



GUATEMALA

June 2018

2018 ARTICLE IV CONSULTATION—PRESS RELEASE; STAFF REPORT; AND STATEMENT BY THE EXECUTIVE DIRECTOR FOR GUATEMALA

Under Article IV of the IMF's Articles of Agreement, the IMF holds bilateral discussions with members, usually every year. In the context of the 2018 Article IV consultation with Guatemala, the following documents have been released and are included in this package:

- A **Press Release** summarizing the views of the Executive Board as expressed during its May 25, 2018, consideration of the staff report that concluded the Article IV consultation with Guatemala.
- The **Staff Report** prepared by a staff team of the IMF for the Executive Board's consideration on May 25, 2018, following discussions that ended on March 19, 2018, with the officials of Guatemala on economic developments and policies. Based on information available at the time of these discussions, the staff report was completed on May 10, 2018.
- An **Informational Annex** prepared by the IMF staff.
- A **Statement by the Executive Director** for Guatemala.

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

Selected Issues Paper

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

Copies of this report are available to the public from

International Monetary Fund • Publication Services
PO Box 92780 • Washington, D.C. 20090
Telephone: (202) 623-7430 • Fax: (202) 623-7201
E-mail: publications@imf.org Web: <http://www.imf.org>
Price: \$18.00 per printed copy

International Monetary Fund
Washington, D.C.



INTERNATIONAL MONETARY FUND



Press Release No. 18/224
FOR IMMEDIATE RELEASE
June 8, 2018

International Monetary Fund
700 19th Street, NW
Washington, D. C. 20431 USA

IMF Executive Board Concludes 2018 Article IV Consultation with Guatemala

On May 25, 2018, the Executive Board of the International Monetary Fund (IMF) concluded the Article IV consultation¹ with Guatemala.

Underpinned by a solid macroeconomic framework, the economy has endured significant political tensions since 2015. Supporting broad macroeconomic stability, a sound monetary policy management has helped keep inflation expectations firmly anchored. Fiscal deficits have remained at decade lows on the back of low debt tolerance and inadequate budgetary execution, partly a result of anti-corruption efforts. Terms of trade gains and an upsurge in remittances inflows moved the current account into a sizable surplus. The financial system is sound and well-regulated while vulnerabilities seem manageable.

Growth performance nevertheless falls short of the rates needed to achieve Guatemala's aspirations to meaningfully lift the living standards of its citizens. Income per capita over the past decade has grown at an average rate of 1.1 percent, a rate that is insufficient to meaningfully reduce Guatemala's high levels of poverty (currently at 60 percent of the population). Over the past two years, growth slowed to 2.8 percent in 2017, down from 4.1 percent in 2015. The slowdown has been broad-based, evident in employment, private consumption, and investment.

Near-term growth prospects remain subdued, at 3.2 percent in 2018 and 3.6 percent in 2019. Better U.S. growth, accommodative monetary conditions, and some support from pent-up government spending will support the growth pick-up. However, the fiscal impulse will remain moderate and key reforms that could help attract private investment are likely to be held back until after the presidential elections next year. In all, the economy is expected to operate with spare capacity over the near-term and inflation to fall below the mid-point of the central bank's target band. The external position is projected to return to a modest deficit by 2021, driven by a partial normalization of the remittance and terms of trade positive shocks. Risks to the outlook are tilted to the downside. Domestic risks include an under-execution of budget spending and a delay in judiciary decisions that allow the resumption of operations of a large mining company. External risks include worsening global financial conditions and a step-up in the anti-immigration efforts by the U.S. government.

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.

Executive Board Assessment²

They commended Guatemala for maintaining a solid record of macroeconomic stability and resilience, supported by prudent economic management. This has allowed the country to withstand economic shocks and politically difficult circumstances. Guatemala's near-term growth has been good, although poverty levels remain high. Directors noted that a modest recovery can be expected with accommodative monetary conditions, recovery in budgetary spending from low levels and higher growth in the U.S. To guard against downside risks in the near term and foster growth over the medium term, Directors called for greater macroeconomic policy support for the economy. In addition, structural reforms are essential to sustain higher growth, help attract private investment, make growth more inclusive and reduce poverty.

Directors generally encouraged the authorities to adopt a supplementary budget that raises spending limits and supports near term growth, with a particular focus on raising social and capital spending. A stronger effort is also needed to increase spending execution and flexibility. Directors emphasized that inadequate budgetary revenues constrain the government's ability to invest in physical and human capital. In this context, Directors called for an integral fiscal reform encompassing better tax administration and tax policy changes. They underlined that strong governance is critical to durably raise investment and support revenue mobilization.

Directors commended the authorities for keeping inflation expectations firmly anchored over the last several years. Directors considered that the central bank could remain open to lowering the policy rate if the contribution of fiscal policy to growth falls short of expectations, activity indicators have not strengthened by mid-year and inflation risks remain on the downside. Directors acknowledged the central bank's efforts to gradually widen the band before exchange rate intervention is triggered and called for continuing efforts to increase exchange rate flexibility to buffer against shocks. They also underlined the need for continued efforts to improve monetary transmission, including through a reduction in financial dollarization and development of domestic capital markets.

Directors welcomed the soundness of the financial sector. Nevertheless, there remains a need to further develop macroprudential policies and move toward Basel III standards, implement consolidated supervision, reinforce bank resolution, and strengthen the AML/CFT framework.

Directors called for continued efforts to raise living standards. Lifting investment and achieving the Sustainable Development Goals are important to capitalize on the demographic dividend that is expected over the next two decades. Directors encouraged efforts to expand social protection programs and combat informality to improve social outcomes.

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

Directors stressed the importance of improving the business climate, including through pro competition reforms and by reducing the uncertainty weighing on extractive industries. Directors welcomed ongoing efforts to fight corruption, including measures to restore confidence in public procurement and to promote government transparency and accountability. Directors encouraged the authorities to strengthen judicial effectiveness and reinforce the asset disclosure regime for public officials.

Guatemala: Selected Economic and Social Indicators

I. Social and Demographic Indicators

Population 2018 (millions)	17	Gini index (2014)	49
Percentage of indigenous population (2016)	41	Life expectancy at birth (2016)	72
Population below the poverty line (Percent, 2014)	59	Adult illiteracy rate (2015)	21
Rank in UNDP development index (2016; of 188)	125	GDP per capita (US\$, 2016)	4,155

II. Economic Indicators

	2014	2015	2016	Est. 2017	Projections 2018	2019
Income and Prices						
Real GDP	4.2	4.1	3.1	2.8	3.2	3.6
Consumer prices (end of period)	2.9	3.1	4.2	5.7	4.2	3.5
Monetary Sector						
M2	8.7	9.4	6.6	8.4	8.6	7.4
Credit to the private sector	8.8	12.8	5.9	3.8	7.5	8.5
Saving and Investment						
Gross domestic investment	13.7	13.6	12.9	12.1	11.8	11.7
Private sector	12.0	12.3	11.7	11.0	10.7	10.5
Public sector	1.7	1.3	1.2	1.1	1.1	1.2
Gross national saving	11.6	13.5	14.4	13.6	13.0	12.4
Private sector	11.4	13.4	14.1	13.6	13.1	12.7
Public sector	0.2	0.1	0.3	0.0	-0.1	-0.3
External saving	2.1	0.2	-1.5	-1.5	-1.1	-0.7
External Sector						
Current account balance	-2.1	-0.2	1.5	1.5	1.1	0.7
Trade balance (goods)	-10.3	-8.7	-7.6	-8.0	-8.2	-8.3
Exports	18.7	17.0	15.4	14.9	14.8	15.0
Imports	29.0	25.7	23.0	22.9	23.0	23.3
<i>Of which: oil & lubricants</i>	5.6	3.6	3.1	3.5	3.8	3.8
<i>of which repayment of arrears</i>						
Other (net)	8.2	8.6	9.0	9.5	9.3	9.0
<i>Of which: remittances</i>	9.7	10.1	10.7	11.2	11.0	10.8
Capital account balance	0.0	0.0	0.0	0.0	0.0	0.0
Financial account balance (Net lending (+))	-2.9	-0.9	0.5	1.0	1.1	0.7
<i>Of which: FDI, net</i>	-2.2	-1.7	-1.6	-1.3	-1.3	-1.3
Errors and omissions	-0.8	-0.7	-1.0	-0.6	0.0	0.0
Change in reserves assets (Increase (+))	0.1	0.7	2.0	3.4	0.6	0.0
Net International Reserves						
(Stock in months of next-year NFGS imports)	4.0	4.5	4.9	5.7	5.5	5.2
(Stock over short-term debt on residual maturity)	1.6	1.6	1.8	2.2	2.1	1.9
Public Finances						
Central Government						
Revenues	11.5	10.8	11.0	10.8	10.9	10.9
Expenditures	13.4	12.3	12.1	12.1	12.3	12.6
Current	10.5	10.1	10.0	9.9	10.0	10.2
Capital	2.9	2.2	2.1	2.2	2.2	2.4
Primary balance	-0.4	0.1	0.4	0.1	0.0	-0.2
Overall balance	-1.9	-1.4	-1.1	-1.3	-1.4	-1.7
Financing of the central government balance	1.9	1.4	1.1	1.3	1.4	1.7
Net external financing	0.0	0.7	0.8	0.2	0.1	-0.2
Net domestic financing	1.8	0.7	0.3	1.2	1.6	1.9
<i>Of which: use of government deposits</i>	0.0	-0.1	-0.5	-0.1	-0.1	0.0
Rest of Nonfinancial Public Sector Balance	0.4	0.2	0.2	0.2	0.2	0.2
Combined Nonfinancial Public Sector						
Primary balance	0.0	0.3	0.6	0.3	0.2	0.0
Overall balance	-1.5	-1.2	-0.9	-1.1	-1.2	-1.5
Central Government Debt						
External	11.6	11.6	12.0	12.6	12.4	12.4
Domestic 1/	12.6	12.6	12.6	12.1	12.4	12.7
Memorandum Items:						
GDP (US\$ billions)	58.7	63.8	68.7	74.6	81.1	86.3
Output gap (% of GDP)	0.1	0.7	0.3	-0.2	-0.4	-0.2

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

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



GUATEMALA

STAFF REPORT FOR THE 2018 ARTICLE IV CONSULTATION

May 10, 2018

KEY ISSUES

Context. Near-term growth prospects remain constrained by low levels of government spending and subdued private sector sentiment. Key reforms that could strengthen medium term prospects are likely to be held back until after the presidential elections (the first round is scheduled for June next year).

Policy advice. Policies are needed to guard against near-term downside risks and foster growth over the medium-term that benefits all Guatemalans.

- **A macroeconomic policy mix geared toward supporting demand.** A more balanced policy mix would require greater fiscal support through a growth-oriented supplementary budget that loosens spending limits and an improvement in the execution of social and infrastructure spending. However, it is likely that the contribution of fiscal policy to growth will fall short. In that event, and growth and inflation outturns are weaker than the central bank's forecasts, further monetary policy support should be considered.
- **Policies to lift more Guatemalans out of poverty.** This will require action on multiple fronts. First, an integral fiscal package encompassing continued tax administration efforts, tax policy changes, and greater spending flexibility, all geared at high-impact projects in pursuit of the Sustainable Development Goals. Second, expanding social protection, including by creating more formal sector jobs. Third, improving the business climate and sustained efforts to strengthen governance to raise growth, investment and job creation; and to support efforts at revenue mobilization.
- **Strengthening the inflation targeting framework.** The authorities should continue to allow for greater currency flexibility and institute changes to deepen the financial system and improve monetary policy transmission.
- **Increasing financial sector resiliency.** Developing the institutional framework for macroprudential policies, tightening certain aspects of microprudential policies, reinforcing the bank resolution framework, and establishing a more robust AML/CFT framework are important to strengthen resilience and to bolster anti-corruption efforts.

Approved by:
Nigel Chalk (WHD)
 and
Zuzana Murgasova (SPR)

E. Pérez Ruiz (Head), V. Flamini, C. Janada, J. Sin, I. Teodoru (all WHD), and Yara Esquivel (LEG). Antonietta del Cid de Bonilla and Carlos Hurtado (both OED) participated in the discussions. G. Peraza, Regional Resident Representative assisted the mission while Cristhian Vera and Carolina Friend provided support from headquarters.

CONTENTS

THE SUBDUED OUTLOOK WILL BE INSUFFICIENT TO RAISE LIVING STANDARDS	4
RECALIBRATING THE POLICY MIX	7
A. A Fiscal Policy That Better Supports Growth	7
B. Further Monetary Accommodation	9
HIGHER POTENTIAL GROWTH AND BETTER LIVING STANDARDS	9
A. Delivering an Integral Fiscal Reform	9
B. Creating Opportunities in the Formal Labor Market	13
C. Improving Governance for a Better Business Environment	13
IMPROVING THE INFLATION TARGETING FRAMEWORK AND MODERNIZING THE FINANCIAL SYSTEM	16
A. Improving the Inflation Targeting Framework	16
B. Building Financial Sector Resilience	18
STAFF APPRAISAL	20
BOXES	
1. Embracing the Sustainable Development Goals	8
2. Overcoming Road Infrastructure Deficiencies	12
3. Guatemala’s Anti-Corruption Strategy	14
FIGURES	
1. Recent Economic Developments	22
2. Structural Fiscal Indicators	23
3. External Developments	24
4. Financial Developments	25

TABLES

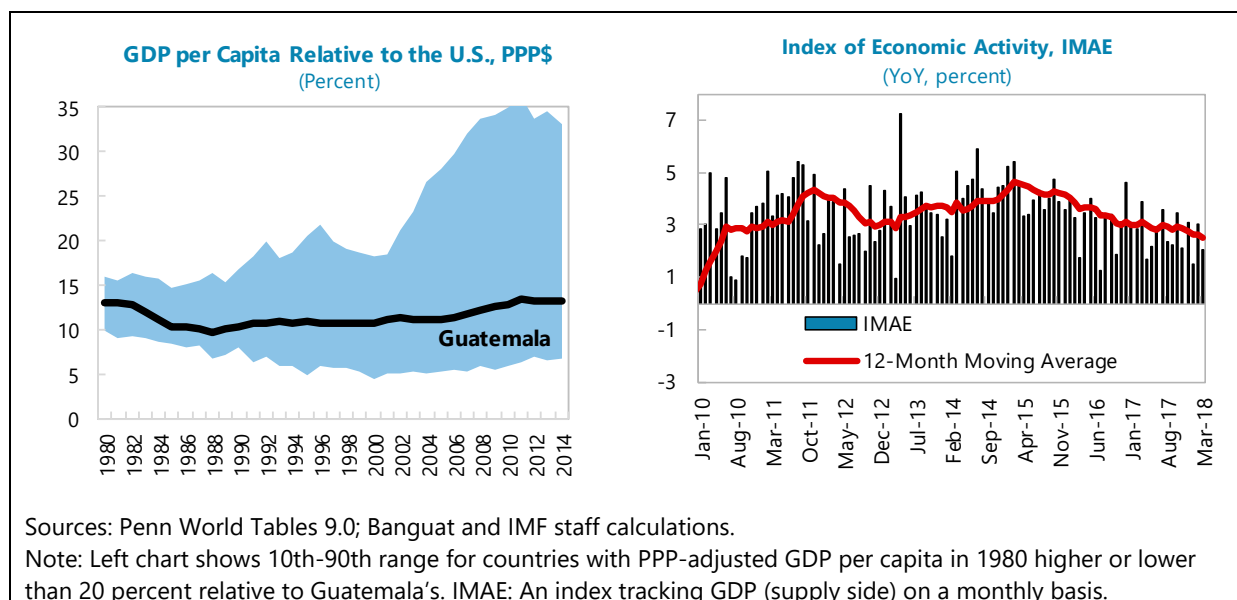
1. Selected Economic and Social Indicators _____	26
2. Central Government Operations and Financial Balance _____	27
3. Summary Balance of Payments _____	28
4. Monetary Sector Survey _____	29
5. Financial Soundness Indicators _____	30
6. Financial Soundness Indicators Heatmap _____	30

ANNEXES

I. External Sector Assessment _____	31
II. Risk Assessment Matrix _____	35
III. Public Debt Sustainability Analysis _____	36
IV. External Debt Sustainability _____	44
V. Past Fund Staff Recommendations and Implementation _____	46

THE SUBDUED OUTLOOK WILL BE INSUFFICIENT TO RAISE LIVING STANDARDS

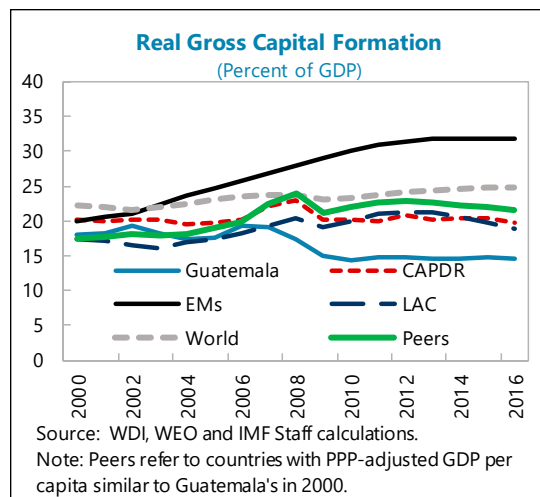
1. Raising living standards continues to be *the* main challenge facing Guatemala. Income per capita over the past decade has grown at an average rate of 1.2 percent, a rate that is insufficient to meaningfully reduce Guatemala's high levels of poverty (currently at 60 percent of the population). Over the last two years, even though strong remittance inflows have helped sustain private consumption, growth has decelerated due to weak confidence, an insufficient contribution of budget spending to growth, and court-mandated suspensions of mining activities. This slowdown has been broad-based, evident in employment, private consumption, investment, and credit growth.



2. Political uncertainty is weighing against economic outturns. Investigations into campaign financing by President Morales (by the Attorney General and the U.N.-sponsored International Commission Against Impunity in Guatemala, CICIG) created significant political tensions in mid-2017 and led to popular demonstrations against the government. This comes soon after the 2015 political crisis when a corruption scandal led to the eventual imprisonment of former-President Pérez Molina. Macroeconomic stability has remained intact throughout, but these political uncertainties have depressed sentiment and diminished prospects for future reforms.

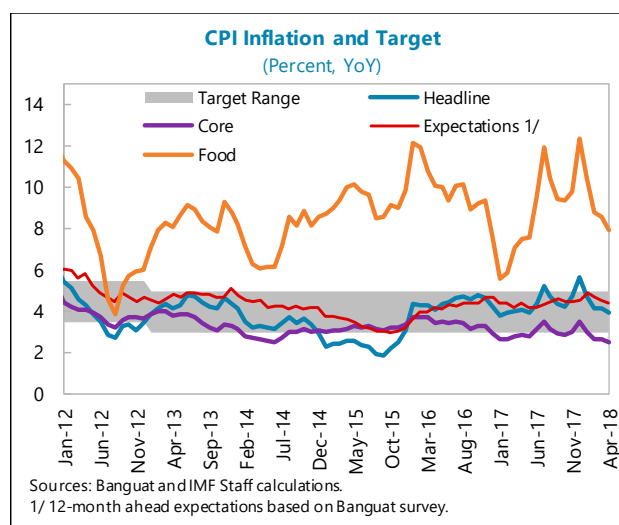
3. The outlook is for a subdued recovery.

Better U.S. growth, accommodative monetary conditions, and some support from pent-up government spending should allow growth to rise to 3.6 percent by 2019, and peak at 3.8 percent in 2020. Under unchanged policies, growth is expected to slow to 3.6 percent by 2023. The output gap is estimated at negative 0.4 percent of potential output in 2018, closing in 2020. Achieving higher medium-term growth will require steps to boost investment (which, at 14.7 percent of GDP in 2016, is low relative to peers). At present, inadequate budgetary revenue constrains the government’s ability to spend on physical and human capital. Further, key reforms that could help attract private investment are likely to be held back until after the presidential elections next year.



4. Inflation is expected to remain within the central bank’s target range and risks are skewed toward the lower part of the band.

Despite political uncertainties over the last couple of years, sound monetary policy management has helped keep inflation expectations firmly anchored. Slowing activity, low oil prices, and a strong currency have kept headline inflation comfortably within the 4±1 percent target range, with the exception of a couple of short-lived bouts of food-driven inflation.¹ Core inflation has been mostly below the lower bound of the target range in 2017 and, as of February 2018, is falling. Even as oil prices rise, rising economic slack is expected to lead headline inflation to fall below the mid-point of the target band over the near-term.



5. Fiscal policy in the past two years has been modestly procyclical. As the output gap turned negative in 2017, the government deficit remained low at 1.3 percent of GDP, about ½ percentage points below the budget target. Delays in updating the household census held back spending on means-tested social transfers and a paralysis in procurement—a side effect of anti-corruption efforts—has kept public investment well below intended levels.

¹ Bouts of food inflation are recurrent in Guatemala, a reflection of weather shocks and a poor road infrastructure. There is little evidence of second round effects to core inflation. Food and non-alcoholic beverages represent 28.75 percent of the CPI basket.

6. The external position is stronger than the level consistent with medium term fundamentals and desirable policies.

- Terms of trade gains and an upsurge in remittance inflows have resulted in a sizable improvement in the current account (CA) since 2015, coupled with a modest REER appreciation. These forces are expected to be in part temporary and, as they unwind, the CA should gradually shift to a deficit of -1.3 percent of GDP.
- The EBA CA methodology points to a CA gap of about 4½ percent of GDP in 2017 based on an estimated cyclically-adjusted CA balance of 1½ percent of GDP and a CA norm of -3.1 percent (Annex I). However, staff regards this as an overstatement of the CA gap. Rather, it is expected that around one-half of the dollar increase in remittances seen since 2015 is temporary (which reduces the cyclically-adjusted CA balance to ½ percent of GDP). Also, the CA norm is adjusted to -2 percent of GDP through an adjustment in the measurement of Guatemala’s political risk profile. Nonetheless, this leaves a CA gap of around 2½ percent of GDP and an undervaluation of the REER of around 15 percent. Spending more on public infrastructure, expanding social protection, and removing structural impediments to investment should help erode much of this CA gap and lead to a modest appreciation of the REER.²

7. There are important downside risks to the outlook. Domestic risks include the economic drag both from binding spending limits and an under-execution of spending. Also, a delay in judiciary decisions could preclude the normalization of operations of a large mining company. Global financial conditions could tighten abruptly, raising the future cost of external financing and weighing on growth. Guatemala also faces serious, albeit low-probability, tail risks from future restrictions on financial transfers from the U.S. (that could disrupt remittances) and from an increase in the deportations of Guatemalan nationals from the U.S., or from a broader global retreat from trade openness (Annex II).

Authorities’ Views

8. The authorities acknowledged the need for wide-ranging reforms to meaningfully lift Guatemalans’ living standards. Although, with general elections next year, these policy changes may be delayed. The authorities’ near-term outlook is broadly aligned with staff’s projections, although they estimate a lower negative output gap of 0.2 percent which closes already by year-end, and viewed inadequate fiscal support to growth as a minor risk. The authorities’ own estimates point to no significant REER misalignment, and they see the upsurge in remittances and gains of trade as the driving forces of the recent REER appreciation. They concurred that the factors driving the strong external position in the last two years are partly temporary and, in line with staff

² The external assessment is based on the EBA CA methodology since Guatemala is not included in the EBA IREER and ES methodologies.

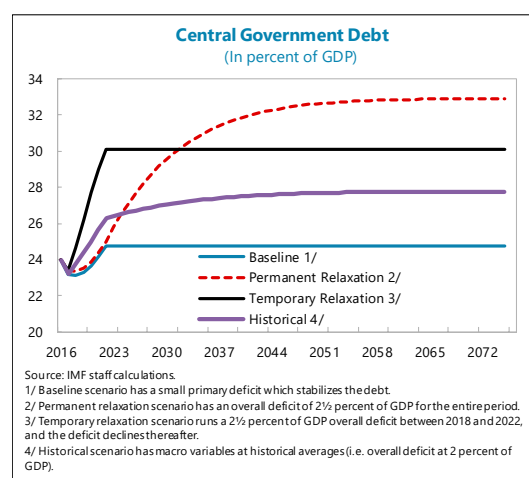
projections, expect the CA balance to return to a modest deficit by 2021 and converge to the estimated norm over the longer-term.

RECALIBRATING THE POLICY MIX

The macroeconomic policy mix should be geared towards supporting demand. Ideally, such support should come from a supplementary budget and an improvement in the government's ability to execute growth-enhancing social and infrastructure programs. If the contribution of fiscal policy to economic growth may fall short of expectations, and if growth and inflation outturns are weaker than the central bank's forecasts, further monetary policy support should be considered as a second best.

A. A Fiscal Policy That Better Supports Growth

9. A supplementary budget, that increases spending limits, would help support near-term growth. Congress rejected the government's 2018 budget (which proposed a spending increase of around 10 percent in real terms). This has curtailed the government's ability to support growth this year. A pending supplementary budget aimed to raise spending by up to ½ percent of GDP merits support and a particular focus should be placed on raising capital spending. Spending should be further increased, by around 1 percent of GDP annually, starting next year, centered on a few high-impact programs in pursuit of the Sustainable Development Goals (SDGs, Box 1). Guatemala has substantial fiscal space to accommodate such higher spending through a temporary increase in the deficit but, over the medium-term, this higher spending should be funded through higher revenues, including through a comprehensive tax reform.



