinancial public sector	-11,464	-16,160	-20,212	-23,396	-20,367	-22,037	-23,755	-25,352	-26,991	-28,700	-30,573	-32,510
Bank of Guatemala losses	25,022	25,711	25,493	24,182	25,687	28,014	30,340	32,667	34,994	37,320	39,647	41,973
Net credit to banks	-37,082	-38,550	-39,793	-53,373	-59,243	-65,850	-71,326	-75,016	-78,190	-81,131	-84,162	-87,225
Of which: legal reserves	-39,140	-40,608	-41,851	-55,431	-61,301	-67,908	-73,384	-77,074	-80,248	-83,189	-86,220	-89,283
Open market operations 2/	-22,745	-19,239	-24,446	-28,619	-24,309	-21,177	-16,283	-12,897	-4,002	4,879	14,694	25,055
Other assets (net)	11,707	7,018	5,455	-4,769	-6,487	3,260	7,780	6,310	6,283	6,376	6,253	6,285
Currency in circulation	33,595	38,023	44,016	56,243	63,417	70,139	77,084	83,605	89,987	96,545	103,688	111,405
Banking sector												
Net foreign position	**-37,419**	**-36,272**	**-35,417**	**-31,666**	**-30,536**	**-31,901**	**-32,917**	**-33,696**	**-34,303**	**-34,774**	**-35,178**	**-35,693**
(in millions of U.S. Dollars)	-5,095	-4,688	-4,600	-4,063	-3,956	-4,054	-4,223	-4,324	-4,402	-4,465	-4,516	-4,582
Net claims on Bank of Guatemala	**56,235**	**58,668**	**60,793**	**78,165**	**79,580**	**83,889**	**85,198**	**86,005**	**81,604**	**76,983**	**71,658**	**65,898**
Legal reserves	39,140	40,608	41,851	55,431	61,301	67,908	73,384	77,074	80,248	83,189	86,220	89,283
BOG securities	19,146	20,111	20,993	24,786	20,330	18,032	13,864	10,981	3,408	-4,155	-12,512	-21,334
Liabilities to BOG	-2,051	-2,051	-2,051	-2,051	-2,051	-2,051	-2,051	-2,051	-2,051	-2,051	-2,051	-2,051
Net domestic assets	**203,446**	**219,425**	**237,162**	**258,420**	**291,048**	**338,685**	**382,560**	**418,266**	**458,353**	**499,650**	**544,905**	**593,938**
Net credit to the NFPS	10,331	19,189	23,673	33,456	38,084	41,252	44,343	48,843	54,882	61,879	69,293	77,847
Official capital and reserves	-6,283	-6,732	-7,802	-8,130	-8,701	-9,675	-10,632	-11,248	-11,879	-12,570	-13,349	-14,203
Credit to the private sector	189,043	202,221	212,195	225,715	254,439	295,149	336,470	360,023	387,024	416,051	449,335	485,282
Other items net	10,355	4,748	9,096	7,379	7,226	11,959	12,380	20,649	28,326	34,289	39,626	45,012
Medium and long-term foreign liabilities	**1,591**	**1,658**	**1,919**	**1,888**	**2,094**	**2,316**	**2,545**	**2,761**	**2,972**	**3,188**	**3,424**	**3,679**
Liabilities to private sector	**220,671**	**240,164**	**260,619**	**303,032**	**337,998**	**388,357**	**432,295**	**467,814**	**502,683**	**538,670**	**577,961**	**620,464**
Demand deposits	71,601	75,347	81,343	102,310	112,538	124,466	136,791	148,363	159,688	171,326	184,000	197,696
Time and savings deposits, and Securities	123,583	137,747	150,000	169,230	188,286	222,585	250,112	271,269	291,976	313,255	336,430	361,471
Capital and reserves (private banks)	22,215	24,400	26,506	28,487	32,208	35,814	39,356	41,636	43,973	46,529	49,411	52,574
Net foreign assets	**40,270**	**53,605**	**70,590**	**112,273**	**131,099**	**125,635**	**127,017**	**134,004**	**133,397**	**132,832**	**132,458**	**131,941**
(In millions of U.S. dollars)	5,483	6,928	9,169	14,405	16,984	15,966	16,297	17,196	17,118	17,055	17,004	16,938
Net domestic assets	**212,314**	**223,570**	**233,192**	**245,884**	**267,444**	**329,684**	**378,872**	**413,629**	**455,198**	**498,011**	**544,495**	**594,884**
Net claims on nonfinancial public sector	-10,665	-7,605	-5,028	8,340	4,218	9,608	10,981	13,684	18,085	23,373	28,913	35,530
Bank of Guatemala losses	25,022	25,711	25,493	24,182	25,687	28,014	30,340	32,667	34,994	37,320	39,647	41,973
Credit to private sector	189,043	202,221	212,195	225,715	254,439	295,149	336,470	360,023	387,024	416,051	449,335	485,282
Other assets (net)	8,915	3,243	532	-12,353	-16,899	-3,087	1,081	7,255	15,095	21,267	26,600	32,098
Medium and long-term foreign liabilities	**1,591**	**1,658**	**1,919**	**1,888**	**2,094**	**2,316**	**2,545**	**2,761**	**2,972**	**3,188**	**3,424**	**3,679**
Liabilities to the private sector	**250,994**	**275,517**	**301,864**	**356,269**	**396,450**	**453,003**	**503,343**	**544,872**	**585,623**	**627,655**	**673,529**	**723,146**
Of which: Money	105,196	113,370	125,358	158,553	175,955	194,604	213,876	231,968	249,675	267,871	287,688	309,101
Of which: Quasi-money	123,583	137,747	150,000	169,230	188,286	222,585	250,112	271,269	291,976	313,255	336,430	361,471
Memorandum items:						(Percent change)						
Currency in circulation	14.3	13.2	15.8	27.8	12.8	10.6	9.9	8.5	7.6	7.3	7.4	7.4
M2	8.4	9.4	9.6	18.9	11.6	14.5	11.2	8.5	7.6	7.3	7.4	7.4
Credit to private sector	3.8	7.0	4.9	6.4	12.7	16.0	14.0	7.0	7.5	7.5	8.0	8.0
						(In percent of GDP)						
Currency in circulation	6.4	6.9	7.4	9.4	9.5	9.5	9.5	9.5	9.5	9.5	9.5	9.5
M2	44.1	46.0	46.8	55.1	55.5	57.4	58.1	58.1	58.1	58.1	58.1	58.1
Net credit of the banking sector to the CG	2.0	3.5	4.0	5.6	5.7	5.6	5.5	5.6	5.8	6.1	6.4	6.7
Credit to private sector	35.9	36.7	35.7	37.6	38.2	40.1	41.6	41.0	41.0	41.1	41.3	41.5
					(In percent of bank liabilities to the private sector)							
Banks' liquid assets	45.0	46.8	46.2	49.6	47.8	43.8	40.7	38.9	36.8	35.0	33.2	31.6
Demand deposits	32.4	31.4	31.2	33.8	33.3	32.0	31.6	31.7	31.8	31.8	31.8	31.9
Time and savings deposits	56.0	57.4	57.6	55.8	55.7	57.3	57.9	58.0	58.1	58.2	58.2	58.3
Capital and reserves (private banks)	10.1	10.2	10.2	9.4	9.5	9.2	9.1	8.9	8.7	8.6	8.5	8.5

Source: 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	2021	2022
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	14.7	14.8
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	15.9	17.1
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	20.8	19.8
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	31.4	29.3
Liquidity ratio	24.5	24.2	23.6	24.5	25.5	24.5	25.1	25.7	27.0	27.1	30.6	29.4	26.7
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	17.3	16.5
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	1.7	1.3
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	207.6	262.5
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	20.8	19.8
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	1.9	2.3
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	19.9	24.3
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	35.2	33.3
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	26.4	26.7
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	34.5	56.7
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	2.4	3.0
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	171.7	262.5
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	1.7	2.1
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	13.4	8.8
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	3.7	0.4

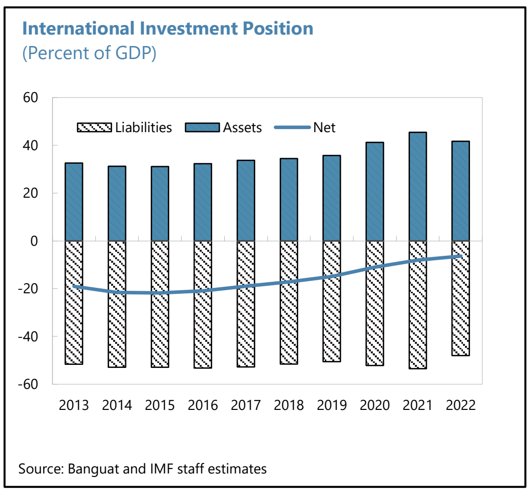
Source: Superintendency of Banks.

Annex I. External Sector Assessment

Overall Assessment. *The external position of Guatemala in 2022 was stronger than the level implied by fundamentals and desirable policies. The Current Account (CA) surplus further declined in 2022 below its 2019 (pre-pandemic) level. Remittances continued their double-digit growth of recent years (18 percent to account for 19 percent of GDP); this was not enough to offset a deterioration of the trade balance largely due to higher commodity prices. The Net International Investment Position (NIIP) remained low despite significant investment needs. The real effective exchange rate [appreciated], while reserves reversed their accumulating trend of recent years (to US$20 by end-2022).*

Potential Policy Responses. *Guatemala's long-standing lagging structural agenda significantly explains the CA gap. Capital and social spending remain low to address the gaps. Increasing infrastructure spending, strengthening human capital, and well-targeted social spending amidst a sustainable fiscal framework would reduce the CA gap. Increasing growth potential and attracting foreign investment will require closing the large infrastructure and human capital gaps, improving the business environment, strengthening governance, and improving the security situation.*

Foreign Assets and Liabilities: Position and Trajectory



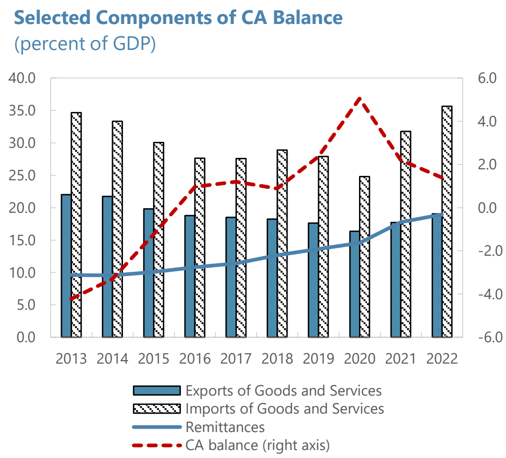
Background. The deficit in the Net International Investment Position (NIIP) maintained its declining trend in 2022 (from 22 percent of GDP in 2015 to six percent in 2022), with assets projected to increase by US$1.6 billion and liabilities by US$0.5 billion. The increase in assets in 2022 follows a trend in that direction from 19 percent of GDP in 2015 to 40.7 percent in 2022, while liabilities in percent of GDP have declined to 49 percent of GDP in 2022, due to limited public borrowing and weak foreign capital inflows.

Net FDI declined after an exceptional surge in 2021 (linked to the US$2.2 billion sale of Tigo Guatemala), to 1.0 percent of GDP, similar to 2018-2020. FDI remained the largest component of external liabilities in 2022, accounting for 50 percent of the total. Portfolio investment accounted for 16 percent, and other investments for 33 percent. External debt comprised around 54 percent of external liabilities in 2022 or around 26 percent of GDP.

Assessment. The current NIIP projected path does not imply risks to external sustainability or a need for a CA adjustment. Absent sustained trend changes in FDI or public sector external borrowing, the NIIP is projected to increase towards balance, unusual for a country with significant investment needs.

2022 (% GDP)	NIIP: -5.7	Gross Assets: - 41	Debt Assets: n.a.	Gross Liab.: -46.4	Debt Liab.: -25

Current Account



Source: Banguat and IMF staff estimates

Background. The CA balance declined from 2.2 percent in 2021 to 1.4 percent in 2022, as continued remittance growth was more than offset by a substantial increase in imports and the trade deficit. Remittances reached 19 percent of GDP in 2022, a historically high level. The significant increase in remittances in recent years is likely permanent, reflecting continuously robust migration to the United States. Imports of goods and services also surged up to historically high levels (35.7 percent of GDP), largely a result of higher international commodity prices because of the war in Ukraine, while the volume of imports remained stagnant. Exports of goods and services also increased (to 19 percent of GDP) because of higher international prices and a substantial recovery of the pandemic-hit tourism sector.

The remittances growth rate is expected to moderate as the U.S. economy and labor market are projected to decelerate but should remain considerably above pre-Covid levels in the medium term because of a higher migrant population. The implementation of the U.S. infrastructure bill will boost construction (a sector that heavily employs Central American immigrants) and thus remittances. Total imports and exports' growth should decline in the medium term in line with the projected downward correction in commodity prices.

Assessment. The External Balance Assessment (EBA) methodology suggests that the external position in 2022 was stronger than the level consistent with fundamentals and desirable medium-term policies. Model estimates of the cyclically adjusted CA, the CA norm, and the CA gap; and identified policy gaps are presented in Table I.1. This assessment compares to the "stronger" assessment for 2021 with the following changes relative to that year:

(1) Estimates of migrants outside Guatemala revolve around 2.7 million, most in the U.S. There are no official statistics; a new UN report is to be published by May 2023. The authorities indicated that the larger remittances significantly correspond to a higher number of remitters and larger amounts and higher frequency per remitter; also, there are reports of labor scarcity in Guatemalan rural areas, which are commonly the source of migrants.

(2) Application of several Covid-related adjustors used in the assessments for 2020 and 2021 for tourism and transportation. The remittance-related adjustor was applied (based on the EBA-Lite methodology), and it was lower than for 2021 due to an upward revision in the medium-term projection of remittances, implying a smaller temporary component.

(3) Relative to the 2021 EBA, in 2022 there is a slightly higher REER to CA elasticity. The same upward adjustment to the CA norm was made to reflect the negative impact of Guatemala's structural bottlenecks (such as a weak business environment and security conditions) on investment.

Annex I. Table 1. Guatemala: EBA Estimates for 2021 and 2022

		2021 1/	2022
EBA CA methodology		*Percent of GDP (except REER Gap)*	
CA-Actual	(A)	**2.5**	**1.4**
Cyclical contributions /2	(B)	-0.2	-0.5
COVID-19 Adjustments	('C)	-0.6	-0.8
of which: Tourism		-0.5	-0.4
Transport		-0.8	-1.0
Household consumption		-0.3	
Medical goods		-0.3	
Remittances		1.2	0.6
Oil adjustor			
Adjusted CA	(D = A-B-C)	**3.3**	**2.7**
CA Norm /2	('E)	**-2.3**	**-2.8**
Adjustments to the norm /3	(F)	-2.0	-2.0
Adjusted CA norm	(G = E-F)	**-0.3**	**-0.8**
CA gap	(H = D - G)	**3.6**	**3.5**
Contribution of identified policy gaps /2,4		1.9	1.3
Elasticity /2	(J)	0.22	0.26
REER Gap (percent) /5	**(K=H/J)**	**-16.3**	**-13.5**

Source: IMF staff estimates.

1/ Data featured in the previous Article IV consultation in 2022.

2/ Estimates from the EBA CA model. The standard error of the CA norm is 0.6 percent of GDP.

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 percent owes to lower fiscal deficit and 0.5 percent owes to lower health spending.

5/ "-" indicates undervaluation

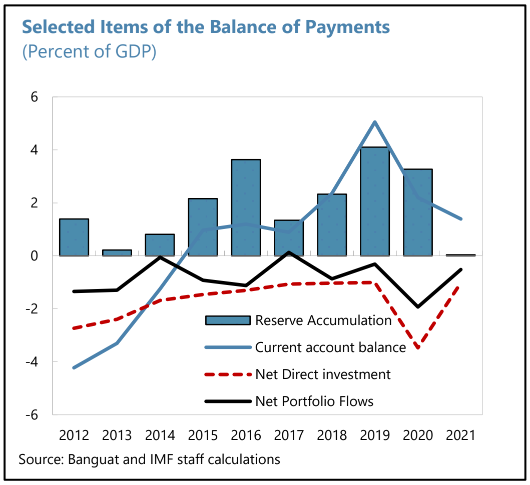
Real Exchange Rate

Background. The Real Effective Exchange Rate (REER) appreciated by 3.4 percent in 2022. The REER has thus experienced a 49 percent appreciation since 2010 and a 20 percent appreciation since 2015. In contrast, the value of the quetzal has stayed closer in line with the U.S. dollar in recent years and fell by 2 percent relative to that currency from end-2021 to end-2022.

Assessment. The External Balance Assessment (EBA) CA methodology suggests that the REER is below the level implied by fundamentals and lower than in 2021. Under the assumption that the estimated CA gap will be closed by an adjustment in the trade balance, the EBA model implies a REER undervaluation of 13.5 percent.

(4) The EBA REER Level and Index model indicates that REER was severely overvalued (about 38 and 20 percent, respectively), in 2022. However, both models had an unusually poor fit for Guatemala. Because Guatemala is not included in the EBA REER index model, the model's estimate relies on imputed values for the missing data, such as the country fixed effect.

