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IMF Country Report No. 13/247

GUATEMALA

2013 ARTICLE IV CONSULTATION

August 2013

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 2013 Article IV consultation with Guatemala, the following documents have been released and are included in this package:

- **Staff Report** for the 2013 Article IV consultation, prepared by a staff team of the IMF, following discussions that ended on May 20, 2013, 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 July 9, 2013. The views expressed in the staff report are those of the staff team and do not necessarily reflect the views of the Executive Board of the IMF.
- **Staff Supplement** of July 11, 2013 as an Information Annex.
- **Public Information Notice** (PIN) . summarizing the staff appraisal, which was considered and endorsed by the Executive Board without a meeting.

The document listed below has been or will be separately released.

Selected Issues and Analytical Notes

The policy of publication of staff reports and other documents allows for the deletion of market-sensitive information.

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International Monetary Fund
Washington, D.C.

GUATEMALA

STAFF REPORT FOR THE 2013 ARTICLE IV CONSULTATION

July 9, 2013

KEY ISSUES

Context. Economic performance has been solid since the 2008-09 global crisis. Output has converged toward potential, inflation is under control, macroeconomic policy remains prudent, and the financial system has strengthened. However, global and domestic risks to the outlook are tilted downwards, while buffers are modest and space for counter-cyclical policies is narrow. Long-term inclusive growth is constrained by low investment in physical and human capital, institutional weaknesses, and lack of security.

Near-term policies are broadly on track, but the monetary stance may need reassessment. With the output gap closed, the broadly neutral fiscal policy stance is adequate, but further tightening of monetary policy may be required if inflationary pressures persist. Sustaining an adequate fiscal stance will require protecting the 2012 tax reform against calls for amendments.

It is desirable to enhance fiscal sustainability over the medium term. Though the debt-to-GDP ratio remains moderate, the ability to implement counter-cyclical fiscal policies is limited by Guatemala's high government debt-to-revenue ratio. Full debt stabilization requires moderate tightening of the budgetary stance over the medium term. The emphasis should be on greater revenue mobilization, given the overall low level of spending.

Focus should continue on upgrading the monetary and exchange rate (XR) framework. Anchoring low and stable inflation will require measures to bolster monetary policy transmission, including by expanding XR flexibility which would establish the inflation target as the undisputed primary objective of the central bank. It should provide an additional shock absorber and reduce incentives for dollarization.

Further strengthening of the financial system is necessary. Guatemala is well prepared to apply Basel III rules though important work remains, not least to implement fully risk-based and consolidated supervision.

Structural reforms are vital to achieving long-term inclusive growth. Paving the way towards high, inclusive growth will depend upon raising the low tax-to-GDP ratio to support priority public spending, thereby addressing critical social and developmental needs.

Approved By
G. Milesi-Ferretti (WHD) and Masato Miyazaki (SPR)

Discussions took place in Guatemala City during May 9-20. The mission comprised L. Figliuoli (Head), S. Medina Cas, L. Erickson (all WHD), N. Li (ICD), and J. Wong (FIN), and F. Delgado (Regional Resident Representative). L. Cosenza (OED) participated in the meetings.

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OVERVIEW

1. **Guatemala's economic performance has been solid since the 2008-09 global financial crisis.** In its aftermath, activity rebounded quickly, spurred by both net exports and domestic demand—supported by rising world commodity prices and counter-cyclical policies—and buttressed by an 18-month precautionary Stand-by Arrangement (SBA). Growth is now nearing potential and macroeconomic policies stay a prudent course, not least with declining fiscal deficits—helping to maintain relatively low inflation. XR flexibility remains limited, while the financial system has strengthened. The macro outlook is broadly positive.

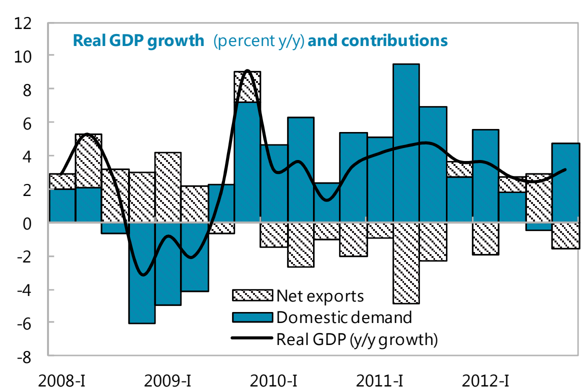
2. **The main challenge is to unleash higher and more inclusive long-term growth, while enhancing resilience to shocks and preserving macroeconomic stability.** Potential growth is constrained by weak investment in physical and human capital, and by the elevated crime and insecurity; poverty is widespread. Increasing high-quality public spending to support equitable growth is critical, but it will need to go hand-in-hand with boosting public revenue and strengthening expenditure management to safeguard macroeconomic stability. A nimbler handling of shocks would be allowed by widening the scope for counter-cyclical budget and monetary policies—fiscal space is currently limited by the very low tax burden, monetary space by sticky inflation expectations and modest XR flexibility. The financial sector, while firming, is mildly dollarized and under-developed. Addressing these structural weaknesses should help enlarge the policy toolbox further.

3. **The government's policy plans are aligned with these objectives, but advancing the reform agenda has proven harder than expected at the start of the administration.** President Pérez-Molina, who took office in January 2012, pledged to mobilize revenue and step up the efficiency and transparency of public spending (IMF, Country Report No. 12/146). However, initial reform efforts have suffered setbacks or stalled. The ruling party may muster sufficient political clout to press on with its program, but the window of opportunity could be closing soon, as positioning for the next Presidential election begins during the second half of the four-year administration.

RECENT ECONOMIC DEVELOMENTS

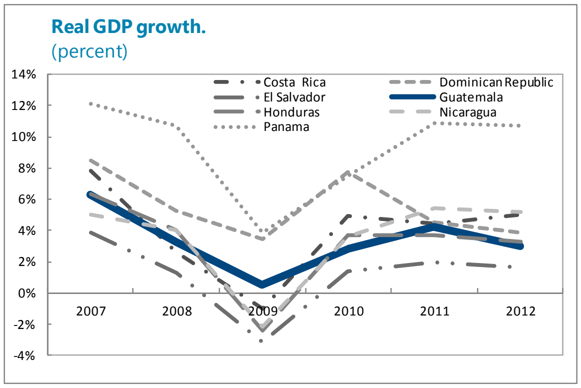
4. **Key developments since the 2012 Article IV Consultation have been positive:**

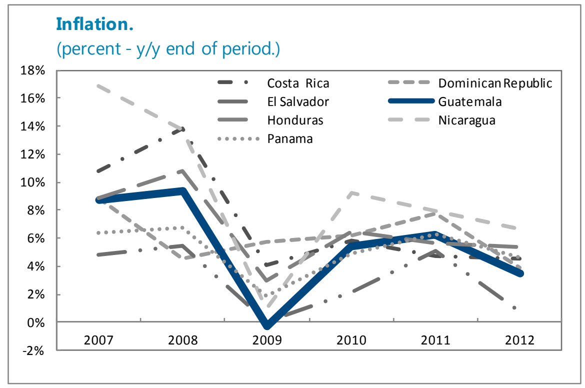
- ***Growth has been robust, while converging to trend.*** Rebounding from the global crisis and natural disasters in 2010, activity surged by 4¼ percent in 2011, helping close the output gap that opened during 2008-09 (AN 1). Economic expansion decelerated to 3 percent in 2012, underpinned by healthy domestic demand (Figure 1 and Table 1).



Source: Country authorities and Fund staff estimates.

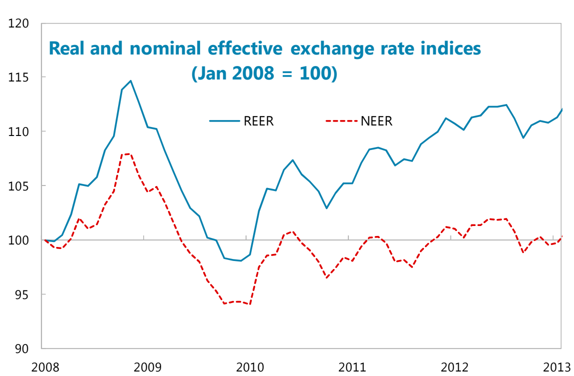
- ***Inflation declined in 2012 but has begun to pick up.*** In 2011, high world food and oil prices pushed up headline inflation, which reached 6¼ by end-year. As commodity prices stabilized and domestic demand pressures weakened, inflation fell sharply in 2012—closing at 3.4 percent by December. However by May 2013, inflation rose to 4.3 percent owing mainly to domestic prices, but it still remained within the central bank's target range (of 4.0±1 percent) (Figure 1 and Table 1).

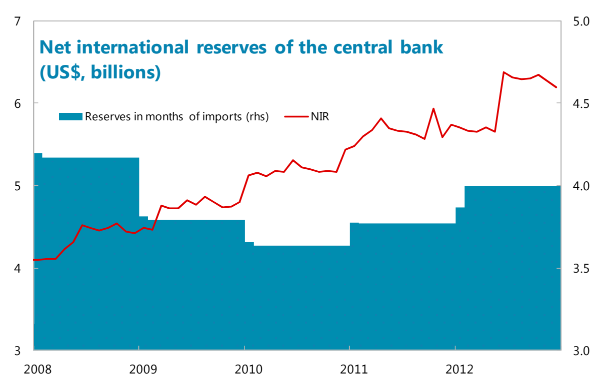




Sources: Country authorities and Fund staff calculations.

- ***The balance of payments has strengthened.*** The current account deficit declined to just below 3 percent of GDP in 2012 (from almost 3½ percent in 2011)—as a softening in traditional export prices was more than offset by a strong recovery in remittances from the U.S. and more favorable net factor income, amid tepid growth in import values (Figure 2). Rising FDI, as well as official and private capital inflows, more than financed this deficit. Thus, net international reserves (NIR) reached US$6.2 billion at end-2012—in line with reserve adequacy metrics. End-May 2013, NIR rose to US$7.3 billion following the issuance of an international bond in February totaling US$700 million (1¼ percent of GDP) with a 15-year maturity and a 5 percent yield (Figure 2 and Table 3).





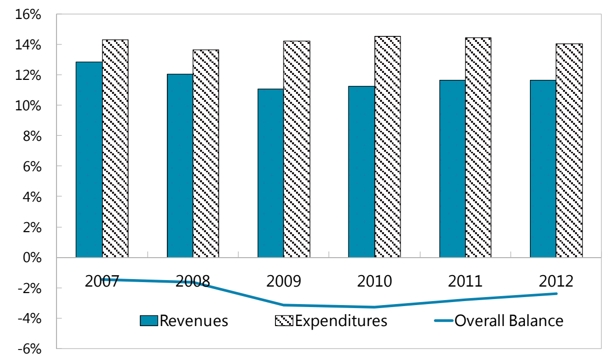
Source: Country authorities and Fund staff estimates.

5. Competitiveness is broadly adequate though with some signs of erosion. The Fund's multilaterally consistent estimates under the External Balance Assessment (EBA) methodology imply that Guatemala's REER is in line with current fundamentals, while the CGER methodology points to moderate overvaluation vis-à-vis medium term fundamentals. At the same time, the REER has appreciated substantially in recent years, accompanied by some trend widening of the external current account deficit (Box 1).

6. **Monetary policy has been on hold until lately and foreign exchange intervention has declined.** After reducing the policy rate by 50 bps in June 2012 (to 5 percent), the central bank kept it constant until late April 2013, when it was lifted by 25 bps. The modest hike aimed to stem incipient signs of inflationary pressures without exacerbating the possible adverse impact on domestic growth from prevailing downside global risks. The XR fluctuation margin used to determine intervention was widened in late 2012 (from 0.60 to 0.65 percent of the five-day moving average of the XR). Under this rules-based framework, the central bank's cumulative FX purchases declined notably. Yet, XR flexibility remains limited— quite low relative to the rest of Latin America and somewhat below the regional average (Figure 4 and Table 5).

7. **The fiscal deficit continued to narrow in 2012 but not enough to prevent a further rise in the public debt ratio.** The central government deficit declined to just below 2½ percent of GDP in 2012, down from about 2¾ percent in 2011, entailing a neutral fiscal stance (Figure 3). Consolidation was driven by a cut in public spending (as a share of GDP). Net financing shifted from primarily domestic sources to external flows, with the placement of an international bond of US$700 million (some 1½ percent of GDP) at favorable terms and long maturity. Central Government debt remains low at about 24 percent of GDP; it is, however, on an upward trend, and high in relation to tax revenue (221 percent), when compared to peers with similar credit ratings (Figure 3 and Tables 4A-C).

Fiscal revenue/expenditures vs. overall balance
(percent of GDP)

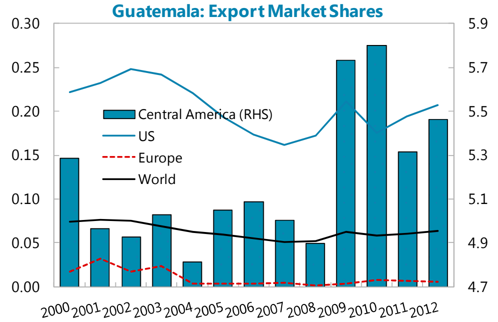


Sources: Country authorities and Fund staff calculations.

Box 1. Guatemala: External Stability Assessment

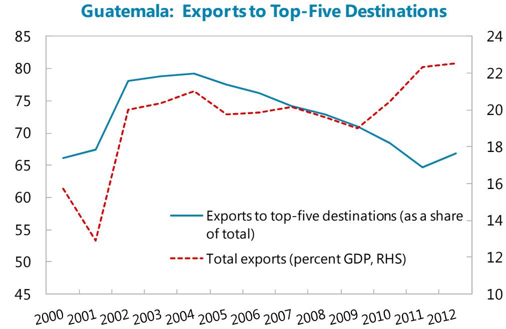
Guatemala's share in global trade has fallen in the last decade, but its export markets have become more diversified. Between 2000 and 2012, Guatemala's share in global trade decreased by nearly 25 percent to 0.06 percent of world trade, as its participation in US and European markets shrank. However, its position in Central America has been strengthened and export destinations have diversified as the top-five markets[1] account for 67 percent of total exports in 2012, down from 80 percent in 2002.

Guatemala: Export Market Shares



Source: Direction of Trade (DOT) statistics and Fund staff estimates.

Guatemala: Exports to Top-Five Destinations



Source: Direction of Trade (DOT) statistics and Fund staff estimates.

Survey-based competitiveness indicators highlight some challenges for Guatemala. The country's ranking in the 2012-2013 Global Competitiveness Index improved only slightly to the 83rd position (out of 144 countries), from 84th in the previous survey. Concerns about crime, corruption, excessive government bureaucracy and inadequate infrastructure and human capital as cited as main drawbacks. The country has a somewhat better position in the Doing Business Index, ranking 93rd out of 183 countries, above the Latin America and Caribbean average of 97.

The CPI-based real effective exchange rate (REER) has appreciated by 40 percent since 2000, partially driven by Guatemala's inflation differential with its main trading partner (the US). Relative productivity increases in Guatemala may have alleviated the impact of this appreciation on competitiveness, but ULC-based REER indicators are not available. Shifts in US GDP have also led to movements in the remittances inflows and—in conjunction with the global demand for commodities—in the terms of trade (TOT). Although the nominal effective exchange rate (NEER) has depreciated somewhat since 2007, this change has been modest, at less than 10 percent in cumulative terms.

The current account (CA) deficit has widened in recent years, despite significant remittance inflows. Although Guatemala ran a small CA surplus in 2009, the deficit reached about 3 percent of GDP in 2012, mainly driven by a widening of the trade deficit from about 9 to nearly 11½ percent of GDP—still lower than the over 14 percent of GDP observed in 2004-2008. The services and income deficit has also widened from below 3 percent of GDP in 2004 to nearly 4 percent of GDP in 2012. During this period, large U.S. remittances (around 10 percent of GDP) have helped support an average current account deficit of about 3½ percent of GDP.

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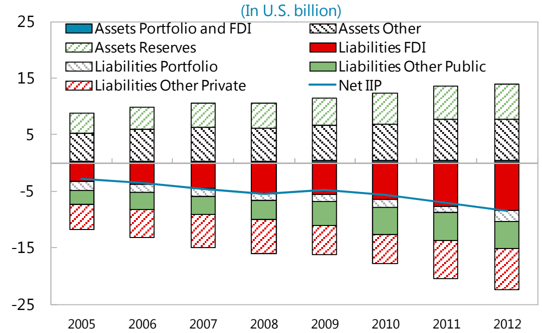
[1] The top 5 destinations for Guatemala's exports are: the U.S. (40 percent), El Salvador (12 percent), Honduras (8 percent), Mexico (6 percent) and Nicaragua (4 percent).

Box 1. Guatemala: External Stability Assessment (Continued)

The financing structure of the current account deficit, the high levels of reserves and low external liabilities mitigate external risks to Guatemala. Although Guatemala's net IIP position is negative, it is relatively small (19 percent of GDP in 2012) and almost 40 percent of total liabilities consist of FDI, equivalent to over 17 percent of GDP in 2012. The stock of net international reserves (NIR) stood at nearly 4 months of reserves in 2012 and 1.7 times the short term debt on residual maturity. The NIR is also well within Fund reserve adequacy metrics, with values of about 140 percent of the composite reserve adequacy metric since 2005, considered fully adequate for precautionary pruposes.[2]

Guatemala: International Investment Position

(In U.S. billion)



Sources: Central Bank of Guatemala and Fund staff estimates.

IMF's multilaterally consistent estimates suggest that Guatemala's REER is broadly in line with fundamentals both in the short term and relative to medium term benchmarks:.

- ***External Balance Assessment*** (EBA) estimates based on current fundamentals and desirable policies point to a sustainable cyclically adjusted current account deficit of 4.1 percent of GDP, which is 1.3 percentage points above the current cyclically adjusted deficit of 2.8 percent.

- ***CGER methodologies,*** which rely on medium term fundamentals, point to a moderate overvaluation ranging between 8.8 and 13.9 percent for the benchmark external sustainability and macrobalance approaches, respectively. However, in order to interpret appropriately these estimates the significant proportion of FDI in Guatemala's total external liabilities should be taken into account. Thus, if an alternative estimate for the NFA position which excludes FDI is used, then the external sustainability approach instead implies an undervaluation of 3.7 percent, broadly in line with the EBA estimates.

- A simple average across the different methodologies implies a moderate overvaluation of 3.1 percent. Given a mean squared error of 0.7 percent, Guatemala's REER is broadly in line with fundamentals.

Estimates of Competitiveness

A. Using EBA methodology 1/			B. Using CGER methodologies 2/		
	Current Account gap	Implied Overvaluation 3/		Current Account gap	Implied Overvaluation 3/
			MacroBalance	-2.8	13.9
CA regression-based	1.3	-6.6	*External sustainability (baseline)*	-1.8	8.8
			External sustainability (modified NFA)	0.7	-3.7

Source: Fund staff estimates.

1/ Deviations from norms implied by fundamentals and desirable policies.

2/ Deviations from levels implied by medium-term fundamentals.

3/ Negative implies an undervaluation.

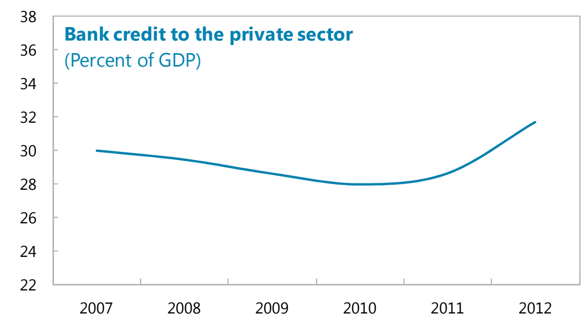
[2] This is a weighted composite of export earnings, short-term debt, medium and long term debt and equity liabilities and broad money. For more, see Assessing reserve adequacy (SM/11/31).

8. Fiscal structural reform attempts have suffered setbacks and delays:

- ***Revenue mobilization.*** Last year, a tax package was passed by parliament—yielding 1-1½ percent of GDP—to come into force in 2013.[1] Claims against the reform have piled up before the Constitutional Court.[2] So far these challenges have been largely unsuccessful, though associated uncertainties have weighed down on collections and possible amendments to the reform may erode revenues. A draft Competitiveness Law sent to Congress by the President grants fiscal incentives to firms incorporated outside Guatemala City, with possible significant fiscal costs in the medium term.

- ***Expenditure management.*** A comparatively low revenue-to-GDP ratio, budget rigidities, and weak internal control systems keep Guatemala's public social expenditure below the regional average[3] and hinder resource allocation to high-priority areas. Accumulated domestic arrears, which spiked in 2010, remain unresolved. Some efforts to quantify their stock were made,[4] but a plan to clear them has yet to be put in place—not least because the discussion is clouded by questions on the validity of the claims. Nor has there been progress in adopting a comprehensive strategy to avoid their recurrence, since needed amendments to the Organic Budget Law are stalled in Congress.

9. Though credit to the private sector is growing fast, the financial system remains solid and fundamental reforms have advanced. Bank deposits and credit to the private sector continued to expand—at 12½ and 15½ percent (y/y), respectively, in April—though private sector credit as a share of GDP had only recovered to levels above those observed before the global crisis by 2012 (Figure 4). Loan and deposit dollarization are at about 30 and 20 percent, respectively, with loan dollarization picking up (AN 4). Banks are profitable, liquid, well-capitalized, and domestically-funded. Non-performing loans are low (Table 6). Long-awaited amendments to the Banking Sector Law and the Central Bank Organic Law entered into force in April, reducing risks from offshore operations and



Source: Country authorities.

[1] The reform modernized the income tax, eliminated several VAT exemptions, and improved administration (IMF Country Report No. 12/146).

[2] The Constitutional Court has received claims against 35 (out of the total 45) articles in the reform, but so far suspended only two; one of them is relatively important, relating to more rigorous rules for transfer pricing, though the authorities estimate that the impact on fiscal revenue will be minimal.

[3] A recent Fund technical assistance mission found that these budget rigidities are important, limit the flexibility to respond to shocks, and could interrupt payments for multi-year projects. An earlier study by the IADB reached similar conclusions (*Los Sistemas de Gasto Público en América Central y la República Dominicana: Disciplina Fiscal y Eficiencia,* IADB, 2006).