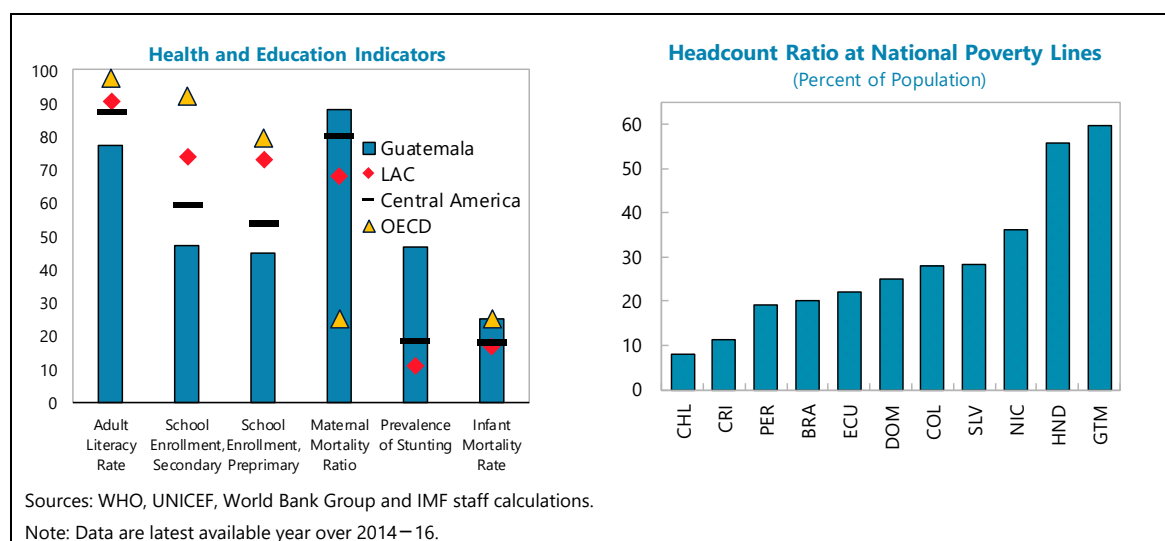
10. In parallel, attention should be focused on improving the execution of spending. Reforms of the Procurement Law, adopted over the past two years, have facilitated greater oversight over public spending and contributed to tackling corruption. However, as a side-effect, these improvements have led to a slower execution of spending. Efforts are underway to expedite those projects carried over from the previous year and to provide greater clarity for how Comptroller auditors will apply administrative versus criminal procedures in procurement. Additional measures could speed up budget execution, without diluting the focus on governance, by:

- shifting the General Comptroller's activities towards the development of preventive capacities and concurrent auditing;
- providing a clear interpretation of the norms applied to procurement and apply unified criteria to protect public employees from arbitrary decisions by auditors;

- using the newly created Vice Ministry for Transparency to coordinate and supervise the myriad of entities involved in procurement;
- adopting a medium-term budget framework that would include a national investment strategy that is embedded within a multi-year investment budget.

Box 1. Embracing the Sustainable Development Goals

Guatemala’s development outcomes lag other countries that are at a similar level of development. Poverty and extreme poverty, at 60 and 23 percent of population respectively, are amongst the highest in the region and have been increasing over the last decade. The prevalence of stunting in children under 5 years old is among the highest in the world. Infant and maternal mortality rates are well above Latin American and Caribbean averages and over 40 percent of the population does not have access to safe drinking water. Pre-primary education and school enrollment rates, particularly for secondary education, are low. A range of social outcomes are markedly worse in rural areas and for indigenous populations.



The authorities have embraced the SDGs as part of their national development strategy, but moving from planning to executing policies remains challenging. Through a process of consultation within the public sector and with civil society, the Ministry of Planning has mapped the key elements of the K’atun 2032 national development plan into the SDGs and into 10 National Priorities. However, the costing of interventions needed to close those developments gaps, and the associated revenue mobilization strategies to fund this spending, remain largely unaddressed.

The Fund is engaging with Guatemala on the spending and financing implications of the SDGs. The work plans to leverage existing work and to collaborate with other institutions including the World Bank, UN agencies, and local think tanks. The focus will be on costing the spending needed to achieve the SDGs and help the authorities reconcile their long-term development vision with a more practical medium-term spending and financing strategy. Preliminary estimates point to substantial costs from pursuing the SDGs. A local think tank (the *Instituto Centroamericano de Estudios Fiscales*) estimates the additional expenditure needs at 3.7 percent of GDP by 2021.

Authorities' Views

11. The authorities acknowledged the acute need for increased spending on education, health, and infrastructure. They argued that Congressional aversion to higher deficits could be better overcome if spending were focused on perceptible, high-impact programs, couched within a multi-year social spending and investment plan. The authorities recognized that current execution rates remain low, and highlighted the lack of unified criteria in the assessment of the bidding process by auditors and continued reluctance by public officials to approve projects—fearing that they could be personally liable for any noncompliance with procurement rules. Ensuring legal certainty for public officials was deemed critical to overcome low execution. The authorities noted, however, that there was now a large pipeline of infrastructure projects which have already gone through the lengthy bidding process.

B. Further Monetary Accommodation

12. Further reductions in the policy rate should be considered if growth and inflation disappoint relative to the central bank's forecasts. Reflecting monetary policy accommodation, policy rates, adjusted for expected inflation are negative and are below estimates of the neutral policy rate. Nonetheless, there are important uncertainties to the outlook, including inadequate budget execution preventing fiscal policy from sufficiently supporting domestic demand this year. If activity indicators have not strengthened by mid-year and inflation risks appear to remain on the downside, the central bank should stay open to further lowering policy rates to support the economy. The recently-adopted laws on microcredit, collateral, and securitization of accounts receivable should help strengthen monetary policy transmission.

Authorities' Views

13. The authorities saw limited space for further monetary policy easing. By their estimates, activity has already bottomed out, the output gap is projected to close by year-end, and core inflation is expected to accelerate. They envisioned improvements in budget execution in the coming months and expected an expansion of credit and increases in oil prices to pose upside risks to inflation. Even so, they would be open to re-evaluate the need for further cuts in the policy rates if downside risks to output and inflation materialize and provided inflation expectations remain firmly anchored.

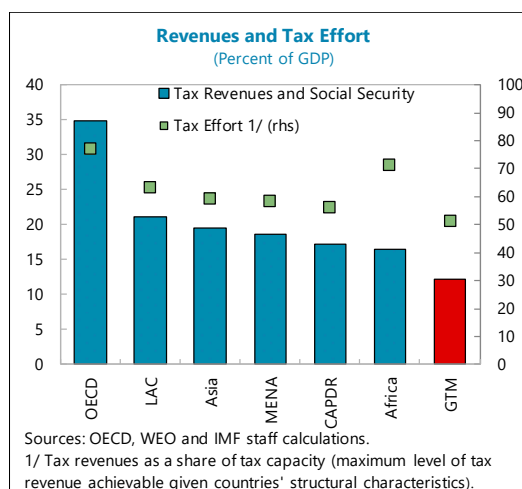
HIGHER POTENTIAL GROWTH AND BETTER LIVING STANDARDS

A. Delivering an Integral Fiscal Reform

14. Revenue mobilization efforts need to continue. Permanently raising revenues to at least 15 percent of GDP is essential to accommodate needed social and infrastructure spending. Achieving such a level of revenue needs continued tax administration efforts and a comprehensive

tax reform should be accompanied by efforts to raise execution capacity and improve spending efficiency.

- *Strengthening tax and customs administration.* Efforts should focus on reinforcing VAT controls, with an emphasis on risk-based auditing; strengthening the large-taxpayer office management; improving the use of tax information to correct non-compliance; enhancing tax collection enforcement faculties (including through easier implementation of bank secrecy provisions); and implementing a customs post-clearance audit program to deter non-compliance and facilitate trade. These efforts can at best yield additional revenues of 1 percent of GDP.



- *Embracing tax reform.* Guatemala fails to meet the key principles of a modern tax system that were enshrined in the 2000 Fiscal Pact. For the government to fulfill its basic public policy functions, additional revenues of around 3½ percent of GDP will be needed. Options to raise such revenues include an increase in PIT rates (which could be frontloaded given extremely low current levels), a simplification of the corporate income tax, higher indirect taxes, fewer tax exemptions, and redirecting some existing tax expenditures to improve health and pension coverage.

15. Revenue mobilization should be supplemented with measures to raise spending efficiency. Ninety percent of spending is allocated *ex-ante* by either Constitutional or other legal provisions. To make the budget more responsive to spending needs, revenue earmarking and mandatory spending floors should be scaled back, spending objectives should be couched within a medium-term budget framework, and program performance outcomes should be evaluated *ex-post*. The provision of health and education services should shift the input mix away from personnel costs and toward greater capital outlays. Better aligning pay with performance in the provision of public services and reforming current regulations of the Laws on the Civil Service and Salaries in Public Administration will be important milestones. Completing the public-sector personnel census should help make the hiring of public officials more transparent and provide for a better cost-benefit assessment of the current structure of public employment.³

³ Support is being provided by the European Union and the World Bank, with the CICIG as an observer. The census aims, *inter alia*, to identify and eliminate ghost positions in the public administration.

16. Additional revenues should be geared at high-impact programs in pursuit of the SDGs.

Spending additional revenues from tax reforms on social priorities would compensate any regressive effects from the tax policy changes. Such programs should include:

- Expanding preventive and primary health care, especially in rural areas;
- Increasing access to nutrition, water and sanitation services;
- Broadening the coverage of the main social assistance program *Mi Bono Seguro* (which covers less than 30 percent of the extreme poor).
- Expanding pension coverage to alleviate adult poverty (currently the pension scheme covers less than 20 percent of the elderly population). Parametric reforms (higher retirement ages and contributions) will also be needed to limit increases in unfunded pension liabilities.
- Expanding pre-primary education programs, including childcare, and investing in training teachers and improving school facilities.
- Maintaining and expanding the roads network (Box 2).

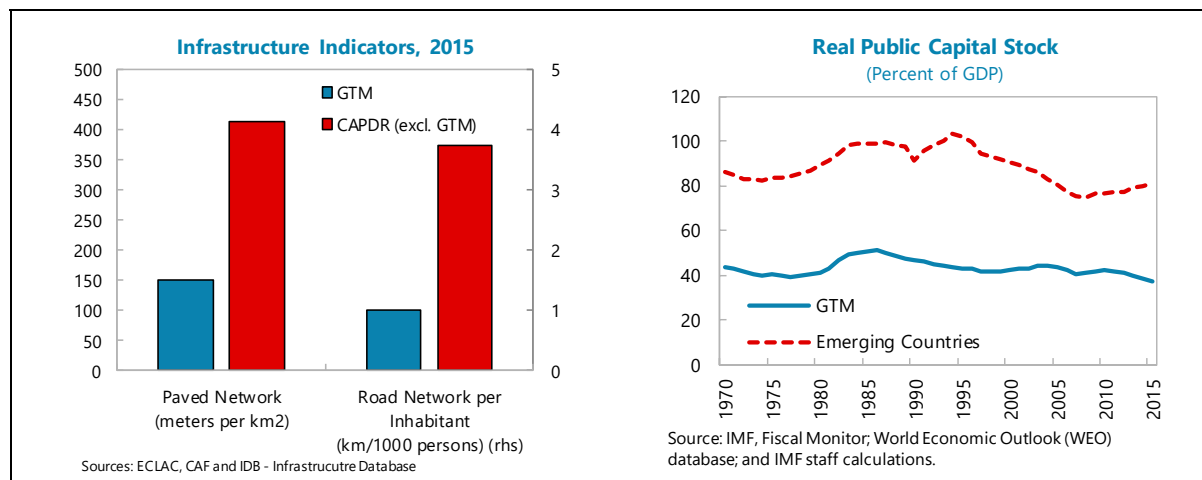
Such changes should also emphasize improved coordination amongst the line Ministries and be subject to systematic *ex post* performance evaluation as part of the annual budgetary exercise.

Authorities' Views

17. The authorities reiterated their commitment towards tax administration efforts but emphasized that these measures will take time to bear fruit. The authorities also acknowledged the need for tax policy changes but noted that prospects to pass it are slim, given the fast-approaching presidential elections as well as the political focus on corruption cases. They agreed an integral fiscal reform would be important to increase buy-in from Congress. Such a package would need to include better spending efficiency, enhanced transparency of procurement processes, civil service reform, and a broadening of the tax base. They concurred that political support could be better garnered with the resolute implementation of visible and high-impact spending programs. There was agreement on the need to raise the level and coverage of conditional transfer programs, alongside improved coordination amongst the various ministries involved. Better targeting would be aided by an expedited completion of the national census and improved monitoring of the eligibility of beneficiaries.

Box 2. Overcoming Road Infrastructure Deficiencies

Infrastructure investment in Guatemala has been declining over recent years, from 3.1 percent of GDP in 2008 to 0.6 percent in 2015 (versus a Latin America average of 3.7 percent). Mirroring low infrastructure investment, the capital stock in Guatemala was about one-half of other emerging and developing economies in 2015. Of particular concern is the quality of the road system: the 16,457-km network provides about 1 meter of roads per inhabitant and 151 meters per square kmr (against 3.7 and 413 meters, respectively, in CAPDR).



Poor infrastructure increases logistics costs to enterprises, constrains the expansion of domestic and regional markets, and acts as a major impediment to growth. Out of 160 countries, Guatemala’s overall World Bank’s Logistics Performance Index fell from 77 in 2014 to 111 in 2016. The transport of goods and people to ports and other destinations runs at an average speed of 37 km per hour, a long way off the international average speed of 60 km per hour. On average, it takes 1.61 minutes/km and costs US\$2.52/km to transport a standardized shipment of goods from a warehouse to the domestic port of export (compared to 1.07 minutes/km and US\$1.16/km in Mexico). Infrastructure deficiencies also impair imports substitution in response to supply-side shocks, resulting into higher food inflation which directly hurts the poor.

The government is exploring options to upgrade the roads network. Preliminary estimates suggest that the costs associated with paving the dirt roads and closing the gap with the rest of the region, in meter of roads per inhabitant, are significant (about 3½–4 percent of 2017 GDP for the next 20 years, as estimated by the Development and Investment Corporation for Central America, IDC Group). Given the size of the infrastructure as well as the need to reconcile private profitability with social goals for rural roads, both private and public disbursements are likely to be needed. An infrastructure bill is being prepared that should consolidate the numerous regulations in the sector, provide legal certainty on right-of-way acquisition and the legal nature of the contract. Although the specific financing vehicles to catalyze needed investments remain unspecified, it will be important to limit contingent fiscal risks from any private-public projects.

B. Creating Opportunities in the Formal Labor Market

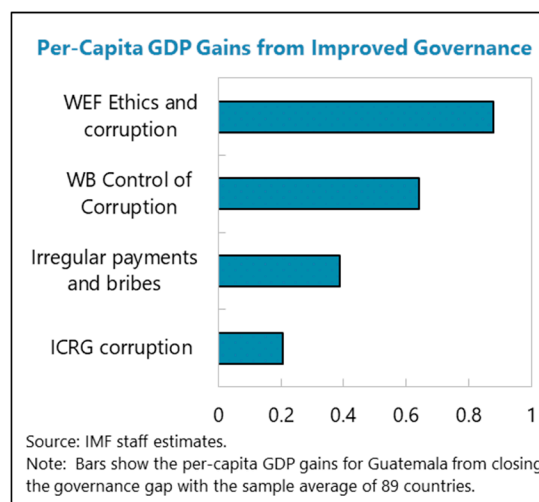
18. Tackling labor market informality will promote a fairer tax and social protection system. High informality in Guatemala (70 percent of total employment) results in low coverage for basic social protections, high poverty, and low productivity. Some of the policy-related motivations for informality can be reduced by:

- Bringing the minimum wage closer to regional standards.⁴ This could be done by adopting objective criteria for the determination of the level of the minimum wage and conditioning future increases on a reduction in informality;
- Raising the productivity of informal workers⁵ including through investments in education and by investing in rural roads and irrigation;
- Fostering apprenticeship schemes, such as *Mi Primer Empleo*, and other vocational training programs;
- Setting the minimum level of remuneration for part-time work to achieve an increase in overall employment;
- Extending health and pension systems to the self-employed and to microenterprises (at present 15 percent of workers are precluded from participating in the social security system).

C. Improving Governance for a Better Business Environment

19. Improved governance is critical to durably raise investment and to support efforts at revenue mobilization (Box 3). The per capita GDP gains from improved governance are likely to be substantial.

Collaboration between the General Prosecutor's office, law enforcement agencies, and the International Commission Against Impunity in Guatemala has been effective in enhancing independent investigation of acts of corruption. There is scope to strengthen judicial effectiveness as per the Law on the Judicial Career and to reinforce the regime of asset disclosures for public officials. Ensuring the collection and publicity of information on the ultimate beneficial owners of corporate vehicles could help avoid conflict of interest and tackle illicit flows.



⁴ About 60 percent of full-time workers (73½ percent of private-sector workers) receive salaries lower than the minimum wage (ENEI 2017, INE).

⁵ One in four employees are functionally illiterate (UNICEF, 2015). Only 3 percent of workers have a secondary school degree.

Box 3. Guatemala’s Anti-Corruption Strategy

The 2015 political crisis led to broad-based anti-corruption efforts. The government reasserted its control over the tax and customs administration, reformed public procurement practices, and enhanced the independence of the Attorney General’s office. In parallel, the Office of the General Prosecutor’s Office and the CICIG made inroads into dismantling networks suspected of illegal activities in areas such as tax fraud, campaign financing, irregular procurement practices, and influence peddling in the judiciary.

While there has been important progress, measures of corruption in Guatemala still trail those of some regional peers. To reinforce good governance, the government is considering several measures:

- *Restoring the confidence in public procurement* by setting up a General Prosecutors unit at the Comptroller General’s Office to discriminate between administrative and criminal cases; and continued training of the auditors on procurement rules.
- *Promoting transparency and accountability* through greater access to public information (Third National Action Plan of Open Government 2016–18) and by disseminating government policy priorities in health, education, security and justice (Open Budget and the Multi-annual Budget).
- *Speeding up judicial backlog* through a law on plea bargaining which will allow judicial processes to be concluded faster when the defendant (i) accepts all charges; (ii) repairs the damage (either through a payment or through a reparation plan to the victim); (iii) provides valuable information to prosecute others.

Sustained support from the government for such efforts will play a central role in the ongoing fight against corruption. To realize the long-run benefits of the anti-corruption efforts, in addition to the measures already identified by the authorities, there is scope to:

- *Strengthen judicial capacities.* While prosecution of acts of corruption has increased over the years, conviction rates have been low. Judicial integrity has also been questioned more recently due to several corruption investigations against judges. Further efforts are needed to strengthen judicial effectiveness and integrity through a production based business model, enhanced transparency in the appointment procedures for judges and magistrates (via reform of the Law and Regulation for the Nominations Committee), effective implementation of the merit-based system for judges’ careers, and full application of the sanctions system (as per the new Law on the Judicial Career). Online publication of judicial decisions is another important step towards reinforcing legal certainty.

		2010	2017	Avg. 2010-17	Totals 2010-17
Passive bribery	Indictments	7	11	11.0	88
	Convictions	3	2	5.1	41
Active bribery	Indictments	0	4	1.1	9
	Convictions	0	2	0.5	4
Misappropriation	Indictments	0	11	2.6	21
	Convictions	0	2	0.4	3
Trading in influence	Indictments	0	2	0.4	3
	Convictions	0	0	0.1	1

Source: Office of the General Prosecutor.

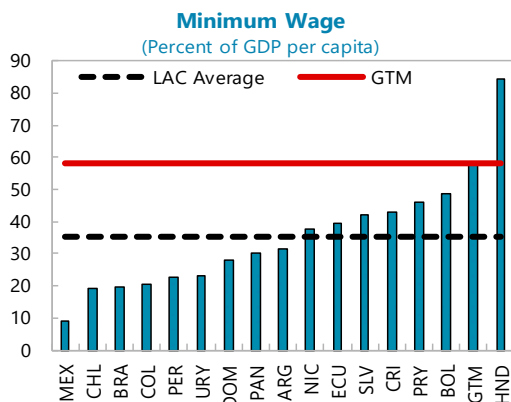
- *Strengthen the asset disclosures regime of public officials.* Since 2014, the Comptroller General’s Office has submitted a total of 540 cases for criminal investigation to the General Prosecutors Office, including for breaches to the Public Probity Law or for unexplained patrimonial increases. This information has been used by the General Prosecutor and the CICIG in the investigation of acts of corruption and illicit enrichment, leading to convictions. However, there is still room to strengthen the regime of asset disclosures for public officials, including both assets legally and beneficially owned, with dissuasive actions for non-compliance and false declaration. Making the asset declaration system for senior officials public and easier access to banking information for verification purposes, are important initiatives in this respect. An additional step to avoid conflict of interest and tackle illicit flows is to ensure transparency on the ultimate beneficial ownership of corporate vehicles.

	2014	2015	2016	2017
Received	31,128	17,943	25,948	18,967
Verified	269	220	428	282
Submitted to the GPO	23	16	208	293
Dismissed by the GPO	6	2	18	0
Administrative sanctions	31	36	49	45

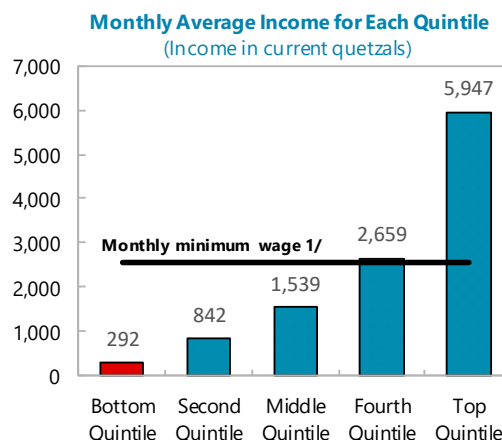
Source: Office of the General Prosecutor.

Labor Market Informality and the Minimum Wage

Guatemala's minimum wage appears high in regional comparison

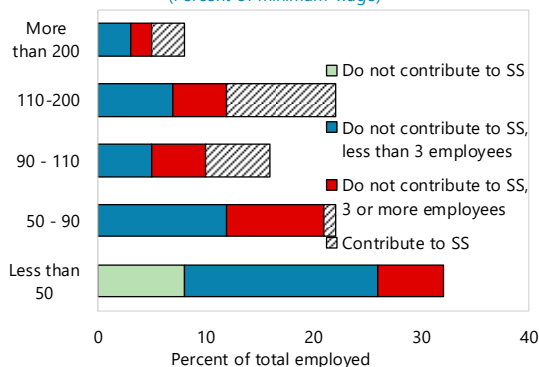


At least 60 percent of workers perceive salaries below the minimum wage



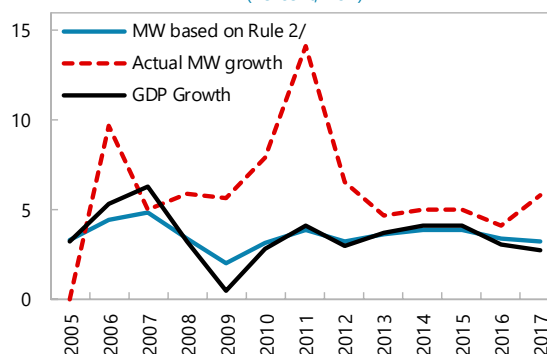
The minimum wage acts as a threshold for informality

Percentage of Employees Contributing to Social Security (SS), by Share of Minimum Wage (Percent of minimum wage)



Minimum wages been highly volatile over time

Minimum Wage vs. Rule vs. GDP (Percent, YoY)



Sources: ENEI 2016, each country's legislation, and IMF staff calculations.

1/ Average of the three official minimum wages for agricultural, non-agricultural, exporter and maquila industries.
 2/ Minimum Wage Growth Rule= Inflation rate + 1/2 (GDP Growth - Population Growth).

20. The authorities should persevere in their efforts to improve the business climate.

- Business facilitation and pro-competition reforms.* The government is introducing online systems for business tax reporting and registration, and a system of arbitration to resolve business disputes (rather than having to pursue a civil claim in the courts). Further efforts could be made to streamline the awarding of construction licenses and reduce judicial backlogs in contract disputes. Simplifying customs procedures will be important to maximize the gains from the recently adopted customs unions with Honduras, and could be done so without compromising revenue mobilization or the warranted control of illicit flows. Strengthening competition policies, including through the adoption of the pending Competition Law will be important to spur domestic investment and improve Guatemala's attractiveness to foreign investors.

- *Reduce uncertainty weighing on extractive industries.* A lack of clarity over the scope and application of ILO Convention 169⁶ has, over the years, prompted recurrent appeals for protection to the Constitutional Court and created disruptions in extractive industries.⁷ The authorities should incorporate the ILO Convention 169 into the domestic legal system in a way that balances the need to attract investment in extractive industries with the rights and protections for indigenous people.

21. **Authorities' Views**

- *Anti-corruption agenda.* The authorities pointed out that while the new Law on the Judicial Career can be beneficial, it requires some changes, namely to provide the newly created Judicial Council in charge of promotions and sanctions with more autonomy, and to streamline sanctions within the current criminal code. They believed that a lack of resources is at the core of the judicial backlog. The Supreme Audit Office believed that there is a need for more resources to carry out the reception and verification of asset disclosures and noted that their electronic filing system would help release resources to more productive uses (although there is general distrust from the public of the online publication of this information).
- *Business climate reforms.* The authorities were confident that the speedier awarding of construction licenses and the swift incorporation of ILO Convention 169 to national legislation would help support investment. They regretted, however, that the Competition bill would be unlikely to pass during the current administration.