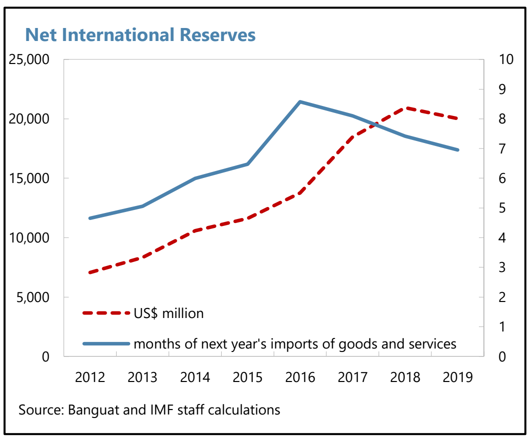
Capital and Financial Accounts: Flows and Policy Measures



Background. FDI liabilities at US$1.4 billion were lower than the exceptionally high US$3.3 billion in 2021, which reflected a US$2.2 billion acquisition by Millicom International Cellular (a Luxembourg-based company) of 45 percent of Tigo Guatemala (a telecommunications company)'s equity. As a share of GDP (1.4 percent), FDI liabilities were above all years in 2018-20, but still below the 2010-17 average (2 percent of GDP). Portfolio investment net inflows of 0.5 percent of GDP in 2022 were much lower than in 2021, reflecting debt repayments in a context of global monetary tightening.

Assessment. There are no significant macroeconomic risks from capital flows, especially given their relatively low level. The solid fiscal stance and low public debt level imply that the large government bond-related portfolio investment flows do not carry important risk.

FX Intervention and Reserves Level



Background. Net International Reserves (NIR) declined from US$20.9 billion end-2021 to US$20.2 billion end-2022. This constitutes a reversal from recent years since the mid-2010s, where Guatemala substantially accumulated reserves since the mid-2010s, largely because of a significant increase in remittances from the United States. The 2022 decline partly reflected a late 2022 retrenching of U.S. financial institutions and higher costs in U.S. borrowing that prompted an accelerated repayment of outstanding balances.

The de facto exchange rate arrangement of Guatemala is classified as a stabilized arrangement.

Assessment. End-2022 reserves are 161 percent of the IMF's metric for Assessing Reserve Adequacy (ARA metric) for countries with stabilized exchange rates like Guatemala. Reserves continue being above other traditional metrics and cover more than 7 months of next year's goods and services imports, 36.5 percent of broad money, and 397 percent of short-term external debt. In 2022, FX intervention has been asymmetric, titled towards the accumulation of foreign exchange, as has been the case in recent years.

Annex II. Risk Assessment Matrix[1]

Source of Risks	Likelihood/ Impact	Policy Advice
Intensification of regional conflict(s). Escalation of Russia's war in Ukraine or other regional conflicts and resulting economic sanctions disrupt trade (e.g., energy, food, tourism, and/or critical supply chain components), remittances, refugee flows, FDI and financial flows, and payment systems.	**High likelihood** **Medium impact**	Monetary policy tightening should continue. Gradually allow the exchange rate to become the shock absorber. Deploy targeted social transfers on vulnerable segments of the population.
Deepening geo-economic fragmentation. Broader and deeper conflict(s) and weakened international cooperation led to a more rapid reconfiguration of trade and FDI, supply disruptions, technological and payments systems fragmentation, rising input costs, financial instability, a fracturing of international monetary and financial systems, and lower potential growth.	**High likelihood** **Medium impact**	Accelerate the structural reform agenda (e.g., infrastructure and education) to make Guatemala a more attractive destination for FDI.
Abrupt global slowdown or recession. Global and idiosyncratic risk factors combine to cause a synchronized sharp growth downturn, with recessions in some countries, adverse spillovers through trade and financial channels, and markets fragmentation. • **U.S.:** Amid tight labor markets, supply disruptions and/or commodity price shocks, inflation remains elevated, prompting the Fed to keep rates higher for longer and resulting in dollar strengthening, a more abrupt financial and housing market correction, and "hard landing". • **Europe:** Intensifying fallout from the war in Ukraine, worsening energy crisis and supply disruptions, and monetary tightening exacerbate economic downturns and housing market corrections. • **China:** Greater-than-expected economic disruptions from COVID resurgence, rising geopolitical tensions, and/or a sharper-than-expected slowdown in the property sector disrupt economic activity. • **EMDEs:** A new bout of global financial tightening, possibly combined with volatile commodity prices, leads to spiking risk premia, debt distress, widening of external imbalances, fiscal pressures, and sudden stops.	**Medium Likelihood** **Medium impact**	Fiscal policy should be used to accelerate the structural reform. Most infrastructure projects are import-dependent. Deploy targeted fiscal transfers towards the most vulnerable.
Commodity price volatility. A succession of supply disruptions (e.g., due to conflicts and export restrictions) and demand fluctuations (e.g., reflecting China reopening) causes recurrent commodity price volatility, external and fiscal pressures, and social and economic instability.	**Medium Likelihood** **Medium impact**	Deploy targeted social transfers on vulnerable segments of the population while accelerating the structural reform agenda.
Monetary policy miscalibration. Amid high economic uncertainty and volatility, major central banks slow monetary policy tightening or pivot to loosen monetary policy stance prematurely, de-anchoring inflation expectations and triggering a wage-price spiral in tight labor markets.	**Medium Likelihood** **Medium impact**	Monetary policy tightening should continue. Gradually allow the exchange rate to become the shock absorber. Deploy targeted social transfers on vulnerable segments of the population.

[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.

Source of Risks	Likelihood/ Impact	Policy Advice
Systemic financial instability. Sharp swings in real interest rates, risk premia, and assets repricing amid economic slowdowns and policy shifts trigger insolvencies in countries with weak banks or non-bank financial institutions, causing markets dislocations and adverse cross-border spillovers.	**Medium Likelihood** **Low impact**	Intensify the monitoring of credit exposures, NPL classification, potential losses, and credit risk management practices. Provide liquidity and deploy macroprudential measures to support the banking sector.
Cyberthreats. Cyberattacks on critical domestic and/or international physical or digital infrastructure (including digital currency and crypto ecosystems) trigger financial and economic instability.	**Medium Likelihood** **Low impact**	Deploy fiscal buffers to soften the impact on growth. Allow the exchange rate to absorb the shock. Provide liquidity and deploy macroprudential measures to support the banking sector.
Extreme climate events. Extreme climate events cause more severe than expected damage to infrastructure (especially in smaller vulnerable economies) and loss of human lives and livelihoods, amplifying supply chain disruptions and inflationary pressures, causing water and food shortages, and reducing growth.	**Medium Likelihood** **Medium impact**	Enhance monitoring of exposures and mitigation measures. Prioritize investments for infrastructure resilience.

Annex III. Public Debt Sustainability Analysis

Debt continues to be on a decreasing path, and it is expected to remain sustainable at 29.4 percent of GDP. Sovereign Risk is assessed as moderate, and debt is resilient to short-term shocks.

A. Sovereign Risk and Debt Sustainability Analysis

Annex III. Table 1. Guatemala: Risk of Sovereign Stress

Horizon	Mechanical Signal	Final Assessment	Comments
Overall	...	**Moderate**	The overall risk of sovereign stress is moderate, reflecting a relatively moderate level of vulnerability in the near- and medium-term.
Near Term 1/			
Medium Term	**Low**	**Moderate**	Medium-term risks are assessed as moderate on the basis of a mechanical signal close to the threshold between low-moderate, moderate GFN financiability index, moderate risks according to the fanchart analysis, and resiliency of the debt dynamics in the stress test scenarios.
Fanchart	**Moderate**	...	
GFN	**Moderate**	...	
Stress test	...	...	
Long Term	...	n.a.	Not applicable
Sustainability Assessment 2/	…	Sustainable	The projected debt path is expected to stabilize and GFNs will remain at manageable levels. Therefore, debt is assessed as sustainable.
Debt Stabilization in the Baseline			Yes

Source: Fund Staff.

Note: The risk of sovereign stress is a broader concept than debt sustainability. Unsustainable debt can only be resolved through exceptional measures (such as debt restructuring). In contrast, a sovereign can face stress without its debt necessarily being unsustainable, and there can be various measures—that do not involve a debt restructuring—to remedy such a situation, such as fiscal adjustment and new financing.

1/ The near-term assessment is not applicable in cases where there is a disbursing IMF arrangement. In surveillance-only cases or in cases with precautionary IMF arrangements, the near-term assessment is performed but not published.

2/ A debt sustainability assessment is optional for surveillance-only cases and mandatory in cases where there is a Fund arrangement. The mechanical signal of the debt sustainability assessment is deleted before publication. In surveillance-only cases or cases with IMF arrangements with normal access, the qualifier indicating probability of sustainable debt ("with high probability" or "but not with high probability") is deleted before publication.

Annex III. Table 2. Guatemala: Debt Coverage and Disclosures

1. Debt coverage in the DSA: 1/	CG	GG	NFPS	CPS	Other	Comments
1a. If central government, are non-central government entities insignificant?					No	

2. Subsectors included in the chosen coverage in (1) above:

CPS	NFPS	GG: expected	CG	#	Subsectors captured in the baseline	Inclusion	Comments
CPS	NFPS	GG: expected	CG	1	Budgetary central government	YES	8/
CPS	NFPS	GG: expected	CG	2	Extra budgetary funds (EBFs)	YES	
CPS	NFPS	GG: expected	CG	3	Social security funds (SSFs)	NO	9/
CPS	NFPS	GG: expected		4	State governments	NO	10/
CPS	NFPS	GG: expected		5	Local governments	NO	
CPS	NFPS			6	Public nonfinancial corporations	NO	
CPS				7	Central bank	NO	
CPS				8	Other public financial corporations	NO	

3. Instrument coverage:	Currency & deposits	Loans	Debt securities	Oth acct. payable 2/	IPSGSs 3/

4. Accounting principles:	Basis of recording		Valuation of debt stock		
	Non-cash basis 4/	Cash basis	Nominal value 5/	Face value 6/	Market value 7/

5. Debt consolidation across sectors:	Consolidated	Non-consolidated

Color code: chosen coverage | Missing from recommended coverage | Not applicable

1/ CG=Central government; GG=General government; NFPS=Nonfinancial public sector; PS=Public sector.
2/ Stock of arrears could be used as a proxy in the absence of accrual data on other accounts payable.
3/ Insurance, Pension, and Standardized Guarantee Schemes, typically including government employee pension liabilities.
4/ Includes accrual recording, commitment basis, due for payment, etc.
5/ Nominal value at any moment in time is the amount the debtor owes to the creditor. It reflects the value of the instrument at creation and subsequent economic flows (such as transactions, exchange rate, and other valuation changes other than market price changes, and other volume changes).
6/ The face value of a debt instrument is the undiscounted amount of principal to be paid at (or before) maturity.
7/ Market value of debt instruments is the value as if they were acquired in market transactions on the balance sheet reporting date (reference date). Only traded debt securities have observed market values.
8/ Values reported as percent of GDP (2022). Item in column i and row j represents sector j's debt with sector i.
9/ Debt with the SSFs Includes debt not recognized by the Central Government.
10/ This item is not disclosed in the official data but it is included in the analysis.

Annex III. Table 2. Guatemala: Debt Coverage and Disclosures (concluded)

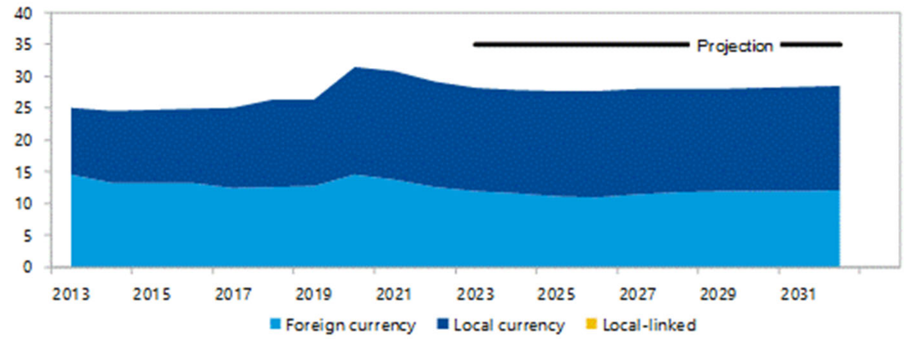
Reporting on Intra-Government Debt Holdings

	Issuer \ Holder	Budget. central govt	Extra-budget. funds (EBFs)	Social security funds (SSFs)	State govt.	Local govt.	Nonfin. pub. corp.	Central bank	Oth. pub. fin corp	Total
1	Budget. central govt			8.7				4.1		12.8
2	Extra-budget. funds									0
3	Social security funds									0
4	State govt.									0
5	Local govt.	2.3		0.05						2.35
6	Nonfin pub. corp.	0.1								0.1
7	Central bank									0
8	Oth. pub. fin. corp									0
	Total	2.4	0	8.75	0	0	0	4.1	0	15.25

Commentary: The coverage in this SRDSA focuses on the central government due to data availability concerns for the broader public sector (historical availability and composition). The outstanding debt SS recognized by law, not included in official MoF data, is included in the analysis in the contingent liability shock, and represents 8.7 percent of GDP. Central Government debt with the Central Bank is estimated at 4.1 percent and it is also included in the analysis in the contingent liability scenario. The authorities continue efforts to improve data timeliness, quality, and coverage with IMF TA. Authorities' preliminary data on the Non-Financial Public Sector debt suggests an adjustment of about -2 percent of GDP without including debt with the Social Security and the Central Bank.

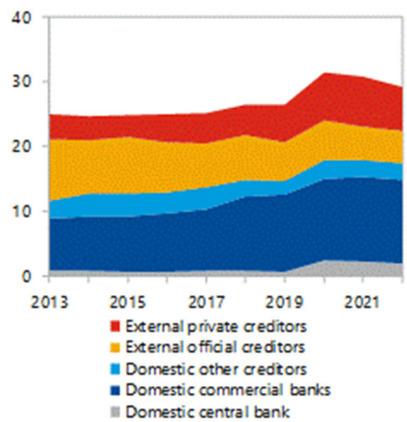
Annex III. Figure 1. Guatemala: Public Debt Structure Indicators

Debt by Currency (Percent of GDP)



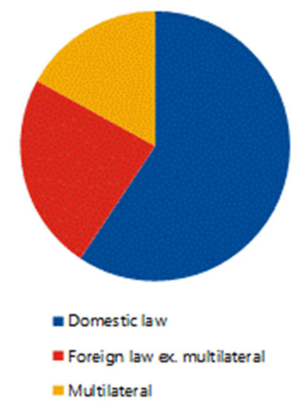
Note: The perimeter shown is central government.

Public Debt by Holder (Percent of GDP)



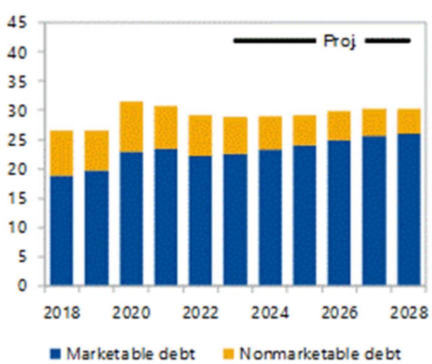
Note: The perimeter shown is central government.

Public Debt by Governing Law, 2022 (percent)



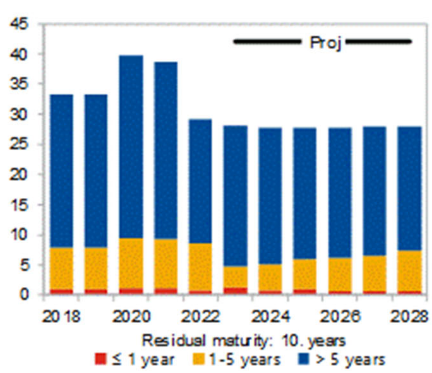
Note: The perimeter shown is central government.

Debt by Instruments (Percent of GDP)



Note: The perimeter shown is central government.

Public Debt by Maturity (Percent of GDP)

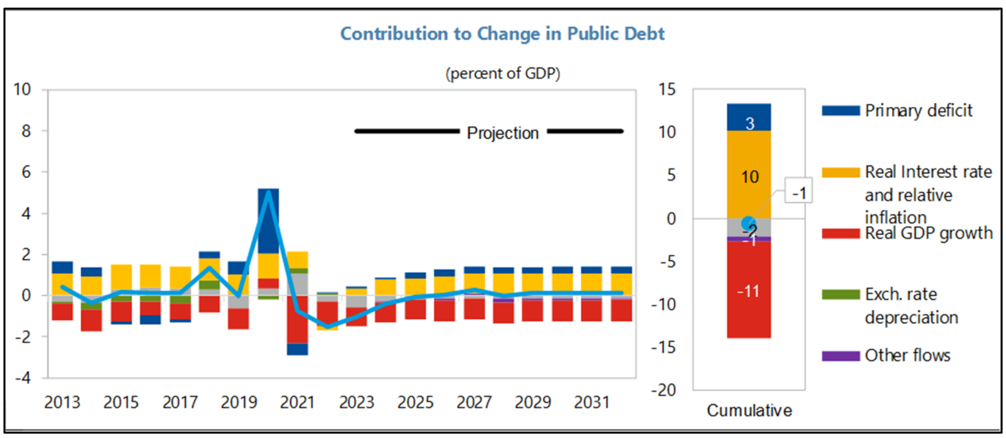


Note: The perimeter shown is central government.

