May 2009
IMF Country Report No. 09/143

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

In the context of the request for a Stand-By Arrangement for Guatemala, 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 March 26, 2009, with the officials of Guatemala on economic developments and policies. Based on information available at the time of these discussions, the staff report was completed on April 13, 2009. 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 supplement of April 13, 2009, on the assessment of the risks to the Fund and the Fund's liquidity position.

- A Press Release summarizing the views of the Executive Board as expressed during its April 22, 2009, discussion of the staff report that approved the request.

- A statement by the Executive Director for Guatemala.

The documents listed below have been separately released.

Letter of Intent sent to the IMF by the authorities of Guatemala*
Memorandum of Economic and Financial Policies by the authorities of Guatemala*
Technical Memorandum of Understanding*
*Also included in Staff Report

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

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International Monetary Fund
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INTERNATIONAL MONETARY FUND

GUATEMALA

Request for Stand-By Arrangement

Prepared by the Western Hemisphere Department
(In consultation with Other Departments)

Approved by Patricia Alonso-Gamo and Dominique Desruelle

April 13, 2009

Precautionary Stand-By Arrangement. In the attached letter of intent, the Guatemalan authorities are requesting an 18-month Stand-By Arrangement (SBA) with total access of SDR 630.6 million (about US$951 million). An initial purchase of SDR 420.4 million (about US$634 million) will become available upon Board approval of the arrangement; the remainder will be available in five quarterly purchases subject to reviews. The authorities intend to treat the arrangement as precautionary.

Context and rationale. Guatemala has made substantial progress in consolidating macroeconomic stability and implementing structural reforms. Adverse external conditions, however, are affecting economic activity and financial conditions. The authorities have taken a number of upfront measures to mitigate the impact of the external shock and preserve macroeconomic stability. The program will support the authorities' policies and provide insurance against significant downside risks.

The program. The authorities' policy strategy has four key elements: (i) a moderate fiscal stimulus to support domestic demand, financed with substantial external resources from multilaterals to minimize crowding out the private sector; (ii) a monetary policy focused on consolidating the decline in inflation and a flexible exchange rate to facilitate economic adjustment; (iii) a strengthening of financial sector policies to increase the resilience of banks, and enhance the banking sector safety net and resolution procedures; and (iv) a refocusing of public expenditures toward strengthening social spending and labor-intensive public works.

Discussions. A staff team comprised by G. Lopetegui (Head), I. Vladkova-Hollar, R. Luzio, and P. Morra (all WHD), and C. Henn (SPR) visited Guatemala City during March 16–26 to hold program discussions. A. Schipke (regional resident representative) assisted the mission. P. Alonso-Gamo (WHD) participated in the final discussions. The mission met with Minister of Finance Juan Alberto Fuentes Knight, Central Bank President Maria Antonieta de Bonilla, and Superintendent of Banks Edgar Barquin**.**

Publication. The authorities have consented to the publication of the staff report and the program documents.

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I. Background

1. **Guatemala has a strong track-record of macroeconomic stability**. Structural reforms, prudent policies, and a favorable external environment led to an acceleration of growth above historical averages and higher private investment in the last few years. Fiscal policy has been strong, with deficits broadly at debt-stabilizing levels and significant progress on tax administration, while good public debt management led to longer maturities and declining debt dollarization. Inflation remained mostly in single digits, though it increased rapidly since mid-2007, to a large extent as a result of the global commodities shock. The recent reversal in commodity prices, however, has helped bring down inflation sharply.

2. **The economy is open and hence vulnerable to external shocks**. Linkages, predominantly to the U.S., operate through three main channels—trade, remittances, and capital flows. While public sector external financing requirements are low (2.4 percent of GDP), recent data releases show large private sector external financing requirements, implying a gross external financing need (current account deficit plus total debt amortization) of 16¼ percent of GDP for 2009, above the median for emerging markets. A large NIR stock (90 percent of short-term external debt on remaining maturity basis and 34 percent of M2 at end-2008) provides an important buffer.

3. **The banking sector has consolidated after tensions in 2006 and 2007**. At that time, two banks representing broadly 10 percent of the system failed and were resolved effectively, with little cost to the public sector. Since then, bank consolidation has increased the resilience of the system as a whole, with the capital to risk weighted assets ratio averaging 13.5 percent, while system-wide liquidity remains high at 40 percent of deposits at end-December 2008. Still, areas for further improvement remain in regulation, supervision, and bank resolution. Risks in credit portfolios are related to loan dollarization, credit concentration, and low levels of provisions. Pockets of illiquidity and linkages to offshore banks are also sources of risks, although offshore operations are gradually decreasing in relative size.

4. **Rapid credit growth during 2006–2007 included a build-up of currency risk on private sector balance sheets**. Aided by low dollar loan rates and a (historically) stable currency, credit in foreign currency gradually increased, including to borrowers operating in nontradable sectors.

Foreign Currency Credit by Economic Activity.
Share in total foreign currency lending portfolio (in%)

Activity	2006	2007	2008
Consumption	15.3	17.0	17.2
Agriculture	9.8	6.7	6.1
Manufacturing	17.7	16.6	17.9
Construction	6.5	8.6	8.6
Commerce	26.6	27.9	23.8
Real Estate & fin.	11.1	11.5	15.7
Others	13.0	11.7	10.7
Total			
In US$ million	2,003	2,996	3,297

Source. Superintendency of Banks of Guatemala and Fund staff estimates.

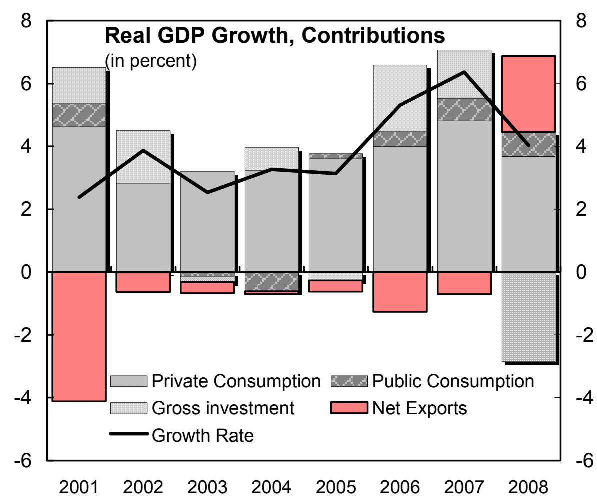
5. **Reducing Guatemala's high poverty and inequality remains a key medium-term challenge**. The stable macroeconomic environment and moderate growth have not been sufficient to make substantial inroads into poverty reduction, with 51 percent of the population living below the poverty line in 2006, well

above countries with similar per-capita GDP. Social spending, as well as public spending on infrastructure, has been constrained by the low tax ratio, and private investment is deterred significantly by high levels of crime.

II. Recent Developments

Signs of the deceleration of economic activity are becoming more evident and while financial conditions remain stable, they are becoming tighter. Inflationary pressures have receded as commodity prices declined and domestic demand weakened.

6. **Growth**: Real GDP growth is estimated to have slowed to 4 percent in 2008, from 6.3 percent in 2007. The decline has been driven by domestic demand, particularly investment, as external demand remained robust through most of 2008. Growth is projected to decelerate to 1 percent in 2009 as consumption slows significantly, with important downside risks (Figure 1).



7. **Inflation**: Annual inflation continues to decline, from its peak of 14 percent in mid-2008, to 9.4 percent by year-end, and further to 5 percent in March 2009. The decline in inflation has become firmly entrenched: various measures of core inflation have declined consistently in the last quarter of 2008; inflation in services and nontradables has moderated substantially; and inflation expectations are declining rapidly.