[4] The estimated stock is Q3.5 billion (¾ percent of GDP), but this has yet to be certified by the Office of the Comptroller.

connected lending, strengthening supervision and the enforcement powers of the superintendence of banks, as well as enhancing the banks' safety net and resolution procedures—in line with staff recommendations. A law to regulate micro-finance institutions is in Congress, and a law to supervise cooperatives is being drafted. In 2012, Guatemala was reclassified into the OECD's "white list" of countries that implement international standards for tax information sharing in the fight against money laundering, terrorism, and tax evasion. Measures to combat money laundering—which include repossession of illicit assets, reporting of transactions higher than US$10,000, greater use of technology in financial intelligence, and stricter monitoring of politicians' finances—have led to an increase in prosecutions.

Financial Soundness Indicators *(in percent)* 1/

	Guatemala	Costa Rica	El Salvador	Honduras	Dominican Republic	Panama	CAPDR 2/	LA6 3/
Regulatory Capital to Risk-Weighted Assets	**14.7**	16.8	17.1	14.7	15.7*	16*	16.1	15.3
Capital to Assets Ratio	**9.0**	14.8	13.9	9.3	9.9*	11.7*	11.9	10.2
Nonperforming Loans to Total Loans Ratio	**1.3**	1.7	2.9	3.3	3.2**	0.9*	2.4	2.5
Return on Assets	**1.6**	1.5	1.6	1.5	2.3**	1.8*	1.7	2.0
Return on Equity	**17.2**	10.3	11.6	15.9	23.2**	7.3*	13.7	19.0

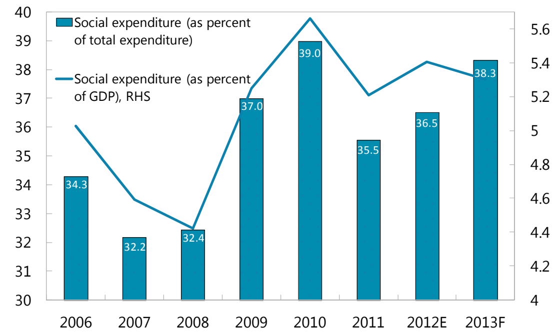
Source: FSI tables, June 2013, IMF, http://fsi.imf.org/fsitables.aspx.
1/ As of December 2012 unless otherwise noted.
* As of June, 2012 ** As of July, 2012.
2/ Comprises Guatemala, El Salvador, Honduras, Panama, and the Dominican Republic.
3/ Comprises Brazil, Chile, Colombia, Mexico, Peru, and Uruguay.

10. Guatemala has gained some ground toward achieving the MDGs, but poverty and crime are widespread. Modest-to-strong progress has been recorded for 12 out of 16 MDG targets: extreme poverty has declined somewhat, primary enrollment has risen (albeit from low levels), and maternal mortality has fallen (Figure 5). However, a third of the population is below the minimum dietary energy consumption, and chronic malnutrition of children younger than 5 years is pervasive at about 50 percent. At the same time, the level of informality is very high, while security concerns are very serious—including those linked to drug trafficking (Box 2).

Box 2. Guatemala: Social Expenditure and MDGs

Poverty in Guatemala is high, affecting mostly the large indigenous and rural populations. While classified as a lower-middle-income country—its per capita income was US$3,183 in 2011—its social indicators often fall below those of much poorer countries. More than 40 percent of the population resides in rural areas, and about 40 percent is indigenous (with 23 separate ethno-linguistic groups). According to UNDP data, total poverty declined from 45 percent in 2000 to 37 percent in 2010. However, indigenous poverty remains high at about 52 percent, while 35 percent of the indigenous population lives in extreme poverty. Moreover, the overall poverty rate measured with the national definition has remained above 50 percent. The country fares poorly in chronic malnutrition of children younger than 5 years, which, at nearly 50 percent, is worse than in Haiti.

Guatemala: Public Social Expenditure



Source: Ministry of Finance.

Guatemala's overall HDI ranking remains stable. Guatemala's ranking by the UNDP Human Development Index (HDI) for 2011 was 131 out of 187 countries, unchanged since 2005. This places Guatemala as a medium human development country, on par with Nicaragua (129), and Honduras (121), but well below the region's more developed countries, Costa Rica (69) and Panama (58).

Progress has been made on achieving a number the Millennium Development Goals (MDGs). The proportion of the population living in extreme poverty has fallen, as has childhood mortality (albeit from low levels). Access to sanitary drinking water has improved and the enrollment rate in primary school exceeds that of Latin America as a whole, although total schooling and the quality of education are below those observed in the rest of the region. More worrisome, the incidence of hunger has almost doubled since the early 1990s.

Public expenditure devoted to social needs has been trending up and spiked in the wake of the natural disasters in 2010, though it remains low as a share of GDP. Due to the country's historically low tax revenues, the government faces difficulties to fund increased spending in education, health, and infrastructure for excluded groups.

The authorities are implementing institutional reforms to better target social programs. The creation of the Ministry of Social Development (MIDES) is expected to ensure greater coherence in public social policy and coordination across agencies. MIDES directly implements a large number of social programs, including the conditional cash transfer (CCT) program Mi Bono Seguro. Additionally, the new Zero Hunger Plan is aimed at consolidating efforts against malnutrition. The Plan prioritizes interventions amongst the most vulnerable, and will ultimately be in place in the 166 municipalities most affected by malnutrition.

MACROECONOMIC OUTLOOK AND RISKS

11. The authorities agreed that the economic outlook is generally benign. Under the baseline scenario, growth is expected to edge up to 3½ percent in 2013 and 2014, reaching its potential rate, supported by ongoing buoyant domestic demand and healthy private sector credit. Inflation would remain within the upper half of the central bank's target range in 2013-14 before stabilizing toward the center of the band. The external current account deficit would decline to around 2½ percent of GDP in the medium term, more than fully financed by FDI and other capital inflows. This scenario envisages some fiscal consolidation with the central government balance stabilizing at 2¼ percent of GDP and public debt rising slowly to around 28 percent of GDP by 2018 (Table 2).

The Outlook for Guatemala is Generally Positive, but Structural Weaknesses Will Constrain Growth.

Guatemala. Baseline Scenario

					Projections					
	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018
	(Annual percent change)									
Real GDP	0.5	2.9	4.2	3.0	3.5	3.5	3.5	3.5	3.5	3.5
Consumer prices (end of period)	-0.3	5.4	6.2	3.4	4.8	4.8	4.4	4.2	4.0	4.0
	(In percent of GDP, unless otherwise indicated)									
Central government balance	-3.1	-3.3	-2.8	-2.4	-2.2	-2.3	-2.3	-2.2	-2.2	-2.2
Central government primary balance	-1.7	-1.8	-1.3	-0.9	-0.7	-0.7	-0.6	-0.4	-0.4	-0.3
Public sector debt	23.3	24.4	23.9	24.6	25.1	26.0	26.7	27.2	27.7	28.2
Current account balance	0.7	-1.4	-3.4	-2.9	-3.1	-3.0	-2.9	-2.7	-2.6	-2.6
Capital and financial account	0.5	3.8	4.3	5.2	4.7	3.3	3.0	2.7	2.6	2.6
External debt	28.0	27.4	27.4	29.1	29.5	28.7	27.7	26.4	25.2	24.0
Reserve adequacy 1/	150.3	150.3	139.0	138.5	148.5	143.8	138.4	133.1	126.9	121.8
Output gap 2/	-0.8	-1.0	0.1	-0.2	-0.1	0.0	0.0	0.0	0.0	0.2
Fiscal impulse	1.2	-0.2	0.0	-0.8	0.1	-0.2	0.0	-0.1	-0.2	0.0

Sources: Bank of Guatemala; Ministry of Finance; and Fund staff estimates and projections.
1/ Stock in percent of weighted aggregate of M2, exports of goods and services, short-term external debt at a remaining maturity, and other external portfolio liabilities. For more details, see *Assessing Reserve Adequacy* (IMF Policy Paper 11/31).
2/ In percent of potential output.

12. Near-term risks are prevalent on the downside, owing to global uncertainties and domestic policy constraints (as detailed also in the Risk Assessment Matrix):

- ***External conditions.*** Weaker than expected growth in the U.S. (potentially also triggered by larger-than-anticipated fiscal tightening) would have adverse spillovers through trade and remittances on Guatemala's economic activity and fiscal accounts, while shocks to neighboring countries would have a greater impact. Faster US growth would have opposite effects, most notably through stronger growth in remittances. In case global growth slows, the impact on the external accounts could be lessened by a potential downward effect on oil prices from reduced global demand. By the same token, a geopolitical oil shock could worsen Guatemala's terms-of-trade, harming external stability and growth. Higher world interest rates would modestly raise the costs of public external financing. More generally, a hike in global risk aversion could curtail access to international capital markets, though, the estimated impact of a deleveraging episode by systemic international financial institutions and large banks would be modest (Box 3 and AN 2).

- ***Domestic risks.*** These relate to policy implementation, including a reversal of crucial elements of the 2012 tax reform, or negative consequences from ongoing initiatives that introduce tax incentives. Weak public revenues could derail fiscal consolidation, aggravate debt dynamics, and lower Guatemala's resilience to shocks—potentially giving rise to adverse feedback loops if external shocks were to materialize at the same time.

13. Longer-term risks are also tilted downwards. On the domestic front, the key concern is that insufficient revenue mobilization could persist and further entrench themselves, deterring investment in physical and human capital. In turn, this could significantly weigh on the country's growth and social prospects in the long run. More generally, the currently envisaged consolidation plan is not yet sufficient to stabilize public debt as a share of GDP. If adverse government debt dynamics were not stemmed, macroeconomic and financial confidence could ultimately be eroded. On the other hand, incipient upside risks are surfacing: abundant global liquidity over a prolonged period could eventually find an attractive location in Guatemala given the country's improving standing in international global markets, thereby stimulating investment and growth. In the same connection, however, the still maturing financial system and monetary policy framework may not be able to handle effectively strong capital inflows—particularly portfolio—nor guard against eventual bubbles and overheating.

Guatemala: Risk Assessment Matrix (RAM)

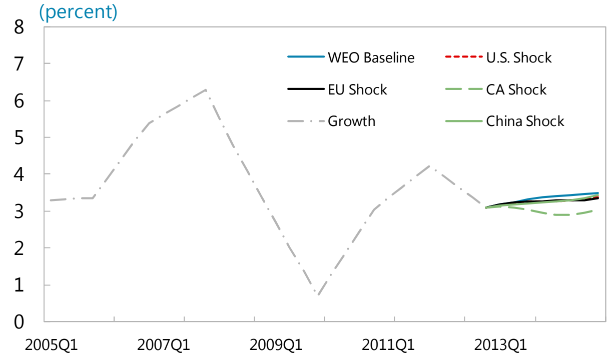
	Up/down side	***Risk***	***Impact***	***Policy Response***
Fiscal policy shock in the U.S. (Sequestration and other fiscal factors slows U.S. economy)	↓	**L**	**M**	Protect tax reform to offset revenue losses. Enhance exchange rate flexibility. Boost investment through reforms in business climate and competitiveness (not fiscal incentives).
EMs capital flow reversal (Lower access to external financing)	↓	**M**	**L**	Continue with fiscal consolidation to reduce external financing needs and enhance XR flexibility.
Oil price to US$140 per barrel (Driven by geopolitical events)	↓	**L**	**M**	Allow full pass-through, maintain strict wage policy, and strengthen social safety net. Tighten monetary policy if inflation expectations rise.
Weaker public revenues (Driven by tax reform reversal and/or introduction of tax incentives)	↓	**H**	**M**	Reach consensus with stakeholders on the need for tax revenue reforms. Spending cuts should safeguard social and investment programs.
Strong capital inflows (Triggered by abundant global liquidity)	↑	**L**	**L**	Strengthen the monetary policy framework, including exchange rate flexibility. Develop the financial system, including capital markets.

Box 3. Guatemala: Cross-Border Spillovers[1]

Compared to other countries in the CAPDR region, Guatemala has a lower sensitivity to shocks originating in the U.S., but a higher response to shocks from other countries within the region. This contrasts with analyses of other CAPDR countries, which point to larger effects from U.S. shocks. These differences might be associated with trade structures. According to the World Bank, Guatemala has a larger share of basic commodity exports (sugar, coffee, nuts) than Costa Rica and El Salvador. This could explain why Guatemala's reaction during the 2009 crisis was milder than in the rest of the CAPDR countries, since a rebound was supported by the pickup in global demand for commodities.

Results from a multi-country VAR analysis show that a CAPDR shock would have the largest short-term impact on Guatemalan growth followed by a U.S. shock. A shock of ½ standard deviation reduction in the dynamic domestic growth component of the CAPDR countries could lower GDP growth by 0.5 percentage points, while a shock in the U.S could reduce growth by 0.1 percentage points. The relatively low near-term sensitivity of the Guatemalan economy to shocks in the U.S. contrasts with the high share of trade between these two countries. While the U.S. is Guatemala's main trading partner, the correlation between the business cycles in both countries is very low. For the period 1976 - 2012, the correlation was only 0.1, and this is unchanged 2008–12. At the same time, the correlation between Guatemala and CAPDR countries is much higher. For the period 1976-2012 correlation was 0.4 in average, rising to 0.9 in 2008-12.

Guatemala: Growth Forecast and Simulation, 2005-2015
(percent)



Source: World Economic Outlook (Spring-2013) and IMF staff estimates.

Fiscal adjustment in the U.S. could have significant but still limited effects on Guatemala. Simulations suggest that each percentage point of GDP of fiscal adjustment in the United States would reduce Guatemalan growth by about 0.3 percentage points.

The upstream exposure of Guatemala to all BIS reporting banks is limited. Guatemala is exposed to rollover risk through direct cross-border lending by international banks and lending of foreign affiliates operating in Guatemala that are funded by their parent banking systems. The upper-bound of the rollover risks is captured by the upstream exposure of Guatemala to all BIS reporting banks, which was about 7 percent of GDP or 21 percent of net credit to the public and private sectors by the Guatemalan banking system, as of March 2013.[2]

- The analysis of various stress scenarios based on the RES/MFU Bank Contagion Module suggests that the impact of large haircuts in the sovereign debt of some European countries on international banks lending to Guatemala would be close to zero. This is due to the limited sovereign exposure of these banks to the euro area periphery countries.
- The estimates also indicate that the direct impact on lending to Guatemala residents from large declines in the value in European sovereign assets held by international banks lending to Guatemala is minimal.

[1] See Analytical Note 2.

[2] Total credit to the non-bank sectors in Guatemala is calculated by adding IFS local (both domestic and foreign owned) banks' claims on non-bank borrowers and BIS reporting banks' direct cross-border claims on non-bank sectors (BIS Locational Banking Statistics Table 6B).

Box 3. Guatemala: Cross-Border Spillovers (cont'd)

Spillovers to Guatemala from International Banks' Exposures as of March 2013

Shock Originating From	Magnitude 1/	Impact on claims on GTM borrowers (percent of GDP) 2/
Greece	30	0.00
Greece, Ireland, and Portugal	30	-0.02
Italy	30	-0.02
Spain	30	-0.19
Italy	10	-0.01
Spain	10	-0.17
Italy and Spain	30	-0.22
Italy and Spain	10	-0.19
France	10	-0.03
Germany	10	-0.29
Belgium	10	-0.01
Switzerland	10	-0.15
UK	10	-0.38
Selected European Countries 3/	10	-1.75
US	10	-1.32
Canada	10	-0.60
Canada and US	10	-2.02

Source: RES/MFU Bank Contagion Module based on BIS, ECB, and IFS data.

1/ Magnitude denotes the percent of on-balance sheet claims (all borrowing sectors) that lose value.

2/ Reduction in foreign banks credit to Guatemala due to the impact of the analyzed shock on their balance sheets, assuming a uniform deleveraging across domestic and external claims.

3/ Greece, Ireland, Portugal, Italy, Spain, France, Germany, Belgium, Switzerland, and UK.

POLICY DISCUSSIONS

14. Discussions focused on the policies required to preserve macroeconomic stability and enhance resilience while supporting higher long-term inclusive growth. In the near-term, with the output gap closed and incipient inflation pressures, the recent increase in the policy rate is appropriate and there may be a case for tightening monetary policy further, while maintaining a neutral fiscal stance. Building room to deal more effectively with shocks will require bolstering budgetary management including raising revenues, upgrading the monetary and XR framework, and strengthening the financial system while setting the basis for its orderly deepening. In order to reduce poverty and raise long-term growth, it is necessary to boost investment in physical and human capital to raise productivity, as well as to implement structural reforms to improve the institutional framework and foster greater security.

A. Near-term Policy Mix

15. There was agreement that the modest reduction in the fiscal deficit expected for 2013 is adequate from a demand management perspective. The 2013 budget aimed at a central government deficit of 2½ percent of GDP. However, disbursement of some multilateral loans will likely be delayed until next year and a moderate revenue underperformance is anticipated, arising from administrative problems in the implementation of new tax regulations and personnel issues, especially with the customs office. Both shortfalls will be largely offset by lower expenditure (¶16). Accordingly, a central government deficit of 2¼ percent of GDP in 2013 is now projected. This entails an approximately neutral fiscal stance which was considered appropriate in light of a virtually closed output gap and growth projected at potential. Moreover, the fiscal sustainability gap (¶s19, 20) is small and does not require immediate correction.[5]

16. The authorities noted that the shortfalls in revenues and external disbursements this year would be met primarily by spending cuts. In particular, expenditures on capital, goods and services, and transfers, would be lower since collections are earmarked to a significant extent. Staff counseled keeping consolidation efforts away from cutting already low public expenditure and making only targeted spending cuts to safeguard priority social programs and investment. The authorities were reluctant to undertake additional borrowing to counter the revenue and financing shortfalls and are determined to protect the critical elements of the 2012 tax reform. Staff reiterated the need to improve public financial management to avoid spending arrears, finalize a reliable estimate of their outstanding stock, and establish a strategy for their clearance. The authorities stressed their commitment to these actions and added that they were considering issuing a bond later in the year for the payment of domestic arrears, contingent on their proper documentation.

[5] The fiscal sustainability gap is the improvement or in the (structural) primary balance required to stabilize the debt-to-GDP ratio.

Box 4. Guatemala: The Monetary Policy Stance

Monetary and financial conditions Index (FCI) was developed for Guatemala to reflect how financial variables influence economic activity. A change in the value of the overall FCI reflects the total contribution of financial conditions to GDP growth. The financial variables used are: a summary measure of interest rates (the real interest rate of bank loans), the real effective exchange rate (REER), the real growth of deposits and credit to the private sector, and a housing price index.

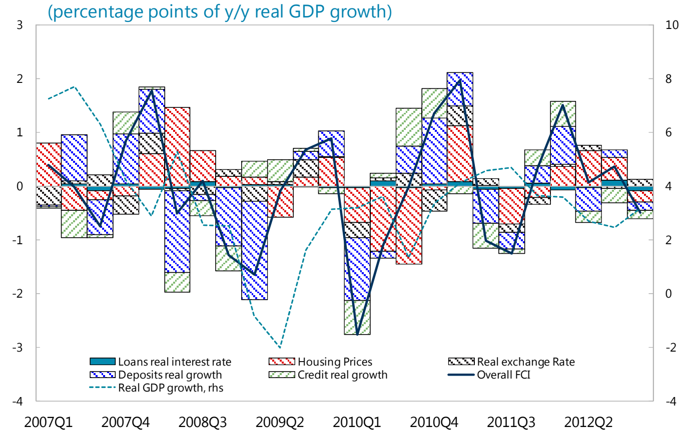
The FCI suggests that overall financial conditions were broadly neutral by the end of 2012. They were fairly loose or positive in the first quarter but turned more negative or tighter in the rest of the year. Overall, the average contribution of the FCI for the whole of 2012 was positive. Nonetheless, relatively underdeveloped financial markets in Guatemala may limit the interpretive value of the model.

- **Following Magud and Tsounta (2012)[1], different methods were used to estimate the neutral real interest rate (NRIR)**. The first one is based on the uncovered interest parity condition. The second model estimates the NRIR using a Taylor rule augmented for inflation expectations. The third method solves a general equilibrium model that focuses on aggregate demand-supply equilibrium.

- **The main results suggest that there is some space for further monetary policy tightening.** To different degrees, all estimations conclude that the monetary policy rate is below neutral levels. Specifically, the NRIR is estimated to lie in a range between 1.4 and 2.4 percent. However, some caveats apply for each of these models and results should be interpreted with caution given data limitations and shallow financial markets in Guatemala.

Monetary and Financial Conditions Index (2007-2012)

(percentage points of y/y real GDP growth)



Sources: Country authorities and Fund staff estimations.

Neutral Real Interest Rate for Guatemala

Expected Inflation Dec-2013	4.9
Actual Monetary Policy Rate	5.25

Method 1/	Neutral Real Interest Rate (NRIR)	Neutral Nominal Interest Rate (NNIR)	Nominal Monetary Policy GAP (bps) 2/
Uncovered Interest Parity	1.4	6.3	105
Expected-Inflation Augmented Taylor Rule	2	6.9	165
General Equilibrium Model	2.4	7.3	205
Average	1.9	6.8	158

Sources: Country Authorities and Fund staff estimates.

Notes: 1/ All units expressed as percent points unless otherwise stated. 2/ (bps): Basis points

[1] Nicolas E. Magud and Evridiki Tsounta, “To Cut or Not to Cut? That is the (Central Bank’s) Question: In Search of the Neutral Interest Rate in Latin America,” *IMF Working Paper, WP/12/243,* October 2012.

17. The authorities concurred to remain vigilant of lingering inflationary pressures. The central bank lowered its end-year inflation target range by half a percentage point (to 4±1 percent) in January 2013. Headline and core inflation are at the mid range of the band, and have started to edge up, while expected inflation is at the top of the range for end-2013 and through 2014. After the entire borrowing needs of the government for 2013 were met with the issuance of a Eurobond in February, and with no further domestic state bond issuance planned for this year, banks remain very liquid. Moreover, the high growth rate of consumer credit is a sign of demand pressures, underpinned also by buoyant remittances. Accordingly, the authorities' decision to raise the policy rate by 25 basis points in late April was fully endorsed by staff. The central bank also considered that sterilization operations to mop up excess bank liquidity had been adequate. Staff advised to raise further the policy rate and to step up liquidity absorption promptly if inflationary pressures do not abate (Box 4 and AN 5). Officials agreed, though they intend to assess the evolution of inflation and inflation expectations after the recent hike in the policy rate before taking further action in the near term.