Annex III. Figure 2. Guatemala: Baseline Scenario

(Percent of GDP unless indicated otherwise)

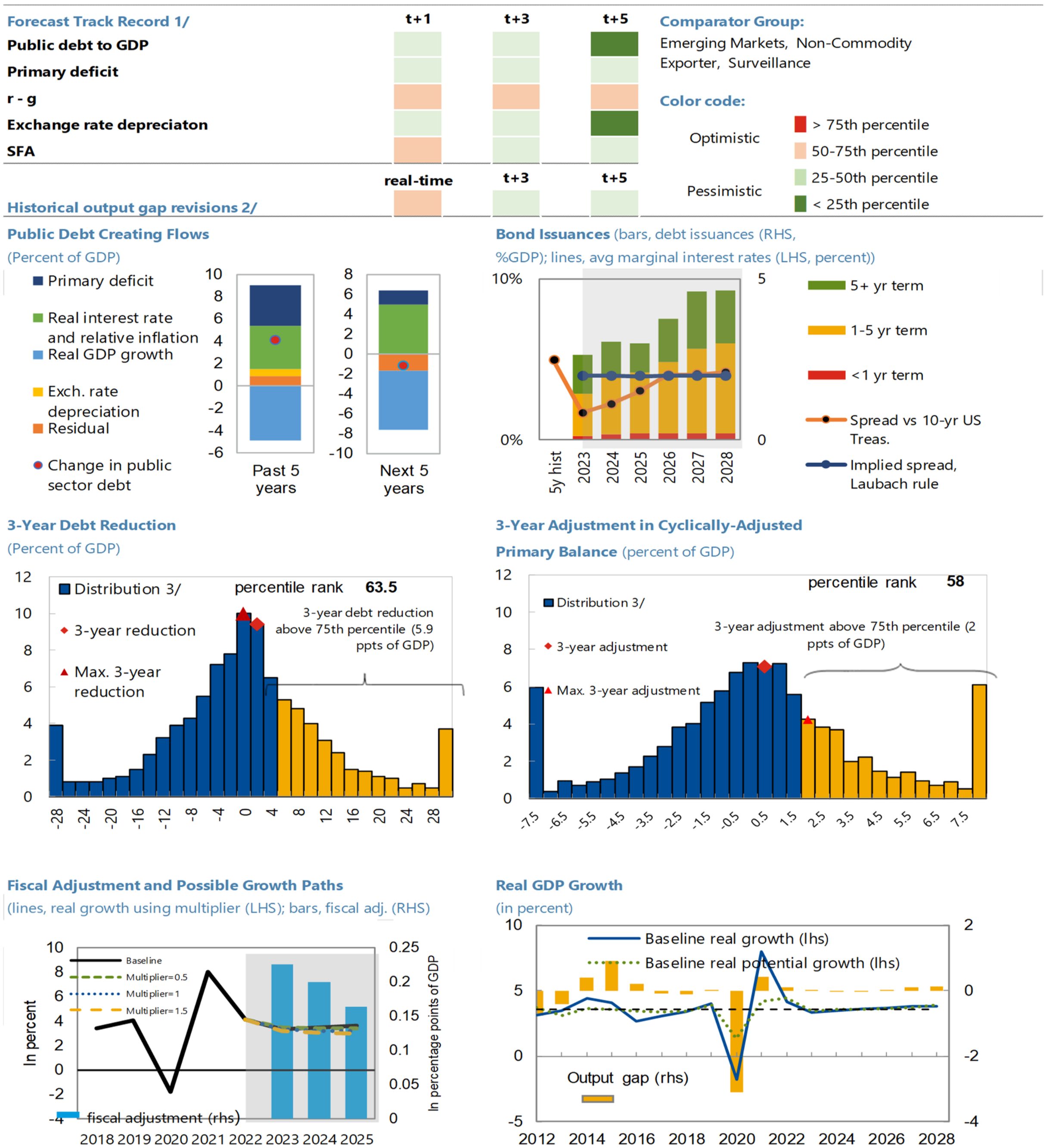
	Actual	Medium-term projection						Extended projection			
	2022	2023	2024	2025	2026	2027	2028	2029	2030	2031	2032
Public debt	29.2	28.2	27.8	27.7	27.8	28.0	28.0	28.1	28.2	28.4	28.5
Change in public debt	-1.5	-1.0	-0.4	0.0	0.0	0.3	0.0	0.1	0.1	0.1	0.1
Contribution of identified flows	-1.3	-0.5	-0.1	0.1	0.2	0.4	0.1	0.3	0.3	0.3	0.3
Primary deficit	0.0	0.1	0.1	0.3	0.3	0.3	0.3	0.3	0.3	0.3	0.3
Noninterest revenues	12.7	12.2	12.1	12.0	11.9	11.8	11.8	11.8	11.8	11.8	11.8
Noninterest expenditures	12.7	12.3	12.3	12.3	12.2	12.1	12.1	12.1	12.1	12.1	12.1
Automatic debt dynamics	-1.3	-0.6	-0.2	-0.1	-0.1	0.0	0.0	0.0	0.0	0.0	0.0
Real interest rate and relative i	-0.2	0.3	0.8	0.8	0.9	1.0	1.1	1.1	1.1	1.1	1.1
Real interest rate	-0.6	-0.1	0.5	0.7	0.8	0.8	0.9	0.9	0.9	0.9	0.9
Relative inflation	0.4	0.4	0.3	0.2	0.1	0.2	0.2	0.2	0.2	0.2	0.2
Real growth rate	-1.2	-0.9	-1.0	-1.0	-1.0	-1.0	-1.1	-1.1	-1.1	-1.1	-1.1
Real exchange rate	0.1	...	...	...	...	...	...	...	...	...	...
Other identified flows	0.0	0.0	-0.1	0.0	-0.1	0.1	-0.2	-0.1	-0.1	-0.1	-0.1
Contingent liabilities	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Other transactions	0.0	0.0	-0.1	0.0	-0.1	0.1	-0.2	-0.1	-0.1	-0.1	-0.1
Contribution of residual	-0.3	-0.6	-0.3	-0.2	-0.1	-0.2	-0.1	-0.1	-0.1	-0.1	-0.1
Gross financing needs	2.3	2.6	3.1	3.0	3.6	3.8	4.0	4.0	4.0	4.0	4.0
of which: debt service	2.3	2.5	3.0	2.7	3.3	3.5	3.8	3.8	3.8	3.8	3.8
Local currency	1.2	1.4	1.9	1.8	2.1	2.5	2.9	2.9	2.9	2.9	2.9
Foreign currency	1.1	1.1	1.1	1.0	1.2	1.0	0.9	0.9	0.9	0.9	0.9
Memo:											
Real GDP growth (percent)	4.1	3.4	3.5	3.6	3.7	3.8	3.9	3.9	3.9	3.9	3.9
Inflation (GDP deflator; percent)	6.2	6.3	4.8	3.9	3.5	3.5	3.4	3.5	3.5	3.5	3.5
Nominal GDP growth (percent)	10.6	9.9	8.5	7.6	7.3	7.4	7.4	7.4	7.4	7.4	7.4
Effective interest rate (percent)	4.0	6.0	6.7	6.4	6.5	6.7	6.9	6.9	6.9	6.9	6.9



Staff commentary:
Debt is expected to decrease in 2023, along with a primary surplus and despite a reduction in GDP growth. Over the medium term, continued fiscal consolidation is expected to keep debt on a downward trajectory. However, debt service is expected to remain broadly constant.

Source: IMF Staff.

Annex III. Figure 3. Guatemala: Realism of Baseline Assumptions



Source: IMF Staff.

1/ Projections made in the October and April WEO vintage.

2/ Data cover annual observations from 1990 to 2019 for MAC advanced and emerging economies. Percent of sample on vertical axis

3/ Starting point reflects the team's assessment of the initial overvaluation from EBA (or EBA-Lite).

Commentary: Realism analysis does not point to major concerns: past forecast errors do not reveal any systematic biases. The forecast track record is generally within bounds for optimism, excepting the SFA projections. Debt creating flows are compositionally similar between the last and next 5 years when considering that the inclusion of data from the onset of the pandemic biases primary deficit's contribution upwards in the former and the high inflation and normalization of monetary policy in the later. The risk premium is expected to remain relatively constant.

Annex III. Figure 4. Guatemala: Medium-Term Risk Analysis

Debt Fanchart and GFN Financeability Indexes

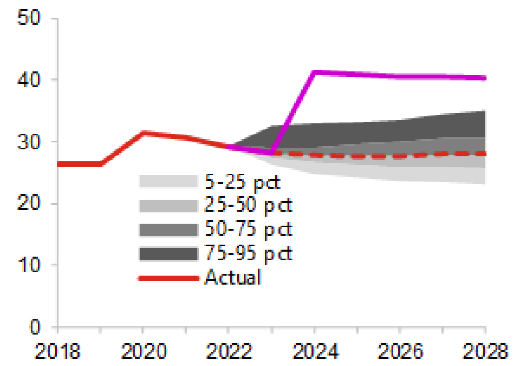
(percent of GDP unless otherwise indicated)

Module	Indicator	Value	Risk index	Risk signal
Debt fanchart module	Fanchart width	11.9	0.2	...
	Probability of debt not stabilizing (pct)	87.2	0.7	...
	Terminal debt level x institutions index	20.6	0.4	...
	Debt fanchart index	...	**1.4**	**Moderate**
GFN finance-ability module	Average GFN in baseline	3.4	1.1	...
	Bank claims on government (pct bank assets)	19.0	6.2	...
	Chg. in claims on govt. in stress (pct bank assets)	9.6	3.2	...
	GFN financeability index	...	**10.5**	**Moderate**

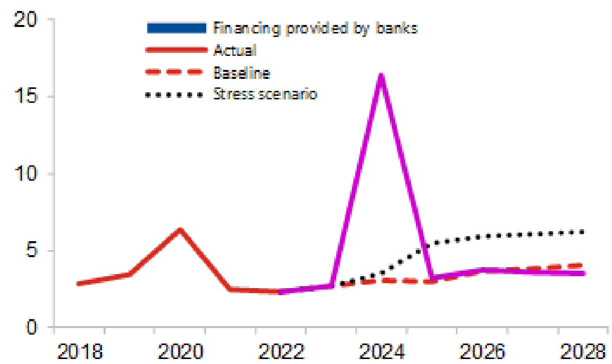
Adv. Econ, Non-Com. Exp, Program: 0 25 50 75 100

Legend: Interquartile range Guatemala

Final Fanchart (Percent of GDP)



Gross Financing Needs (Percent of GDP)

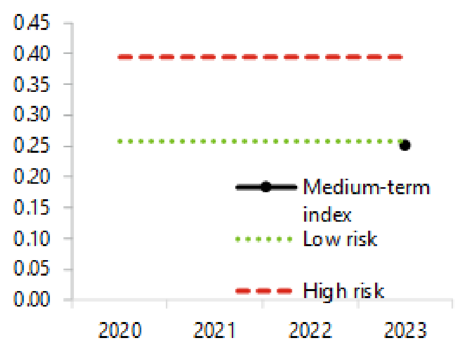


Triggered stress tests (stress tests not activated in gray)

Banking crisis | Commodity prices | Exchange rate | Contingent liab. | Natural disaster

Medium-Term Index

(index number)



Medium-Term Risk Analysis

	Low risk threshold	High risk threhsold	Weight in MTI	Normalized level
Debt fanchart index	1.1	2.1	0.5	0.3
GFN finaceability index	7.6	17.9	0.5	0.2
Medium-term index (MTI)	0.3	0.4	...	0.3, Low

Prob. of missed crisis, 2023-2028 (if stress not predicted): 9.1 pct.

Prob. of false alarm, 2023-2028 (if stress predicted): 42.0 pct.

Commentary: The medium-term risks are estimated to be moderate by the probabilistic analysis and the GFN financiability module, with a medium-term index below the low risk threshold. The Debt Fanchart Module is moderate partly due to relatively low uncertainty in debt projections. The GFN module indicate moderate risks due to low GFN in the baseline and relatively stable bank claims on government. The stress tests show that GFN and debt remain on relatively low levels. The contingent stress scenario shows a one-time increase in the stock of debt from 29 to 41 percent of GDP, above recent historical levels and beyond the debt increase observed during the pandemic. However, debt levels in the stress scenarios remain below the median country.

Annex IV. External Debt Sustainability

Guatemala's external debt (sovereign and private) to GDP is low and resilient to standard DSA-shocks.

- *Under the baseline scenario*, external debt is projected to decline further from 26.3 percent of GDP by end-2022 to 18.8 percent of GDP by 2028. The declining trend started in 2013, with the external debt to GDP at 37.4 percent of GDP; the exceptional circumstances around the pandemic led to a temporal increase in the ratio in 2020 (by 0.3 percent of GDP, however). This trend has been mainly driven by a decline in private bank debt—between 2013 and 2021, the external private bank debt ratio to GDP dropped from 8.2 percent of GDP to 6.6 of GDP and to 5.4 percent of GDP in 2022 (projected), and the nonbank private sector debt fell from 19.3 percent of GDP to 12.9 percent of GDP (and projected at 10.7 percent of GDP in 2022). During this period, the official external debt ratio to GDP remained stable between 12 to 15 percent of GDP. In 2022, the nonprivate external debt is expected to have declined further.

- *The major downside risk* to Guatemala's external debt is a large depreciation shock, which would hike the debt ratio to exceed 40 percent of GDP in 2024 and fall afterward. A current account (excluding interest payments) shock would drive the external debt to GDP ratio to surge by 30 percent of GDP by 2024 to then start falling slowly.

Annex IV. Table 1. Guatemala: External Debt Sustainability Framework, 2018-2028

(In percent of GDP, unless otherwise indicated)

	Actual							Projections						
	2018	2019	2020	2021	2022			2023	2024	2025	2026	2027	2028	Debt-stabilizing non-interest current account 6/
Baseline: External debt	33.4	32.3	32.6	29.9	25.5			**23.4**	**21.7**	**20.4**	**19.4**	**18.7**	**18.2**	**-1.7**
Change in external debt	-1.5	-1.0	0.3	-2.7	-4.4			-2.1	-1.6	-1.3	-1.1	-0.7	-0.5	
Identified external debt-creating flows (4+8+9)	-2.8	-5.0	-6.3	-8.8	-5.2			-3.4	-3.1	-3.0	-2.9	-2.6	-2.3	
Current account deficit, excluding interest payments	-2.2	-3.6	-6.1	-3.1	-2.3			-2.3	-2.1	-2.0	-1.8	-1.5	-1.2	
Deficit in balance of goods and services	10.7	10.3	8.4	14.1	16.6			15.4	14.7	14.2	13.8	13.5	13.3	
Exports	18.2	17.6	16.4	17.7	19.0			17.8	17.0	16.2	15.6	15.1	14.6	
Imports	28.9	27.9	24.8	31.8	35.7			33.3	31.8	30.5	29.5	28.6	27.9	
Net non-debt creating capital inflows (negative)	-1.1	-1.0	-1.0	-3.5	-1.0			-1.1	-1.1	-1.1	-1.1	-1.1	-1.1	
Automatic debt dynamics 1/	0.5	-0.4	0.9	-2.2	-1.9			0.0	0.0	0.0	0.0	0.0	0.0	
Contribution from nominal interest rate	1.3	1.3	1.1	0.9	0.9			0.8	0.8	0.8	0.7	0.7	0.7	
Contribution from real GDP growth	-1.2	-1.3	0.6	-2.4	-1.1			-0.8	-0.8	-0.7	-0.7	-0.7	-0.7	
Contribution from price and exchange rate changes 2/	0.3	-0.4	-0.8	-0.8	-1.7			...	...	...	...	...	...	
Residual, incl. change in gross foreign assets (2-3) 3/	1.2	4.0	6.6	6.1	0.8			1.2	1.5	1.7	1.8	1.9	1.8	
External debt-to-exports ratio (in percent)	183.2	183.5	199.5	168.7	133.8			131.0	127.7	125.9	124.0	123.6	124.7	
Gross external financing need (in billions of US dollars) 4/	5.2	4.2	1.8	3.4	5.2			3.4	3.1	2.8	3.0	3.0	3.4	
in percent of GDP	7.1	5.5	2.3	3.9	5.4	10-Year	10-Year	3.3	2.8	2.3	2.3	2.2	2.3	
Scenario with key variables at their historical averages 5/								**23.4**	**21.9**	**20.5**	**19.1**	**17.8**	**16.5**	**-2.2**
Key Macroeconomic Assumptions Underlying Baseline						Historical Average	Standard Deviation							
Real GDP growth (in percent)	3.4	4.0	-1.8	8.0	4.1	3.6	2.4	3.4	3.5	3.6	3.7	3.8	3.9	
GDP deflator in US dollars (change in percent)	-1.0	1.2	2.6	2.5	6.1	3.0	2.0	5.7	4.8	3.9	3.5	3.4	3.4	
Nominal external interest rate (in percent)	3.8	4.0	3.4	3.1	3.2	3.4	0.3	3.6	3.7	3.8	3.8	3.9	3.9	
Growth of exports (US dollar terms, in percent)	0.8	1.8	-6.5	19.9	18.6	5.0	8.5	2.4	3.5	2.7	3.4	3.7	3.9	
Growth of imports (US dollar terms, in percent)	7.2	1.7	-10.5	41.9	23.9	7.5	15.1	1.9	3.6	3.3	3.8	4.3	4.8	
Current account balance, excluding interest payments	2.2	3.6	6.1	3.1	2.3	1.6	2.8	2.3	2.1	2.0	1.8	1.5	1.2	
Net non-debt creating capital inflows	1.1	1.0	1.0	3.5	1.0	1.7	0.9	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,
= 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.