8. **Balance of payments**: The current account narrowed to 4¾ percent of GDP in 2008, already signaling a slowdown in domestic absorption, and helped by the reversal of the negative terms-of-trade shock from commodity prices in the second half of last year (Table 3 and Figure 2). Since the last quarter of 2008, remittances have been decelerating rapidly, and declined by close to 10 percent in the first two months of 2009. By January, annual export growth, which had remained robust until the third quarter of 2008, slowed to 1 percent while imports declined markedly, by 20 percent. Private capital inflows have slowed, but nonetheless net international reserves increased to US$4.8 billion by end-March 2009 due to recent disbursements of public external financing.

9. **Fiscal sector**: The strength of the fiscal position was maintained during 2008, with the central government deficit declining to 1.7 percent of GDP, despite a real decline in tax revenue (Figure 3 and Table 4). The drop in revenue has become more severe in early 2009, and while there has been a sharp contraction in the tax base (40 percent of tax collections come from imports), there are also structural changes, including lower VAT productivity due to earlier

excessive withholding and some increase in informality, and a collapse of oil royalties associated with declining production and prices.

10. **Financial sector**: Amid greater concern about the quality of credit and slowing funding sources, including a small decline in external credit lines in the last quarter of 2008, banks are rebalancing their portfolios toward liquid assets and away from loans. As a result, credit to the private sector increased only 11 percent in 2008 (26 percent in 2007). Domestic interest rates have risen about 100 bps since the beginning of 2008 (Figure 4). There are no signs yet of significant deterioration of bank portfolios (Table 5).

Guatemala. Banking Sector Balance Sheet, 2006-2008

(in millions of US$)

				Changes		Ann.% change	
	2006	2007	2008	06-07	07-08	06-07	07-08
			On-shore banking system				
Foreign assets	395	451	411	56	-40	14.2	-8.8
Cash & public securities	4,710	4,319	4,785	-391	465	-8.3	10.8
Private sector credit	8,899	10,919	11,679	2,020	760	22.7	7.0
Other Assets	-86	-137	-18	-51	120	59.1	-87.1
Deposits	9,799	10,605	11,689	806	1,084	8.2	10.2
Foreign liabilities	1,428	1,893	1,766	465	-127	32.5	-6.7
Other liabilities	1,876	1,952	1,994	77	41	4.1	2.1
Net worth	815	1,101	1,408	287	307	35.2	27.9
Total assets	13,918	15,552	16,857	1,634	1,305	11.7	8.4
			Off-shore banking system				
Cash & other liquid assets	140	184	270	45	85	32.1	46.2
Investments	727	559	463	-168	-96	-23.1	-17.1
Private sector credit	1,724	1,833	1,996	109	163	6.3	8.9
Other Assets	38	29	-9	-9	-38	-23.5	-131.0
Deposits	2,146	2,176	2,361	29	186	1.4	8.5
Other liabilities	201	136	71	-66	-64	-32.6	-47.3
Net worth	281	294	287	13	-7	4.7	-2.3
Total assets	2,628	2,605	2,720	-23	115	-0.9	4.4

Source: Superintendency of Banks and Fund staff calculations

III. The Authorities' Program

A. Objectives

11. **The authorities have been proactive in addressing the effects of the global crisis through a comprehensive policy response**. Their strategy, whose implementation started already in 2008, is centered on (i) a moderate fiscal stimulus to support domestic demand, financed to a large degree with external resources from multilaterals to minimize crowding out of the domestic private sector; (ii) a monetary policy focused on consolidating the decline in inflation and a flexible exchange rate to facilitate economic adjustment; (iii) a strengthening of

financial sector policies to increase the resilience of banks under adverse scenarios and enhance the banking sector safety net and resolution procedures; and (iv) a refocusing of public expenditures toward strengthening social spending and labor-intensive public works.

12. **To complement these efforts, the authorities are now aiming to build a higher external liquidity cushion, to reduce risks from sudden changes in the current and capital account**. There is concern about the reduced flows of remittances and exports and the risk of a significant slowdown of private capital inflows, factors that may require real and financial adjustments. Fund support is a key element of the strategy to face these risks, not only through the contingent financing provided under the proposed SBA, but also through the endorsement of the authorities' program, which will help maintain investor confidence. Additional contingent financing to protect the banking sector from sudden cuts in external credit lines is being discussed with the IDB. At the same time, public sector financing policy aims at prefinancing government operations, to preserve the existing liquidity cushion (deposits at the central bank).

B. Macroeconomic Framework

13. **The program envisages a gradual economic recovery and a declining inflation rate, with improvements in the external current account, but lower private capital inflows**. Global conditions are expected to improve in the first half of 2010, in line with the latest WEO projections, although there are important downside risks both in terms of the size of the slowdown and its duration. Thus, 2009 will likely be marked by declining remittances and lower capital inflows, but also by the sharp decline in oil prices, helping to improve the current account. Remittances could decline further, due to difficult employment conditions in the U.S., and global risk aversion may trigger capital outflows, putting pressure on banks' liquidity. Risks to the inflation projection are associated with the volatility of commodity prices and pass-through effects from currency movements.

C. Fiscal Policy

14. **The central government deficit is projected to increase to 2.8 percent of GDP in 2009, driven by substantially weaker revenues and moderately higher spending**. Expenditure is envisaged to increase by 0.4 percent of GDP to 14.1 percent of GDP—in line with the average for 2004–08—with social spending growing by about 0.6 percent of GDP. The tax revenue ratio is expected to fall substantially, by 0.8 percent of GDP, as a result of both cyclical factors and structural declines of VAT (0.5 percent) and oil royalties (0.3 percent).

Key Macroeconomic Indicators Under Baseline Scenario
(in percent of GDP, unless otherwise indicated)

	2006	2007	Prel. 2008	Proj. 2009	Proj. 2010
Real GDP growth (in percent)	5.4	6.3	4.0	1.0	1.8
Inflation (percent, end of period)	5.8	8.7	9.4	5.5	4.7
Central government balance	-1.9	-1.8	-1.7	-2.8	-2.6
Public sector debt (gross)	21.8	21.7	20.2	22.5	24.2
External current account balance	-5.0	-5.2	-4.8	-4.0	-4.9
Exports	16.6	17.7	17.9	16.2	16.6
Imports	32.6	33.8	32.1	28.1	29.4
o/w oil	5.8	6.7	6.8	4.2	4.9
Remittances	12.1	12.3	11.3	9.9	9.9
Capital account balance	4.5	4.7	4.3	2.7	3.6
NIR (in US$ millions)	3,878	4,098	4,421	4,416	4,409

15. **The authorities have shifted the financing of the budget deficit toward external sources, almost exclusively from multilaterals**. A multi-year external loan package of about \$1 billion was approved by Congress in January 2009.[1] This measure assures the financing of a substantial part of the deficit and lessens potential crowding out of private sector credit. As revenue has weakened substantially in the last few months, the authorities plan to present to Congress an additional financing package, which would include new external financing from multilaterals (about \$160 million) and greater domestic bond issuance.[2]

16. **As the economy recovers, the increase of the fiscal deficit is expected to be largely reversed by 2011, ensuring sustainable debt levels**. With expenditure remaining constant in terms of GDP, the projected recovery of revenue, including due to an increase in indirect taxes (see paragraph 17), would bring the deficit down to 2 percent of GDP over the medium term. Nonfinancial public sector debt is expected to remain low (slightly above 25 percent of GDP by 2014) and on a sustainable path (Table 8).