B. Increasing Resilience to Shocks

Rebuilding fiscal space and enhancing fiscal sustainability

18. It was recognized that continuing increases in the burden of public debt are a source of vulnerability. While the government debt-to-GDP ratio is comparatively low, it has been rising steadily since the 2008 crisis. The authorities acknowledged that Guatemala cannot rely comfortably on debt financing to support expansionary counter-cyclical policies (particularly if prolonged)—funding risks are likely to escalate rapidly, especially in light of the high debt-to-revenue ratio. The debt structure is solid on many fronts,[6] but exposures to rollover and FX risks are increasing, as the country gains access to international markets. The lack of depth in the domestic financial market (with its highly concentrated investor base and virtually non-existing secondary government debt market) [7] and rigidities that curtail access to official financing in FX (IFI loans must be approved by Congress on a case-by-case basis, and are often made hostage to political negotiations) provide thin coverage against spikes in global risk aversion.

[6] Guatemala's total gross financing needs are small (3½ percent of GDP in 2013), and a large share of debt is contracted at long maturities (10 years), fixed rates and reduced spreads (nearing 200 bps for SCDS).

[7]Most central government domestic debt is held by the three major banks and the social security institute.

The Macro-Scenario Under the Staff's Recommended Consolidation Path Differs Little from the Baseline.

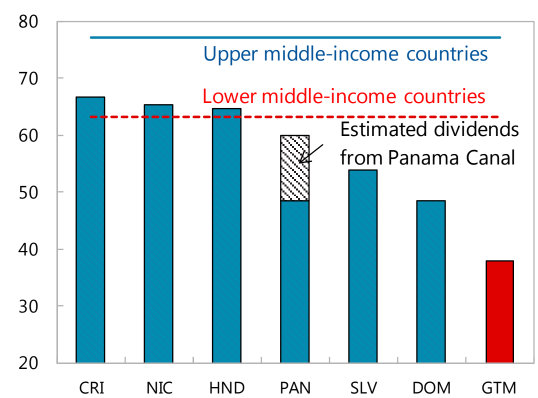
	2014	2015	2016	2017	2018
			Baseline		
Growth (percent)	3.5	3.5	3.5	3.5	3.5
Inflation (e.o.p., percent)	4.8	4.4	4.2	4.0	4.0
Primary balance (percent of GDP)	-0.7	-0.6	-0.4	-0.4	-0.3
Central Government debt (percent of GDP	25.7	26.4	27.0	27.5	28.1
Fiscal impulse	0.0	-0.1	-0.2	0.0	0.0
			Optimal Fiscal Consolidation Scenario		
Growth (percent)	3.4	3.5	3.5	3.5	3.4
Inflation (e.o.p., percent)	4.8	4.4	4.2	4.0	4.0
Primary balance (percent of GDP)	-0.5	-0.3	-0.2	-0.2	-0.1
Central Government debt (percent of GDP	25.2	25.4	25.5	25.6	25.8
Fiscal impulse	-0.2	-0.1	-0.1	-0.1	0.0
Memo item:					
Primary balance, authorities' medium-term projections 1/	-0.6	-0.5	...	...	...

1/ *Presupuesto Multianual, 2013-14,* Ministry of Finance
Source: Fund staff estimates.

19. Hence, fiscal sustainability should be reinforced over the medium term. Stabilizing the debt-to-GDP ratio at its current level—thereby unlocking the ability to implement expansionary counter-cyclical policies without exacerbating budget funding risks) would require a permanent improvement in the primary balance of about 3/4 -1 percent of GDP. If the actuarial deficit of the social security system were taken into account (preliminary estimates are still being refined), the sustainability gap would be correspondingly larger. With output not exceeding potential, continuing global uncertainties exacerbating growth risks, and no pressing financing constraints, the common view was that immediate adjustment is not needed. At the same time, staff indicated that its recommended moderately paced adjustment, starting from 2014, with modest frontloading and spaced over several years, would strike the right balance between reducing the sustainability gap and limiting the negative impact on growth (AN 3), given an estimated fiscal multiplier of 0.4 (multipliers tend to be smaller when activity is at about potential).

20. The authorities agreed and highlighted that current policies are already on track gradually to reduce the sustainability gap. They noted that their medium term budget already envisages a steady reduction of the deficit through 2015. Staff's recommended adjustment path (¶19) would be broadly similar to the authorities' plan, if the latter were extended beyond 2015. In this case, the sustainability gap would be lowered to near-negligible levels without pushing growth significantly below potential. On the other hand,

Tax Effort in the Region (Actual/Potential Tax Revenues)**,** 2010 (percent)

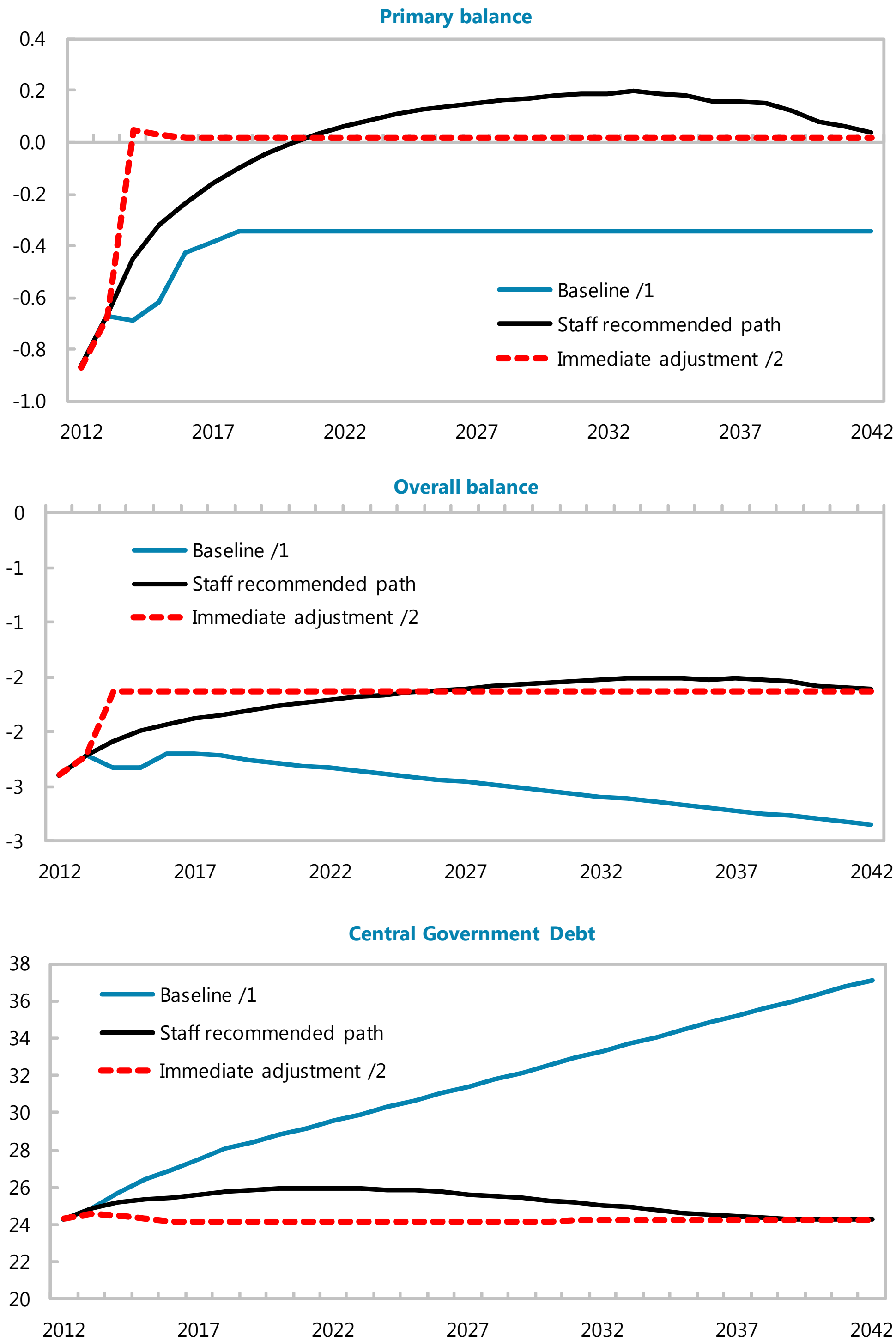


Sources: Country authorities; and Fund staff estimates.

staff's baseline projection anticipated a somewhat smaller and less frontloaded budget tightening than that planned by the authorities, owing to: (i) the expectation that some of the spending delayed in 2013 will be executed in 2014-15; and (ii) a less sanguine view of the yield of the tax reform, in light of the problems encountered in its early implementation. Nonetheless, staff accepted that the macroeconomic implications of the differences between the baseline and alternative scenarios were minor over the medium term, given the low fiscal multiplier. But some residual budget adjustment will be required after 2018 to ensure sustainability.

Guatemala: Long-Term Fiscal Sustainability, 2012-2042

(Percent of GDP)



1/ This path is the baseline through 2018, with a constant primary balance thereafter.
2/ Assumes an adjustment in 2014 which stabilizes the debt-to-GDP ratio.
Source: Fund staff estimates.

21. Staff urged additional efforts to mobilize revenue beyond budget consolidation needs. Guatemala needs not only to achieve long-term fiscal sustainability, but also to maintain macro stability while addressing pressing social needs–not least reduction of widespread absolute and relative poverty–and paving the way toward high, inclusive long-term growth. Meeting these objectives will depend upon raising the currently low level of government revenues to support priority public spending (¶28).[8] In particular, staff advocated reducing tax expenditures (equivalent to 8 percent of GDP), and realigning VAT rates (from 12 to 14 percent) with those prevailing in the region. Lowering the currently high degree of revenue earmarking (about 50 percent) will also be important to widen the fiscal adjustment toolbox. Further work to strengthen the tax and customs administration, and stepping up efforts to reduce informality, should assist in enhancing collections. The authorities saw merit in these recommendations, but emphasized that such an ambitious agenda will take time to implement.

22. The authorities are committed to improve the efficiency of public expenditure and reinforce budgetary management more generally. They noted that planned amendments to the Organic Budget Law would ameliorate transparency and efficiency of public spending, and help reallocate resources toward priority areas. Staff recommended that reforms should also grant more flexibility to the approval of official financing, thus providing room for a greater counter-cyclical cushion and preventing the under-execution of IFI-supported spending. Faster progress would be desirable with the approval of the rest of the transparency package, in Congress since last year, and with implementation of a results-based budget.

Upgrading monetary and exchange rate policy

23. It was agreed that monetary policy transmission should be bolstered to anchor further low and stable inflation. Guatemala's annual inflation is below that of regional peers, and within its target band. Nonetheless, the transmission channels of monetary policy remain feeble, while pass-through effects from commodity prices continue to influence inflation heavily.[9] The authorities concurred that there is scope for enhancing monetary policy transmission through a four-pronged approach. First, it is desirable to raise gradually XR flexibility, credibly conveying to the public that the inflation target is the monetary authorities' primary objective. In this regard, consolidating the operational independence of the central bank from government and private sector interests would be important. Second, efforts ought to be stepped up to de-dollarize credit, mainly by allowing the XR to fluctuate and thereby forcing agents to internalize

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[8] Guatemala's tax "effort"—the ratio of actual revenues to potential—is the lowest among its peers, while the "revenue gap"— the difference between the current level of tax collections and the level that would result from achieving the tax effort prevailing in comparator countries—is estimated to be about 7 percent of GDP. Guatemala's level of public expenditure, 14 percent of GDP in 2012, lags both its CAPDR peers and other EM countries (23 and 32 percent of GDP, respectively). As a broad goal for the long term, the authorities target an increase in revenue to 18 percent of GDP. Consistent with a debt-stabilizing deficit, this would imply an increase of around 5 percentage points of GDP in expenditures.

[9] The pass-through rate for the policy rate has been estimated at 60 percent. See "Medina Cas, Carrion-Menendez and Frantischek "Effectiveness of Monetary Policy, " Piñon and other, eds., *Central American, Panama and the Dominican Republic, Challenges Following the 2008-09 Global Crisis,* IMF, 2012.

FX risks and promote hedging. Third, public debt and private securities markets need to be developed. To this end, it is also important to finalize the draft capital markets law in compliance with IOSCO best practices and enact it. Finally, the framework for monetary operations—including with technical assistance from the Fund—should be further refined.

24. The central bank favors progress towards greater XR flexibility, but at a very prudent and moderate pace. Increased flexibility would provide the economy with an extra shock absorber, while preventing excessive FX risk taking. Staff recognized that the rule-based FX intervention has allowed for some flexibility but also pointed out that intervention has been relatively high—as it is apparent from the high sterilization costs, which have weakened the central bank's balance sheet (¶25). Indeed, a recent increase in net FX liabilities of the non-financial private sector (vis-à-vis 2007) may also be driven by a perceived implicit guarantee on a stable exchange by the central bank (AN 4). In this respect, staff welcomed the slight widening at the end of 2012 of the XR fluctuation margin used to determine intervention and the associated recent decline in FX intervention. There was agreement on the need to continue broadening the intervention rule. However, the authorities considered that the rule had served well to maintain stability and anchor expectations and thus it could be widened only slowly.

25. The government acknowledged the need to support the central bank's balance sheet. In 2011-12, the central bank had annual operational losses of ¼-½ percent of GDP. The Ministry of Finance is obligated by law to compensate the central bank for part of the costs incurred in its monetary operations with a two year lag. However, Congress decided to exclude from the 2013 budget the refund corresponding to 2011, prompting a legal challenge by the central bank. Staff argued that the latter should be compensated for its 2011 losses with a modification to the 2013 budget, while provision should be made for the 2012 losses in the 2014 budget. The Ministry of Finance affirmed that the overdue refund to the central bank may be approved by Congress later this year.

Strengthening the financial system and setting the basis for its orderly deepening

26. The authorities are determined to strengthen the financial system. Guatemala is well placed to apply key Basel III components and is in compliance with most of the Basel I framework. The authorities are working to promote implementation of Basel III rules at the regional level to prevent regulatory arbitrage. However, staff cautioned that important work remains ahead, including full implementation of risk-based supervision, and consolidated supervision. Moreover, further upgrade of financial sector regulations would be desirable, including in preparation for the forthcoming FSAP scheduled for the spring of 2014. In this regard, officials noted that there has been good progress with implementing the amendments to the Banking Sector Law, as regulations have been issued to reduce risks from offshore banking, require credit ratings for banks, and limit loans to shareholders to control credit concentration and connected lending. Staff encouraged the authorities to spur congressional passage of the draft banking secrecy law and supported other measures to combat money laundering to comply with additional OECD and AML/CFT standards (AN 6).

27. Officials concurred that recent strong credit growth calls for great vigilance. In particular, fast expansion of consumer credit (including by micro-financial firms) and foreign currency credit have raised concerns. While this issue will be examined in more detail by the forthcoming FSAP update, staff cautioned that, although there are no immediate acute worries, the continuation over a long period of high rates of credit expansion could eventually undermine the stability of the financial system. The authorities agreed, while underlining that the ongoing credit growth is needed to foster deeper financial markets. They noted that approval of the law for micro-finance institutions, recently submitted to Congress, would also help assuage risks.

C. Poverty Reduction and Achieving Higher Long-Term Inclusive Growth

28. There was consensus on the need to step up well-targeted social spending. Social spending is too low in Guatemala—even relative to regional peers—leaving critical needs unmet. Beyond the inherent benefit of reducing poverty and hunger, effective action by the public sector has the potential to improve a broad range of social indicators and human capital, which impinge directly on the country's productivity. Staff argued that this is critical to foster competitiveness and sustain growth, and to integrate fully vulnerable groups into Guatemala's social fabric, which would also alleviate the high security risks. The authorities agreed that higher levels of social expenditure are required to build a skilled and productive labor force. Albeit officials stressed that resources to fund greater outlays are limited, they underscored social initiatives underway, such as the Zero Hunger Plan.

29. The private investment gap must be urgently bridged. Much scope remains to foster competitiveness through structural reforms to improve the business climate and reduce violence and impunity. The authorities are currently addressing these issues through their competitiveness agenda and several legislative initiatives, including one that aims to improve labor force flexibility and diminish informality. It was agreed that the Public-Private Partnerships (PPP) framework should be used to catalyze high-quality investment and infrastructure, though it first needs to be strengthened to grant the Ministry of Finance more powers to monitor and control contingent fiscal risks. Staff warned against plans, currently under consideration in Congress, to use tax incentives to attract investment, arguing that they are of dubious efficacy and prone to abuse. Indeed, the main determinants of investment by firms are the stability of the tax regime, infrastructure availability, and adequate legal frameworks. Widespread tax incentives may eventually endanger macroeconomic stability and thus hurt development.

30. The authorities viewed regional integration as providing new impetus to support faster growth. The region should complete the customs union, harmonize trade rules, and further integrate services and factor markets. The authorities explained that they are urging Congress to approve the Association Agreement with the EU which would boost regional integration in those areas. They also noted that a Central American free trade agreement with Mexico still needs to be ratified by Congress. Staff estimates Guatemala's real GDP growth may increase by up to 0.8-1.6 percentage points per year by improving logistics, increasing partner diversification, deepening integration into global production chains, and increasing technological sophistication of exports to the levels of the five largest Latin American countries and the EU. Competitiveness could be augmented by market enlargement (from 14 to over 40 million people) and pooling resources for infrastructure and trade. Economies of scale could boost investment, and lowering intraregional trade costs would improve resource allocation.[10]

STAFF APPRAISAL

31. **Growth has been firm in the aftermath of the global crisis, fundamentals remain stable, and the near-term outlook is broadly positive.** Economic activity is projected to be near potential, while inflation should remain contained and within the central bank's target band. Nonetheless, risks to the outlook are tilted to the downside. External risks include weaker than expected growth in the U.S. which would weigh on economic activity, and a geopolitical oil shock that could impair Guatemala's terms of trade and growth. Domestic risks pertain to policies, including a setback on the main items of the 2012 tax reform, or enactment of legislation that entails new fiscal incentives. Weak fiscal revenues could endanger fiscal consolidation and lower Guatemala's resilience to shocks.

32. **The anticipated broadly neutral fiscal stance for 2013 is appropriate while further monetary tightening may be needed.**

- The deficit outturn this year is likely to be only marginally lower than in 2012 (and than budgeted). Since capacity is nearly fully utilized, the resulting virtual absence of fiscal impulses is deemed adequate. Shortfalls in multilateral loan disbursements and revenue also mean that central government spending will be lower than planned. With expenditure levels already low, efforts should be made to limit the reduction in outlays, and at least to protect social programs and investment. Improvements in expenditure controls are necessary to prevent further accumulation of arrears. Clearance of outstanding payment arrears must be subject to rigorous audit of the claims.

- Some evidence suggests that monetary policy stance may be, to a certain extent, accommodating. Thus, if inflation continues to rise, amid robust domestic demand, strong private credit growth, and abundant bank liquidity, the central bank should stand ready further to raise the policy rate and absorb residual excess bank liquidity.

33. **Fiscal consolidation is necessary in the medium term to allow room for counter-cyclical policies and reduce vulnerability to shocks.** Though public debt remains relatively low as a share of GDP, it has been steadily increasing since 2008 and it is quite high in relation to government revenue. Stabilizing the debt-to-GDP ratio will require a permanent improvement in the primary balance of about ¾ -1 percent of GDP. A moderately paced adjustment beginning in 2014-15, with limited frontloading, would balance the need to shrink the sustainability gap against any negative consequences on growth.

34. **Additional revenue mobilization and improvements to public expenditure management should underpin budgetary adjustment.** Raising revenues is essential not only

[10] See S. Medina Cas, A. Swiston and L. Barrot, 2012, "Central America, Panama, and the Dominican Republic: Trade Integration and Economic Performance", IMF Working Paper 12/234.

for achieving long-term fiscal sustainability, thereby anchoring macro stability, but also for boosting health, education, security, and infrastructure outlays, which are all critical to reduce high levels of poverty and raise the potential for sustained inclusive growth. Specifically, reducing tax expenditures, adjusting VAT rates, and further strengthening the tax and customs administration would help lift collections. Enhancing the transparency and efficiency of spending would permit directing limited resources to priority areas, a goal that could also be supported by reforms to lower revenue earmarking and facilitate the approval of official external financing.

