April 2002
IMF Country Report No. 02/80

Guatemala: Request for Stand-By Arrangement—Staff Report; Staff Statement; Press Release on the Executive Board Discussion; and Statement by the Executive Director for Guatemala

In the context of the Request for Stand-By Arrangement, the following documents have been released and are included in this package:

- the staff report for the Request for Stand-By Arrangement, prepared by a staff team of the IMF, following discussions that ended on **February 28, 2002,** 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 March 15, 2002**. The views expressed in the staff report are those of the staff team and do not necessarily reflect the views of the Executive Board of the IMF.

- a staff statement of **April 1, 2002** updating information on recent developments.

- a Press Release summarizing the **views of the Executive Board as expressed during its April 1, 2002 discussion** of the staff report that completed the review.

- a statement by the Executive Director for Guatemala.

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

Letter of Intent sent to the IMF by the authorities of Guatemala*
Memorandum of Economic and Financial Policies of Guatemala*
Technical Memorandum of Understanding of Guatemala*

*May also be included in Staff Report

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

To assist the IMF in evaluating the publication policy, reader comments are invited and may be sent by e-mail to Publicationpolicy@imf.org.

Copies of this report are available to the public from

International Monetary Fund • Publication Services
700 19th Street, N.W. • Washington, D.C. 20431
Telephone: (202) 623-7430 • Telefax: (202) 623-7201
E-mail: publications@imf.org Internet: http://www.imf.org

Price: $15.00 a copy

**International Monetary Fund
Washington, D.C.**

INTERNATIONAL MONETARY FUND

GUATEMALA

Request for Stand-By Arrangement

Prepared by the Western Hemisphere Department

(In consultation with the Fiscal Affairs, Legal, Monetary and Exchange Affairs, Policy Development and Review, Statistics, and Treasurer's Departments)

Approved by Miguel E. Bonangelino and G. Russell Kincaid

March 15, 2002

- Discussions on a program that could be supported by a Stand-By Arrangement (SBA) from the Fund were held in Guatemala City in August, November, and December 2001, and February 2002, and at headquarters in December 2001 and February 2002.

- During the various stages of the discussions the staff comprised Messrs. Arbulú-Neira (Head), Baca-Campodónico (FAD), Bailén, Giustiniani, Martin (all WHD), and Jacome (MAE), and Mmes. Mercer-Blackman, Zacho, and Herrera (Assistant) (all WHD). Mr. López-Calix (IBRD) participated in some meetings. Mr. Oyarzábal, Executive Director for Guatemala, participated in the key discussions.

- The staff met with the president and vice-president of the republic, the ministers of finance, economy, and energy and mining, the president of the central bank, members of congress and of the monetary board, other government officials, representatives of the private sector, and members of the international community.

- Guatemala is on the standard 12-month Article IV consultation cycle, has accepted the obligations of Article VIII, Sections 2, 3, and 4 of the Articles of Agreement, and maintains an exchange system free of restrictions on current payments and transfers.

Contents

Appendices

Attachment

Annexes

Executive Summary

Background: Since taking office in January 2000, the administration of President Portillo sought to strengthen macroeconomic stability and advance in the implementation of the UN-supported Peace Accords. A tightening of fiscal spending in 2000 proved to be temporary and with the adverse terms of trade and global slowdown in 2001, macroeconomic conditions weakened again. In 2001, real GDP growth slowed, and inflation picked up in part reflecting an increase in the VAT rate. The authorities introduced a package of tax and tax administration measures in July and November 2001 to limit the fiscal weakening resulting from a substantial increase in public sector outlays. In January 2002 they reestablished custom duties on gasoline and in February 2002 they increased excise taxes by a significant amount. Except for part of the second half of the year, the stance of monetary policy remained tight during 2001, which together with proceeds from privatization and from Eurobonds earmarked for amortizing short-term debt in 2002 resulted in a further strengthening of the net international reserves (NIR) position to US$2.3 billion (about 175 percent of short-term debt on a remaining maturity base at end-2001).

The program: The authorities are requesting a 12-month Stand-By Arrangement in an amount equivalent to SDR 84 million (40 percent of quota) to support an economic program aimed at reducing the fiscal deficit and restructuring the financial system, while sustaining higher outlays on social and basic infrastructure as called for by the Peace Accords. The program assumes an acceleration of real GDP growth to 2¼ percent (1¾ percent in 2001) and a reduction in inflation to a 4–6 percent range (about 9 percent in 2001). The NIR position would decline somewhat to the equivalent of 145 percent of short-term debt on a remaining maturity basis at end-2002.

In the fiscal area in 2002, the deficit of the combined public sector would be halved to 1½ percent of GDP and the central government deficit would be narrowed to 1¼ percent of GDP (2¾ percent of GDP in 2001) on the strength of revenue measures introduced in 2001 —including an increase in the VAT rate—and 2002, and expenditure restraint. Central government revenue would rise to 11½ percent of GDP as the expected increase by 1 percentage point of GDP to 10¾ percent of GDP would be partially offset by a fall in nontax revenue from the highest historical level in 2001. Following widespread public demonstrations against the increase in the VAT rate in August 2001, the authorities decided not to raise taxes in what remains of the current administration (the new administration will assume office in January 2004) to avoid political difficulties that could jeopardize the legislative agenda of structural reforms. Central government expenditure will be cut by 1 percent of GDP to 12¾ percent of GDP while protecting social expenditure (at about 5 percent of GDP). Moreover, the government would strengthen targeting and resource allocation in the social areas.

The authorities are committed to keep monetary policy as tight as needed to achieve the inflation objective of the program. The authorities continue to permit the fluctuations in the exchange rate to reflect market conditions.

In the structural area, the program asks for approval of the new laws on central bank, banking supervision, and monetary framework before completion of the program review (scheduled for August 2002). Also during the program period, new laws on probity, role of the comptroller general, and government procurement will be presented to congress.

I. Introduction

1. With the signing of the **UN-sponsored Peace Accords in 1996**, the authorities designed an ambitious program to mobilize domestic resources and external aid to address deep-rooted social problems, improve human capital, and raise productivity (Table 1). This program was to help place the economy on a sustainable higher growth path required to deal with poverty. However, their program has progressed slowly mainly because of uneven macroeconomic performance, low implementation capacity, inadequate tax effort, and lower-than-expected aid disbursements. The tax ratio, at 9¾ percent of GDP in 2001, remains lower than the 12 percent originally targeted in the accords for 2000.[1]

2. Following two years of improved macroeconomic performance, **the authorities shifted to expansionary fiscal and monetary policies in 1998** with the aim of fostering high economic growth in the presence of adverse terms of trade and weather conditions. Economic growth rose in 1998 but weakened in 1999, while the external current account deficit widened, which together with strong private capital outflows led to a substantial decline in net international reserves. In addition, the financial system began to show signs of weakness.

3. Upon taking office in January 2000, the administration of President Portillo sought to **strengthen macroeconomic policies and move forward with the implementation of the Peace Accords**. A tightening of fiscal spending in 2000, however, proved to be temporary and with the adverse external conditions and global slowdown in 2001, macroeconomic conditions weakened again. Moreover, tax revenues were not increased as called for under the Peace Accords. However, the authorities began to take actions to deal with the weaknesses of the financial system.

4. At the **conclusion of the 2001 Article IV consultation** on May 14, 2001 (SM/01/116), Directors expressed concern about the acceleration of public expenditure and emphasized the need for corrective actions to strengthen fiscal policy and the banking system. They stressed the importance of increasing the tax effort from its low level, to meet social expenditure needs, and cover the costs of bank restructuring. They called for a comprehensive inspection of each financial institution and urged the authorities to raise the regulatory and supervisory framework of the financial system to international standards.

5. The authorities have framed an **economic program for 2002** aimed at strengthening the fiscal position, while helping to achieve the revenue and social expenditure targets of the Peace Accords, and to begin addressing the weaknesses of the financial system. The

---

[1] Difficulties in raising tax revenue to the 12 percent target led the authorities to negotiate with the Peace Commission in 1999 a revision of the schedule to achieve this fiscal objective in 2002.

objectives and policies of the government's economic program, which are consistent with the recommendations of Executive Directors at the conclusion of the last Article IV consultation, are set forth in the attached memorandum of economic and financial policies (MEFP) attached to the letter of intent (Annex I). On the basis of this program, the authorities are requesting a 12-month SBA in an amount equivalent to SDR 84 million (40 percent of quota on an annual basis) to end-March 2003. The Government of Guatemala intends to treat the SBA as precautionary.

6. Guatemala's **statistical system is adequate for surveillance** and economic analysis, but there are significant weaknesses in national accounts, public finances, balance of payments, and external debt. The authorities are addressing many of these shortcomings with technical assistance from the Fund and other international institutions (Appendix III).

II. Background and Recent Economic Developments

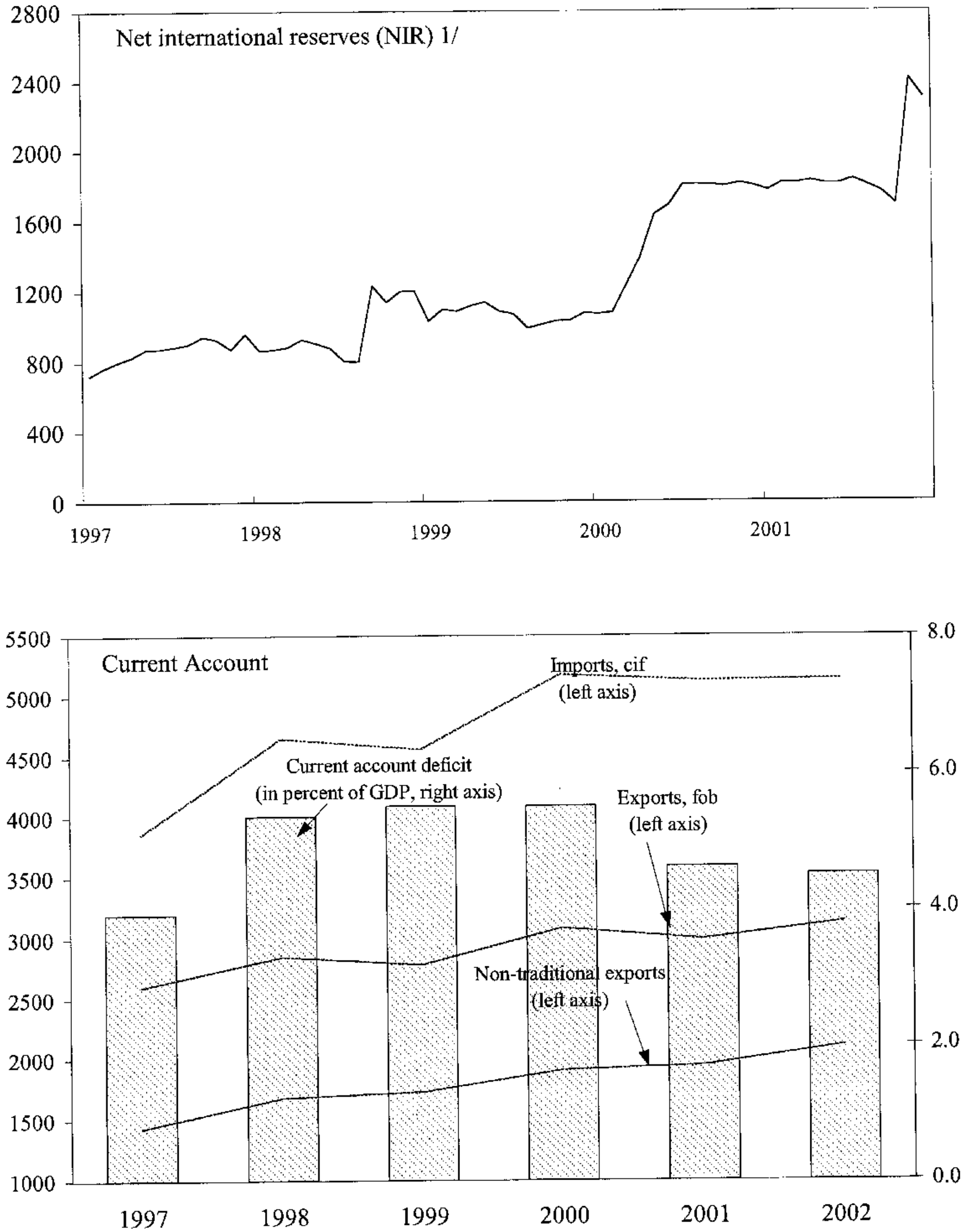
7. In 2001 **real GDP growth is estimated to have slowed** to 1¾ percent reflecting a continuing decline in the terms of trade as well as the economic slowdown in the United States and neighboring countries.[2] Despite weak domestic demand, **inflation picked up to about 9 percent** (above the 4–6 percent range targeted in the authorities' monetary program), in part owing to the effect of increasing the VAT rate in August 2001 and easing of monetary policy during part of the year (see below). The NIR rose by some US$500 million bringing the stock by year's end to the equivalent of about 130 percent of base money and 175 percent of short-term debt on a remaining maturity basis (Figure 1). **The external current account deficit narrowed,** notwithstanding lower export receipts (reflecting in part a decline in coffee prices), as imports fell by even a larger amount. **The capital account surplus fell** to 7 percent of GDP because of declining private sector inflows; net official capital inflows recovered benefiting from a placement of government bonds in the Euro market in November 2001 equivalent to US$325 million (more than 1½ percent of GDP) (Table 2).

8. **The overall deficit of the combined public sector widened from 2 percent of GDP in 2000** to 3 percent of GDP in 2001 as the government, yielding to political pressures, increased overall outlays by 22 percent (Table 3 and Figure 2). To arrest the fiscal weakening, the authorities introduced tax measures in July 2001, including an increase in the VAT rate from 10 to 12 percent, and raises in income tax rates on commercial and agricultural enterprises, in excise taxes on fuel oil, and in import duties on used cars. Also in July 2001, congress approved reforms to the tax and penal codes aimed at strengthening the superintendency of tax administration (SAT), which is making progress in reducing evasion, particularly at customs offices. Moreover, in November 2001 congress approved an increase in the excises on cigarettes.[3]

[2] For a description of developments in 2000, see SM/01/116 (4/19/2001).

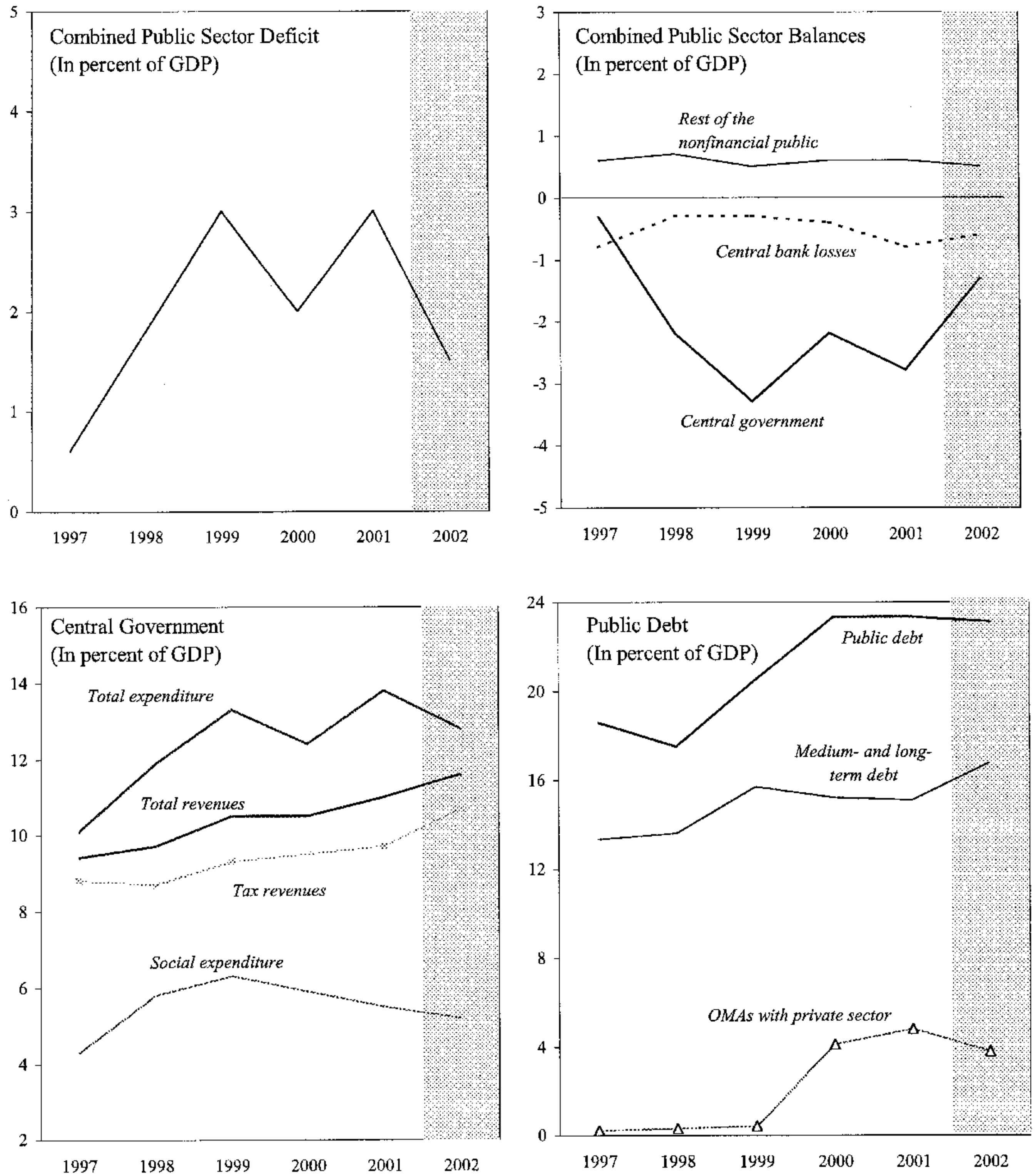
[3] The reference price for the tax was increased by 230 percent.

Figure 1. Guatemala: External Sector Indicators
(In millions of U.S. dollars, unless otherwise noted)



Sources: Bank of Guatemala; and Fund staff estimates and projections.
1/ Excludes claims on Nicaragua amounting US$145.7 million up to 1997 and US$75.7 million in 2002, which are included in the official data.

Figure 2. Guatemala: Public Sector Indicators 1/



Sources: Bank of Guatemala; and Fund staff estimates and projections.
1/ Data for 2001 and 2002 are projected and programmed, respectively.

9. **The stance of monetary policy remained tight in the first half of 2001, but there was some easing in the second half** (Table 5). The net domestic assets of the central bank fell during the first half of the year and the net international reserves position strengthened, as the central bank stepped up its placements of open market certificates (see Table 5). These placements more than sterilized central bank credit (equivalent to 1 percent of GDP) extended to three banks that were intervened early in the year. Beginning in late July, the central bank eased the stance of monetary policy by refraining from rolling over open market certificates as they matured. This decision was prompted by concerns regarding the observed real appreciation of the quetzal during the first seven months of the year (about 9 percent in the 12-months through July) at a time when terms of trade were falling further. As inflation picked up in July, the central bank tightened the credit stance again in November. Notwithstanding the uneven implementation of monetary policy, the average interest rate of open market certificates fell steadily from 18 percent at end-2000 to 10 percent by end-2001 reflecting the falling of rates abroad and, to a lower extent, the shortening of average maturities of certificates.[4] Commercial bank lending rates, however, fell by only 200 basis points to 18 percent by end-2001, as banks were cautious in extending credit to the private sector in response to tightened regulations (Table 6 and Figure 3).

10. For many years some Guatemalan financial institutions have been intermediating in foreign currency with residents and registering such operations in related offshore banks. Since May 2001Guatemalan residents have been allowed to **hold assets and liabilities in foreign currency** in the domestic banking system.[5] Thus far there has been no indication of currency substitution, and foreign currency deposits in the domestic banking system stood at some US$220 million (less than 4 percent of M2) by end-2001.[6] Guatemala continued to maintain a **managed floating exchange rate regime** with the central bank intervening only for smoothing purposes.[7] During 2001, the quetzal depreciated in nominal effective terms by about 1 percent, but it appreciated in real effective terms by 1¼ percent (Figure 4).

11. Overall the **indicators of external vulnerability improved somewhat in** 2001 (Table 7), including the narrowing of the current account deficit and the decline of public

---

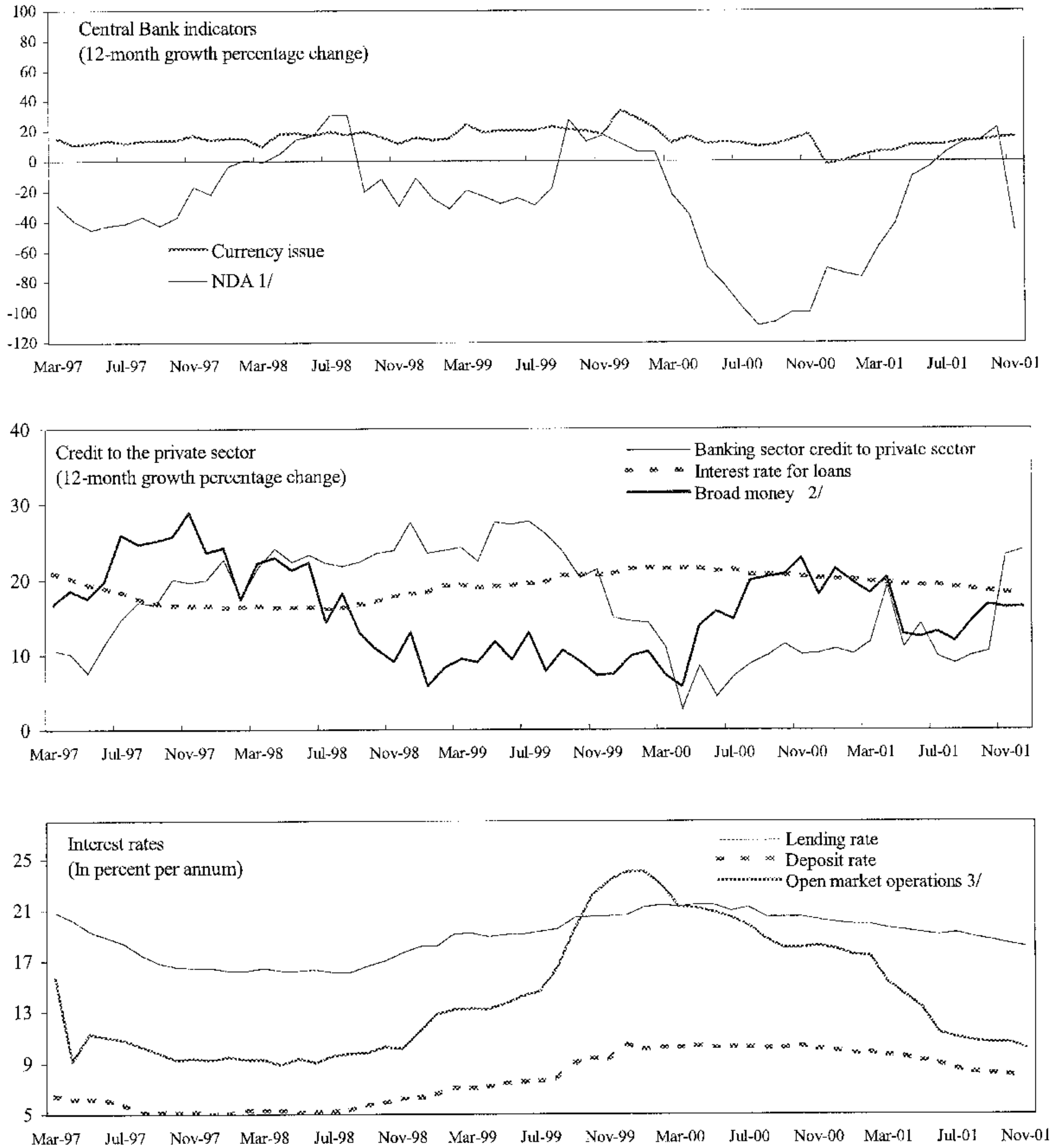
[4] Low-yield certificates at less than 30 days rose from 2 percent of the stock of certificates by end-2000 to 15 percent of the stock by end-2001.