17. **The authorities will pursue improvements in tax policy and administration to offset revenue losses**. Congress has already made permanent a temporary tax on net assets (yielding about 1 percent of GDP), reducing downside risk to tax collections. A 0.2 percent of GDP in revenue is expected to result from a package of indirect revenue measures, currently under discussion in Congress and expected to be approved before end-2009 (MEFP paragraph 10). In parallel, the tax authority, SAT, is implementing a medium-term plan (elaborated with support of IMF technical assistance) to achieve a consistent decline of tax evasion rates (MEFP paragraph 11). While recognizing the need for a higher tax ratio to strengthen the provision of

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[1] This financing comprises budget-support and investment loans from World Bank and IDB.

[2] Additional loans for \$100 million from the World Bank and about \$60 million from CABEI and bilateral sources.

key public goods, the authorities regretted that the current economic circumstances would make even more difficult to garner enough political support for a significant tax reform (as originally envisaged by the government in early 2008).

18. **If the tax ratio falls further, financing constraints would limit the room for maneuver and require expenditure adjustment**. The authorities are working to identify nonessential spending programs to be ready in case cuts become inevitable. Before submission of the 2010 budget to congress, staff will discuss with the authorities the size of structural revenue losses, to agree on revenue and spending measures that may be needed in 2010 to maintain public debt on a stable path (MEFP, paragraph 9).

D. Monetary and Exchange Rate Policy

19. **The central bank has started to ease monetary policy in a measured manner**. Given the expected continued decline in inflation, the contraction in real monetary aggregates in 2008, and downside risks to growth, the monetary board has reduced the policy rate 100 bps since end-2008 to 6.25 percent. For 2009, inflation is targeted to decline to 5½ percent, with a tolerance margin of +/- 1 percent. To this end, the Monetary Board will set changes to the policy interest rate, as needed, based on the analysis of current developments and added emphasis on forward-looking variables (MEFP paragraphs 13 and 14).

20. **The authorities will seek to strengthen their inflation-targeting framework and have set a medium-term target of 4 percent with a tolerance margin of +/- 1 percent**. Steps have been taken to promote the development of secondary markets for public debt, supported by IMF technical assistance, to obtain market price signals that will better guide monetary policy (MEFP paragraph 15).

21. **Changes to the foreign-exchange intervention rule have allowed greater flexibility of the exchange rate, increasing the effectiveness of monetary policy and facilitating economic adjustment**. The central bank will continue intervening symmetrically in the foreign-exchange market (up to US$24 million daily) when the exchange rate deviates from its 5-day moving average by 0.75 percent (previously 0.5 percent).[3] Since September 2008 the exchange rate has depreciated 8¼ percent, with limited intervention ($88 million, or 2% of NIR) over the last 5 months.

22. **Continued deterioration of the external outlook, however, would challenge the conduct of monetary and exchange rate policies, possibly requiring a tighter monetary stance and/or more foreign-exchange intervention**. In light of this risk, the authorities are proceeding with monetary easing only gradually and, while committing to the foreign-exchange intervention rule, they reserve the right to conduct additional discretionary intervention to avoid sudden movements of the exchange rate.

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[3] Nominal thresholds for the exchange rate, which were embedded in the old rule to trigger more frequent intervention by the central bank, were eliminated by mid-2008.

E. Financial Sector Policy

23. **The domestic banking sector has limited exposure to the sources of the global financial crisis**. The participation of foreign banks is small, with a market share of 8 percent of deposits, and banks have not invested in high-risk instruments related to the U.S. mortgage market. Moreover, the financial system underwent significant consolidation in recent years, with weaker institutions being absorbed by more solid ones. A large offshore sector, however, has been a source of concern, due to difficulties in effectively supervising institutions incorporated in foreign jurisdictions. While liquidity, solvency, and profitability have been maintained (Table 5), the tightening of financial conditions and the expected deceleration of economic activity are set to put some pressures on the banking sector, increasing nonperforming loans and reducing liquidity.

24. **Starting in 2008, the authorities have addressed the most pressing financial risks (MEFP, paragraph 18), focusing on**:

- **Enhancing banking supervision**, with continuous on-site supervision since mid-2008 and regular dialogue with banks' Boards of Directors to detect risks earlier and discuss contingency plans.

- **Ensuring adequate bank liquidity**. The central bank introduced temporary measures to provide liquidity in domestic and foreign currency, by flexibilizing reserve requirements and introducing reverse repos in foreign currency (MEFP paragraph 18). The overall assistance via reverse repos has been below the established limits for the system as a whole (US$290 million), averaging less than US$100 million.[4] These short-term measures would be rolled over, if needed, within the limits necessary to avoid disequilibrium in the money market.

- **Bolstering banks' solvency**. Provisioning requirements have been changed, requiring a gradual increase to ensure full-provisioning of NPLs by mid-2011. This measure addresses a long standing concern, as the current provisioning ratio still stands at 70 percent of NPLs, below the averages of Central and Latin America. In addition, CHN (the state-owned mortgage bank) received a cash capital injection of Q$200 million by the government, which allowed the bank to meet the minimum capital ratio.

25. **The program now seeks to fortify the financial system through a further strengthening of regulation and supervision and enhancing the banking sector safety net and resolution procedures**. The superintendency of banks is working on changes to liquidity and credit risk management regulations, which will induce banks to compute liquidity gaps at

[4] The central bank has also made explicit that it stands ready to redeem central bank paper before maturity and purchase public bonds from banks, in an effort to reduce perceived liquidity risks and avoid further shortening of maturities in central bank paper placements.

different maturities and make them internalize risks in the dollar-denominated loan portfolio arising from lending to borrowers without foreign-currency earnings (structural benchmarks, MEFP paragraph 19 and Table 3). Consolidated supervision of financial conglomerates with regional operations will be strengthened through enhanced coordination with foreign supervisors.

26. **A key structural measure is the submission of amendments to the banking laws, by June 2009** (structural benchmark, MEFP paragraph 20 and Table 3). Key provisions include: (i) reducing risks from offshore operations by limiting retail operations, eliminating the obligation of the offshore's domestic partner to cover capital deficiencies, and cooperating closely with home supervisors to ensure corrective action of solvency concerns; (ii) reducing connected lending, by setting a limit to the aggregate exposure with connected parties; (iii) enhancing enforcement powers of the superintendency, by allowing the supervisor to request corrective action (i.e., limits to dividend distribution) when bank solvency is threatened; and (iv) strengthening the instruments and size of the banking sector safety net, including giving the central bank larger room for lender-of-last-resort functions and increasing the deposit insurance premium. To improve resolution procedures, the authorities will propose additional options for the transfer of assets of failed banks, quick licensing of top-rated foreign institutions to participate in resolution, and possibly, allowing the bank recapitalization fund to supplement capitalization of banks by the private sector, should the need arise. With the approval of the amendments to the banking law, Guatemala would make important progress toward the adoption of FSAP recommendations (Table 6).

F. Social Protection and Growth Policy

27. **The authorities' social protection policy aims at enhancing current programs to offset the effect of the crisis on the neediest**. Social spending will increase from 4.4 percent of GDP in 2008 to 5.0 percent of GDP in 2009. To address extreme poverty, emphasis will be placed on four flagship government programs. A key conditional cash transfer program initiated in 2008 (*Mi familia progresa*) will be expanded to reach 500,000 families and 0.3 percent of GDP in 2009 (MEFP paragraph 22).

28. **The authorities are putting in place a number of policies to enhance productivity and raise investment over the medium term**. High crime rates and energy costs, alongside low labor force productivity are key constraints to private sector activity. The authorities are addressing these areas with policies to develop infrastructure, improve access to credit, deepen economic integration—free trade agreements (FTAs) ratified with Colombia and Panama will take effect in 2009 and congress is considering the ratification of a FTA with Chile—and seek improvements in the corporate restructuring framework (MEFP, paragraph 24).