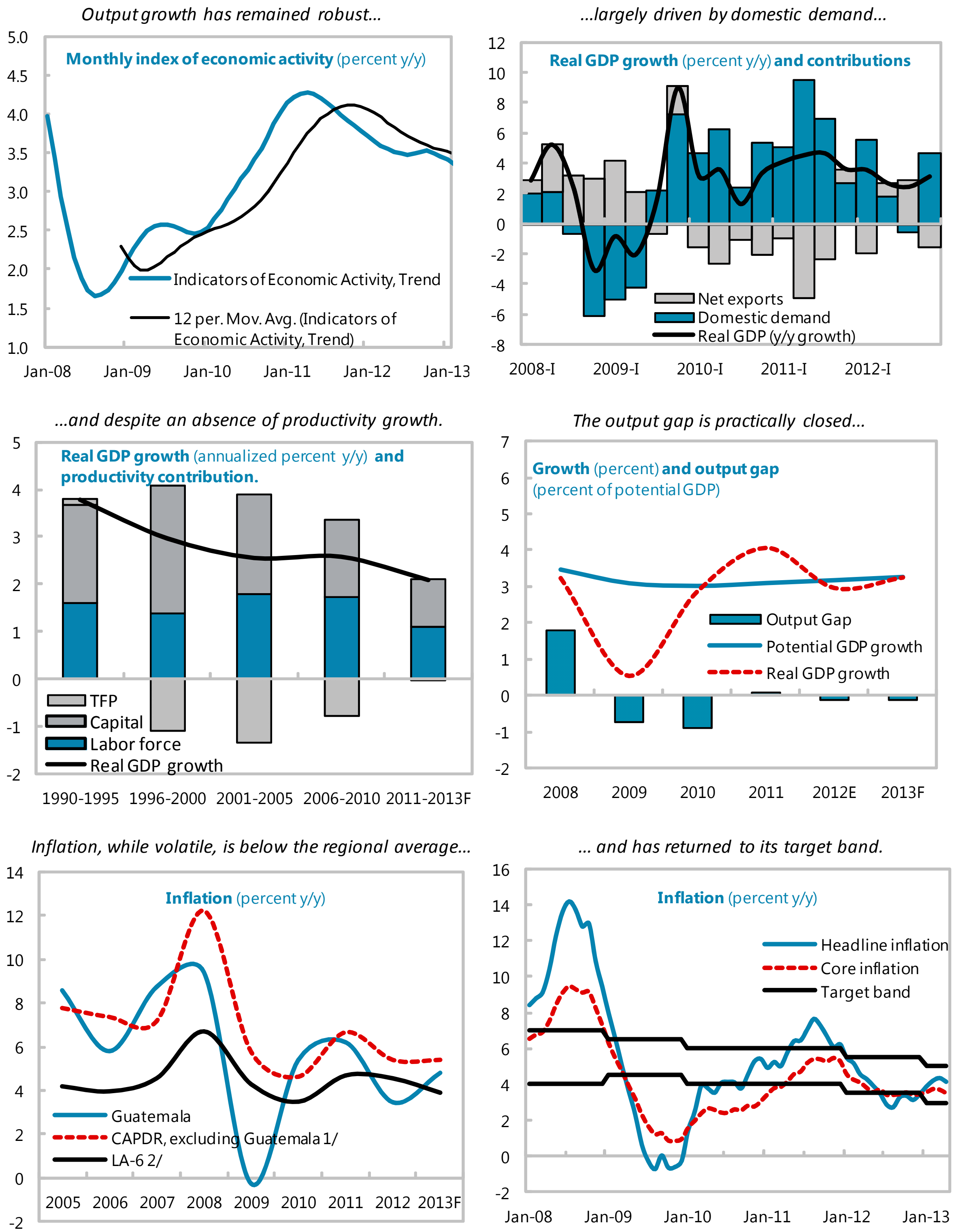
35. The monetary policy framework should be upgraded, including by enhancing XR flexibility. Strengthening monetary transmission would make it easier for the central bank to reduce the volatility of inflation in response to external shocks and thus help maintain it at moderate levels. To this end, it would be important to buttress further the central bank's operational independence and the soundness of its balance sheet. Efforts to de-dollarize by allowing more XR fluctuation, developing domestic securities markets, and refining monetary operations are all critical for augmenting the monetary transmission mechanism. Likewise, more rapid progress in allowing greater XR flexibility would reinforce the role of inflation as the primary objective of monetary policy.

36. Further financial sector reforms are desirable while keeping careful watch over recent strong credit growth. Though much progress has been made, financial regulations should continue to be modernized, with special emphasis on full implementation of risk-based and consolidated supervision, gradual introduction of the Basel III framework, passage of the law for micro-finance institutions, and enactment of AML/CFT measures such as the banking secrecy law. Though not an immediate danger, the authorities should remain vigilant over high rates of growth of credit to the private sector—especially rapid expansion of consumer credit by micro-financial firms and foreign currency credit. Indeed, if sustained over a long period, a credit surge could eventually undermine financial stability.

37. High levels of poverty should be reduced by increasing social spending and by reforms aimed at boosting growth and regional integration. Higher social spending is essential to lift human capital, thus boosting competitiveness and growth, which would also be stimulated by greater public infrastructure expenditure. Private investment should also be raised through structural reforms to improve the business climate and reduce violence and impunity. The Public-Private Partnerships initiative should be strengthened to foster greater investment and improve infrastructure while managing fiscal risks. The recent congressional approval of the EU association agreement will help spur regional trade integration and the customs union.

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

Figure 1. Guatemala: Growth and Inflation

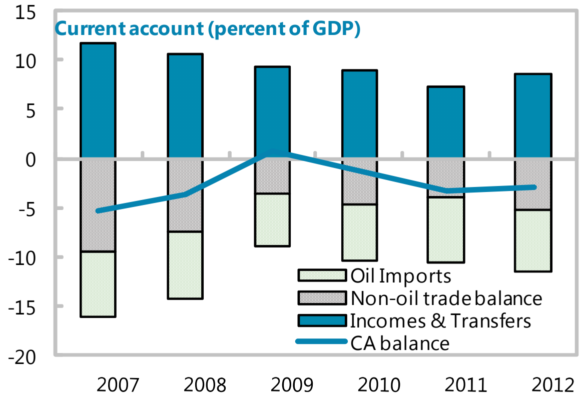


Sources: Country authorities and Fund staff estimates.
1/ CAPDR excluding Guatemala comprises Costa Rica, Dominican Rep, El Salvador, Honduras, and Panama.
2/ LA-6 comprises Brazil, Chile, Colombia, Mexico, Peru and Uruguay.

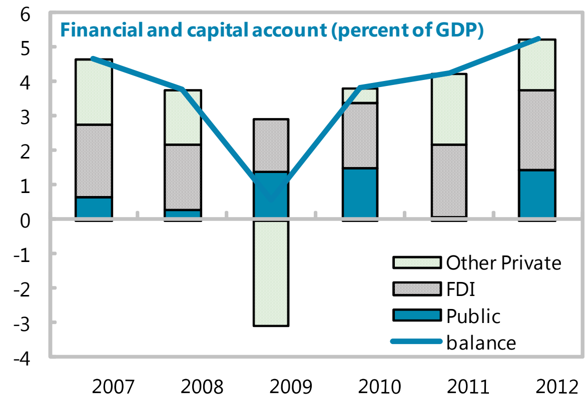
Figure 2. Guatemala: External Sector Developments

The current account deficit has widened in recent years, but remains comfortably financed.

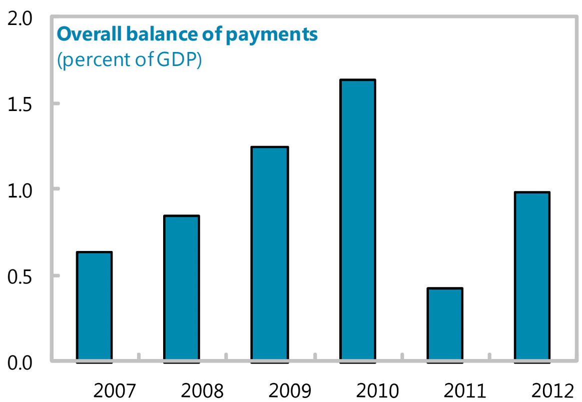
The current account deficit has widened...



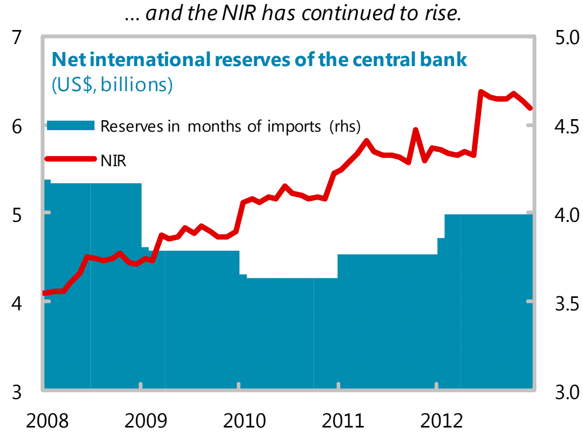
... but capital inflows have increased...



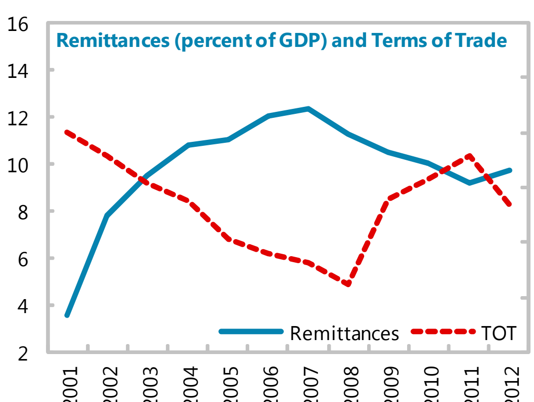
... the overall BoP is in surplus...



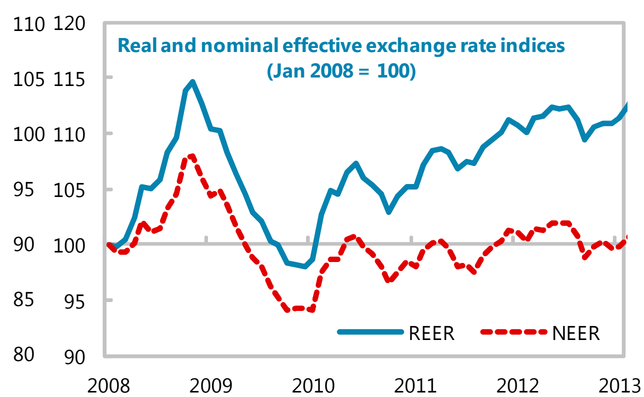
... and the NIR has continued to rise.



Terms of trade have recovered as remittances fell...

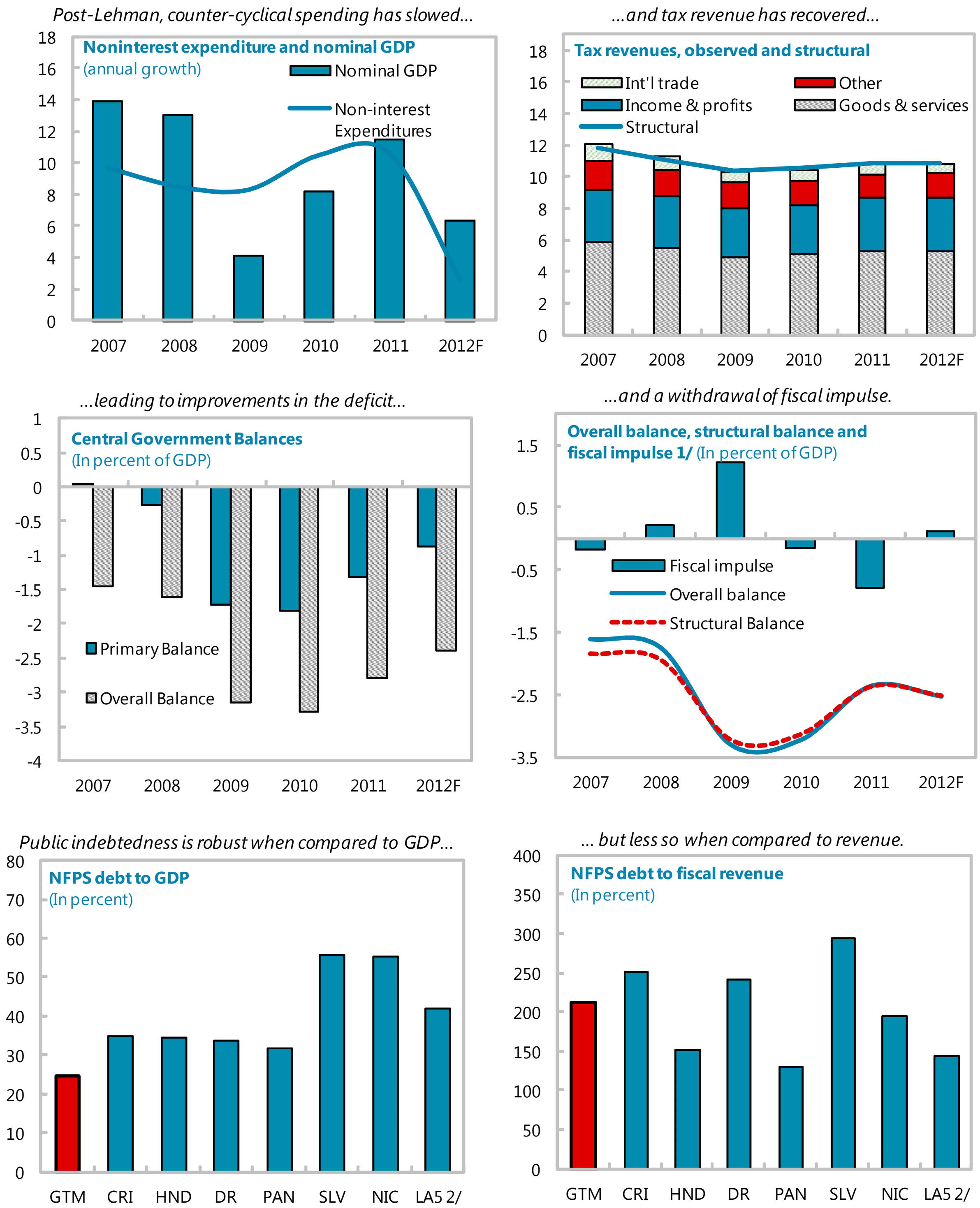


...but the REER has continued to appreciate.



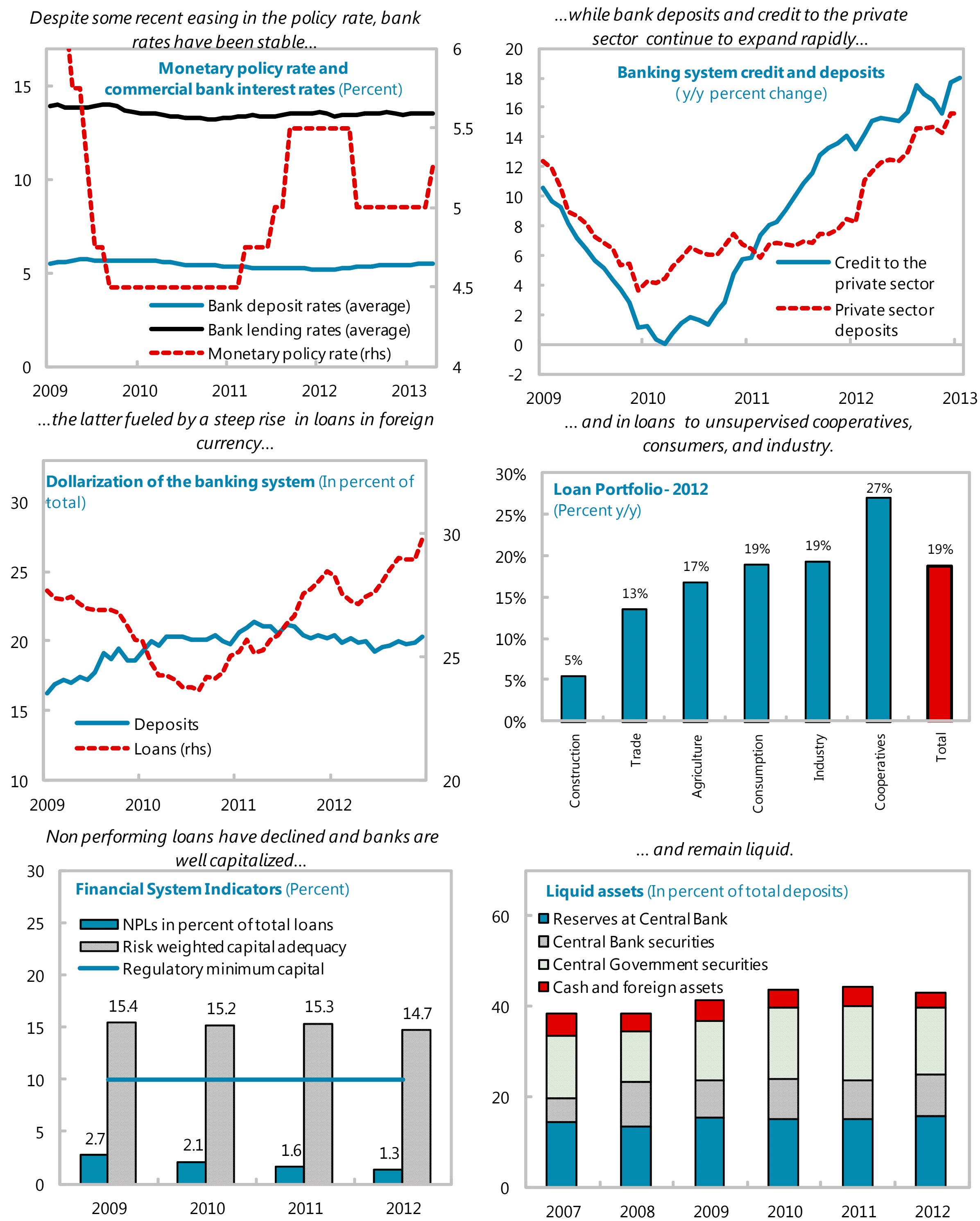
Sources: Country authorites and Fund staff estimates.

Figure 3. Guatemala: Fiscal Sector Developments



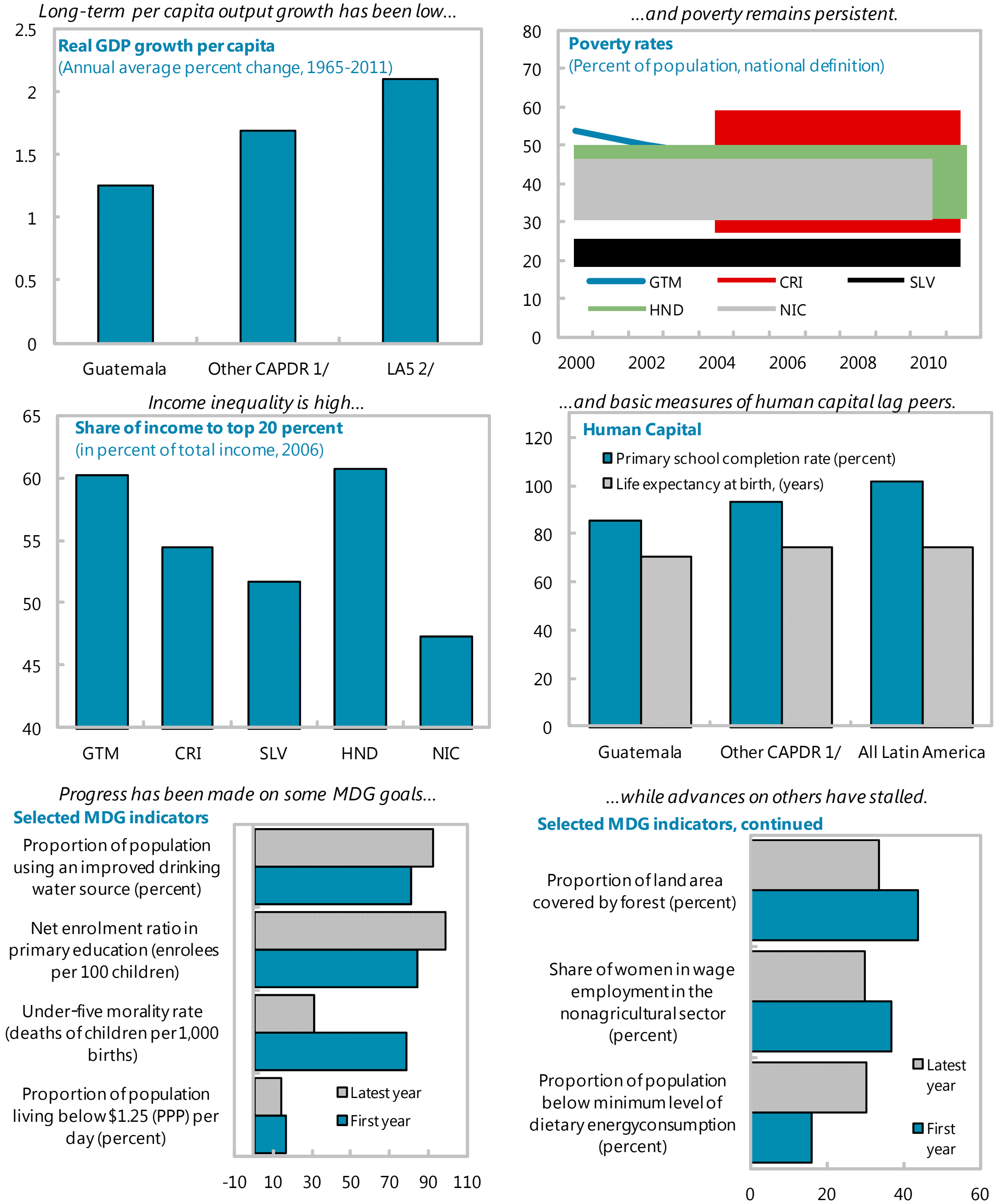
Sources: Country authorities and Fund staff estimates.
1/ Corrected for non-recurrent revenue.
2/ Simple average of Brazil, Chile, Colombia, Mexico, and Peru.

Figure 4. Guatemala: Money and Credit



Sources: Country authorities and Fund staff estimates.

Figure 5. Guatemala: Social Development and the Millennium Development Goals



Sources: World Bank WDI and United Nations.
1/ Simple average of Costa Rica, Dominican Republic, El Salvador, Honduras, Nicaragua, and Panama.
2/ Simple average of Brazil, Chile, Colombia, Mexico, and Peru.