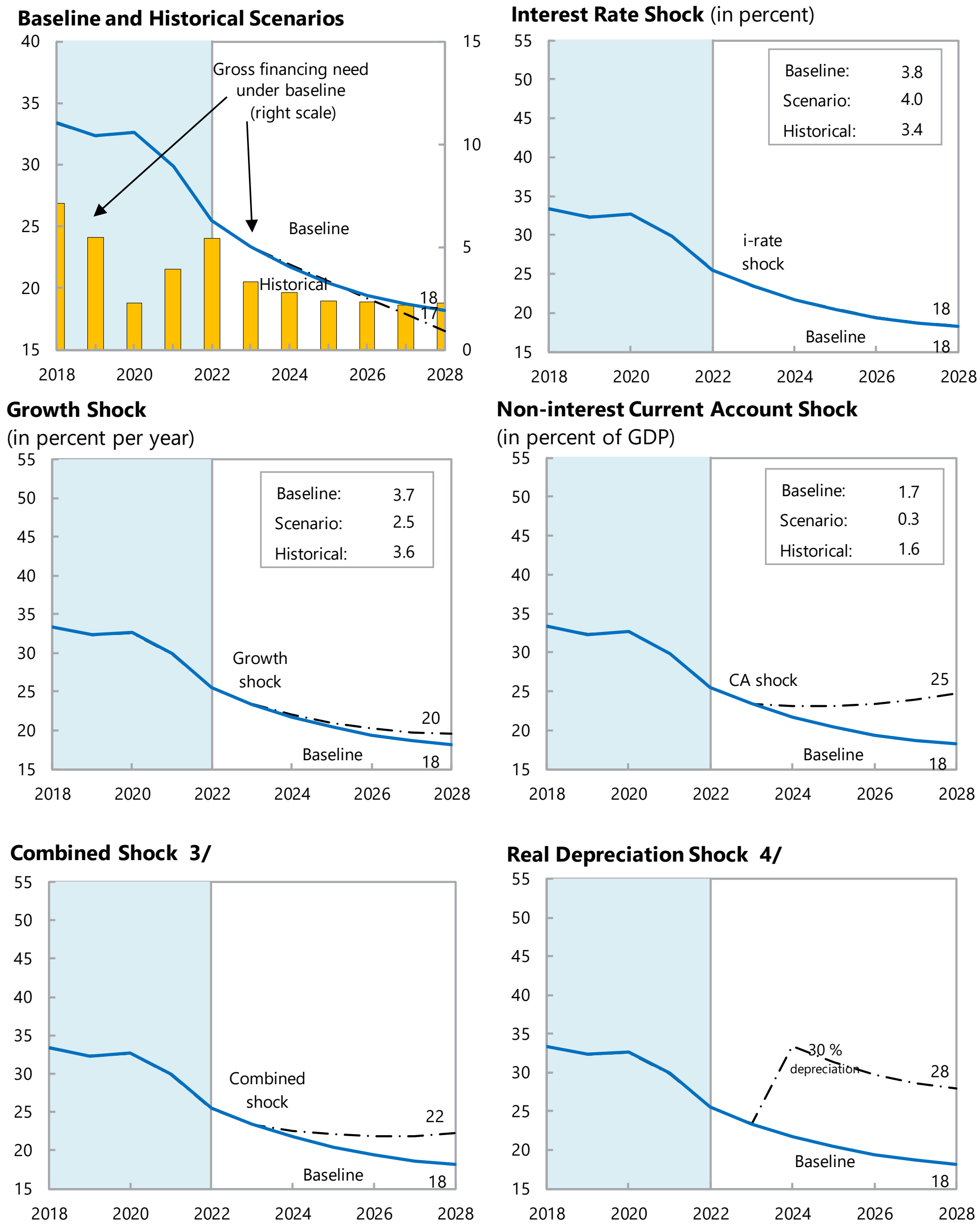
4/ Defined as current account deficit, plus amortization on medium- and long-term debt, plus short-term debt at end of previous period.

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.

Annex IV. Figure 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 2024.

Annex V. Banking System Vulnerabilities and Stress Tests (End-December 2022)

A. Banking System Vulnerabilities and Resilience to Shocks[1]

Stress Tests are applied to the Guatemalan banking system assessing both the solvency and liquidity stance of banks in the face of potential shocks. Results use the bank data provided by the authorities and, on that basis, the banks appear to be well prepared to absorb a range of shocks with available buffers. The regulatory forbearance applied during COVID has been phased out by now. The analysis suggests that in the eventuality of a run, one out of the 17 banks could run out of liquidity.

B. Soundness of the Banking System and Risks

1. **Banks are well capitalized with sound indicators of asset quality.** The Capital Adequacy Ratio (CAR) for the banking system was 16.8 percent as of December 2022, below the 17.3 percent in December 2021 (Table 5), but well-above the minimum 10 percent threshold required by the regulatory authorities. At the same time, for the system, a low 1.3 percent of total loans was impaired at the end of December 2023 (Appendix Table 1). The level of provisions has significantly increased over time—at 262 percent in December 2022 compared to 208 percent in December 2021 and 197 percent in 2020.

Soundness Indicators
(Percent, End-December 2022)

	Banking System 1/
Capital Adequacy Ratio	
Capital / Risk Weighted Assets 2/	16.8
Asset Quality	
Non-Performing Loans / Total Loans	1.3
Provisions / NPLs	94.7
FX Loans / Total Loans	33.1
Funding	
Deposits / Total Liabilities	89.4
Deposits / Total Loans	162.9
Profitability	
ROA	2.3
ROE	24.3
Liquidity	
Liquid Assets / Total Assets	33.1
Liquid Assets / ST Liabilities	70.0
Sensitivity to Market Risk	
Net FX Exposure / Capital	11.5

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.

2. **Deposits continued to be the main source of funding for banks' lending activities.** They continued to represent nearly 90 percent of total liabilities at the end of December. The deposit to loans ratio reduced marginally (from 174 percent in December 2021)**.** On the other hand, loans continue to represent over half of the banks' asset portfolio, long-term government bonds

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

comprise just less than one fifth,[2] cash and T-bills represent over one eighth. Most potential losses and risks to solvency are likely to originate in the loan book. The valuation of investments in long-term government bonds are affected by changes in their prices in international markets and interest rate increases.

3. The banking system is concentrated, and FX-induced risk remains a vulnerability. The largest five banks account for nearly 80 percent of total assets (out of 17), and the top 2 banks account for over 50 percent of the market share. Dollar exposures in both assets and liabilities remain a source of risk to the system. A third of banks loans are denominated in foreign currency, and a large share has been extended to un-hedged borrowers, exposing the system to FX risk through credit risk[3].

C. Solvency Stress Test

4. 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*.

5. The impact of individual shocks to solvency is moderate and could be handled by existing buffers:

- 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 consumption—which account for close to 70 percent 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 limited: the CAR for the system would fall by 1.4 and 2.9 percent, to 14.8 and 13.4 percent, respectively. The CAR of one bank would decline below the 10 percent minimum in the former case, and four banks' CAR would fall below 10 percent in the sectoral stress test exercise (Figure 1 and Table 2). According to the results, the Guatemalan banks would be in a slightly better position to withstand a credit risk shock in December 2022 compared with last December.

- 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 or fall. While the simulated increase in interest rates would result in a marginal gain in interest income,

[2] Banks' holdings of government bonds account for 24 percent of total assets in December 2022, with over 50 percent being for sale and 40 percent to hold to maturity.

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

valuation losses on sovereign bond holdings would reduce the system-wide CAR by 2.9 percentage points. Although, the higher rising rates on bond pricing had a more detrimental impact in 2022 than in December 2021, the CAR (after repricing) remained at or above the 10 percent minimum for all banks.

- 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 a large percent of loans denominated in foreign currency were extended to borrowers without natural edges. Results indicate that a hypothetical FX depreciation would marginally lower banks capitalization. Losses also arise from the indirect effect through credit risk and thereby deterioration of credit quality. Overall, the CAR for the whole system would decline by about a percentage point to 16.1 percent (Figure 1 and Table 2). The change in December's FX risk is similar to December 2021 but the CAR (post shock) was higher.

6. 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 (the proportional increase in NPLs); (ii) interest rate risk; and (iii) FX risk. Such a combined shock represents a very extreme scenario in the tail risk of the distribution and with a low probability of materialization. Results show that, even under these extreme assumptions, the CAR would fall by 6 percentage points to 11.2 percent and thereby still would comply with the 10 percent regulatory minimum. However, six individual banks would fall short of the minimum regulatory CAR thus requiring some recapitalization. After such a severe combined solvency shock, the identified capital shortfalls would amount to 0.8 percent of GDP (Figure 1 and Table 2).

7. 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. 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 relatively light within banks.[4]

8. 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 questions such as: what would have to be the NPL increase necessary for: (i) the system-wide CAR falls; (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 about 15.9 percent would be necessary for the system-wide CAR to fall below 10 percent, NPLs would need to increase to 18.2 of

[4] This contagion risk is measured here from the supply side (the banks network) and not from the demand side (depositors. Below, a different technique is used to measure the risk from the demand side.

currently loans for nine banks respectively to fall below the 10 percent regulatory minimum (Figure 1 and Table 2).

9. The liquidity stress test suggests that liquidity shortfalls following a short-lived drain on deposits could affect some banks. The liquidity stress test assumes a widespread liquidity drain of 7.5 and 2.5 percent per day of demand and time deposits respectively, affecting all banks in the system proportionally, without liquidity contagion or any intervention (from other banks or the central bank). Banks, however, could roll off maturing assets and convert them into new cash inflows (Figure 1 and Table 2). Results indicate that the share of liquid assets would tumble, one out of 17 banks would end-up illiquid after 5 days of continuous withdrawals.

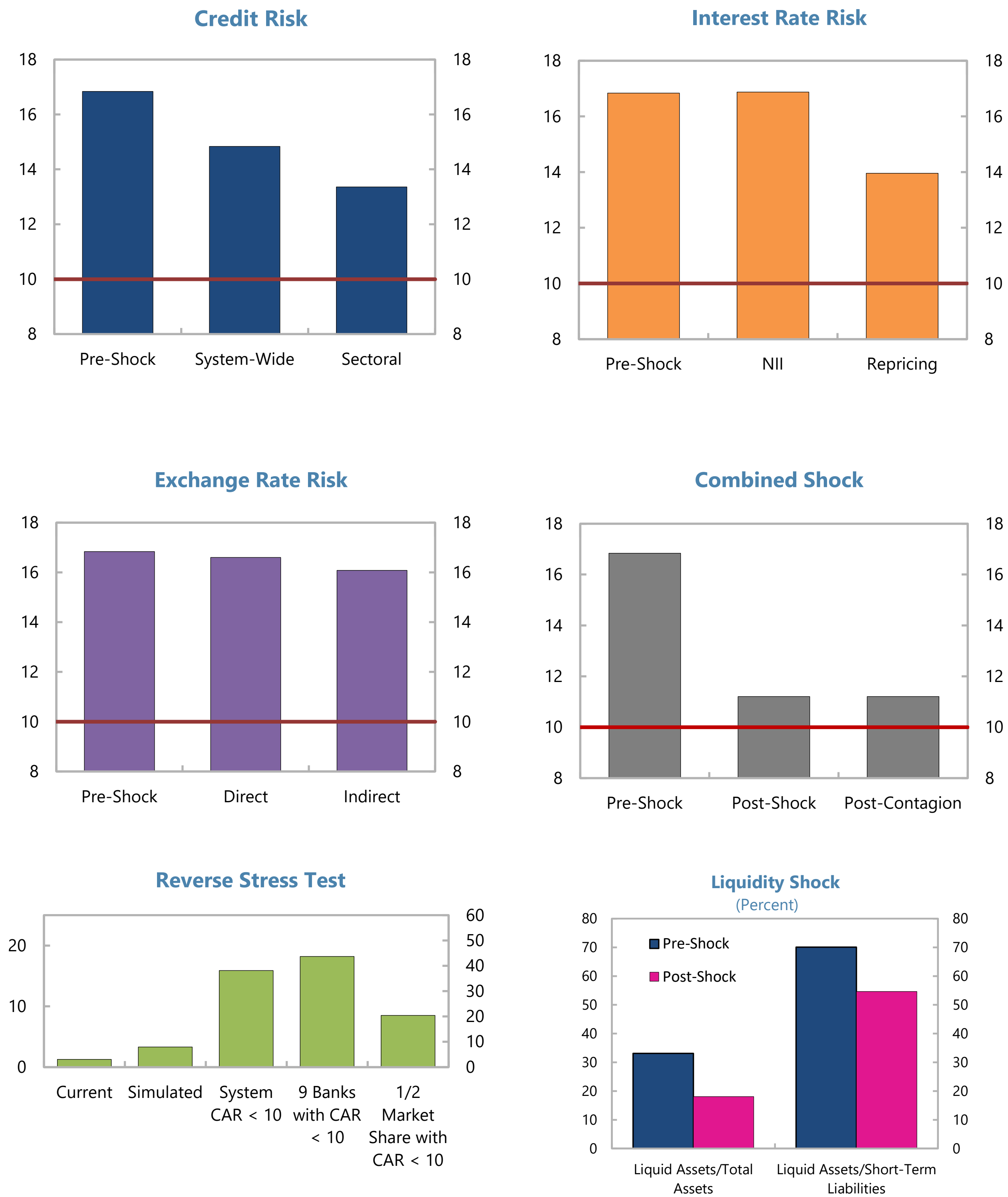
Annex V. Table 1. Guatemala: Stress Test

	2022	2021
	Banking System	
Capital Adequacy Ratio (CAR) pre-shock	16.8	15.6
Credit Risk 1/		
1. System-wide proportional increase in NPLs		
Post-shock CAR (percent)	14.8	14.2
CAR change (pct points)	-1.4	-1.4
2. Sectoral Shock		
Post-shock CAR (percent)	13.4	14.0
CAR change (pct points)	-2.9	-1.6
Interest rate Risk 2/		
1. Net Interest Income (NII) impact		
Post-shock CAR (percent)	16.9	15.7
CAR change (pct points)	0.0	0.1
2. Repricing impact		
Post-shock CAR (percent)	14.0	14.8
CAR change (pct points)	-2.9	-0.8
Overall change in CAR (NII and repricing)	-2.9	-0.8
FX Risk 3/		
1. Direct FX impact		
Post-shock CAR (percent)	16.6	15.5
CAR change (pct points)	-0.2	-0.1
2. Indirect FX impact (through credit risk)		
Post-shock CAR (percent)	16.1	14.8
CAR change (pct points)	-0.5	-0.6
Overall change in CAR (direct and indirect)	-0.8	-0.7
Combined Shock 4/		
Post-shock CAR (percent)	11.2	12.7
CAR change (pct points)	-5.6	-2.9
Interbank Contagion		
CAR after macroshocks	11.2	12.7
CAR after contagion	11.2	12.7
Reverse Stress Test (implied increase in NPLs, percent of performing loans)		
System CAR < 10	15.9	13.1
9 banks with CAR <10	18.2	23.5
1/2 market share with CAR <10	8.5	7.8
Liquidity 5/		
Post-shock liquid assets/total assets	18.1	13.4
Post shock liquid assets/short-term liabilit	54.6	39.0
# of liquid banks after 5 days	16.0	17.0

Source: SIB; and IMF staff estimates.

1/ Assumes 3.3 percent of performing loans becoming non-performing in the system-wide shock and 10 percent on the sectoral shock to the manufactoring, trade, and non-bank financial sectors.
2/ Assumes a 150 basis points increase in the nominal interest rates.
3/ Assumes a 20 percent depreciation of the bilateral USD exchange rate.
4/ Assumes a combination of the system-wide credit shock, interest rate, and FX shock.
5/ Assumes a 10 percent per day withdrawal of demand deposits and a 3 percent per day withdrawal of time deposits.

Annex V. Figure 1. Guatemala: Stress Test



Source: SIB; and IMF staff estimates.

Annex VI. Domestic Revenue Mobilization Measures

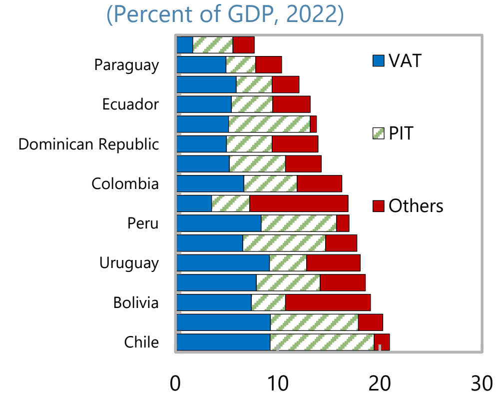
Guatemala's 2022 tax revenue was around 12 percent of GDP, with domestic VAT collection underperforming. Revenue mobilization is chronically low despite the well-identified social and infrastructure needs of the country. This Annex summarizes measures recommended in the past for Guatemala but failed to be adopted and key lessons from countries that successfully increased revenue mobilization. These examples illustrate the importance of increasing the Value-Added Tax (VAT) and Personal Income Tax (PIT) rates, eliminating tax exemptions, increasing the tax base, and strengthening the tax administration system. Staff's estimates of the tax capacity for Guatemala indicate a tax potential ranging between 21 and 24 percent of GDP.

1. **Guatemala's efforts centered on the tax administration agenda,** but more is needed to raise revenues over the medium term. The average tax revenue to GDP in the CAPDR region is 15 percent (12 percent in Guatemala). VAT and PIT revenue in Guatemala are also below average (Figure). Tax administration efforts in Guatemala have focused on digitalization, custom administration, and fiscal control (Table). The Tax Administration estimates tax administration efforts resulted in 0.3 percent of GDP additional tax revenue in 2022.

Tax Administration Efforts
(2022)

Restucturing of technical teams to focus on fiscal control and customs	
Digitalization	
	Mobile app
	Taxpayers service improvements and online customer service
	Electronic payments
	Online register of taxpayers
Customs administration efforts	
	Upgrades in customs' systems and digitalization
	Risk assesment improvements
Fiscal control and Anti-tax evasion measures	
	Tax-credit improvements (waiting times and electronic)
	Increase in number and quality of audits
	Taxpayers' financial statements analysis

Tax Revenue
(Percent of GDP, 2022)



Source: IMF Staff's calculations.

Annex VI. Box 1. Stochastic Frontier: An Application to Tax Potential

Model. Following Fenochietto and Pessino (2013), the stochastic frontier model that governs tax potential can be written as

$$T_{i,t} = \alpha + \beta' X_{i,t} + v_{i,t} + u_{i,t},$$

where $T_{i,t}$ is the log tax revenue to GDP ratio for country i and year t, $X_{i,t}$ is a vector that contains variables that affect tax revenue, and $v_{i,t}$ and $u_{i,t}$ are unobservable components. $v_{i,t}$ represents the usual disturbance error; $u_{i,t}$ represents the tax inefficiency, it is a non-negative disturbance associated with factors that contribute to not attaining the country's tax capacity. We assume $u_{i,t}$ follows a time-varying decay model with truncated-normal disturbance in the baseline model. β and α are parameters of the model to be estimated

The tax capacity is defined as:

$$Tax\ Capacity_{i,t} = \exp(\alpha + \beta' X_{i,t} + v_{i,t}),$$

that is, the predicted tax revenue to GDP ratio without inefficiency.