IV. Risks

29. **Risks to the outlook are significant and stem from a possible sharper-than-expected deterioration of the external current or capital accounts**.

- Guatemala has large external financing requirements. The current account deficit plus total debt amortization is estimated at 16.2 percent of GDP in 2009. A large financing gap (around 2.5 percent of GDP) could arise under a scenario where remittances decline a further 5 percent relative to baseline, FDI inflows return to 2005 levels, and a decline in rollover rates on the stock of short-term external private sector debt.

Guatemala: Gross External Financing Requirements

	2008e	2009p	2009 alt
Gross External Financing Requirement (US$, millions)	**6,910**	**6,183**	**6,359**
(in percent of GDP)	17.7	16.2	16.7
Current Account Deficit	1,861	1,512	1,688
Public Sector	260	242	242
Private Sector	4,789	4,429	4,429
Short-term debt on original maturity	4,077	3,536	3,536
Banks	940	857	857
Non-bank private sector (commercial credits)	3,137	2,680	2,680
Short-term debt on remaining maturity (amortizations due)	712	893	893
Sources of Financing (in US$ millions)	**6,896**	**6,183**	**5,420**
Net FDI inflows	815	553	508
Gross medium- and long-term borrowing (public sector)	382	860	860
Roll-over of ST debt	4,789	4,429	3,817
New Borrowing	754	-156	-262
Other capital flows 1/	489	496	496
Change in gross reserves (decrease = +)	-333	0	0
Financing Gap (in US$ millions)	**0**	**0**	**939**
(in percent of GDP)	…	…	2.5
Assumptions:			
Rollover of short-term debt (excl. commercial credit)	*100%*	*100%*	*65%*

1/ Includes errors and omissions.

- In a more severe downturn, especially if coupled with some depreciation of the currency and capital outflows, the solvency and liquidity of the banking sector may be reduced, as NPLs would increase and liquidity outflows could affect smaller banks.

30. **The program is designed to mitigate those risks**. The resources made available to the central bank under the SBA would deter speculative portfolio shifts and a sharp depreciation of the currency. Structural measures are focused on strengthening the banking sector.

V. Program Access, Conditionality, and Capacity to Repay the Fund

A. Access

31. **The proposed 18-month SBA would involve exceptional access and upfront phasing**.[5] The baseline projection for 2009–10 does not envisage an external financing gap and NIR ratios are projected to remain broadly stable. To face the risks to the outlook, total access is proposed at 300 percent of quota ($951 million or 2.5 percent of GDP), with a first purchase on program approval of 200 percent of quota, leading to access of 260 percent of quota during the first year of the program. The proposed access and frontloading of purchases are designed to strengthen the country's ability to withstand external shocks and support the increased exchange rate flexibility. Guatemala's quota (about US$320 million) is small relative to the average

[5] The arrangement requires exceptional access because purchases would exceed 200 percent of quota during the first 12 months.

inflow of private capital witnessed in recent years and the proposed access is commensurate to potential balance of payments shocks.

32. **Guatemala meets the four criteria of the exceptional access framework**. There are potential risks in the current and capital accounts. Guatemala's debt is low and debt dynamics are sustainable. While terms of access to private capital markets have worsened, access has not been curtailed, and staff expects that Guatemala will regain normal access during the program period. The authorities' policy program is strong, as is their track record in maintaining macroeconomic stability (Box 1).

B. Program Monitoring and Conditionality

33. **The conditionality of the program focuses on ensuring adequate macroeconomic policies and strengthening financial stability and bank resolution**. Given the quantity and quality of the pre-emptive measures already taken by the authorities, the proposed program does not envisage prior actions. The arrangement would have quarterly reviews with test dates in March, June, September, and December, with a first test date in June 2009 and a first review in September 2009. Available statistics are adequate for program monitoring.

- **Quantitative performance criteria** (MEFP Table 2) are being set initially for end-June and end-September 2009 (and indicative targets for end-December 2009), including: (i) a floor on the central government fiscal balance for 2009—equivalent to a deficit of 2.8 percent of GDP—with an adjuster for up to 0.2 percent of GDP if additional external financing is identified, (ii) a floor on NIR, securing an adequate liquidity buffer and assurance that the policy mix remains appropriate; and (iii) a continuous performance criterion on the nonaccumulation of external arrears.

- **An indicative floor** is established on central government deposits at the central bank, which could serve as an early indication of difficulties in obtaining additional financing.

- **Consultation clause on inflation**: a path for the expected annual inflation rate at the end of each quarter has been set. If annual inflation at these test dates deviates from the estimated inflation rate by more than 2 percentage points, up or down, a consultation with staff will be triggered. If inflation is more than 3 percentage points above the estimated rate at the test dates, a consultation with the Executive Board will be triggered prior to resuming purchases.

- **Structural Benchmarks** (MEFP Table 3): Submission to Congress of amendments to the banking law and central bank charter by June 2009, and the elaboration of draft regulations on liquidity management and credit risk in foreign-currency loans, by end-December 2009.

C. Capacity to Repay the Fund

34. **Guatemala's capacity to repay the Fund is strong**. Guatemala has no debt outstanding to the Fund and the proposed access will not affect significantly the level of total external debt (36 percent) nor its sustainability over the medium term. The recent GRA lending reform

marginally increases Guatemala's commitment fees but decreases its interest charges on potential drawings by up to US$3.2 million annually.

35. **A safeguards assessment should be completed by the time of the first review (September 2009)**. The last safeguards assessment of the Bank of Guatemala was completed on August 9, 2002.

VI. Staff Appraisal

36. **Guatemala's economic performance has been solid in recent years but is now being affected by the global recession**. Aggregate demand growth is slowing rapidly, due to falling remittances, lower export prices and demand, and lower capital inflows. Given close economic and financial ties with the region and the United States, downside risks are considerable.

37. **The authorities' economic program seeks to preserve macroeconomic and financial stability, mitigate the effects of the global crisis on economic activity, and strengthen social protection**. Traditionally prudent fiscal and monetary policies now allow room for a moderate stimulus. The planned expansion of public spending is focused on labor-intensive public works and a strengthening of the social safety net. Building on recent progress and adopting lessons from their own experience, the authorities plan to strengthen financial sector policies, especially with regard to enhancing the banking sector safety net and resolution procedures.

38. **Monetary policy should be focused on anchoring inflation at low levels**. Staff supports the recent easing of monetary conditions, which is expected to continue in the coming months, in light of continued weakness of economic activity and falling inflation. Further easing should be gradual and the authorities should prevent that the short-term real interest rates turn negative. Efforts to promote deepening of secondary markets should help develop a yield curve and allow for price signals to better guide monetary policy.

39. **The authorities' commitment to exchange-rate flexibility is welcome**. Greater exchange rate flexibility is increasing the effectiveness of monetary policy and will facilitate adjustment to external shocks. While the experience with rules-based intervention has been positive so far, staff supports occasional discretionary intervention to avoid sudden movements of the exchange rate, which could result in higher economic uncertainty given the levels of liability-dollarization and might lead to loss of confidence and portfolio shifts.

40. **While the fiscal position is strong, the authorities need to focus on preventing erosion of the revenue base**. The room for fiscal impulse is limited because of financing constraints, and deficits above program levels may erode confidence in the capacity of the authorities to reverse the widening of the deficit over the medium term. Thus, the authorities should be prepared to prioritize spending if downside risks to tax revenue materialize. The deterioration of the fiscal position in 2009–2010 will need to be reversed in subsequent years, once tax revenue rebounds, to maintain public debt at safe levels.