Table 1. Guatemala: Selected Economic and Social Indicators

I. Social and Demographic Indicators

Population 2010 (millions)	14	Gini index (2006)	54
Percentage of indigenous population (2006)	38	Life expectancy at birth (2009)	71
Population below the poverty line (Percent, 2006)	51	Adult illiteracy rate (2009)	26
Rank in UNDP development index (2011; of 187)	131	GDP per capita (US$, 2011)	3,236

II. Economic Indicators

					Est.	Proj.	
	2008	2009	2010	2011	2012	2013	2014
	(Annual percent change)						
Income and Prices							
Real GDP	3.3	0.5	2.9	4.2	3.0	3.5	3.5
Consumer prices (end of period)	9.4	-0.3	5.4	6.2	3.4	4.8	4.8
Monetary Sector							
M2	7.6	10.0	11.3	10.7	9.8	10.5	10.2
Credit to the private sector	11.0	1.1	5.7	14.1	17.7	16.0	14.0
	(In percent of GDP, unless otherwise indicated)						
Savings and Investment							
Gross domestic investment	16.4	13.1	13.9	15.1	14.4	14.7	14.8
Private sector	13.2	9.1	11.2	11.9	12.3	12.1	12.1
Public sector	3.2	3.9	2.7	2.9	2.3	2.6	2.7
Gross national saving	12.8	13.8	12.6	11.8	11.6	11.6	11.7
Private sector	10.4	12.6	12.7	11.3	11.2	10.8	11.0
Public sector	2.4	1.2	-0.1	0.5	0.3	0.7	0.7
External saving	3.6	-0.7	1.4	3.4	2.9	3.1	3.0
External Sector							
Current account balance	-3.6	0.7	-1.4	-3.4	-2.9	-3.1	-3.0
Trade balance (goods)	-14.2	-8.9	-10.3	-10.4	-11.4	-11.6	-11.7
Exports	20.0	19.3	20.6	22.1	20.1	19.4	18.8
Imports	-34.3	-28.2	-31.0	-32.5	-31.4	-31.0	-30.5
Of which: oil & lubricants	-6.8	-5.5	-5.7	-6.5	-6.3	-6.0	-5.7
Other (net)	10.6	9.6	9.0	7.1	8.5	8.5	8.7
Of which: remittances	11.3	10.5	10.0	9.2	9.8	9.8	9.9
Capital and financial account	3.7	0.5	3.8	4.3	5.2	4.7	3.3
Public sector	0.3	2.1	1.5	0.1	1.5	1.6	0.4
Private sector	3.4	-1.6	2.4	4.2	3.8	3.1	2.8
Of which: FDI	1.9	1.5	1.9	2.1	2.3	2.4	2.4
Errors and omissions	0.7	0.0	-0.8	-0.5	-1.4	0.0	0.0
Overall balance	0.9	1.3	1.6	0.4	1.0	1.6	0.2
Net International Reserves							
(Stock in months of next-year NFGS imports)	4.2	3.8	3.7	3.8	3.9	4.2	4.1
(Stock over short-term debt on residual maturity)	1.6	2.0	1.9	1.9	1.7	2.0	2.0
Public Finances							
Central Government							
Revenues	12.0	11.1	11.2	11.6	11.6	12.1	12.3
Expenditures	13.6	14.2	14.5	14.4	14.0	14.3	14.6
Current	9.9	10.7	11.0	10.8	11.1	11.1	11.3
Capital	3.7	3.5	3.6	3.6	2.9	3.2	3.3
Of which: reconstruction	n.a.	n.a.	0.2	0.6	0.0	0.0	0.0
Primary balance	-0.3	-1.7	-1.8	-1.3	-0.9	-0.7	-0.7
Overall balance	-1.6	-3.1	-3.3	-2.8	-2.4	-2.2	-2.3
Overall balance (without reconstruction)	n.a.	n.a.	-3.1	-2.2	n.a.	n.a.	n.a.
Financing of the central government balance	1.6	3.1	3.3	2.8	2.4	2.2	2.3
Net external financing	0.3	1.3	1.5	0.1	1.5	1.6	0.4
Net domestic financing	1.3	1.8	1.8	2.7	0.9	0.6	1.9
Of which: use of government deposits	0.8	0.4	-0.1	0.5	0.5	0.1	0.0
Rest of Nonfinancial Public Sector Balance	0.9	0.4	0.5	0.4	0.4	0.4	0.4
Combined Nonfinancial Public Sector							
Primary balance	0.6	-1.3	-1.3	-0.9	-0.5	-0.3	-0.3
Overall balance	-0.7	-2.8	-2.8	-2.4	-2.0	-1.8	-1.9
Central Government Debt	**20.1**	**22.9**	**24.1**	**23.7**	**24.3**	**24.9**	**25.7**
External	11.3	13.0	13.1	11.5	12.4	13.4	13.1
Domestic 1/	8.9	9.9	11.0	12.1	11.9	11.5	12.6
Memorandum Items:							
GDP (US$ billions)	39.1	37.7	41.3	47.7	50.4	53.9	57.1

1/ Does not include recapitilization obligations to the central bank.
Sources: Bank of Guatemala; Ministry of Finance; and Fund staff estimates and projections.

Table 2. Guatemala: Medium-term Framework

					Prel.	Projections					
	2008	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018
	(Contribution to real GDP growth, unless otherwise stated)										
Real GDP (annual percentage change)	3.3	0.5	2.9	4.2	3.0	3.5	3.5	3.5	3.5	3.5	3.5
Domestic demand	1.0	-1.6	4.7	6.0	2.9	5.1	4.0	3.8	3.9	3.9	3.8
Public consumption	1.0	1.3	0.8	0.6	0.8	0.3	0.3	0.2	0.3	0.2	0.1
Gross fixed investment	-1.1	-2.3	-0.3	0.9	0.7	0.6	0.9	0.9	1.0	1.1	1.4
External demand	2.3	2.2	-1.8	-1.7	0.1	-1.6	-0.5	-0.3	-0.4	-0.4	-0.3
Exports of goods and nonfactor services	0.0	-0.7	1.6	0.8	0.6	0.1	1.1	1.1	1.1	1.1	1.2
Imports of goods and nonfactor services	2.3	2.8	-3.3	-2.5	-0.5	-1.7	-1.6	-1.4	-1.5	-1.5	-1.6
	(In percent of GDP)										
Savings and investment											
Gross domestic investment	16.4	13.1	13.9	15.1	14.4	14.7	14.8	14.9	15.1	15.5	16.1
Gross national saving	12.8	13.8	12.6	11.8	11.6	11.6	11.7	12.1	12.5	12.8	13.6
External saving	3.6	-0.7	1.4	3.4	2.9	3.1	3.0	2.9	2.7	2.6	2.6
Balance of payments											
Current account balance	-3.6	0.7	-1.4	-3.4	-2.9	-3.1	-3.0	-2.9	-2.7	-2.6	-2.6
Trade balance (goods)	-14.2	-8.9	-10.3	-10.4	-11.4	-11.6	-11.7	-11.6	-11.5	-11.7	-11.8
Other (net)	10.6	9.6	9.0	7.1	8.5	8.5	8.7	8.8	8.8	9.0	9.3
Of which: Remittances	11.3	10.5	10.0	9.2	9.8	9.8	9.9	10.0	10.1	10.3	10.5
Capital and financial account	3.7	0.5	3.8	4.3	5.2	4.7	3.3	3.0	2.7	2.6	2.6
Public sector	0.3	2.1	1.5	0.1	1.5	1.6	0.4	0.3	0.3	0.2	0.2
Private sector	3.4	-1.6	2.4	4.2	3.8	3.1	2.8	2.7	2.4	2.4	2.4
Of which: FDI	1.9	1.5	1.9	2.1	2.3	2.4	2.4	2.4	2.4	2.4	2.4
Errors and omissions	0.7	0.0	-0.8	-0.5	-1.4	0.0	0.0	0.0	0.0	0.0	0.0
Overall balance	0.9	1.3	1.6	0.4	1.0	1.6	0.2	0.1	0.0	0.0	0.0
Public finances											
Central government											
Revenues	12.0	11.1	11.2	11.6	11.6	12.1	12.3	12.1	12.1	12.0	12.0
Of which: Tax revenues	11.3	10.3	10.4	10.8	10.9	11.4	11.6	11.4	11.4	11.3	11.3
Direct Taxes	3.3	3.2	3.1	3.4	3.4	4.1	4.2	4.1	4.1	4.1	4.2
Indirect Taxes	8.0	7.2	7.3	7.4	7.4	7.3	7.4	7.3	7.2	7.2	7.2
Expenditures	13.6	14.2	14.5	14.4	14.0	14.3	14.6	14.5	14.2	14.2	14.2
Current	9.9	10.7	11.0	10.8	11.1	11.1	11.3	11.3	11.2	11.1	11.0
Capital	3.7	3.5	3.6	3.6	2.9	3.2	3.3	3.2	3.0	3.1	3.2
Primary balance	-0.3	-1.7	-1.8	-1.3	-0.9	-0.7	-0.7	-0.6	-0.4	-0.4	-0.3
Overall balance	-1.6	-3.1	-3.3	-2.8	-2.4	-2.2	-2.3	-2.3	-2.2	-2.2	-2.2
Financing of the central government balance	1.6	3.1	3.3	2.8	2.4	2.2	2.3	2.3	2.2	2.2	2.2
Net external financing	0.3	1.3	1.5	0.1	1.5	1.6	0.4	0.3	0.3	0.2	0.2
Net domestic financing	1.3	1.8	1.8	2.7	0.9	0.6	1.9	2.0	1.9	2.0	2.0
Central Government Debt	20.1	22.9	24.1	23.7	24.3	24.9	25.7	26.4	27.0	27.5	28.1
External	11.3	13.0	13.1	11.5	12.4	13.4	13.1	12.7	12.2	11.8	11.3
Domestic 1/	8.9	9.9	11.0	12.1	11.9	11.5	12.6	13.8	14.7	15.7	16.7
Memorandum items:											
GDP (billions of quetzales)	295.9	308.0	333.1	371.3	394.6	428.4	461.8	497.8	536.6	576.4	617.8
GDP deflator	9.4	3.5	5.1	5.5	4.6	4.9	4.2	4.1	4.1	3.8	3.6
CPI (eop)	9.4	-0.3	5.4	6.2	3.4	4.8	4.8	4.4	4.2	4.0	4.0
Net international reserves (millions of US$)	4,422	4,797	5,442	5,737	6,197	7,053	7,194	7,243	7,269	7,239	7,254

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

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

Table 3. Guatemala: Summary Balance of Payments

	2009	2010	2011	Prel. 2012	2013	2014	Projections 2015	2016	2017	2018
				(In millions of U.S. dollars)						
Current account balance	**273**	**-563**	**-1,599**	**-1,447**	**-1,677**	**-1,739**	**-1,734**	**-1,715**	**-1,779**	**-1,854**
Trade balance (goods)	-3,348	-4,271	-4,963	-5,731	-6,262	-6,676	-7,023	-7,377	-7,896	-8,475
Exports, f.o.b.	7,295	8,536	10,519	10,107	10,439	10,741	11,142	11,460	11,933	12,416
Imports, f.o.b.	-10,643	-12,807	-15,482	-15,838	-16,701	-17,417	-18,165	-18,837	-19,829	-20,891
Of which: oil & lubricants	-2,060	-2,344	-3,119	-3,150	-3,211	-3,262	-3,325	-3,412	-3,517	-3,608
Real services (net)	97	-27	-119	-52	-31	-14	-9	-4	-16	-32
Income (net)	-1,102	-1,211	-1,650	-1,372	-1,634	-1,728	-1,837	-1,974	-2,059	-2,166
Current transfers (net)	4,626	4,946	5,134	5,708	6,251	6,679	7,134	7,640	8,193	8,820
Of which: remittances	3,951	4,147	4,396	4,920	5,263	5,631	6,025	6,465	6,950	7,506
Capital and financial account	206	1,587	2,029	2,632	2,522	1,879	1,786	1,744	1,753	1,875
Capital account	1	3	3	0	0	0	0	0	0	0
Financial account	205	1,584	2,027	2,632	2,522	1,879	1,786	1,744	1,753	1,875
Central Bank 1/	273	-1	-2	-2	0	0	0	0	0	0
Public sector	521	612	37	733	842	255	178	183	141	138
Bonds (net)	-12	-6	-325	700	400	0	0	0	0	0
Loans	534	617	362	33	442	255	178	183	141	138
Disbursements	805	881	644	297	734	547	498	503	475	475
Amortization	-272	-263	-282	-264	-291	-292	-321	-320	-334	-337
Private sector	-589	973	1,992	1,914	1,680	1,624	1,609	1,561	1,612	1,737
FDI	574	782	1,009	1,168	1,302	1,380	1,461	1,548	1,637	1,730
Portfolio investment	-112	-6	-67	24	26	28	30	33	35	38
Other investment	-1,051	197	1,050	722	352	216	117	-20	-60	-31
Errors and omissions	-6	-346	-225	-686	0	0	0	0	0	0
Overall balance	473	677	206	499	846	140	52	29	-26	21
				(In percent of GDP)						
Current account balance	**0.7**	**-1.4**	**-3.4**	**-2.9**	**-3.1**	**-3.0**	**-2.9**	**-2.7**	**-2.6**	**-2.6**
Trade balance (goods)	-8.9	-10.3	-10.4	-11.4	-11.6	-11.7	-11.6	-11.5	-11.7	-11.8
Exports, f.o.b.	19.3	20.6	22.1	20.1	19.4	18.8	18.4	17.9	17.6	17.3
Imports, f.o.b.	-28.2	-31.0	-32.5	-31.4	-31.0	-30.5	-30.1	-29.4	-29.3	-29.2
Of which: oil & lubricants	-5.5	-5.7	-6.5	-6.3	-6.0	-5.7	-5.5	-5.3	-5.2	-5.0
Real services (net)	0.3	-0.1	-0.2	-0.1	-0.1	0.0	0.0	0.0	0.0	0.0
Income (net)	-2.9	-2.9	-3.5	-2.7	-3.0	-3.0	-3.0	-3.1	-3.0	-3.0
Current transfers (net)	12.3	12.0	10.8	11.3	11.6	11.7	11.8	11.9	12.1	12.3
Of which: remittances	10.5	10.0	9.2	9.8	9.8	9.9	10.0	10.1	10.3	10.5
Capital and financial account	**0.5**	**3.8**	**4.3**	**5.2**	**4.7**	**3.3**	**3.0**	**2.7**	**2.6**	**2.6**
Capital account	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Financial account	0.5	3.8	4.3	5.2	4.7	3.3	3.0	2.7	2.6	2.6
Central Bank 1/	0.7	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Public sector	1.4	1.5	0.1	1.5	1.6	0.4	0.3	0.3	0.2	0.2
Bonds (net)	0.0	0.0	-0.7	1.4	0.7	0.0	0.0	0.0	0.0	0.0
Loans	1.4	1.5	0.8	0.1	0.8	0.4	0.3	0.3	0.2	0.2
Disbursements	2.1	2.1	1.4	0.6	1.4	1.0	0.8	0.8	0.7	0.7
Amortization	-0.7	-0.6	-0.6	-0.5	-0.5	-0.5	-0.5	-0.5	-0.5	-0.5
Private sector	-1.6	2.4	4.2	3.8	3.1	2.8	2.7	2.4	2.4	2.4
FDI	1.5	1.9	2.1	2.3	2.4	2.4	2.4	2.4	2.4	2.4
Portfolio investment	-0.3	0.0	-0.1	0.0	0.0	0.0	0.1	0.1	0.1	0.1
Other investment	-2.8	0.5	2.2	1.4	0.7	0.4	0.2	0.0	-0.1	0.0
Errors and omissions	**0.0**	**-0.8**	**-0.5**	**-1.4**	**0.0**	**0.0**	**0.0**	**0.0**	**0.0**	**0.0**
Overall balance	**1.3**	**1.6**	**0.4**	**1.0**	**1.6**	**0.2**	**0.1**	**0.0**	**0.0**	**0.0**
Memorandum items:										
Value of exports, f.o.b. (percentage change)	-7.0	17.0	23.2	-3.9	3.3	2.9	3.7	2.9	4.1	4.1
Value of imports, f.o.b. (percentage change)	-20.7	20.3	20.9	2.3	5.4	4.3	4.3	3.7	5.3	5.4
Stock of NIR (in millions of U.S. dollars) 1/	4,797	5,442	5,737	6,197	7,053	7,194	7,243	7,269	7,239	7,254
NIR in months of next-year NFGS imports	3.8	3.7	3.8	3.9	4.2	4.1	4.0	3.8	3.8	3.8
NIR over short-term debt on residual maturity	2.0	1.9	1.9	1.7	2.0	2.0	2.0	2.0	2.0	2.0
Nominal GDP (in billions of U.S. dollars)	37.7	41.3	47.7	50.4	53.9	57.1	60.4	64.0	67.7	71.6

Sources: Bank of Guatemala; Ministry of Finance; and Fund staff estimates and projections.
1/ Includes 2009 SDR allocations of US$271 million.

Table 4A. Guatemala: Public Sector Balance

	2008	2009	2010	2011	Prel. 2012	Projections 2013	2014
			(In millions of quetzales)				
Central Government							
Total revenues	**35,578**	**34,037**	**37,359**	**43,026**	**45,841**	**51,922**	**56,661**
Tax revenues	33,358	31,812	34,755	40,260	42,818	48,694	53,417
Direct Taxes	9,714	9,715	10,330	12,715	13,454	17,401	19,437
Indirect Taxes	23,644	22,096	24,425	27,545	29,364	31,294	33,979
Nontax revenues	2,220	2,225	2,604	2,766	3,023	3,227	3,245
Total expenditures	**40,355**	**43,709**	**48,386**	**53,511**	**55,320**	**61,406**	**67,419**
Current	29,291	32,986	36,522	40,092	43,881	47,718	52,051
Wages	9,260	11,154	12,529	14,156	15,081	17,501	18,242
Goods & services	7,392	7,511	8,126	8,501	10,295	9,689	10,786
Social security benefits	2,347	2,776	2,979	3,147	3,306	3,577	4,156
Interest	4,026	4,374	4,940	5,476	6,022	6,611	7,580
Transfers	6,165	7,086	7,818	8,593	8,967	10,095	11,041
Other	102	84	130	220	209	246	246
Capital	11,064	10,723	11,864	13,419	11,439	13,688	15,368
Of which: reconstruction	n.a.	n.a.	641	2,293	0	0	0
Primary expenditures	36,329	39,335	43,446	48,035	49,297	54,795	59,839
Primary balance	**-751**	**-5,297**	**-6,087**	**-5,009**	**-3,456**	**-2,873**	**-3,178**
Overall balance	**-4,777**	**-9,672**	**-11,027**	**-10,485**	**-9,479**	**-9,484**	**-10,758**
Overall balance (without reconstruction)	**n.a.**	**n.a.**	**-10,386**	**-8,192**	**n.a.**	**n.a.**	**n.a.**
Financing	**4,777**	**9,672**	**11,027**	**10,485**	**9,479**	**9,484**	**10,758**
Net external financing	850	4,117	5,110	378	5,743	6,702	2,066
Loans	850	4,117	5,110	2,923	262	3,520	2,066
Disbursements	2,763	6,273	7,161	5,030	2,329	5,838	4,426
Amortizations	1,913	2,155	2,051	2,106	2,066	2,318	2,361
Bonds	0	0	0	-2,545	5,481	3,182	0
Placements	0	0	0	0	5,481	5,569	0
Amortizations	0	0	0	2,530	0	2,387	0
Net domestic financing	3,928	5,554	5,917	10,107	3,736	2,782	8,692
Net issuance of bonds	2,019	4,388	6,171	8,305	2,019	2,307	8,917
Gross bond issuance	3,851	5,172	7,890	9,609	4,540	2,693	11,862
Amortizations	1,832	783	1,719	1,304	2,520	386	2,945
Other	-393	0	0	0	-336	0	0
Use of government deposits	2,302	1,166	-254	1,801	2,052	475	-225
Rest of nonfinancial public sector balance 1/	**2,654**	**1,200**	**1,700**	**1,485**	**1,579**	**1,714**	**1,847**
Consolidated nonfinancial public sector							
Primary balance	1,903	-4,097	-4,387	-3,524	-1,878	-1,160	-1,331
Interest	4,026	4,374	4,940	5,476	6,022	6,611	7,580
Overall balance	**-2,123**	**-8,472**	**-9,327**	**-9,000**	**-7,900**	-7,770	-8,910
Central bank balance	**609**	**-381**	**-690**	**-923**	**-1,488**	**-1,429**	**-1,164**
Memorandum items:							
Central Government debt	59,548	70,579	80,271	87,852	95,988	106,687	118,776
External	33,338	39,981	43,502	42,778	48,894	57,286	60,457
Domestic 2/	26,210	30,598	36,769	45,075	47,094	49,401	58,318
Consolidated NFPS debt	53,798	63,973	72,390	78,370	86,178	95,975	107,175
Central government gross borrowing requirement	8,522	12,611	14,796	16,425	14,065	14,575	16,063
Social spending	13,080	16,165	18,857	19,012	19,012	23,871	23,990
GDP	295,872	307,967	333,093	371,278	394,634	428,405	461,817

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

1/ 2012 balance is a staff estimate.