To measure efficiency, we define the tax effort as the ratio between the actual tax revenue and the stochastic frontier- the tax capacity:

$$TaxEffort_{i,t} = \frac{\exp\left(\alpha + \beta' X_{i,t} + v_{i,t} + u_{i,t}\right)}{\exp(\alpha + \beta' X_{i,t} + v_{i,t})} = \frac{Tax\ Revenue\ ratio_{i,t}}{Tax\ Capacity_{i,t}}\ .$$

Tax effort is between 0 and 1, and it indicates closeness to the optimal frontier: A country with a tax revenue ratio equal to capacity has no inefficiency.

Empirical Setting. Staff's empirical setting uses a panel dataset for 76 emerging and middle-income countries[1] covering the period 1990-2022. The estimated efficiency frontier is defined by:

- Dependent variable: $T_{i,t}$, is the logarithm of tax revenue to GDP. Tax revenue and nominal GDP are extracted from the WEO.
- Independent variables:
  - Governance: Measured by the logarithm of the percentage of firms expected to give gifts in meetings with tax officials from WDI.
  - Formal Firms: Logarithm of firms formally registered when operations started as a percentage from WDI.
  - Education spending: Logarithm of the government expenditure on education as a percentage of GDP from the UNESCO Institute for Statistics.
  - GDP per capita: Logarithm of the PPP-adjusted GDP per capital from WDI.
  - Public Capital Spending: Logarithm of public gross fixed capital formation as a percentage of GDP from the WEO.
  - Trade: Logarithm of the sum of imports and exports as a percentage of GDP. Imports, exports, and nominal GDP are taken from WEO.
  - Human Capital: Human Capital Index (0-1) from WDI.

[1] Sample selection is based on data availability. The sample includes Albania, Argentina, Armenia, Bangladesh, Benin, Bhutan, Botswana, Brazil, Bulgaria, Burkina Faso, Cameroon, Cambodia, Chad, Chile, China, Colombia, Congo, Costa Rica, Côte d'Ivoire, Dominican Republic, Ecuador, El Salvador, Ethiopia, Gabon, Georgia, Ghana, Guatemala, Guinea, Guyana, Honduras, India, Indonesia, Jordan, Kazakhstan, Kenya, Madagascar, Malawi, Malaysia, Mali, Mauritius, Mexico, Moldova, Morocco, Mozambique, Myanmar, Namibia, Nepal, Nicaragua, Niger, Pakistan, Panama, Paraguay, Peru, Philippines, Poland, Romania, Rwanda, Senegal, Serbia, South Africa, Tanzania, Thailand, Togo, Trinidad and Tobago, Tunisia, Türkiye, Uganda, Ukraine, Zambia.

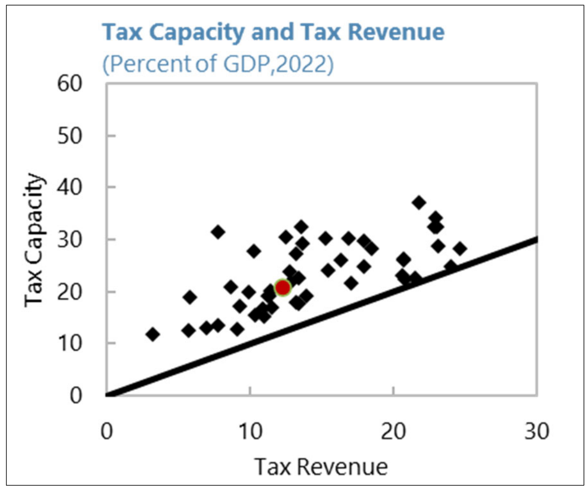
2. The tax efficiency frontier is explained by capital and social spending, productivity, trade openness, and formality in the labor market on tax capacity. Estimates of the tax frontier are in line with the results in the literature. Countries with higher public investment and education spending are near their tax capacity. Similarly, GDP per capita and trade are positively correlated with tax potential.

Tax Frontier Estimation

VARIABLES	(1) Tax Frontier	(2) Tax Frontier	(3) Tax Frontier	(4) Tax Frontier
Governance	-0.0135	-0.00848	0.00398	-0.0119
	(0.0107)	(0.00931)	(0.0103)	(0.00963)
Formal Firms	0.204*	0.271**	0.198*	0.317**
	(0.123)	(0.136)	(0.119)	(0.144)
Education Spending	0.106***	0.139***	0.108***	0.125***
	(0.0143)	(0.0255)	(0.0143)	(0.0255)
GDP per capita	0.0773***	0.222***	0.166***	0.138***
	(0.0193)	(0.0240)	(0.00931)	(0.0245)
Public Investment	0.163***	0.146***	0.157***	0.160***
	(0.00819)	(0.0123)	(0.00820)	(0.0118)
Trade	0.283***	0.236***	0.294***	0.248***
	(0.0150)	(0.0213)	(0.0150)	(0.0232)
Human Capital	0.127	0.0100	0.286	0.359
	(0.255)	(0.232)	(0.272)	(0.265)
Guatemala's Tax Capacity (2022)	24.4	20.96	23.49	21.48
Observations	2,100	982	2,100	982
Number of countries	76	76	76	76
Time-Invariant/Time-Decay	Time-Decay	Time-Decay	Time-Invariant	Time-Invariant
Sample (Starting Year)	1990	2010	1990	2010
Observations	2,100	982	2,100	982

Standard errors in parentheses
*** p<0.01, ** p<0.05, * p<0.1

3. Guatemala's estimated tax capacity ranges between 21 to 24 percent of GDP. Under a time-decay model, the estimated tax efficiency[1] in Guatemala is 58 percent, comparable to the CAPDR average but slightly below the 62 percent average for Latin America and the Caribbean. The estimated tax efficiency for Guatemala is consistent with a tax capacity of 21 percent. Other models reach a slightly higher tax capacity level.



4. Successful revenue mobilization episodes in other emerging economies point to the importance of approving a comprehensive reform package. Successful cases suggest addressing tax exemptions and increasing direct and indirect tax rates was important. Improved compliance through taxpayer segmentation and automation was also very relevant (Akitoby et al., 2018).

Revenue Mobilization Measures during Successful Episodes

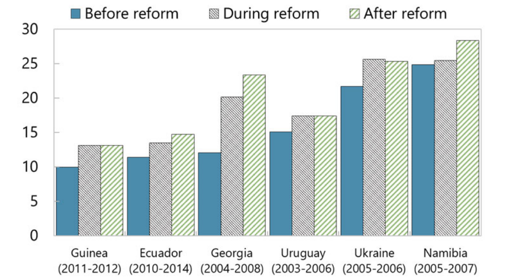
Episode	VAT	Excise	Trade tax	CIT	PIT	Rev. Admin.	Subsidy
	Measures						
Guinea (2011-2012)					Yes	Yes	
Ecuador (2010-2014)				Yes			
Georgia (2004-2008)	Yes	Yes	Yes	Yes	Yes	Yes	
Uruguay (2003-2006)		Yes				Yes	
Ukraine (2005-2006)	Yes	Yes		Yes		Yes	
Namibia (2005-2007)	Yes					Yes	Yes

Source: Akitoby et al, 2018. Selected episodes are considered successful if revenue mobilization was sustained or partially sustained.
VAT represents Value added tax measures; Excise represents measures related to excise taxes; Trade taxes represent measures related to import- o export-specific taxes; PIT represents measures related to Property Income Tax; Rev. Admin represents revenue administration measures; Subsidy represents changes in subsidies.

[1] The link between tax efficiency and tax capacity is explained in detail in Box 1.

5. Transparency and pro-growth measures are also important guiding principles to significantly boost tax revenue. Cross-country evidence shows that the long-run estimated gains following a comprehensive tax reform were three percent of GDP for the medium country, with the least attaining two percent of GDP and the most 11 percent of GDP. Reforms included the removal of complexity in the tax system and measures promoting investment and growth.

Episodes of Revenue Mobilization
(Tax revenue, percentage of GDP)



Sources: Episodes listed from successful revenue mobilization from Akitoby et al (2018). Data from WEO. Staff calculations. "Before reform", "during reform" and "after reform" indicate the average tax revenue 3 years before the episode, during the episode, and 3 years after, respectively.

6. Inefficiencies in the tax system across sectors and tax expenditure are also measures to consider. Tax expenditure in Guatemala is estimated at 2.8 percent of GDP, with a significant share of Constitutional spending clauses (Table). Eliminating *the other exemptions by law* could reduce tax expenditures by about 2.1 percent of GDP.

Tax Expenditure in Guatemala (2021)

	Total	VAT	PIT	Other taxes
Spending Clauses in the Constitution	0.6	0.3	0.3	0.00
Other in the Law	2.1	1.4	0.5	0.24
Total	2.8	1.7	0.8	0.24

VAT represents Value added tax related exemptions; *PIT* represents measures related to Property Income Tax

7. Guatemala has received significant advice and support from different international agencies on how to reform its tax system and mobilize revenue. Measures that have been previously discussed and have proven successful for other countries are:

a. *Tax administration measures* to improve compliance with VAT and PIT gaps

  i. Undertaking an external evaluation and estimation of the VAT compliance gap

  ii. Strengthening the tax register and fiscal control of Large Taxpayers. For example, by providing timely and accurate information on Large Taxpayers and improving the auditing and debt collection process (definition of risk profiles, credible tax fines, and streamlining the follow-up process)

  iii. Centralizing and improving the taxpayer register

  iv. Continuing digitalization efforts (including e-filing of VAT in real-time)

  v. Continuing customs administration efforts.

b. Tax reform measures

i. Reducing tax expenditures by eliminating tax exemptions and exonerations

ii. Updating sector-specific taxes (e.g., primary sector; non-alcoholic beverages)

iii. Evaluating and formulating a tax reform that increases the marginal tax rate to international standards. A 2016 IMF study found the potential return of these measures is estimated at about 3.5 percentage points of GDP

iv. Revising PIT segmentation.

Reform Options

Recommendation	Estimated impact (percent of GDP)
Increase in VAT to percent	1.2
Use three rates for ISRPI (7.5%, 20%, 32.5%)	0.9
Increase ISC rates on gasoline and diesel	0.4
Increase ISRAL rate by 3 percentage points	0.2
Introduce ISC for telecommunications (10% rate)	0.15
Apply dual regime only to natural persons at 10%	0.1
Introduce banking VAT	0.05
Increase ISC on non-alcoholic beverages	0.05
Phase out IUSI deductions on ISO	0.05
Total	3.5

Source: Fenochietto and others, 2016

Note: VAT is Vaue Added Tax, ISRPI is the personal icome tax, ISC is the consumption tax, and IUSI is the property tax. Table presents the estimated impact on tax collection as percent of GDP.

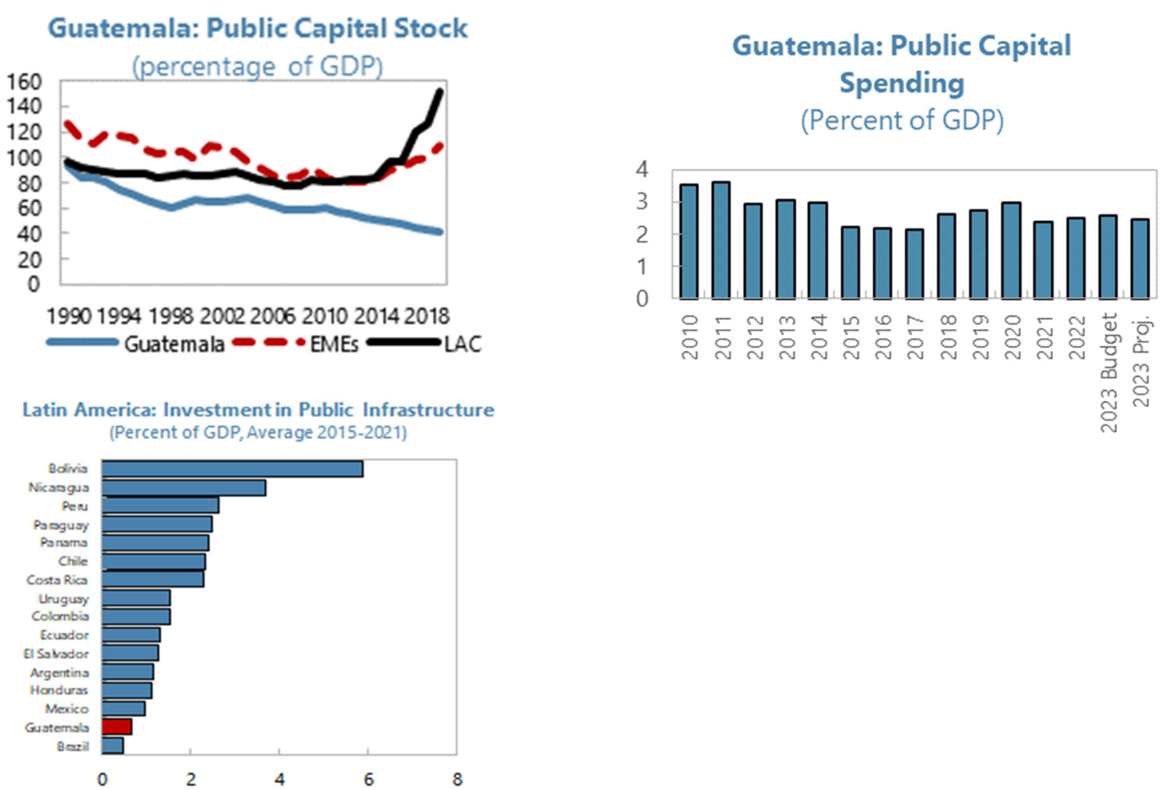
Annex VII. Public Investment and Macroeconomic Impact in Guatemala

A public investment boost in Guatemala could increase productivity and private investment while reducing the current account surplus in the short term. Staff estimates that a temporary 1 percent of GDP-increase in public investment leads to an increase of about 0.3 percent of GDP in the short term and 1-1.2 percent of GDP in the long term. These results imply public sector crowding-in private investment. Also, the analysis finds public investment helps attract FDI, but the pull effect appears to be limited to export-related FDI.

A. Public Capital and Public Investment Spending in Guatemala

1. **Guatemala's stock of public capital has decreased in the last two decades, and the levels of public investment are low** (Figure 1)**.** Guatemala's public investment stock has fallen by 20 percentage points since 2010, and spending on public capital has remained below 3 percent of GDP in the last decade. As a percent of GDP, Guatemala's investment lies well below the average levels in Central America and Latin America. Public investment infrastructure (2015-2021 average), in particular, is below 1 percent of GDP, and ranks below 18 out of 21 in Latin America across different types of infrastructure (energy, water, communication, and transport). Factors hindering Guatemala's public investment include complex and lengthy planning, budget allocation, and implementation processes.

Annex VII. Figure 1. Guatemala: Public Capital Stock and Spending, and Public Infrastructure Investment



Source: Guatemala's Ministry of Finance; Infralatam; Staff's calculations and projections.

B. Modeling the Macroeconomic Impact of Public Investment

Model 1: Local Projections

2. How does public investment helps attract FDI? Staff use two approaches (local projections and DSGE-based simulations) to analyze the impact of public infrastructure. The first approach builds on Geli and Moura (2023), Jordá (2005) and Ramey (2016) and quantifies the effect of public investment using multiplier effects and impulse response functions for a sample of 114 emerging and middle-income economies (Box 1).

Annex VII. Box 1. Guatemala: An Empirical Model for Public Investment

The model estimated considers the cumulative change of public investment to real GDP, $\boldsymbol{y_{i,\tau}^{cum}}$ is explained by the real GDP, private investment and FDI.

The analysis uses two regression models: (i) multiplier analysis and (ii) impulse response functions with respect to a shock to public capital spending.

Multiplier Analysis. Following Geli and Moura (2023), the empirical model is:

$$\boldsymbol{y_{i,\tau}^{cum} = \alpha_i + \beta_h^{multiplier} PI_{i,t}^{cum} + \theta' \mathbf{Controls}_{i,t} + \delta_t + u_{i,t}, (1)}$$

where $i =$ country and $\tau = t + h$, with h representing the period following a shock in t. The variables in the model are:

- $\boldsymbol{y_{i,t+h}^{cum}}$, the cumulative change defined as:

$$\boldsymbol{y_{i,t+h}^{cum} = \frac{\sum_{j=0}^{h} Y_{i,t+j} - j\, Y_{i,t-1}}{GDP_{t-1}}} \ .$$

- $PI_{i,t+h}^{cum}$, the cumulative public capital spending defined as

$$\boldsymbol{PI_{i,t+h}^{cum} = \frac{\sum_{j=0}^{h} PI_{i,t+j} - j\, PI_{i,t-1}}{GDP_{t-1}}} \ .$$

- $\boldsymbol{\alpha_i}$, a country fixed effect
- $\boldsymbol{\delta_t}$, a time fixed effect
- $\mathbf{Controls}_{\boldsymbol{i,t}}$, the vector of control variables in the baseline specification includes initial GDP growth, initial FDI to GDP ratio, initial debt to GDP, lagged currency depreciation.
- $\boldsymbol{u_{i,t}}$, an unobserved confounder variable.

To identify multipliers, the analysis uses public capital stock, defined by Geli and Moura (2023) as the forecast error for public capital spending (i.e., the difference between the projected and the realized value) as the instrument for public capital spending

Fiscal forecast errors are defined (using World Economic Outlook real-time vintage data) by

$$\boldsymbol{CapShock_{i,t} = pi_{i,t} - pi_{i,t}^{forecast}},$$

where $\boldsymbol{pi_{i,t}}$ is the observed public spending ratio to GDP for country i and year t;

Annex VII. Box 1. Guatemala: An Empirical Model for Public Investment (concluded)

$\boldsymbol{pi^{forecast}_{i,t}}$ is the forecast of the September WEO vintage for public spending ratio to GDP for country i and year t.