41. **The focused expansion of social spending is expected to have a strong impact on the neediest segment of the population, especially as remittances decline sharply**. The conditional cash-transfer program, developed with support from the World Bank and the IDB, is expected to reach 500,000 families during 2009, securing school access and health services for children in the poorest municipalities.

42. **Over the medium term, the need for a revenue enhancing tax reform remains.** While there is room to improve efficiency and targeting of public expenditure, the effectiveness of social spending is limited by the low spending levels. Furthermore, greater provision of public goods—infrastructure, security, health, and education—is needed to increase productivity and investment and raise growth. A broader tax base will also reduce the instability of the tax ratio, enhancing the capacity to undertake a countercyclical fiscal policy.

43. **The banking sector has become more resilient, but downside risks to the outlook call for continued and close monitoring of developments**. The preemptive measures adopted by the authorities—continuous on-site supervision, enhanced liquidity mechanisms, gradually tighter provisioning requirements, and recapitalization of a public bank—are welcome. Planned regulatory reforms, including amendments to the banking law and regulatory changes, should be implemented decisively. To better assess the impact of the external shock on the banking sector, the superintendency of banks is improving stress-test methodologies.

44. **The financial sector safety net should continue to be strengthened**. Legal reforms aim at boosting the central bank's lender-of-last-resort function and the deposit insurance fund. A number of changes to the banking resolution procedures will facilitate faster transfer of asset and liabilities of problem banks. Preparation to manage contingencies is adequate.

45. **The medium term growth strategy is rightly focused**. The authorities should continue promoting investment in human capital and infrastructure, while seeking benefits from increasing international integration. Social spending, especially in areas such as education and health, should be encouraged, and policies to improve security actively promoted. Increasing the private sector's involvement in infrastructure investment through public-private partnerships will also help overcome capacity constraints in the public sector.

46. **The level of access under the proposed arrangement will provide an additional liquidity cushion, while keeping Fund exposure manageable**. Guatemala would be in a strong position to repay the Fund if it were to make all purchases under the proposed SBA. While there are downside risks to the program, particularly more severe balance of payments shocks and recession, those risks can be contained with decisive policy implementation and additional contingent external financing that the authorities may secure.

47. **In view of the sound strategy and policies proposed by the authorities, staff supports their request for a SBA for SDR 630.6 million**.

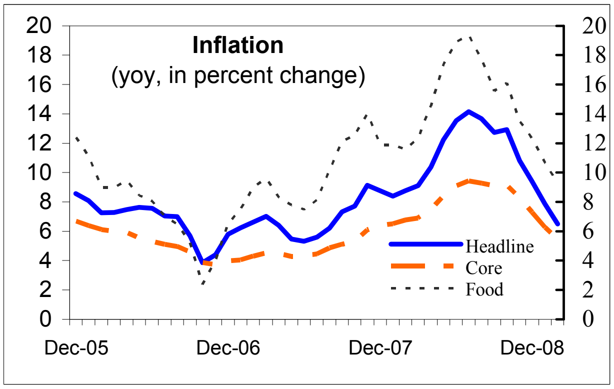
Box 1. Exceptional Access Criteria

The proposed Stand-By Arrangement exceeds the annual normal limit of access to Fund resources. Fund policy allows for access in excess of normal limits (i.e., exceptional access), provided that the following four criteria are met: (i) The member is experiencing or has the potential to experience exceptional balance of payments pressures on the current account or the capital account, resulting in a need for Fund financing that cannot be met within the normal limits; (ii) a rigorous and systematic analysis indicates that there is a high probability that the member's public debt is sustainable in the medium term; (iii) the member has prospects of gaining or regaining access to private capital markets within the timeframe when Fund resources are outstanding; and (iv) the policy program of the member provides a reasonably strong prospect of success, including not only the member's adjustment plans, but also its institutional and political capacity to deliver that adjustment.
Staff assesses that Guatemala meets all four criteria for exceptional access:

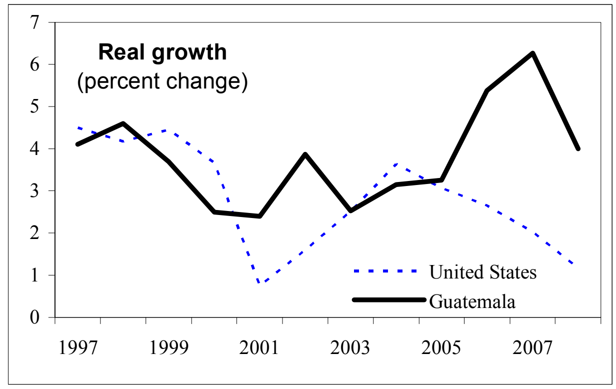
- **Criterion 1—Actual or potential exceptional balance of payments pressures**. Guatemala has followed a strategy to offset the expected decline in private capital inflows with a substantial increase in flows from multilaterals (about $1 billion over 2009-2010). However, risks remain. Guatemala has large rollover requirements in the near term (about 12 percent of GDP), and a further decline in remittances, lower capital inflows, and lower rollover rates could create exceptional balance of payments pressures.
- **Criterion 2—Sustainable public debt position**. Guatemala's public debt stock is low (21 percent of GDP), and its dynamics are sustainable under a range of plausible shocks, including a severe exchange rate shock, given efforts over the past couple of years to reduce dollar-denominated debt. Guatemala has a strong track record of conservative fiscal policy, and, currently, there are no indications of any potential contingent liabilities of the government that could arise from private external indebtedness.
- **Criterion 3—Access to private capital markets**. Terms of access to private capital markets have worsened since September 2008 (at least 150 basis points increase in the cost of external credit lines, a widening of 250 bps in sovereign spreads), but access has not been curtailed. Staff expects that Guatemala's terms of access will become more favorable once global conditions improve.
- **Criterion 4—Strength of the policy program and capacity to deliver**. Guatemala has a track-record of macroeconomic stability and the authorities have been proactive in responding to the effects of the global crisis. They have delivered on measures to bolster bank solvency, strengthen supervision, increase the flexibility of the exchange rate regime, reduce inflation, and prevent an erosion of the tax base by making permanent a previously temporary tax on net assets.

Figure 1. Guatemala. Recent Developments

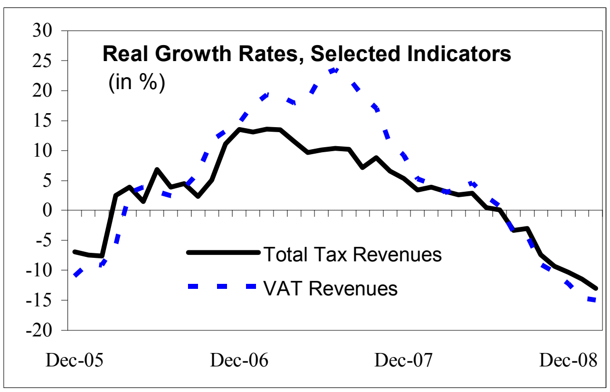
Inflation has fallen rapidly from its 2008 peak, aided by the decline in commodity prices



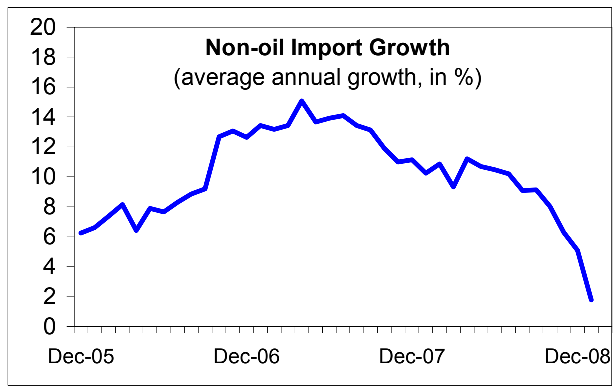
Real GDP growth slowed, following robust performance in 2006 and 2007