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

Table 4B. Guatemala: Public Sector Balance

	2008	2009	2010	2011	Prel. 2012	Projections 2013	2014	2015	2016	2017	2018
					(In percent of GDP)						
Central government											
Total revenues	**12.0**	**11.1**	**11.2**	**11.6**	**11.6**	**12.1**	**12.3**	**12.1**	**12.1**	**12.0**	**12.0**
Tax revenues	11.3	10.3	10.4	10.8	10.9	11.4	11.6	11.4	11.4	11.3	11.3
Direct taxes	3.3	3.2	3.1	3.4	3.4	4.1	4.2	4.1	4.1	4.1	4.2
Indirect taxes	8.0	7.2	7.3	7.4	7.4	7.3	7.4	7.3	7.2	7.2	7.2
Nontax revenues	0.8	0.7	0.8	0.7	0.8	0.8	0.7	0.7	0.7	0.7	0.7
Total expenditures	**13.6**	**14.2**	**14.5**	**14.4**	**14.0**	**14.3**	**14.6**	**14.5**	**14.2**	**14.2**	**14.2**
Current	9.9	10.7	11.0	10.8	11.1	11.1	11.3	11.3	11.2	11.1	11.0
Wages	3.1	3.6	3.8	3.8	3.8	4.1	3.9	3.9	3.9	3.8	3.7
Goods & services	2.5	2.4	2.4	2.3	2.6	2.3	2.3	2.4	2.3	2.3	2.3
Social security benefits	0.8	0.9	0.9	0.8	0.8	0.8	0.9	0.9	0.9	0.9	0.9
Interest	1.4	1.4	1.5	1.5	1.5	1.5	1.6	1.7	1.8	1.8	1.9
Transfers	2.1	2.3	2.3	2.3	2.3	2.4	2.4	2.4	2.3	2.3	2.3
Other	0.0	0.0	0.0	0.1	0.1	0.1	0.1	0.0	0.0	0.0	0.0
Capital	3.7	3.5	3.6	3.6	2.9	3.2	3.3	3.2	3.0	3.1	3.2
Of which: reconstruction	n.a.	n.a.	0.2	0.6	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Primary expenditures	12.3	12.8	13.0	12.9	12.5	12.8	13.0	12.8	12.5	12.4	12.4
Primary balance	**-0.3**	**-1.7**	**-1.8**	**-1.3**	**-0.9**	**-0.7**	**-0.7**	**-0.6**	**-0.4**	**-0.4**	**-0.3**
Overall balance	**-1.6**	**-3.1**	**-3.3**	**-2.8**	**-2.4**	**-2.2**	**-2.3**	**-2.3**	**-2.2**	**-2.2**	**-2.2**
Overall balance (without reconstruction)	**n.a.**	**n.a.**	**-3.1**	**-2.2**	**n.a.**	**n.a.**	**n.a.**	**n.a.**	**n.a.**	**n.a.**	**n.a.**
Financing	**1.6**	**3.1**	**3.3**	**2.8**	**2.4**	**2.2**	**2.3**	**2.3**	**2.2**	**2.2**	**2.2**
Net external financing	0.3	1.3	1.5	0.1	1.5	1.6	0.4	0.3	0.3	0.2	0.2
Loans	0.3	1.3	1.5	0.8	0.1	0.8	0.4	0.3	0.3	0.2	0.2
Disbursements	0.9	2.0	2.1	1.4	0.6	1.4	1.0	0.8	0.8	0.7	0.7
Amortizations	0.6	0.7	0.6	0.6	0.5	0.5	0.5	0.5	0.5	0.5	0.5
Bonds	0.0	0.0	0.0	-0.7	1.4	0.7	0.0	0.0	0.0	0.0	0.0
Placements	0.0	0.0	0.0	0.0	1.4	1.3	0.0	0.0	0.0	0.0	0.0
Amortizations	0.0	0.0	0.0	0.7	0.0	0.6	0.0	0.0	0.0	0.0	0.0
Net domestic financing	1.3	1.8	1.8	2.7	0.9	0.6	1.9	2.0	1.9	2.0	2.0
Net issuance of bonds	0.7	1.4	1.9	2.2	0.5	0.5	1.9	2.1	2.0	2.0	2.0
Gross bond issuance	1.3	1.7	2.4	2.6	1.2	0.6	2.6	2.9	3.0	2.4	2.5
Amortizations	0.6	0.3	0.5	0.4	0.6	0.1	0.6	0.8	1.0	0.4	0.5
Other	-0.1	0.0	0.0	0.0	-0.1	0.0	0.0	0.0	0.0	0.0	0.0
Use of government deposits	0.8	0.4	-0.1	0.5	0.5	0.1	0.0	0.0	0.0	0.0	0.0
Rest of nonfinancial public sector balance 1/	**0.9**	**0.4**	**0.5**	**0.4**	**0.4**	**0.4**	**0.4**	**0.4**	**0.4**	**0.4**	**0.4**
Consolidated nonfinancial public sector											
Primary balance	0.6	-1.3	-1.3	-0.9	-0.5	-0.3	-0.3	-0.2	0.0	0.0	0.1
Interest	1.4	1.4	1.5	1.5	1.5	1.5	1.6	1.7	1.8	1.8	1.9
Overall balance	**-0.7**	**-2.8**	**-2.8**	**-2.4**	**-2.0**	**-1.8**	**-1.9**	**-1.9**	**-1.8**	**-1.8**	**-1.8**
Central bank balance	**0.2**	**-0.1**	**-0.2**	**-0.2**	**-0.4**	**-0.3**	**-0.3**	**-0.2**	**-0.2**	**-0.2**	**-0.2**
Memorandum items:											
Central Government debt	**20.1**	**22.9**	**24.1**	**23.7**	**24.3**	**24.9**	**25.7**	**26.4**	**27.0**	**27.5**	**28.1**
External	11.3	13.0	13.1	11.5	12.4	13.4	13.1	12.7	12.2	11.8	11.3
Domestic 2/	8.9	9.9	11.0	12.1	11.9	11.5	12.6	13.8	14.7	15.7	16.7
Consolidated NFPS debt	18.2	20.8	21.7	21.1	21.8	22.4	23.2	23.9	24.4	25.0	25.5
Central government gross borrowing requirements	2.9	4.1	4.4	4.4	3.6	3.4	3.5	3.7	3.7	3.1	3.2
Social spending	4.4	5.2	5.7	5.1	4.8	5.6	5.2	5.2	5.2	5.2	5.2
Structural primary balance	-0.6	-1.8	-1.6	-0.9	-0.9	-0.8	-0.8	-0.7	-0.5	-0.5	-0.5
Fiscal Impulse	0.2	1.2	-0.2	-0.8	0.1	-0.2	0.0	-0.1	-0.2	0.0	0.0

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

1/ 2012 balance is a staff estimate.

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

Table 4C. Guatemala: Statement of the Central Government Operations and Financial Balance, GFSM 2001 Classification

	2009	2010	2011	Prel. 2012	Projections 2013	2014	2015	2016	2017	2018
	(In millions of quetzales)									
Central government operations										
Revenue	**34,026**	**37,331**	**43,013**	**45,822**	**51,911**	**56,649**	**60,426**	**64,665**	**69,415**	**74,316**
Taxes	31,219	34,075	39,140	41,765	47,767	52,493	55,946	59,836	64,227	68,756
Other revenue	2,807	3,256	3,873	4,058	4,143	4,156	4,480	4,829	5,187	5,560
Expenditure	**43,698**	**48,358**	**53,498**	**55,301**	**61,394**	**67,407**	**71,978**	**76,447**	**82,110**	**88,018**
Expense	**39,928**	**44,111**	**48,023**	**52,918**	**58,531**	**64,192**	**68,646**	**73,024**	**78,373**	**83,883**
Compensation of employees	11,154	12,529	14,156	15,081	17,501	18,242	19,166	20,927	21,902	22,550
Use of goods and services	7,511	8,126	8,501	10,295	9,689	10,786	11,705	12,239	13,146	14,091
Interest	4,374	4,940	5,476	6,022	6,611	7,580	8,488	9,480	10,488	11,573
Other expense	16,889	18,517	19,890	21,519	24,731	27,585	29,287	30,377	32,838	35,669
Net acquisition of nonfinancial assets	**3,769**	**4,247**	**5,475**	**2,383**	**2,863**	**3,215**	**3,332**	**3,423**	**3,737**	**4,135**
Gross Operating Balance	**-5,902**	**-6,780**	**-5,010**	**-7,095**	**-6,621**	**-7,543**	**-8,220**	**-8,359**	**-8,958**	**-9,567**
Net lending (+)/borrowing (–)	**-9,672**	**-11,027**	**-10,485**	**-9,479**	**-9,484**	**-10,758**	**-11,552**	**-11,781**	**-12,695**	**-13,702**
Net acquisition of financial assets	**-1,166**	**254**	**-1,801**	**-1,716**	**-475**	**225**	**212**	**228**	**188**	**134**
Net incurrence of liabilities	**8,506**	**11,281**	**8,684**	**7,762**	**9,009**	**10,983**	**11,764**	**12,009**	**12,883**	**13,836**
Financial Balance 1/										
Net financial worth 2/	**-52,551**	**-61,314**	**-69,944**	**-76,223**	**-86,818**	**-98,421**	**-110,830**	**-123,472**	**-136,784**	**-151,023**
Financial assets	**18,028**	**18,957**	**17,909**	**19,765**	**19,869**	**20,354**	**20,781**	**21,223**	**21,777**	**22,274**
Domestic	**18,028**	**18,957**	**17,909**	**19,765**	**19,869**	**20,354**	**20,781**	**21,223**	**21,777**	**22,274**
Currency and deposits	18,028	18,957	17,909	19,765	19,869	20,354	20,781	21,223	21,777	22,274
Foreign	**0**	**0**	**0**	**0**	**0**	**0**	**0**	**0**	**0**	**0**
Net incurrence of liabilities	**70,579**	**80,271**	**87,853**	**95,988**	**106,687**	**118,776**	**131,610**	**144,695**	**158,560**	**173,297**
Domestic 3/	**30,598**	**36,769**	**45,075**	**47,094**	**49,401**	**58,318**	**68,620**	**79,093**	**90,776**	**103,425**
Debt securities	30,598	36,769	45,075	47,094	49,401	58,318	68,620	79,093	90,776	103,425
Foreign	**39,981**	**43,502**	**42,778**	**48,894**	**57,286**	**60,457**	**62,991**	**65,602**	**67,784**	**69,872**
Debt securities	7,971	7,655	4,918	10,500	13,866	14,129	14,377	14,619	14,836	15,031
Loans	32,009	35,847	37,860	38,394	43,419	46,328	48,614	50,982	52,948	54,841
	(In percent of GDP)									
Central Government Operations										
Revenue	**25.5**	**25.4**	**26.5**	**26.3**	**27.3**	**27.3**	**26.3**	**24.7**	**23.5**	**24.1**
Taxes	23.4	23.2	24.1	24.0	25.1	25.3	24.3	22.9	21.7	22.3
Other revenue	2.1	2.2	2.4	2.3	2.2	2.0	1.9	1.8	1.8	1.8
Expenditure	**32.8**	**32.9**	**32.9**	**31.8**	**32.2**	**32.4**	**31.3**	**29.2**	**27.8**	**28.6**
Expense	**29.9**	**30.0**	**29.6**	**30.4**	**30.7**	**30.9**	**29.9**	**27.9**	**26.5**	**27.2**
Compensation of employees	8.4	8.5	8.7	8.7	9.2	8.8	8.3	8.0	7.4	7.3
Use of goods and services	5.6	5.5	5.2	5.9	5.1	5.2	5.1	4.7	4.4	4.6
Interest	3.3	3.4	3.4	3.5	3.5	3.6	3.7	3.6	3.5	3.8
Other expense	12.7	12.6	12.2	12.4	13.0	13.3	12.7	11.6	11.1	11.6
Net acquisition of nonfinancial assets	**2.8**	**2.9**	**3.4**	**1.4**	**1.5**	**1.5**	**1.4**	**1.3**	**1.3**	**1.3**
Gross Operating Balance	**-4.4**	**-4.6**	**-3.1**	**-4.1**	**-3.5**	**-3.6**	**-3.6**	**-3.2**	**-3.0**	**-3.1**
Net lending (+)/borrowing (–)	**-7.2**	**-7.5**	**-6.5**	**-5.4**	**-5.0**	**-5.2**	**-5.0**	**-4.5**	**-4.3**	**-4.4**
Net acquisition of financial assets	**-0.9**	**0.2**	**-1.1**	**-1.0**	**-0.2**	**0.1**	**0.1**	**0.1**	**0.1**	**0.0**
Net incurrence of liabilities	**6.4**	**7.7**	**5.3**	**4.5**	**4.7**	**5.3**	**5.1**	**4.6**	**4.4**	**4.5**
Financial Balance 1/										
Net financial worth 2/	**-39.4**	**-41.7**	**-43.0**	**-43.8**	**-45.6**	**-47.4**	**-48.2**	**-47.2**	**-46.2**	**-49.0**
Financial assets	**13.5**	**12.9**	**11.0**	**11.4**	**10.4**	**9.8**	**9.0**	**8.1**	**7.4**	**7.2**
Domestic	**13.5**	**12.9**	**11.0**	**11.4**	**10.4**	**9.8**	**9.0**	**8.1**	**7.4**	**7.2**
Currency and deposits	13.5	12.9	11.0	11.4	10.4	9.8	9.0	8.1	7.4	7.2
Foreign	**0.0**	**0.0**	**0.0**	**0.0**	**0.0**	**0.0**	**0.0**	**0.0**	**0.0**	**0.0**
Net incurrence of liabilities	**52.9**	**54.6**	**54.1**	**55.2**	**56.0**	**57.2**	**57.3**	**55.3**	**53.6**	**56.3**
Domestic 3/	**22.9**	**25.0**	**27.7**	**27.1**	**25.9**	**28.1**	**29.9**	**30.2**	**30.7**	**33.6**
Debt securities	22.9	25.0	27.7	27.1	25.9	28.1	29.9	30.2	30.7	33.6
Foreign	**30.0**	**29.6**	**26.3**	**28.1**	**30.1**	**29.1**	**27.4**	**25.1**	**22.9**	**22.7**
Debt securities	6.0	5.2	3.0	6.0	7.3	6.8	6.3	5.6	5.0	4.9
Loans	24.0	24.4	23.3	22.1	22.8	22.3	21.2	19.5	17.9	17.8

Sources: Ministry of Finance; Bank of Guatemala; and Fund staff estimates and projections.
1/ Based on available stock elements.
2/ Changes in net financial worth do not equal net lending due to valuation adjustments and statistical discrepancies.
3/ Does not include recapitilization obligations to the central bank.

Table 5. Guatemala: Monetary Sector Survey

	2008	2009	2010	2011	2012	Projections 2013	2014
	(In millions of quetzales)						
Bank of Guatemala (BOG)							
Net international reserves 1/	**34,305**	**39,963**	**43,556**	**44,673**	**48,802**	**56,529**	**58,755**
(In millions of U.S. dollars) 1/	4,422	4,797	5,442	5,737	6,197	7,053	7,194
Net domestic assets	**-17,551**	**-21,793**	**-23,811**	**-24,365**	**-27,641**	**-33,558**	**-33,844**
Net claims on nonfinancial public sector	-12,974	-9,320	-10,640	-9,655	-10,440	-10,833	-11,451
Central government (CG)	-8,000	-5,209	-6,100	-4,748	-3,828	-3,354	-3,576
Rest of nonfinancial public sector	-4,974	-4,111	-4,540	-4,907	-6,612	-7,478	-7,875
Bank of Guatemala losses	14,399	14,780	15,470	16,445	17,766	19,196	20,359
Net credit to banks	-11,283	-14,516	-15,933	-18,051	-21,425	-22,919	-25,463
Of which: legal reserves	-13,345	-16,577	-17,994	-20,111	-23,484	-24,978	-27,522
Open market operations 2/	-10,848	-11,130	-12,640	-13,529	-14,034	-19,229	-20,206
Other assets (net)	3,155	-1,607	-67	424	492	227	2,917
Currency in circulation	16,754	18,170	19,745	20,308	21,161	22,971	24,911
Banking sector							
Net foreign position	**-10,560**	**-6,971**	**-7,989**	**-13,568**	**-19,253**	**-17,658**	**-19,263**
(in millions of U.S. Dollars)	-1,361	-837	-998	-1,743	-2,445	-2,203	-2,359
Net claims on Bank of Guatemala	**20,897**	**23,597**	**26,782**	**29,497**	**35,158**	**41,733**	**45,233**
Legal reserves	13,345	16,577	17,994	20,111	23,484	24,978	27,522
BOG securities	9,606	9,074	10,842	11,438	13,726	18,807	19,763
Liabilities to BOG	-2,054	-2,054	-2,053	-2,053	-2,052	-2,052	-2,052
Net domestic assets	**88,831**	**92,309**	**102,085**	**118,672**	**133,539**	**140,751**	**156,469**
Net credit to the NFPS	-559	1,527	6,222	9,096	6,317	6,893	11,087
Official capital and reserves	-2,752	-3,143	-3,604	-4,016	-4,159	-4,762	-5,381
Credit to the private sector	87,209	88,189	93,250	106,392	125,176	145,194	165,553
Other items net	4,933	5,735	6,217	7,200	6,206	-6,575	-14,791
Medium and long-term foreign liabilities	**1,210**	**1,112**	**670**	**953**	**1,658**	**531**	**10**
Liabilities to private sector	**97,959**	**107,823**	**120,208**	**133,648**	**147,787**	**164,296**	**181,862**
Demand deposits	35,710	38,811	43,713	48,267	52,195	57,519	62,928
Time and savings deposits	51,739	57,637	64,090	72,652	81,680	90,851	100,938
Capital and reserves (private banks)	10,510	11,375	12,405	12,729	13,912	15,926	17,996
Monetary survey							
Net foreign assets	**23,746**	**32,992**	**35,566**	**31,105**	**29,549**	**38,871**	**39,491**
(In millions of U.S. dollars)	3,061	3,961	4,444	3,995	3,752	4,850	4,835
Net domestic assets	**93,419**	**96,170**	**106,831**	**125,895**	**141,365**	**149,348**	**168,302**
Net claims on nonfinancial public sector	-13,533	-7,793	-4,418	-559	-4,123	-3,940	-364
Bank of Guatemala losses	14,399	14,780	15,470	16,445	17,766	19,196	20,359
Credit to private sector	92,153	93,842	99,241	112,998	132,236	153,382	174,888
Other assets (net)	399	-4,660	-3,462	-2,990	-4,514	-19,290	-26,582
Medium and long-term foreign liabilities	**1,210**	**1,112**	**670**	**953**	**1,658**	**531**	**577**
Liabilities to the private sector	**115,954**	**128,049**	**141,728**	**156,047**	**169,256**	**187,689**	**207,217**
Of which: Money	52,464	56,981	63,458	68,575	73,356	80,490	87,839
Of which: Quasi-money	63,490	71,069	78,270	87,472	95,900	107,199	119,378
Memorandum items:	(Percent change)						
Currency in circulation	-1.3	8.4	8.7	2.9	4.2	8.6	8.4
M2	7.6	10.0	11.3	10.7	9.8	10.5	10.2
Credit to private sector	11.0	1.1	5.7	14.1	17.7	16.0	14.0
	(In percent of GDP)						
Currency in circulation	5.7	5.9	5.9	5.5	5.4	5.4	5.4
M2	35.2	37.2	38.3	38.0	39.3	40.0	40.9
Net credit of the banking sector to the CG	-0.2	0.5	1.9	2.5	1.6	1.6	2.4
Credit to private sector	29.5	28.6	28.0	28.7	31.7	33.9	35.8
	(In percent of bank liabilities to the private sector)						
Banks' liquid assets	34.7	37.0	39.8	40.2	40.2	40.9	41.3
Demand deposits	36.5	36.0	36.4	36.1	35.3	35.0	34.6
Time and savings deposits	52.8	53.5	53.3	54.4	55.3	55.3	55.5
Capital and reserves (private banks)	10.7	10.5	10.3	9.5	9.4	9.7	9.9

Sources: Bank of Guatemala; and Fund staff estimates and projections.
1/ Excludes foreign currency liabilities of the central bank to financial institutions.
2/ Includes open market placements with the private sector (financial and nonfinancial).

Table 6. Guatemala: Financial Soundness Indicators

	2008	2009	2010	2011	2012	2013 April
On-shore banks						
Regulatory capital to risk-weighted assets	13.5	15.4	15.2	15.3	14.7	14.6
Nonperforming loans to total gross loans	2.2	2.7	2.1	1.6	1.3	1.4
Provisions to non-performing loans	73.2	89.3	115.3	126.2	143.4	163.0
Cash to total deposits	19.4	21.6	20.3	21.6	21.6	20.3
Return on assets	1.7	1.7	1.7	1.7	1.6	1.6
Return on equity	16.3	15.7	16.3	18.5	17.2	18.0
Foreign currency-denominated loans to total loans	33.6	31.0	30.2	34.0	35.2	34.9
Foreign currency-denominated liabilities to total liabilities	24.3	23.9	24.6	27.5	28.6	28.2
Off-shore banks						
Statutory capital to risk-weighted assets	14.7	18.1	18.5	16.2	16.8	n.a.
Nonperforming loans to total gross loans	2.2	2.3	2.1	1.7	1.2	n.a.
Provisions to non-performing loans	58.1	75.4	110.7	143.0	172.4	n.a.
Return on assets	1.5	1.4	1.4	1.8	1.8	n.a.
Return on equity	14.2	12.8	12.6	16.0	15.6	n.a.
Total assets off-shore banks to total assets on-shore banks	16.1	16.5	14.3	12.7	12.2	n.a.

Source: Superintendency of Banks.

Table 7. Guatemala: Indicators of External Vulnerability

					Prel.	Projections	
	2008	2009	2010	2011	2012	2013	2014
External indicators							
Merchandise exports (12-month percentage change)	12.4	-7.0	17.0	23.2	-3.9	3.3	2.9
Traditional merchandise exports (12-month percentage change)	18.5	3.8	17.2	24.9	-4.1	-11.1	4.9
Nontraditional merchandise exports (12-month percentage change)	10.5	-10.6	16.9	22.6	-3.8	8.8	2.3
Merchandise imports (12-month percentage change)	7.6	-20.7	20.3	20.9	2.3	5.4	4.3
Imports of oil and lubricants (12-month percentage change)	17.4	-23.0	13.8	33.1	1.0	2.0	1.6
Non-oil imports (12-month percentage change)	5.4	-20.1	21.9	18.2	2.6	6.3	4.9
Terms of trade (12-month percentage change)	-2.8	9.1	1.4	3.9	-3.6	-0.1	0.4
Current account balance (in percent of GDP)	-3.6	0.7	-1.4	-3.4	-2.9	-3.1	-3.0
Capital and financial account balance (in percent of GDP)	3.7	0.5	3.8	4.3	5.2	4.7	3.3
Net international reserves							
In millions of U.S. dollars	4,422	4,797	5,442	5,737	6,197	7,053	7,194
In percent of reserve adequacy metric 1/	133.5	150.3	150.3	139.0	138.5	148.5	
In percent of M2	32.9	34.9	34.1	31.6	31.5	33.0	31.1
In percent of base money	114.0	115.0	115.4	110.5	109.3	117.9	112.1
In percent of short-term external debt on a remaining maturity basis	158.7	196.7	193.8	186.8	169.5	201.6	198.7
In months of next-year's imports of goods and nonfactor services	4.2	3.8	3.7	3.8	3.9	4.2	4.1
External indebtness indicators							
Total external debt (in percent of GDP)	27.0	28.0	27.4	27.4	29.1	29.5	28.7
External private sector debt (in percent of GDP)	15.7	15.1	14.4	15.9	16.7	16.1	15.0
External public sector debt (in percent of GDP)	11.3	13.0	13.1	11.5	12.4	13.4	13.7
Public sector external interest payments in percent of exports of goods and nonfactor services	3.1	3.4	3.2	2.6	2.5	3.2	4.1
Public sector external amortization payments in percent of exports of goods and services	2.9	3.8	3.0	5.5	2.5	5.9	2.8

Sources: Bank of Guatemala and Fund staff estimates.

1/ Stock in percent of weighted aggregate of M2, exports of goods and services, short-term external debt at a remaining maturity, and other external portfolio liabilities. For more details, see *Assessing Reserve Adequacy* (IMF Policy Paper 11/31).