IMPROVING THE INFLATION TARGETING FRAMEWORK AND MODERNIZING THE FINANCIAL SYSTEM

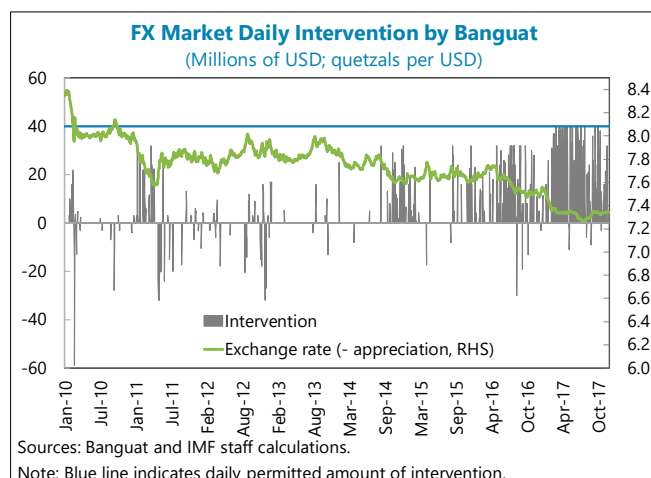
A. Improving the Inflation Targeting Framework

22. Additional steps are needed to strengthen the inflation targeting framework. Monetary policy has been successful in keeping inflation and inflation expectations within the 4 ± 1 percent target range over the last 5 years. The framework would benefit from:

⁶ ILO Convention 169 provides for the consultation of indigenous communities in investment projects affecting them.

⁷ Mining and quarries production contracted by 22.1 percent in 2017, contributing 1.6 percentage points to the decline in overall activity.

- *A more flexible exchange rate to facilitate adjustment to changing external and domestic conditions.* Over the past 2–3 years, in the context of strong remittance inflows and a gain in the terms of trade, the central bank’s foreign currency intervention rule has resulted in a sustained accumulation of foreign currency reserves. As a result, in March 2018, the de facto exchange rate arrangement was reclassified to stabilized from floating. Official



reserves are now between 114 (under a stabilized FX regime) and 173 (under a floating FX regime) percent of the composite ARA metric. As such, reserves are adequate to respond to a range of significant shocks. Although FX interventions have been sterilized through open market operations and higher government deposits at the Central Bank, a relatively stable exchange rate might have reduced incentives to de-dollarize. Going forward, the authorities should limit FX interventions to smooth excessive volatility and allow for greater currency flexibility. This could be accomplished by a further increase in the size of the exchange rate move after which FX intervention is triggered and by reducing the amount of intervention undertaken once the rule has been triggered.

- *The central bank should be recapitalized* to cover its accumulated operational losses from past quasi-fiscal operations which have eroded the central bank’s capital base.⁸
- *Improving monetary policy transmission.* Continued efforts to discourage financial dollarization, encourage bank competition, and foster the development of a secondary market through a comprehensive securities market and public debt law, would help deepen financial intermediation and improve monetary policy transmission over the medium term.

Authorities’ Views

23. The authorities expressed reservations about the reclassification of the de facto exchange rate assessment. They argued that the FX intervention is based on a transparent rule that is designed to smooth exchange rate adjustment without affecting its trend. In their view, such intervention is warranted given insufficient hedging by market participants and possible herd behavior in the FX market. The realized intervention has been one-sided because of positive shocks to the balance of payments from stronger terms of trade and the upsurge in remittance inflows. The central bank believed these flows would start weakening or even reversing by mid-year and FX

⁸ The Central Bank keeps debt on its balance sheet, which was a result of the quasi-fiscal operations performed in the 1980s and 1990. Every week the Central Bank sterilizes the repayment of a large amount of securities reaching maturity, which complicates liquidity management.

intervention would be accordingly scaled back. More broadly, the authorities reiterated their commitment to a more flexible exchange rate for it to play a greater role as an adjustment mechanism.

B. Building Financial Sector Resilience

24. The financial system is sound and well-regulated while vulnerabilities seem manageable. Banks are well capitalized, appear to have sufficient liquidity, and nonperforming loans are low. Staff stress test results indicate that sharp increases in interest rates or severe liquidity shocks in U.S. dollar funding markets could challenge banks' resilience, although such shocks would be absorbed within available capital and liquidity buffers. Moreover, efforts are in train to buttress banks' ability to withstand such shocks, including through requiring supplemental capital for market risk and a separate liquidity coverage requirement for foreign currency holdings. Banks remain exposed to exchange rate-related credit and funding risk, given the high incidence of FX loans with unhedged borrowers (44 percent of FX loans and 17 percent of total loans) which would warrant a further tightening of prudential requirements on FX loans to unhedged borrowers. These could include higher provision, risk-weighting, and collateral requirements, along with enhanced supervision of underwriting standards.

25. Various measures could further modernize the financial sector:

- **Guatemala should gradually move toward Basel III standards.** The authorities could also strengthen the macroprudential framework by developing systemic risk indicators and by designating, and clearly defining, the responsibility for macroprudential regulations. The authorities should also implement consolidated supervision, including through a harmonization of consolidation procedures with international standards and the introduction of consolidated regulatory requirements for financial groups. There is also scope to reinforce the supervision of cooperatives and microcredit institutions.
- **The new banking law that is being considered by Congress merits support and would strengthen the bank resolution framework and reinforce depositor protection.** The legislation would create greater clarity on the triggers for resolution as well as provide safeguards for the use of public funds.
- **The recently-adopted laws on microcredit, collateral, and the securitization of accounts receivable are important steps toward fostering financial development and inclusion.** The authorities' plans to establish an inter-ministerial committee with coordinating functions on financial inclusion merit support, and a particular focus should be placed on balancing social and financial stability goals.

26. A stronger AML/CFT framework will be paramount to support efforts against corruption and organized crime. Adoption of a revised AML/CFT bill, already endorsed in 2014 by the bank supervisor, the private sector, and international organizations, would make it more difficult

to conceal proceeds of corruption and would deter illicit flows. The bill and implementing regulations, when established, would (i) expand the list of reporting entities to include notaries and



other non-financial businesses and professionals, (ii) enhance preventive measures for reporting entities, (iii) establish an obligation for financial institutions to adopt a risk-based approach and a sound sanctioning regime for noncompliance, (iv) secure greater protection for supervisors, and (v) enhance interaction between the supervisor and law enforcement authorities. In addition, risk-based AML/CFT supervision should be strengthened both for offsite and onsite activities. Finally, ensuring transparency on the ultimate beneficial ownership of corporate vehicles would help tackle illicit flows.

Authorities' Views

27. The authorities concurred with staff assessments of vulnerabilities. They underscored the benefits of existing prudential measures to contain FX loans to unhedged borrowers, indicating their preference to wait until these measures take full effect before considering additional tightening of prudential requirements. The Banking Supervisor reiterated their support for a gradual adoption of Basel III and the implementation of a macroprudential framework during the next three years. They also pointed out efforts towards finalizing the draft AML/CFT law, which requires harmonization with the rest of the legal framework, including the Criminal Code and the Code of Commerce. Their expectation is that it would be submitted to Congress shortly. The authorities underlined recent progress in the development of the necessary framework and tools for the effective implementation of risk-based supervision.

STAFF APPRAISAL

28. The economy endured a political crisis in mid-2017, weakening confidence and diminishing prospects for future structural reforms. Investigations into campaign financing created significant political tensions and led to popular demonstrations against the government. The solid macroeconomic framework preserved stability throughout. Going forward, political fragmentation has weakened prospects for reforms and eroded investor confidence.

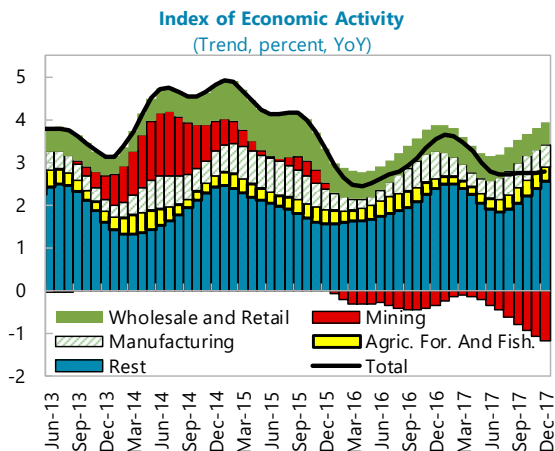
29. The outlook is for a subdued recovery. Better U.S. growth, accommodative monetary conditions, and a normalization in the government's capacity to meet its budgetary spending commitments should allow growth to rise to 3.6 percent by 2019—broadly in line with Guatemala's estimated growth potential. Achieving better medium-term growth will require higher public and private investment. However, inadequate budgetary revenue constrains the government's ability to spend on physical and human capital, and key reforms that could help attract private investment are likely to be held back until, at a minimum, the latter months of 2019.

30. The external position is stronger than the level consistent with medium term fundamentals and desirable policies. Spending more on public infrastructure, expanding social protection, and removing structural impediments to investment would facilitate the needed CA adjustment and generate a modest appreciation of the REER.

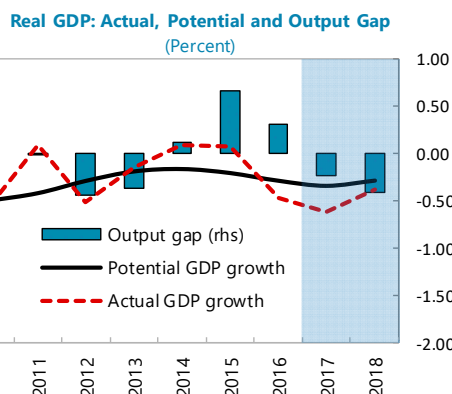
- 31. A supplementary budget that raises spending limits would help support near-term growth.** After Congress failed to approve the government's budget 2018 proposal, the government's ability to meaningfully expand spending has been constrained. The government's intention to put forward a supplementary budget—that would aim to raise spending by up to ½ percent of GDP in 2018—merits support and a particular focus should be placed on raising capital spending. In parallel, there should be an increased focus on increasing the execution of spending.
- 32. Monetary policy should be attuned to signs of weakening inflation.** With growth and inflation risks tilted to the downside, the central bank should be open to further lowering the policy rate if activity indicators have not strengthened by mid-year and inflation risks appear to remain to the downside.
- 33. A range of policies are needed to foster medium-term growth that benefits all Guatemalans.** Reversing the downward trend in investment is key to raising living standards and to capitalize on the demographic dividend that is expected over the next two decades. This requires an integral fiscal reform that encompasses continued tax administration efforts, tax policy changes, and an increase in spending efficiency, all geared toward high-impact projects in pursuit of the Sustainable Development Goals. Social outcomes can be improved through expanding social protection programs and by combatting informality. Improving the business climate and strengthening governance will durably raise investment and private sector job creation.
- 34. Additional steps are needed to strengthen the inflation targeting framework.** These include greater exchange rate flexibility to underline the primacy of the inflation objective and to allow the exchange rate to play a greater role as an adjustment mechanism. Efforts should continue to discourage financial dollarization and foster the development of domestic capital markets.
- 35. Developing macroprudential policies, implementing consolidated supervision, and reinforcing the bank resolution are all important steps to increase financial sector resiliency.** In adopting Basel III standards, priority should be given to mitigating vulnerabilities to interest rate and FX liquidity risks. Strengthening the AML/CFT framework is important to maintain the access of domestic banks to the international financial system and to support efforts against corruption.
- 36. It is recommended that the next Article IV consultation be held on the standard 12-month cycle.**

Figure 1. Guatemala: Recent Economic Developments

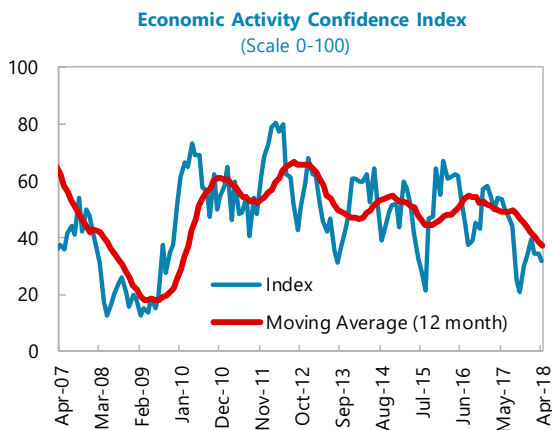
Growth has decelerated over the past two years....



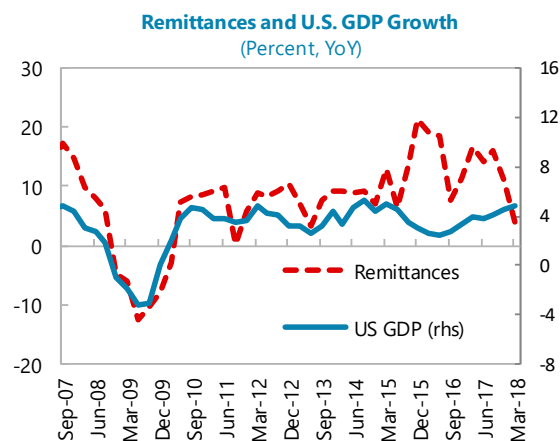
... and the output gap has started to open



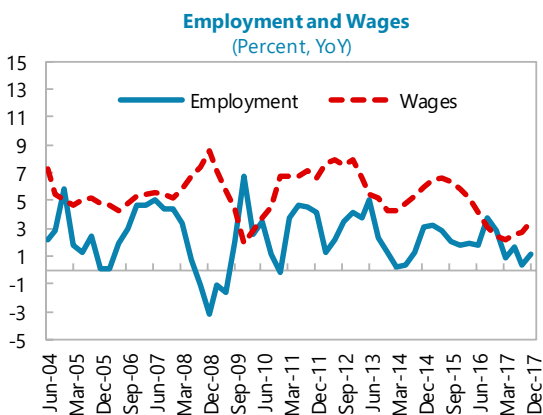
... amidst deteriorating confidence...



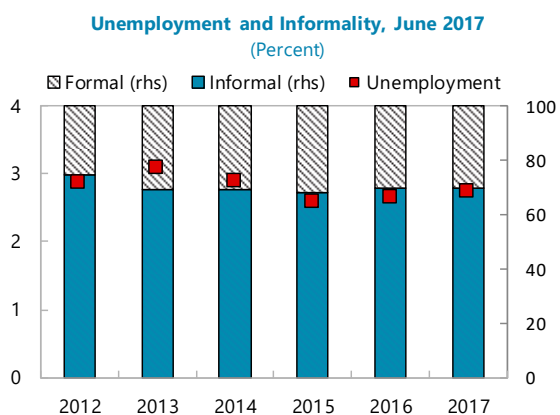
...although inflows of remittances remain strong



Employment and wages growth has remained moderate.



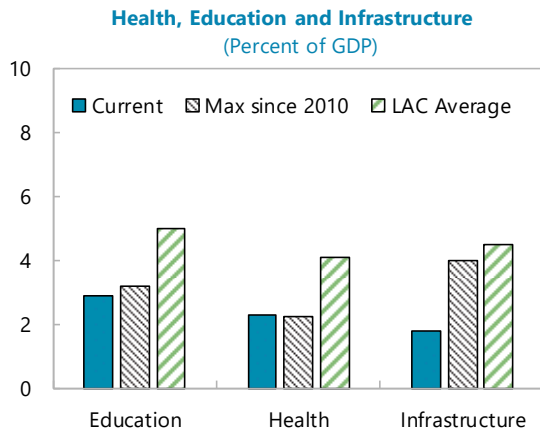
Official unemployment remains low but the level of informality continues to be high.



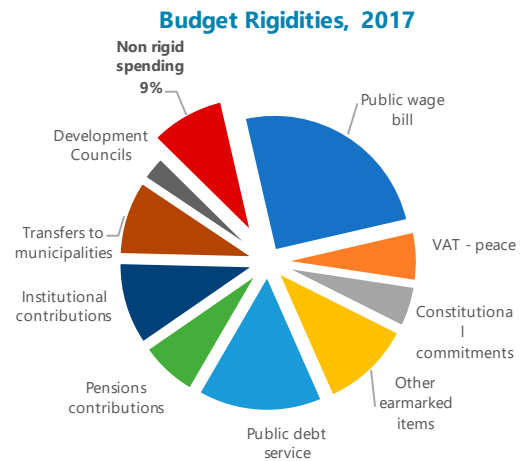
Sources: National authorities and Fund staff calculations.

Figure 2. Guatemala: Structural Fiscal Indicators

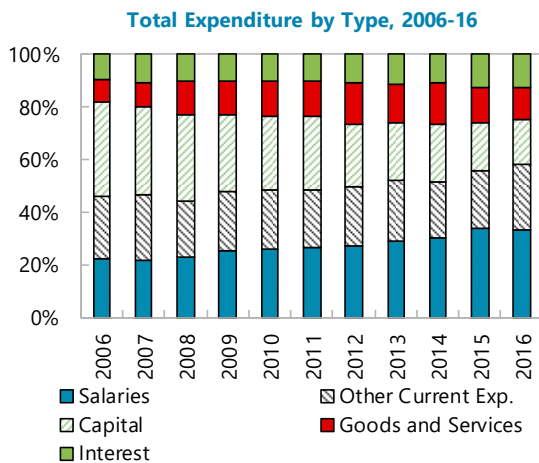
Sizable gaps in health, education, and infrastructure spending remain



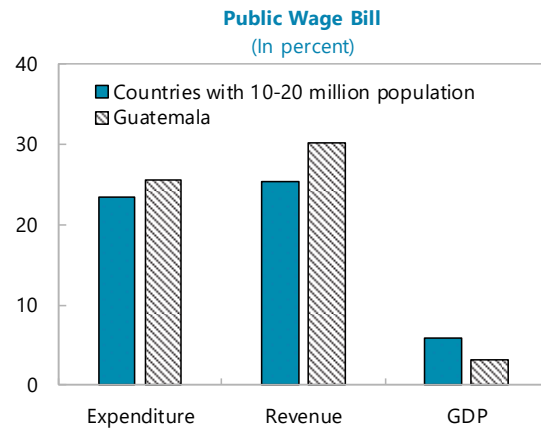
There is scope to reduce spending rigidities...



...to shift the spending mix towards greater capital outlays...



...and to better align pay with performance

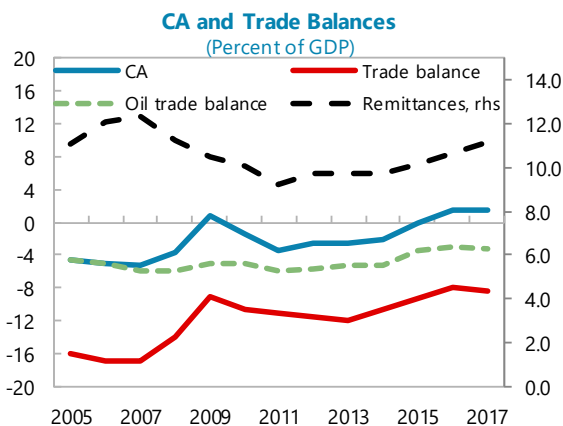


Sources: National authorities and IMF staff calculations; World Bank, Size of the Public Sector Database.

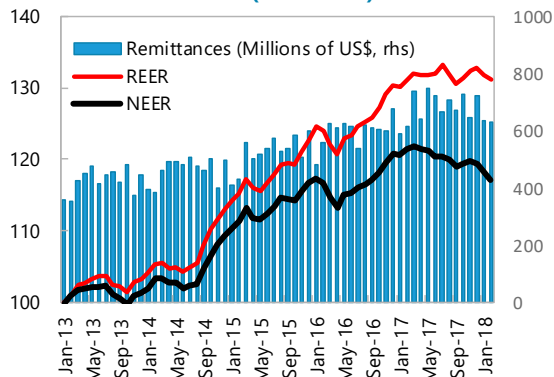
Figure 3. Guatemala: External Developments

The recent improvement in the current account reflects a lower energy import bill and stronger remittances

Strong remittance inflows contributed to the appreciation of the REER...



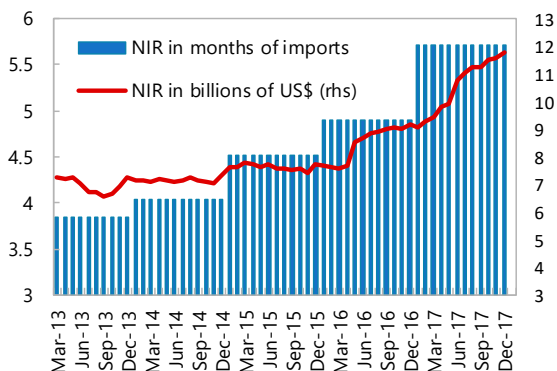
Recent Evolution of Guatemala's Exchange Rate (2013=100)



...and the accumulation of foreign reserves.

The CA is forecast to return to deficit in the medium term, which would be largely financed by FDI inflows.

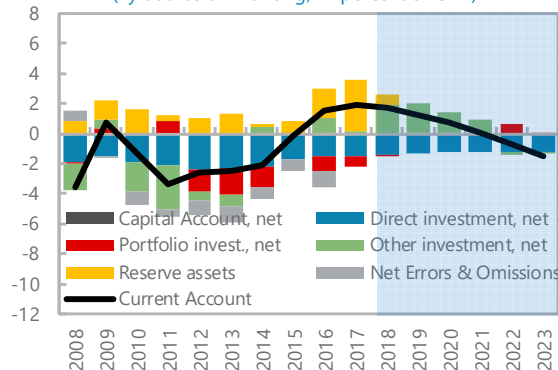
Net International Reserves (NIR) of the Central Bank



At negative 22½ percent of GDP, Guatemala's net IIP position is small by regional standards.

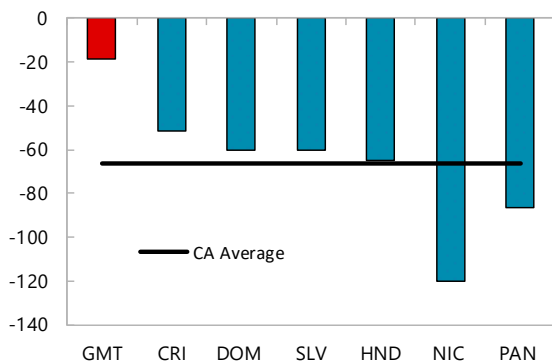
Current Account

(By source of financing; in percent of GDP)

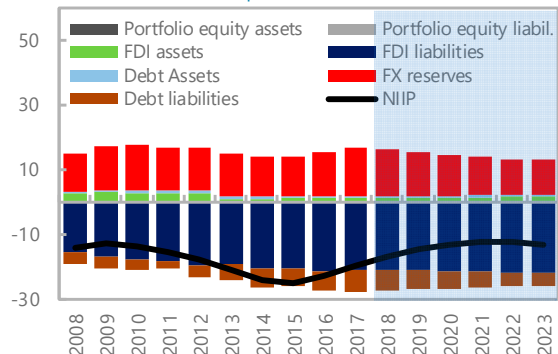


A large portion of external liabilities comprises non-debt creating FDI inflows.

Net IIP (Percent of GDP, 2017)



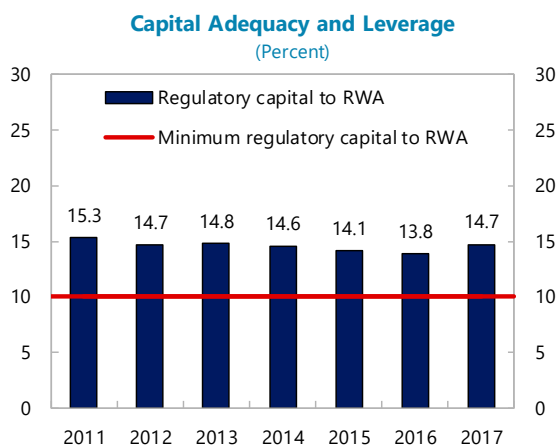
IIP Composition, by Instrument (In percent of GDP)



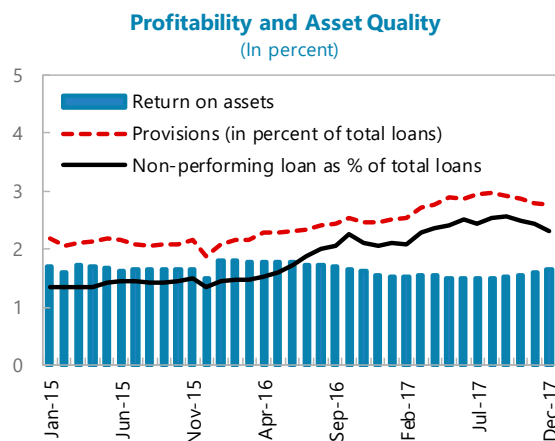
Sources: Banguat and IMF staff calculations.

Figure 4. Guatemala: Financial Developments

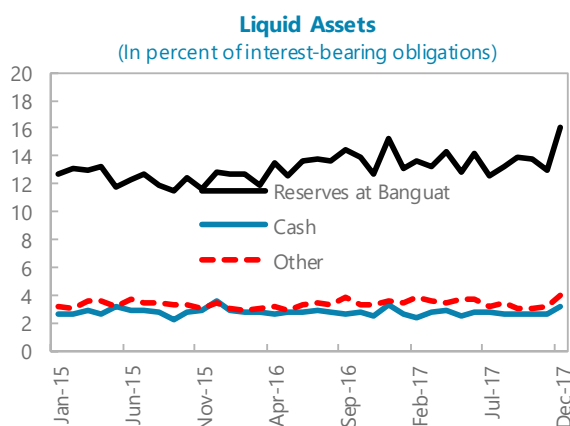
Banks are well capitalized, with capital adequacy well above the regulatory minimum.