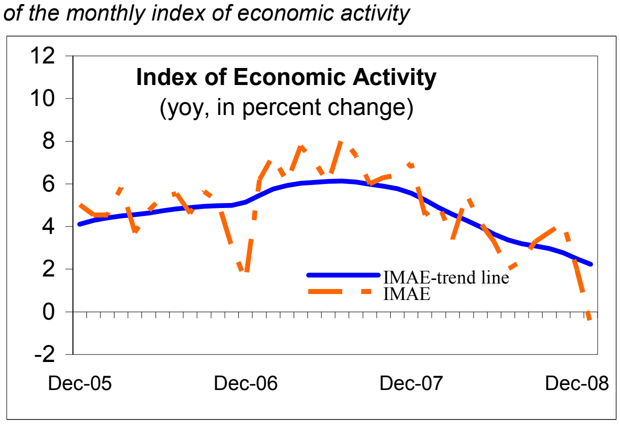
Real declines in tax collections, especially in VAT collections…



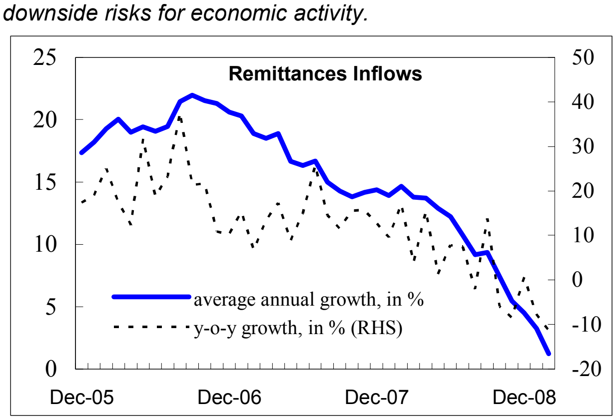
… and lower non-oil import growth suggest economic activity is weakening



... as reflected by a sharp slowdown in the growth rate of the monthly index of economic activity



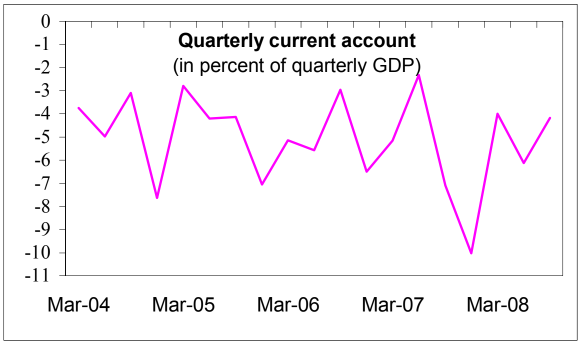
Family remittances are falling sharply, posing further downside risks for economic activity.



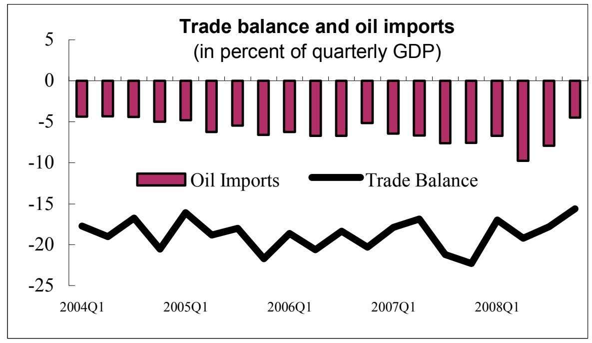
Sources: Bank of Guatemala; and Fund staff estimates.

Figure 2. Guatemala External Sector

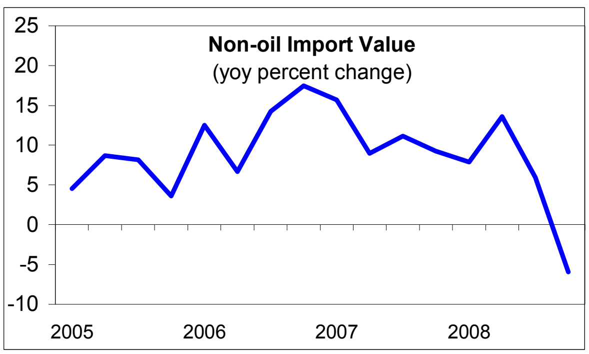
The current account deficit has been narrowing since the beginning of 2008…



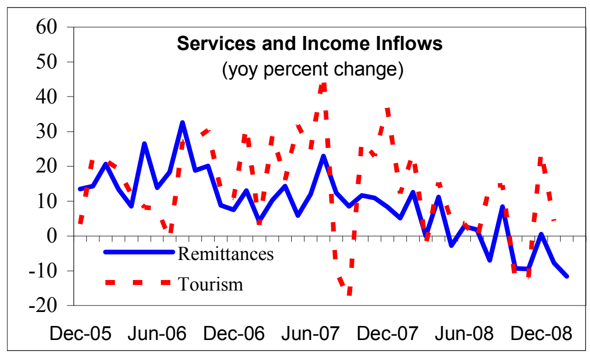
…mainly owing to a lower oil bill.



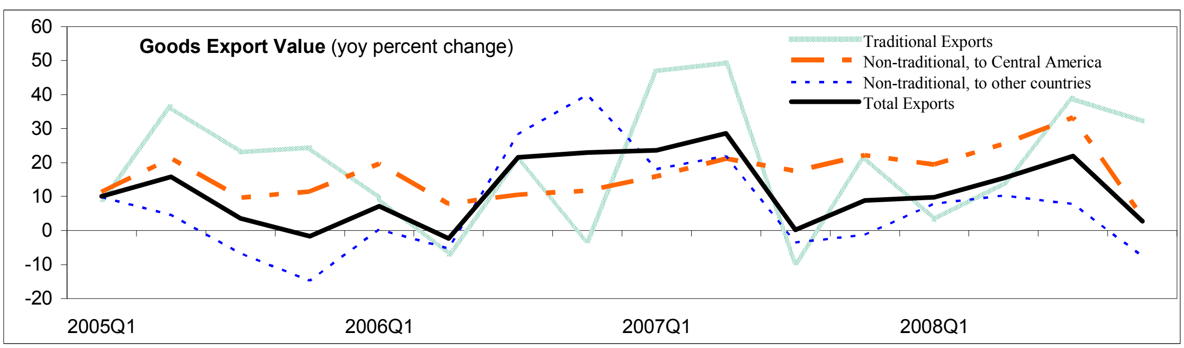
However, non-oil imports have also started declining in the last quarter of 2008, …



…as Guatemala feels the impact of the global crisis through falling remittances and stagnating tourism.