Table 8. Guatemala: External Debt Sustainability Framework, 2008-18

(In percent of GDP, unless otherwise indicated)

	Actual					Projections						
	2008	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018	Debt-stabilizing non-interest current account 6/
Baseline: External debt	27.0	28.0	27.4	27.4	29.1	**29.8**	**28.7**	**27.3**	**25.8**	**24.2**	**22.9**	**-2.5**
Change in external debt	-3.5	1.0	-0.6	0.0	1.7	0.7	-1.1	-1.4	-1.5	-1.6	-1.4	
Identified external debt-creating flows (4+8+9)	-2.2	-1.3	-3.0	-2.1	-1.4	-0.6	-0.7	-0.9	-1.0	-1.0	-1.0	
Current account deficit, excluding interest payments	2.1	-2.0	0.2	2.3	1.8	1.5	1.4	1.3	1.1	1.1	1.1	
Deficit in balance of goods and services	14.3	8.6	10.4	10.7	11.5	11.4	11.4	11.1	11.1	11.1	11.3	
Exports	25.5	24.9	26.1	26.8	24.7	24.1	23.4	22.9	22.5	22.1	21.7	
Imports	39.8	33.5	36.5	37.5	36.2	35.5	34.8	34.0	33.6	33.2	33.1	
Net non-debt creating capital inflows (negative)	-1.9	-1.6	-1.9	-2.2	-2.4	-2.5	-2.5	-2.5	-2.5	-2.5	-2.5	
Automatic debt dynamics 1/	-2.4	2.3	-1.3	-2.3	-0.8	0.3	0.4	0.3	0.4	0.4	0.4	
Contribution from nominal interest rate	1.5	1.3	1.2	1.1	1.0	1.3	1.3	1.3	1.3	1.2	1.2	
Contribution from real GDP growth	-0.9	-0.1	-0.7	-1.0	-0.8	-0.9	-1.0	-0.9	-0.9	-0.9	-0.8	
Contribution from price and exchange rate changes 2/	-3.0	1.2	-1.7	-2.3	-1.1	...	...	...	...	...	...	
Residual, incl. change in gross foreign assets (2-3) 3/	-1.2	2.4	2.4	2.2	3.0	1.3	-0.4	-0.5	-0.5	-0.6	-0.4	
External debt-to-exports ratio (in percent)	105.8	112.5	104.9	102.4	117.9	123.7	122.7	119.3	114.8	109.6	105.2	
Gross external financing need (in billions of US dollars) 4/	5.2	3.4	3.8	5.3	5.5	6.1	6.0	6.0	6.0	5.9	5.9	
in percent of GDP	13.2	9.1	9.3	11.1	10.8	11.4	10.6	10.0	9.4	8.8	8.3	
Scenario with key variables at their historical averages 5/						**29.8**	**29.2**	**28.4**	**27.6**	**26.8**	**26.0**	**-2.9**
Key Macroeconomic Assumptions Underlying Baseline												
Nominal GDP (US dollars)	39.1	37.7	41.3	47.7	50.4	53.4	56.6	60.0	63.4	67.2	71.0	
Real GDP growth (in percent)	3.3	0.5	2.9	4.2	3.0	3.3	3.4	3.5	3.5	3.5	3.5	
GDP deflator in US dollars (change in percent)	11.1	-4.1	6.5	9.2	4.0	2.7	2.4	2.5	2.2	2.3	2.0	
Nominal external interest rate (in percent)	5.6	4.7	4.6	4.5	4.1	4.6	4.7	4.8	4.9	5.0	5.4	
Growth of exports (US dollar terms, in percent)	14.6	-5.9	14.9	18.4	-2.6	3.4	2.9	3.7	3.9	4.1	3.8	
Growth of imports (US dollar terms, in percent)	7.3	-18.8	19.4	18.3	2.0	4.0	3.9	3.6	4.6	4.5	5.3	
Current account balance, excluding interest payments	-2.1	2.0	-0.2	-2.3	-1.8	-1.5	-1.4	-1.3	-1.1	-1.1	-1.1	
Net non-debt creating capital inflows	1.9	1.6	1.9	2.2	2.4	2.5	2.5	2.5	2.5	2.5	2.5	

1/ Derived as [r - g - r(1+g) + ea(1+r)]/(1+g+r+gr) times previous period debt stock, with r = nominal effective interest rate on external debt; r = change in domestic GDP deflator in US dollar terms, g = real GDP growth rate, e = nominal appreciation (increase in dollar value of domestic currency), and a = share of domestic-currency denominated debt in total external debt.

2/ The contribution from price and exchange rate changes is defined as [-r(1+g) + ea(1+r)]/(1+g+r+gr) times previous period debt stock. r increases with an appreciating domestic currency (e > 0) and rising inflation (based on GDP deflator).

3/ For projection, line includes the impact of price and exchange rate changes.

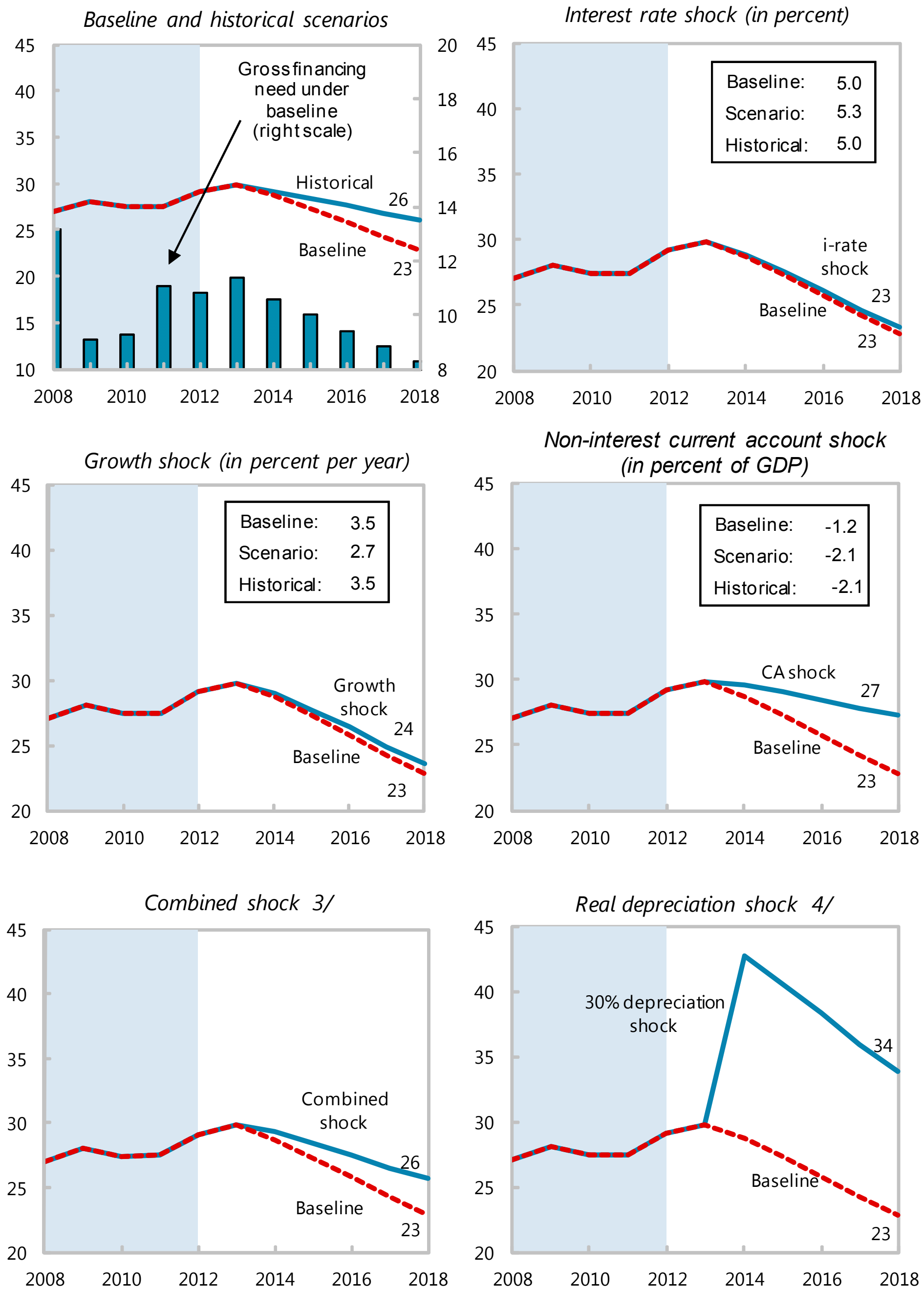
4/ Defined as current account deficit, plus amortization on medium- and long-term debt, plus short-term debt at end of previous period.

5/ The key variables include real GDP growth; nominal interest rate; dollar deflator growth; and both non-interest current account and non-debt inflows in percent of GDP.

6/ Long-run, constant balance that stabilizes the debt ratio assuming that key variables (real GDP growth, nominal interest rate, dollar deflator growth, and non-debt inflows in percent of GDP) remain at their levels of the last projection year.

Figure 6. 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.

Table 9. Guatemala: Public Sector Debt Sustainability Framework, 2008-18

(In percent of GDP, unless otherwise indicated)

	Actual					Projections						
	2008	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018	Debt-stabilizing primary balance 9/
Baseline: Public sector debt 1/	20.1	22.9	24.1	23.7	24.3	**24.9**	**25.7**	**26.4**	**27.0**	**27.5**	**28.1**	**0.2**
o/w foreign-currency denominated	12.4	14.1	14.4	13.2	14.2	15.0	14.5	13.9	13.4	12.9	12.3	
Change in public sector debt	-1.2	2.8	1.2	-0.4	0.7	0.6	0.8	0.7	0.5	0.5	0.5	
Identified debt-creating flows (4+7+12)	-0.6	3.3	1.0	0.3	0.8	0.3	0.5	0.5	0.3	0.3	0.4	
Primary deficit	0.3	1.7	1.8	1.3	0.9	0.7	0.7	0.6	0.4	0.4	0.3	
Revenue and grants	12.0	11.1	11.2	11.6	11.6	12.1	12.3	12.1	12.1	12.0	12.0	
Primary (noninterest) expenditure	12.3	12.8	13.0	12.9	12.5	12.8	13.0	12.8	12.5	12.4	12.4	
Automatic debt dynamics 2/	-0.9	1.5	-0.8	-1.1	0.0	-0.4	-0.2	-0.2	-0.1	0.0	0.0	
Contribution from interest rate/growth differential 3/	-1.1	0.6	-0.2	-0.7	-0.2	-0.4	-0.2	-0.2	-0.1	0.0	0.0	
Of which contribution from real interest rate	-0.5	0.7	0.4	0.2	0.5	0.4	0.6	0.7	0.7	0.8	0.9	
Of which contribution from real GDP growth	-0.6	-0.1	-0.6	-0.9	-0.7	-0.8	-0.8	-0.8	-0.9	-0.9	-0.9	
Contribution from exchange rate depreciation 4/	0.2	0.9	-0.5	-0.4	0.1	...	...	...	...	...	...	
Other identified debt-creating flows	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	
Privatization receipts (negative)	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	
Recognition of implicit or 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 (specify, e.g. bank recapitalization)	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	
Residual, including asset changes (2-3) 5/	-0.6	-0.5	0.2	-0.7	-0.2	0.3	0.3	0.3	0.2	0.2	0.2	
Public sector debt-to-revenue ratio 1/	167.4	207.4	214.5	203.5	209.2	205.5	209.6	217.8	223.7	228.4	233.1	
Gross financing need 6/	2.9	4.1	4.4	4.4	3.6	3.4	3.5	3.7	3.7	3.1	3.2	
in billions of U.S. dollars	1.1	1.5	1.8	2.1	1.8	1.8	2.0	2.2	2.4	2.1	2.3	
Scenario with key variables at their historical averages 7/						**24.9**	**25.5**	**26.1**	**26.6**	**27.1**	**27.5**	**-0.3**
Scenario with no policy change (constant primary balance) in 2013-2018						**24.9**	**25.7**	**26.5**	**27.2**	**28.1**	**29.0**	**0.2**
Key Macroeconomic and Fiscal Assumptions Underlying Baseline												
Real GDP growth (in percent)	3.3	0.5	2.9	4.2	3.0	3.5	3.5	3.5	3.5	3.5	3.5	
Average nominal interest rate on public debt (in percent) 8/	7.2	7.3	7.0	6.8	6.9	6.9	7.1	7.1	7.2	7.2	7.3	
Average real interest rate (nominal rate minus change in GDP deflator, in	-2.2	3.8	1.9	1.3	2.2	2.0	3.0	3.0	3.1	3.5	3.7	
Nominal appreciation (increase in US dollar value of local currency, in per	-1.9	-6.8	4.1	2.7	-1.1	...	...	...	...	...	...	
Inflation rate (GDP deflator, in percent)	9.4	3.5	5.1	5.5	4.6	4.9	4.2	4.1	4.1	3.8	3.6	
Growth of real primary spending (deflated by GDP deflator, in percent)	-0.9	4.6	5.1	4.8	-1.9	6.0	4.9	1.9	1.3	3.1	3.1	
Primary deficit	0.3	1.7	1.8	1.3	0.9	0.7	0.7	0.6	0.4	0.4	0.3	

1/ Indicate coverage of public sector, e.g., general government or nonfinancial public sector. Also whether net or gross debt is used.

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

3/ The real interest rate contribution is derived from the denominator in footnote 2/ as r - π (1+g) and the real growth contribution as -g.

4/ The exchange rate contribution is derived from the numerator in footnote 2/ as ae(1+r).

5/ For projections, this line includes exchange rate changes.

6/ Defined as public sector deficit, plus amortization of medium and long-term public sector debt, plus short-term debt at end of previous period.

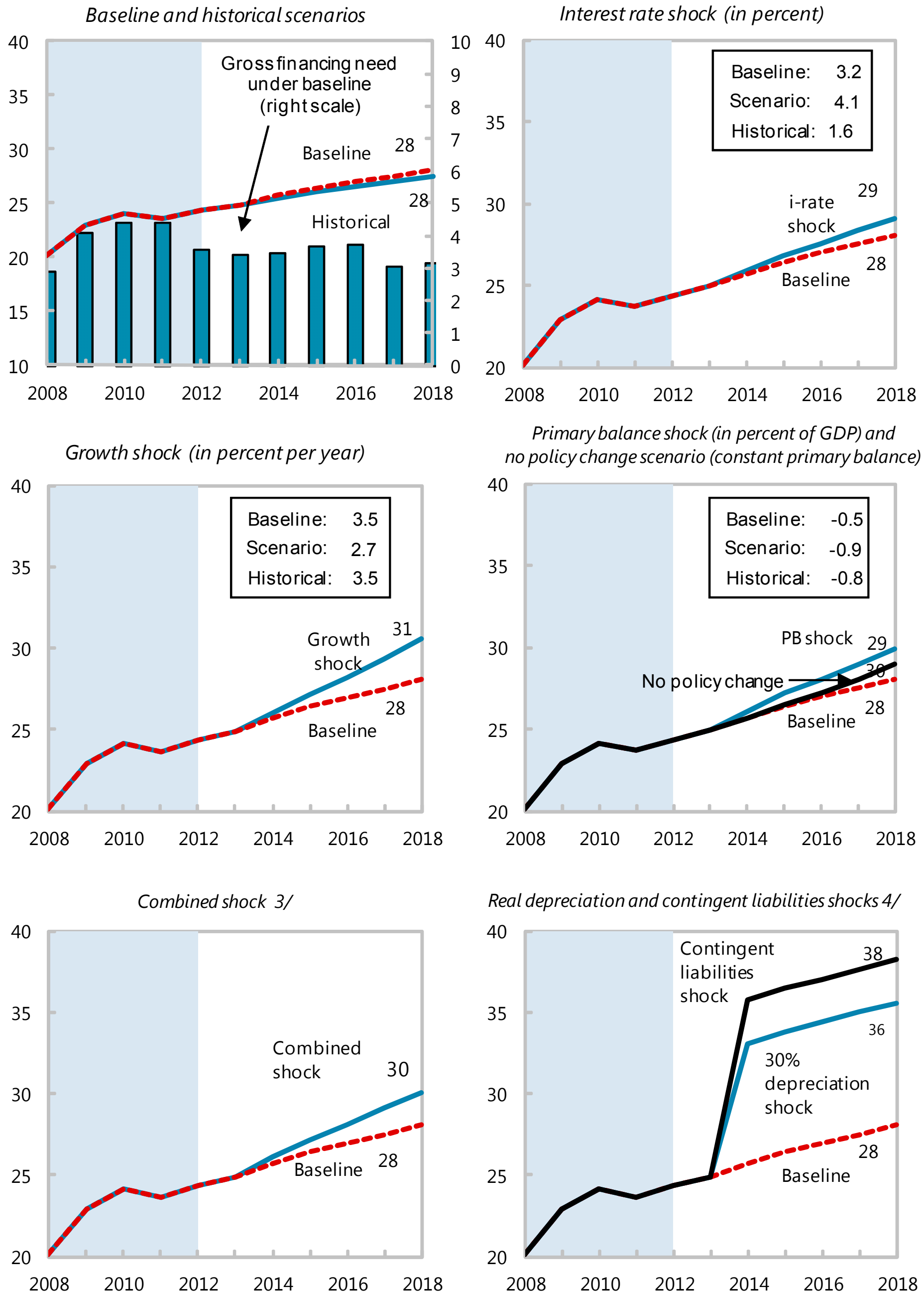
7/ The key variables include real GDP growth; real interest rate; and primary balance in percent of GDP.

8/ Derived as nominal interest expenditure divided by previous period debt stock.

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

Figure 7. Guatemala: Public Debt Sustainability: Bound Tests 1/ 2/

(Public 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 primary balance.
4/ One-time real depreciation of 30 percent and 10 percent of GDP shock to contingent liabilities occur in 2010, with real depreciation defined as nominal depreciation (measured by percentage fall in dollar value of local currency) minus domestic inflation (based on GDP deflator).

INTERNATIONAL MONETARY FUND

GUATEMALA

July 9, 2013

STAFF REPORT FOR THE 2013 ARTICLE IV CONSULTATION—INFORMATIONAL ANNEX

Prepared By The Western Hemisphere Department

CONTENTS

FUND RELATIONS

(As of May 31, 2013)

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

General Resources Account:	**SDR Million**	**Percentage of Quota**
Quota	210.20	100.00
Fund holdings of currency	210.21	100.00
Reserve Tranche Position	0.00	0.00

SDR Department:	**SDR Million**	**Percentage of Allocation**
Net cumulative allocation	200.91	100.00
Holdings	173.51	86.36

Outstanding Purchases and Loans: None

Latest Financial Arrangements:

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

Projected Payments to Fund[1]

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

	Forthcoming				
	2013	2014	2015	2016	2017
Principal					
Charges/Interest	0.01	0.02	0.02	0.02	0.02
Total	0.01	0.02	0.02	0.02	0.02

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

[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.

(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 financial reporting transparency and the management of foreign exchange reserves. Recommendations were made to further strengthen the bank's governance and independence.

Exchange Rate Arrangement. Since March 1994, Guatemala has had an arrangement based on an interbank foreign exchange market in which authorized financial institutions buy and sell foreign exchange at market-determined rates. Financial institutions authorized to operate in the foreign exchange market include commercial banks, finance companies, and exchange houses. While Guatemala has a de jure floating exchange rate arrangement, the de facto arrangement has classified as "stabilized". Guatemala has accepted the obligations of Article VIII, Sections 2, 3 and 4, and its exchange system is free of restrictions on the making of payments and transfers for current transactions. As of May 31, 2013 the reference exchange rate was Q7.82 per U.S. dollar.

FSAP participation. An FSAP was conducted on July 3–7, 2000 and on September 11–23, 2000, and the Financial System Stability Assessment was discussed by the Executive Board on May 14, 2001 at the time of the 2001 Article IV consultation. An FSAP update was undertaken during October 27–November 10, 2005.

Technical Assistance 2010–13

Department	Date of Delivery	Purpose
FAD, CAPTAC	2011, 2012, 2013	Treasury single account (multiple missions)
	2010, 2011, 2012, 2013	Revenue administration (multiple missions)
	2010, 2011, 2012, 2013	Customs administration (multiple missions)
	February 2012	Control of budgetary execution
	April 2011	Debt management strategy
	March 2011	Revenue forecasting
	March 2011	Government cash flow and financial planning
	July 2010	Public expenditure management
	March 2010	Macro-fiscal framework
MCM, CAPTAC	2011, 2012, 2013	Risk-based bank supervision (multiple missions)
	2011, 2012, 2013	Monetary operations, forecasting and liquidity administration (multiple missions)
	2011	Capital market development (multiple missions)
	March 2011	Application of international financial reporting standards in the banking system
	November-December 2010	Foreign exchange market function and intervention strategy

	November-December 2010	Risk-based supervision for the insurance sector
	April-May 2010	Developing secondary public debt markets and enhancing monetary operations
STA, CAPTAC	2012, 2013	Producer price index (multiple missions)
	2011, 2012, 2013	Export and import price indexes (multiple missions)
	2011, 2012, 2013	National accounts statistics (multiple missions)
	2010, 2011, 2012, 2013	Balance of payments and international investment position statistics (multiple missions)
	2010, 2011	Public finance statistics (multiple missions)
	2010, 2011	Monetary and financial statistics (multiple missions)

Article IV Consultation. The last Article IV consultation was concluded by the Executive Board on April 30, 2012.

Resident Representative. Through May, 2013, Mr. Fernando Delgado was the Regional Resident Representative for Central America, Panama, and the Dominican Republic, and was based in Guatemala. The post is currently vacant.

RELATIONS WITH THE WORLD BANK AND BANK-FUND COLLABORATION UNDER THE JOINT MANAGEMENT ACTION PLAN (JMAP)

1. **The IMF's Guatemala team led by Mr. Lorenzo Figliuoli (Mission Chief) has met on various occasions with the World Bank's Guatemala team led by Mr. Oscar Calvo-Gonzalez (Lead Economist and PREM Sector Leader)** to discuss macroeconomic challenges, identify macro-critical structural reforms, and coordinate the two teams' work for the period August 2013–July 2014.