[5] For a description of the law allowing the free negotiations of foreign exchange, see SM/01/116 (4/19/01).

[6] Foreign and local currency deposits are subject to the same legal reserve requirements.

[7] During 2001 intervention amounted to some US$26 million, compared with total annual operations in the FOREX market of over US$14 billion.

Figure 3. Guatemala: Monetary Sector Indicators, 1995-2001.



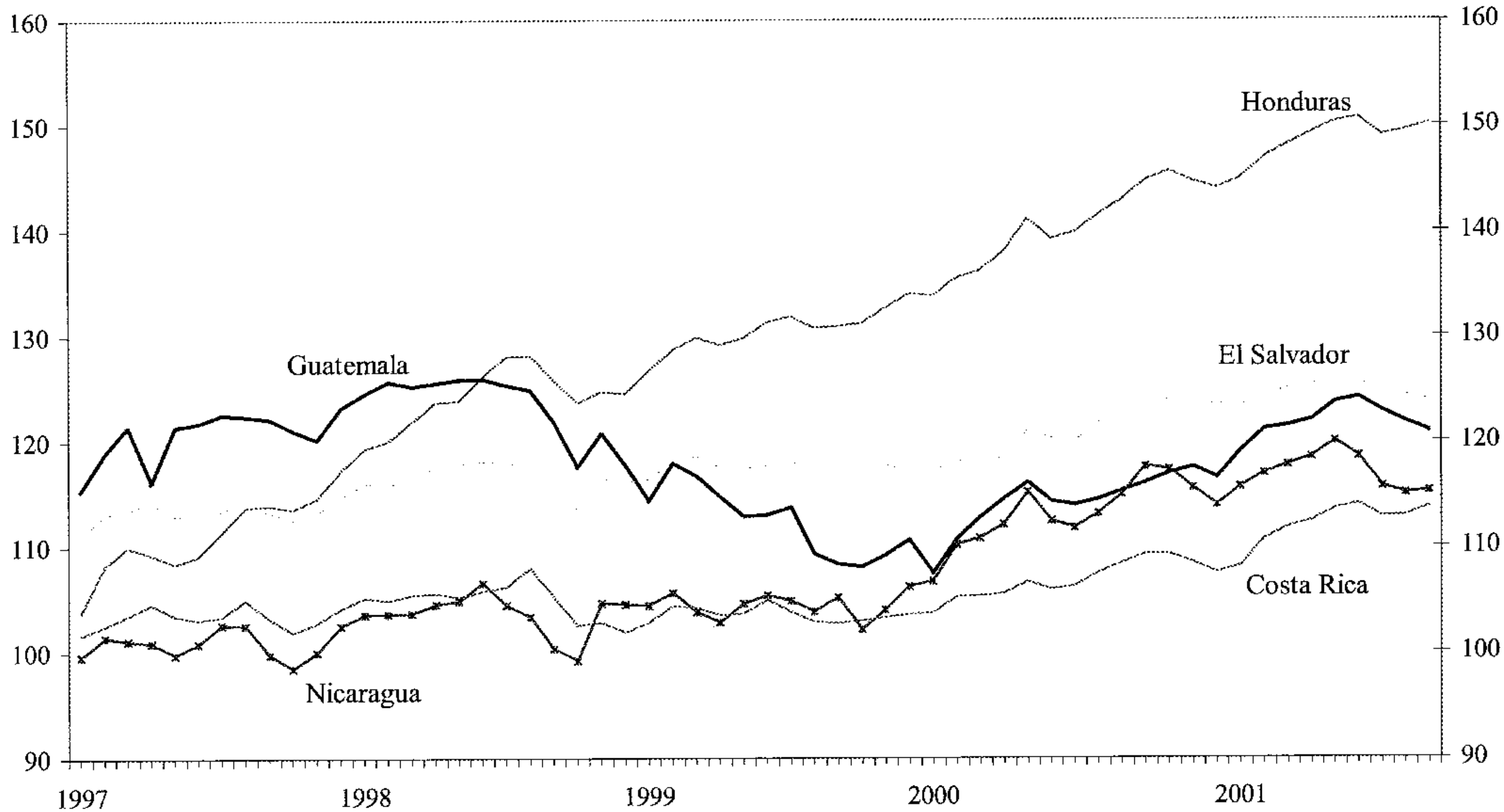
Sources: Bank of Guatemala; and Fund staff estimates.

1/ 12-month net domestic assets flows as percentage of currency issue.

2/ Includes M1, savings and time deposits, and financial obligations of the banking system.

3/ Data refer to the weighted interest rate of open market paper, except for 1997 and 1998, which refer to 180-day bond interest rates.

Figure 4. Guatemala: Real Effective Exchange Rates within the Central American Region 1/ 2/
(1995=100)



Source: Information Notice System.
1/ An increase (decrease) means appreciation (depreciation)
2/ Measure real effective exchange rate in a multilateral (trade weighted) sense.

sector external debt to 16 percent of GDP.[8] In 2001 the ratios of NIR to M2 rose to 45 percent and, as noted, the stock of short-term debt (on remaining maturity basis) rose to 175 percent.

12. **The financial sector, however, remains fragile** (Table 8). As of November 2001, nonperforming loans (NPLs) represented about 15 percent of total loans, while increases in the banks' provisions still only covered about 25 percent of NPLs. The FSSA report (SM/01/119, 4/23/01) recommended, as an important step to improve the health of the banking system, to close insolvent banks with a view to limiting the risk of asset stripping and losses of the central bank. Three small banks were intervened early in 2001 and in October 2001 the authorities requested the courts their liquidation, while another insolvent bank was capitalized to set the stage for its sale in 2002. Moreover, in October 2001 congress approved an anti-money laundering (AML) law, authorizing the seizing of assets reasonably suspected to be proceeds from criminal activity, and the sharing of information with other countries. The authorities expect that implementation of this law would permit to strengthen AML activity and take Guatemala off the list of the "noncooperative" jurisdictions established by the OECD-backed Financial Action Task Force.

III. The Economic Program for 2002

13. Guatemala's economic prospects over the medium term hinge critically on strengthening macroeconomic policies, improving social conditions,[9] and restructuring the financial system. To this end, the authorities' medium-term economic program aims at reducing the fiscal sector deficit to a sustainable level and restructuring the financial system, while sustaining higher outlays on social and basic infrastructure, as called for under the Peace Accords. The program contemplates a substantial mobilization of resources, through public revenue increases and the support of the international community, which is tied to the implementation of the peace process. Full implementation of the program would help

---

[8] The decline in the external debt resulted from a tripartite debt swap agreement between Spain, Nicaragua, and Guatemala in March 2001 whereby Guatemala transferred to Spain claims of about US$530 million on Nicaragua in settlement of its arrears to Spain.

[9] Guatemala's social indicators are among the lowest in Latin America. About 60 percent of the population lives below the poverty line with a quarter of the population living in extreme poverty. Life expectancy is the lowest among Central American countries, close to half of the children under five years suffer from malnutrition, and about one-third of the population is illiterate.

accelerate economic growth to 5½ percent by 2006 and strengthen the external position while achieving the social targets agreed in the accords.[10]

14. For 2002, the program assumes an acceleration of real GDP growth to 2¼ percent on the basis of a gradual improvement of the international environment, in line with WEO projections, and a reduction in inflation to a 4–6 percent range. Net international reserves will decline moderately to help finance public sector short-term debt amortization, but will stay at 110 percent of base money and 145 percent of short-term debt by end-2002. The program targets a narrowing of the combined public sector deficit to 1½ percent of GDP in 2002, which would allow some easing of the current tight stance of monetary policy while attaining the inflation target. Under this policy mix, exchange rate movements should continue to reflect market conditions with the central bank intervention continuing to be limited to market smoothing. Structural measures will be centered on the financial system and key areas of governance.

A. Fiscal Policy

15. **The program targets a reduction of the combined public sector deficit to 1½ percent of GDP in 2002** (3 percent in 2001). The central government deficit would narrow to 1¼ percent of GDP (2.8 percent of GDP in 2001). Central government revenue would increase to 11½ percent of GDP as a fall in nontax revenue from its high historical level in 2001 would partially offset the projected increase in tax revenue. Tax revenue is projected to increase from 9¾ percent of GDP in 2001 to 10¾ percent of GDP in 2002 reflecting the full-year effect of the revenue measures introduced in 2001, the reestablishment of a 10 percent custom duty on gasoline in January 2002, and the increase in excise taxes in February 2002.[11] Following widespread public demonstrations against the increase in the VAT rate in August 2001, the authorities had decided not to raise taxes further in the remaining period of the current administration (the administration will be in office up to early January 2004) to avoid political difficulties with their legislative agenda on structural reforms (see below). However, they will be working on a tax reform to be presented to the new administration. Furthermore, in the memorandum of economic and financial policies the authorities have indicated that they would consider introducing additional tax measures in

---

[10] The growth objectives over the medium term could be achieved on a continuing increase in non-coffee agricultural export capacity; increased efficiency and productivity resulting from structural reforms; and higher public and private investment. The gradual integration of the large rural indigenous population into the market economy together with strengthening of human capital through poverty reduction and improvement in basic education and preventive health should raise productivity of labor and expand the domestic demand.

[11] By 125 percent for soft drinks, 100 percent for wine, 22 percent for beer, and 11 percent for liquors.

case tax collections were to fall below the amount envisaged in the program. In that event, the staff recommended eliminating most VAT exemptions and zero-rated items except for export products, eliminating the VAT credit against the income tax, and reducing the minimum taxable income (to a level in line with other Latin American countries).

16. The authorities are aware that phasing out some revenue earmarking was important to reduce expenditure rigidities and improve the quality and targeting of expenditure. However, they said that most of the earmarking was specified in the constitution and, of the rest, they were not in a position of phasing out the earmarking of VAT revenue (the most important one not specified in the constitution) because such an earmarking was part of the political negotiation to raise the VAT rate from 7 to 10 percent in 1996 and from 10 to 12 percent in 2001.

17. A key element of the program is the introduction of mechanisms of expenditure control to correct the 2001 overruns. **Central government expenditure** would fall from 13¾ percent of GDP in 2001 to 12¾ percent of GDP in 2002 with the adjustment envisaged to fall on current expenditure, while capital outlays remaining about constant in terms of GDP. The projected central government expenditure includes some 1/10 percentage point of GDP on account of interest payments resulting from the resources needed to restructure the banking system.[12] A reduction of government expenditure of this magnitude is already reflected in the budget approved by congress in November 2001, implementation of which will be guided by a presidential decree issued in February 2002. This decree establishes quarterly limits for government expenditure and, inter alia, prohibits central government appropriations outside the budget, freezes civil service wages, and precludes increasing the number of civil servants except in specific areas (Box 1).

18. Within the reduced level of government spending relative to GDP, the program aims at protecting social expenditure. Over the next four years total social expenditure is projected to increase at an annual average rate of 11½ percent in real terms to 6¾ percent of GDP by 2006 (Table 9). Following an 11 percent increase in 2001, social expenditure in 2002 is projected to increase slightly while the government strengthens targeting and resource allocation.[13] In this regard, the National System of Public Investment (SNIP) will begin

---

[12] Under the program, the potential amount of (cash) resources needed to finance the restructuring of the banking system would be ½–¾ percentage points of GDP, which would be financed with a Financial Sector Adjustment Loan from the World Bank and other external financial resources. Both the disbursement of these resources and their use for restructuring banks are recorded as financing "below the line." Only the corresponding interest payments are recorded "above the line."

[13] To improve targeting of social expenditure the authorities would place priority in education in rural areas through public investment in community and parent managed primary schools, and in teachers offering bilingual education. Also they will place priority in public investment

(continued...)

ranking proposed projects strictly on the basis of social merits, and the government will coordinate the procurement of goods and services of the social funds to avoid waste and duplication. The latter will be facilitated by the inclusion of the social funds in the Integrated Financial Management System (IFMS) (see below). The resulting higher efficiency in the delivery of social goods and services would permit in 2002 to increase expenditure in both

Box 1. Expenditure Control

The decree (*acuerdo gubernativo*) of February 2002 introduced the following actions to control expenditure:

- Set specific quarterly expenditure ceilings for each ministry.

- Prohibit increases in central government budgetary appropriations (*ampliación presupuestal*) unless they have been declared priority expenditures and have external financing in line with the macroeconomic program.

- Prohibit offsetting savings in expenditure other than in the wage bill with additional spending in different categories.

- Freeze general wages (including bonuses) to the civil service.

- Prohibit the increase in the number of civil servants except in the health, education, and security sectors, areas in which the decree stipulates ceilings for the possible increases.

- Indicate that all government investment will be included in the budget, and subject to the review and approval of the National System of Public Investment (SNIP) and the prior certification of available financing by the ministry of finance. The ministry of finance through the commission of programming and budget execution will monitor the implementation of the government's investment program. This commission will put special emphasis on monitoring operations involving advance payments (*anticipos*) to suppliers by checking that the line ministry (or unit) issues an identification document (*comprobante único de registro—CUR)* prior to approval of the operation, and that the contract with the supplier is rescinded before the operation is reversed.

- Reiterate that all inter-ministerial transfers will have to be approved by the ministry of finance.

in community based projects in basic health, water and sanitation, and rehabilitation of existing post and centers. All these projects will be under a coordinating commission comprising, inter alia, representatives of the ministry of finance and the civil society.

basic health and education,[14] which are priority sectors in the new government's Poverty Reduction Strategy presented in the Consultative Group meeting held in Washington, D.C. during February 11–12, 2002.

19. On the financing side, net privatization proceeds and net foreign financing amounting to a combined 0.6 percentage point of GDP will result in a public sector net domestic financial requirement equivalent to about 1 percent of GDP in 2002. Over the medium term, the combined public sector deficit would be limited to ½–1 percent of GDP and the total public debt ratio would stabilize at about 30 percent of GDP in 2005.

B. Monetary Policy

20. Monetary policy in 2002 will be oriented to **keep inflation within the 4–6 percent range. Net international reserves would stay at US$2.1 billion at end 2002** (145 percent of short-term debt on a remaining maturity basis), consistent with a payment of US$180 million of short-term public sector debt with proceeds from the Eurobonds floated in 2001. On the basis of the programmed fiscal deficit, and an increase in currency issue in line with nominal GDP growth, the net domestic assets of the central bank—the intermediate target of the monetary program—are projected to increase by about 25 percent of currency issue at the beginning of 2002. The above projections suggest that some room exists for net redemption of open market paper for the year as a whole. However, the central bank would need to sell certificates in the open market during the first half of the year,[15] when fiscal adjustment takes hold and the demand for money is seasonally low; in this regard, the authorities indicated their readiness to allow increases in interest rates as needed. On the basis of fiscal performance and the recovery of money demand in the second half of the year, consideration could be given for an easing of monetary policy. The authorities will monitor monetary developments closely, particularly in view of the uncertainty as regards the behavior of money demand resulting from the planned restructuring of the banking system (see below).

21. Management of monetary policy will be facilitated by **the central bank's decision to continue limiting its credit to banks with** liquidity problems. A central bank regulation of February 2001 limits its lender-of-last resort facilities to collateralized short-term liquidity assistance at punitive interest rates. The new banking law also brings the offshore institutions under full regulation and supervision of the superintendency of banks (SB) (see below). In this regard, it would be desirable for the authorities to press ahead with plans to tighten

---

[14] Expenditure in health would increase by about 15 percent, and in education by about 10 percent in part financed with resources from the world bank.

[15] To be more than offset by the central bank buying certificates in the open market in the second half of the year.

further prudential regulations limiting banks' unhedged exposure to exchange risk in line with the recommendations of the Basel Committee.

C. External Policies

22. In 2002 the **external current account deficit is projected to remain** unchanged at about 4½ percent of GDP despite a further, albeit small, terms of trade deterioration (Table 10). Export growth would pick up somewhat in line with the expected recovery in the U.S. economy and import growth would continue to be restrained, but tourism revenue and workers' remittances would fall (in terms of GDP). The capital account surplus is projected to narrow to 3½ percent of GDP reflecting the envisaged payment of short-term official debt noted above and reduced proceeds from privatization.

23. Despite the real appreciation of the quetzal since 1995, **external competitiveness does not appear to be a problem** as evidenced by the strong performance of nontraditional exports over the past 10 years. Following a slight fall in 2001 because of the slowdown of the U.S. economy, nontraditional exports are projected to recover beginning in late 2002 and 2003. Nonetheless, the staff urged the authorities to monitor the evolution of external competitiveness closely in view of the still high external current account deficit and continued deterioration of terms of trade.[16]

24. The authorities stressed their commitment to permitting **the exchange rate to reflect market conditions** with the central bank continuing to refrain from intervening in the FOREX market except for smoothing operations. Tight fiscal, monetary and wage policies will back this exchange rate system. In this regard, the decision of the authorities to freeze civil service wages in 2002 would encourage wage moderation in the private sector and support competitiveness. Guatemala has a relatively open trade regime with a restrictiveness index rating of 4 on the Fund's scale. Guatemala's obligations under the Central American Common Market have already been fulfilled in 1999 when the maximum import tariff was reduced to 15 percent. Efforts for further trade liberalization would focus on bilateral and regional trade arrangements consistent with WTO guidelines.

25. **The public sector external debt ratio in Guatemala is the lowest in Central America** (Table 11). As Guatemala will continue to pay short-term debt falling due during the early months of 2002, short-term debt is projected to be negligible by end-2002. In all, the external debt is projected to fall to 15½ percent of GDP by end-2002, and the debt service would decline to 13½ percent of exports of goods and nonfactor services.

---

[16] Using data reported by the social security institute (covers about one-third of the labor force) the unit labor cost in Guatemala has risen some 12 percent since 1995 (well above the increase in El Salvador and Mexico). However, these figures should be interpreted with caution because of limited reliability of labor market data.

D. Structural Measures

26. The authorities, aware of the fragility of the financial sector, have been taking actions to address weaknesses and risks identified in the FSSA report (Box 2). In January 2002 congress approved a new banking law improving **the prudential regulatory framework, and setting up a new framework for the resolution of insolvent banks**, and including offshore activities and onshore activities not previously supervised by the superintendency of banks. The new legislation provides the authority for the transfer of assets of nonviable banks to other banks with the judicial intervention limited to the liquidation of only the nonperforming assets (Box 3). It also creates a Trust Fund, which will be the only provider of credit deemed necessary to support the restructuring and resolution of banks. Moreover, the authorities are undertaking a comprehensive examination of banks (a structural benchmark under the program) to assess the need for additional actions to strengthen their balance sheets, including through merger and acquisitions. Regarding the inclusion of offshore institutions and onshore activities, not previously supervised, the authorities said that such a process would take 3–6 months as the superintendency of banks had strengthened its human and computer resources and had begun data collection.

27. The authorities have prepared new laws for the central bank, and banking supervision, and a new monetary law with assistance from the World Bank, the IDB, and the Fund (Appendix VI). However, approval of these laws has been resisted by opposition parties because of political considerations and it may require additional time to obtain the two-thirds majority needed for passage in congress.[17] The authorities are working with congress to secure passage of these three laws by August 15, 2002, before completion of the review under the program.

28. To improve **governance and public accountability**, the government has submitted to congress draft laws strengthening the existing laws on probity, and on the office of the comptroller general, which are crucial to reduce corruption and further improve the institutional and the legal system. Moreover, the authorities will present to congress before end-April 2002 a draft law to govern purchases and procurement of the central administration so as to introduce greater transparency and efficiency in such areas. In addition, building on progress made in the budget formulation and execution through the Integrated Financial Management System (IFMS), the authorities plan to extend the IFMS to other public

[17] Passage of the new banking law required simple majority only as is the case for the approval of the Banking Supervision Law. However, the strength of the latter would be substantially diluted if it is not accompanied by a reform of the Central Bank Law that grants autonomy to the superintendency of banks. Moreover, the authorities are of the view that presentation of the Banking Supervision Law and the reform of the Central Bank Law as a package would enhance the possibility of congress' approval of the reform of the central bank.

institutions outside the government. In this regard, the authorities already have extended the IFMS to the Social Investment Fund, and will extend it to the social security system by June 2002, and to other social funds and the largest municipalities by end-2002.

Box 2. Structural Conditionality

Coverage of structural conditionality in the current program

New law for the central bank defining clearly its objective of preserving price stability and reinforcing its autonomy. New law of banking supervision reinforcing the autonomy of supervisors, and a new monetary law providing an improved legal framework to facilitate exchange convertibility. In addition, the authorities would undertake a program of comprehensive on-site inspections of all banks to identify those that might need to increase their capital. All these measures are structural benchmarks to be implemented before completion of the review under the program, as they would help address weaknesses in the banking sector and reduce vulnerability. By improving confidence, these measures would also help set the stage for Guatemala to achieve sustainable growth to help deal with poverty.