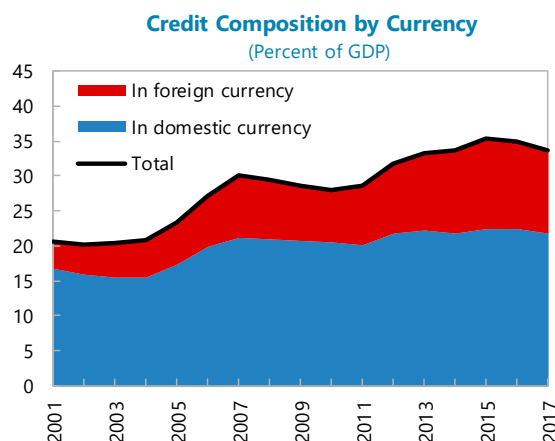
Profitability remains strong, although trending down with the deceleration of economic activity.



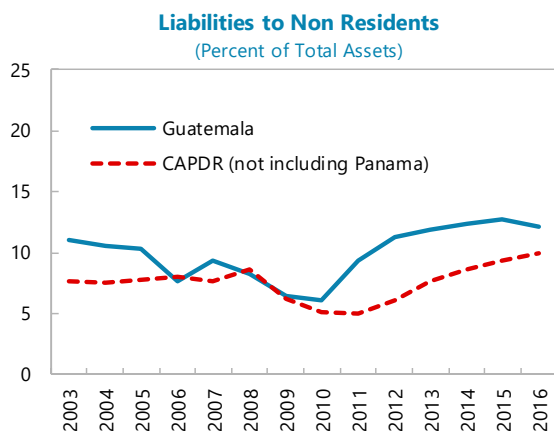
Liquidity is adequate and tilted towards reserves at the central bank.



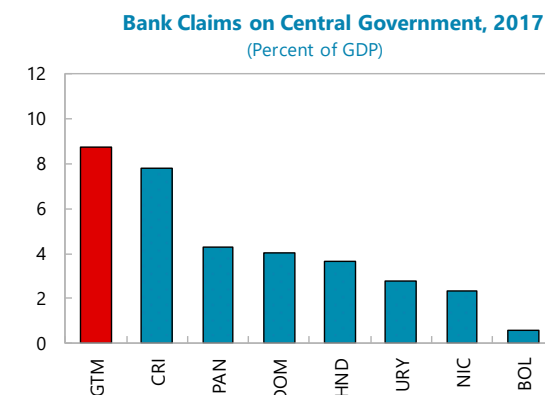
Credit dollarization exposes banks to credit risk...



...foreign liabilities raise banks' vulnerability to rollover risk.



...and holdings of sovereign bonds expose banks to interest rate-driven valuation losses.



Sources: Banguat and staff calculations.

Table 1. Guatemala: Selected Economic and Social Indicators

I. Social and Demographic Indicators																			
Population 2018 (millions)																	17	Gini index (2014)	49
Percentage of indigenous population (2016)																	41	Life expectancy at birth (2016)	72
Population below the poverty line (Percent, 2014)																	59	Adult illiteracy rate (2015)	21
Rank in UNDP development index (2016; of 188)																	125	GDP per capita (US\$, 2016)	4,155
II. Economic Indicators																			
	2007	2008	2009	2010	2011	2012	2013	2014	2015	2016	Est. 2017	Projections 2018	2019	2020	2021	2022	2023		
	(Annual percent change)																		
Income and Prices																			
Real GDP	6.3	3.3	0.5	2.9	4.2	3.0	3.7	4.2	4.1	3.1	2.8	3.2	3.6	3.8	3.7	3.6	3.6		
Consumer prices (end of period)	8.7	9.4	-0.3	5.4	6.2	3.4	4.4	2.9	3.1	4.2	5.7	4.2	3.5	3.5	3.7	3.8	4.0		
Monetary Sector																			
M2	10.2	7.6	10.0	11.3	10.7	9.8	9.0	8.7	9.4	6.6	8.4	8.6	7.4	7.4	7.4	7.4	7.4		
Credit to the private sector	26.0	11.0	1.1	5.7	14.1	17.7	12.0	8.8	12.8	5.9	3.8	7.5	8.5	10.4	10.5	10.7	9.0		
	(In percent of GDP, unless otherwise indicated)																		
Saving and Investment																			
Gross domestic investment	20.8	16.4	13.1	13.9	15.2	15.0	14.0	13.7	13.6	12.9	12.1	11.8	11.7	11.8	12.0	12.2	12.5		
Private sector	17.2	13.2	9.3	10.8	12.6	13.1	12.2	12.0	12.3	11.7	11.0	10.7	10.5	10.6	10.7	10.9	11.2		
Public sector	3.6	3.2	3.8	3.1	2.7	1.9	1.9	1.7	1.3	1.2	1.1	1.1	1.2	1.2	1.3	1.3	1.3		
Gross national saving	15.6	12.8	13.8	12.6	11.9	12.4	11.5	11.6	13.5	14.4	13.6	13.0	12.4	12.0	11.7	11.4	11.2		
Private sector	12.3	10.4	12.8	12.2	11.6	12.5	11.4	11.4	13.4	14.1	13.6	13.1	12.7	12.4	12.3	12.1	11.9		
Public sector	3.3	2.4	1.0	0.4	0.3	-0.1	0.1	0.2	0.1	0.3	0.0	-0.1	-0.3	-0.4	-0.6	-0.7	-0.7		
External saving	5.2	3.6	-0.7	1.4	3.4	2.6	2.5	2.1	0.2	-1.5	-1.5	-1.1	-0.7	-0.2	0.3	0.8	1.3		
External Sector																			
Current account balance	-5.2	-3.6	0.7	-1.4	-3.4	-2.6	-2.5	-2.1	-0.2	1.5	1.5	1.1	0.7	0.2	-0.3	-0.8	-1.3		
Trade balance (goods)	-16.1	-14.2	-8.9	-10.3	-10.4	-11.4	-11.5	-10.3	-8.7	-7.6	-8.0	-8.2	-8.3	-8.5	-8.7	-9.0	-9.2		
Exports	20.5	20.0	19.3	20.6	22.1	20.0	18.9	18.7	17.0	15.4	14.9	14.8	15.0	15.0	15.1	15.1	15.1		
Imports	36.6	34.3	28.2	31.0	32.5	31.4	30.4	29.0	25.7	23.0	22.9	23.0	23.3	23.6	23.8	24.0	24.3		
Of which: oil & lubricants	6.7	6.8	5.5	5.7	6.5	6.3	5.8	5.6	3.6	3.1	3.5	3.8	3.8	3.8	3.8	3.9	3.9		
of which repayment of arrears																			
Other (net)	10.8	10.6	9.6	9.0	7.1	8.8	9.0	8.2	8.6	9.0	9.5	9.3	9.0	8.8	8.5	8.2	7.9		
Of which: remittances	12.3	11.3	10.5	10.0	9.2	9.8	9.7	9.7	10.1	10.7	11.2	11.0	10.8	10.7	10.4	10.2	10.0		
Capital account balance	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0		
Financial account balance (Net lending (+))	-4.0	-2.9	0.7	-2.2	-3.8	-3.5	-3.6	-2.9	-0.9	0.5	1.0	1.1	0.7	0.2	-0.3	-0.8	-1.3		
Of which: FDI, net	-2.1	-1.9	-1.5	-1.9	-2.1	-2.4	-2.3	-2.2	-1.7	-1.6	-1.3	-1.3	-1.3	-1.3	-1.3	-1.3	-1.3		
Errors and omissions	1.2	0.7	0.0	-0.9	-0.5	-0.9	-1.1	-0.8	-0.7	-1.0	-0.6	0.0	0.0	0.0	0.0	0.0	0.0		
Change in reserves assets (Increase (+))	0.6	0.9	1.3	1.6	0.4	1.0	1.3	0.1	0.7	2.0	3.4	0.6	0.0	0.0	0.0	0.0	0.0		
Net International Reserves																			
(Stock in months of next-year NFGS imports)	3.2	4.2	3.8	3.6	3.7	3.9	3.8	4.0	4.5	4.9	5.7	5.5	5.2	4.8	4.5	4.2	4.2		
(Stock over short-term debt on residual maturity)	1.6	1.6	2.0	1.9	1.9	1.8	1.8	1.6	1.6	1.8	2.2	2.1	1.9	1.8	1.5	1.6	1.6		
Public Finances																			
Central Government																			
Revenues	12.8	12.0	11.1	11.2	11.6	11.6	11.6	11.5	10.8	11.0	10.8	10.9	10.9	11.0	10.9	11.0	11.0		
Expenditures	14.3	13.6	14.2	14.5	14.4	14.0	13.8	13.4	12.3	12.1	12.1	12.3	12.6	12.8	13.0	13.1	13.2		
Current	9.9	9.9	10.7	11.0	10.8	11.1	10.8	10.5	10.1	10.0	9.9	10.0	10.2	10.3	10.5	10.6	10.6		
Capital	4.4	3.7	3.5	3.6	3.6	2.9	3.0	2.9	2.2	2.1	2.2	2.2	2.4	2.5	2.5	2.6	2.6		
Primary balance	0.0	-0.3	-1.7	-1.8	-1.3	-0.9	-0.6	-0.4	0.1	0.4	0.1	0.0	-0.2	-0.3	-0.4	-0.4	-0.4		
Overall balance	-1.4	-1.6	-3.1	-3.3	-2.8	-2.4	-2.1	-1.9	-1.4	-1.1	-1.3	-1.4	-1.7	-1.8	-2.0	-2.1	-2.2		
Financing of the central government balance	1.4	1.6	3.1	3.3	2.8	2.4	2.1	1.9	1.4	1.1	1.3	1.4	1.7	1.8	2.0	2.1	2.2		
Net external financing	1.2	0.3	1.3	1.5	0.1	1.5	0.0	0.7	0.8	0.8	0.2	0.1	-0.2	-0.3	-0.3	-1.0	-0.3		
Net domestic financing	0.3	1.3	1.8	-7.2	-5.2	-1.5	0.6	1.8	0.7	0.3	1.2	1.6	1.9	2.1	2.3	3.1	2.5		
Of which: use of government deposits	-0.7	0.8	0.4	-9.0	-7.5	-2.1	0.1	0.0	-0.1	-0.5	-0.1	-0.1	0.0	0.0	0.0	0.0	0.0		
Rest of Nonfinancial Public Sector Balance	1.1	0.9	0.4	0.5	0.4	0.4	0.4	0.4	0.2	0.2	0.2	0.2	0.2	0.2	0.2	0.2	0.2		
Combined Nonfinancial Public Sector																			
Primary balance	1.2	0.6	-1.3	-1.3	-0.9	-0.5	-0.2	0.0	0.3	0.6	0.3	0.2	0.0	-0.1	-0.2	-0.2	-0.2		
Overall balance	-0.3	-0.7	-2.8	-2.8	-2.4	-2.0	-1.7	-1.5	-1.2	-0.9	-1.1	-1.2	-1.5	-1.6	-1.8	-1.9	-2.0		
Central Government Debt																			
External	21.3	20.1	22.9	24.1	23.7	24.3	24.6	24.3	24.2	24.5	24.7	24.8	25.1	25.5	25.9	26.3	26.7		
Domestic 1/	12.1	11.3	13.0	13.1	11.5	12.4	12.9	11.6	11.6	12.0	12.6	12.4	12.4	12.5	12.7	12.9	13.1		
	9.2	8.9	9.9	11.0	12.1	11.9	11.7	12.6	12.6	12.6	12.1	12.4	12.7	12.9	13.1	13.3	13.5		
Memorandum Items:																			
GDP (US\$ billions)	34.1	39.1	37.7	41.3	47.7	50.4	53.9	58.7	63.8	68.7	74.6	81.1	86.3	91.9	97.6	103.5	109.6		
Output gap (% of GDP)	2.0	1.7	-0.8	-1.0	0.0	-0.4	-0.4	0.1	0.7	0.3	-0.2	-0.4	-0.2	-0.1	0.0	0.0	0.0		

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

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

Table 2. Guatemala: Central Government Operations and Financial Balance
(GFSM 2001 Classification)

	2013	2014	2015	2016	Est.		Projections				
					2017	2018	2019	2020	2021	2022	2023
(In millions of quetzales)											
Central government operations											
Revenue	49,250	52,217	52,858	57,413	59,984	64,940	69,996	75,560	81,096	87,495	94,328
Taxes	45,467	48,478	49,507	53,961	56,477	61,199	65,982	71,250	76,465	82,518	88,979
Other revenue	3,783	3,739	3,350	3,453	3,506	3,741	4,014	4,311	4,631	4,977	5,349
Expenditure	58,260	60,811	59,865	63,076	67,271	73,496	80,944	88,253	96,017	104,575	113,137
Expense	54,500	56,544	57,829	61,800	65,183	71,186	78,321	85,340	92,824	101,076	109,303
Compensation of employees	16,968	18,466	20,304	21,028	22,328	23,643	25,945	27,933	30,007	32,251	34,659
Use of goods and services	8,661	9,346	7,996	7,686	7,205	8,770	9,409	10,105	10,856	11,668	12,163
Interest	6,569	6,583	7,617	7,724	8,003	8,669	9,699	10,810	12,117	13,634	15,370
Other expense	22,302	22,149	21,913	25,361	27,647	30,104	33,268	36,492	39,845	43,524	47,111
Net acquisition of nonfinancial assets	3,760	4,267	2,036	1,276	2,089	2,311	2,623	2,912	3,192	3,500	3,835
Gross Operating Balance	-5,249	-4,327	-4,971	-4,387	-5,199	-6,245	-8,325	-9,780	-11,729	-13,581	-14,975
Net lending (+)/borrowing (-)	-9,010	-8,594	-7,007	-5,663	-7,288	-8,556	-10,948	-12,692	-14,921	-17,081	-18,810
Net acquisition of financial assets	-21,657	-23,194	-22,983	2,453	524	715	134	134	134	134	134
Net incurrence of liabilities	8,677	7,153	7,638	8,143	8,313	11,226	11,082	12,826	15,055	17,215	18,943
Financial Balance 1/											
Net financial worth 2/	-83,447	-87,469	-91,955	-91,033	-91,583	-102,766	-114,307	-127,950	-143,920	-162,190	-181,950
Financial assets	20,718	22,789	26,201	34,231	40,164	40,821	40,824	40,715	40,555	40,317	40,273
Domestic	20,718	22,789	26,201	34,231	40,164	40,821	40,824	40,715	40,555	40,317	40,273
Currency and deposits	20,718	22,789	26,201	34,231	40,164	40,821	40,824	40,715	40,555	40,317	40,273
Foreign	0	0	0	0	0	0	0	0	0	0	0
Net incurrence of liabilities	104,164	110,258	118,156	125,264	131,747	143,587	155,130	168,664	184,475	202,507	222,223
Domestic 3/	49,412	57,428	61,477	65,406	72,344	82,981	95,273	109,980	127,113	152,106	173,407
Debt securities	49,412	57,428	61,477	65,406	72,344	82,981	95,273	109,980	127,113	152,106	173,407
Foreign	54,753	52,831	56,679	59,858	59,404	60,606	59,857	58,685	57,362	50,401	48,816
Debt securities	13,584	13,140	13,239	18,333	21,505	22,085	22,239	22,484	22,760	17,665	17,926
Loans	41,169	39,691	43,440	41,525	37,898	38,521	37,618	36,200	34,602	32,736	30,890
(In percent of GDP)											
Central Government Operations											
Revenue	11.6	11.5	10.8	11.0	10.8	10.8	10.9	11.0	10.9	11.0	11.0
Taxes	10.7	10.7	10.1	10.3	10.2	10.2	10.3	10.3	10.3	10.4	10.4
Other revenue	0.9	0.8	0.7	0.7	0.6	0.6	0.6	0.6	0.6	0.6	0.6
Expenditure	13.8	13.4	12.3	12.1	12.1	12.3	12.6	12.8	13.0	13.1	13.2
Expense	12.9	12.5	11.8	11.8	11.7	11.9	12.2	12.4	12.5	12.7	12.8
Compensation of employees	4.0	4.1	4.2	4.0	4.0	4.0	4.0	4.1	4.1	4.1	4.1
Use of goods and services	2.0	2.1	1.6	1.5	1.3	1.5	1.5	1.5	1.5	1.5	1.4
Interest	1.6	1.4	1.6	1.5	1.4	1.4	1.5	1.6	1.6	1.7	1.8
Other expense	5.3	4.9	4.5	4.9	5.0	5.0	5.2	5.3	5.4	5.5	5.5
Net acquisition of nonfinancial assets	0.9	0.9	0.4	0.2	0.4	0.4	0.4	0.4	0.4	0.4	0.4
Gross Operating Balance	-1.2	-1.0	-1.0	-0.8	-0.9	-1.0	-1.3	-1.4	-1.6	-1.7	-1.7
Net lending (+)/borrowing (-)	-2.1	-1.9	-1.4	-1.1	-1.3	-1.4	-1.7	-1.8	-2.0	-2.1	-2.2
Net acquisition of financial assets	-5.1	-5.1	-4.7	0.5	0.1	0.1	0.0	0.0	0.0	0.0	0.0
Net incurrence of liabilities	2.1	1.6	1.6	1.6	1.5	1.9	1.7	1.9	2.0	2.2	2.2
Financial Balance 1/											
Net financial worth 2/	-19.7	-19.3	-18.8	-17.4	-16.5	-17.2	-17.8	-18.6	-19.4	-20.4	-21.3
Financial assets	4.9	5.0	5.4	6.6	7.2	6.8	6.4	5.9	5.5	5.1	4.7
Domestic	4.9	5.0	5.4	6.6	7.2	6.8	6.4	5.9	5.5	5.1	4.7
Currency and deposits	4.9	5.0	5.4	6.6	7.2	6.8	6.4	5.9	5.5	5.1	4.7
Foreign	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Net incurrence of liabilities	24.6	24.3	24.2	24.0	23.7	24.0	24.2	24.5	24.9	25.4	26.0
Domestic 3/	11.7	12.6	12.6	12.5	13.0	13.9	14.8	15.9	17.2	19.1	20.3
Debt securities	11.7	12.6	12.6	12.5	13.0	13.9	14.8	15.9	17.2	19.1	20.3
Foreign	12.9	11.6	11.6	11.5	10.7	10.1	9.3	8.5	7.7	6.3	5.7
Debt securities	3.2	2.9	2.7	3.5	3.9	3.7	3.5	3.3	3.1	2.2	2.1
Loans	9.7	8.7	8.9	8.0	6.8	6.4	5.9	5.2	4.7	4.1	3.6

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 recapitalization obligations to the central bank.

Table 3. Guatemala: Summary Balance of Payments

	2013	2014	2015	2016	Est.	Projections					
					2017	2018	2019	2020	2021	2022	2023
(In millions of U.S. dollars)											
Current account balance	-1,351	-1,230	-96	1,023	1,134	922	577	212	-264	-800	-1,416
Trade balance (goods)	-6,176	-6,064	-5,557	-5,186	-5,992	-6,654	-7,208	-7,834	-8,527	-9,286	-10,123
Exports, f.o.b.	10,183	10,992	10,824	10,581	11,118	12,008	12,913	13,812	14,696	15,583	16,514
Imports, f.o.b.	16,359	17,056	16,381	15,767	17,110	18,662	20,121	21,645	23,222	24,869	26,637
<i>Of which: oil & lubricants</i>	3,147	3,297	2,306	2,124	2,599	3,079	3,247	3,478	3,725	4,008	4,298
Net services	-223	-203	-339	-242	-437	-507	-555	-617	-693	-782	-883
Net income	-1,064	-1,408	-1,399	-1,507	-1,419	-1,580	-1,770	-1,917	-2,065	-2,211	-2,365
Net transfers	6,113	6,445	7,198	7,959	8,981	9,662	10,110	10,580	11,020	11,478	11,955
<i>Of which: remittances</i>	5,246	5,699	6,461	7,354	8,338	8,964	9,367	9,789	10,180	10,587	11,011
Capital account balance	0	0	0	0	0	0	0	0	0	0	0
Financial account balance	-1,918	-1,724	-567	332	720	922	577	212	-264	-800	-1,416
Foreign direct investment	-1,262	-1,283	-1,104	-1,068	-967	-1,051	-1,118	-1,190	-1,264	-1,341	-1,420
Net acquisition of financial assets	92	-117	72	107	68	74	79	84	89	95	100
Net incurrence of liabilities	1,353	1,166	1,176	1,175	1,035	1,125	1,197	1,274	1,353	1,435	1,520
Portfolio investment	-933	-794	49	-677	-843	-425	-398	-424	-450	222	-506
Net acquisition of financial assets	-6	38	-8	19	4	4	4	4	4	4	4
Net incurrence of liabilities	926	833	-57	696	847	429	402	428	454	-218	510
<i>Of which: government bonds</i>	400	0	0	700	500	51	0	0	0	-700	0
Financial derivatives	0	0	0	0	0	0	0	0	0	0	0
Other investment	-426	280	13	686	-36	1,897	2,093	1,826	1,450	318	510
Change in reserves assets	702	73	475	1,392	2,566	500	0	0	0	0	0
Errors and omissions	-567	-495	-470	-691	-414	0	0	0	0	0	0
(In percent of GDP)											
Current account balance	-2.5	-2.1	-0.2	1.5	1.5	1.1	0.7	0.2	-0.3	-0.8	-1.3
Trade balance (goods)	-11.5	-10.3	-8.7	-7.6	-8.0	-8.2	-8.3	-8.5	-8.7	-9.0	-9.2
Exports, f.o.b.	18.9	18.7	17.0	15.4	14.9	14.8	15.0	15.0	15.1	15.1	15.1
Imports, f.o.b.	30.4	29.0	25.7	23.0	22.9	23.0	23.3	23.6	23.8	24.0	24.3
<i>Of which: oil & lubricants</i>	5.8	5.6	3.6	3.1	3.5	3.8	3.8	3.8	3.8	3.9	3.9
Net services	-0.4	-0.3	-0.5	-0.4	-0.6	-0.6	-0.6	-0.7	-0.7	-0.8	-0.8
Net income	-2.0	-2.4	-2.2	-2.2	-1.9	-1.9	-2.1	-2.1	-2.1	-2.1	-2.2
Net transfers	11.4	11.0	11.3	11.6	12.0	11.9	11.7	11.5	11.3	11.1	10.9
<i>Of which: remittances</i>	9.7	9.7	10.1	10.7	11.2	11.0	10.8	10.7	10.4	10.2	10.0
Capital account balance	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Financial account balance	-3.6	-2.9	-0.9	0.5	1.0	1.1	0.7	0.2	-0.3	-0.8	-1.3
Foreign direct investment	-2.3	-2.2	-1.7	-1.6	-1.3	-1.3	-1.3	-1.3	-1.3	-1.3	-1.3
Net acquisition of financial assets	0.2	-0.2	0.1	0.2	0.1	0.1	0.1	0.1	0.1	0.1	0.1
Net incurrence of liabilities	2.5	2.0	1.8	1.7	1.4	1.4	1.4	1.4	1.4	1.4	1.4
Portfolio investment	-1.7	-1.4	0.1	-1.0	-1.1	-0.5	-0.5	-0.5	-0.5	0.2	-0.5
Net acquisition of financial assets	0.0	0.1	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Net incurrence of liabilities	1.7	1.4	-0.1	1.0	1.1	0.5	0.5	0.5	0.5	-0.2	0.5
<i>Of which: government bonds</i>	0.7	0.0	0.0	1.0	0.7	0.1	0.0	0.0	0.0	-0.7	0.0
Financial derivatives	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Other investment	-0.8	0.5	0.0	1.0	0.0	2.3	2.4	2.0	1.5	0.3	0.5
Change in reserves assets	1.3	0.1	0.7	2.0	3.4	0.6	0.0	0.0	0.0	0.0	0.0
Errors and omissions	-1.1	-0.8	-0.7	-1.0	-0.6	0.0	0.0	0.0	0.0	0.0	0.0
Memorandum items:											
Value of exports, f.o.b. (percentage change)	0.8	7.9	-1.5	-2.2	5.1	8.0	7.5	7.0	6.4	6.0	6.0
Value of imports, f.o.b. (percentage change)	3.3	4.3	-4.0	-3.7	8.5	9.1	7.8	7.6	7.3	7.1	7.1
Stock of NIR (in millions of U.S. dollars) 1/	6,433	6,587	7,077	8,321	10,578	11,078	11,078	11,078	11,078	11,078	11,078
NIR in months of next-year NFGS imports	3.8	4.0	4.5	4.9	5.7	5.5	5.2	4.8	4.5	4.2	4.2
NIR over short-term debt on residual maturity	1.8	1.6	1.6	1.8	2.2	2.1	1.9	1.8	1.5	1.6	1.6