2. **The teams agreed that Guatemala's main macroeconomic challenges are to safeguard fiscal sustainability, increase the effectiveness of monetary policy, and maintain financial sector stability.**

3. **The teams concurred that Guatemala's near-term outlook is generally positive, though there are risks stemming from global uncertainty and the limited scope to adopt countercyclical policies in case downside risks materialize.**

4. **Based on the shared assessment of macroeconomic challenges, the teams have identified the following structural reform areas as macro-critical:**

- *Fiscal consolidation and revenue strengthening*. Guatemala's fiscal position had deteriorated in 2009-10 due to a decline in public revenues in the aftermath of the global crisis and an increase in current expenditures. Significant fiscal adjustment occurred in 2011-12, though still insufficient to stop the rise in the ratio of public debt to GDP. The 2012 tax reform has yielded less additional revenue than anticipated due to implementation problems and legal challenges. Stabilizing public sector debt at current levels will require a fiscal adjustment of about ¾-1 percent of GDP over the medium term. However, beyond this goal, adopting additional revenue-enhancing measures and improving the efficiency and composition of public expenditure will be critical to achieving increases in spending in critical areas (e.g. social programs, infrastructure, and security).

- *Monetary policy framework*. Strengthening further the monetary framework, including by allowing greater exchange rate flexibility, is key to improve the effectiveness of monetary policy,

- *Financial sector stability*. Guatemala is well placed to apply key Basel III components and is in compliance with most of the Basel I framework. However, important work remains, including the full implementation of risk-based supervision and consolidated supervision. Approval of the law for micro-finance institution, currently under consideration by Congress, and the securities market law would also add to the system's resilience.

5. **The teams agreed the following division of labor:**

- *Fiscal consolidation and revenue strengthening*. The Fund will continue to provide policy recommendations on macro-fiscal issues, including the overall strategy of fiscal consolidation. The Fund will continue to provide technical assistance on budgetary management, which is expected to help strengthen expenditure controls and prevent the accumulation of new domestic payment arrears. The Bank has completed a Public Expenditure Review which will be presented in 2013 along with a database on expenditures at the municipal level. In 2012 the Bank's Board approved a Development Policy Loan for $200 million which aims at: (i) strengthening tax administration and tax policy; (ii) enhancing the quality of public expenditure and; (iii) improving the coordination and management of social policy. This Development Policy Loan is currently being reviewed by the Guatemalan Congress and is expected to be approved in 2013.

- *Monetary policy framework*. The Fund will continue to provide policy recommendations and technical assistance to improve the monetary framework, including regarding exchange rate flexibility.

- *Financial sector stability*. The Bank and the Fund will cooperate as necessary in assisting Guatemala to strengthen its financial system. A new FSAP is scheduled for the spring of 2014 and will be undertaken in collaboration by the Fund and the Bank.

6. **The teams have the following requests for information from their counterparts:**

- The Fund team requests to be kept informed of progress in the above macro-critical structural reform areas. Timing: when milestones are reached (and at least semi-annually).

- The Bank team requests to be kept informed of the Fund's assessments of macroeconomic policies and prospects, including updates of the Fund's macroeconomic framework, and progress in the above macro-critical structural reform areas.

7. **The attached table lists the teams' separate and joint work programs during August 2013–July 2014.**

World Bank and IMF Planned Activities in Macro-Critical Structural Reform Areas August 2013–July 2014

Title	Products	Provisional Timing of Missions	Expected Delivery Date
World Bank Work Program	DPL Fiscal Space for Greater Opportunities Public Expenditure Review	September 2013 August 2013	December 2013 Presentation in August 2013
IMF Work Program	Staff visit Technical Assistance: Strengthening medium-term expenditure framework Enhancing public expenditure management and control of arrears Strengthening risk management and ex-post controls, particularly for tax and customs administration Regional customs harmonization Review of the legal and regulatory PPP framework Development of liquidity risk management models and stress testing methodology for the banking system Extending risk-based supervision methodology to insurance sector Harmonization of regional financial statistics Strengthening balance of payments statistics	November 2013 2013-2014	
Joint Bank-Fund work program	FSAP	March, 2013	

8. **The attached table summarizes the financial relations between Guatemala and the World Bank (in million U.S. dollars).**

Project Name	Total loan	Undisbursed through FY12	Projected disbursements in FY13
Second Rural and Main Roads	46.7	1.9	1.0
Maternal and Infant Health and Nutrition	49.0	0.6	0.1
Support for Rural Economic Development	30.0	21.4	8.7
Land Administration	62.3	44.2	9.0
Education Quality and Secondary Education	80.0	43.8	17.5
Emergency Support for Social Services	100.0	25.4	25.1
GT Enhancing MSME Productivity Project	32.0	32.0	1.4

RELATIONS WITH THE INTER-AMERICAN DEVELOPMENT BANK

(As of June, 2013)

A. Recent Projects and Objectives

1. **On December 2012, the IADB approved its country strategy for Guatemala for 2012–2016.** It focuses on improving living conditions for the Guatemalan population, particularly those living in rural areas. The strategy's priority target areas are structured along two axes, the first institutional, covering the areas of (i) fiscal and municipal management, (ii) social protection, and (ii) peaceful coexistence and citizen security; and the second addressing rural development, including the areas of (iv) productive development, (v) health, and (vi) transportation. Work will also be done in the crosscutting areas of climate change adaptation and mitigation, natural disaster impact mitigation, indigenous peoples and gender; and regional integration will be promoted, particularly in the transportation and energy sectors.

2. **As of June 2013, the IADB portfolio of approved sovereign-guaranteed investment and policy-based loans under execution amounted to US$805.5 million, with an undisbursed balance of US$636.9 million.**

3. **The existing sovereign guaranteed portfolio focuses on:** (i) reform and modernization of the state; (ii) education, health, and social investment; (iii) environment and natural disasters; (iv) improving productive infrastructure (especially, electrification, water, and sanitation in rural areas); and private firms and SME development and trade. In the private sector, the IADB has an active loan (US$ 33 million approved) to support MSMEs development, the housing sector and trade.

4. **The pipeline for 2013 includes three projects in the private sector for US$41 million:** one in the financial sector for US$30 million; one operation focus on MSME sector for US$5 million; and two credit line operations for trade financing for US$6 million. On the sovereign-guaranteed side, 2013 work plan will focus on accelerating the implementation of the current portfolio rather than in approving additional financing.

IADB Loan Disbursements 2009-12

(In millions of U.S. dollars, Sovereign Guaranteed Loans)

2009	2010	2011	2012
331.2	384.2	195.7	134.7
-83.7	-82.6	-93.8	-89.4
247.5	301.6	101.9	45.3
-64.5	-77.2	-79	-71.6
-3.9	-3.6	-4.8	-6.3
179.1	220.8	18.1	-32.6

IADB Portfolio in Guatemala as of June 2013

(In millions of U.S. dollars)

Sector	Approved	Undisbursed
Water and sanitation	99.8	66
Education	150	109.8
Energy	55	38
Social Investment	16.6	1
Environment and natural disasters	74.4	44.8
Private firms and SME development	29	28.8
Reform/Modernization of the state	275.7	268.2
Health	85	66.5
Trade	20	13.7
Total	**805.5**	**636.9**

Notes: Includes sovereign-guaranteed loans.

STATISTICAL ISSUES

(As of April May 31, 2013)

Assessment of Data Adequacy for Surveillance	
General: Data provision is broadly adequate for surveillance.	
National accounts: In 2010, the Bank of Guatemala began publishing quarterly national accounts statistics consistent with the *SNA 1993,* with 2001 as the base year.	
Consumer prices and unemployment: In 2011, the consumer price index was re-based to December, 2010, and the index weights were updated to reflect changes in the consumption basket since the base 2000 index. Unemployment is estimated only on an annual basis.	
Government finance statistics: Revenue, expenditure, and financing statistics for social security agencies, local governments, and nonfinancial public enterprises are not reported, hindering the calculation of a consolidated operations statement and balance sheet for the nonfinancial public sector. The coverage and periodicity of data on central government financing and debt is adequate.	
Monetary and financial statistics: The quality, coverage, and periodicity of data for the Bank of Guatemala and commercial banks are sufficient. Data for the offshore sector and savings cooperatives is only available quarterly, and with a lag of five weeks.	
External sector statistics: The Bank of Guatemala publishes quarterly balance of payments data according to the fifth edition of the *Balance of Payments Manual.* In 2012, the Bank of Guatemala increased the periodicity of publication of international investment position data from annual to quarterly. Detail on private sector external debt by creditor and by maturity structure is not available.	
Data Standards and Quality	
Guatemala became a participant in the General Data Dissemination System in 2004. Several data categories are yet to meet the periodicity or timeliness requirements necessary for subscription to the Special Data Dissemination Standard.	A data ROSC was completed on October 28, 2004.

Guatemala: Common Indicators Required for Surveillance

(As of May 31, 2013)

	Date of latest observation	Date received	Frequency of Data 7/	Frequency of Reporting 7/	Frequency of Publication 7/
Exchange Rates	May, 31. 2013	6/4/2013	D	D	D
International Reserve Assets and Reserve Liabilities of the Monetary Authorities 1/	May, 31. 2013	6/4/2013	M	M	M
Reserve/Base Money	May, 31. 2013	6/4/2013	W	W	W
Broad Money	May, 31. 2013	6/4/2013	W	W	W
Central Bank Balance Sheet	May, 31. 2013	6/4/2013	D	D	D
Consolidated Balance Sheet of the Banking System	May, 31. 2013	6/4/2013	M	M	M
Interest Rates 2/	May, 31. 2013	6/4/2013	W	W	W
Consumer Price Index	April, 30. 2013	5/6/2013	M	M	M
Revenue, Expenditure, Balance and Composition of Financing 3/– Central Government	Apr. 2013	6/12/2013	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/	Apr. 2013	6/12/2013	M	M	M
External Current Account Balance	Q4/12	3/30/2012	Q	Q	Q
Exports and Imports of Goods and Services	Q4/12	3/30/2012	Q	Q	Q
GDP/GNP	Q4/12	4/4/2013	Q	Q	Q
Gross External Debt	Q4/12	3/30/2012	Q	Q	Q
International Investment Position	Q4/12	3/30/2012	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. General government data is not produced by the authorities.

4/ The general government consists of the central government (budgetary funds, extra budgetary funds, and social security funds) and state and local governments. General government data is not produced by the authorities.

5/ Including currency and maturity composition. General government data is not produced by the authorities.

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).

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International Monetary Fund
Washington, D.C. 20431 USA

IMF Executive Board Concludes 2013 Article IV Consultation with Guatemala

On July 25, 2013, the Executive Board of the International Monetary Fund (IMF) concluded the Article IV consultation[1] with Guatemala and considered and endorsed the staff appraisal on a lapse of time basis[2].

Key developments since the 2012 Article IV Consultation have been positive. Growth has been robust, while converging to trend and the output gap is virtually closed. As commodity prices stabilized and domestic demand pressures weakened, inflation fell sharply in 2012—closing at 3.4 percent by December (compared to 6¼ in 2011). While subsequently inflation rose somewhat—to 4.3 percent by May 2013, owing mainly to domestic prices—it still remained within the central bank's target range of 4.0±1 percent. The current account deficit declined to just below 3 percent of Gross Domestic Product (GDP) in 2012, from almost 3½ percent in 2011. Rising Foreign Direct Investment (FDI), as well as official and private capital inflows, more than financed this deficit. Net international reserves are in line with reserve adequacy metrics and the exchange rate is broadly in line with fundamentals, though with some signs of erosion of external competitiveness.

Monetary policy has been on hold until lately and foreign exchange intervention has declined. The central bank kept the policy rate constant at 5 percent until late April 2013, when it was lifted by 25 bps, with the aim of stemming incipient signs of inflationary pressures. The exchange rate fluctuation margin used to determine intervention was widened in late 2012.

The central government's deficit continued to narrow in 2012 to just below 2½ percent of GDP, but not enough to prevent a further rise in the ratio of public debt to GDP to

[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. The Executive Board takes decisions under its lapse of time procedure when it is agreed by the Board that a proposal can be considered without convening formal discussions.

[2] The Executive Board takes decisions under its lapse of time procedure when it is agreed by the Board that a proposal can be considered without convening formal discussions.

24 percent, comparatively manageable but a significant burden for government finances, given the low level of revenues. Net financing shifted from primarily domestic sources to external flows, with the placement of an international bond of US$700 million at favorable terms and long maturity. Last year, a tax package was passed by parliament—yielding 1-1½ percent of GDP—and came into force in 2013. Claims against the reform have piled up before the Constitutional Court. So far these challenges have been largely unsuccessful, though associated uncertainties have weighed down on collections and possible amendments to the reform may erode revenues. A draft Competitiveness Law sent to Congress by the President grants fiscal incentives to firms incorporated outside Guatemala City, with possible significant fiscal costs in the medium term. Accumulated domestic arrears, which spiked in 2010, remain unresolved.

Though credit to the private sector is growing fast, the financial system remains solid. Financial soundness indicators are strong and new legislation has been enacted to strengthen the system further. In 2012, Guatemala was reclassified into the OECD's "white list" of countries that have implemented internationally agreed tax standards. New measures to combat money laundering have led to an increase in prosecutions.

Guatemala has gained some ground toward achieving the Millenium Development Goals (MDGs), but poverty and crime are widespread. Modest-to-strong progress has been recorded for 12 out of 16 MDG targets. However, a third of the population is below the minimum dietary energy consumption, and chronic malnutrition of children younger than 5 years is pervasive at about 50 percent. At the same time, the level of informality is very high, while security concerns are very serious.

The economic outlook is generally benign. Growth is expected to edge up to 3½ percent in 2013 and 2014, reaching its potential rate, supported by ongoing buoyant domestic demand and healthy private sector credit. Inflation is projected to remain within the upper half of the central bank's target range in 2013-14 before stabilizing toward the center of the band. The external current account deficit would decline to around 2½ percent of GDP into the medium term, more than fully financed by FDI and other capital inflows.

Risks are prevalent on the downside, owing to global uncertainties and domestic policy constraints. Weaker-than-expected growth in the U.S, a hike in global oil prices or shocks to neighboring countries could all depress output in Guatemala. The reversal of crucial elements of the 2012 tax reform or negative consequences from ongoing initiatives that introduce tax incentives could derail fiscal consolidation. Insufficient revenue mobilization could persist into the long term, deterring investment in physical and human capital. More generally, currently envisaged consolidation plans are not yet sufficient to stabilize public debt as a share of GDP.

Executive Board Assessment

In concluding the 2013 Article IV consultation with Guatemala, the Executive Directors endorsed the staff's appraisal as follows:

Growth has been firm in the aftermath of the global crisis, fundamentals remain stable, and the near-term outlook is broadly positive. Economic activity is projected to be near potential, while inflation should remain contained and within the central bank's target band. Nonetheless, risks to the outlook are tilted to the downside. External risks include weaker than expected growth in the U.S. which would weigh on economic activity, and a geopolitical oil shock that could impair Guatemala's terms of trade and growth. Domestic risks pertain to policies, including a setback on the main items of the 2012 tax reform, or enactment of legislation that entails new fiscal incentives. Weak fiscal revenues could endanger fiscal consolidation and lower Guatemala's resilience to shocks.

The anticipated broadly neutral fiscal stance for 2013 is appropriate while further monetary tightening may be needed. The deficit outturn this year is likely to be only marginally lower than in 2012 (and than budgeted). Since capacity is nearly fully utilized, the resulting virtual absence of fiscal impulses is deemed adequate. Shortfalls in multilateral loan disbursements and revenue also mean that central government spending will be lower than planned. With expenditure levels already low, efforts should be made to limit the reduction in outlays, and at least to protect social programs and investment. Improvements in expenditure controls are necessary to prevent further accumulation of arrears. Clearance of outstanding payment arrears must be subject to rigorous audit of the claims. Some evidence suggests that monetary policy stance may be, to a certain extent, accommodating. Thus, if inflation continues to rise, amid robust domestic demand, strong private credit growth, and abundant bank liquidity, the central bank should stand ready further to raise the policy rate and absorb residual excess bank liquidity.

Fiscal consolidation is necessary in the medium term to allow room for counter-cyclical policies and reduce vulnerability to shocks. Though public debt remains relatively low as a share of GDP, it has been steadily increasing since 2008 and it is quite high in relation to government revenue. Stabilizing the debt-to-GDP ratio will require a permanent improvement in the primary balance of about ¾-1 percent of GDP. A moderately paced adjustment beginning in 2014-15, with limited frontloading, would balance the need to shrink the sustainability gap against any negative consequences on growth.

Additional revenue mobilization and improvements to public expenditure management should underpin budgetary adjustment. Raising revenues is essential not only for achieving long-term fiscal sustainability, thereby anchoring macro stability, but also for boosting health, education, security, and infrastructure outlays, which are all critical to reduce high levels of poverty and raise the potential for sustained inclusive growth. Specifically, reducing tax expenditures, adjusting VAT rates, and further strengthening the tax and customs administration would help lift collections. Enhancing the transparency and efficiency of spending would permit directing limited resources to priority areas, a goal that could also be supported by reforms to lower revenue earmarking and facilitate the approval of official external financing.

The monetary policy framework should be upgraded, including by enhancing exchange rate flexibility. Strengthening monetary transmission would make it easier for the central bank to reduce the volatility of inflation in response to external shocks and thus help maintain it at moderate levels. To this end, it would be important to buttress further the central bank's operational independence and the soundness of its balance sheet. Efforts to de-dollarize by allowing more exchange rate fluctuation, developing domestic securities markets, and refining monetary operations are all critical for augmenting the monetary transmission mechanism. Likewise, more rapid progress in allowing greater exchange rate flexibility would reinforce the role of inflation as the primary objective of monetary policy.

Further financial sector reforms are desirable while keeping careful watch over recent strong credit growth. Though much progress has been made, financial regulations should continue to be modernized, with special emphasis on full implementation of risk-based and consolidated supervision, gradual introduction of the Basel III framework, passage of the law for micro-finance institutions, and enactment of Anti Money Laundering/Combating of Financing of Terrorism measures such as the banking secrecy law. Though not an immediate danger, the authorities should remain vigilant over high rates of growth of credit to the private sector—especially rapid expansion of consumer credit by micro-financial firms and foreign currency credit. Indeed, if sustained over a long period, a credit surge could eventually undermine financial stability.

High levels of poverty should be reduced by increasing social spending and by reforms aimed at boosting growth and regional integration. Higher social spending is essential to lift human capital, thus boosting competitiveness and growth, which would also be stimulated by greater public infrastructure expenditure. Private investment should also be raised through structural reforms to improve the business climate and reduce violence and impunity. The Public-Private Partnerships initiative should be strengthened to foster greater investment and improve infrastructure while managing fiscal risks. The recent congressional approval of the EU association agreement will help spur regional trade integration and the customs union.

Guatemala: Selected Economic and Social Indicators

I. Social and Demographic Indicators

Population 2010 (millions)	14	Gini index (2006)	54
Percentage of indigenous population (2006)	38	Life expectancy at birth (2009)	71
Population below the poverty line (Percent, 2006)	51	Adult illiteracy rate (2009)	26
Rank in UNDP development index (2011; of 187)	131	GDP per capita (US$, 2011)	3,236

II. Economic Indicators

	2009	2010	2011	Est. 2012	Proj. 2013	Proj. 2014
			(Annual percent change)			
Income and Prices						
Real GDP	0.5	2.9	4.2	3.0	3.5	3.5
Consumer prices (end of period)	-0.3	5.4	6.2	3.4	4.8	4.8
Monetary Sector						
M2	10.0	11.3	10.7	9.8	10.5	10.2
Credit to the private sector	1.1	5.7	14.1	17.7	16.0	14.0
			(In percent of GDP, unless otherwise indicated)			
Savings and Investment						
Gross domestic investment	13.1	13.9	15.1	14.4	14.7	14.8
Gross national saving	13.8	12.6	11.8	11.6	11.6	11.7
External saving	-0.7	1.4	3.4	2.9	3.1	3.0
External Sector						
Current account balance	0.7	-1.4	-3.4	-2.9	-3.1	-3.0
Trade balance (goods)	-8.9	-10.3	-10.4	-11.4	-11.6	-11.7
Exports	19.3	20.6	22.1	20.1	19.4	18.8
Imports	-28.2	-31.0	-32.5	-31.4	-31.0	-30.5
Of which: oil & lubricants	-5.5	-5.7	-6.5	-6.3	-6.0	-5.7
Other (net)	9.6	9.0	7.1	8.5	8.5	8.7
Of which: remittances	10.5	10.0	9.2	9.8	9.8	9.9
Capital and financial account	0.5	3.8	4.3	5.2	4.7	3.3
Errors and omissions	0.0	-0.8	-0.5	-1.4	0.0	0.0
Overall balance	1.3	1.6	0.4	1.0	1.6	0.2
Net International Reserves						
(Stock in months of next-year NFGS imports)	3.8	3.7	3.8	3.9	4.2	4.1
(Stock over short-term debt on residual maturity)	2.0	1.9	1.9	1.7	2.0	2.0
Public Finances						
Central Government						
Revenues	11.1	11.2	11.6	11.6	12.1	12.3
Expenditures	14.2	14.5	14.4	14.0	14.3	14.6
Current	10.7	11.0	10.8	11.1	11.1	11.3
Capital	3.5	3.6	3.6	2.9	3.2	3.3
Primary balance	-1.7	-1.8	-1.3	-0.9	-0.7	-0.7
Overall balance	-3.1	-3.3	-2.8	-2.4	-2.2	-2.3
Financing of the central government balance	3.1	3.3	2.8	2.4	2.2	2.3
Net external financing	1.3	1.5	0.1	1.5	1.6	0.4
Net domestic financing	1.8	1.8	2.7	0.9	0.6	1.9
Of which: use of government deposits	0.4	-0.1	0.5	0.5	0.1	0.0
Central Government Debt	**22.9**	**24.1**	**23.7**	**24.3**	**24.9**	**25.7**
External	13.0	13.1	11.5	12.4	13.4	13.1
Domestic	9.9	11.0	12.1	11.9	11.5	12.6
Memorandum Items:						
GDP (US$ billions)	37.7	41.3	47.7	50.4	53.9	57.1

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