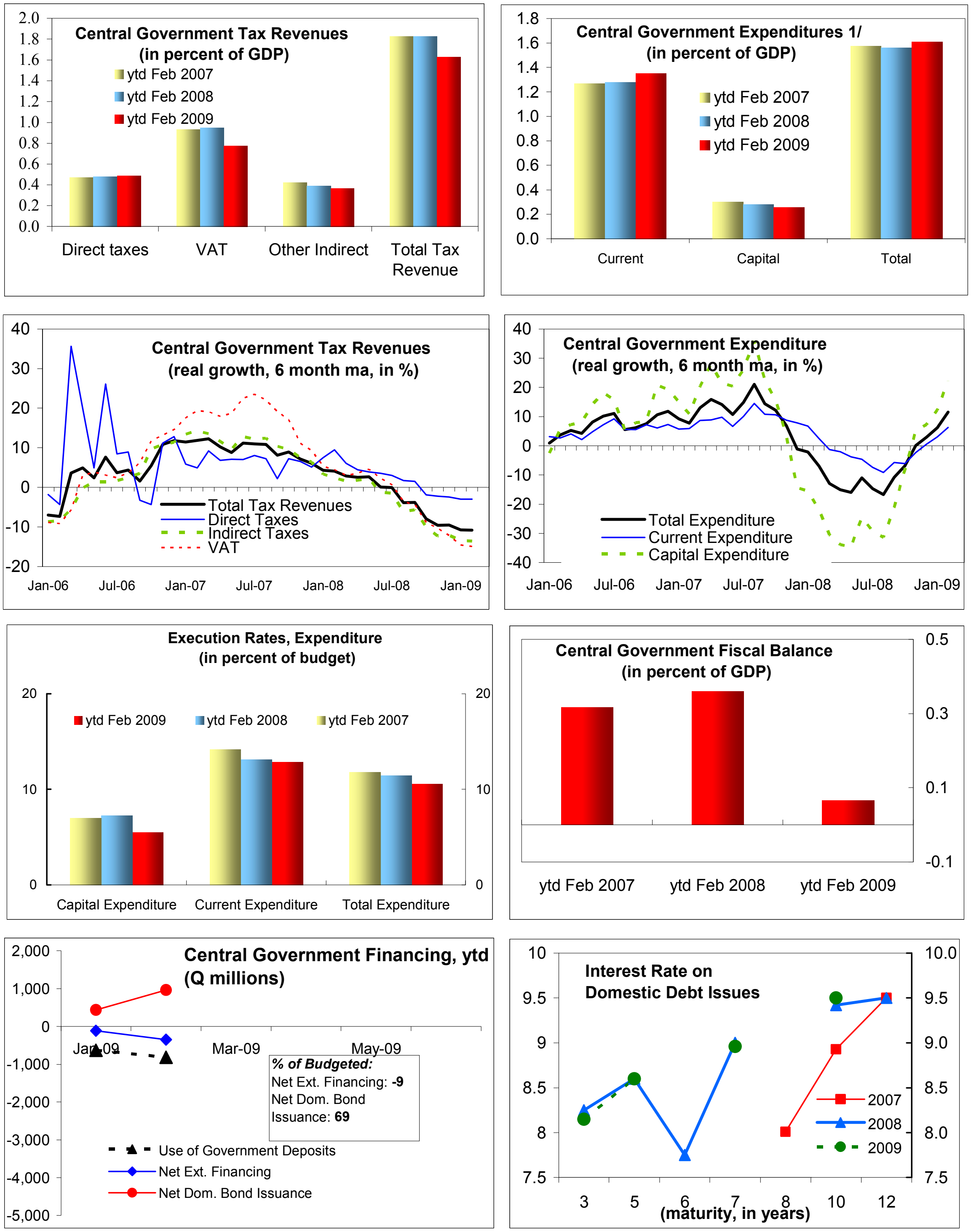


Goods exports are still growing at positive interannual rates but are now also quickly weakening.



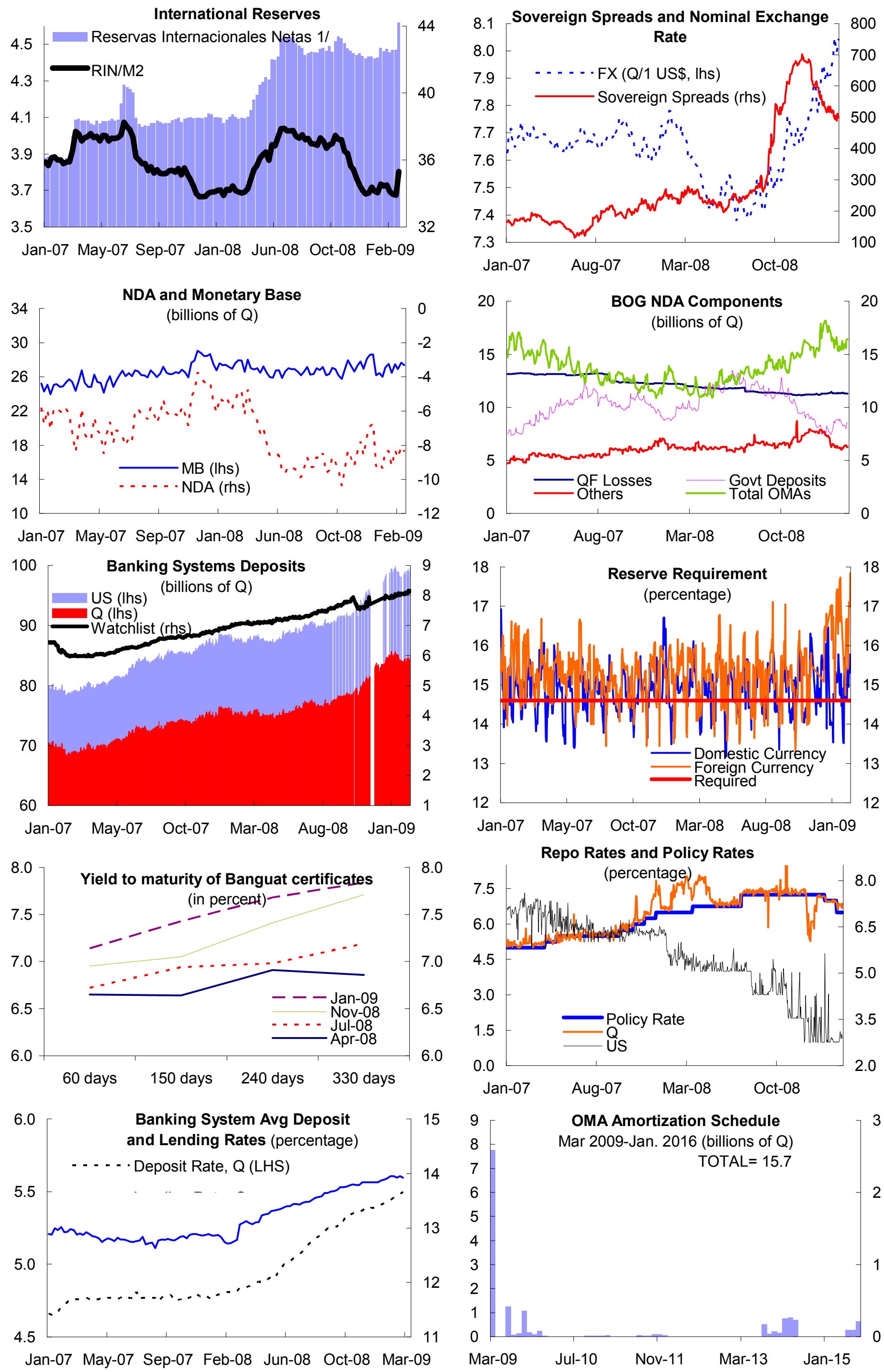
Sources: Bank of Guatemala; and Fund staff estimates.