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

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

Table 4. Guatemala: Monetary Sector Survey

	2013	2014	2015	2016	2017	2018	2019	Projections				
								2020	2021	2022	2023	
(In millions of quetzales)												
Bank of Guatemala (BOG)												
Net international reserves 1/ (In millions of U.S. dollars) 1/	50,515	50,031	54,155	62,816	77,679	82,110	82,684	83,593	84,620	85,844	87,113	87,113
Net domestic assets	-28,142	-25,897	-27,007	-33,418	-44,084	-45,562	-43,278	-41,272	-39,349	-37,419	-35,320	-35,320
Net claims on nonfinancial public sector	-10,565	-9,765	-9,500	-15,290	-20,996	-21,623	-21,561	-21,331	-21,024	-20,600	-20,467	-20,467
Central government (CG)	-2,904	-3,042	-3,274	-6,697	-9,532	-10,248	-10,382	-10,515	-10,649	-10,783	-10,917	-10,917
Rest of nonfinancial public sector	-7,661	-6,723	-6,225	-8,593	-11,464	-11,375	-11,179	-10,815	-10,375	-9,817	-9,550	-9,550
Bank of Guatemala losses	19,201	20,901	22,285	23,586	25,022	26,221	27,420	28,619	29,818	31,017	32,216	32,216
Net credit to banks	-24,499	-25,724	-27,419	-33,180	-37,082	-33,535	-36,130	-38,955	-42,001	-43,602	-45,193	-45,193
Of which: legal reserves	-26,558	-27,782	-29,478	-35,239	-39,140	-35,593	-38,189	-41,014	-44,059	-45,661	-47,251	-47,251
Open market operations 2/	-16,785	-17,032	-17,642	-15,991	-22,745	-22,894	-20,597	-18,203	-16,186	-15,901	-15,618	-15,618
Currency in circulation	22,373	24,134	27,148	29,398	33,595	36,548	39,406	42,321	45,271	48,425	51,792	51,792
Banking sector												
Net foreign position (in millions of U.S. Dollars)	-22,472	-26,865	-32,991	-34,924	-37,419	-39,629	-42,422	-45,375	-48,219	-50,487	-52,848	-52,848
Net claims on Bank of Guatemala	38,071	39,838	42,519	46,960	56,235	53,031	53,671	54,458	55,786	57,145	58,495	58,495
Legal reserves	26,558	27,782	29,478	35,239	39,140	35,593	38,189	41,014	44,059	45,661	47,251	47,251
BOG securities	13,564	14,107	15,093	13,773	19,146	19,489	17,534	15,495	13,778	13,536	13,295	13,295
Liabilities to BOG	-2,052	-2,052	-2,052	-2,052	-2,051	-2,051	-2,051	-2,051	-2,051	-2,051	-2,051	-2,051
Net domestic assets	148,872	165,841	185,572	194,277	203,425	227,373	247,180	268,924	291,675	315,932	341,485	341,485
Net credit to the NFPS	7,262	10,154	8,943	8,653	10,331	15,680	21,936	29,502	38,338	51,185	61,991	61,991
Official capital and reserves	-4,504	-5,366	-5,464	-5,943	-6,283	-6,649	-7,161	-7,821	-8,569	-9,485	-10,321	-10,321
Credit to the private sector	140,159	152,455	172,036	182,199	189,043	203,221	220,495	243,426	268,986	297,768	324,567	324,567
Medium and long-term foreign liabilities	1,442	2,413	2,743	1,673	1,570	1,691	1,814	1,949	2,093	2,250	2,418	2,418
Liabilities to private sector	163,029	176,401	192,357	204,639	220,671	239,084	256,615	276,059	297,149	320,340	344,715	344,715
Demand deposits	55,257	59,682	64,081	67,722	71,601	78,925	84,680	90,945	97,698	105,002	112,843	112,843
Time and savings deposits	91,316	99,753	109,679	117,013	126,855	136,650	146,615	157,460	169,152	181,800	195,376	195,376
Capital and reserves (private banks)	16,455	16,966	18,597	19,904	22,215	23,509	25,320	27,654	30,299	33,538	36,496	36,496
Monetary survey												
Net foreign assets (In millions of U.S. dollars)	28,043	23,166	21,164	27,892	40,260	42,481	40,261	38,219	36,401	35,357	34,265	34,265
Net domestic assets	162,020	182,707	203,633	210,062	218,959	238,247	260,637	284,817	310,519	338,023	366,983	366,983
Net claims on nonfinancial public sector	-3,303	389	-557	-6,637	-10,665	-5,943	376	8,172	17,314	30,585	41,524	41,524
Bank of Guatemala losses	19,201	20,901	22,285	23,586	25,022	26,221	27,420	28,619	29,818	31,017	32,216	32,216
Credit to private sector	147,446	159,386	179,586	190,129	197,302	212,100	230,127	254,060	280,736	310,773	338,742	338,742
Medium and long-term foreign liabilities	1,442	2,413	2,743	1,673	1,570	1,691	1,814	1,949	2,093	2,250	2,418	2,418
Liabilities to the private sector	188,621	203,459	222,055	236,281	257,649	279,037	299,084	321,087	344,826	371,129	398,830	398,830
Of which: Money	77,630	83,816	91,229	97,119	105,196	115,473	124,086	133,265	142,968	153,427	164,636	164,636
Of which: Quasi-money	110,992	119,644	130,825	139,161	152,453	163,564	174,997	187,821	201,858	217,703	234,194	234,194
Memorandum items:												
	(Percent change)											
Currency in circulation	5.7	7.9	12.5	8.3	14.3	8.8	7.8	7.4	7.0	7.0	7.0	7.0
M2	9.0	8.7	9.4	6.6	8.4	8.6	7.4	7.4	7.4	7.4	7.4	7.4
Credit to private sector	12.0	8.8	12.8	5.9	3.8	7.5	8.5	10.4	10.5	10.7	10.7	10.7
	(In percent of GDP)											
Currency in circulation	5.3	5.3	5.6	5.6	6.0	6.1	6.1	6.1	6.1	6.1	6.1	6.1
M2	39.9	40.4	41.2	41.0	41.8	42.1	42.2	42.2	42.1	42.1	42.1	42.1
Net credit of the banking sector to the CG	1.7	2.2	1.8	1.7	1.9	2.6	3.4	4.3	5.2	6.4	7.2	7.2
Credit to private sector	33.1	33.6	35.2	34.9	34.0	34.0	34.3	35.3	36.3	37.4	37.9	37.9
	(In percent of bank liabilities to the private sector)											
Banks' liquid assets	40.0	40.7	39.7	41.6	45.0	42.4	42.1	42.1	42.4	43.7	44.1	44.1
Demand deposits	33.9	33.8	33.3	33.1	32.4	33.0	33.0	32.9	32.9	32.8	32.7	32.7
Time and savings deposits	56.0	56.5	57.0	57.2	57.5	57.2	57.1	57.0	56.9	56.8	56.7	56.7
Capital and reserves (private banks)	10.1	9.6	9.7	9.7	10.1	9.8	9.9	10.0	10.2	10.5	10.6	10.6

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

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

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

Table 5. Guatemala: Financial Soundness Indicators

	2007	2008	2009	2010	2011	2012	2013	2014	2015	2016	2017
On-shore banks											
Reserves as a percentage of Deposits, in NC	15.5	13.4	14.7	14.6	14.6	14.5	14.5	14.6	14.5	14.8	15.0
Reserves as a percentage of Deposits, in FC	15.8	15.1	18.2	18.6	16.2	16.8	20.8	17.1	15.9	16.7	16.3
Short-term liquidity	20.3	19.4	21.6	20.3	21.6	21.6	21.9	20.7	18.9	20.5	21.2
Liquid asset to total asset ratio	15.3	24.4	28.2	28.4	29.0	27.5	28.1	28.8	26.9	27.7	28.4
Liquidity ratio	11.2	20.3	23.7	24.5	24.2	23.6	24.5	25.5	24.5	25.1	25.7
Regulatory capital to risk-weighted assets	13.8	13.5	15.4	15.2	15.3	14.7	14.8	14.6	14.1	13.8	14.7
Nonperforming loans to total gross loans	2.1	2.2	2.7	2.1	1.6	1.3	1.2	1.3	1.4	2.1	2.3
Provisions to non-performing loans	42.7	73.2	89.3	115.3	126.2	143.4	157.6	151.9	138.4	120.4	119.6
Cash to total deposits	20.3	19.4	21.6	20.3	21.6	21.6	21.9	20.7	18.9	20.5	21.2
Return on assets	1.6	1.7	1.7	1.7	1.7	1.6	1.5	1.5	1.5	1.6	1.7
Return on equity	16.9	16.3	15.7	16.3	18.5	17.2	16.0	16.6	16.3	16.9	17.8
Foreign currency-denominated loans to total loans	33.2	33.6	31.0	30.2	34.0	35.2	36.7	38.5	39.9	39.0	38.6
Foreign currency-denominated liabilities to total liabilities	25.0	24.3	23.9	24.6	27.5	28.6	30.3	31.1	30.8	29.8	29.1
Off-shore banks											
Statutory capital to risk-weighted assets	15.0	14.7	18.1	18.5	16.2	16.8	15.8	15.6	14.5	14.8	15.3
Nonperforming loans to total gross loans	2.9	2.2	2.3	2.1	1.7	1.2	0.8	0.9	1.2	1.2	1.7
Provisions to non-performing loans	36.7	58.1	75.4	110.7	143.0	172.4	229.4	178.4	148.8	138.3	114.9
Return on assets	2.2	1.5	1.4	1.4	1.8	1.8	1.4	1.5	1.2	1.5	1.6
Return on equity	19.4	14.2	12.8	12.6	16.0	15.6	12.8	13.8	12.0	14.9	15.3
Total assets off-shore banks to total assets on-shore banks	16.8	16.1	16.5	14.3	12.7	12.2	11.7	10.7	9.6	9.1	8.4

Source: Superintendency of Banks.
For 2017 Items 54-59 are as of 2017Q3.

Table 6. Guatemala: Financial Soundness Indicators Heatmap

Guatemala	2016Q1	2016Q2	2016Q3	2016Q4	2017Q1	2017Q2	2017Q3
Overall Financial Sector Rating	M	M	M	M	M	M	M
Credit cycle	L	L	L	L	L	L	n.a.
Change in credit / GDP ratio (pp, annual)	1.2	0.7	-0.1	0.0	-0.4	-0.6	n.a.
Growth of credit / GDP (% , annual)	3.6	2.0	-0.2	-0.1	-1.2	-1.9	n.a.
Credit-to-GDP gap (st. dev)	-1.1	-1.1	-1.0	-0.6	-0.7	-0.5	n.a.
Balance Sheet Soundness	M	M	M	M	M	M	M
Balance Sheet Structural Risk	M	M	M	M	M	M	M
<i>Deposit-to-loan ratio</i>	127.4	128.5	128.6	125.9	127.1	128.5	129.8
<i>FX liabilities % (of total liabilities)</i>	30.7	29.6	29.2	29.8	29.3	28.7	28.7
<i>FX loans % (of total loans)</i>	39.3	38.5	38.0	39.0	37.7	37.5	38.0
Balance Sheet Buffers	M	L	M	M	M	M	M
Leverage	M	L	L	L	L	L	L
Capital-to-assets ratio (%)	6.8	7.2	7.3	7.1	7.2	7.3	7.2
Profitability	L	L	L	L	L	L	L
ROA	1.7	1.8	1.7	1.5	1.5	1.5	1.5
ROE	18.5	19.2	18.8	16.7	16.4	15.9	15.8
Asset quality	M	M	H	H	H	H	H
NPL ratio	1.47	1.73	2.07	2.05	2.29	2.52	2.6
NPL ratio change (% , annual)	8.5	19.1	44.6	52.5	56.3	45.8	23.5
Memo items:	2016Q1	2016Q2	2016Q3	2016Q4	2017Q1	2017Q2	2017Q3
Credit-to-GDP (%)	33.7	33.6	33.2	33.8	33.3	32.9	n.a.
Credit-to-GDP gap (%; HP filter)	0.4	0.0	-0.6	-0.4	-1.1	-1.8	n.a.
Credit growth (%; annual)	10.6	9.0	6.5	6.9	5.9	4.8	4.4
CAR (in %)	14.2	13.9	15.4	14.9	15.4	15.4	16.0
Tier 1 CAR (in %)	10.4	11.0	12.0	11.5	11.7	12.1	12.1

Note: The indicator-specific thresholds are determined based on analytical findings in GFSR (Fall 2011; Chapter 3); Dell'Ariccia et al. (2012); Key Aspects of Macroprudential Policy (2013); Guidance Note on Macroprudential Policy (2014); and Basel III.

Annex I. External Sector Assessment

Staff estimates based on the EBA current account (CA) methodology suggest the external position is stronger than the level implied by medium-term fundamentals and desirable policies. Lower-than-desirable fiscal spending and severe structural weaknesses keep the investment ratio low and reduces the possibility of achieving higher economic growth over the medium term.

A. Background

Current Account

1. The temporary CA surplus is expected to reverse over the forecast horizon. The CA balance flipped into surplus in 2016, rising to 1½ percent of GDP owing to improvements in the non-oil trade balance (0.9 percent of GDP), the energy balance (0.5 percent of GDP), and remittance inflows (0.6 percent of GDP). The CA balance for 2017 continues to be strong and is estimated at 1½ percent of GDP. The surge in remittances (over 13 percent growth in both 2016 and 2017, raising remittances as a share of GDP by 1 percentage point from 10.1 percent in 2015 to 11.0 percent in 2017) was fueled by Guatemalan expatriates' concerns over the potential imposition of restrictions on transfers after the U.S. presidential elections. As the shock of foreign-held saving diminishes and perceptions of transfers abate, the pace of remittances inflows is expected to moderate. This, alongside domestic demand acceleration should rise the trade deficit from its current low and push the CA balance back into deficit by the end of the forecast period (-1.3 percent of GDP by 2023).

Real Exchange Rate

2. The REER appreciated in the last two years. Strong remittance inflows have resulted in excess U.S. dollar liquidity, exerting upward pressure on the exchange rate. The REER appreciated by 6 percent and 5½ percent in 2016 and 2017 respectively, while the NEER appreciated by around 3 percent in both years. IMF FSGM estimates suggest that an increase in remittances inflows by 14 percent can cause the real exchange rate to appreciate by about 5 percent, broadly in line with the realized outcomes.

Capital and Financial Flows

3. Stable FDI flows had been an important contributor to the financing of the CA deficit prior to 2016. FDI inflows had been stable at around 2 percent of GDP up to 2015 but have been decreasing as a share of GDP over the last two years. FDI inflows accounted for 1.4 percent of GDP in 2017. Reflecting the still present challenges of the current Administration to improve the business climate, FDI is forecast to stay below 1½ percent of GDP but would still suffice to fully cover the current account deficit in 2023. Portfolio and other capital inflows have played a more limited role given Guatemala's weak financial integration. Portfolio investment inflows increased in 2016 and 2017 due to sovereign Eurobond issuance but the amounts were low (1.0 percent and 0.7 percent of GDP, respectively).

4. Healthy external financing mitigates external risks. The latest data shows that, at negative 22¼ percent of GDP in 2016, Guatemala's net IIP position is small by regional standards (Central America average of 65 percent) and is forecast to decline to around 15 percent of GDP by 2023. Non-debt creating FDI inflows comprises about 42 percent of total external liabilities in 2016 and is forecast to increase to about 50 percent in the medium term. In 2016, public external borrowing accounts for about 12 percent of GDP and is forecast to decline further over the medium term.

B. External Sector Assessment

5. The external position is stronger than the level consistent with medium term fundamentals and desirable policies.

- The EBA cyclically-adjusted CA norm is estimated to be -3.1 percent of GDP, reflecting Guatemala's relatively young population and low per capita income. However, the political and institutional risk indicator for Guatemala appears out of line with the country's political and institutional circumstances (it ranks Guatemala at a stronger position than Argentina or Colombia). Once this indicator is adjusted to a level that is more consistent with Guatemala's peers, the EBA norm would improve by around 1 percent of GDP.
- At the same time, the EBA CA methodology estimates a cyclically adjusted balance of 1½ percent. However, this does not take into account the temporary nature of the higher remittance flows. Assuming that half of the dollar increase in remittances seen since 2015 is temporary, the cyclically adjusted CA position would be around ½ percent of GDP.
- Combined, these adjustments would imply a CA gap of 2.4 percent of GDP and a corresponding REER undervaluation of about 15½ percent. Policy gaps (linked to the low fiscal deficit and inadequate health spending) would account for around ¾ of this needed CA adjustment. Removing structural impediments to investment will be also essential to facilitate external adjustment.
- Under the EBA-lite ES (External Sustainability) approach,¹ the CA norm that stabilizes Guatemala's net IIP at the region's weighted average is -3.6 percent of GDP. Compared with the projected medium-term CA balance, it implies a similar CA gap (2.3 percent) as the EBA CA methodology.

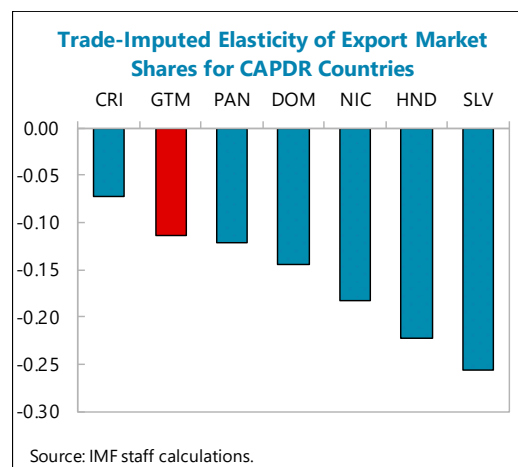
¹ The EBA IREER (Index of Real Effective Exchange Rate) and ES models do not provide estimates for Guatemala.

EBA External Sector Assessment			
		EBA CA	EBA-lite ES
Actual CA ^{1/}	(A)	1.5	
Cyclical contributions ^{2/}	(B)	-0.1	
Cyclically adjusted CA	(C=A-B)	1.6	
Underlying CA position ^{3/}	(D)	0.4	-1.3
Cyclically adjusted CA-Norm ^{4/}	(E)	-3.1	-3.6
Cyclically adjusted CA-Norm, staff's correction for risk profile ^{5/}	(F)	-2.0	
CA gap ^{6/}	(G=D-F)	2.4	2.3
Implied REER gap ^{7/} (percent)	(H)	-15.6	-15.0
Contribution of identified policy gaps ^{2/,8/}	(I)	1.8	
Residual CA gap	(J=G-I)	0.6	

Source: Fund staff estimates.
 1/ Estimate for 2017.
 2/ Estimates from the EBA CA model.
 3/ Under the EBA CA methodology, underlying CA position is the CA balance for 2017 adjusted for the effects of temporary remittance inflows (1.2 percent of GDP). Under the EBA-lite ES approach, it is the CA balance projected for the medium-term.
 4/ Under the EBA CA methodology, CA norm is estimated using panel regression. Under the EBA-lite ES approach, it is the CA level (not cyclically adjusted) that stabilizes Guatemala's net IIP at the region's weighted average (-56.9 percent of GDP).
 5/ ICRG for Guatemala adjusted to include concerns related to the rule of law.
 6/ Being D minus E under the ES approach.
 7/ Implied by the elasticity of CA balance to REER estimated for Guatemala (-0.15) using EBA CA methodology. ("-" = Undervaluation).
 8/ Of which, 1.3 percent owes to lower fiscal deficit and 0.5 percent owes to lower health spending than desirable policies.

6. Signs of weakening competitiveness highlight the need for an improved business environment.

- Cost competitiveness.** Although REER appreciation in recent years has raised concerns regarding the competitiveness and future performance of Guatemalan exports, staff analysis suggests that losses in cost competitiveness would have had a muted impact on exports performance.² Estimates relying on product-level elasticities imply that a 10 percent appreciation of Guatemala's REER would lead to a reduction in total exports of approximately 1.2 percent (or US\$100 million). Reflecting the lower contribution of manufacturing (18 percent) and the greater contribution of commodities (57 percent) in total exports, Guatemala displays a somewhat smaller sensitivity to exchange rate movements that in other Central American countries.



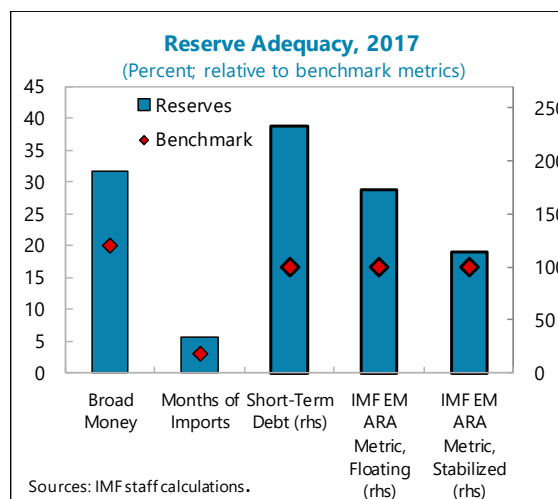
² See Alvarez, R., Y. Carrière-Swallow, and J. Puig, 2018. "Export Elasticities in CAPDR: A Market Share Approach", Working Paper, International Monetary Fund and IMF (2017), "Adjustment to Terms of Trade Shifts in Latin America", Chapter 3 in *Regional Economic Outlook: Western Hemisphere*, April.

- Structural competitiveness factors.* Guatemala’s competitiveness weaknesses appear linked to structural impediments weighing on investment returns and their predictability. According to the survey-based Global Competitiveness Report by the World Economic Forum, Guatemala’s competitiveness has worsened in 2017–18. Most businesses reported crime and theft, corruption, government bureaucracy and poor infrastructure as the most problematic factors for doing business in Guatemala. In addition, the World Bank’s 2018 Doing Business Survey shows that Guatemala scores weakly in enforcing contracts and protecting minority investors, and all sub-categories deteriorated compared to last year, especially dealing with construction permits and starting a business.³



C. Reserve Adequacy Assessment

7. Reserves have continued to increase in line with the narrowing of the CA deficit and currency appreciation. At 173 percent of the composite ARA (Assessing Reserve Adequacy) EM metric, the stock of net international reserves at end-2017 is over the upper bound of the Fund’s recommended range (100–150 percent) for a floating FX regime (114 of ARA EM metric under a stabilized FX regime). Coverage is above other traditional metrics (greater than 3 months of imports, 20 percent of broad money, and 100 percent of short-term external debt). The stock of the net international reserves increased from 4½ months of imports in 2015 to 5.7 months of imports at end-2017 and is expected to reach 4.2 months of imports over the medium-term.



³ Survey-based indicators reflect investors’ perceptions on the business environment.