Structural areas covered by the IDB and the world bank lending and conditionality

The IDB is extending an important Financial Sector Loan to help finance public sector expenditure; the conditionality of the loan includes approval of the three laws mentioned above and implementation of an economic program that could be supported by an arrangement from the Fund. In addition, to improve transparency and reduce corruption, the IDB will assist Guatemala to implement a new procurement law.

The World Bank will assist the authorities to extend the budget control system (IFMS) to other public sector entities outside of the government including the social funds and the largest municipalities by end-2002. In addition the World Bank has helped the authorities in drafting laws strengthening probity and the role of the office of the comptroller general. Moreover, the World Bank would provide assistance under a financial sector law to help establish a trust fund to finance the restructuring of the banking system and the starting of the deposit insurance scheme.

Other relevant structural conditions not included in the current program

The reform of the social security system, which currently registers a surplus, might begin to register cash deficits by 2010–15. The authorities plan to begin the studies needed to move from the existing pay-as-you-go system to a privately funded system in 2003. In addition, the capitalization of the central bank is expected to begin in 2003 after approval of the new central bank law and implementation of related regulations.

Box 3. Banking Law

- Includes offshore institutions and onshore activities not previously supervised (e.g., credit cards) under full regulation and supervision by the superintendency of banks (SB). It "levels the playing field" for the regulation of all financial institutions.

- Defines what constitutes a financial conglomerate and ensures that all parts of the conglomerate are regulated, with loans to partner companies being fully guaranteed.

- Grants the SB the authority to change capital requirements and to enforce prompt correction when deficiencies are observed in banks, in particular on capital adequacy, liquidity, internal controls, and risk management. In addition, it also gives the SB authority to impose penalties on banks, directors and management; including removal of the latter, and to presume the existence of related parties.

- Reforms the regime for banking resolution limiting the judicial liquidation to NPLs of insolvent banks and makes operative a deposit insurance scheme.

- Removes bank secrecy on lending operations.

The new banking law allows for the assumption by a solvent bank of performing assets and deposits of an insolvent bank. If as a result of this operation the solvent bank needs additional capital to meet the regulatory capital standards, it will receive a subordinate credit from a special Trust Fund (see below), which counts as tier-two capital. Hence, courts' participation is limited to liquidate nonperforming assets of insolvent banks only.

The Trust Fund is funded by the government (including with resources from external financing) and administered by the central bank. The fund will be used to extend credits to: (i) help solvent banks participating in resolution transactions, as noted above; (ii) support mergers and acquisitions, particularly to convert liquidity short-term with the central bank into longer-term debt; and (iii) support restructuring of banks (not undergoing a merger or acquisition) but that need to strengthen their capital under a plan approved by the SB.

29. In the **area of privatization**, Guatemala has divested almost all the government's participation in the largest enterprises. The authorities would sell Guatemala's remaining shares in the power company (EEGSA) (about 14 percent of the total), energy distribution companies (DEEGSA and DEOGSA), and the national airline.

E. Medium-Term Outlook

30. The medium-term scenario assumes that the financial and structural policies described above are followed by additional tax measures to achieve a tax ratio of 12 percent of GDP by 2004 and about 13 percent of GDP by 2006, with the combined public sector deficit narrowing to a range of ½–1 percent of GDP in the period (see Table 9). On the assumption

that the external environment faced by Guatemala improves in line with the WEO projections, real GDP growth could rise from 2¼ percent in 2002 to a projected 5½ percent by 2006, as noted above, with inflation declining to the level of trading partners. To this effect, gross domestic investment would be expected to increase from 16¼ percent of GDP in 2002 to 18¼ percent of GDP in 2006, reflecting higher public investment in social and basic infrastructure and an increase in private sector investment; such an increase would be based on a reduction in domestic interest rates induced by a reduction in the stock of open market certificates during the period.[18] The external current account deficit would narrow as a result of an improvement in productive capacity and external competitiveness. External financing on concessional terms or from multilateral agencies, together with private sector inflows, would more than cover such deficits. The net international reserve position would remain at 4¼ months of imports of goods and services and would increase steadily to over 165 percent of external short-term debt on a remaining maturity basis.

IV. Performance Criteria, Access, and Reviews

31. **The program will be monitored through quarterly performance criteria** on: (i) net international reserves (NIR); (ii) net domestic assets of the monetary authority (NDA); (iii) deficit of the combined public sector; (iv) expenditure of the central government; and (v) contracting or guaranteeing of new nonconcessional external debt. The arrangement would also include indicative targets on central government social expenditures and a continuous performance criterion on the non-accumulation of external arrears (Appendix VII).

32. As indicated in the technical memorandum of understanding (TMU) (Annex II), the program includes **adjustors** on the NIR, NDA of the monetary authority, and deficit of the combined public sector in the case of shortfalls or excesses in the disbursements of external financing, and in the case of disbursements and uses of external credit to finance the government-funded trust to support the restructuring of the financial system. The program also includes an adjustor to the external debt ceiling in the event that long-term bonds were issued to amortize short-term debt. The program contains **structural benchmarks**: approval by congress of the new laws of the central bank and banking supervision and the monetary law and completion of on-site inspections of banks and adopting measures necessary to deal with banks that resulted to be insolvent. Both benchmarks should be implemented before completion of the review under the program (see below). The authorities have implemented

[18] The scenario assumes an increase in the domestic public sector debt (including open market certificates) from 6½ percent of GDP in 2002 to 13¼ percent of GDP in 2006; however, these figures include domestic bonds by the equivalent of 6 percent of GDP in 2003 issued to recapitalize the central bank and domestic bonds by the equivalent of 6 percent of GDP in 2005 to reform the social security system.

the following **prior actions** before Board consideration of the request for the SBA approval of the 2002 budget consistent with the program, issuance of the Presidential Decree (Acuerdo Gubernativo) strengthening expenditure control, implementation of a critical mass of fiscal measures, and the capitalization of the Banco del Ejército (Annex I).

33. There would be **four purchases under the arrangement**, the first upon approval and the remaining to be divided into three equal purchases on the basis of performance at end-June, end-September, and end-December 2002 (Appendix V). It is expected that **the authorities treat the arrangement as precautionary**. **One review** would be contemplated under the arrangement on performance through end-June 2002 and should be completed by August 15, 2002.

34. On the financing side, the program assumes external disbursements equivalent to US$400 million, out of which US$190 million would be granted by the IDB, US$130 million by the World Bank, US$40 million by the Central American Bank of Integration (CABEI), and the rest by bilateral institutions. Of the IDB financing, US$120 million are related to a financial sector loan and would be disbursed in two tranches: the first at the Board approval of the SBA and the second after approval by congress of the three pending financial sector laws; the rest—already approved by the IDB Board—are related to projects on road construction, social investment, and housing. Of the World Bank financing, US$100 million are related to a Financial Sector Adjustment Loan,[19] would be disbursed in two tranches after approval by congress of the three pending financial sector laws; the rest—already approved by the World Bank Board—are related to projects on rural roads, land reform, and education. Financing from CABEI is related to projects on road construction and development of the northern area, and has been already approved by the Bank's Board. Financing from bilateral creditors was firmed up during the CG meeting held in Washington during mid-February 2002 (Table 12).

35. The level of access is justified in view of uncertainties regarding the terms of trade, the global economic environment, and the situation of the domestic banking system. While satisfactory financing assurances from the World Bank, the IDB, and donors exist, the current turmoil in the international capital market could jeopardize other envisaged external financing. Eventual financing gaps would be fully covered by exceptional financing from the Fund, the World Bank, and other IFIs and donors. Guatemala does not have outstanding Fund credit and its medium-term external position can be judged to be viable under the assumption of full compliance with the proposed program.

[19] Both the World Bank loan and its corresponding use to help restructuring the banking system are recorded below the line. Only the interest payment associated with the loan is projected above the line.

V. STAFF APPRAISAL

36. The authorities have sought to advance an ambitious agenda of social and economic reforms to address the country's social problems, and place the economy on a sustainable higher growth path. To this end, they have framed an economic program for 2002 aimed at strengthening the public finances and addressing the weaknesses of the financial system. In support of these objectives, the government has requested a Stand-By Arrangement from the Fund, which they intend to treat as purely precautionary.

37. **The fiscal position is targeted to improve substantially in 2002**, based on important revenue measures—including the increase in the VAT rate—as well as tight expenditure controls. The authorities' commitment to improve tax administration also is important for the achievement of the fiscal objectives and the authorities should vigorously implement the recently approved amendments to the tax and fiscal codes, which provide for closure of establishments and mandatory prison for tax evaders. The staff notes the authorities' readiness to take additional measures in case of slippages in tax collections, and encourages them to monitor closely developments in revenue to facilitate actions that may be needed on a timely basis. Looking beyond 2002, the staff would urge the authorities to work to **bring the tax ratio up to 12 percent of GDP** as soon as feasible as has been called under the Peace Accords. Delays in reaching this objective would increase the risks of fiscal underperformance or attainment of social objectives, and thus undermine donors' support for the Peace Accords.

38. **The strengthening of expenditure policies** also is a key element of the fiscal program. The recently approved presidential decree setting mechanisms of expenditure control is welcomed and its full implementation is a matter of high priority, containment of the wage bill, and of nonessential expenditure should be pursued with determination. At the same time, the staff encourages the authorities to put in place the infrastructure needed to improve resource allocation and protect social expenditure in line with the new government's Poverty Reduction Strategy presented to the Consultative Group meeting in February 2002.

39. The authorities would need to **maintain a tight stance of monetary policy** consistent with the objectives of reducing inflation to the 4–6 percent range and maintaining net international reserves at a comfortable level. Close monitoring of monetary developments will be needed, particularly in view of the possible increased volatility in the demand for money that might result if other insolvent banks are liquidated, and the authorities must be ready to raise interest as needed to ensure achievement of the program's objectives. Any easing of monetary policy should await a sufficient strengthening of the fiscal position and improvement in the performance of the banking system. At the same time, the **exchange rate should continue to reflect market conditions**, with the central bank refraining from intervening in the foreign exchange market except for smoothing fluctuations.

40. The staff welcomes the authorities' actions to **address risks and weaknesses of the financial system** identified in the 2001 FSSA report. Insolvent banks are under liquidation, sale, or being capitalized and the authorities are urged to act promptly and with determination in any bank insolvency in the future. The recently approved banking law contains important steps in the areas of prudential regulation of offshore activities, consolidated supervision of financial groups, and rapid liquidation of insolvent banks. The authorities are encouraged to strengthen their efforts to secure a prompt approval of the new laws of the central bank, banking supervision, and monetary law to enhance the credibility and transparency of monetary policy by strengthening the central bank independence and defining its role centered on price stability. The authorities should continue auditing all financial institutions according to the working plan prepared by the superintendency of banks, which will provide the basis for the adoption of measures to strengthen bank balance sheets, including through capitalization, mergers, and acquisitions. Approval of the **anti-money laundering law** is welcomed and its implementation is crucial to help Guatemala to be removed from the list of "noncooperative" jurisdictions elaborated by the OECD–backed Financial Action Task Force.

41. The authorities should be commended for the recent steps to **improve governance and transparency**. To build on this, the government should make every effort to seek early passage of the new laws on probity, on the role of the comptroller general, and on government procurement and purchases. In addition, extension of the budget control system (IFMS) to other public sector entities outside of the government, including the social funds and the largest municipalities, will be key to improve transparency.

42. The **timeliness and quality of economic data** need to be improved without delay to facilitate follow up of the economic program. In particular, the authorities are encouraged to reduce delays and correct deficiencies in the provision of information on the public sector outside of the government and on the commercial banking system with the help of technical assistance from international organizations, including the Fund while improving accountability and transparency of government operations. An important step in this direction would be to implement the recommendations of the FAD technical assistance mission on public expenditure management, especially on the budget execution process.

43. **The authorities' policies are appropriate for achieving the goals that have been set**. However, important risks—such as a possible further weakening of economic activity with adverse effects on tax receipts or political pressures to increase public expenditure—exist. In part such risks have been mitigated by the authorities' commitment to the economic program as demonstrated by increasing the VAT rate and other taxes, introducing an austere 2002 budget, and issuing a presidential decree to control expenditure in line with such a budget, and acting decisively to deal with insolvent banks. Developments up to end-2001 also augurs well for the success of the program. Accordingly, approval of Guatemala's request for a Stand-By Arrangement from the Fund is recommended.

Table 1. Guatemala: Comparative Social Indicators

	Guatemala	Nicaragua	Honduras	El Salvador	Costa Rica	Average for Latin America and the Caribbean
Rank in UNDP Human Development Index (Out of 174 countries) (2000)	120	116	113	104	48	...
GDP per capita in U.S. dollars (2000)	1,680	470	990	2,150	4,100	3,820
People not expected to survive to age 40 (In percent of population) (1998)	15.3	12.2	11.3	10.7	3.9	9.7
Life expectancy at birth (years) (1998)	64.4	68.1	69.6	69.4	76.2	69.7
Infant mortality (per 1000 live births) (1998)	41.0	39.0	33.0	30.0	14.0	32.0
Population without access to safe water (1990-98)	32.0	22.0	22.0	34.0	4.0	22.0
Population without access to health services (1981-93)	40.0	n.a.	38.0	n.a.	3.0	n.a.
Population without access to sanitation (1990-98)	13.0	15.0	26.0	10.0	16.0	29.0
Adult illiteracy (1998)	32.7	32.1	26.6	22.2	4.7	12.3
Primary school net enrollment (1997) (percent of relevant age of the population)	73.8	78.6	87.5	89.1	91.8	93.3
Secondary school net enrollment (1997) (percent of relevant age of the population)	34.9	50.5	36.0	36.4	55.8	65.3
Ratio of the per capita income of the richest 20 percent to the per capita income of the poorest 20 percent of the population (1987-98)	30.0	13.1	17.1	16.6	13.0	n.a.
Percentage of population below the poverty line (1989-98)	58.0	n.a	53.0	38.0	11.0	n.a.

Source: UNDP Human Development Report 2000.

Table 2. Guatemala: Macroeconomic Flows

	Average 1991-96	1997	1998	1999	2000	Prel. 2001	Proj. 2002
(Annual percent change, unless otherwise indicated)							
Income and prices							
Real GDP	3.9	4.4	5.0	3.8	3.6	1.8	2.3
GDP deflator	16.6	8.3	9.5	5.0	5.7	7.6	5.7
Consumer prices (end of the year)	17.2	7.1	7.5	4.9	5.1	8.7	5.0
Consumer prices (average)	17.8	9.2	6.6	5.2	6.0	7.3	6.5
Monetary sector							
Credit to private sector 1/	21.2	13.5	19.4	11.4	8.2	17.5	6.2
Liabilities to private sector	21.6	15.5	13.3	9.8	23.3	15.8	7.9
Interest rate (annual rate, time deposits) 2/	15.1	9.6	10.8	17.9	15.3	15.0	...
External sector							
Export volume	8.8	12.9	7.8	8.3	15.1	6.7	2.5
Import volume	10.3	31.9	25.0	-0.8	10.8	3.2	-1.0
Terms of trade	0.2	11.1	5.2	-8.7	-0.4	...	...
Real effective exchange rate 3/	....	8.1	-4.5	-6.0	6.2	4.1	...
(In percent of GDP, unless otherwise indicated)							
Current account	**-4.7**	**-3.5**	**-5.3**	**-5.5**	**-5.5**	**-4.6**	**-4.5**
Trade balance	-8.3	-7.0	-9.3	-9.7	-11.0	-10.3	-9.4
Exports	13.9	14.6	14.7	15.2	16.2	14.5	14.7
Imports	22.2	21.7	24.0	25.0	25.7	24.8	24.1
Factor payments (net)	-1.2	-1.6	-0.9	-1.0	-1.3	-0.9	-1.3
Current transfers (net)	3.2	3.4	3.6	3.9	4.6	4.7	4.6
Other	1.5	1.4	1.2	1.3	2.2	1.9	1.6
Capital account	**5.0**	**5.2**	**6.4**	**4.9**	**9.3**	**7.0**	**3.5**
Public sector	0.3	1.4	1.2	1.6	0.6	1.2	0.0
Private sector	4.3	3.3	4.9	2.9	8.2	5.4	3.1
Official transfers	0.4	0.5	0.4	0.4	0.5	0.4	0.4
Net official reserves (in U.S. dollars) (increase -) 4/	**-137**	**-287**	**-243**	**126**	**-728**	**-500**	**210**
Gross domestic investment	**15.6**	**14.0**	**17.4**	**17.4**	**17.0**	**15.4**	**16.2**
Public sector	2.8	4.1	5.0	5.5	4.1	4.2	4.0
Private sector	12.8	9.9	12.4	11.9	12.9	11.2	12.2
Gross domestic saving	**10.8**	**10.5**	**12.1**	**11.9**	**11.5**	**10.8**	**11.7**
Public sector	1.9	3.3	3.1	2.3	1.9	1.0	2.4
Private sector	8.9	7.2	9.0	9.6	9.6	9.8	9.3
External saving	**4.8**	**3.5**	**5.3**	**5.5**	**5.5**	**4.6**	**4.5**
Combined public sector balance							
(including central bank losses)	**-1.7**	**-0.6**	**-1.8**	**-3.0**	**-2.0**	**-3.0**	**-1.5**
Overall balance of the nonfinancial public sector (deficit -)	-0.6	0.2	-1.5	-2.7	-1.7	-2.2	-0.9
Financing	**1.7**	**0.6**	**1.8**	**3.0**	**2.0**	**3.0**	**1.5**
External financing	0.8	1,9	1.5	1.7	0.8	1.1	0.3
Domestic financing	0.9	-1.3	-2.7	0.7	0.5	0.1	0.9
Privatization proceeds	0.0	0.0	3.0	0.6	0.7	1.8	0.3
Memorandum items:							
Nominal GDP (in billions of quetzales)	...	107,873	124,023	135,287	148,115	162,241	175,460
Nominal GDP (in millions of U.S. dollars)	...	17,790	19,395	18,319	19,079	20,630	20,911

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

1/ In relation to the stock of liabilities to the private sector.

2/ End-period.

3/ End-period; a positive change indicates an appreciation. In 2001 refers to the 12-month change through end-October.

4/ The change in net international reserves in 2001 includes US$180 million of a temporary deposit of the government at the central bank, which is part of proceeds from a Eurobond floated at end 2001 earmarked to pay short-term debt. Consequently, in 2002 the change in net international reserves includes the use of these US$180 million. Net of this temporary deposit, the net international reserves would increase by US$190 million in 2001 and would decrease by US$30 million in 2002.

Table 3. Guatemala: Operations of the Combined Public Sector

(In percent of GDP)

	1997	1998	1999	2000	Prel. 2001	Proj. 2002
I. Central Government Operations						
Total revenue	**9.4**	**9.7**	**10.5**	**10.5**	**11.0**	**11.6**
Tax revenue	8.8	8.7	9.3	9.5	9.7	10.7
Direct taxes	2.2	1.9	2.1	2.5	2.5	2.7
Indirect taxes	6.7	6.8	7.2	7.0	7.2	8.0
Nontax revenue and transfers	0.6	0.9	1.1	0.9	1.3	0.9
Total expenditures	**10.1**	**11.9**	**13.3**	**12.4**	**13.8**	**12.8**
Current expenditures	6.2	7.3	8.1	8.6	9.6	8.7
Wages and salaries	2.7	3.0	3.2	3.5	3.6	3.5
Goods and services	0.9	1.1	1.1	1.3	1.6	1.2
Interest	0.8	1.1	1.3	1.2	1.4	1.5
Transfers	1.8	2.1	2.4	2.6	3.0	2.4
Capital expenditure	3.9	4.6	5.2	3.7	4.2	4.1
Of which						
Fixed capital formation	1.7	1.7	1.8	1.5	1.4	1.5
Net lending 2/	0.0	0.0	0.0	0.0	0.0	0.5
Current account balance (deficit -)	**3.0**	**2.2**	**2.2**	**1.6**	**1.2**	**2.7**
Overall balance (deficit -) 1/	**-0.4**	**-2.2**	**-3.3**	**-2.2**	**-2.8**	**-1.3**
Financing	**0.4**	**2.2**	**3.3**	**2.2**	**2.8**	**1.3**
External (net)	2.0	1.5	2.4	0.9	1.1	0.4
Domestic (net) 2/	-1.6	-2.4	0.3	0.5	-0.1	0.6
Sale of assets	0.0	3.1	0.6	0.7	1.8	0.3
II. Combined Public Sector Operations						
Combined public sector balance	**-0.6**	**-1.8**	**-3.0**	**-2.0**	**-3.0**	**-1.5**
Current account	3.3	3.1	2.3	1.9	1.0	2.4
Nonfinancial public sector	0.3	-1.5	-2.8	-1.9	-2.2	-0.8
Central government	-0.3	-2.2	-3.3	-2.2	-2.8	-1.3
Rest of the nonfinancial public sector	0.6	0.7	0.5	0.6	0.6	0.5
Bank of Guatemala losses	-0.8	-0.3	-0.3	-0.4	-0.8	-0.6
Combined public sector financing	**0.6**	**1.8**	**3.0**	**2.0**	**3.0**	**1.5**
External (net)	1.9	1.5	1.7	0.8	1.1	0.3
Foreign loans (net)	0.5	1.2	0.8	0.4	0.1	0.8
Bonded debt	1.4	0.3	0.9	0.4	0.9	-0.4
Domestic (net)	-1.3	-2.8	0.7	0.5	0.1	0.9
Banking system	-0.9	-2.7	1.7	1.0	0.1	0.9
Bank of Guatemala 3/	-1.5	-2.5	1.9	1.2	-0.7	1.0
Commercial banks 2/	1.0	-0.3	-0.2	-0.2	0.8	-0.1
Bonded debt	-0.4	-0.1	-1.0	-0.5	0.0	0.0
Change in floating debt	-0.3	0.0	0.0	0.0	0.0	0.0
Sale of assets	0.0	3.1	0.6	0.7	1.8	0.3
Memorandum item:						
GDP (in millions of quetzales)	107,873	124,023	135,287	148,115	162,241	175,460

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

1/ Includes statistical discrepancy between results from "above the line" and "below the line".