The estimation of equation 1 uses two-stage least squares and uses forecast errors -$\boldsymbol{CapShock_{i,t}}$- as instruments for $\boldsymbol{PI^{cum}_{i,t}}$.

Impulse Response Functions. The empirical model is:

$$y^{cum}_{i,t+h} = \alpha_i + \beta^{IRF}_h CapShock_{i,t} + \theta' \ \ \mathbf{Controls}_{i,t} + \delta_t + u_{i,t}, (2)$$

where β^{IRF}_h is the cumulative response of the variable of interest to a shock in capital spending. Equation (2) is estimated using local projections as in Jordá (2005).

Data and sample. The sample covers 114 emerging and middle-income economies between 2010 and 2022 (Table).[1] The robustness checks are done using Latin America and the Caribbean.

Sample of Countries in Empirical Analysis

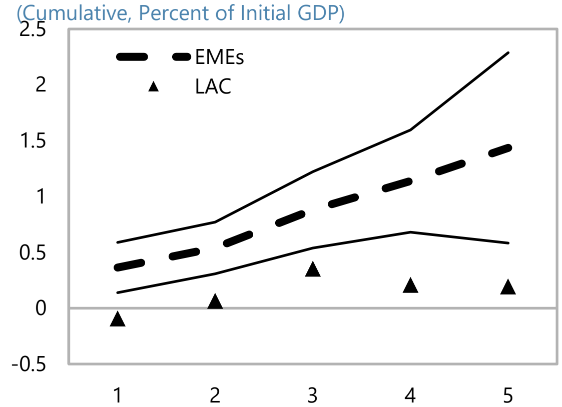
Albania	Cabo Verde	Ethiopia	Kuwait	Panama	Tajkistan
Algeria	Cambodia	Gabon	Lebanon	Paraguay	Tanzania
Angola	Cameroon	Gambia	Lesotho	Peru	Thailand
Antigua and Barbud	Central African Republic	Georgia	Madagascar	Philippines	Togo
Argentina	Chad	Ghana	Malawi	Poland	Trinidad and Tobago
Armenia	Chile	Grenada	Malaysia	Romania	Turkmenistan
Azerbaijan	Colombia	Guatemala	Maldives	Russia	Turkiye
Bahamas	Comoros	Guinea	Mali	Rwanda	Uganda
Bahrain	Congo	Guinea-Bissau	Mauritius	Saudi Arabia	Ukraine
Bangladesh	Costa Rica	Guyana	Mexico	Senegal	United Arab Emirates
Barbados	Croatia	Haiti	Moldova	Serbia	Uruguay
Belize	Côte d'Ivoire	Honduras	Morocco	Seychelles	Vietnam
Benin	Djbouti	India	Mozambique	Sierra Leone	Yemen
Bolivia	Dominica	Indonesia	Myanmar	South Africa	Zambia
Bosnia and Herzego	Dominican	Iran	Namibia	South Sudan	
Botswana	Ecuador	Iraq	Nepal	St. Kitts and Nevis	
Brazil	Egypt	Jordan	Nicaragua	St. Lucia	
Bulgaria	El Salvador	Kazakhstan	Niger	St. Vincent and the Grenadines	
Burkina Faso	Equatorial Guinea	Kenya	Nigeria	Suriname	
Burundi	Eswatini	Kosovo	Oman	São Tomé and Principe	

[1] Results are robust to alternative specifications including initial tax-revenues to GDP, public education spending, human capital levels, among other control variables. The sample period is chosen based on availability of WEO vintages, required to construct the forecast error series for public capital spending used in the empirical estimation.

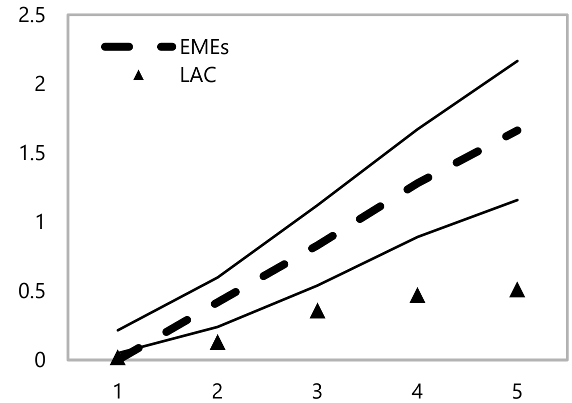
3. **Public capital spending appears to have a positive and permanent effect on GDP that is sustained through private investment and FDI inflows (Figure 1).** One percent increase in public capital increases GDP by about 0.3 percent in the short term and by 1 percent in the long term. Also, a one percent increase in public investment spending increases private investment by about 0.4 percent in the short term and close to 2 percent in the medium and long term. Furthermore, FDI cumulative inflows increase by about 0.5 percent of GDP.

Annex VII. Figure 2. Guatemala: Empirical Estimates of the Effects of an Increase in Public Capital Expenditure

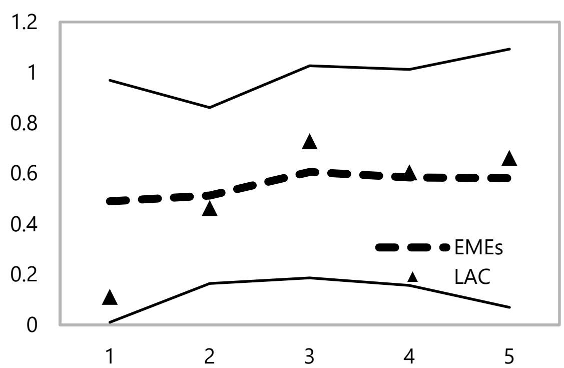
Multiplier of Public Capital Expenditure Shock on GDP
(Cumulative, Percent of Initial GDP)



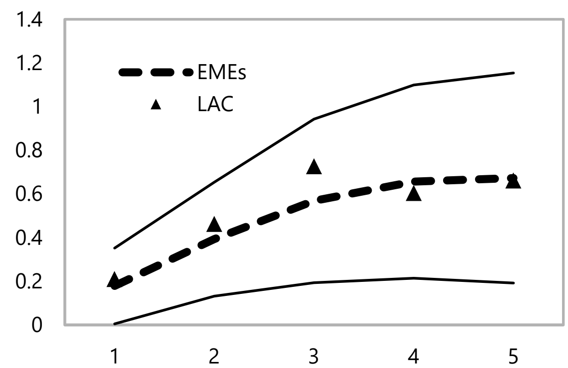
IRF of Public Capital Expenditure Shock on GDP
(Cumulative, Percent of Initial GDP)



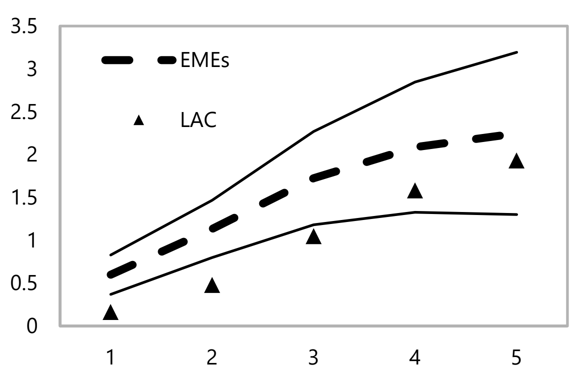
Multiplier of Public Capital Expenditure on FDI
(Cumulative Inflows , Percent of Initial GDP)



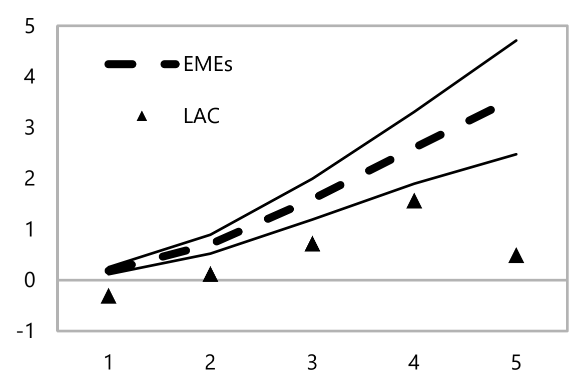
IRF of Public Capital Expenditure Shock on FDI
(Cumulative Inflows , Percent of Initial GDP)



Multiplier of Public Capital Expenditure on Investment
(Cumulative, Percent of Initial GDP)



IRF of Public Capital Expenditure Shock on Investment
(Cumulative, Percent of Initial GDP)



Source: IMF Staff estimates.

Annex VII. Box 2. Guatemala: Public Investment Multiplier and FDI: A Sectoral Analysis

Empirical Model

The model in Box 1 is extended to allow for heterogeneous responses across sectors using bilateral-sector level FDI flows for a subset of emerging economies.

$\boldsymbol{FDI^{cum}_{i,o,s,t+h}}$, defined as the cumulative FDI in host country i received from country of origin o, sector s, after h periods following a shock in period t is

$$\boldsymbol{FDI^{cum}_{i,o,s,t+h} = \alpha_{i,o} + \gamma_s + \beta^s_h CapShock_{i,t} + \theta' \mathbf{Controls}_{i,s,t} + u_{i,o,s,t}}, \mathbf{(2)}$$

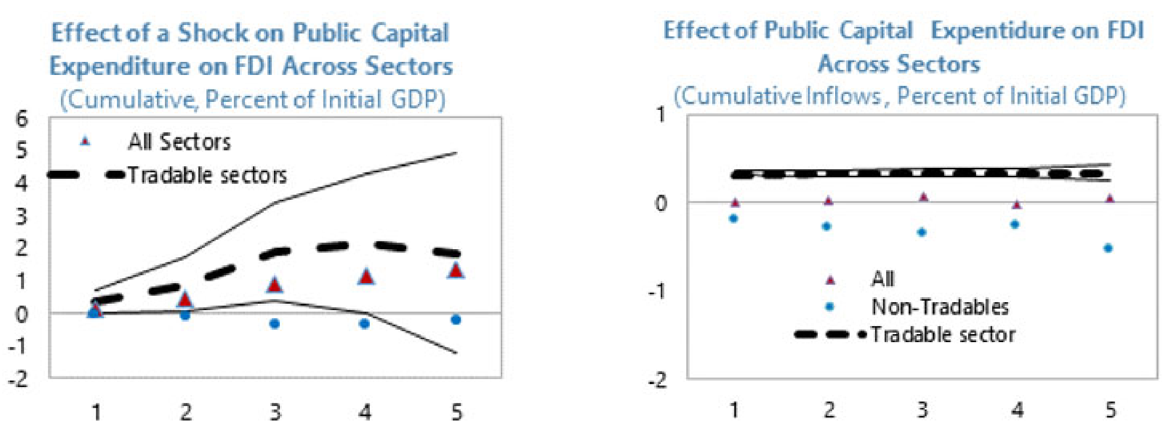
where $\boldsymbol{\alpha_{i,o}}$ is a bilateral fixed effect, $\boldsymbol{\gamma_s}$ is a sector fixed effect, and the explanatory vector $\mathbf{Controls}_{i,s,t}$ in the baseline specification includes initial GDP growth, initial FDI to GDP ratio in sector s, initial FDI to GDP ratio.[1] $\boldsymbol{u_{i,t}}$ is an unobserved confounder variable.

The analysis focuses on differences across export-related vs. domestic-consumption-based sectors. The sample covers 6 emerging economies including: Chile, Colombia, Guatemala, Hungary, Mexico, and Poland.[2] The data source for Chile, Colombia, Hungary, Mexico, and Poland is the OECD FDI statistics and Banguat for Guatemala.

[1] Results are robust to alternative specifications including other control variables such as initial debt to GDP, lagged currency depreciation.
[2] The sample period is chosen based on availability of WEO vintages, required to construct the forecast error series for public capital spending used in the empirical estimation.

4. Public investment has a larger impact on FDI when related to export-related FDI. Sectoral estimates on cumulative FDI inflows are stronger in sectors with higher tradable components (Figure). The analysis suggests that public investment is more effective in attracting FDI that wants to exploit lower costs to export rather than those dedicated to domestic absorption. The estimates for Guatemala are consistent with tradable-enhancing flows, although the point estimates are smaller.

Annex VII. Figure 3. Guatemala: Heterogeneous Impact of Public Capital Expenditure Across Sectors



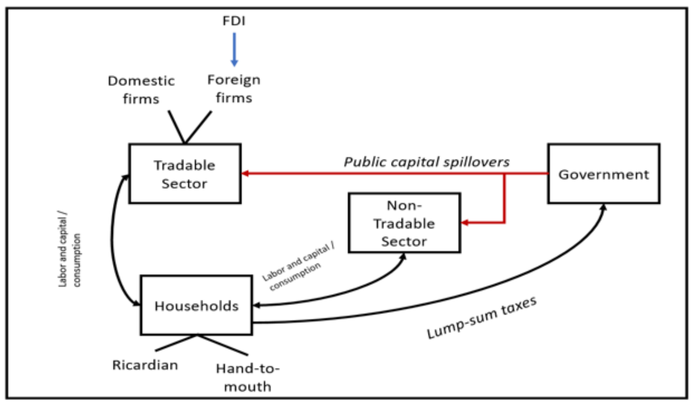
Model 2: Debt, Investment, Growth, And FDI Dynamic Model

5. The second modeling approach studies public investment complementarities using a dynamic general equilibrium model of a small open economy. Building on the DIGNAR model developed by the IMF staff analyzes the impact of infrastructure spending and the role of increasing efficiency; Staff's empirical estimates are complemented with model-based counterfactuals for Guatemala building on a medium-sized DSGE model with public investment complementarities. The model examines the impact of public investment on foreign direct investment using Hale (2023) and Melitz (2006).

Annex VII. Box 3. A DSGE Model with FDI and Public Investment Complementarities

Model Structure. It is a dynamic model with two types of households and three production sectors

Model Mechanisms



Source: Staff's representation of the augmented model with FDI

- *Households*: There are two types of agents: Ricardian and hand-to-mouth. Ricardian households optimize intertemporally and have access to capital and financial markets. Hand-to-mouth agents are financially constrained.
- *Production sectors:* There are three types of firms: domestic firms that produce non-tradable goods; domestically owned firms that produce tradable goods; and foreign-owned firms that produce exporting goods.
- *Government:* The government finances capital spending using lump-sum taxes. Public capital spending has positive productivity spillovers to all sectors in the economy. Public investment in infrastructure, however, is subject to some investment inefficiency, modeled as the size of the increase in productive capital stock relative to the increase in investment spending (typically below to one):

$$K_t^{public} = \theta_{efficiency} I_t^{Public} + (1 - \delta_g) K_{t-1}^{public} + adjustmentcosts_t$$

Extended Baseline Model with FDI. Staff's model builds on Hale (2003) and Melitz (2006) to allow for FDI in the form of acquisitions. Public investment in infrastructure will attract FDI as the model exhibits positive production spillovers. At the same time, foreign firms will contribute to the demand for capital and labor in the economy.

The model FDI-related building blocks:

Annex VII. Box 3. A DSGE Model with FDI and Public Investment Complementarities (concluded)

- Prospective foreign affiliates indexed by i face a potential cost of entry c_i. The cost is known at the time the foreign firm decides whether to enter.
- Production by foreign affiliates follows a Cobb-Douglas production function that uses capital ($k_{i,t}$) and labor ($l_{i,t}$). Foreign firms also face positive spillovers from public capital investment. Foreign firms maximize profits and compete monopolistically in the exports market choosing the optimal price, $p_{i,t}$, every period.
- Foreign firms face random utility shocks of staying in the market, and therefore there is a mass of firms that exit the market every period. Utility shocks follow a Fréchet distribution.
- The value of foreign firm i is:

$$V_{i,t} = \max_{p_{i,t},k_{i,t},l_{i,t}} \Pi_{i,t} + \beta \ E_t \max\{V_{i,t+1} - u_{i,t+1}, -v_{i,t+1}\},$$

where $\Pi_{i,t}$ are profits, $u_{i,t+1}$ and $v_{i,t+1}$ are utility shocks, and β is the discount factor. The marginal foreign firm satisfies:

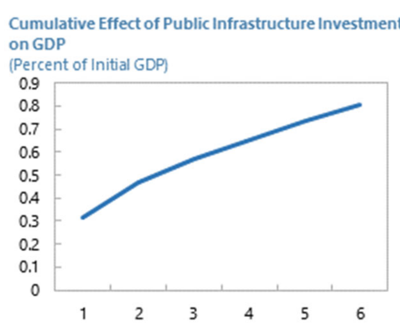
$$E_t(V_{i,t+1}) = \bar{c}.$$

Simulations: Staff calibrates the model to the Guatemalan economy and estimates two counterfactual exercises:

- Shock to public capital spending: Staff simulates a temporary increase in I_t^{Public} .
- Shock to public capital spending and efficiency of investment: Staff simulates a temporary increase in I_t^{Public} following a permanent increase in the investment efficiency, $\theta_{efficiency}$.

6. A temporary increase in public infrastructure has positive effects on GDP. A one percent increase in the stock of public investment is estimated to increase GDP by 0.3 percent in the short term and 0.8 percent in the medium term. Also, a comparable increase in private investment has a positive impact on GDP. Furthermore, FDI increases by 0.1 percent in the short-term and 7 percent in the medium term. Public infrastructure investment reduces the current account surplus in the short term and reduces consumption prices.