Annex II. Risk Assessment Matrix¹

Source of Risks	Relative Likelihood	Expected Impact	Policy Response
External risks			
Significant US slowdown and its spillovers	Medium	High Weakening of export demand and remittances would significantly weigh on activity and tax revenues.	Ease monetary policy if weak demand drives inflation below target; let automatic fiscal stabilizers operate and consider discretionary stimulus, including investment in infrastructure.
Tighter global financial conditions	High	Medium A decline in capital flows to emerging markets would reduce capital flows to Guatemala, putting depreciation pressure on the exchange rate, and lead to an increase in cost of government financing, as well as potentially an increase in cost of funding for the private sector.	Allow exchange rate flexibility to help absorb external shocks; further strengthen supervision and regulation of the financial sector; consider taking additional measures to discourage dollarization; provide emergency liquidity assistance as needed; ease monetary policy if financial distress weakens demand and drives inflation below target.
Further pressure on traditional bank business models	Medium	High Limited correspondent bank profitability could result in possible of correspondent banking services, which in turn could curtail cross-border payments, trade finance, and remittances, disrupt foreign credit lines and reduce banking sector liquidity.	Strengthen risk-based AML/CFT supervision of the banking sector.
Retreat from cross-border integration	Medium	Low If protectionism prevails it could slow down global trade flows, which in turn would depress global growth, including in a very open economy like Guatemala. REER appreciation (depreciation) could impact competitiveness and exports.	Allow exchange rate flexibility to help absorb external shocks; advance structural reforms to boost competitiveness; ease monetary policy if weak demand drives inflation below target; let automatic fiscal stabilizers operate and consider discretionary stimulus, including investment in infrastructure.
Policy uncertainty	Medium	High Potential changes in U.S. immigration and trade policies could slow remittance, trade and FDI inflows. REER appreciation (depreciation) could impact competitiveness and exports.	Advance structural reforms that would facilitate job creation and increase income; ease monetary policy if weak demand drives inflation below target and let automatic fiscal stabilizers operate; allow exchange rate flexibility to help absorb external shocks.
Lower energy prices	Low	Low Persistently low oil prices would improve Guatemala's terms of trade and counterbalance inflationary pressures, potentially yielding a modest boost to growth prospects.	Take advantage of favorable environment to advance fiscal reforms, including reforming energy taxes.
Domestic risks			
Persistent political uncertainty and delays in judiciary decisions	Medium	High Uncertainty and delays in judiciary decisions significantly weigh on investment and growth, especially in extractive industries, and worsen social prospects in the long run.	Address governance weaknesses; improve business climate and competitiveness; invest in infrastructure; implement ILO Convention 169.
Tight spending limits and budget under-execution	Medium	High Investment, productivity, potential growth and inflation would be negatively affected.	Loosen spending limits and improve the government's ability to execute growth-enhancing social and infrastructure programs. Ease monetary policy if the contribution of fiscal policy to economic growth falls short of expectations.
Unexpected changes in political dynamism or implementation of large announced projects	Low	High Improved political credibility of the administration and higher investment would lift private sentiment and bring about stronger growth.	Take advantage of favorable conditions to invest in infrastructure, boost potential, and increase income.
<p><small>1/ The Risk Assessment Matrix (RAM) shows events that could materially alter the baseline path (the scenario most likely to materialize in the view of IMF staff). The relative likelihood is the staff's subjective assessment of the risks surrounding the baseline ("low" is meant to indicate a probability below 10 percent, "medium" a probability between 10 and 30 percent, and "high" a probability between 30 and 50 percent). The RAM reflects staff views on the source of risks and overall level of concern as of the time of discussions with the authorities. Non-mutually exclusive risks may interact and materialize jointly.</small></p>			

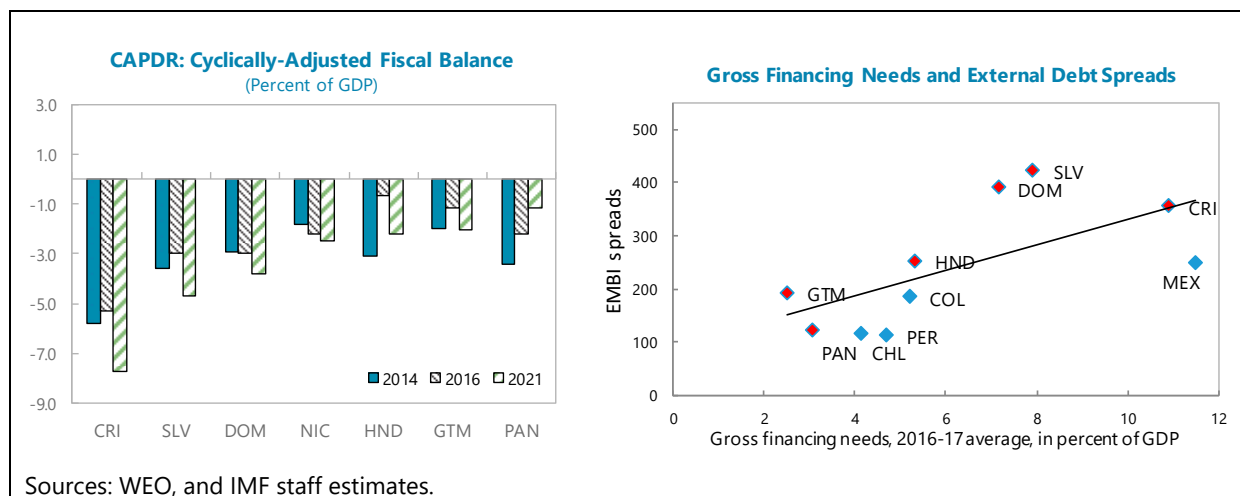
¹ The Risk Assessment Matrix (RAM) shows events that could materially alter the baseline path (the scenario most likely to materialize in the view of IMF staff). The relative likelihood is the staff's subjective assessment of the risks surrounding the baseline ("low" is meant to indicate a probability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

Annex III. Public Debt Sustainability Analysis

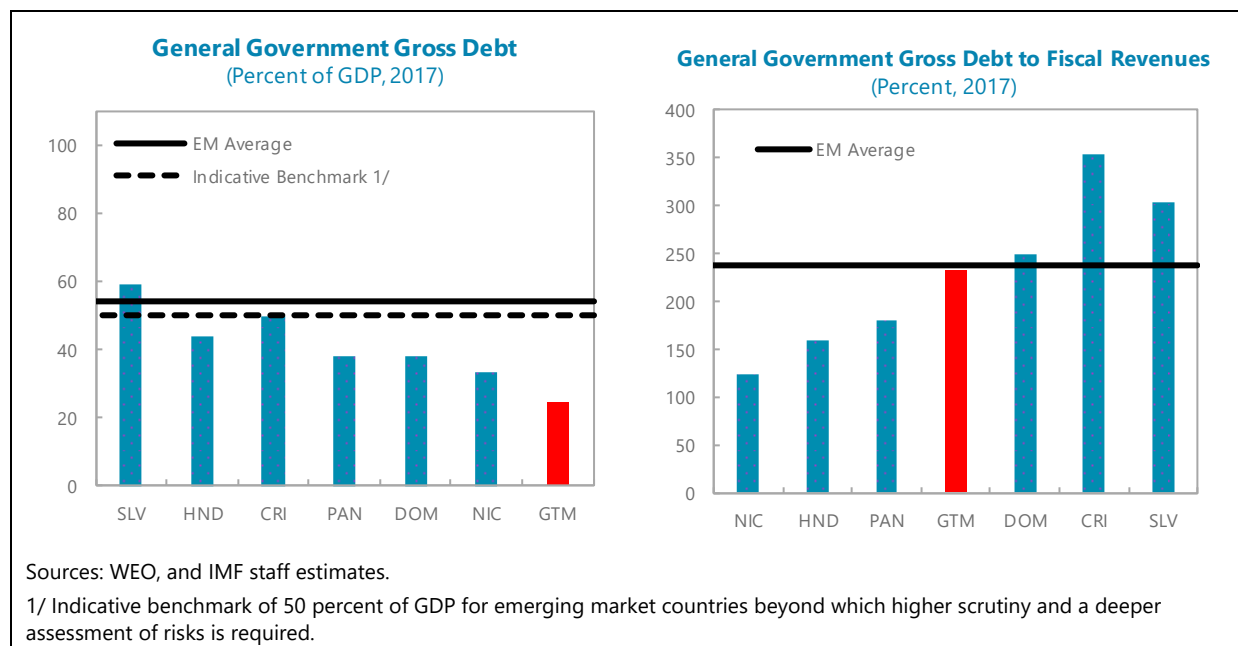
This annex presents an assessment of Guatemala’s medium and long-term debt sustainability. The results suggest that under the current policies, central government debt is sustainable at 24 percent of GDP. Risks around the baseline projections include lower fiscal deficits due to under-execution of spending, which would put the public debt path on a slightly falling trajectory. An alternative scenario which considers a short-term relaxation of the fiscal deficit by 1.2 percent of GDP would only slightly increase the debt-to-GDP ratio in the longer term. Another alternative scenario based on a permanent relaxation by 1.2 percent of GDP also indicates debt stabilization in the longer term at levels of 33 percent of GDP. The debt path is quite resilient to macro shocks.

A. Introduction

1. Guatemala has a solid track record of a prudent fiscal policy. Guatemala’s average overall fiscal balance at under 2 percent of GDP over the past 20 years, and public debt at 23 percent of GDP, reflect both prudent fiscal management and a stable macroeconomic environment. Fiscal performance deteriorated in the aftermath of the global financial crisis as the deficit increased from 1½ percent of GDP to over 3 percent of GDP by 2010, but quickly declined to around 2½ percent of GDP by 2012. The deficit fell further to 1.2 percent of GDP in 2016–17 during the political crisis, largely driven by the sharp decline in social spending, transfers and capital spending. Revenue targets were met in 2016, while the revenue shortfall in 2017 was due to lower direct revenues as a result of a negative output gap.



2. Guatemala's debt is low as a share of GDP though it is moderately high in relation to fiscal revenues. Public debt currently stands at 24 percent of GDP and has been virtually unchanged over the last four years. This level compares favorably to other countries in the region and to emerging market peers. Moreover, it is well below an indicative benchmark of 60 percent of GDP for countries with market access.² However, Guatemala's position looks less favorable when debt is compared to revenues since revenues are low by international standards.³ Domestic public debt is mostly denominated in Quetzals (11.7 percent of GDP in 2017, versus only 1.1 percent of GDP denominated in U.S. dollars). External public debt stands at 10 ½ percent of GDP in 2017.



3. Additional efforts at revenue mobilization will be needed to ensure adequate provision of basic public goods. Guatemala's low revenue capacity constrains the level of government spending, currently at 12 percent of GDP. The literature finds that the optimal size of the government, in particular with respect to human development, is at least 15 percent of GDP.⁴ Hence, it would be desirable raising fiscal revenues to 15 percent of GDP in the medium term to accommodate higher social and infrastructure spending as well as support efforts to durably reduce crime and corruption. Improving tax performance, however, will require strong and sustained political commitment. The 2012 tax reform provided additional tools for the government to enforce tax controls and supervision, as well as eliminate VAT exemptions and reduce rates of the corporate

² See Annex II of the IMF "Staff Guidance Note for Public Debt Sustainability Analysis in Market Access Countries," 2013 at <https://www.imf.org/external/np/pp/eng/2013/050913.pdf>.

³ Guatemala has one of the lowest revenue-to-GDP ratios in the world (see, for example, "Tax Capacity and Growth: Is There a Tipping Point," by Vitor Gaspar, Laura Jaramillo and Philippe Wingender; FAD Seminar Series, December 9, 2015).

⁴ Peden, E. (1991), Karras, G. (1997), Davies (2009), Gunalp and Dincer (2005). On the upper side, estimates vary but mainly fall below 30 percent of GDP.

income tax while broadening its base. The additional revenue from the 2012 tax reform was envisaged at 1–1½ percent of GDP over the course of several years. However, the customs agency faced significant administrative delays in implementing the reform. As a result, the revenue yield of the reform turned out to be much lower than envisaged with virtually unchanged tax-to-GDP ratio after the reform.

4. Tax administration efforts should be reinforced. Effective implementation of reforms committed to by the SAT are expected to yield at most an additional 1 percentage point of GDP in revenues over five years. In 2016, there was a reasonable improvement in tax collection and the revenue-to-GDP ratio increased slightly due to efforts to combat fraud in customs. In 2017, a combination of exchange rate and growth shocks led to a shortfall in revenues compared to SAT targets. Over the medium term, continued efforts in tax administration reforms at the SAT and stronger tax enforcement are needed to achieve revenue targets.

B. Assessing Debt Dynamics and Fiscal Sustainability

5. The sustainability of public finances was analyzed under three alternative scenarios. The first scenario (the baseline) assumes an overall fiscal deficit of 1.4 and 1.7 percent of GDP in 2018 and 2019, respectively, and 2.1 percent of GDP between 2020–23. The second scenario assumes a *temporary* relaxation (for 5 years) of the overall deficit to 2½ percent of GDP. The third scenario assumes a primary balance consistent with a *permanent* relaxation of the overall fiscal deficit to 2½ percent of GDP until 2075. The fourth scenario assumes that real GDP growth rate, real interest rate and the primary balance remain at their historical averages over the past ten years.⁵

6. Fiscal position is sustainable in the long-run under all three scenarios, while the debt ratio is higher under the permanent relaxation. In the baseline scenario the debt-to-GDP ratio stabilizes at the current level of 24.7 percent of GDP in the medium and long term; and the debt-to-revenue ratio remains at around 215 percent. In the scenario of temporary relaxation, the debt-to-GDP ratio rises slightly in the short term and stabilizes at 30 percent of GDP in the long term while debt-to-revenue ratio increases to 262 percent. In the permanent relaxation scenario, the debt ratio continues rising over a long horizon but stabilizes at 33 percent of GDP with the debt-to-revenue ratio reaching 286 percent. Under all three scenarios the debt-to-GDP does not exceed an indicative benchmark for countries with market access at 60 percent.

7. Sensitivity analysis suggests that Guatemala’s public debt is fairly resilient to shocks. We consider 5 sensitivity tests, including a shock to the primary balance, a shock to the real GDP growth, a shock to the real interest rate, a shock to the real exchange rate as well as a shock combining all of the above. The size of the shocks was based on the historical standard deviations of the corresponding variables.

⁵ The years of 2009 and 2010, when the effects of the global financial crisis affected Guatemala most deeply, were excluded. The historical sample was extended by two earlier years to compensate (i.e., the historical average is still based on a 10-year sample).

- *Real GDP Growth Shock.* GDP growth rate is reduced by 1 standard deviation for 2 consecutive years; level of noninterest expenditures is the same as in the baseline; deterioration in primary balance leads to higher interest rate; decline in growth leads to lower inflation (0.25 percentage points per 1 percentage point decrease in GDP growth).
- *Primary Surplus Shock.* Minimum shock equivalent to 50 percent of planned adjustment (50 percent implemented), or baseline minus half of the 10-year historical standard deviation, whichever is larger. There is an increase in interest rates of 25bp for every percentage point of GDP worsening in the primary balance.
- *Interest Rate Shock.* Interest rate increases by the difference between average real interest rate level over projection and maximum real historical level, or by 200bp, whichever is larger.
- *Real Exchange Rate Shock.* Estimate of overvaluation or maximum historical movement of the exchange rate, whichever is higher; pass-through to inflation with default elasticity of 0.25 for EMs and 0.03 for AEs.

8. In addition, a stochastic simulation of the public debt path has been constructed by producing frequency distributions of debt paths under these shocks. Simulations yield a very slight upward trend in public debt-to-GDP ratio, with the median debt forecast reaching about 25 percent of GDP, almost identical to the baseline projection. The 95 percent upper confidence interval reaches 29 percent of GDP. A restricted simulation in which upside shocks are disregarded yields an only slightly-higher 95 percent upper confidence interval of 30 percent of GDP. The narrowness of these ranges reflects the historical stability of Guatemala's macro variables.

Guatemala Public Sector Debt Sustainability Analysis (DSA) – Baseline Scenario

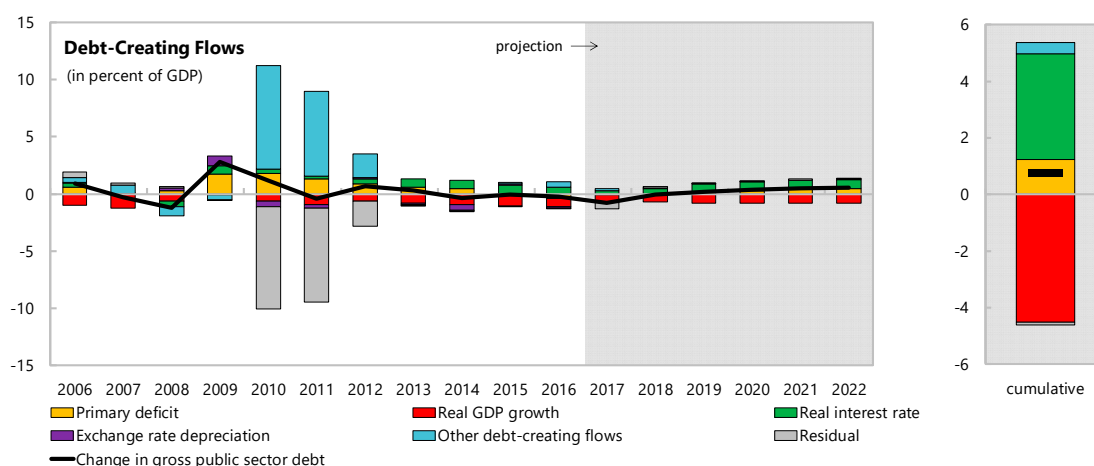
(In percent of GDP unless otherwise indicated)

Debt, Economic and Market Indicators ^{1/}

	Actual			Projections						As of August 30, 2013		
	2006-2014 ^{2/}	2015	2016	2017	2018	2019	2020	2021	2022	Sovereign Spreads		
Nominal gross public debt	23.0	24.2	24.0	23.2	23.1	23.3	23.7	24.1	24.7	EMBIG (bp) ^{3/} 238		
Public gross financing needs	3.6	2.8	2.6	2.3	2.1	2.3	2.6	2.7	2.9	5Y CDS (bp) N/A		
Real GDP growth (in percent)	3.7	4.1	3.1	2.8	3.2	3.6	3.8	3.7	3.6	Ratings	Foreign	Local
Inflation (GDP deflator, in percent)	5.2	3.2	3.9	4.9	4.5	3.7	3.5	3.6	3.7	Moody's	Baa2	Baa2
Nominal GDP growth (in percent)	9.1	7.5	7.1	7.8	7.8	7.5	7.4	7.4	7.5	S&Ps	BBB	BBB
Effective interest rate (in percent) ^{4/}	7.1	6.9	6.5	6.3	6.6	6.9	7.1	7.3	7.5	Fitch	BBB+	BBB+

Contribution to Changes in Public Debt

	Actual			Projections						cumulative	debt-stabilizing primary balance ^{9/}
	2006-2014	2015	2016	2017	2018	2019	2020	2021	2022		
Change in gross public sector debt	0.4	-0.1	-0.2	-0.8	-0.1	0.2	0.4	0.5	0.6	0.8	
Identified debt-creating flows	2.5	-0.1	-0.2	-0.2	-0.2	0.1	0.2	0.4	0.5	0.8	
Primary deficit	0.8	-0.1	-0.4	-0.1	0.0	0.2	0.3	0.4	0.4	1.2	0.0
Primary (noninterest) revenue and grants	11.8	10.8	11.0	10.6	10.7	10.8	10.8	10.8	10.9	64.7	
Primary (noninterest) expenditure	12.6	10.7	10.6	10.5	10.7	11.0	11.1	11.2	11.3	65.9	
Automatic debt dynamics ^{5/}	-0.4	0.0	-0.3	-0.3	-0.3	-0.1	-0.1	0.0	0.0	-0.8	
Interest rate/growth differential ^{6/}	-0.4	-0.1	-0.1	-0.3	-0.3	-0.1	-0.1	0.0	0.0	-0.8	
Of which: real interest rate	0.4	0.8	0.6	0.3	0.4	0.7	0.8	0.8	0.8	3.7	
Of which: real GDP growth	-0.8	-0.9	-0.7	-0.6	-0.7	-0.8	-0.8	-0.8	-0.8	-4.5	
Exchange rate depreciation ^{7/}	0.0	0.1	-0.2	...	...	...	...	...	...	...
Other identified debt-creating flows	2.0	0.1	0.5	0.2	0.1	0.0	0.0	0.0	0.0	0.4	
Fiscal, Central Government, Total financing ^{2/}	2.0	0.1	0.5	0.1	0.1	0.0	0.0	0.0	0.0	0.0	0.3
Contingent liabilities	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Privatization receipts (+ reduces financing)	0.0	0.0	0.0	0.1	0.0	0.0	0.0	0.0	0.0	0.1	
Residual, including asset changes ^{8/}	-2.1	0.0	0.0	-0.6	0.1	0.1	0.1	0.1	0.1	-0.1	



Source: IMF staff.

1/ Public sector is defined as central government.

2/ Based on available data.

3/ EMBIG.

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

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

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

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

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

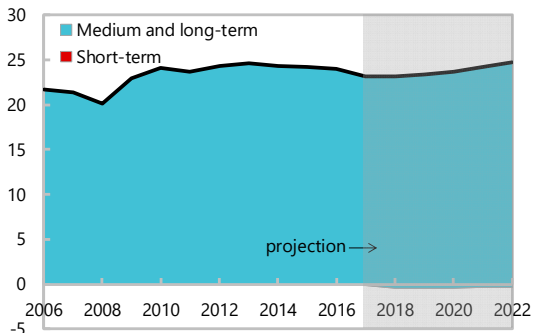
9/ Assumes that key variables (real GDP growth, real interest rate, and other identified debt-creating flows) remain at the level of the last projection year.

Guatemala Public DSA – Composition of Public Debt and Alternative Scenarios

Composition of Public Debt

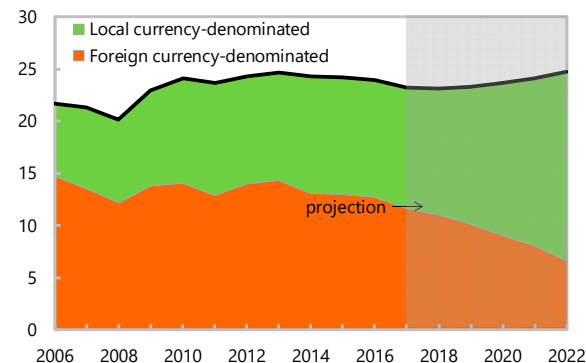
By Maturity

(in percent of GDP)



By Currency

(in percent of GDP)

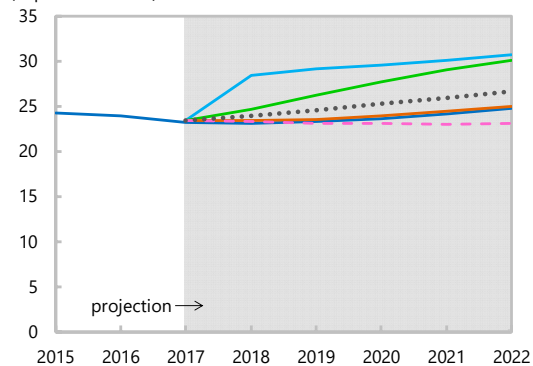


Alternative Scenarios

- Baseline
- Contingent Liability Shock
- Historical
- Temporary Relaxation
- Constant Primary Balance
- Permanent Relaxation

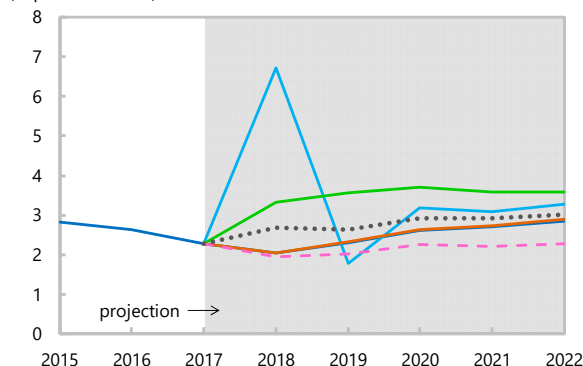
Gross Nominal Public Debt

(in percent of GDP)



Public Gross Financing Needs

(in percent of GDP)



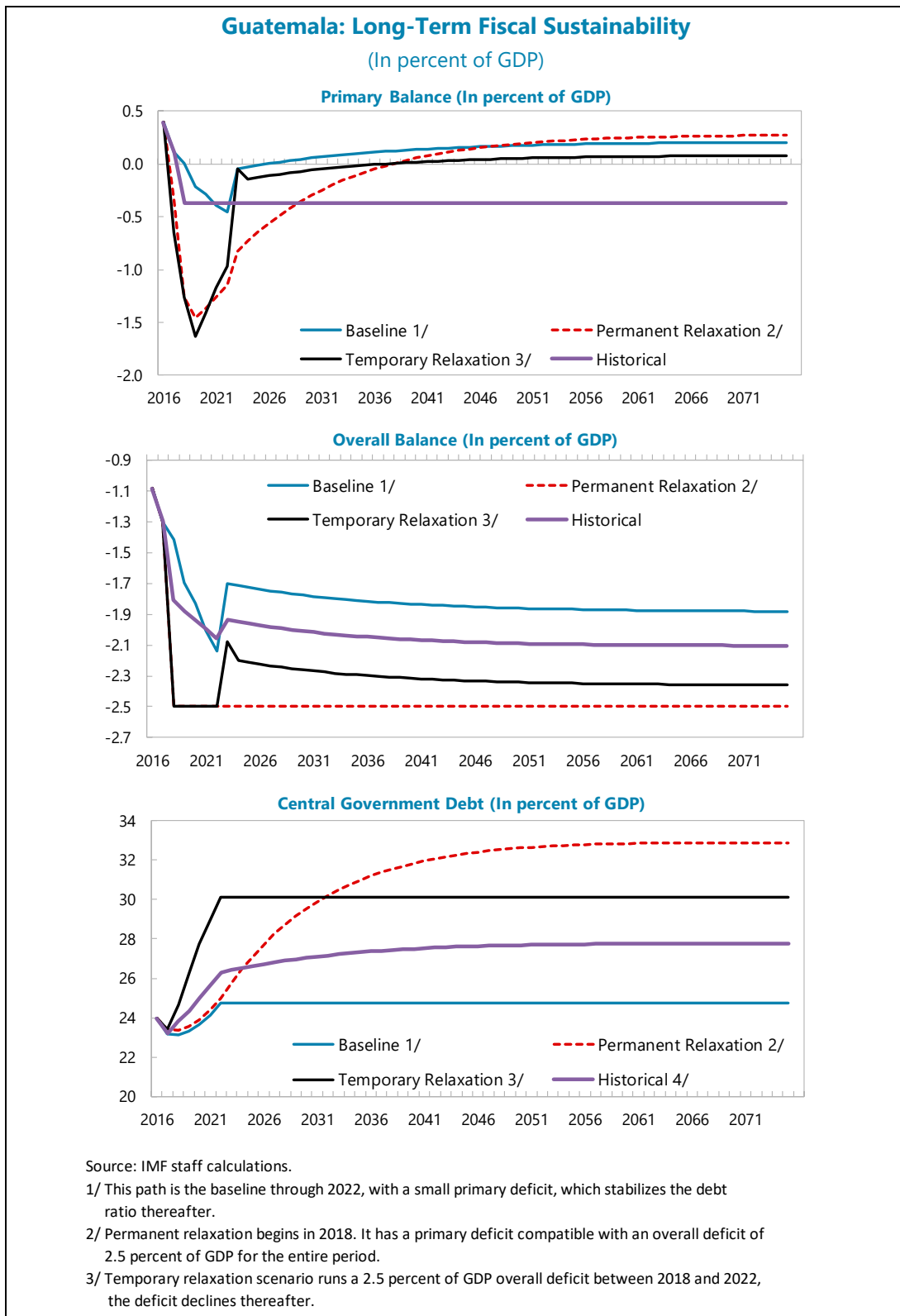
Underlying Assumptions

(in percent)

Baseline Scenario	2017	2018	2019	2020	2021	2022
Real GDP growth	2.8	3.2	3.6	3.8	3.7	3.6
Inflation	4.9	4.5	3.7	3.5	3.6	3.7
Primary Balance	0.1	0.0	-0.2	-0.3	-0.4	-0.4
Effective interest rate	6.3	6.6	6.9	7.1	7.3	7.5
Constant Primary Balance Scenario						
Real GDP growth	2.8	3.2	3.6	3.8	3.7	3.6
Inflation	4.9	4.5	3.7	3.5	3.6	3.7
Primary Balance	0.1	0.1	0.1	0.1	0.1	0.1
Effective interest rate	6.3	6.6	6.9	7.1	7.3	7.5
Temporary Relaxation						
Real GDP growth	2.8	3.2	3.6	3.8	3.7	3.6
Inflation	4.9	4.5	3.7	3.5	3.6	3.7
Primary Balance	0.1	-1.3	-1.6	-1.4	-1.2	-1.0
Effective interest rate	6.3	6.6	6.9	7.1	7.3	7.5

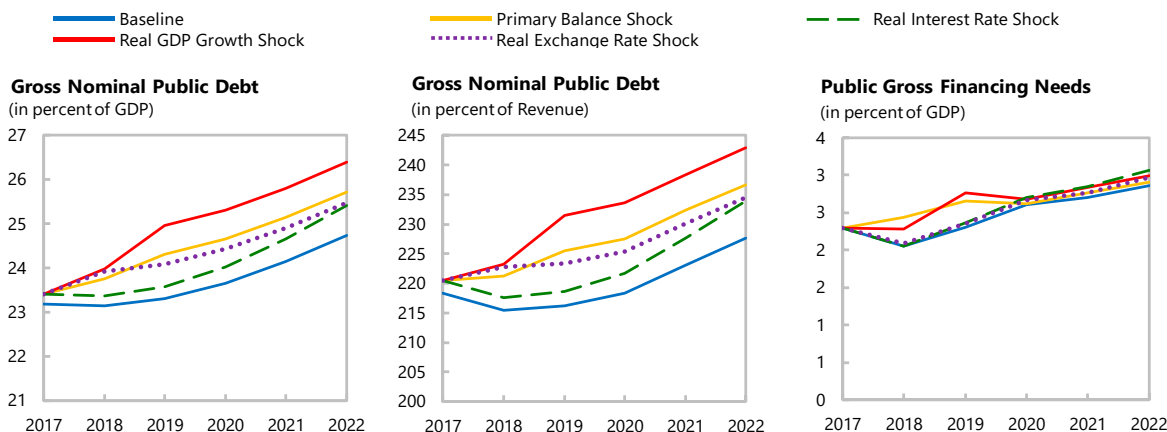
Historical Scenario	2017	2018	2019	2020	2021	2022
Real GDP growth	2.8	3.5	3.5	3.5	3.5	3.5
Inflation	4.9	4.5	3.7	3.5	3.6	3.7
Primary Balance	0.1	-0.6	-0.6	-0.6	-0.6	-0.6
Effective interest rate	6.3	6.6	6.8	6.8	6.9	7.0
Contingent Liability Shock						
Real GDP growth	2.8	1.8	2.2	3.8	3.7	3.6
Inflation	4.9	4.1	3.4	3.5	3.6	3.7
Primary Balance	0.1	-4.3	-0.2	-0.3	-0.4	-0.4
Effective interest rate	6.3	8.1	7.2	7.3	7.4	7.6
Permanent Relaxation						
Real GDP growth	2.8	3.2	3.6	3.8	3.7	3.6
Inflation	4.9	4.5	3.7	3.5	3.6	3.7
Primary Balance	0.1	0.0	-0.2	-0.3	-0.4	-0.4
Effective interest rate	6.3	6.6	6.9	7.1	7.4	7.6

Source: IMF staff.