2/ In 2001 and 2002 includes a trust fund equivalent to 0.2 and 0.3 percent of GDP respectively, which is not included in the accounts of the banking system of table 5. In 2002, includes the use of the trust fund to finance net lending to the coffee producers.

3/ Includes change in net liabilities with the nonfinancial public sector and central bank losses.

Table 4. Guatemala: Summary Accounts of the Monetary Authorities

	1997	1998	1999	2000	Prel. 2001	Proj. 2002
Accounting exchange rate (quetzales/U.S. dollars)	6.0	6.0	8.0	8.0	8.0	8.0
(Stocks in millions of quetzales)						
Net official reserves 1/	**5,741**	**7,197**	**8,591**	**14,413**	**18,409**	**16,729**
(in millions of U.S. dollars)	957	1,200	1,074	1,802	2,301	2,091
Net domestic assets	**-265**	**-890**	**-163**	**-6,199**	**-8,933**	**-6,528**
Net claims on nonfinancial public sector	-5,836	-8,083	-7,354	-6,573	-10,065	-9,463
Central government	-2,692	-5,979	-5,004	-3,625	-6,328	-4,969
Rest of nonfinancial public sector 2/	-3,144	-2,104	-2,351	-2,948	-3,737	-4,494
Bank of Guatemala losses	8,437	8,846	9,205	9,743	11,003	12,088
Net credit to banks	-5,538	-4,379	-2,684	-4,211	-3,752	-4,205
Of which						
Reserves 3/	-5,620	-4,611	-3,336	-5,004	-5,986	-6,439
Open market operations 4/	-242	-391	-485	-6,090	-7,542	-6,462
Medium- and long-term foreign liabilities	-976	-794	-852	-731	-635	-544
Other assets (net)	3,890	3,911	2,008	1,663	2,058	2,058
Currency issue	**5,476**	**6,307**	**8,429**	**8,214**	**9,476**	**10,201**
(Flows in millions of quetzales)						
Net official reserves 1/	**1,721**	**1,456**	**1,394**	**5,822**	**3,996**	**-1,680**
(in millions of U.S. dollars)	287	243	-126	728	500	-210
Net domestic assets	**-1,065**	**-625**	**727**	**-6,036**	**-2,734**	**2,405**
Net claims on nonfinancial public sector	-2,736	-2,247	729	782	-3,492	602
Bank of Guatemala losses	832	409	359	538	1,261	1,085
Net credit to banks	-1,244	1,159	1,695	-1,527	459	-453
Of which						
Reserves 3/	-1,228	1,009	1,275	-1,668	-982	-453
Open market operations 4/	2,150	-149	-93	-5,605	-1,452	1,080
Medium- and long-term foreign liabilities	257	182	-59	121	96	91
Other assets (net)	-324	21	-1,903	-345	394	0
Currency issue	**656**	**831**	**2,122**	**-214**	**1,262**	**725**
(12-month percent change over the stock of currency issued at the beginning of the period)						
Net domestic assets	**-22.1**	**-11.4**	**11.5**	**-71.6**	**-33.3**	**25.4**
Net claims on nonfinancial public sector	-56.8	-41.0	11.6	9.3	-42.5	6.4
Bank of Guatemala losses	17.3	7.5	5.7	6.4	15.3	11.5
Currency issue	**13.6**	**15.2**	**33.6**	**-2.5**	**15.4**	**7.7**
Memorandum item:						
Outstanding stock of central bank's paper	**3,010.5**	**2,269**	**2,652**	**8,613**	**11,028**	**10,634**

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

1/ Excludes claims on Nicaragua amounting to US$145.7 million up to 1999 and US$75.7 million in 2000, which are included in official data. The stock of NIR in December 2001 includes US$180 million corresponding to part of the proceeds from a Eurobond issue that will be deposited at the central bank.

2/ Includes open market placements with the nonfinancial public sector.

3/ Includes cash deposits, and remunerated reserves.

4/ Includes open market placements with both the financial and nonfinancial private sector.

Table 5: Quarterly Accounts of the Monetary Authorities

	2000	2001				2002			
	Q4	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4
Accounting exchange rate (Quetzales/U.S. dollars)	8.0	8.0	8.0	8.0	8.0	8.0	8.0	8.0	8.0
	(Stocks in millions of quetzales)								
Net official reserves 1/	**14,412.8**	**14,525.6**	**14,528.0**	**14,414.4**	**18,408.8**	**17,648.8**	**18,808.8**	**17,768.8**	**16,728.8**
(In millions of U.S. dollars)	1,801.6	1,815.7	1,816.0	1,801.8	2,301.1	2,206.1	2,351.1	2,221.1	2,091.1
Net domestic assets	**-6,198.6**	**-6,725.3**	**-6,740.4**	**-6,520.6**	**-8,932.9**	**-8,497.5**	**-10,081.0**	**-9,183.4**	**-6,527.7**
Net claims on nonfinancial public sector	-6,571.5	-7,878.3	-7,514.3	-7,847.9	-10,064.9	-9,033.4	-10,969.4	-10,281.1	-9,462.9
Bank of Guatemala losses	9,742.5	9,918.6	10,400.5	10,782.5	11,003.3	11,312.0	11,790.0	12,077.0	12,088.1
Net credit to banks	-4,210.5	-2,715.6	-2,375.9	-2,740.3	-3,751.5	-3,859.5	-4,034.5	-4,102.8	-4,204.8
Open market operations (private sector)	-6,090.0	-6,634.3	-7,846.5	-7,211.6	-7,542.1	-8,325.1	-8,277.5	-8,262.9	-6,461.8
Medium- and long- term foreign assets	-731.2	-716.8	-677.6	-671.2	-635.0	-616.2	-581.2	-572.2	-543.6
Other assets (net)	1,662.1	1,301.1	1,273.4	1,167.9	2,057.3	2,024.7	1,991.6	1,958.6	2,057.3
Currency issue	**8,214.2**	**7,800.3**	**7,787.6**	**7,893.8**	**9,475.9**	**9,151.3**	**8,727.8**	**8,585.4**	**10,201.1**
	(Flows in millions of quetzales)								
Net official reserves	**-37.6**	**112.8**	**2.4**	**-113.6**	**3,994.4**	**-760.0**	**1,160.0**	**-1,040.0**	**-1,040.0**
(In millions of U.S. dollars)	-4.7	14.1	0.3	-14.2	499.3	-95.0	145.0	-130.0	-130.0
Net domestic assets	**1,276.8**	**-526.7**	**-15.1**	**219.8**	**-2,412.3**	**435.4**	**-1,583.5**	**897.6**	**2,655.7**
Net claims on nonfinancial public sector	634.5	-1,306.8	364.0	-333.6	-2,217.0	1,031.5	-1,936.0	688.3	818.2
Bank of Guatemala losses	27.9	176.1	481.9	382.0	220.8	308.7	478.0	287.0	11.1
Net credit to banks	-633.5	1,494.9	339.7	-364.4	-1,011.2	-108.0	-175.0	-68.3	-102.0
Open market operations (private sector)	768.5	-544.3	-1,212.2	634.9	-330.5	-783.0	47.6	14.6	1,801.1
Medium- and long- term foreign assets	-83.2	14.4	39.2	6.4	36.2	18.8	35.0	9.0	28.6
Other assets (net)	562.6	-361.0	-27.8	-105.5	889.4	-32.6	-33.1	-33.0	98.7
Currency issue	**1,239.2**	**-413.9**	**-12.7**	**106.2**	**1,582.1**	**-324.6**	**-423.5**	**-142.4**	**1,615.7**

Sources: Bank of Guatemala, and Fund staff estimates.

1/ In 2000, excludes claims on Nicaragua amounting to US$75.7 million in 2000, which are included in official data. These claims were canceled in 2002 as part of a trilateral agreement with Spain and Nicaragua. In December 2001 includes US$180 million corresponding to part of the proceeds from a Eurobond issue earmarked to amortize short-term debt that will be deposited at the central bank.

29

Table 6. Guatemala: Summary Accounts of the Banking System

	1997	1998	1999	2000	Prel. 2001	Proj. 2002
Accounting exchange rate (quetzales/U.S. dollars)	6.0	6.0	8.0	8.0	8.0	8.0
	(Stocks in millions of quetzales)					
Net foreign assets	**3,567**	**4,407**	**5,168**	**10,113**	**14,580**	**12,900**
(in U.S. dollars) 1/	594	734	646	1,264	1,823	1,613
Net domestic assets	**26,922**	**29,786**	**32,430**	**35,881**	**38,300**	**44,011**
Net claims on nonfinancial public sector	-4,182	-7,436	-6,888	-6,885	-9,601	-8,753
Central government	-1,193	-5,028	-4,074	-2,692	-3,361	-1,756
Rest of nonfinancial public sector	-2,989	-2,407	-2,814	-4,193	-6,240	-6,997
Bank of Guatemala losses	8,437	8,846	9,205	9,743	11,003	12,088
Credit to private sector and other investment 2/	20,700	26,395	30,194	33,207	41,126	44,338
Other assets (net)	1,967	1,980	-81	-183	-4,229	-3,663
Medium- and long-term foreign liabilities	**1,120**	**903**	**1,061**	**944**	**722**	**624**
Liabilities to the private sector	**29,369**	**33,290**	**36,537**	**45,051**	**52,158**	**56,287**
Money	11,293	12,914	14,672	17,698	20,965	22,579
Quasi-money and other liabilities	18,076	20,376	21,865	27,353	31,194	33,708
	(Flows in millions of quetzales)					
Net foreign assets	**1,400**	**840**	**762**	**4,945**	**4,467**	**-1,680**
(in U.S. dollars) 1/	233	140	-88	618	558	-210
Net domestic assets	**2,306**	**2,864**	**2,644**	**3,452**	**2,419**	**5,711**
Net claims on nonfinancial public sector	-1,707	-3,254	548	3	-2,716	848
Bank of Guatemala losses	832	409	359	538	1,261	1,085
Credit to private sector and other investment 2/	3,432	5,695	3,799	3,013	7,920	3,212
Other assets (net)	-251	13	-2,061	-102	-4,046	566
Medium- and long-term foreign liabilities	**-241**	**-217**	**158**	**-117**	**-222**	**-98**
Liabilities to the private sector	**3,947**	**3,920**	**3,248**	**8,514**	**7,107**	**4,129**
Money	2,529	1,621	1,759	3,026	3,266	1,614
Quasi-money and other liabilities	1,418	2,300	1,489	5,488	3,841	2,514
	(12-month percent change over initial stock of liabilities to the private sector)					
Net domestic assets	**9.1**	**9.7**	**7.9**	**9.4**	**5.4**	**10.9**
Net claims on nonfinancial public sector	-6.7	-11.1	1.6	0.0	-6.0	1.6
Credit to private sector and other investment 2/	13.5	19.4	11.4	8.2	17.6	6.2
Liabilities to the private sector	**15.5**	**13.3**	**9.8**	**23.3**	**15.8**	**7.9**
Money	9.9	5.5	5.3	8.3	7.3	3.1
Quasi-money and other liabilities	5.6	7.8	4.5	15.0	8.5	4.8
	(12-month percent change)					
Memorandum item:						
Credit to private sector and other investment 2/	19.9	27.5	14.4	10.0	23.8	7.8

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

1/ Excludes claims on Nicaragua amounting to US$145.7 million up to 1999 and US$75.7 million in 2000, which are included in official data. The stock of NIR in December 2001 includes US$180 million corresponding to part of the proceeds from a Eurobond issue that will be deposited at the central bank.

2/ Includes credit to the private sector and nonbank financial intermediaries.

Table 7. Guatemala: Indicators of External Vulnerability

	1997	1998	1999	2000	2001
Financial indicators					
Broad money (12-month percentage change)	23.5	12.9	7.2	17.8	21.1
Private sector credit (12-month percentage change)	19.9	27.5	14.4	10.0	23.8
Central bank paper yield (nominal) 1/	9.2	11.8	23.2	17.9	9.5
Central bank paper yield (real)	2.0	4.0	17.4	12.2	0.5
Domestic public sector debt (in percent of GDP) 2/	3.1	2.5	2.4	5.8	6.2
External indicators					
Merchandise exports (12-month percentage change)	16.4	9.6	-2.3	10.8	...
Merchandise imports (12-month percentage change)	22.4	20.7	-2.0	13.4	...
Terms of trade (12-month percentage change)	11.0	6.1	-9.4	-0.4	...
Current account balance (in percent of GDP)	-3.5	-5.3	-5.5	-5.5	...
Capital account balance (in percent of GDP)	5.2	6.4	4.9	9.3	...
Net international reserves 3/					
In millions of U.S. dollars	957	1,200	1,074	1,802	2,301
In percent of M2	21.8	26.9	25.5	36.1	44.2
In percent of base money	56.2	80.2	75.4	113.2	131.2
In percent of base money and central bank certificates 4/	55.0	77.3	72.3	75.7	73.3
In percent of base money, central bank certificates, and government debt with nonresidents	49.4	65.5	59.4	65.9	59.0
In percent of short-term external debt on a remaining maturity basis 5/	78.0	78.3	73.7	121.0	175.4
In percent of short-term external debt on a remaining maturity basis plus current account deficit less FDI	51.3	48.2	43.1	72.6	...
In months of next-year's imports of goods and services	2.2	2.7	2.2	3.6	...
Commercial banks foreign assets (in millions of U.S. dollars)	72.3	66.7	71.9	105.5	190.8
Commercial banks foreign liabilities (in millions of U.S. dollars)	434.6	531.8	499.8	643.0	679.9
Public sector external debt (in percent of GDP) 6/	14.7	14.9	18.1	17.2	16.3
External interest payments in percent of exports of goods and services	4.4	4.0	3.8	5.0	5.1
External amortization payments in percent of exports of goods and services	12.1	10.4	9.8	14.5	16.3
Public sector and financial sector external debt (in percent of GDP)	17.9	17.7	20.7	20.9	19.5
Real effective exchange rate appreciation, 12-month period (-)	8.1	-4.5	-6.0	6.2	1.2

Sources: Bank of Guatemala; and Fund staff estimates.

1/Refer to open market operations weighted interest rates, except for 1997 and 1998 which refer to 180-day bond interest rates.
2/ Includes central government debt with residents and open market certificates of the Bank of Guatemala with the private sector.
3/ Excludes claims on Nicaragua amounting to US$145.7 million up to 1999, and US$72.5 million in 2000, which are included in official data.
4/ Open market certificates held by the private sector.
5/ End of period short-term debt on a remaining maturity basis as recorded by the BIS. In 2001, preliminary data.
6/ Includes central government, public enterprises, and Bank of Guatemala.

Table 8. Guatemala: Summary of the Structure and Performance of the Financial Sector 1/

	1997	1998	1999	2000	Prel. 2001 2/
Number of banks	35	34	34	32	29
Majority state-owned (in percent of total assets)	5.1	6.5	8.8	8.5	13.9
Majority foreign-owned (in percent of total assets)	0.1	0.3	0.5	0.6	6.7
Foreign branches (as a percent of total assets)	2.6	2.9	3.0	3.5	4.7
Number of banks accounting for at least					
25 percent of total assets	3	3	3	3	2
75 percent of total assets	15	15	14	14	10
Total assets of banks (in percent of nominal GDP)	29.1	29.1	29.0	33.9	33.3
Credit to private sector (in percent of nominal GDP)	19.1	21.3	22.4	21.8	17.8
Foreign currency-denominated assets (in percent of total assets)	9.2	10.3	10.3	11.2	13.3
Contingent and off-balance sheet accounts (in percent of total assets)	13.5	16.6	13.2	29.6	32.6
Of which					
Foreign currency denominated (in percent of total assets)	3.7	4.5	2.9	2.7	2.5
Central bank credit to banks (end of period)	0.1	0.2	0.6	0.5	0.4
Average pretax return on total assets (in percent)	1.3	1.0	1.4	1.1	1.4
Average financial spread 3/	10.5	10.8	9.3	9.1	11.3
Interest rate spread in interbank market (in percent)	8.0	7.7	6.8	6.3	5.2
Loans that are nonperforming, substandard, or of lower quality (in percent of total loans) 4/	7.2	8.5	12.7	12.8	14.6
Total provisions for loan losses (specific plus general)					
In percent of nonperforming loans 4/	22.8	23.7	28.0	27.8	23.6
In percent of total loans	1.6	2.0	3.6	3.6	2.3
Risk-weighted capital/asset ratio	13.3	12.4	14.0	14.2	14.7
Foreign currency debt rating 5/	Ba2	Ba2	Ba2	Ba2	Ba2

1/ The Guatemalan financial system consists of the central bank, 29 commercial banks, including two branches of foreign banks and one majority foreign-owned bank, and 44 nonbank financial intermediaries. In addition, there are credit unions, leasing, and factoring companies, and credit card companies.

2/ Data refers to November. Excludes three banks intervened in March 2001, but includes total nonperforming loans of these three banks.

3/ Spread between lending and deposit interest rates calculated from the income statement and the balance sheet data of commercial banks.

4/ Includes repossessed collateral.

5/ Moodys rated Guatemala for the first time in July 1997 for long-term currency bonds placed in the Euromarket.

Table 9. Guatemala: Medium-Term Projections

	1997	1998	1999	2000	Prel. 2001	Projection 1/ 2002	2003	2004	2005	2006
Real GDP growth	**4.4**	**5.0**	**3.8**	**3.6**	**1.8**	**2.3**	**3.5**	**4.8**	**5.5**	**5.5**
Real per-capita income growth 2/	**1.6**	**2.3**	**1.1**	**0.9**	**-0.9**	**-0.4**	**0.8**	**2.1**	**2.8**	**2.8**
Consumer prices (end-period)	**7.1**	**7.5**	**4.9**	**5.1**	**8.9**	**5.0**	**3.9**	**3.5**	**3.2**	**2.8**
ICOR	**3.2**	**3.5**	**4.5**	**4.7**	**8.4**	**7.0**	**4.8**	**3.7**	**3.2**	**3.3**
	(In percent of GDP)									
Savings and investment										
Gross domestic investment	14.0	17.4	17.4	17.0	15.2	16.2	16.9	17.8	17.8	18.2
Public	4.1	5.0	5.5	4.1	4.2	4.0	4.4	5.0	5.0	5.2
Of which										
Central government	3.9	4.6	5.2	3.7	3.9	3.7	4.1	4.7	4.7	4.9
Private	9.9	12.4	11.9	12.9	11.0	12.2	12.5	12.8	12.8	13.0
National savings	10.5	12.1	11.9	11.5	10.6	11.7	12.7	13.4	13.8	14.2
Public	3.3	3.1	2.3	1.9	1.0	2.4	3.3	4.0	4.0	4.3
Of which										
Central government	3.0	2.2	2.2	1.6	1.2	2.7	2.9	3.5	3.5	3.8
Private	7.2	9.0	9.6	9.6	9.6	9.3	9.4	9.4	9.8	9.9
Primary balance	**1.1**	**-0.4**	**-1.3**	**-0.3**	**-0.5**	**1.0**	**1.6**	**1.7**	**1.7**	**1.7**
Overall balance combined public sector	**-0.6**	**-1.8**	**-3.0**	**-2.0**	**-3.0**	**-1.5**	**-0.9**	**-0.8**	**-0.8**	**-0.8**
Financing	0.6	2.1	3.0	2.0	3.0	1.5	0.9	0.8	0.8	0.8
External (net)	1.9	1.5	2.3	0.8	0.9	0.3	1.0	0.9	0.9	0.9
Domestic (net)	-1.3	-2.7	0.1	0.5	0.3	0.9	-0.1	-0.1	-0.1	-0.1
Sale of assets	0.0	3.1	0.6	0.7	1.8	0.3	0.0	0.0	0.0	0.0
Central government										
Revenues	9.4	9.7	10.5	10.5	11.0	11.5	12.1	12.8	13.1	13.4
Of which										
Tax revenues	8.8	8.7	9.3	9.5	9.7	10.7	11.3	12.0	12.3	12.6
Expenditures	10.1	11.9	13.3	12.4	13.8	12.8	13.1	13.8	14.1	14.4
Of which										
Social and other peace related	4.3	5.8	5.3	5.0	5.5	5.2	5.6	6.4	6.4	6.7
Interest payments	0.8	1.1	1.3	1.2	1.4	1.5	1.5	1.5	2.1	2.0
External sector										
Current account	-3.5	-5.3	-5.5	-5.5	-4.6	-4.5	-4.2	-4.0	-4.0	-4.0
Of which										
Exports, f.o.b.	14.6	14.7	15.2	16.2	14.5	14.7	15.6	15.9	16.5	16.8
Imports, c.i.f.	-21.7	-24.0	-24.9	-27.1	-24.8	-24.1	-24.8	-25.8	-26.0	-26.3
Capital account	5.2	6.4	4.9	9.3	7.0	3.5	5.1	4.9	4.9	4.9
Official capital and transfers	1.9	1.6	2.0	1.1	1.6	0.4	1.4	1.2	1.2	1.2
Private sector	3.3	4.9	2.9	8.2	5.4	3.1	3.7	3.7	3.7	3.7
Net international reserves 3/	**2.2**	**2.7**	**2.2**	**3.6**	**4.6**	**4.0**	**4.1**	**4.1**	**4.1**	**4.1**
In percent of short-term external debt on a remaining maturity basis	78.0	78.3	73.7	121.0	175.4	145.6	150.7	154.8	158.2	163.8
Total public debt	**18.6**	**17.5**	**20.4**	**23.0**	**22.5**	**21.8**	**27.0**	**25.3**	**29.6**	**27.7**
External	15.5	15.0	18.0	17.2	16.3	15.4	15.6	15.2	14.8	14.5
Domestic 4/	3.1	2.5	2.4	5.8	6.2	6.4	11.4	10.1	14.8	13.2

Source: Fund staff estimates and projections.

1/ Assumes additional fiscal adjustment to reach a tax ratio of 12 percent of GDP by 2004 and between 12.5 and 13 percent of GDP in 2006.
2/ In 2002-06, the annual population growth rate is assumed to remain at 2.7 percent.
3/ In months of imports of goods and services. Excludes claims on Nicaragua amounting to US$145.7 million, up to 1999 and US$75.7 million in 2000, which are recorded in official data.
4/ Assumes an increase of 6 percent of GDP in 2003 to capitalize the central bank, and of 6 percent of GDP in 2005 to reform the social security system.