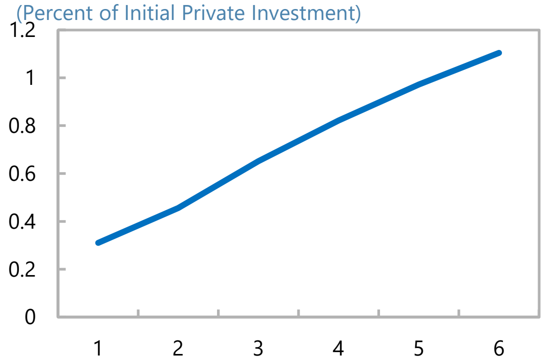
Annex VII. Figure 4. Guatemala: Macroeconomic Effects of Public Infrastructure



Annex VII. Figure 4. Guatemala: Macroeconomic Effects of Public Infrastructure (concluded)

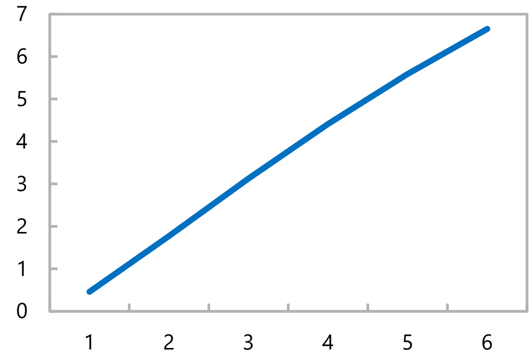
Cumulative Effect of Public Infrastructure on Private Investment

(Percent of Initial Private Investment)



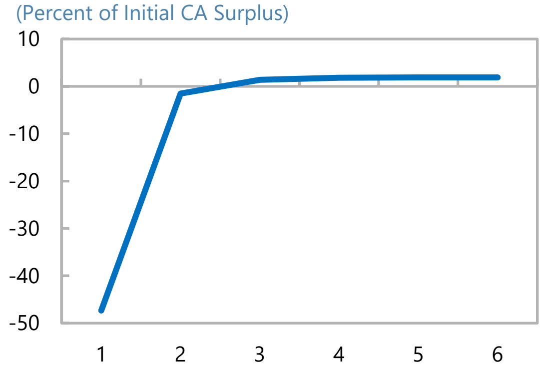
Cumulative Effect of Public Infrastructure on FDI

(Percent of Initial FDI)



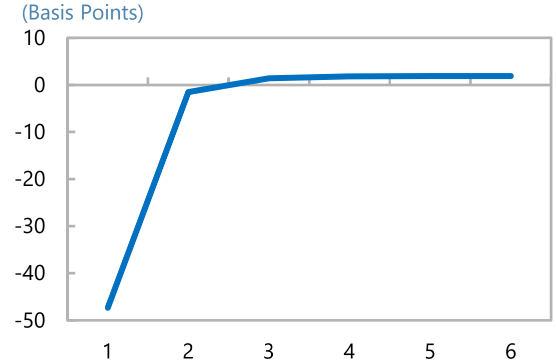
Cumulative Effect of Public Infrastructure on the CA Surplus

(Percent of Initial CA Surplus)



Cumulative Effect of Public Infrastructure on the Consumer Price Index

(Basis Points)

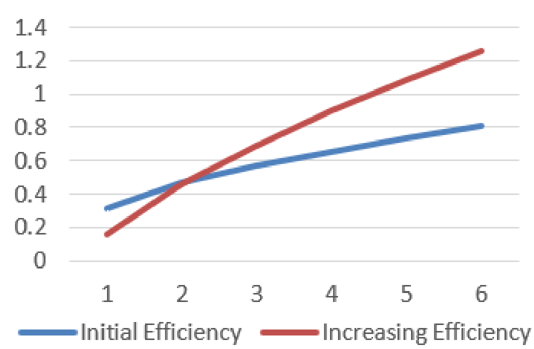


Source: Staff calculations. Figure presents the cumulative impact of an increase on public infrastructure on macroeconomic outcomes using a DSGE model with FDI. The size of the shock is 1 percent of the initial GDP. The shock is temporary and occurs in period 1.

7. Increasing efficiency boosts the effect of public infrastructure on GDP. A counterfactual exercise shows that increasing capital spending efficiency by 5 percent can increase the public investment multiplier from 0.8 to 1.2 percent of the GDP.

Cumulative Effect of Public Infrastructure Investment on GDP

(Percent of Initial GDP)



Annex VIII. Update on Implementation of Past Recommendations

2022 Article IV Recommendations	Authorities' Actions	Staff's Appraisal of Authorities' Progress	2023 Article IV Recommendations
Fiscal			
Scaling up budget execution in the near term to support cash transfers for health, education, and nutrition.	The authorities continued to provide social support to alleviate poverty and inflationary pressures by extending temporary and targeted subsidies and increasing social spending in 2022 and 2023. At the same time, education, health, social programs, and military spending increased in 2022, the latter because of the acquisition of helicopters and machinery to strengthen national security measures. A similar increase in budget allocations is reported in 2023.	Fiscal support (0.7 percent of GDP) continued to partially offset the sharp rise in international prices and the impact of natural disasters in 2022. However, health, education, and social spending remained below 5 percent of GDP in 2022 and in the 2023 budget.	Improve execution of social spending included in the 2023 budget, use the 2022 unspent cash balances to support the most vulnerable, reduce information gaps to better target support.
Re-deployment of some of the 2020 social measures if economic conditions worsen.	Authorities emphasized that they could expand social support using unspent cash balances if economic conditions worsen.	Fiscal support could be expanded if economic conditions worsen considering low-debt levels and unspent cash balances.	Same, with an emphasis on reducing information gaps to enhance effectiveness.
Enhancing the infrastructure governance framework. further enhance the public finance management framework (PFM).	PPP Law and agreed to adopt the IMF's Public Investment Management Assessment (PIMA) program, including the climate module. The first PPP *Autopista Escuintla Puerto Quetzal* (Escuintla-Quetzal port Highway) should start in 2023.	PPP Law is to provide a clear framework for PPP investments, but implementation remains a challenge. The first PPP is at risk of not being executed. The PIMA/C-PIMA is to provide recommendations to further strengthen the public investment framework.	We added measures from the Fiscal Transparency Evaluation. The PIMA/C-PIMA is scheduled for May 2023.
Further emphasis on policies that address long-standing social gaps is necessary to alleviate poverty and strengthen social cohesion.	The National Households' Income and Expenditure Survey is in progress. In recent years, some programs have been expanded, such as the school meal program, which has increased daily per capita	Social spending remains below 5 percent, and cash transfers are limited, and targeting could be improved.	Use of the survey to improve targeting.

2022 Article IV Recommendations	Authorities' Actions	Staff's Appraisal of Authorities' Progress	2023 Article IV Recommendations
	spending and coverage. As of 2023, it also includes the middle level (previously only covered early childhood education pre-school and primary). The Ministry of Public Health's infrastructure has expanded in the last 3 years. In fact, investment spending increased in 2022 due to infrastructure in the health sector, including equipment, indicating an increase in the supply of this sector.		
Raise tax collections through further tax administration gains and tax policies, all supported by a solid medium-term fiscal framework.	In 2022, the tax revenue to GDP ratio increased by more than 12% and it is expected a gradual increase in the medium-term due to the measures that the SAT has been implementing in recent years.	The tax revenue to GDP ratio increased in 2021 and 2022 due to tax administration efforts and high import prices. Still, tax revenue to GDP remains below the average in CAPDR and Latin America (Annex V).	Adoption of a comprehensive tax reform and addressing domestic VAT collection gaps among others.
Medium-Term Fiscal Framework (MTFF), underpinned by an explicit medium-term anchor, operationalized through consistent annual deficit limits and a medium-term fiscal strategy.	The authorities have an MTFF but it is not aligned with infrastructure and social objectives. However, work is underway to ensure better alignment between the MTFF and the proposed objectives.	The MTFF could be better aligned to medium-term targets and to help close social and infrastructure gaps. Debt management strategy is based on the budget and is not linked to the MTDS. The composition and instruments are determined contingent on market conditions.	We have expanded the recommendation to ensure alignment and consistency between the MT revenue, expenditure, and debt strategy. The publication and discussion at Congress should add accountability.
Further improvements in the Medium-Term Debt Sustainability framework detailing a public debt strategy—including composition of domestic and external debt and maturity plans—aligned with the MTFF, which could better anchor market and investors'	The World Bank provided technical assistance on the EDMP, but it is not included in the analysis. The Debt Management Office (*Crédito Público*) is updating the medium-term debt management strategy, based on the amounts approved in the budget for fiscal year 2023. In the meantime, work on the strategy is ongoing in a separate document to consider the amounts approved in the		We are also asking developing the borrowing strategy, completing the sovereign yield curve, consistency with the MT spending and revenue projections, plans to broaden the investor base, and the development of the secondary debt market.

2022 Article IV Recommendations	Authorities' Actions	Staff's Appraisal of Authorities' Progress	2023 Article IV Recommendations
expectations, which in turn could help attract foreign investments and lower Guatemala's risk premium	national budget, as the preparation of the medium-term fiscal framework begins before the approval of the budget. Regarding the breakdown of the composition of financing, the strategy displays the annual percentages of internal and external financing, as well as the breakdown by instrument. As for the terms of the instruments, financing obtained through short- and long-term treasury bonds is included as a general category.		
Monetary Policy			
Forward-looking and data-dependent monetary policy should be carefully calibrated to ensure that inflation expectations remain firmly anchored while guarding against downside risks.	The Central Bank has continued to closely monitor the behavior of inflation, its forecasts, and inflationary expectations, as well as the evolution of other relevant macroeconomic variables, in order to adopt any measure to assure convergence of inflation to the goal in the relevant monetary horizon (24 months). In that sense, monetary policy decisions have reflected a prudent and forward-looking approach based on all the available relevant information assessment.	The authorities have been increasing the policy rate in line with inflation pressures data.	Similar, but added measures to enhancing the IT framework (institutional updates, modernization of the reserves requirement and OMOs framework, and strengthening the modeling capacity for monetary policy forecasting) to improve transmission and information available.
Foreign Exchange Policy			
Greater exchange rate (FX) flexibility can help absorb external shocks and further communication improvements. FX interventions should be limited to addressing disorderly market conditions and remain rules-based, with the rationale of such interventions clearly	Guatemala has a flexible exchange rate regime, which is consistent with the Inflation Target framework. In that context, the Central Bank´s participation in the foreign exchange market has the purpose of moderating exchange rate volatility without affecting its trend. This participation is rule-based, which is symmetrical, transparent, and well known by all		Gradual flexibilization of the FX. The pace should go hand-in-hand with a number of technical reforms and the development of markets (hedging and FX), and medium-term reforms (e.g., IFRS-accounting)

2022 Article IV Recommendations	Authorities' Actions	Staff's Appraisal of Authorities' Progress	2023 Article IV Recommendations
communicated to avoid misperceptions.	the market's participants. Additionally, the fluctuation margin has been widening over the last years. Given market conditions, the Central Bank has also implemented a reserve accumulation mechanism in recent years, which has played an important role in neutralizing the excess supply of foreign currency in the FX market, which comes from extraordinary remittances flows.	In 2023 the criteria of the participation rule has continued to evolve with the volatility trigger increasing from ±0.50 percent (2008) to ±0.90 percent as of January 2023. The maximum amount for interventions has also expanded (from US$ 8 million per auction) to US$ 20 million per auction as of January 2023. The number of daily auctions (from 3 auctions to 5 auctions as of January 2023). The exchange rate remains very stable around its historical mean. The participation and reserve accumulation rules have been used frequently, with the Central Bank absorbing the FX risk.	
Recapitalization of the central bank, in line with Article 9 of Banguat Law, to help to reduce excess liquidity in the banking system, further develop the local currency bond market	The Central Bank is still making efforts to get the restitution of net deficiencies before the Ministry of Finance and Congress of the Republic. The net deficiencies recorded in 2021, were included in the approved 2023 government budget.	Banguat is expected to receive $54 million before the end of the year to cover 2021 losses. The stock due is still large	Adopt a strategy to recapitalize Banguat.
Additional refinements to the forward-looking communication strategy could be made by providing stronger emphasis on the prospects for monetary policy under the baseline and sensitivity scenarios, consistent with the growth and inflation projections and risk scenarios.	The Central Bank's communication strategy continues to be guided by the objective of building up and maintaining the monetary authority's credibility. Concerning the prospects for monetary policy, the Central Bank authorities continued holding press conferences and public presentations after monetary	There has been some progress with the monetary policy decisions being followed up by a meeting with journalist the day after.	The communication strategy for monetary policy decisions needs to be realigned with the institutional reforms at Banguat. The reform agenda needs to come with a communication strategy too.

2022 Article IV Recommendations	Authorities' Actions	Staff's Appraisal of Authorities' Progress	2023 Article IV Recommendations
	policy decisions to highlight the factors that the Monetary Board considered to reach a decision, as well as a brief discussion on the risks that would change the policy stance. Furthermore, the Central Bank continued publishing the summary of the arguments presented by board members during policy discussions (with a lag of 30 days). In addition, the monetary policy reports include a discussion on the balance of risks that the board considered for the policy decisions it took in between those reports. Authorities also offer public presentations to targeted audiences.		
Financial Sector			
Expedite passage of the revised banking and AML/CFT laws and operationalize Fintech, e-money and financial inclusion initiatives.	The Central Bank and the Superintendency of Banks (SIB) have continuing working on draft legislation for electronic money (e-money) operators. The Central Bank, the SIB, and the Ministry of Economy have continued implementing the National Financial Inclusion Strategy (ENIF) 2019-2023.	IMF staff is coordinating a capacity development event to raise awareness and enhance institutional capacity on key AML/CFT stakeholders at the request of the authorities. There has been progress on e-money draft legislation, but it is still pending approval.	Focus on the approval by Congress of the revised AML/CFT law to bring it in line with the best international standard.
Structural Reforms			
Adopt labor market and business climate reforms to keep up with increasing labor supply and mitigate migration flows.	The government implemented minimum wage increases, differentiated by administrative divisions for 2023. The Guatemalan Institute of Social Security (IGSS) regulated access to social security for part-time workers. On the business climate front, in 2022, Congress of the Republic approved the Insolvency Law	Approval of the insolvency law and establishment of the Construction Single Window licenses. Minimum salary now considers different cost of living between the capital and the rest of the country.	Measures to fasten the implementation of infrastructure projects. Adoption of a results-based framework linking initiatives to outcomes. Measures to reduce informality.

2022 Article IV Recommendations	Authorities' Actions	Staff's Appraisal of Authorities' Progress	2023 Article IV Recommendations
	(Decree Number 8-2022), the Law to Strengthen the Maintenance and Construction of Strategic Infrastructure (Decree Number 21-2022), the Law		
Governance			
Strengthening the AGO will therefore be an important step in the process	The Presidential Commission Against Corruption continued working on developing and following-up on mechanisms to control corruption across the Executive branch. A highlight of their work in 2022 is that this commission presented a policy proposal to prevention and control of corruption, which is currently under review.	The former AGO was reappointed for 4 more years. The authorities' focus is on strengthening transparency and digitalization.	Adoption of a plan that is aligned to the recommendations of a future 2023 Governance diagnostic mission.

Annex IX. Capacity Development

This annex presents the Capacity Development (CD) priorities of Guatemala under the technical assistance program provided by the IMF.[1] *Key priorities include mobilizing revenues, enhancing the inflation targeting framework, improving fiscal transparency, modernizing financial sector regulations, and strengthening data collection and compilation.*

1. The main CD objectives focus on consolidating past achievements and making further progress on macro-critical reform areas. Key CD workstreams are:

- **Revenue administration.** This workstream centers on (i) strengthening the large taxpayers' management; (ii) implementing a compliance risk management strategy; (iii) digitalizing core processes and taxpayers' services, and (iv) enhancing SAT's administrative enforcement faculties. Past recent achievements include the strengthening the legal framework, the approval of the Strategic Plan to improve compliance and to reinforce support functions, the start-up of the internal affairs and compliance risk management offices, greater focus on the management of large taxpayers and to custom's processes. Support is directed to: (i) strengthening the large taxpayers' management; (ii) implementing a compliance risk management strategy; (iii) digitalizing core processes and taxpayers' services, and (iv) enhancing SAT's administrative enforcement faculties.

- **Public Financial Management.** This workstream centers on strengthening the medium-term fiscal framework with a focus on increasing efficiency, transparency, accountability, prioritizing public spending while maintaining fiscal sustainability. Past recent achievements include the strengthening of financial programming and budget planning as well as the completion of the Fiscal Transparency Evaluation (FTE) update.

- **Central Bank Operations and Monetary and Macroprudential Policies.** This workstream centers on enhancing the Inflation Targeting framework through: (i) building further forecasting capacity to define monetary policy under risk scenarios; (ii) enhancing the monetary operations framework; and (iii) improving communication strategy for improved anchoring of inflation expectations. Past recent achievements on the inflation targeting framework front include improvements to the modelling framework and inflation expectation measurement.

- **Financial Supervision and Regulation.** This workstream centers on the tailored implementation of the Basel standards, enhancing credit risk management, bolstering non-banking sector supervision, strengthening the cybersecurity risk framework, and providing support for the preparation of the legal framework for e-money. Past recent achievements include important inputs for a draft Banking and Financial Groups Law—aligning legislation to

[1] A comprehensive description of the capacity development integration is available in the IMF Country Report No. 22/164.

Basel III standards—and the draft AML/CFT law—aligning with FATF standard—both of which are pending approval by Congress, as well as improvements to the Stress Testing framework.

- **Governance Finance and Real Sector Statistics.** This workstream centers on (i) updating the CPI basket; (ii) updating the household survey data; (iii) consolidating the government financial statistics analytical framework and increasing public debt coverage data. Past recent achievements include the strengthening of the production of government statistics (general government) and on the production of a producer price index.