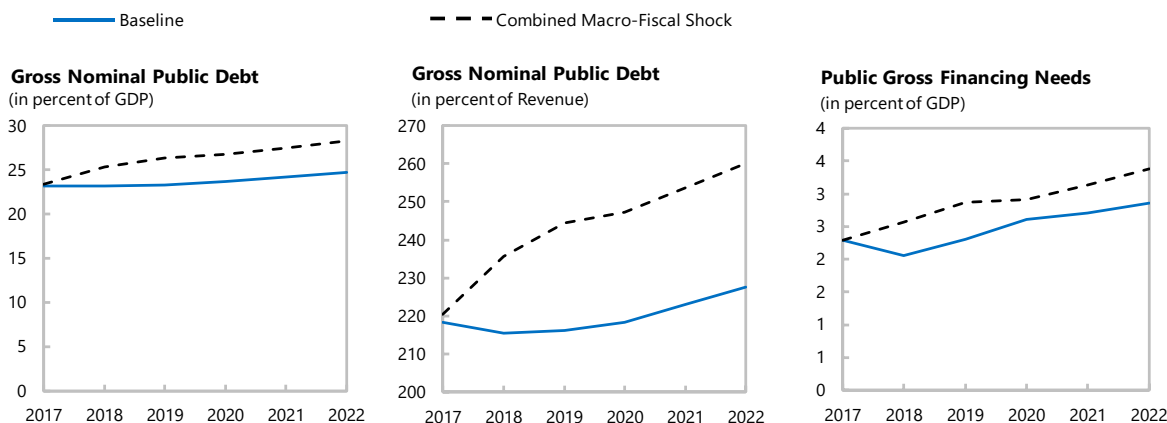


Guatemala Public DSA – Stress Test

Macro-Fiscal Stress Tests



Additional Stress Tests



Underlying Assumptions (in percent)

	2017	2018	2019	2020	2021	2022
Primary Balance Shock						
Real GDP growth	2.8	3.2	3.6	3.8	3.7	3.6
Inflation	4.9	4.5	3.7	3.5	3.6	3.7
Primary balance	0.1	-0.4	-0.6	-0.3	-0.4	-0.4
Effective interest rate	6.3	6.6	6.9	7.1	7.3	7.5
Real Interest Rate Shock						
Real GDP growth	2.8	3.2	3.6	3.8	3.7	3.6
Inflation	4.9	4.5	3.7	3.5	3.6	3.7
Primary balance	0.1	0.0	-0.2	-0.3	-0.4	-0.4
Effective interest rate	6.3	6.6	7.1	7.5	7.9	8.3
Combined Shock						
Real GDP growth	2.8	1.8	2.2	3.8	3.7	3.6
Inflation	4.9	4.1	3.4	3.5	3.6	3.7
Primary balance	0.1	-0.4	-0.6	-0.3	-0.4	-0.4
Effective interest rate	6.3	6.9	7.0	7.5	7.9	8.3
Real GDP Growth Shock						
Real GDP growth	2.8	1.8	2.2	3.8	3.7	3.6
Inflation	4.9	4.1	3.4	3.5	3.6	3.7
Primary balance	0.1	-0.2	-0.6	-0.3	-0.4	-0.4
Effective interest rate	6.3	6.6	6.9	7.1	7.3	7.5
Real Exchange Rate Shock						
Real GDP growth	2.8	3.2	3.6	3.8	3.7	3.6
Inflation	4.9	6.9	3.7	3.5	3.6	3.7
Primary balance	0.1	0.0	-0.2	-0.3	-0.4	-0.4
Effective interest rate	6.3	6.9	6.8	7.0	7.3	7.5

Source: IMF staff.

Annex IV. External Debt Sustainability

Guatemala: External Debt Sustainability Framework, 2013-23

(In percent of GDP, unless otherwise indicated)

	Actual				Projections								Debt-stabilizing non-interest current account 6/
	2013	2014	2015	2016	2017	2018	2019	2020	2021	2022	2023		
Baseline: External debt	33.1	34.1	32.8	31.5	31.1	30.0	29.2	28.4	27.7	26.4	25.9	-1.8	
Change in external debt	2.7	1.0	-1.4	-1.2	-0.5	-1.1	-0.7	-0.8	-0.7	-1.3	-0.5		
Identified external debt-creating flows (4+8+9)	-1.8	-2.8	-4.3	-5.4	-3.6	-3.3	-3.0	-2.6	-2.0	-1.5	-0.9		
Current account deficit, excluding interest payments	1.5	1.0	-0.8	-2.6	-2.6	-2.2	-1.7	-1.2	-0.7	-0.2	0.4		
Deficit in balance of goods and services	11.9	10.7	9.2	7.9	8.6	8.8	9.0	9.2	9.4	9.7	10.0		
Exports	23.6	23.5	21.4	19.5	18.7	18.6	18.8	18.9	18.9	18.9	18.9		
Imports	35.5	34.2	30.6	27.4	27.3	27.4	27.8	28.1	28.3	28.6	28.9		
Net non-debt creating capital inflows (negative)	-2.3	-2.2	-1.7	-1.6	-1.3	-1.3	-1.3	-1.3	-1.3	-1.3	-1.3		
Automatic debt dynamics 1/	-1.0	-1.7	-1.7	-1.2	0.3	0.1	0.0	0.0	0.0	0.0	0.0		
Contribution from nominal interest rate	1.0	1.1	1.0	1.1	1.1	1.0	1.0	1.0	1.0	0.9	0.9		
Contribution from real GDP growth	-1.1	-1.3	-1.3	-0.9	-0.8	-0.9	-1.0	-1.0	-1.0	-1.0	-0.9		
Contribution from price and exchange rate changes 2/	-0.9	-1.5	-1.4	-1.4	...	...	...	...	...	...	...
Residual, incl. change in gross foreign assets (2-3) 3/	4.5	3.8	2.9	4.2	3.1	2.2	2.2	1.8	1.3	0.2	0.4		
External debt-to-exports ratio (in percent)	140.2	144.9	153.0	162.0	166.1	161.3	155.6	150.7	146.7	139.7	137.0		
Gross external financing need (in billions of US dollars) 4/	4.8	4.8	4.3	3.4	3.5	4.0	4.8	5.5	6.3	8.0	8.3		
in percent of GDP	9.0	8.3	6.7	5.0	10-Year	10-Year	4.7	4.9	5.6	6.0	6.5	7.7	7.5
Scenario with key variables at their historical averages 5/					31.1	32.3	32.7	32.4	31.6	29.8	28.1	-3.2	
Key Macroeconomic Assumptions Underlying Baseline													
					Historical Average	Standard Deviation							
Nominal GDP (US dollars)	53.9	58.7	63.8	68.7			74.6	81.1	86.3	91.9	97.6	103.5	109.6
Real GDP growth (in percent)	3.7	4.2	4.1	3.1	3.5	1.5	2.8	3.2	3.6	3.8	3.7	3.6	3.6
Exchange rate appreciation (US dollar value of local currency, change)	-0.3	1.6	1.0	0.7	0.0	2.9	2.1	0.9	-0.8	-0.9	-1.2	-1.3	-1.4
GDP deflator (change in domestic currency)	3.4	3.0	3.2	3.7	4.9	2.1	3.6	4.4	3.5	3.5	3.6	3.7	3.7
GDP deflator in US dollars (change in percent)	3.1	4.7	4.3	4.4	4.9	4.0	5.8	5.4	2.7	2.6	2.4	2.3	2.2
Nominal external interest rate (in percent)	3.5	3.5	3.1	3.7	3.9	0.8	3.8	3.6	3.6	3.6	3.6	3.6	3.7
Growth of exports (US dollar terms, in percent)	1.4	8.7	-1.3	-2.1	6.1	8.9	4.4	8.0	7.5	7.0	6.4	6.0	6.0
Growth of imports (US dollar terms, in percent)	4.0	5.1	-2.7	-3.8	4.5	11.1	8.5	9.1	7.8	7.6	7.3	7.1	7.1
Current account balance, excluding interest payments	-1.5	-1.0	0.8	2.6	-0.8	2.0	2.6	2.2	1.7	1.2	0.7	0.2	-0.4
Net non-debt creating capital inflows	2.3	2.2	1.7	1.6	2.0	0.3	1.3	1.3	1.3	1.3	1.3	1.3	1.3

1/ Derived as $[r - g - r(1+g) + ea(1+r)] / (1+g+r+g)$ 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 $[-r(1+g) + ea(1+r)] / (1+g+r+g)$ 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.

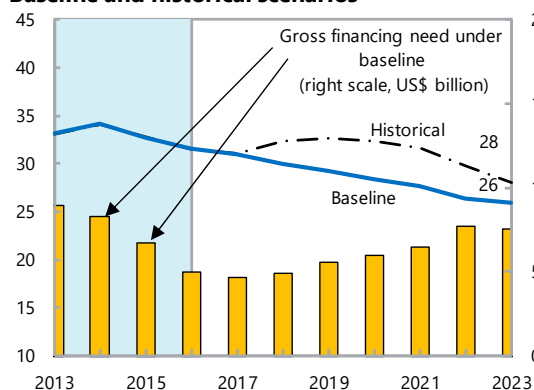
5/ The key variables include real GDP growth; nominal interest rate; dollar deflator growth; and both non-interest current account and non-debt inflows in percent of GDP.

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.

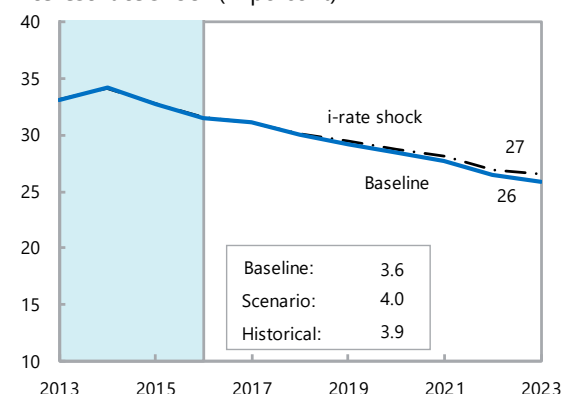
Guatemala: External Debt Sustainability: Bound Test 1/ 2/

(External debt in percent of GDP)

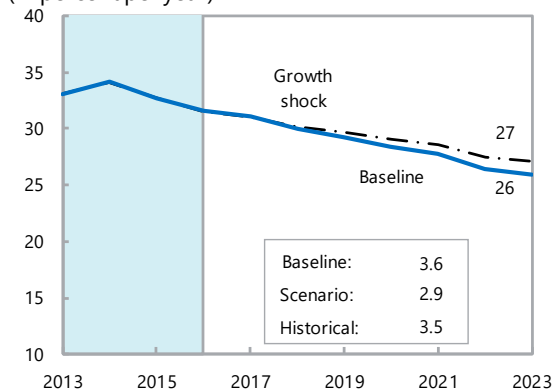
Baseline and historical scenarios



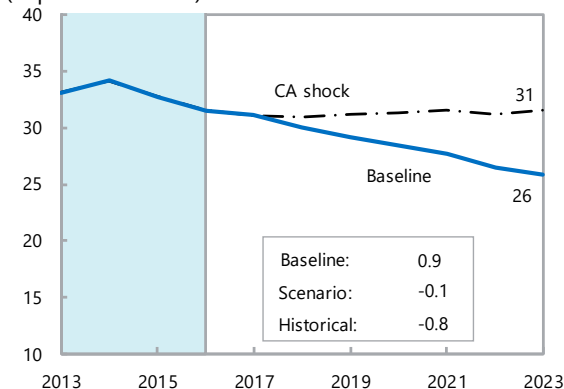
Interest rate shock (in percent)



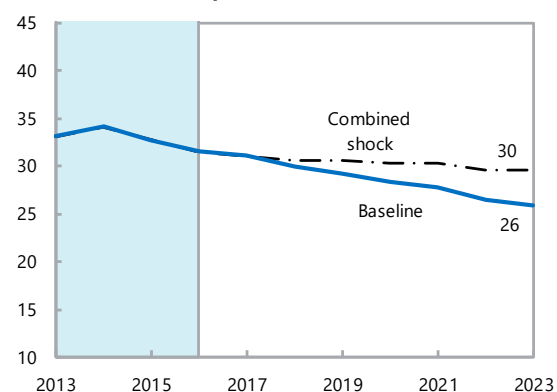
Growth shock (in percent per year)



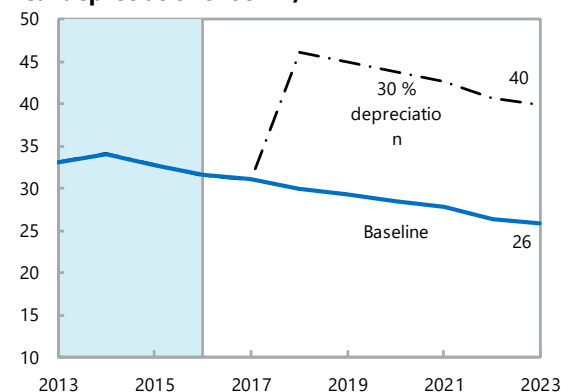
Non-interest current account shock (in percent of GDP)



Combined shock 3/



Real depreciation shock 4/



Sources: International Monetary Fund, Country desk data, and staff estimates.

1/ Shaded areas represent actual data. Individual shocks are permanent one-half standard deviation shocks. Figures in the boxes represent average projections for the respective variables in the baseline and scenario being presented. Ten-year historical average for the variable is also shown.

2/ For historical scenarios, the historical averages are calculated over the ten-year period, and the information is used to project debt dynamics five years ahead.

3/ Permanent 1/4 standard deviation shocks applied to real interest rate, growth rate, and current account balance.

4/ One-time real depreciation of 30 percent occurs in 2018.

Annex V. Past Fund Staff Recommendations and Implementation

2016 Article IV Staff Recommendations	Implementation
Fiscal Policy	
<ul style="list-style-type: none"> • Strengthen the SAT by improving control and minimizing tax evasion. • Review of the tax system to help raise revenue by at least 3½ percent of GDP in the longer term. Main options include an increase in the number of brackets and top marginal rate of the PIT; a smaller increase in the VAT rate; a simplification of the corporate income tax; and higher energy taxes. • Reduce the high level of revenue earmarking to strengthen the efficiency of the budget. • Improve fiscal transparency and efficiency by implementing the IMF's recent technical assistance advice on fiscal transparency. 	<ul style="list-style-type: none"> • The taxpayer Register has become a priority for the SAT. The VAT control strategy is now offering: (i) a plan to drive a more effective control on VAT refunds, and ensure risk-based compliance; (ii) taxpayer integrated consultancy service to access taxpayers' complete information; (iii) reinforced invoicing authorization, and e-form to VAT refund application filing. With respect to taxpayer services, an updated web portal as well as a new model-office has been created. The index of audit efficiency increased from 58 percent (2016) to 64 percent (August 2017). • In August 2016 the government proposed a tax reform in line with staff recommendations, but the proposal had to be withdrawn due to lack of political support. • Limited progress has been made on reducing the high level of revenue earmarking. • The authorities are implementing some of the recommendations, including: (i) defining an action plan to improve fiscal transparency; (ii) designing an action plan to implement GFSM 2014 (guided by CAPTAC-DR), with actions until 2020; (iii) creating the open government data portal with data on budget formulation and execution, and grants to municipalities; (iv) publishing fiscal risks as an appendix of Budgets 2017 and 2018; and (v) making progress towards the publication of consolidated nonfinancial public sector data (on a GFSM 1986 format).

2016 Article IV Staff Recommendations	Implementation
Monetary Policy and Financial Sector	
<ul style="list-style-type: none"> • Continue strengthening the institutional framework for inflation targeting. • Further macro-prudential measures should be prepared in case the degree of dollarization persists and credit quality deteriorates. Staff also pointed out the need to further strengthen capital buffers through a stricter definition of related parties to mitigate risks of overestimating capital and adopting capital ratios consistent with Basel III (including a capital surcharge for large systemic institutions). • Continue implementing risk-based AML/CFT supervision, and bring the framework in line with the 2012 FATF standards. • Further efforts are needed to improve consolidated supervision of financial conglomerates, to adjust the legal framework in line with international standards, appoint national lead supervisors, and create a regional council for financial stability. Stepping up the ring-fencing of on-shore banks with respect to the operations of off-shore banks will also be important. 	<ul style="list-style-type: none"> • The authorities have further widened the fluctuation margin for interventions in the foreign exchange market from 0.75 to 0.8 percent of the five-day moving average of the exchange rate. Congress approved a government transfer to cover the central bank's annual losses from quasi-fiscal operations, but limited progress was made to recapitalize the central bank. No additional measures were taken to further discourage dollarization develop private debt and security markets. The securities market law was not submitted to Congress. • The authorities are developing a comprehensive macro-prudential program with Fund TA and are planning to gradually adopt Basel III standards in 2018–21. They also received a TA on market risk regulations. • The superintendence of banks is taking measures to strengthen the overall AML/CFT capacity of its financial intelligence unit, including through Fund TA. It is reviewing the AML/CFT law to be submitted to Congress. • Progress is still slow on improving consolidated supervision of financial conglomerates, tightening the definitions of related parties, and stepping up the ring-fencing of on-shore banks with respect to the operations of off-shore banks.
Exchange Rate Policy	
<ul style="list-style-type: none"> • Staff recommended that efforts ought to be stepped up to de-dollarize credit, mainly by allowing the exchange rate to fluctuate and thereby forcing agents to internalize FX risks and promote hedging. 	<ul style="list-style-type: none"> • The authorities have further widened the fluctuation margin for interventions in the foreign exchange market from 0.75 to 0.8 percent of the five-day moving average of the exchange rate. Interventions have been conducted according to the rule.

2016 Article IV Staff Recommendations	Implementation
Structural Policies	
<ul style="list-style-type: none"> • Raise government spending on security, the judicial system, infrastructure, education, health, and social assistance. Improve the efficiency and targeting of social assistance programs. Facilitate regional and international integration. Strengthen competition policies, including through the adoption of the pending competition law. Promoting rural development. • Foster financial deepening and inclusion. 	<ul style="list-style-type: none"> • Little progress has been made to increase social spending and investment in infrastructure. The competition law remains pending. • The authorities adopted a microcredit, collateral, and securitization of accounts receivable laws, which will foster financial inclusion. The leasing law is pending approval.



GUATEMALA

May 10, 2018

STAFF REPORT FOR THE 2018 ARTICLE IV CONSULTATION—INFORMATIONAL ANNEX

Prepared by: The Western Hemisphere Department

CONTENTS

FUND RELATIONS	2
RELATIONS WITH THE WORLD BANK AND BANK-FUND COLLABORATION UNDER THE JOINT MANAGEMENT ACTION PLAN (JMAP)	7
RELATIONS WITH THE INTER-AMERICAN DEVELOPMENT BANK	12
STATISTICAL ISSUES	14

FUND RELATIONS

(As of March 28, 2018)

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

General Resources Account:	SDR Million	Percentage of Quota
Quota	428.60	100.00
Fund holdings of currency	374.01	87.26
Reserve Tranche Position	54.60	12.74

SDR Department:	SDR Million	Percentage of Allocation
Net cumulative allocation	200.91	100.00
Holdings	120.73	60.09

Outstanding Purchases and Loans: None

Latest Financial Arrangements:

<u>Type</u>	<u>Date of Arrangement</u>	<u>Expiration Date</u>	<u>Amount Approved (SDR Million)</u>	<u>Amount Drawn (SDR Million)</u>
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 Fund¹

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

	2018	2019	2020	2021	2022
Principal					
Charges/Interest	0.50	0.66	0.66	0.66	0.66
Total	0.50	0.66	0.66	0.66	0.66

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

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

Exchange Rate Arrangement. Since March 1994, Guatemala has had an arrangement based on an interbank foreign exchange market in which authorized financial institutions buy and sell foreign exchange at market-determined rates. Financial institutions authorized to operate in the foreign exchange market include commercial banks, finance companies, and exchange houses. Guatemala has a *de jure* floating exchange rate arrangement, although the Bank of Guatemala (BOG) may intervene to limit volatility in the nominal exchange rate without affecting its trend. The BOG intervenes through foreign exchange auctions based on a symmetric and public rule that limits daily volatility. Effective January 1, 2018, the fluctuation margin (added to or subtracted from the five-day moving average of the exchange rate) that determines whether the BOG may intervene was increased to 0.80 percent (previously 0.75 percent) as part of the BOG’s commitment to increase exchange rate flexibility. The BOG may also intervene outside the scope of this rule whenever the nominal exchange rate shows unusual volatility, but this instrument has only been used once during the GFC. However, in March 2018 the *de facto* exchange rate arrangement has been reclassified as “stabilized” from “floating” reflecting limited exchange rate volatility. 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 March 28, 2018, the reference exchange rate was Q7.40 per U.S. dollar.

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

Article IV Consultation. The last Article IV consultation was concluded by the Executive Board on August 22, 2016.

Resident Representative. Mr. Gerardo Peraza is the Regional Resident Representative for Costa Rica, Guatemala, and El Salvador, and is based in Guatemala.