Table 10. Guatemala: Summary Balance of Payments

	1997	1998	1999	2000	Prel. 2001	Proj. 2002
Current account 1/	**-630**	**-1,036**	**-1,015**	**-1,049**	**-940**	**-966**
Trade balance	-1,254	-1,804	-1,779	-2,090	-2,132	-2,000
Exports, f.o.b.	2,598	2,847	2,781	3,082	2,990	3,134
Traditional	1,170	1,167	1,056	1,175	1,047	1,026
Of which						
Coffee	616	581	588	569	335	322
Nontraditional	1,428	1,680	1,725	1,907	1,943	2,109
Imports, c.i.f. 1/	3,852	4,651	4,560	5,171	5,121	5,134
Services	13	63	49	172	221	59
Factor services (net)	-228	-169	-181	-226	-173	-286
Of which						
Interest on public debt	-140	-140	-130	-152	-194	-233
Other	-88	-29	-50	-74	21	-53
Nonfactor (net)	241	231	229	398	394	345
Current transfers (net)	611	705	714	868	971	975
Capital account	**890**	**1,248**	**891**	**1,777**	**1,440**	**756**
Official transfers	85	71	68	87	88	95
Public sector	222	234	294	116	240	1
Disbursements	144	326	400	205	145	301
Amortization	171	157	169	166	136	163
Of which						
Bank of Guatemala (net) 2/	83	54	26	24	-11	-13
Bonds (net)	249	66	160	89	182	-97
Public sector deposit (net)	0	0	-97	-11	49	-39
Private sector 3/	583	943	529	1,574	1,113	660
Of which						
FDI and privatization.	85	673	357	230	470	186
Medium and long-term debt		125	-137	596	541	367
Balance of payments support	30	30	0	0	0	0
Overall balance	**289**	**242**	**-125**	**728**	**500**	**-210**
	(Annual percent change)					
Exports, f.o.b.	16.4	9.6	-2.3	10.8	-3.0	4.8
Imports, c.i.f.	22.4	20.7	-2.0	13.4	-1.0	0.3
	(In percent of GDP)					
Current account	**-3.5**	**-5.3**	**-5.5**	**-5.5**	**-4.6**	**-4.5**
Trade balance	-7.1	-9.3	-9.7	-11.0	-10.3	-9.4
Exports, f.o.b.	14.6	14.7	15.2	16.2	14.5	14.7
Imports, c.i.f.	21.7	24.0	24.9	27.1	24.8	24.1
Services	0.1	0.3	0.3	0.9	1.1	0.3
Of which						
Interest on public debt	0.8	-0.7	-0.7	-0.8	-0.9	-1.1
Current transfers (net)	3.4	3.6	3.9	4.6	4.7	4.6
Capital account	**5.2**	**6.4**	**4.9**	**9.3**	**7.0**	**3.5**
Official transfers	0.5	0.4	0.4	0.5	0.4	0.4
Public sector 2/	1.4	1.2	1.6	0.6	1.2	0.0
Private sector 3/	3.3	4.9	2.9	8.2	5.4	3.1
Balance of payments support	0.2	0.2	0.0	0.0	0.0	0.0
Overall balance	**1.7**	**1.2**	**-0.7**	**3.8**	**1.8**	**-1.0**
Memorandum items:						
Net reserves in months of next year imports of goods and services 4/	2.2	2.7	2.2	3.6	4.6	4.0
Nominal GDP (in millions of U.S. dolllars)	17,790	19,395	18,319	19,079	20,641	21,320

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

1/ Figures for 1999-2001 should be interpreted with caution. The collection of trade data has improved significantly since July 2000. The increase reported since then may reflect previously unrecorded imports, which would have been recorded in the capital account as errors and omissions.

2/ In 2000 includes the effect of a restructuring of a US$25 million dollar short-term liability with Mexico.

3/ Includes errors and omissions. It also includes privatization-related flows equivalent to 3 percent of GDP in 1998, 0.9 percent in 1999, 0.8 percent in 2000, 1.8 percent in 2001 and 0.3 percent in 2002.

4/ Excludes claims on Nicaragua amounting to US$145.7 million up to 1999 and US$75.7 million in 2000, which are included in official data.

Table 11. Guatemala: Summary of Public External Debt

	1997	1998	1999	2000	Prel. 2001	Proj. 2002
	(In millions of U.S. dollars)					
Outstanding debt 1/2/	**2,620.2**	**2,886.8**	**3,304.7**	**3,285.1**	**3,358.9**	**3,267.6**
Medium- and long-term debt	2,369.1	2,598.4	2,847.5	2,814.5	2,912.9	3,069.4
Nonfinancial public sector	1,820.8	2,094.2	2,369.7	2,352.2	2700.7	3,001.7
Of which						
Bonds	189.4	248.2	204.1	150.0	475.0	475.0
CORFINA	377.8	372.0	371.2	370.9	131.5	0.0
Bank of Guatemala	170.5	132.2	106.6	91.4	80.7	67.7
Short-term debt	251.1	288.4	457.2	470.6	446.0	198.2
Nonfinancial public sector	163.1	186.9	355.9	381.7	435.5	187.7
Bank of Guatemala	9.8	23.3	23.1	10.7	10.5	10.5
Arrears of interest	78.2	78.2	78.2	78.2	0.0	0.0
Debt flows						
Drawings	634.9	624.3	744.4	761.6	851.5	361.8
Nonfinancial public sector 3/	603.6	594.1	744.4	761.6	851.5	361.8
Bank of Guatemala	1.2	0.0	0.0	0.0	0.0	0.0
BOP support	30.1	30.2	0.0	0.0	0.0	0.0
Scheduled debt obligations	**523.0**	**499.8**	**469.3**	**786.4**	**854.7**	**554.6**
Interest	140.2	139.7	130.0	152.0	194.0	233.0
Nonfinancial public sector	119.4	125.2	120.0	143.1	187.0	226.5
CORFINA	0.0	0.0	0.0	0.0	0.0	0.0
Bank of Guatemala	20.8	14.5	10.0	8.9	7.0	6.5
Principal	382.8	360.1	353.2	634.4	660.7	321.6
Public sector	297.0	305.9	327.3	610.4	650.2	308.6
CORFINA	2.0	0.0	0.0	0.0	0.0	0.0
Bank of Guatemala	83.8	54.2	25.9	24.0	10.5	13.0
Memorandum items:						
Stock of arrears, end of period 4/	103.2	103.2	103.2	103.2	0.0	0.0
Interest	78.1	78.1	78.1	78.1	0.0	0.0
Principal	25.1	25.1	25.1	25.1	0.0	0.0
	(In percent of GDP)					
Outstanding debt	**15.5**	**15.0**	**18.0**	**17.2**	**16.3**	**15.3**
Medium and long term	13.3	13.4	15.6	14.7	14.1	14.4
Short term	2.2	1.6	2.4	2.5	2.2	0.9
Of which						
Bank of Guatemala	1.4	1.1	1.0	0.9	0.5	0.3
Debt flows						
Drawings	3.6	3.2	4.1	4.0	4.1	1.7
Scheduled debt obligations	2.9	2.6	2.6	3.9	4.1	2.6
Interest	0.8	0.7	0.7	1.0	0.9	1.1
Principal	2.2	1.9	1.8	2.9	3.2	1.5
Memorandum items:						
Stock of arrears, end of period	0.6	0.5	0.6	0.5	0.0	0
Interest	0.4	0.4	0.4	0.4	0.0	0
Principal	0.1	0.1	0.1	0.1	0.0	0
Debt service (as percent of exports)	**16.5**	**14.5**	**13.7**	**19.5**	**21.2**	**13.8**
Interest	4.4	4.0	3.8	5.0	5.1	5.9
Principal	12.1	10.4	9.8	14.5	16.2	7.8

Sources: Bank of Guatemala ; and Fund staff estimates.

1/ Includes arrears and valuation adjustments.

2/ In 2002 includes disbursements of $120 million by the IDB linked to the approval of the financial sector laws.

3/ Includes bonded debt held by non residents.

4/ Includes CORFINA (Spain).

Table 12. Guatemala: External Financing Requirements and Sources

(In millions of U.S. dollars)

	1997	1998	1999	2000	Prel. 2001	Proj. 2002
Gross financing requirements	1,300	1,638	1,365	2,370	2,079	1,082
External current account deficit						
(excludes official transfers)	630	1,036	1,015	1,049	940	966
Of which						
Coffee exports	616	581	588	569	335	322
Nontraditional exports	1,428	1,680	1,725	1,907	1,943	2,109
Debt amortization	383	360	475	594	639	325
Public sector	171	157	266	177	136	163
Loans 1/	170.8	157.4	169	166	136	163
Deposits	0	0	97	11	0	0
Bonded debt 2/	212	203	208	416	503	162
Net reserves accumulation	287	242	-125	728	500	-210
IMF repurchases and repayments	0	0	0	0	0	0
Available financing	1,300	1,639	1,365	2,370	2,079	1,082
Foreign investment (net)	85	673	256	230	470	186
Debt financing from private creditors	957	539	642	1,849	1,377	500
To public sector (bonds)	461	269	369	505	685	65
To commercial banks (net)	444	135	-138	596	541	368
To private sector (net)	52	136	411	748	102	107
Deposits in foreign banks	0	0	0	0	49	-39
Official credit to the public sector	228	397	468	292	233	396
Official transfers	85	71	68	87	88	95
Borrowing	144	326	400	205	145	301
Balance of payments support	30	30	0	0	0	0
IMF (net)	0	0	0	0	0	0
Accumulation of arrears (exceptional)	0	0	0	0	0	0
Financing gap	0	0	0	0	0	0

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

1/ Excludes the IMF.

2/ Original maturity of less than five years.

GUATEMALA—FUND RELATIONS

(As of February 28, 2001)

I. **Membership Status:** Joined: December 28, 1945, Article VIII

II. **General Resources Account:**	**SDR Million**	**Percentage of Quota**
Quota	210.20	100.00
Fund holdings of currency	210.21	100.00

III. **SDR Department**	**SDR Million**	**Percentage of Allocation**
Net cumulative allocation	27.68	100.0
Holdings	6.73	24.32

IV. **Outstanding Purchases and Loans:** None

V. **Financial Arrangements:**

Type	**Approval Date**	**Expiration Date**	**Amount Approved (SDR Million)**	**Amount Drawn (SDR Million)**
Stand-By	12/18/92	03/17/94	54.00	0.00
Stand-By	10/26/88	02/28/90	54.00	23.16
Stand-By	08/31/83	12/31/84	114.75	57.38

VI. **Projected Obligations to the Fund** (SDR million; based on existing use of resources and present holdings of SDRs):

	Overdue	**Forthcoming**				
	06/30/2001	**2001**	**2002**	**2003**	**2004**	**2005**
Charges/interest	0.0	0.5	0.5	0.5	0.5	0.5
Total	**0.0**	**0.5**	**0.5**	**0.5**	**0.5**	**0.5**

VII. Safeguards Assessment

Under the Fund's safeguards assessment policy, the Bank of Guatemala (BOG) is subject to a full Stage One safeguards assessment with respect to the Stand-By Arrangement. Such assessment is underway.

VIII. Exchange Rate Arrangements

Since March 1994, Guatemala has 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. The central bank is supposed to intervene in the market only to moderate exchange rate fluctuations as well as to purchase foreign exchange to service public sector debt. As of December 31, 2001 the exchange rate in the interbank market was Q 7.98 per U.S. dollar.

IX. Last Article IV Consultation

The last Article IV consultation was concluded by the Executive Board on May 14, 2001 (EBM/01/49, the relevant documents were SM/01/116 and SM/01/139). Guatemala is on the standard 12-month consultation cycle.

X. Technical Assistance

In June 2000 an STA mission assisted the authorities in developing a new CPI. In October and December 2000, a joint World Bank-IMF mission visited Guatemala to help prepare draft legislation on central bank, banking sector, and banking supervision. In December 2000 an MAE mission provided assistance on payments system issues. On February 2001, MAE provided assistance on bank restructuring. On May 2001 FAD provided assistance on tax policy and administration.

GUATEMALA—RELATIONS WITH THE WORLD BANK GROUP

I. Financial Relations

(In millions of U.S. dollars as of December 31, 2001)

A. IBRD Operations by Sector

	Disbursed	Undisbursed
Agriculture	18.9	39.1
Education	78.8	66.8
Electric power and other energy	194.8	0.0
Finance	16.8	0.0
Structural adjustment	120.0	0.0
Public sector management	46.3	73.3
Social protection	74.5	25.0
Telecommunications	69.2	0.0
Transportation	96.6	29.6
Urban development	34.1	0.0
Water supply and sanitation	3.6	0.0
Total	**753.6**	**233.8**
Repaid principal	414.0	
Debt outstanding[1]	329.6	
IFC Investments[2]	71.0	0.0

B. IBRD Loan Disbursements

	1996	1997	1998	1999	2000	2001
Total net disbursement	**55.9**	**4.3**	**15.2**	**55.9**	**38.2**	**34.7**
Gross disbursements	68.9	16.5	29.5	70.5	51.4	46.3
Principal repayments	13.0	12.2	14.3	14.5	13.2	11.6

Source: World Bank.

[1]Includes exchange rate adjustments (-US$9.65 million).
[2]Includes only loans and equity instruments held by the International Finance Corporation as of December 31, 2001.

II. Recent IBRD Activities

The last Country Assistance Strategy report (CAS No. 18036) was prepared in June 1998 and focused on coordination with international donors to support the peace process. The report covered: poverty reduction, enhanced economic growth, improved social cohesion for decision making, and modernization of the public sector. The most recent economic report is the Public Expenditure Review (No. 19617, February 2000). A Poverty Assessment report is expected during FY 2002, based on an ongoing Living Standards Measurement Survey (LSMS).

As of December 31, 2001 the IBRD portfolio contains 12 investment projects for a total disbursed balance of US$203.5 million. The portfolio is relatively new, as all projects have been approved after 1997 and the latest one, the Universalization of Basic Education Project (US$62 million), was recently approved on May 2001. There are three projects under discussion for FY 2002: the Natural Resources Management project, Social Infrastructure and Safety Nets, and the Integrated Financial Management System III (SIAF). In addition, the Bank is considering support for a Financial Sector Adjustment Loan, in cooperation with IDB. In term of non-lending services the Bank has completed a series of Public Investment Reviews analyzing progress in implementation of the Peace Accord targets, and is currently undertaking a poverty assessment, which also includes support to the government for the elaboration of a Poverty Reduction Strategy.

GUATEMALA—STATISTICAL ISSUES

The Guatemalan authorities have made efforts to improve the macroeconomic statistical systems and are very cooperative in providing data to the Fund. However, important deficiencies remain in the areas of government finance, balance of payments, money and banking, and national accounts and price statistics. As mentioned below, except for government finance, the authorities are beginning to address problems with help from STA.

National accounts statistics

Guatemala's national accounts are produced by the central bank based on the 1953 U.N. System of National Accounts (SNA) with 1958 as the base year. The coverage of national accounts statistics is limited to (i) GDP at constant (1958) prices by industry; and (ii) GDP at both constant and current prices, by expenditure components. Data are published annually with preliminary data available with a lag of about three months. With the assistance of a U.N. statistical advisor, the central bank is implementing the 1993 SNA with 1998 as the base year. STA has provided technical assistance in August 1997 with follow-up missions in national accounts in January 1998 and March 1999, and a June 2000 mission for the CPI. With respect to the CPI, the NSI introduced a new CPI based on weights from a household expenditure survey conducted in 1998/1999, and publication of the new CPI began in February 2001.

Monetary authorities

Data on the monetary authorities, commercial banks, and other financial institutions are being compiled on a monthly basis and sent regularly to the Fund for publication in the IFS. In 1998 a technical assistance mission recommended to the Bank of Guatemala (BOG) measures to improve the data compilation of the financial system. Such measures included: (i) the compilation of monetary statistics for savings and credit cooperatives; (ii) the revision of the money and credit aggregates; (iii) the classification of domestic institutional units into central and local governments, nonfinancial public enterprises, and the financial corporations sub-sector (central bank, depository corporations, and other financial corporations), which will improve the coherence of monetary data with data from the balance of payments, fiscal sector, and national accounts; and (iv) the breakdown between residents and nonresidents in the monetary accounts. A recent monetary and financial statistics mission (September 2001) advised the BOG to establish a work plan to undertake all of these recommendations. However, the work plan is yet to be developed.

Government finance statistics

There are problems in reconciling the government public sector balance as measured from above the line from that as measured from the financing flows (below the line). While progress has been made in adopting the new accounting framework for the budget, little work has been made in improving statistics of the social security and public enterprises. In fact overall public sector data are not compiled on a regular basis by the ministry of finance.

Balance of payments

The balance of payments statistics are based on reports of foreign exchange transactions from commercial banks and customs but with considerable lags. The balance of payments data are prepared quarterly and compiled and presented according to the principles of the fourth edition of the balance of payments manual *(BPM4)*. A number of surveys have been introduced to collect information according to the guidelines of the fifth edition of the Balance of Payments Manual *(BPM5)*. The staff of the Bank of Guatemala is currently being trained to apply the methodology of *BPM5*. The authorities are implementing the recommendations of the STA's 1997 multisector mission in the following areas: (i) improving the accuracy of the foreign exchange records by both the Bank of Guatemala and the reporting banks; and (ii) obtaining import, freight, and insurance data directly from customs documents.

Guatemala: Core Statistical Indicators

(As of February 5, 2001)

	Exchange Rates	International Reserves	Reserve/ Base Money	Central Bank Balance Sheet	Broad Money	Interest Rates	Consumer Price Index	Exports/ Imports	Current Account Balance	Overall Government Balance	GDP/ GNP	External Debt/ Debt Service
Date of Latest Observation	12/28/01	12/21/01	12/14/01	11/30/01	11/30/01	12/28/01	12/01/01	09/01	12/00	12/00	2000	2000
Date Received	12/31/01	12/28/01	12/28/01	12/28/01	12/28/01	12/31/01	12/28/01	12/11/01	3/15/01	2/5/01	4/19/01	3/01
Frequency of Data	D	D	W	W	M	W	W	M	A	M	A	A
Frequency of Reporting	D	D	W	W	M	W	W	O	O	M	A	A
Source of Update	A	A	A	A	A	A	A	A	A	A	A	A
Mode of Reporting	E/C	E/C	C	C	C	C	C	C	C	C	C/E	C/V
Confidentiality	C	D	D	D	D	C	C	D	D	D	C	D
Frequency of Publication	D	M	M	M	M	D	M	Q	A	A	A	A

1/ D-daily, W-weekly, M-monthly, Q-quarterly, A-annual, or O-other (only when requested).

2/ A-direct reporting by central bank, ministry of finance.

3/ E-electronic data transfer, C-cable or facsimile, T-telephone, M-mail, V-staff visits, or O-other.

4/ (A) for use by the staff only, (B) for use by the staff and the Executive Board, (C) for unrestricted use, (D) embargoed for a specified period and are thereafter for unrestricted use, or (E) subject to other use restrictions.

GUATEMALA—RELATIONS WITH THE INTER-AMERICAN DEVELOPMENT BANK
(As of January 31, 2002)

I. IDB Current Portfolio as of January 30, 2002
(In millions of U.S. dollars)

Sector	Approved	Undisbursed
Social sectors	470.2	198.2
Community development	250.3	91.5
Credit to micro-enterprises	10.0	0.7
Environment	57.1	21.1
Housing	60.0	6.9
Education	37.4	23.2
Health	55.4	54.9
Physical infrastructure	181.6	144.8
Agriculture	33.0	24.6
Reform loans	52.7	20.8
Infrastructure and investment	7.7	1.0
Health	13.6	0.0
Customs	1.4	0.2
Justice	25.0	14.6
Trade	5.0	5.0
Emergency assistance	40.0	1.0
Technology development	10.7	10.6
Total	**788.2**	**400.0**

A. IDB Loan Disbursements

	1999	2000	1995	1996	1997	1998
Disbursements	**42.8**	**37.3**	**96.9**	**131.7**	**169.6**	**65.7**
Amortization	36.2	47.1	42.6	54.7	46.4	42.3
Interest and charges	30.0	35.0	30.0	48.6	42.1	49.0
Net cash flow	**-23.4**	**-44.8**	**24.3**	**28.4**	**81.1**	**-25.6**

B. Recent Economic and Sector Missions

The most recent economic strategy document on Guatemala (Country Paper) was approved by the IDB Board of Directors in September 2001. The Bank's priority, outlined in this document, is to help the government to reduce poverty. The Bank's implementation strategy focuses on three pillars: (i) economic growth, macroeconomic stability, and competitiveness; (ii) human capital development, social protection, and equity; and (iii) modernization of the state and governance.

In the 1999–2000 period, the Bank approved loans to support technology development (US$11 million), to modernize the road system (US$150 million), to help municipal development (US$20 million), and to improve health services (US$55 million). The Bank has also supported the implementation of the Fiscal Pact, approved in May 2000, through a comprehensive technical cooperation program. In 2001, the Bank has approved loans to strengthen the ministry of economy (US$5 million), and to expand the education reform (US$22 million). About 90 percent of the projects are current, and are expected to meet their development objectives. In 2002, the Bank is preparing operations to support financial sector reform (US$200 million), to improve the environment in high basin areas (US$40 million), and to help improve the labor market (US$11 million). Other operations in preparation include programs in the areas of rural electricity, water in rural areas, security, poverty reduction, housing, environment, social protection, and micro-credit. The Bank is also helping the authorities to define a strategy to reduce poverty. Other non-financial activities include the Bank's coordination of the Consultative Group meetings with the next meeting scheduled for February 11–12, 2002 at the IDB headquarters.

C. Tentative Schedule of Disbursements

	2001 1/	**2002**	**2003 2/**
Disbursements	**115.4**	**250.0**	**220.0**
Amortization	42.1	43.8	55.8
Interest and charges	61.5	72.0	74.0
Net cash flow	**11.8**	**134.2**	**90.2**

1/ Preliminary figures.
2/ Projected in the pipeline.

GUATEMALA: SCHEDULE OF PURCHASES UNDER THE STAND-BY ARRANGEMENT

Date	Amount	Conditions
	(In millions of SDRs)	
April 1, 2002	52.55	Board approval
August 15, 2002	10.48	Observance of end-June 2002 performance criteria and completion of review (August 15, 2002)
November 15, 2002	10.48	Observance of end-September 2002 performance criteria
March 15, 2003	10.48	Observance of end-December 2002 performance criteria

Guatemala—Pending Financial Reforms

Central banking law

- Defines price stability as the main objective of the central bank.