Annex IX. Table 1. Guatemala: IMF Capacity Development Missions (January 2021 – February 2023)

Workstream	Provider	Date
Revenue Administration and Customs		
Strengthen Tax Compliance Obligations	CAPTAC-DR	February 2023
Sea cargo process modeling and digitalization of customs processes	CAPTAC-DR	November 2022
Enhance Tax Compliance Obligations	CAPTAC-DR	July 2022
Air Cargo process improvement	CAPTAC-DR/FAD	December 2021
Document systems entry point & participants guide	FAD	November 2021
Trade operators' registry for special procedures	CAPTAC-DR/FAD	October 2021
Customs Anti-fraud strategy	CAPTAC-DR/FAD	October 2021
Strengthen Tax Refund Procedures	FAD	September 2021
Customs Anti-fraud strategy	CAPTAC-DR/FAD	August 2021
Definition of a Customs Digitalization action plan (Various missions)	CAPTAC-DR/FAD	March-May 2021
Implementing a new model for controlling special procedures operations	CAPTAC-DR	March 2021
Post clearance audit program	CAPTAC-DR	February 2021
Public Financial Management		
Fiscal Transparency Evaluation (FTE) Update	FAD	September 2022
Hackathon event (various topic)	FAD	July 2022
Fiscal Sustainability Model	FAD	January 2022
Budget - Economic Forecasts	CAPTAC-DR	March 2021
Treasury	CAPTAC-DR	March 2021
Budget - Medium Term Fiscal Framework	CAPTAC-DR	February 2021

Annex IX. Table 1. Guatemala: IMF Capacity Development Missions (January 2021 – February 2023) (Concluded)		
Monetary Policy and Central Bank Operations		
Monetary Policy Implementation Framework Evaluation	CAPTAC-DR	August 2022
Monetary Policy Modeling, Forecasting & Communication	MCM	September 2021
Profitability and Capital Adequacy Assessment	MCM/CAPTAC-DR	August 2021
Financial Supervision and Regulation		
Cybersecurity	CAPTAC-DR	December 2022
Retail Credit Risk Diagnosis and Regulation	CAPTAC-DR	November 2022
Bank's recovery plan	MCM	July 2022
Training on e-money	MCM	December 2021
Real and Government Statistics		
Government Finance Statistics and Public Sector Debt Statistics	STA	September 2022
Price Statistics	STA	June 2022
Government Finance Statistics and Public Sector Debt Statistics	STA	May 2022
Public Sector Debt Statistics	STA	October 2021
Government Finance Statistics and Public Sector Debt Statistics	STA	June 2021
National Accounts	CAPTAC-DR	March 2021
Government Finance Statistics and Public Sector Debt Statistics	CAPTAC-DR	February 2021
Data Governance	CAPTAC-DR	February 2021

Annex IX. Table 2. Guatemala: IMF Capacity Development Planned Missions in 2023 (As of February 2023)	
Workstream	**Objective**
Revenue Administration, Customs and Tax Policy	
Customs and Revenue Administrations	Strengthen revenue administration management and governance arrangements for customs and tax authority.
Compliance Risk Management	Strengthen revenue administration management and governance arrangements for customs and tax authority.
Public Financial Management and Budget Planning	
Fiscal Risks Management (risks of the financial sector and risks of natural disasters)	Strengthen identification, monitoring, and management of fiscal risks.
Macroeconomic forecasts and financial programming models	Strengthen the integration of improved macroeconomic forecasts to budget preparation and execution.
Public Investment Management Assessment (PIMA) with Climate module (C-PIMA)	Assess and strengthen public infrastructure governance to increase effectiveness in public investment.
Monetary and Macroprudential Policies and Central Bank Operations	
Liquidity Forecasting	Improve liquidity forecast framework.
Monetary and Macroprudential Policies and Inflation Targeting	Strengthen the monetary framework.
Financial Supervision and Regulation	
Supervisory and regulatory framework on Use of Cloud Services	Develop/strengthen the cybersecurity risk supervisory guideline in reference to the use of cloud services and train supervisors and technical teams.
Basel Standards and Capital Buffers Regulation	Develop/strengthen supervisory and regulatory framework.
AML/CFT – Structures and Tools (Supervision)	Strengthen the development, adoption, and implementation of a sound and effective approach to risk-based supervision of financial institutions (FIs) and designated nonfinancial businesses and professions (DNFBPs) under the supervision of the "Intendencia de Verificacion Especial-IVE".
Real and Government Statistics	
Government Finance Statistics and Public Sector Debt Statistics	Strengthen compilation and dissemination of macroeconomic and financial statistics for decision making according to internationally accepted statistical standards, including developing statistical infrastructure, source data, service ability and/or metadata.

INTERNATIONAL MONETARY FUND

GUATEMALA

April 28, 2023

STAFF REPORT FOR THE 2023 ARTICLE IV CONSULTATION—INFORMATIONAL ANNEX

Prepared By Western Hemisphere Department

CONTENTS

FUND RELATIONS

(As of March 31, 2023)

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

General Resources Account:	SDR Million	Percentage of Quota
Quota	428.6	100.00
Fund holding of currency	373.97	87.25
Reserve Tranche Position	54.69	12.76
SDR Department:	**SDR Million**	**Percentage of Allocation**
Net cumulative allocation	611.70	100.00
Holdings	530.99	86.80

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	04/22/2009	10/21/2010	630.60	0.00
Stand-by	06/18/2003	03/15/2004	84.00	0.00
Stand-by	04/01/2002	03/31/2003	84.00	0.00

Outright Loans:

Type	Date of Commitment	Date Drawn/Expired	Amount Approved (SDR Million)	Amount Drawn (SDR Million)
RFI	06/10/2020	05/21/2021	428.60	0.00

Projected Payments to Fund[1]
(SDR Million; based on existing use of resources and present holdings of SDRs, as of March 31, 2023**):**

	Forthcoming				
	2023	2024	2025	2026	2027
Principal					
Charges/Interest	2.09	2.80	2.80	2.80	2.80
Total	**2.09**	**2.80**	**2.80**	**2.80**	**2.80**

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 that are authorized to operate in the foreign exchange market include commercial banks, financial 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 (the participation rule) as well as a rule to accumulate reserves (the reserves accumulation rule). Effective January 1st, 2022, the fluctuation margin (added to or subtracted from the five-day moving average of the exchange rate) that determines whether Banguat may intervene was kept at 0.90 percent and the maximum daily amount for interventions was increased to US$ 100 million (previously US$50 million). 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 amounted to US$539 million in 2022, compared to US$2,119 million and US$2,010 million in 2021 and 2020 respectively. Therefore, the de facto exchange rate arrangement remains classified as "stabilized" (it was reclassified to "stabilized" from "crawl-like" on September 26, 2018). As of March 12, 2023, the reference exchange rate was Q7.807 per U.S. dollar. Guatemala has accepted the obligations under Article VIII, Sections 2, 3 and 4, and maintains an exchange system that is free of restrictions on the making of payments and transfers for current international transactions and multiple currency practices.

[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.

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 6, 2022.

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 2011–23 (updated February 2023)

Department	Date of Delivery	Purpose
FAD, CAPTAC	2023	Strengthening Tax Compliance Obligations
	2022	Fiscal Transparency Evaluation (FTE) Update
	2022	Hackathon event (various topic)
	2022	Fiscal Sustainability Model
	2022	Sea cargo process modeling and digitalization of customs processes
	2022	Enhance Tax Compliance Obligations
	2022	Fiscal Sustainability Model
	2021	Customs Anti-fraud strategy
	2021	Document systems entry point & participants guide
	2021	Strengthening Tax Refund Procedures
	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 shortand 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	2022	Bank's recovery plan
	2022	Retail Credit Risk Diagnosis and Regulation
	2022	Cybersecurity

	2022	Monetary Policy Implementation Framework Evaluation
	2022	Stress Testing (Banguat and the SIB)
	2021	Monetary Policy Modeling, Forecasting & Communication
	2021	Electronic money (e-money)
	2021	Profitability and Capital Adequacy Assessment
	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**
LEG	2016-Ongoing	AML/CFT Risk-based Supervision of FIs and DNFBPs
Department	**Date of Delivery**	**Purpose**
STA, CAPTAC	2022	Government Finance Statistics (GFS), Financial Sector Stability Fund (FSSF, Financial Sector Statistics), Balance Sheet Analysis (BSA)
	2022	Price Statistics
	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, 2011	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

RELATIONS WITH OTHER INTERNATIONAL FINANCIAL INSTITUTIONS

- **World Bank.** A second Development Policy Loan (DPL) of US$ 250 million was approved by the World Bank Board on October 20, 2022.[2] It extends the support for Guatemala's efforts to navigate a prolonged COVID-19 crisis and pursue a build back better approach to stimulate inclusive, sustainable, and green growth and avoid a return to the pre-pandemic status quo. The World Bank's active portfolio in Guatemala amounts to US$ 1 billion and includes five operations (most are pending Guatemala's Congress approval). In addition, the World Bank provides technical assistance and analytical services focused on governance, transport, human capital development, social safety nets and disaster risk insurance.

- **Inter-American Development Bank.** The programs focus on (i) institution-strengthening; (ii) improvement of basic service delivery to the most vulnerable population; and (iii) promotion of the private sector for stronger, more inclusive, and sustainable growth. The active portfolio loan amounts to around US$ 1.2 billion (most are pending Guatemala's Congress approval).

[2] The first DPL was approved on December 17, 2020, for US$ 500 million.

STATISTICAL ISSUES

(As of March 12, 2023)

I. Assessment of Data Adequacy for Surveillance
General. Data provision has some shortcomings but is broadly adequate for surveillance.
National accounts. 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 monthly, hindering the calculation of a consolidated operations statement and balance sheet for the nonfinancial public sector. On a yearly basis (2013-2021) 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 2023.
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 Banguat 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 April 20, 2023)

	Date of latest observation	Date received	Frequency of Data[7]	Frequency of Reporting[7]	Frequency of Publication[7]
Exchange Rates	03/12/2023	03/12/2023	D	D	D
International Reserve Assets and Reserve Liabilities of the Monetary Authorities[1]	February 2023	March 2023	M	M	M
Reserve/Base Money	February 2023	March 2023	W	W	W
Broad Money	February 2023	March 2023	W	W	W
Central Bank Balance Sheet	3/31/2022	4/4/2022	D	D	D
Consolidated Balance Sheet of the Banking System	February 2023	March 2023	M	M	M
Interest Rates[2]	February 2023	March 2023	W	W	W
Consumer Price Index	February 2023	March 2023	M	M	M
Revenue, Expenditure, Balance and Composition of Financing[3] – Central Government	Dec. 2022	Jan. 2023	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 2022	Jan. 2023	M	M	M
External Current Account Balance	Q4/2022	April 2023	Q	Q	Q
Exports and Imports of Goods and Services	Q4/2022	April 2023	Q	Q	Q
GDP/GNP	Q4/2022	April 2023	Q	Q	Q
Gross External Debt	Q4/2022	April 2023	Q	Q	Q
International Investment Position[6]	Q4/2022	April 2023	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. Guerra and Ms. Lankester Campos on Guatemala
May 15, 2023

On behalf of our Guatemalan authorities, we would like to thank Ms. Oliva and her team for their open and constructive discussions during the mission, their proactive engagement, valuable analysis, and comprehensive report. Our authorities broadly share staff's assessment.

It has been proven that political cycles must be considered when analyzing the economy, given the effect political forces may have on it. Notwithstanding, Guatemala has proven its resilience during presidential elections. Our authorities have no doubt that this will be the case in the presidential elections on June 25th. The public and private sectors have been working on a first-time initiative aimed at ensuring the continuity of policies they have implemented to unlock longstanding structural vulnerabilities. The initiative is also addressing issues such as social inclusion, poverty, informality, and infrastructure gaps, all of which are key to boosting Guatemala's economic potential and enhancing resilience. The initiative builds on the program "Guatemala no se detiene (Guatemala moving forward)," a key accord between the public and private sectors to improve the country´s economic, social, and environmental performance. In fact, they consider this Article IV consultation to be of particular importance to support this initiative, as well as the recent significant improvements in sovereign credit risk ratings from the main credit agencies.

Economic stance

Over the last two decades, Guatemala has built a strong economy, resilient to external and domestic shocks with ample buffers and reinforced by both a prudent fiscal stance and a credible monetary policy framework.

After a strong growth recovery of 8 percent in 2021, the economy grew 4.1 percent in 2022, and Banguat expects a 3.5 percent growth rate for this year, its potential level of growth. For 2024, the authorities envisage a stable macroeconomic framework, which is in line with the latest figures of short-term economic indicators, including the Monthly Index of Economic Activity, the Confidence Index of Economic Activity, and the high growth of family remittances.

Recently, S&P and Fitch improved Guatemala's sovereign debt rating from BB- to BB stable, considering its economy's strengths, such as its solid external position, the moderate level of debt to GDP, and its prudent monetary policy.

As mentioned before, the authorities recognize the importance of addressing structural challenges. In fact, to lower informality, two increases to minimum wages were approved, along with regulations to facilitate partial-time hiring. Also, efforts have been directed towards electronic invoicing, digitalizing public sector procedures, and further implementing the Tax Simplification, Update, and Incorporation Law. To improve the business climate, key laws were recently approved: the leasing and insolvency laws, the law to encourage foreign investment, and the Free Zones Act.

Similarly, to reduce infrastructure gaps, specific initiatives serve as examples: the first PPP *Autopista Escuintla-Puerto Quetzal* (Escuintla-Quetzal port Highway) should start in 2023, and investment spending increased in infrastructure for the health sector.

On monetary and exchange rate policy

In the last monetary policy meeting, on April 26th, the Monetary Board decided to increase the monetary policy interest rate by 25 b.p., from 4.75 percent to 5 percent, as part of a gradual strategy to bring inflation down without significantly harming economic activity. The decision was made with a data-dependent and forward-looking approach. Inflation has decreased significantly in the past two months, from 9.92 percent in February to 8.32 percent in April. Going forward, there is still uncertainty around inflation developments and risks from a challenging external environment; therefore, Banguat will act cautiously, continue to monitor inflation developments closely, and communicate clearly and transparently on the need for keeping a restrictive monetary policy stance until inflation is robustly close to target. The authorities expect inflation to return to the upper limit of the target band (4.0 percent ± 1 p.p.) by the end of 2023 and be at the midpoint of the band by 2024.

Authorities concur that greater exchange rate (FX) flexibility can help absorb external shocks and are committed to further improvements in the communication framework. Still, they assess that temporary measures have helped to maintain exchange rate expectations more stable while avoiding abrupt capital outflows or reductions in external foreign currency financing. Overall, they consider that the approach towards greater flexibility should be gradual so as not to hinder a competitive and transparent foreign exchange market. Also, given the current account results and outlook, no significant misalignment with fundamentals is considered to be present. They expect the current account surplus to close in about two years, owing to higher imports and further moderation in the remittances' rate of growth.

Since the mid-2010s, Banguat has accumulated large buffers in the form of international reserves, which are assessed to be adequate in the current environment of protracted high uncertainty. Finally, Banguat is evaluating possible strategies to recapitalize the central bank, but further discussion would have to take place with the new administration.

On fiscal policy

The authorities remain fully committed to ensuring long-standing fiscal stability and debt sustainability, as well as maintaining their good debt servicing track record. Guatemala has remained among those with the lowest shares of debt to GDP in the Latin American region and has made progress on customs, tax administration enforcement, and digitalization. In fact, the deficit has been below the anchor for two consecutive years, and tax revenue reached an all-time high of 12.0 percent of GDP in 2022. Our authorities are aware that this result is still very low compared with Guatemala´s peers.

In that context, authorities concur that more progress is required on the revenue side, keeping on 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. They consider that broadening the tax base is the right strategy to increase the tax burden, at least in the medium term.

The 2023 budget, approved by Congress in November 2022, envisages an overall deficit of three percent of GDP and a decline in total expenditure of 0.5 percent of GDP. Nonetheless, social spending will be higher in 2023 as part of the authorities' efforts to support the most vulnerable. The authorities acknowledge that their current MT Framework could be improved to be better anchored to close infrastructure and social gaps.

Public debt continues to be on a decreasing path, and it is expected to remain sustainable at 29.4 percent of GDP with high probability and moderate sovereign risk. The 2022 ratio of 29.4 estimated by staff includes pending debt balances against the social security institute, IGSS, of about 0.2 percent of GDP. Yet, the Ministry of Finance does not recognize the debt claimed by IGGS, and some judicial processes are in court for resolution.

Even when the authorities recognize that it will be the new administration in charge of building upon the progress made, they are committed to working on the PIMA/Climate-PIMA evaluation during the first half of June with the IMF team as a first step to identify the main steps moving forward on streamlining processes. As they believe its results could enhance their public investment framework and its resilience to climate events.

On the financial sector

The authorities consider the banking sector to be sound, and the overall financial system remains resilient. Despite the challenges posed by the pandemic and current circumstances, bank credit to the private sector grew by 20 percent in domestic currency in 2022, financed by the growth in customer deposits, which represented nearly 90 percent of the total bank's liabilities at the end of December 2022.

The banking system maintains soundness with solvency ratios well above the regulatory levels, capital ratios (16.5 percent) well above the regulatory minimum capital adequacy ratio (10 percent), nonperforming loans reported at 1.3 percent, and sound profitability with returns on assets at 2.3 percent and returns on equity above 24 percent. Also, the liquidity of the banking system remains adequate, with short-term and MT liquidity ratios estimated at 20 percent and 48 percent, respectively.

Going forward, authorities agree on the importance of the approval of the Banking and Financial Groups Law Reform and the approval and implementation of the AML/CFT Law that addresses gaps and aligns Guatemala's regime with the FATF standards. The latter is critical to achieving a positive outcome on the next AML/CFT evaluation, to be conducted by the FATF in 2027.

Finally, the Guatemalan authorities remain committed to strengthening structural reforms in fiscal transparency and governance, benefiting from the discussion of a Fund's technical assistance. Also, significant efforts are directed towards strengthening data availability and quality. Endeavors to improve the business climate, address labor market informality, and strengthen resilience to climate change will continue until this presidential period while working on synergies for the agenda to continue amid the governmental change.