Technical Assistance 2011–18

Department	Date of Delivery	Purpose
FAD CAPTAC	2018	Fees and License Rights
	2018, 2017	Trade Operators Based on Risk; Integral Load Control Plan; Customs Administration Process; VAT Credit Control; Cash Planning in Treasury
	2017	System Requirements in Treasury; Fiscal Risks; Treasury Single Account
	2016	Improving Collection with Equity and Efficiency (tax policy mission)
	2016	Revenue administration mission (to define short- and medium-term strategy to reform tax and customs administration)
	2016	Fiscal Transparency Evaluation
	2015, 2014	Support tax control strategy with emphasis on mass control
	2014	Establish tax payers' profiles and data to measure effectiveness of actions
	2015, 2014, 2013, 2012, 2011	Revenue administration (multiple missions)
	2014	Integrated control on VAT Credit; Tax and Customs Compliance Improvement Program; Information based Integrated Control Model
	2013, 2012, 2011	Treasury single account (multiple missions)
	2013, 2012, 2011	Customs administration (multiple missions)
	2012	Control of budgetary execution
	2011	Debt management strategy
	2011	Revenue forecasting
	2011	Government cash flow and financial planning

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

Department	Date of Delivery	Purpose
MCM, CAPTAC	2011	Application of international financial reporting standards in the banking system
	2010	Foreign exchange market function and intervention strategy
	2010	Risk-based supervision for the insurance sector
	2010	Developing secondary public debt markets and enhancing monetary operations
STA, CAPTAC	2018	Sectorization of the public sector and disclosure of fiscal data
	2017, 2016, 2015, 2014, 2013, 2012, 2011	National accounts statistics (multiple missions)
	2016, 2015, 2014, 2013, 2012	Producer price index (multiple missions)
	2016, 2015, 2014, 2013, 2012, 2011	Export and import price indices (multiple missions)
	2016, 2015, 2014, 2013, 2012, 2011, 2010	Balance of Payments Statistics and IIP
	2015	Training and CD: Financial Accounts
	2014	Coordinated FDI and Portfolio Surveys
	2014	Regional National Accounts
	2013, 2012, 2011	Monthly Index of Economic Activity
	2013	Training: Balance of Payments Statistics
	2013	Balance of Payments Statistics

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

1. **The IMF's Guatemala team led by Mrs. Perez is in coordination with the World Bank's Guatemala team led by Ms. Homa-Zahra Fotouhi (Country Manager)** to discuss macroeconomic challenges facing Guatemala, identify macro-critical structural reforms, and coordinate the two teams' work for the period July 2017–July 2019.
2. **The teams agreed that Guatemala's main macroeconomic challenges are to safeguard macroeconomic stability while addressing social and structural deficiencies.**
3. **The teams concurred that Guatemala's near-term outlook is subdued, with risks stemming from domestic policy constraints and global uncertainty.**
4. **Based on the shared assessment of macroeconomic challenges, the teams have identified the following structural reform areas as macro-critical:**
 - ***Fiscal Policy.*** Short-term priorities include arresting revenue decline as a share of GDP and increasing transparency and efficiency of fiscal spending. Raising the level of revenue and expenditure while prioritizing the latter, would be essential over the medium term. While not an immediate concern, rising demographic pressures, if left unaddressed, would pose challenges for the budget in the longer term.
 - ***Revenue mobilization.*** Guatemala's revenue-to-GDP ratio continues to be among the lowest in the world. The 2012 tax reform has yielded less additional revenue than anticipated due to implementation problems and legal challenges. Revenues further declined amid the 2015 political crisis and The World Bank (WB) and the IMF, together with the IADB and the U.S. Treasury, have been working in close collaboration in assisting the new administration to arrest the revenue decline and develop a long-term strategy for strengthening tax and customs administration in the SAT. Going forward, implementing this strategy and revamping the tax policy framework are key priorities.
 - ***Government spending: level, efficiency, and transparency.*** Both teams believe that improving the efficiency and composition of public spending as well as raising its transparency are complements to raising the level of public spending through greater revenue mobilization. The latter, in turn, will be critical to achieving social and structural objectives that will help raise growth and make it more inclusive.
 - ***Pension reform.*** In the longer run, a parametric pension reform will be required to limit increases in unfunded pension liabilities.

- **Monetary policy framework.** Strengthening further the monetary framework, including by allowing greater exchange rate flexibility, discourage dollarization and foster the development of domestic capital markets, is key to improve the effectiveness of monetary policy.
- **Financial sector issues.** Guatemala is well placed to apply key Basel III components. However, important work remains, including continued implementation of the risk-based AML/CFT supervision, strengthening the bank resolution framework, and enhancing consolidated supervision of financial conglomerates. The adoption of the national strategy for financial inclusion and measures to reduce entry costs will help stimulate financial inclusion, spur growth and reduce inequality.
- **Labor market.** Tackling labor market informality requires actions on multiple fronts. Informality in Guatemala stands at 70 percent of total employment, resulting in low coverage for basic social protections, high poverty, and low productivity. Some of the policy-related motivations underlying such high levels of informality can be reduced by bringing the minimum wage into line with regional averages, raising the education levels and productivity of informal workers, fostering apprenticeship schemes and part-time employment, and making the self-employed eligible for health and pension systems.
- **ILO 169 Convention.** Legal uncertainty affecting investment in extractive industries should be addressed. A lack of clarity over the scope and application of ILO Convention 169 has, over the years, prompted recurrent appeals for protection to the Constitutional Court, in turn creating disruptions in extractive industries. The authorities should aim for a swift incorporation of the Convention into Guatemala's domestic legal system in a way that balances the need to attract investment and jobs with the rights and protections of indigenous groups.

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

- **Fiscal Policy.** The IMF will continue providing advice on the overall strategy for fiscal policy. The IMF and the WB will continue coordinating recommendations on macro-fiscal issues and conducting the debt sustainability analysis as well as providing the authorities with support for their Medium-Term Debt Strategy (MTDS).
- **Revenue mobilization.** The IMF has fielded several tax policy and administration missions during this period, including missions aimed at developing and implementing the SAT reform, and missions aimed at raising revenue-to-GDP ratio in the long run and reduce informality. The Fund will continue providing technical assistance on the overarching strategy for tax administration and tax policy reforms. It will also provide support for implementing specific aspects of these reforms through its regional technical assistance center in Guatemala, CAPTAC-DR. The WB together with the other TA providers will continue providing advice, and on-the-ground support, on the implementation of these strategies, and is currently preparing a large lending operation to support the medium-term institutional development agenda in the tax administration.

- **Government spending: level, efficiency, and transparency.** The IMF will take the lead on defining the overall spending envelope consistent with macroeconomic and social objectives. The WB will take the lead on providing recommendations on improving the composition and efficiency of public spending as well as financing of various programs. The Bank completed a Public Expenditure Review in 2013 along with a database on expenditures at the municipal level. The WB approved a Development Policy Loan (November 2016), and an Investment Project Financing to strengthen the Tax Superintendence (January 2017), both of which are expected to be approved by Congress in the second quarter of 2018. Furthermore, to enhance transparency in public expenditure the WB is delivering Technical Assistance to the Ministry of Finance to implement a Fiscal Observatory. The first phase of this, which includes prioritized sectors such as health and education, is expected to be completed by the end of 2018. In addition, the WB is managing a grant from the European Union to conduct the First Civil Servants Census, which is expected to be completed in 2019. Finally, the WB is working with Congress and the ministry of finance to design a new procurement framework which will serve as the basis for the discussions of a new Procurement Law, the final version is expected to be delivered by the second quarter of 2018.
 - **Monetary policy framework.** The IMF will continue providing policy recommendations and technical assistance to improve the monetary framework, including macro-prudential policy and strengthening of the monetary transmission mechanism.
 - **Financial sector stability.** An FSAP follow that in 2014 was undertaken in collaboration by the Fund and the Bank. It identified the main arrears of reforms need to strengthen the financial system. The WB and the IMF will continue cooperating as necessary in assisting Guatemala to follow up on the 2014 FSAP recommendations, bringing the financial framework in compliance with the 2012 FATF standards, and continue effectively implementing risk-based AML/CFT supervision.
 - **Labor market.** The WB will continue the dialogue with the Government to identify areas in which policy reforms can be implemented.
 - **ILO 169 Convention.** On May 2017 the Constitutional Court instructed Congress to approve a law that guides the consultations of ILO 169. The WB received a request from the Government of Guatemala to support the Ministry of Labor through technical assistance, to strengthen the draft of the law prior to the discussions in Congress. The law is expected to be approved by the second quarter of 2017.
- 6. The teams have the following requests for information from their counterparts:**
- The IMF team requests to be kept informed of progress in the above macro-critical structural reform areas when milestones are reached (and at least semi-annually).

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

The table below lists the teams' separate and joint work programs during March 2018–July 2019.

World Bank and IMF Planned Activities in Macro-Critical Structural Reform Areas March 2018–July 2019			
Title	Products	Provisional Timing of Missions	Expected Delivery Date
World Bank Work Program	DPF Enhancing Governance and Policies to Address Malnutrition	May 2018	May 2018
	IPF Transparency and Efficiency in Tax Administration	May 2018	May 2018
IMF Work Program including CAPTAC–DR	2018 Article IV consultation	March 2018	March 2018
	Technical Assistance: Revenue Administration and Governance Revenue Quantity Tax Policy Institutional Structures Tax Administration Core Functions Structures and Tools (Supervision) Customs core administration Tax Administration Core Functions Asset Management Budget Preparation Fiscal Risks Fiscal Reporting Regulatory and Prudential Framework Insurance Regulation and Supervision Monetary Policy Implementation & Operations Establishment of an effective macroprudential policy framework. Monetary Policy Implementation & Operations Government Finance Real Sector - National Accounts Macroprudential Policy		May 2018– April 2019

7. The below table summarizes the financial relations between Guatemala and the World Bank (in million U.S. dollars).

Guatemala and the World Bank Financial Relations			
Project Name *	Total loan	Undisbursed through FY17	Projected disbursements in FY18
First Improved governance of Public Resources and Nutrition	250	250	250
Transparency and Efficiency in Tax Administration	55	55	
Guatemala Nutrition and Health Project	100	100	
Urban Infrastructure and Violence Prevention	45	45	

*All of these operations are pending Congressional approval.

RELATIONS WITH THE INTER-AMERICAN DEVELOPMENT BANK

(As of March 2018)

A. Recent Projects and Objectives

- 1. On December 2017, the IADB approved its country strategy for Guatemala for 2017–20.** The IDB Group Strategy for 2017–20 with Guatemala assigns priority to public administration and transparency, reducing the gaps in access to basic services by the poor, and the promotion of actions to stimulate private investment. Rural and indigenous populations will receive attention through measures involving cultural relevance and gender equality, as well as through initiatives to adapt to climate change across economic sectors. The strategy's focus on three pillars: (i) improving public management and transparency; (ii) reducing poverty and inequality; and (iii) enhancing private sector development. The country strategy will give priority to addressing factors limiting the execution of programs, defining new implementation mechanisms applicable both to the active portfolio and future programs. The Strategy will coordinate actions with the Plan of the Alliance for the Prosperity of the Northern Triangle in such a way as to maximize support for each of the countries involved.
- 2. As of March 2018, the IADB portfolio of approved sovereign-guaranteed loans under execution amounted to US\$784.0 million, with an undisbursed balance of US\$559.7 million.** The existing sovereign guaranteed portfolio focuses on: (i) education; (ii) water and sanitation; (iii) health; (iv) infrastructure; (v) security and justice; (vi) competitiveness; and (vii) fiscal transparency.
- 3. The pipeline for 2018 includes two projects in the public sector for US\$200 million** in the areas of health (US\$100 million) and infrastructure (US\$100 million).

Loan Transaction

(In millions of U.S. dollars)

	2014	2015	2016	2017	2018(p)
Disbursement	80.5	296.8	48.9	57.8	2.2
Repayments	130.2	147.2	145.2	203.2	22.2
Net Lending	-49.7	149.6	-96.3	-145.4	-19.9
Subscriptions and Contributions	2.0	2.0	1.9	0.0	0.0
Interest and Charges	78.5	76.3	85.5	84.9	10.8
Net Cash Flow	-130.2	71.4	-183.8	-230.3	-30.7

Source: Inter-American Development Bank.

Note: (p) as of March 2018.

IADB Sovereign Guaranteed Loan Portfolio as of March 2018

(In millions of U.S. dollars)

Sector	Approved	Undisbursed
Fiscal Transparency	250.0	250
Competitiveness	29.0	14.1
Security and Justice	90.0	61.0
Infrastructure	30.0	8.5
Water and Sanitation	50.0	36.4
Health	35.0	12.3
Education	300.0	177.4
Total	784.0	559.7

Source: Inter-American Development Bank.

STATISTICAL ISSUES

(As of April 2, 2018)

I. Assessment of Data Adequacy for Surveillance
<p>General: Data provision has some shortcomings, but is broadly adequate for surveillance.</p>
<p>National accounts: The Bank of Guatemala (Banguat) publishes annual and quarterly national accounts consistent with the <i>System of National Accounts 1993 (1993 SNA)</i>, with 2001 as the base year. In addition, a monthly index of economic activity (IMAE) consistent with the quarterly and annual accounts is disseminated on a regular basis. Banguat has started the national accounts rebasing process that is planned to be completed in 2018 and disseminated in the first quarter of 2019, with 2013 as the new base year and adopting the main recommendations of the <i>2008 SNA</i>.</p>
<p>Consumer prices and unemployment: the consumer price index is disseminated monthly, using weights from 2009–10, based on the National Household Income and Expenditure Survey (ENIGFAM), conducted between July 2009 and July 2010. The CPI is compiled at national level and for eight regions. Unemployment is estimated only on a biannual basis.</p>
<p>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.</p> <p>Guatemala provides annual fiscal data for the GFSY with institutional coverage of Budgetary Central Government. The country participates in a regional capacity development program for the harmonization of GFS for Central America, Panama, and the Dominican Republic led by the IMF's Regional Center for Technical Assistance (CAPTAC-DR). A workshop to launch this program was conducted on September 2017, where all country participants discussed the status in applying the GFS methodology in their countries, and defined expected outcomes and priorities under this program. Further technical assistance from CAPTAC-DR under this program was received in October 2017 and February 2018, and is scheduled for April and December 2018.</p>
<p>Monetary and financial statistics: Monetary and financial statistics are reported on a regular monthly basis to STA using the standardized report forms (SRFs) for the central bank, other depository corporations, and other financial corporations (OFCs). OFCs comprise insurance companies, warehouses and exchange houses. Monetary data exclude credit card companies, securities dealers, other financial intermediaries, and other financial auxiliaries.</p>
<p>Financial sector surveillance: The authorities report on monthly basis all twelve core financial soundness indicators (FSIs) and ten (out of thirteen) of the encouraged set for the deposit taking sector. The authorities are working on expanding the FSI coverage of the OFCs sector.</p>

External sector statistics: Guatemala has made significant progress on the prerequisites for data quality as well as on methodological soundness of concepts and definitions, scope, classification, and basis for recording. The legislation on the obligation of the private sector to provide information to the Bank of Guatemala for statistical purposes is still pending, which affects the response rate to balance of payments surveys and limits the availability of the required information. On dissemination of external sector statistics, Guatemala has successfully: (1) migrated to the sixth edition of the *Balance of Payments and International Investment Position Manual (BPM6)*; (2) disseminated the Reserves Data Template; (3) disseminated comprehensive inward/outward data on the Coordinated Direct Investment Survey (CDIS), and; (4) provided total external debt statistics by sector on the World Bank's website. Compilers at the Central Bank should be encouraged to participate in the Coordinated Portfolio Investment Survey (CPIS).

II. Data Standards and Quality

Guatemala participates in the enhanced General Data Dissemination System (e-GDDS) and meets nearly all of the recommended periodicity and timeliness recommendations of the e-GDDS.

A data ROSC was completed on October 28, 2004.

Table of Common Indicators Required for Surveillance

	Date of latest observation	Date received	Frequency of Data ^{7/}	Frequency of Reporting ^{7/}	Frequency of Publication ^{7/}
Exchange Rates	Feb/2018	3/5/2018	D	D	D
International Reserve Assets and Reserve Liabilities of the Monetary Authorities ^{1/}	Feb/2018	3/5/2018	M	M	M
Reserve/ Base Money	Dec/2017	12/19/2017	W	W	W
Broad Money	Nov/2017	12/19/2017	W	W	W
Central Bank Balance Sheet	Dec/2017	1/10/2018	D	D	D
Consolidated Balance Sheet of the Banking System	Nov/2017	12/20/2017	M	M	M
Interest Rates ^{2/}	Nov/2017	12/19/2017	W	W	W
Consumer Price Index	Feb/2018	4/2/2018	M	M	M
Revenue, Expenditure, Balance and Composition of Financing ^{3/-} Central Government	Dec/2017	12/20/2017	M	M	M
Revenue, Expenditure, Balance and Composition of Financing ^{4/-} General Government			N/A	N/A	N/A
Stocks of Central Government and Central Government-Guaranteed Debt ^{5/}	Dec/2017	12/20/2017	M	M	M
External Current Account Balance	Q4/2017	4/3/2018	Q	Q	Q
Exports and Imports of Goods and Services	Q4/2017	4/3/2018	Q	Q	Q
GDP/GNP	Q4/2016	12/08/2017	Q	Q	Q
Gross External Debt	Q4/2017	12/20/2017	Q	Q	Q
International Investment Position ^{6/}	Q4/2017	4/3/2018	Q	Q	Q

^{1/} Includes reserve assets pledged or otherwise encumbered as well as net derivative positions.

^{2/} Both market-based and officially-determined, including discount rates, money market rates, rates on treasury bills, notes and bonds.

^{3/} Foreign, domestic bank, and domestic nonbank financing.

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

^{5/} Including currency and maturity composition.

^{6/} Includes external gross financial asset and liability positions vis-à-vis nonresidents.

^{7/} Daily (D); weekly (W); monthly (M); quarterly (Q); annually (A); irregular (I); and not available (NA).

Statement by Mr. Carlos Hurtado, Executive Director for Guatemala
May 25, 2018

The Guatemalan Authorities would like to thank the Staff for the candid dialogue during the 2017 Article IV consultation and for the set of reports produced, particularly the Selected Issues Papers, which they find very useful and opportune. While authorities broadly agree with the staff assessment, we would like to emphasize the following topics:

Economic Resilience and Growth

Guatemala has a solid track record of macroeconomic stability and strong resilience.

This is reflected in steady rates of economic growth, stable exchange rate and interest rates, low and stable inflation, low fiscal deficits, a solid, solvent and liquid banking system, and low levels of public debt (at 24 percent of GDP, Guatemalan public debt is one of the lowest in the region, remains stable and has an historical strong record of payment). Disciplined macroeconomic and financial policies have contributed to the economy's strong resilience to different shocks both external and domestic. In this context; economic growth averaged 3.5 percent since 2007. The economy slightly decelerated to 2.8 percent in 2017, but official projections point out to a recovery of 3.4 percent in 2018, driven by the expected higher economic growth in the U.S., which would lead to an increase in exports, and a recovery in internal demand, in particular public investment. The authorities concur with staff that the economy needs to grow faster in order to create more jobs, increase per-capita income and, consequently, contribute to reduce poverty; the robust economic fundamentals described are solid basis to underpin growth and investment.

Monetary and Exchange Rate Policies

Inflation has been within the target range during the last eight years, and monetary policy has been accommodative over the past three years.

The policy rate was cut by 100 basis points in 2015 (from 4 percent to 3 percent), taking into account that inflation was on target, inflationary expectations were anchored, economy was decelerating, and fiscal policy was pro-cyclical. The policy rate remained unchanged until November 2017, when the monetary authorities approved an additional cut of 25 basis points. The current policy rate (2.75 percent) is well below the authorities' estimation of neutral interest rate, negative in real terms, and one of the lowest among the Latin American countries under the inflation targeting regime.

From a forward-looking standpoint, the authorities see limited space for additional monetary policy accommodation.

Liquidity is ample in the banking system, the output gap, although still negative, is closing, and core inflation is expected to accelerate; moreover, fiscal budget execution is expected to improve this year and credit to accelerate, which would create upward demand pressures on inflation, albeit moderate. In addition, on the external front, risks to higher inflation may arise from increases in oil prices, while the normalization of the US monetary policy would make it unwise additional policy rate cuts. That said, as

customary, the monetary authorities will opportunely take the necessary measures to keep inflation on target, based on the assessment of a comprehensive balance of inflation risks steaming from both the external and domestic economic conditions.

The authorities do not share the reclassification of the de-facto exchange rate arrangement from floating to stabilized. Consistent with the Inflation Targeting Regime, the exchange rate (ER) is flexible given that market supply and demand are the main determinants in the FX market. A clear and transparent rule for central bank's intervention has been in place for more than 10 years; the central bank's objective is to intervene only to smooth volatility without changing the ER trend, as evidence has demonstrated. That said, the authorities have made clear their commitment to a more flexible exchange rate by gradually increasing the margin of the afore mentioned rule.

Financial System

Guatemala's financial system is one of the more solids and excels in the fight against money laundering. The soundness of the banking system ranks 11 among 137 countries assessed, according to the global competitiveness index published by the World Economic Forum in its 2017-2018 report, improving consistently since 2015. According to the Mutual Evaluation Report of the Republic of Guatemala performed in 2016 by the Latin American financial action group (GAFILAT), the country ranks among the first ten in world comparison in the areas of technical compliance and effectiveness in AML/CFT (this ranking was published by the Basel Institute on Governance in August 2017). With support from the Fund and GAFILAT, a revision of the law is underway to strengthen the AML/CFT framework, and is expected to be completed during the second semester of this year.

The authorities continue efforts oriented to improve financial inclusion. Guatemala ranks 20 in the getting credit category of the Doing Business 2018 report. The Law of Factoring and Discounts Contracts was approved last January and in April Congress approved reforms to the Law of Movable Guarantees. A law initiative to give the leasing financial mechanism the appropriate legal framework is pending Congress approval.

Fiscal Policy

Efforts to enhance tax administration and transparency have continued. A law for strengthening fiscal transparency and the governance of the Superintendency of Tax Administration (SAT) was passed in August 2016. The law aims to reform the organizational structure of the SAT to incorporate mechanisms that contribute to achieving its objectives, including the necessary operational resources for its functioning. Since the law enactment, the tax administration has successfully aligned the following transversal axes of its policies: i) transparency and tackling corruption; ii) increase institutional efficiency, increase cooperation, fiscal audit and tackling evasion; iii) provide better service to taxpayers; and iv) use of technology and personal development. The government has continued enhancing transparency through the open budget exercise; in addition, a new Vice-Ministry of Finance in charge of Transparency was established for institutional strengthening and transparency in

the management of public resources and the implementation of the Procurement Law, as well as for technical and technological assistance. An anti-smuggling law is pending approval by Congress.

The authorities are aware of the need to promote deeper reforms to increase revenue mobilization that will allow increasing social and capital expenditures. They consider that a comprehensive reform is needed to stand more political viability. The reform should include measures to increase the quality and efficiency of spending, keep transparency of procurement processes while enhancing their efficiency, reform the civil service and broaden the tax base. Additional revenues coming from tax policy changes should aim to finance visible and high impact spending programs.

Programs with the highest potential to reduce poverty and inequity, linked to the Sustainable Development Objectives (SDO), are being identified with support from the WB and the IMF. The authorities are looking for effective and focalized investment mechanisms, and innovative execution schemes for a successful implementation. The General Road Infrastructure Law initiative, presented to Congress on April 2018, is under assessment by the corresponding commission. The authorities share staff's view on the need to push other reforms such as one in the Comptroller General's Office that can help to accelerate budget execution.

In June 2017, Congress ratified the Convention on Mutual Administrative Assistance in Tax Matters. The Convention is an instrument available for all forms of tax cooperation to tackle tax evasion and avoidance, a top priority for all countries, it was amended to respond to the G20 call at its 2009 London Summit to align the instrument to international standards on exchange of information on tax and customs matters on request and to open it to all countries, in particular, to ensure that developing countries could benefit from the new transparent environment.

Policies to Foster Growth and Employment

The government's policy to foster growth and investment comprise four pillars and three transversal axes. The four pillars are i) trade and local and foreign investment; ii) financial access and entrepreneurship; iii) productive infrastructure and orderly urbanization; and iv) competitiveness and formal employment. Legal certainty, governance and macroeconomic stability are the transversal axes of this policy.

Efforts for the implementation of the Northern Triangle Prosperity Alliance Plan are ongoing. Inter-institutional and multi-sectorial coordination is carried-out by the Ministry of Economy (through the National Competitiveness Program -PRONACOM-). Guatemala is currently implementing the plan in 51 municipalities, of which 41 have been identified as having critical needs for socio-economic development

A number of reforms are being promoted to improve the business climate. Reforms to the Commercial Code were approved in 2017, including reducing the amount of initial capital to start a business; also, to expedite the process for the issuance of construction licenses, state authorities plan to implement a project to open the Single Window for Construction Licenses by end May.

The Competition Law is currently in the last stage of approval. Proposed amendments need to be considered at this stage. The Congress' Commission of Economy and Foreign Trade, in coordination with the Ministry of Economy and PRONACOM, with the support of the Competition Rights Institute, has organized a series of public presentations on the challenges and impacts of this initiative.

A law initiative that provides the legal framework for the Consultation of Indigenous Peoples, in accordance with Convention 169 of the International Labor Organization is under consideration by Congress. This initiative seeks balance between reducing uncertainty related to investments in the extractive sector, and protecting indigenous peoples' rights. The initiative has been passed to the work commission for assessment.

Governance

As staff pointed out in the SIP, Guatemala continues making significant efforts to fight corruption. Guatemala has changed its institutional status quo since 2015 and it is expected that soon it will arrive at a new and more favorable equilibrium. As it is well known, during 2015-2018, the General Prosecutor's Office (MP) and the International Commission Against Impunity in Guatemala (CICIG) have unveiled several high-impact cases of corruption that led to the detention and trial of high level individuals, both from public and private sectors. The transparency of the recent election process for the new general prosecutor was recognized at national level and by the international community. Several laws have been approved to strengthen the judicial system and there are others being discussed: reform to the organic law of the public ministry (approved in March 2016); law of the judicial career (approved in July 2016 and reformed in October 2017).

The Financial Intelligence Unit (IVE) continue to strengthen its capacity and analytical skills to conduct financial analysis and enforce compliance with the AML/CFT regulations. As a result, suspicious transactions reports, IVE requirements, and national reporting requirements overseen by IVE, among others, have increased dramatically over the past 5 years, as summarized in Table 1 page 42 of the SIP.