- Reinforces the independence of the central bank to choose monetary policy's instruments.

- Grants financial autonomy to the central bank, by requiring the government to recapitalize it. It also establishes procedures for distribution of the central bank's profits and cover of its losses. In addition, it establishes rules to cover losses resulting from monetary and exchange rate policies.

- Limits the lender-of-last-resort (LOLR) facilities to collateralized short-term assistance at a punitive interest rate.

- Requires the central bank to be formally accountable, and increases transparency. The president of the central bank must report to congress (at least once a year) on monetary policy, and the central bank's accounts must follow accepted accounting principles, disclosed on a timely basis, and be subject to independent auditing.

Banking supervision law

- Provides the SB with legal powers to enforce "fit and proper tests" for prospective owners, especially when there are changes in ownership.

- Introduces legal protection for staff of the SB against actions taken in the exercise of their responsibilities.

- Gives the SB powers over external auditors of banks, including full access to external auditors' working papers.

Monetary law

- Provides an improved legal framework to facilitate exchange convertibility, free capital mobility, domestic contracts in foreign currency, and domestic financial intermediation in foreign currency (including the constitution of foreign currency deposits).

Source: Guatemala—Financial System Stability Assessment (SM/01/119), 5/18/01.

Guatemala—Performance Criteria (PC) and Indicative Targets (IT) Under the Stand-By Arrangement 1/

Fiscal targets (PCs and ITs) (in millions of quetzales)	
• Ceiling on cumulative overall deficit of combined public sector 2/3/	
January 1–March 31, 2002 (IT)	535
January 1–June 30, 2002 (PC)	50
January 1–September 30, 2002 (PC)	1,140
January 1–December 31, 2002 (PC)	2,585
• Ceiling on cumulative central government expenditure 2/3/	
January 1–March 31, 2002 (IT)	4,665
January 1–June 30, 2002 (PC)	9,280
January 1–September 30, 2002 (PC)	15,225
January 1–December 31, 2002 (PC)	22,515
• Floor on cumulative central government social expenditure (IT) 2/	
January 1–March 31, 2002	1,515
January 1–June 30, 2002	3,515
January 1–September 30, 2002	6,070
January 1–December 31, 2002	9,095
Monetary sector targets	
• Floor on the stock of net international reserves (millions of US$) outstanding 4/	
By March 31, 2002 (IT)	2,200
By June 30, 2002 (PC)	2,350
By September 30, 2002 (PC)	2,220
By December 31, 2002 (PC)	2,091
• Ceilings on the stock of net domestic assets of the monetary authority outstanding 5/	
By March 31, 2002 (IT)	-8.500
By June 30, 2002 (PC)	-10,080
By September 30, 2002 (PC)	-9,180
By December 31, 2002 (PC)	-6,528
External sector targets	
• Ceilings on stock of short-term public external debt outstanding (millions of US$)	
By March 31, 2002 (IT)	40
By June 30, 2002 (PC)	30
By September 30, 2002 (PC)	15
By December 31, 2002 (PC)	15
• Ceilings on cumulative glow of contracted public external debt of more than one year 6/	
January 1–March 31, 2002 (IT)	440
January 1–June 30, 2002 (PC)	540
January 1–September 30, 2002 (PC)	665
January 1–December 31, 2002 (PC)	710
• Continuous performances criterion on non-accumulation of external arrears	
January 1–March 31, 2002 (IT)	0
January 1–June 30, 2002 (PC)	0
January 1–September 30, 2002 (PC)	0
January 1–December 31, 2002 (PC)	0

1/ The program is based on a projected net external financing of the nonfinancial public sector of US$21 million during the first half of 2002, US$17 million during the first three months of 2002, and US$53 million during 2002.

2/ The ceilings on overall deficit of combined public sector and central government expenditure and the floor on central government social expenditure will be adjusted upwards by the full amount of the excess with respect to the baseline (footnote 1) of the financing from the IDB, the World Bank, CABEI, and bilateral institutions up to a maximum of US$15 million during the first half of 2002, US$25 million during the first three quarters of 2002 and US$40 million during 2002.

3/ The ceilings on overall deficit of the combined public sector and central government expenditure will be adjusted upwards (downwards) by the excess (shortfall) of the special credit to coffee producers with respect to US$60 million in 2002 with the upward adjustment not exceeding US$40 million

4/ The floors on NIR will be adjusted: (i) downwards by the full amount of the shortfall of net external financing with respect to the base line (footnote1) up to a maximum of US$21 million during the first half of 2002, US$17 million during the first three quarters of 2002, and US$53 million during 2002; (ii) upwards by any excess of the net external financing beyond US$15 million during the first half of 2002, US$25 million during the first three months of 2002,US$40 million during 2002; (iii) upwards by any temporary excess of the amount of bonds issued to substitute short-term debt; (iv) upwards by any external credit to help finance the restructuring of the banking system and subsequently downwards by the proceeds used to finance the restructuring of the banking system..

5/ Corresponding offsetting adjustments will be made to the ceilings on the stock of net domestic assets of the monetary authority for the adjustments to the floors on NIR (footnote 3).

6/ These ceilings reflect contractual debt with the IDB, World Bank, CABEI, and bilateral creditors (i.e., the program does not include floating new bonds). They would be adjusted (i) upwards by the amount of bonds issued to substitute short-term debt; (ii) upwards by the amount of external financing to help finance the restructuring of the banking system; and (iii) upwards by the contracted amount corresponding to the excess of net external financing from the IDB, World Bank, CABEI, and bilateral creditors.

Guatemala City, Guatemala

March 15, 2002

Mr. Horst Köhler
Managing Director
International Monetary Fund
Washington D.C. 20431

Dear Mr. Köhler:

1. Guatemala's main challenges in 2002 are to strengthen its macroeconomic performance while defending social expenditure to help achieve the targets of the 1996 Peace Accords, and addressing the weaknesses of the financial system. The attached memorandum of economic and financial policies sets forth the objectives and policies of the government's economic program and the measures that the government of Guatemala intends to adopt during 2002. In support of these objectives and policies, Guatemala hereby requests a 12-month Stand-By Arrangement in an amount equivalent to SDR 84 million (40 percent of quota). The Government of Guatemala intends to treat the Stand-By Arrangement as precautionary.

2. The memorandum of economic and financial policies includes quarterly performance criteria for key variables in 2002. The government will conduct with the Fund a review of the program that will be completed by August 15, 2002 and, at any time during the period of the arrangement, the Government of Guatemala will consult with the Fund, at the initiative of the government or whenever the Managing Director of the Fund requests such consultation, on the adoption of any measures that may be appropriate for achieving the objectives of the program.

3. The government has implemented the following prior actions before Board consideration of the request for the Stand-By Arrangement: approval of the 2002 budget consistent with the program, issuance of the Presidential Decree (Acuerdo Gubernativo) strengthening expenditure control, implementation of a critical mass of fiscal measures, and the capitalization of the Banco del Ejercito. The government's economic program also contains structural benchmarks: submitting to congress the new laws of the central bank and banking supervision and monetary laws before completion of the review noted above, completion of on-site inspections of banks and adopting measures necessary to deal with banks that might result to be insolvent.

4. The government is of the view that it is important to provide a convincing signal of Guatemala's commitment to maintain sound economic policies during 2003, a year leading

to a political transition. Hence, the government intends to follow this program with another covering 2003 that could be supported by a Stand-By Arrangement from the Fund. To this end, it would begin negotiations with the Fund on a subsequent Arrangement at the time of the review under the 2002 program.

5. Guatemala is committed to provide the Fund with such information as the Fund requests on the progress made in policy implementation and the achievement of the program objectives.

Sincerely yours,

/s/
Eduardo Humberto Weymann Fuentes
Minister of Finance

/s/
Lizardo Arturo Sosa López
President of the Bank of Guatemala

Attachments

GUATEMALA—MEMORANDUM OF ECONOMIC AND FINANCIAL POLICIES

1. Upon assuming office in January 2000, the administration of President Alfonso Portillo was confronted with a very difficult economic situation resulting from domestic and external factors. On the domestic side, Guatemala was implementing loose demand policies and poor management of the exchange rate policy. The macroeconomic conditions also reflected adverse terms of trade and weather conditions (including Hurricane Mitch) and turbulence in international capital markets. On the eve of the inauguration of the new administration the international reserve position had weakened significantly, in part reflecting large capital outflows, and economic activity was slackening. The deterioration of the macroeconomic situation and an inadequate legal and regulatory framework of the financial sector had weakened the financial system and some small banks had fallen into insolvency. Furthermore, lack of resources and limited institutional capacity had held back the implementation of the 1996 donor-supported Peace Accords, which had set an ambitious social agenda to address inequalities and institutional failures through the mobilization of domestic and external resources (including an increase in the tax ratio to 12 percent of GDP by end-2000).

2. Against this background the new administration moved quickly in the fiscal and monetary areas, including through steps to reform the financial system, to address the country's economic problems, and reinvigorate the implementation of the Peace Accords. As a result, the combined public sector deficit (including the losses of the central bank) narrowed from 3 percent of GDP in 1999 to 2¼ percent in 2000, as the government reduced expenditures and increased the top income tax rate from 25 percent to 31 percent; widened the base of the VAT to include custom duties; and phased out some tax exemptions. However, in 2001 lack of effective expenditure controls contributed to a substantial increase in outlays, weakening again the fiscal position. Nonetheless, the combined public sector deficit was limited to 3 percent of GDP as the government introduced in July 2001 a package of measures amid strong popular opposition. The package included an increase in the VAT rate from 10 to 12 percent, and higher income tax rates on commercial and agricultural enterprises, excise taxes on fuel oil, and import duties on used cars. In addition, in November 2001 congress approved an increase in the excises of cigarettes. In January 2002 the authorities increased custom duties on gasoline, and in February 2002 congress approved additional tax measures including increases in the excises on beer, alcoholic beverages, and soft drinks.

3. During 2001 progress was achieved in improving tax administration. In July 2001 congress approved reforms to the tax and penal codes that will enhance the effectiveness of the Tax Administration Superintendency (SAT). With financial assistance from the World Bank, the SAT has continued to improve its human resources management, information systems, and training.

4. To control inflation and strengthen net international reserves, the central bank (BANGUAT) has intensified open market placements to absorb part of the external capital

inflows, and sterilize the central bank credit expansion resulting from the refund to depositors of the intervened three banks and the withdrawal of government's deposits. These placements have been made over the past two years in the context of a steady decline in interest rates, which reflect renewed confidence in the quetzal. The net international reserve position has strengthened considerably from about US$1 billion at the time of the inauguration of the new administration to an estimated US$2.3 billion, or about 130 percent of base money by end-2001. The external current account deficit amounted to 5½ percent of GDP in 2000 and is estimated to have narrowed in 2001 as the effect of the slowdown of economic activity on imports more than offset a lower external demand for exports. The capital account surplus rose owing to the sharp increase in private capital inflows and the 2001 proceeds from the privatization of the telephone company (GUATEL). Real GDP growth has slackened to 2¼ percent in 2001 while inflation, after remaining at 5 percent in 2000, rose to about 9 percent in 2001 reflecting mostly a one-off price spike resulting from the increase of the VAT rate and food shortages resulting from the drought that affected the country.

5. To address the weakness of the financial sector, the monetary authority initiated a thorough assessment of the banking system with help from the FSAP mission. As a result, in October 2001 the Monetary Board (MB) requested that the courts liquidate three banks and two finance companies that were intervened early in the year. Shareholders of another weak bank, the *Banco del Ejército*, increased its capital in December 2001, and a draft law permitting its sale was approved by congress in January 2002; the due diligence for the sale of this bank will be initiated before June 30, 2002.

6. In order to improve the efficiency and soundness of the financial sector, congress approved on January 31, 2002 a new banking law. This law introduces consolidated supervision and capital adequacy requirements, including offshore operations, and allows for the reform of the regime for bank resolution and exit procedures while making operative an explicit but limited deposit guarantee. The resolution of banks will be financed exclusively by the government. In addition, the government with help from the Fund, World Bank, and IDB has been preparing new central banking and banking supervision laws and a new monetary law. The draft of the central banking law defines clearly that its objective is to preserve price stability, and reinforce its autonomy. The draft of the law on banking supervision aims at reinforcing the functional autonomy of supervisors through adequate sanctioning and information gathering powers and legal protection. The draft of the monetary law provides an improved legal framework to facilitate exchange convertibility, free capital mobility, domestic contracts in foreign currency, and domestic financial intermediation in foreign currency (including the constitution of foreign currency deposits). The government is working with congress to secure the two-thirds majority needed for the passage of these laws before August 15, 2002. In the meantime, the government is determined to use its statutory powers to protect the independence of the central bank. Accordingly in February 2001, the monetary board issued a regulation limiting its lender-of-last resort facilities to collaterized short-term liquidity assistance at punitive interest rates.

7. Congress approved an Anti-Money Laundering Law in October 2001, which classifies money-laundering activities as a criminal offense, expands the banking secrecy rules to deal with suspicious financial transactions, and permits the Guatemalan authorities to share information with other countries. In addition, the law creates an autonomous authority to investigate suspicious transactions. The government is of the view that this law strengthens money-laundering controls sufficiently to take Guatemala off the list of "noncooperative" countries as elaborated by the OECD-backed Financial Action Task Force (FATF).

8. Guatemala's obligations under the Central American Common Market were fulfilled in January 1999 when the maximum common external tariff was reduced to 15 percent. Starting in October 2000, exports of maquila, particularly textiles and apparel, enter free of duty to the U.S. market under the Caribbean Basin Initiative. In March 2001, a free trade agreement between Mexico and the Northern Triangle (Guatemala, Honduras, and El Salvador) became operational, reducing import tariffs and barriers to capital and labor mobility among these countries.

9. Most of Guatemala's indicators of external vulnerability have improved since 2000. The external debt-to-GDP ratio has declined to about 16 percent, and the ratio of NIR to the stock of short-term debt on a remaining maturity basis has increased to about 175 percent. In October 2001, Standard & Poor's rated Guatemala's foreign currency sovereign credit BB with a stable outlook and Moody's Investors Service assigned a foreign currency country ceiling of Ba2. As a result, Guatemala recovered its access to the Euromarket, by floating US$325 million of ten-year bonds in November 2001 with proceeds earmarked to repay short-term government debt falling due in late 2001 and 2002, hence helping to improve the debt profile.

10. Following a year of slow advances, the structural transformation set out in the 1996 Peace Accords accelerated in 2001. Social expenditure rose by some 20 percent to the equivalent of 5½ percent of GDP, particularly in primary health and education and in food aid to peasants affected by the drought in the east of the country. The government declared a state of emergency as the drought intensified poverty in rural areas already affected by the collapse of international coffee prices. The latter has had a negative effect on rural workers who depend on seasonal work in coffee plantations.

The Economic Program for 2002

11. The government is strongly committed to speed up the implementation of the Peace Accords, and to strengthen macroeconomic performance by substantially improving the fiscal position, defending public sector expenditure in the social areas, and addressing the weaknesses of the financial system. The government is aware of the urgent need to address the structural weakness of the public finances, and lingering difficulties in the financial sector. Monetization of the fiscal deficit, including the cost of bailing out troubled banks, may undermine confidence in the central bank's ability to maintain stability over the medium term. In fact, it is becoming difficult to tighten monetary policy further given the already significant amount of outstanding open market certificates (6¾ percent of GDP at end-2001).

The financial system remains fragile as nonperforming loans (NPLs) represented about 15 percent of total loans and despite increases in the banks' provisions these only covered about 25 percent of NPLs as of November 2001.

12. Reflecting the weak external demand and the effects of the September 11, 2001 events, the government has lowered its forecast of real GDP growth to 2⅓ percent in 2002 (same as in 2001 and slightly below population growth). The program described below targets a reduction in inflation to a 4–6 percent range in 2002, and the narrowing of the external current account deficit further. Net international reserves are expected to fall slightly to US$2.1 billion (115 percent of base money at end-2002), mostly reflecting the service of external debt in 2002 using proceeds from bonds floated in the Euromarket in 2001.

Fiscal policy

13. Fiscal policy will aim at reducing the combined public sector deficit to 1½ percent of GDP and the central government deficit to 1¼ percent of GDP in 2002, while protecting expenditure in the social areas and covering the cost of restructuring the banking system. Quarterly ceilings on the combined public sector deficit are presented in Table 1.

14. Tax revenue is projected to increase by 1 percentage point of GDP to 10¾ percent of GDP in 2002, reflecting the full-year effect of the tax packages approved in 2001 and measures introduced in 2002, and improved tax administration. While under the present circumstances it would not be possible to meet the tax ratio of 12 percent of GDP in 2002 as previously scheduled, the government is fully committed to achieve this fiscal target by 2004 as recently discussed with the Peace Commission.

15. An important element of the fiscal program for 2002 is to hold total expenditure of the central government about constant following a 22 percent increase in 2001, which would imply a decrease in terms of GDP by 1 percentage point to 12¾ percent in 2002. Quarterly ceilings on central government expenditure are presented in Table 2. The tightening of expenditure reflects the plan adopted by the President of the Republic to ensure an increase in national savings despite the decline in world coffee prices and a negative external environment. Consistent with this plan, the government issued a decree *(acuerdo gubernativo)* in February 2002 introducing expenditure actions as indicated below. These actions are linked to those aimed at strengthening budget control and management with early warning indicators under the Integrated Financial Management System (IFMS, see below).

16. Notwithstanding the measures noted above, the government will study further possible steps to strengthen expenditure control. In this regard the Fiscal Affairs Department of the Fund will provide technical assistance focusing on making an overall evaluation of existing mechanisms of public expenditure management to identify weakness and suggest corrective actions to the processes of budget preparation and execution, and cash planning and management.

17. The government is of the view that the envisaged progress in strengthening fiscal policy has to be accompanied by a sustained improvement in social conditions. Over the long

run, the gradual integration of the large rural indigenous population into the market economy, together with the strengthening of human capital through poverty reduction and access to basic education and health, should raise the productivity of labor and expand the domestic economy. During the program period social expenditure will be maintained at over 5 percent of GDP and the government plans to improve the efficiency of social expenditure by coordinating purchases of different social funds. The program includes quarterly targets on social expenditure which are presented in Table 3.

Monetary policy

18. In general, the central bank will continue to maintain a tight stance of monetary policy until after the fiscal position and the banking system are strengthened. Monetary policy aims at reducing inflation and maintaining an adequate level of international reserves. Broad money is projected to increase by above 8 percent in 2002 allowing for an increase in bank credit to the private sector of 9 percent (slightly faster than nominal GDP). The monetary program assumes net domestic assets of the central bank as the intermediate target, which are projected to increase by 15 percent, providing room for the projected private sector credit growth, while achieving the targeted net international reserves. The program sets quarterly ceilings on the net domestic assets of the central bank (Table 4) and quarterly floors on net international reserves (Table 5).

Banking system

19. As noted, the government is strengthening its efforts to secure approval of the new laws of the central bank and banking supervision and monetary law by August 15, 2002.

20. An important step in improving the health of the banking system is to resolve the situation of the insolvent banks. The authorities are implementing a mechanism to handle consolidation and regularization of banks under which performing assets of an insolvent bank would be transferred to a solvent bank, and judicial participation will be limited to liquidating nonperforming assets (instead of all assets). Hence, the mechanism would expedite banking resolution.

21. Furthermore, the monetary authority has decided to undertake a comprehensive examination of the banks in the system to assess the need for additional actions to strengthen their balance sheets, and the possible consolidation of financial institutions through mergers and acquisitions. To this effect, the superintendency of banks has initiated a program of comprehensive on-site inspections of all banks according to the schedule noted below. Based on these inspections, the government will identify banks in need of increasing their capital base and will agree with their shareholders on plans to capitalize such banks without delay. The program considers as structural benchmarks the initiation of the capitalization program before August 15, 2002 of banks identified as undercapitalized in the inspections to be concluded before April 30, 2002.

External policies

22. In order to maintain Guatemala's relatively favorable debt-service profile over the medium term, the government intends to limit the contracting or guaranteeing by the public sector (including the central bank) of nonconcessional external debt. Consistent with these overall guidelines, quarterly ceilings on gross external debt have been established, which are set out in Table 6. The government is aware of the need to monitor closely indicators of external vulnerability and in this regard it will make efforts to establish its own database of corporate external debt (currently this debt is monitored using the database of the Bank of International Settlements).

23. The exchange rate will continue to move in response to market conditions, and the central bank will continue limiting its intervention in the FOREX market only to smooth out fluctuations. The central bank will continue to assess on a continuous basis Guatemala's external competitiveness in view of the still high external current account deficit and the weak world coffee prices. The government will continue its efforts aimed at further trade liberalization, including through bilateral and regional trade arrangements consistent with WTO guidelines.

24. Guatemala maintains an exchange system that is free of restrictions and will not impose new restrictions on the making of payments and transfers for current international transactions, introduce multiple currency practices, impose or intensify import restrictions for balance of payments reasons, or enter into new bilateral payments agreements that are inconsistent with Article VIII of the Fund's Articles of Agreement. Moreover, Guatemala will continue with its stated policy of not incurring external payment arrears (Table 7).

Structural reforms

25. Guatemala has made substantial advances in the area of privatization as it has divested almost all of its participation in the largest enterprises. During 2002 the government is planning to sell its remaining shares in the power company (EEGSA) (about 14 percent of the total), energy distribution companies, and the national airline.

26. The government also will improve the targeting of the subsidy on electricity services. To this end, during the second quarter of 2002 the national commission of energy will propose to congress modifications to the general electricity law to, inter alia, limit the subsidy to a maximum household consumption of 300 Kw a month.

27. The government has been providing nonrecurring assistance to coffee producers suffering from the effect of low world prices. This assistance—at the government's borrowing costs plus a margin—is helping coffee producers to restructure their debts with the banking system, and to diversify into other products and sectors. The government is concerned that the problems in the coffee sector could be structural in nature and is beginning to take actions to foster the restructuring of the agricultural sector, including with assistance from the World Bank and IDB, such as through improvements in rural

infrastructure and technical assistance to diversify into nontraditional agricultural exports, and tourism.

28. The government is of the view that improving transparency and reducing corruption are important elements of its overall strategy. A crucial element of this strategy is strengthening and extending the Integrated Financial Management System (IFMS) to other public agencies outside of the central government. Accordingly, the IFMS included the Social Investment Fund in December 2001, and will include the Guatemalan Social Security System (IGSS) before August 31, 2002. In addition, it will include the Land Reform Fund (FONTIERRA), the Solidarity and Community Development Fund, and the largest municipalities by end-2002. Also, the IFMS includes upgrading the congress' computer capability for budget oversight and evaluation. Moreover, with technical assistance from the World Bank, the government has prepared draft legislation, currently under consideration by congress, to strengthen the laws on probity and on the office of the comptroller general. The government has negotiated with the IDB a modernization loan, which will assist with the establishment of an anti-corruption strategy. As a first step, this loan will help the authorities draft a new procurement law, which will be sent to congress by April 2002. Also, the government, with technical assistance from US AID is preparing a draft law, which will require the government to present together with the annual budget an estimate of the revenue foregone from tax privileges, exemptions, and exonerations.

29. Moreover, the government requested technical assistance from the Fund to prepare the basic questionnaire to adopt the Fund's code on fiscal transparency.

30. The government plans to initiate a comprehensive review of the social security system with the aim of protecting the sustainability of the fiscal accounts and increasing national savings. The government, with assistance from the World Bank, will update actuarial studies to evaluate the costs and benefits of different options to reform the system.

Table 1. Performance Criterion on the Overall Deficit of the Combined Public Sector 1/

(In millions of quetzales)

Overall Deficit of the Combined Public Sector	Ceiling
January 1–June 30, 2001 (actual)	1,880
January 1–December 31, 2001 (estimated)	4,915
January 1–March 31, 2002 (indicative target)	535
January 1–June 30, 2002	50
January 1–September 30, 2002	1,140
January 1–December 31, 2002	2,585

1/ Cumulative flows from the beginning of corresponding year.

Table 2. Performance Criterion for the Central Government Expenditure 1/

(In millions of quetzales)

	Ceiling
January 1–June 30, 2001 (actual)	9,560
January 1–December 31, 2001 (estimated)	22,330
January 1–March 31, 2002 (indicative target)	4,665
January 1–June 30, 2002	9,280
January 1–September 30, 2002	15,225
January 1–December 31, 2002	22,515

1/ Cumulative flows from the beginning of corresponding year.

Table 3. Indicative Targets for the Central Government Social Expenditure 1/

(In millions of quetzales)

Central Government Social Expenditure	Floors
January 1–June 30, 2001 (actual)	3,950
January 1–December 31, 2001 (estimated)	8,970
January 1–March 31, 2002 (indicative target)	1,515
January 1–June 30, 2002	3,515
January 1–September 30, 2002	6,070
January 1–December 31, 2002	9,095

1/ Cumulative flows from the beginning of corresponding year.

Table 4. Performance Criterion for the Stock of Net Domestic Assets of the Bank of Guatemala

(In millions of quetzales)

	Ceiling (end of period)
June 30, 2001 (actual)	-6,634
December 31, 2001 (estimated)	-8,933
March 31, 2002 (indicative target)	-8,490
June 30, 2002	-10,080
September 30, 2002	-9,180
December 31, 2002	-6,528

Table 5. Performance Criterion on NIR of the Monetary Authorities (MA)

(In millions of U.S. dollars)

	Floor (end of period)
June 30, 2001 (actual)	1,802
December 31, 2001 (estimated)	2,301
March 31, 2002 (indicative target)	2,200
June 30, 2002	2,350
September 30, 2002	2,220
December 31, 2002	2,091

Table 6. Performance Criterion on Nonconcessional External Debt of the Public Sector

(In millions of U.S. dollars)

	Short-Term 0–1 Year Maturity 1/	More than 1 Year 2/
January 1–June 30, 2001 (actual)	340	124
January 1–December 31, 2001 (estimated)	115	610
January 1–March 31, 2002 (indicative target)	40	440
January 1–June 30, 2002	30	540
January 1–September 30, 2002	15	665
January 1–December 31, 2002	15	710

1/ Stocks at end-period.

2/ Cumulative flows of contracted debt from the beginning of corresponding year.

Table 7. Continuous Performance Criterion on Non-accumulation of External Arrears

(In millions of U.S. dollars)

January 1–June 30, 2001 (actual)	0
January 1–December 31, 2001 (estimated)	0
January 1–March 31, 2002 (indicative target)	0
January 1–June 30, 2002 (performance criteria)	0
January 1–September 30, 2002 (performance criteria)	0
January 1–December 31, 2002 (performance criteria)	0

Prior Actions and Structural Benchmarks Under the Stand-By Arrangement

Prior actions

- Approval of the 2002 budget by congress consistent with the program.
- Issuance of the Presidential Decree (Acuerdo Gubernativo) strengthening expenditure control as described below.
- Tax measures described in paragraph 2 of this memorandum (i.e., increase in excise taxes for soft drinks, wine, beer, and liquor) enter into effect.
- Capitalization of Banco del Ejército by Q 150 million needed to set the stage for its privatization.

Structural benchmarks

- The new central bank and banking supervision laws, and the monetary law will be approved by congress before completion of the review of the program, scheduled for August 15, 2002.
- The superintendency of banks will complete a comprehensive assessment through on-site inspections of banks according to the plan indicated below. Results of ongoing inspections and of those to be completed before April 30, 2002, and measures to be adopted to deal with banks that are determined to be insolvent, will be reported to the Fund before completion of the review of the program, scheduled for August 15, 2002.

GUATEMALA— EXPENDITURE CONTROL

The decree (*acuerdo gubernativo*) of February 2002 introduced the following actions to control expenditure:

(i) set specific quarterly expenditure ceilings for each ministry; (ii) prohibit increases in central government budgetary appropriations (*ampliación presupuestal*) unless they have been declared priority expenditures and have external financing in line with the macroeconomic program; (iii) prohibit offsetting savings in expenditure other than in the wage bill with additional spending in different categories; (iv) freeze general wages (including bonuses) to the civil service; (v) prohibit the increase in the number of civil servants except in the health, education and security sectors, areas in which the decree stipulates ceilings for the possible increases; (vi) indicate that all government's investment will be included in the budget, and subject to the review and approval of the National System of Public Investment (SNIP) and the prior certification of available financing by the ministry of finance. The ministry of finance through the commission of programming and budget execution will monitor the implementation of the government's investment program. This commission will put special emphasis in monitoring operations involving advance payments (*anticipos*) to suppliers by checking that the line ministry (or unit) issues an identification document (*comprobante único de registro—CUR)* prior to approval of the operation, and that the contract with the supplier is rescinded before the operation is reversed; and (vii) reiterate that all inter-ministerial transfers will have to be approved by the ministry of finance.

GUATEMALA—PROGRAM OF ON-SITE INSPECTIONS

Ongoing inspections

Banco del Café
Banco SCI
Banco del Quetzal
Vivibanco
Banco Corporativo
Banco de Comercio

Inspections to be completed before April 30, 2002

Banco Industrial
Banco de Occidente
Banco G&T Continental
Banco Agrocomercantil
Banco Reformador
Banco de Exportación
Banco Internacional

Inspections to be completed before August 31, 2002

Banco de Desarrollo Rural
Banco Uno
Banco de la República
Banco Privado de Desarrollo
Banco de Antigua
Banco de América Central
Banco Cuscatlán de Guatemala
Citibank N.A.
Lloyds Bank PLc Sucursal Guatemala

GUATEMALA—TECHNICAL MEMORANDUM OF UNDERSTANDING

1. This technical memorandum of understanding (TMU) sets out the quarterly performance criteria (PCs) and indicative targets (ITs) as well as structural benchmarks established in the memorandum of economic policies (MEP) attached to the letter of intent dated March 15, 2002. This TMU also spells out the list of data that the authorities are committed to provide to the Fund staff on a timely basis. Progress in the implementation of the policies indicated in the MEP will also be monitored by a program review. The review is expected to be completed with the Executive Board on August 15, 2002, based on performance by end-June.

I. Fiscal Targets

A. Performance Criterion on the Overall Deficit of the Combined Public Sector [1]

(In millions of quetzales)

Overall Deficit of the Combined Public Sector	Ceiling
January 1–June 30, 2001 (actual)	1,880
January 1–December 31, 2001 (estimated)	4,915
January 1–March 31, 2002 (indicative target)	535
January 1–June 30, 2002	50
January 1–September 30, 2002	1,140
January 1–December 31, 2002	2,585

[1] As measured by the net financing requirement defined in the text below. Combined public sector defined in the text below.

2. The balance of the **combined public sector** (PS) is defined as the sum of the overall balances of the nonfinancial public sector (NFPS) and the operating result (quasi-fiscal balance) of the Banco de Guatemala. The **NFPS** consists of (i) the central government, the social security institute (IGSS), the municipalities and other decentralized agencies, which conform the general government; and (ii) the public enterprises: electricity company (INDE), telecommunications company (GUATEL), water and sewerage company (EMPAGUA), Quetzal Port, and six other small enterprises.

3. For any given calendar period, the **balance of the NFPS** is measured in quetzales as the sum of cumulative flows from the beginning of the corresponding year of: (i) net domestic financing of the NFPS; (ii) net external financing of the NFPS; and (iii) privatization proceeds, as defined below. Items denominated in foreign currency will be converted into quetzales at the actual exchange rate of each transaction.

4. The **domestic financing of the NFPS** is defined as the sum of (i) net credit (direct credit less deposits) from the domestic financial system; (ii) net proceeds from the placement, with the domestic financial system and other private sector residents, of bonds (issued or guaranteed by any PS entity) denominated in domestic or foreign currency or indexed to any foreign currency; (iii) floating debt (difference between the amount of expenditure on a commitment basis (*devengado*) and on a cash basis (*pagado*); (iv) suppliers' credit; (v) amount of pending VAT devolution to exporters below the "normal" level; and (vi) the value of any new leasing contracts entered into by the public sector during the program period, which is the present value at the commercial interest reference rate (CIRR) (at the inception of the lease) of all lease payments expected to be made during the period of the lease contract excluding those that cover the operation, repair, or maintenance of the property.

5. The **domestic financial system** comprises the banking sector, and the nonbank financial intermediaries. The banking sector includes the monetary authority and the commercial and development banks. The monetary authority (MA) includes the Bank of Guatemala and the Security Regulation Fund (Fondo de Regulación de Valores).

6. The **net external financing of the NFPS** is defined as the sum of (i) disbursements of loans; (ii) proceeds from the placement with nonresidents of bonds (issued or guaranteed by any PS entity) denominated in domestic or foreign currency or indexed to any foreign currency; (iii) changes in net financial assets held abroad by the PS; (iv) suppliers' credits; and (v) the value of any new leasing contracts entered into by the public sector during the program period, which is the present value at the commercial interest reference rate (CIRR) (at the inception of the lease) of all lease payments expected to be made during the period of the lease contract excluding those that cover the operation, repair, or maintenance of the property.

7. Privatization proceeds are defined as the cash payments (converted to quetzales at the actual market exchange rate of each transaction) and nonrecurrent fees (e.g., prepayments) received by the PS in payment for concessions to operate public services and for divestments of public enterprises. For purposes of the program, nonrecurrent fees will be accounted for over the concession period, distributed in equal quarterly amounts.

8. The balance of the combined public sector (PS) defined above assumes that interest and amortization payments on domestic and external debt are on a due-basis. Interest and amortization payments on foreign currency denominated debt as well as any financing transaction denominated in foreign currency are converted into quetzales at the bid-ask average market exchange rate prevailing at the moment (or settlement) of the transaction. Any unforeseen changes in the recording procedures of PS accounts that may require an adjustment in the overall balance of the PS shall be agreed with the Fund staff before any change is effected.

B. Performance Criterion for the Central Government Expenditure [1]

(In millions of quetzales)

	Ceiling
January 1–June 30, 2001 (actual)	9,560
January 1–December 31, 2001 (estimated)	22,330
January 1–March 31, 2002 (indicative target)	4,665
January 1–June 30, 2002	9,280
January 1–September 30, 2002	15,225
January 1–December 31, 2002	22,515

[1] Measured as defined in the text below.

9. For any given calendar period **expenditure of the CG is** defined as the cumulative flows from the beginning of the corresponding year of expenditure as reported in the financial statistics of the central government prepared by the Directorate of Fiscal Analysis of the Ministry of Finance (see below). Any unforeseen change in the reporting of measurement of the central government expenditure that may require an adjustment in the definition of social expenditure will be agreed with Fund staff before the change is effected.

C. Indicative Targets for the Central Government Social Expenditure [1]

(In millions of quetzales)

Central Government Social Expenditure	Floors
January 1–June 30, 2001 (actual)	3,950
January 1–December 31, 2001 (estimated)	8,970
January 1–March 31, 2002	1,515
January 1–June 30, 2002	3,515
January 1–September 30, 2002	6,070
January 1–December 31, 2002	9,095

[1] Measured as defined in the text below.

10. For any given calendar period, **the central government social expenditure** is defined as the cumulative flows from the beginning of the corresponding year of social expenditure, as reported in the financial statistics of the central government, for the follow up of the Peace Accords prepared by the Directorate of Fiscal Analysis of the Ministry of Finance (see below). Any unforeseen changes in the reporting or measurement of the social expenditure that may require an adjustment in the definition of social expenditure will be agreed with the Fund staff before the change is effected.

II. Monetary Targets

A. Performance Criterion on NIR of the Monetary Authorities (MA)[1]

(In millions of U.S. dollars)

	Floor (end of period)
June 30, 2001 (actual)	1,802
December 31, 2001 (estimated)	2,301
March 31, 2002	2,200
June 30, 2002	2,350
September 30, 2002	2,220
December 31, 2002	2,091

[1] Includes the Bank of Guatemala and the Security Regulation Fund. Measured as defined in the text below.

11. **The stock of NIR of the MA** is defined as the difference between the U.S. dollar value of gross liquid foreign assets, and short-term foreign liabilities as defined below.

12. The definition of gross foreign assets and net foreign assets should be consistent with the Data Template on International Reserves and Foreign Currency Liquidity and the fifth edition of the Balance of Payments Manual (BPM5). Gross reserve assets must be under the control of the monetary authorities and include monetary gold, holdings of SDRs, any reserve position in the Fund, and holdings of foreign exchange in convertible currencies. Excluded from reserve assets are capital participation in IFIs, any assets in nonconvertible currencies, holdings of precious metals other than monetary gold, encumbered reserve assets, reserve assets pledged as collateral for foreign loans, reserve assets pledged through forward contracts, and redeposits at the commercial banks. **Short-term foreign liabilities** of the MA are defined as the sum of (i) all foreign currency-denominated liabilities of the MA with an original maturity of one year or less; (ii) liabilities to the Fund; (iii) any foreign currency liabilities of the MA to residents, including financial institutions; and (iv) any short-term liability converted into a medium-term liability during the program period.

B. Performance Criterion for the Stock of Net Domestic Assets of the Bank of Guatemala[1]

(In millions of quetzales)

	Ceiling (end of period)
June 30, 2001 (actual)	-6,634
December 31, 2001 (estimated)	-8,933
March 31, 2002	-8,490
June 30, 2002	-10,080
September 30, 2002	-9,180
December 31, 2002	-6,528

[1] Measured as defined in the text below.

13. **The stock of NDA of the Bank of Guatemala is defined** as the difference between the stock of currency issue and the stock of NIR of the Bank of Guatemala as defined above. For the purpose of calculating NDA, the assets and liabilities denominated in foreign currency of the Bank of Guatemala will be valued at Q 8 per U.S. dollar.

III. External Debt Ceiling

A. Performance Criterion on Nonconcessional External Debt of the Combined Public Sector[1]

(In millions of U.S. dollars)

	Short Term 0–1 Year Maturity (Outstanding stock)	More than 1 Year (cumulative flow of contracted debt)[2]
January 1–June 30, 2001 (actual)	340	124
January 1–December 31, 2001(estimated)	115	610
January 1–March 31, 2002	40	440
January 1–June 30, 2002	30	540
January 1–September 30, 2002	15	665
January 1–December 31, 2002	15	710

[1] Measured as defined in the text below.
[2] From the beginning of the corresponding year.

14. The ceiling on short-term debt covers the outstanding stock (rather than in a contracting basis) of external debt with original maturity of one year or less owed or

guaranteed by the combined public sector. For purposes of this performance criterion, the term "debt" has the meaning set forth in point 9 of the Guidelines on Performance Criteria with Respect to Foreign Debt (Decision No. 12274-(00/85), August 24, 2000), and for this performance criterion concessionality does not apply. The ceiling on long-term debt covers the external debt with an original maturity of more than one year contracted or guaranteed by the combined public sector. This performance criterion applies not only to "debt" as defined in point 9 of the Guidelines on Performance Criteria with Respect to Foreign Debt, but also to commitments contracted or guaranteed for which values have not been received. The ceilings refer to debt with a grant element of less than 35 percent calculated on the basis of current specific commercial interest reference rate (CIRR) as discount rates. The ten-year average CIRR shall be used as the discount rate for loans of a maturity of at least 15 years; for loans of a maturity of less than 15 years, the discount rate is based on the average CIRR of the preceding six-month period. The ceilings on external debt apply to the cumulative amount for the year. For program purposes external debt denominated in currencies other than U.S. dollars will be converted into U.S. dollars at the exchange rate between the respective currencies as of December 31 of the previous year.

15. Guatemala will maintain its stated policy of not incurring external payment arrears. This performance criterion applies on a continuous basis. Arrears are defined as a bill that has been received for goods and services verified as successfully delivered but not paid after what is considered "acceptable grace period" normally 30 days.

B. Continuous Performance Criterion on Nonaccumulation of External Arrears

(In millions of U.S. dollars)

January 1–June 30, 2001 (actual)	0
January 1–December 31, 2001 (estimated)	0
January 1–March 31, 2002	0
January 1–June 30, 2002	0
January 1–September 30, 2002	0
January 1–December 31, 2002	0

IV. Adjustment for External Financing

16. The program is based on projected net external financing of the nonfinancial public sector of US$21 million in the first half of 2002, US$17 million in the first three quarters of 2002, and US$53 million in 2002. The shortfall (excess) of external financing noted below is net of the projected disbursements referred to in paragraph 19. The program is also based on projected central government revenue of Q 9,600 million during the first half of 2002, Q 14,500 during the first three quarters of 2002, and Q 20,100 in 2002.

17. **In the event of a shortfall of net external financing**, floors on net international reserves will be adjusted downward and the ceilings on net domestic assets of the MA will be adjusted upward by the full amount of the shortfall up to a maximum of US$21 million during the first half of 2002, US$17 million during the first three quarters of 2002, and US$53 million during 2002.

18. **In the event of excess of net external financing** from the IDB, the World Bank, and the Central American Bank of Economic Integration (CABEI) only, ceiling on the combined public sector deficit will be adjusted upward (to a more negative value), and on the central government's total expenditure and floors on the central government social expenditure will be adjusted upward by the full amount of the excess of external financing up to a maximum of US$15 million during the first half of 2002, US$25 million during the first three quarters of 2002, and US$40 million during 2002. The nonconcessional external debt ceilings for each quarter will be adjusted accordingly by the contracted amount.[1] In the event of external financing beyond the quarterly amounts noted above (US$5 million during the first quarter of 2002, US$15 million during the first half of 2002, US$25 million during the first three quarters of 2002, and US$40 million during 2002), the targets on net international reserves will be adjusted upward and the limits on net domestic assets will be adjusted downward by the full amount of the excess in each quarter.

19. The program projections for external financing do not include the **Financial Sector Adjustment Loan from the World Bank** or other external loans to be used to finance the restructuring of the banking system. To the extent that these loans are disbursed, the floors of the net international reserves of the MA and the ceilings on the nonconcessional external debt will be adjusted upward and the ceilings on the net domestic assets of the MA will be adjusted downward by the net amount of the loan. The nonconcessional external debt ceiling will be adjusted accordingly by the contracted amount. When proceeds from this loan are used the floor of net international reserves of the MA will be adjusted downward, and the ceiling on the net domestic assets of the MA will be adjusted upward by the amount used.

V. Adjustment for Central Government Revenue

20. In the event of excess of government revenue with respect to the amounts noted in paragraph 16, both the ceilings on total expenditure and the floors on social expenditure will be adjusted upward by the full amount of the excess (i.e., the adjustment will allow an increase in social expenditure only).

[1] The program assumes cumulative flows of contracted debt from the IDB, the World Bank, and CABEI of US$540 million during the first half of 2002, US$665 million during the first three quarters of 2002, and US$710 million during 2002.

VI. Adjustment for Credit to Coffee Producers

21. Limit on the overall deficit of the combined public sector will be adjusted upward (to a more negative value)/downward (to a less negative value), and on the central government expenditure will be adjusted upward (downward) by any excess (shortfall) of bonds issued to provide financial assistance to coffee producers with respect to the equivalent of US$40 million in 2001 and US$60 million in 2002. In any event, the bonds issued to help coffee producers should not exceed the equivalent of US$100 million over the 2001–02 period.

VII. Adjustment for Debt Substitution

22. In the event that proceeds from bonds issued to substitute debt exceed the amount of substituted debt, floors on NIR will be adjusted upward, and ceilings on net domestic assets will be adjusted downward by this excess. The nonconcessional external debt ceilings will be adjusted accordingly by the contracted amount.

VIII. Structural Benchmarks

23. There are structural benchmarks during 2002 on submitting to congress the new laws of the central bank and banking supervision and the monetary law, and assessing the conditions of banks and adopting measures necessary to deal with banks that resulted insolvent. Both structural benchmarks should be implemented before completion of the review under the program.

IX. Information

24. The authorities are committed to provide regularly to the Fund staff the necessary information to monitor the program in an adequate manner, in particular as it refers to the following specific daily, weekly, and monthly data with a delay not exceeding the lag indicated in parenthesis.

25. The Bank of Guatemala will send the IMF information through:

(a) A daily electronic mail.

(b) A weekly fax.

(c) A monthly fax.

(d) A monthly pouch of data sent by a courier.

In addition, timely information will be provided to the Fund on economic and financial measures taken by the government, as well as changes in legislation including regulations approved by the Central Bank of Guatemala, the ministry of finance, the superintendency of banks, the SAT, and other key economic agencies.

The daily electronic mail will be sent at the beginning of the next working day unless otherwise agreed, and will contain:

(i) The level of net international reserves.

(ii) The stock of currency issued .

(iii) The deposits of the central government and the rest of the nonfinancial public sector in the Bank of Guatemala.

(iv) The exchange rate of the quetzal vis-à-vis the U.S. dollar.

(v) Amount of the central bank intervention in the FOREX market (end of working day).

(vi) Placements and amortization of certificates of open market operations by maturity, interest rate and holder (nonfinancial private sector, financial sector, nonfinancial public sector).

The weekly information will contain and will be sent with a lag of no more than one week:

(i) The level of gross international reserves and level and composition and liabilities as defined in paragraphs 12 and 13.

(ii) Principal accounts of the balance sheet of the central bank.

(iii) Daily buying and selling exchange rates in the interbank foreign exchange markets.

(iv) Weekly amounts of the central bank intervention in the FOREX market.

(v) Placements and amortization of certificates of open market operations by maturity, interest rate and holder (nonfinancial private sector, financial sector, nonfinancial public sector).

(vi) Commercial banks average deposit and loan interest rates in domestic and foreign currencies.

(vii) Foreign currency cash flow of the central bank.
(viii) Devolution of VAT to exporters.

Monthly information

(i) Details of cumulative losses of Bank of Guatemala.

(ii) Main monthly accounts of the commercial and development banks.

(iii) Monthly accounts of the central bank.

(iv) Monthly consumer price index.

(v) Monthly information of IGSS position with the banking system.

(vi) Main economic and financial laws, and related monetary board regulations.

26. The ministry of finance will fax every month the following information:

(i) Updated monthly data for net disbursements of public and publicly guaranteed external debt of one year or less, and contracted debt of more than one year. These data will be prepared by the Public Credit Directorate of the ministry of finance.

(ii) Data on disbursements and amortization of credit from the IDB and World Bank.

(iii) Total government revenue measured on a cash basis, and divided between tax revenue and nontax revenue, transfers and grants. Tax revenue will be divided between direct taxes (income tax, IEMA, oil royalties, other) and indirect taxes (domestic VAT , VAT on imports, excise taxes on oil, alcohol and beverages, stamp taxes, vehicle taxes, import taxes, other taxes).

(iv) Total government expenditure measured both on a commitment basis and a cash basis, and divided between current and capital expenditure. Current expenditure will be divided between expenditure in wages and salaries, goods and services, external and internal debt interest payments, and transfers (identifying at least those to municipalities and social funds). Capital expenditure will be divided between direct investment and capital transfers (identifying at least those to municipalities and social funds).

(v) Total government social expenditure, defined as expenditure in education, science, and culture; health and social assistance; housing; internal security; the Judicial Organism, the Constitutional Court and the Attorney General's office.

(vi) The stock of floating debt (*deuda flotante*) at the beginning and the end of the period.

(vii) External financing of the central government and INDE, including disbursements and amortizations of external loans and bonded debt placed with nonresidents, as well as any variation of external arrears.

(viii) Domestic financing of the central government, including variation of deposits in the central bank and commercial banks, as well as bonded debt placed with residents and any variation of arrears with domestic debt holders.

(ix) Privatization receipts.

GUATEMALA—DEFINITION OF CENTRAL GOVERNMENT EXPENDITURE 1/

Central government expenditure is defined as all direct expenditure and transfers made by the institutions that comprises the central government:

- current expenditure: expenditure in wages and salaries, goods and services, interest payments, and current transfers; and

- capital expenditure: direct capital expenditure, net lending, and capital transfers.

Central Government Expenditure

June 2001

(In millions of quetzales)

Total	**9,557.2**
Current expenditure	7,054.2
Wages and salaries	2,711.2
Goods and services	1,205.8
Interest payments	1,077.0
Current transfers	2,059.0
Capital expenditure	2,503.0
Direct expenditure	892.0
Net lending	0.0
Capital transfers	1,611.0

1/ Source: Directorate of Fiscal Analysis of the Ministry of Finance.

GUATEMALA—DEFINITION OF CENTRAL GOVERNMENT SOCIAL EXPENDITURE 1/

Central government social expenditure is defined as all direct expenditure and transfers made by the institutions that comprises the central government in the following areas:

- Education, science, and culture
- Health and social assistance
- Housing
- Internal security
- Judicial organism and Constitutional Court
- Attorney General's Office

Central Government Social Expenditure

June, 2001

(In millions of quetzales)

Total	**3,950.1**
Education, science, and culture	1,011.6
Health and social assistance	1,897.4
Housing	43.5
Internal security	550.2
Judicial Organism and Constitutional Court	281.3
Attorney's General Office	166.1

1/ Source: Directorate of Fiscal Analysis of the Ministry of Finance.

GUATEMALA—PRIOR ACTIONS AND STRUCTURAL BENCHMARKS UNDER THE PROGRAM

Prior actions

- Approval of the 2002 budget by congress consistent with the program.
- Issuance of the Presidential Decree (Acuerdo Gubernativo) strengthening expenditure control as described in paragraph 15 of the Memorandum of Economic and Financial Policies.
- The entrance into effect of tax measures approved by congress in January and February 2002 (described in paragraph 2 of the Memorandum of Economic and Financial Policies).
- Capitalization of Banco del Ejército by Q 150 million needed to set the stage for its privatization.

Structural benchmarks

- The submission to congress of the new laws on the central bank and banking supervision and the monetary law before the completion of the review of the program, scheduled for August 15, 2002.
- The Superintendency of Banks will complete a comprehensive assessment through on-site inspections of banks according to the plan indicated in the Memorandum of Economic and Financial Policies. Results of ongoing inspections and of those to be completed before April 30, 2002, and measures to be adopted to deal with banks that are determined to be insolvent, will be reported to the Fund before completion of the review of the program, scheduled for August 15, 2002.

Statement by the IMF Staff Representative
April 1, 2002

1. Guatemala has complied with all the prior actions under the program. Also, the following information has become available since the staff report (EBS/02/49) was circulated to Executive Directors. It does not change the thrust of the staff appraisal.

2. The central government position was in balance during January–February 2002 as compared with a deficit of 3 percent of GDP on an annual basis a year earlier. Central government revenue rose to 10¾ percent of GDP (9 percent of GDP during the similar period of 2001) reflecting the tax and tax enforcement measures introduced in August 2001. Government's expenditure fell to 10¾ percent of GDP (12¼ percent of GDP during the similar period of 2001) mostly reflecting a cut by half of defense expenditure while social spending rose slightly.

3. Net international reserves fell slightly to US$2.2 billion during the first quarter of 2002 reflecting amortization of short-term debt as envisaged in the program. Preliminary data for end-March suggest that Guatemala complied with the indicative targets on both the stock of net international reserves and net domestic assets of the central bank.

4. In early March 2002 the government reached a political agreement with the main opposition parties on a congressional agenda, which includes approval of the remaining financial sector laws and laws on probity, the role of the comptroller general and government procurement by mid-May 2002. In addition, the minister of finance had informed the staff that the commission in charge of following up the Peace Accords has endorsed the postponement of the deadline to achieve the tax ratio of 12 percent of GDP from 2002 to 2004.

Press Release No. 02/16
FOR IMMEDIATE RELEASE
April 1, 2002
Corrected: 4/10/02

International Monetary Fund
Washington, D.C. 20431 USA

IMF Approves One-Year Stand-By Credit for Guatemala

The International Monetary Fund (IMF) today approved a one-year stand-by credit for Guatemala for SDR 84 million (about US$105 million) to support the government's economic program for 2002. The government of Guatemala will treat the stand-by credit as precautionary and does not intend to make any drawings.

In commenting on the Executive Board discussion, Eduardo Aninat, Deputy Managing Director and Acting Chairman, said:

"Guatemala's economic program aims at strengthening macroeconomic policies, improving the health of the banking system, and enhancing social conditions as specified under the 1996 Peace Accords. The improvement of the fiscal position and structural measures included in the program will be crucial elements to restoring macroeconomic stability and placing the economy on a sustainable higher growth path.

"The program for 2002 is framed around a further recovery in economic activity helped by the gradual improvement of the international environment, and a reduction in inflation to a 4-6 percent range. Net international reserves would be maintained at a relatively comfortable level, providing adequate cover for imports and short-term debt.

"The program targets a narrowing of the fiscal deficit by half to 1½ percent of GDP in 2002 through revenue-raising measures and improved expenditure control. Revenue would rise as a result of tax measures adopted in 2001–02—including the increase in the VAT rate—and the authorities' actions to strengthen tax administration and enforcement. Expenditure control will be enhanced with the full implementation of the presidential decree of February 2002 that guides a strict implementation of the budget. At the same time, to mitigate the impact of austerity on the government's Poverty Reduction Strategy the authorities will put in place the infrastructure needed to protect social expenditure, and avoid waste and duplication in social funds.

"Looking ahead, the authorities are urged to avoid further delays in bringing the tax ratio to the target of 12 percent of GDP under the 1996 Peace Accords. Further delays in reaching this target would make it difficult to improve the delivery of social services and raise Guatemala's low social indicators.

"The program contemplates the continuation of the tight stance of monetary policy to achieve the objectives on inflation and international reserves. The authorities will continue to implement a flexible exchange rate policy, which allows the exchange rate to reflect market conditions.

"The authorities are undertaking measures to address the weaknesses of the financial system. They are liquidating insolvent banks and financial companies, and in January 2002 Congress enacted a new banking law improving the prudential regulation framework and setting a new system for bank resolution. Guatemala has recently approved an anti-money laundering law. Furthermore, new laws on the central bank, banking supervision, and the monetary framework are expected to be approved in the near term.

"The authorities are taking steps to improve governance and transparency. Building on this, the program includes the approval of legislation on probity, the role of the comptroller general, and public sector procurement," Mr. Aninat said.

ANNEX

Program Summary

With the signing of the UN-sponsored Peace Accords of 1996, the Guatemalan authorities designed an ambitious program to mobilize domestic resources and external aid to address deep-rooted social problems, improve human capital, and raise productivity so that the economy could achieve the sustainable higher growth path required to reduce poverty. Uneven macroeconomic performance, low implementation capacity, inadequate tax collection, and lower-than-expected aid disbursements have hindered progress, and the tax ratio, at 9.7 percent of GDP in 2001, remained lower than the 12 percent projected in the Peace Accords for 2000.

The new administration, which took office in January 2000, sought to strengthen macroeconomic stability and to implement the Peace Accords, but an initial tightening of fiscal spending proved to be temporary, and with the adverse terms of trade and global slowdown in 2001, macroeconomic conditions have weakened again. A new effort is now under way, aimed at reducing the fiscal deficit and restructuring the financial system, while sustaining the higher outlays for social needs and basic infrastructure, as called for by the Peace Accords.

The authorities' program, which the stand-by credit supports, assumes an acceleration of **real GDP** growth to 2 ¼ percent in 2002 from 1 ¾ percent in 2001, and a reduction in **inflation** to the 4-6 percent range, from an estimated 9 percent in 2001. The program also envisages a decline in net international reserves to about 145 percent of short-term debt on a remaining maturity base at end-2002 from about 175 percent at end-2001.

To these ends, the **fiscal** program stipulates that the deficit of the combined public sector would be halved to 1½ percent of GDP in 2002, with a narrowing of the central government deficit to 1 ¼ percent of GDP, from 2 ¾ percent in 2001. This is to be achieved on the strength of revenue measures introduced in 2001 and 2002, and expenditure restraint, which includes a cut in central government outlays by 1 percent of GDP while maintaining **social expenditure** at about 5 percent of GDP. The government will also strengthen targeting and resource allocation in social areas. **Monetary policy** will be kept as tight as needed to achieve the inflation objective of the program.

In the **structural area**, the program seeks the approval of new laws affecting the central bank, banking supervision, and the monetary framework by mid-year 2002. New laws on probity, the role of the comptroller general, and government procurement will be presented to Congress during the program period.

Guatemala joined the IMF on December 28, 1945, and its current quota is SDR 210.2 million (about US$262 million); it has no outstanding use of IMF credit.

Guatemala: Selected Economic and Financial Indicators

	1997	1998	1999	2000	Prel. 2001
(Annual percentage change)					
Real economy (change in percent)					
Real GDP	4.4	5.0	3.8	3.6	1.8
Consumer prices (end of period)	7.1	7.5	4.9	5.1	8.9
National savings (in percent of GDP)	10.5	12.1	11.9	11.5	10.8
Gross domestic investment (in percent of GDP)	14.0	17.4	17.4	17.0	15.4
Public finance (in percent of GDP) 1/					
Combined public sector balance (deficit -)	-0.6	-1.8	-2.9	-2.0	-3.0
Central government balance (deficit -)	-0.5	-1.8	-3.0	-2.2	-2.8
Money and credit (end-year, percent change)					
Net domestic assets 2/	9.1	9.7	7.9	9.4	10.9
Of which					
Net claims on nonfinancial public sector	-6.7	-11.1	1.6	0.0	-6.0
Credit to private sector	13.5	19.4	11.4	8.2	17.6
Liabilities to private sector 2/	15.5	13.3	9.8	23.3	15.8
Interest rates (end of period)					
Deposit rate (time deposits)	9.6	10.8	17.9	15.3	13.8
Lending rate	16.4	18.1	20.6	20.1	17.9
External sector (in percent of GDP)					
Trade balance	-7.1	-9.3	-9.7	-11.0	-10.3
Current account (including official transfers)	-3.5	-5.3	-5.5	-5.5	-4.6
Change in net international reserves (in millions of U.S. dollars, increase -)	-287	-243	125	-728	-500
Net international reserves (in millions of U.S. dollars) 3/	957	1200	1074	1802	2301
Gross reserves 3/ (in months of next year's imports of goods and services)	2.2	2.8	2.2	3.6	4.6
External public debt (as percentage of GDP)	14.7	15.0	18.0	17.2	16.3
Real effective exchange rate (percent change, end-period; appreciation +)	8.1	-4.5	-5.9	4.9	1.2

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

1/ As measured on the financing side.
2/ In relation to the stock of liabilities to the private sector at the beginning of the period.
3/ Excludes claims on Nicaragua amounting to US$145.7 million up to 1999 and US$75.7 million in 2000.

Statement by Hernán Oyarzábal, Alternate Executive Director and Orlando Garner, Advisor to the Executive Director for Guatemala
April 1, 2002

On behalf of our Guatemalan authorities, we would like to thank the staff for their hard work in preparing a well-written report on the country's recent economic and financial developments and for the ongoing policy dialogue, valuable advise and assistance offered. Furthermore, our authorities would like to express their gratitude for the invaluable support extended to Guatemala by the international community during the Consultative Group meeting held in Washington, D.C. on February 11-12, 2002.

Background

Guatemala's macroeconomic setting at the end of 1999 was characterized by a low net international reserve position that placed the country at high risk of a foreign currency crisis, which might have further undermined the already weak position of the domestic financial system; and slow down implementation of the 1996 U.N. supported Peace Accords. This setting was the result of large swings in fiscal and monetary policies, adverse external shocks, weather conditions, and volatile capital flows in previous years. Against this background, the administration of President Portillo—since assuming office in January 2000—sought to restore macroeconomic stability and advance in the implementation of the 1996 Peace Accords. Soon after taking office, our authorities adopted measures to control expenditures that narrowed the combined public sector (including the central bank) deficit from 3 percent of GDP in 1999 to 2.5 percent of GDP in 2000, and the central bank maintained a tight monetary policy. As a result, net international reserves rose by US$725 million to US$1.8 billion by end-2000 leading to a marked improvement of indicators of external vulnerability.

Recent Economic Performance

The Guatemalan economy has not been immune to the deterioration in the international environment in 2001, including the September 11 events. As the economy of the U.S. and neighboring countries slowed, real GDP growth declined by half to around 2 percent —the lowest rate in the last ten years. The slack economic activity, together with a serious drought that affected the Northeastern region of the country and a continued fall in world coffee prices—the economy's mainstay—are intensifying the already difficult problems of poverty and unemployment. Despite slow domestic demand, inflation rose 8.9 percent in 2001, well above the 4 to 6 percent range targeted in the monetary program, reflecting the non-recurring effect of an increase in the VAT rate and weather-related food shortages.

During the first half of 2001, expenditure increases—including in areas identified in the Peace Accords—began to put pressure on the fiscal accounts. This prompted the authorities to implement a tax package in July 2001, including an increase in the VAT rate from 10 to 12 percent and a reform of the tax and penal codes aimed at strengthening the superintendence of tax administration. Moreover, in November 2001 Congress approved an increase in the excise on cigarettes. In January 2002, the authorities increased custom duties on gasoline, and in February 2002 Congress approved additional tax measures, including increases in the excise on beer, alcoholic beverages, and soft drinks. These measures, needed to continue financing social expenditure, were implemented despite widespread public demonstrations against them.

Net international reserves continued to strengthen by US$500 million to a stock of US$2.3 billion by end 2001. This reflected the tight stance of monetary policy together with the third installment of proceeds from the privatization of the telecommunications company and part of proceeds from a bond issue in the Euro market.

In fact, in November 2001, Guatemala returned to the Euro market for the first time since 1997, where it issued a bond for US$325 million with proceeds earmarked to amortize short-term debt falling due over 2001-2002. This 10-year bond (at a 10¼ interest rate) is currently quoted at a premium (107.6 percent).

In the financial sector, the Monetary Board intervened and subsequently requested the Courts the liquidation of three insolvent banks and two insolvent finance companies. Also, Congress approved an anti-money laundering law, which, in the view of our authorities, strengthens money laundering control sufficiently to take Guatemala off the list of "non-cooperative" countries elaborated by the OECD-backed Financial Action Task Force.

The Economic Program

Our authorities are aware that the critical challenges facing Guatemala over 2002 and the medium term are to speed up the implementation of the Peace Accords and to strengthen the macroeconomic performance by substantially improving the fiscal position and addressing the weaknesses of the banking system. The economic program aims at supporting a real GDP growth of 2 ¼ percent in 2002 and a reduction in inflation to a 4-6 percent range, while the coverage of net international reserves will stay at the equivalent to 145 percent of short-term debt on the remaining maturity basis by end 2002. In support of this program, our authorities are requesting a 12-month Stand-By Arrangement from the Fund in an amount equivalent to SDR 84 million.

Our authorities are also requesting the posting of a Fund Resident Representative in Guatemala, which they consider crucial to help policy implementation and program follow-up.
Moreover, the authorities intend to follow this program with another one covering 2003, an electoral year. In due time, our authorities will request that such a program be supported by another stand-by arrangement from the Fund.

Fiscal Policy

The fiscal objective of the program is to reduce the combined public sector deficit by half to 1.5 percent of GDP in 2002. To this end, public sector savings would rise from 1 percent of GDP in 2001 to 2.5 percent of GDP in 2002 by increasing tax revenue from 9¾ of GDP in

2001 to 10 ¾ percent in 2002, which would reflect the annual effect of tax and tax administration measure introduced in 2001 and an increase in excises on beer, alcoholic beverages and soft drinks, approved last February. Our authorities regret that Guatemala will not be able to reach the tax ratio of 12 percent of GDP agreed under the Peace Accords. Under the current political environment—following the recent increase in the VAT rate—proposals for tax increases would only jeopardize approval by Congress of the structural agenda. Thus, the authorities have agreed with the Peace Commission to reach this fiscal target by 2004.

On the expenditure side, our authorities have been implementing a strict program of control making good use of the Integrated Financial Management System (IMFS). As a result, government expenditure is expected to fall by 1 percentage point of GDP to 12 ¾ percent in 2002. Within this general framework our authorities are determined to protect social expenditures, which would remain over 5 percent of GDP. Moreover, our authorities are taking steps to reduce waste and avoid duplication in the expenditures of the social programs.

Monetary Policy and the Financial Sector

The Central Bank would continue to maintain a tight monetary policy in order to reach the inflation objective of the program. The Central Bank would also continue monitoring inflation and monetary developments closely and would be ready to increase interest rates as needed to comply with the objectives of the program. In addition, the exchange rate would continue to reflect market conditions, with the central bank refraining from intervening in the Forex market, except for smoothing purposes. Management of monetary policy will be facilitated by a strict implementation of the central bank's regulation limiting its lender-of-last- resort functions to short-term liquidity problems.

Our authorities appreciate the technical assistance provided by the Fund, the World Bank and the Inter-American Development Bank, for the preparation of the necessary legislation to strengthen the Guatemalan financial system. In this regard, the Law on Banks and Financial Groups was approved on January 2002. This law aims at rationalizing the legal framework of the financial system by introducing consolidated supervision and capital adequacy requirements, including offshore operations and allowing expeditious bank resolution. In addition, the stockholders of Banco del Ejercito (the Armed Forces Bank) increased the bank's capital in March 2002 thus setting the stage for its privatization in 2002. Moreover, our authorities have reached a broad-base political agreement with all parties represented in Congress to, interalia, approve by May 2002 the new laws of central bank and banking supervision, and the new monetary law. The Central Bank Law reinforces the autonomy of the monetary authority and defines precisely the objectives of the Central Bank. The Supervision Law strengthens the functional independence and supervision capacity of the Superintendence of Banks and the Monetary Law reinforces the free monetary exchange and the movement of capital.

External Sector

External competitiveness is not a problem in Guatemala. The slight fall in nontraditional exports in 2001 reflected mostly the slow down in the international economy and recovery is expected in 2002 and 2003. Our authorities believe that the fiscal and monetary policy implemented under this economic program goes a long way to help support external competitiveness. Guatemala has a relatively open trade regime. After complying with obligations under the Central American Common Market, Guatemala is now striving to further trade liberalization focusing on bilateral and regional trade arrangements. Our authorities want to stress that these arrangements will be consistent with WTO guidelines.

Structural Reforms

Our authorities are determined to improve governance and transparency. To this end, the Integrated Financial Management System (IFMS) would be extended to public sector entities outside the government, such as municipalities, the judicial and legislative branches and to autonomous and decentralized agencies.

As part of the political agreement mentioned above, necessary steps are being taken to expedite the approval of the laws on probity and on the Office of the Comptroller General, already in Congress. In addition, our authorities are preparing a new procurement law with assistance from the Inter-American Development Bank.

Despite the progress achieved so far, the challenges ahead are considerable, but our authorities are confident that perseverance in implementing their reform agenda will help place Guatemala on the path of sustainable economic growth needed to deal with entrenched poverty problems. In this regard, they expect that these efforts will continue to receive the technical and financial support from the international community, including from the Fund.

Finally, the authorities would like to give recognition to the assistance given by Mr. Arbulú-Neira and his team. They have done an excellent job in helping to set the economic programs and the political dialogue on the current economic reform.