Figure 3. Guatemala. Fiscal Sector, February 2009



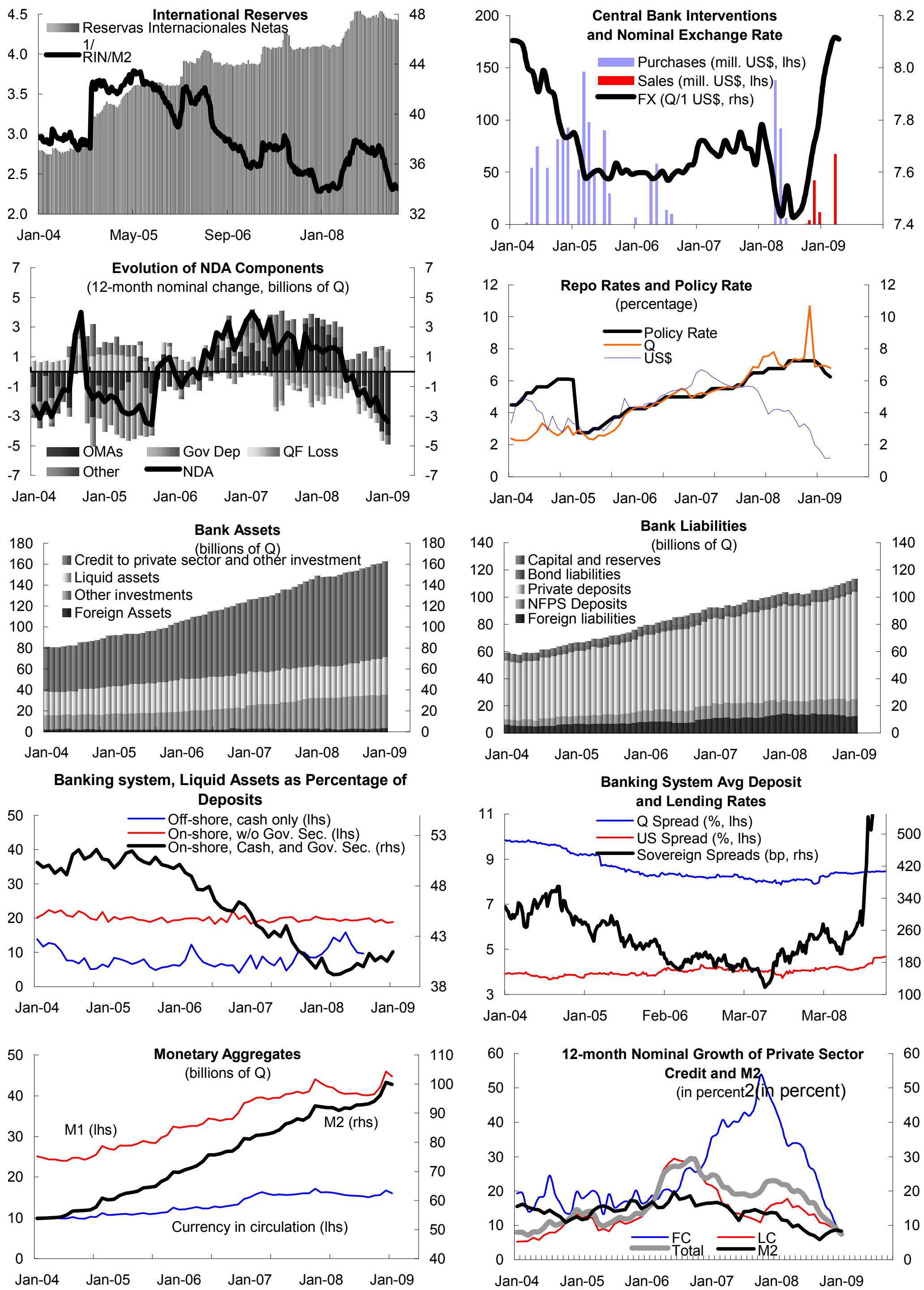
Sources: Ministry of Finance; and Fund staff estimates.

Figure 4. Guatemala: Weekly Financial Sector Developments



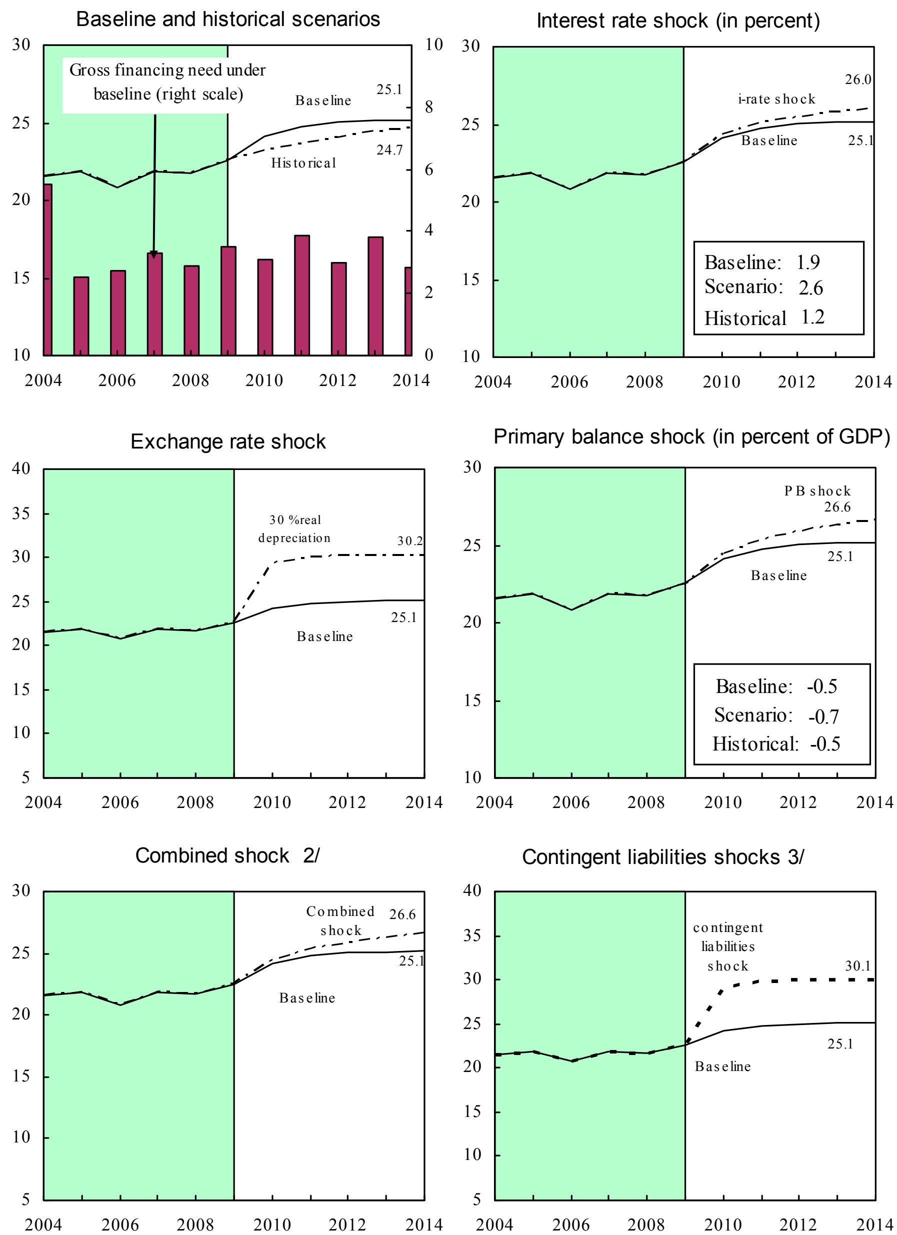
Source: Banguat and Superintendency of Banks.

Figure 5. Guatemala: Financial Sector, January 2009



Sources: Banguat; and Superintendency of Banks.

Figure 6. Guatemala: Public Debt Sustainability: Bound Tests 1/
(Public debt in percent of GDP)



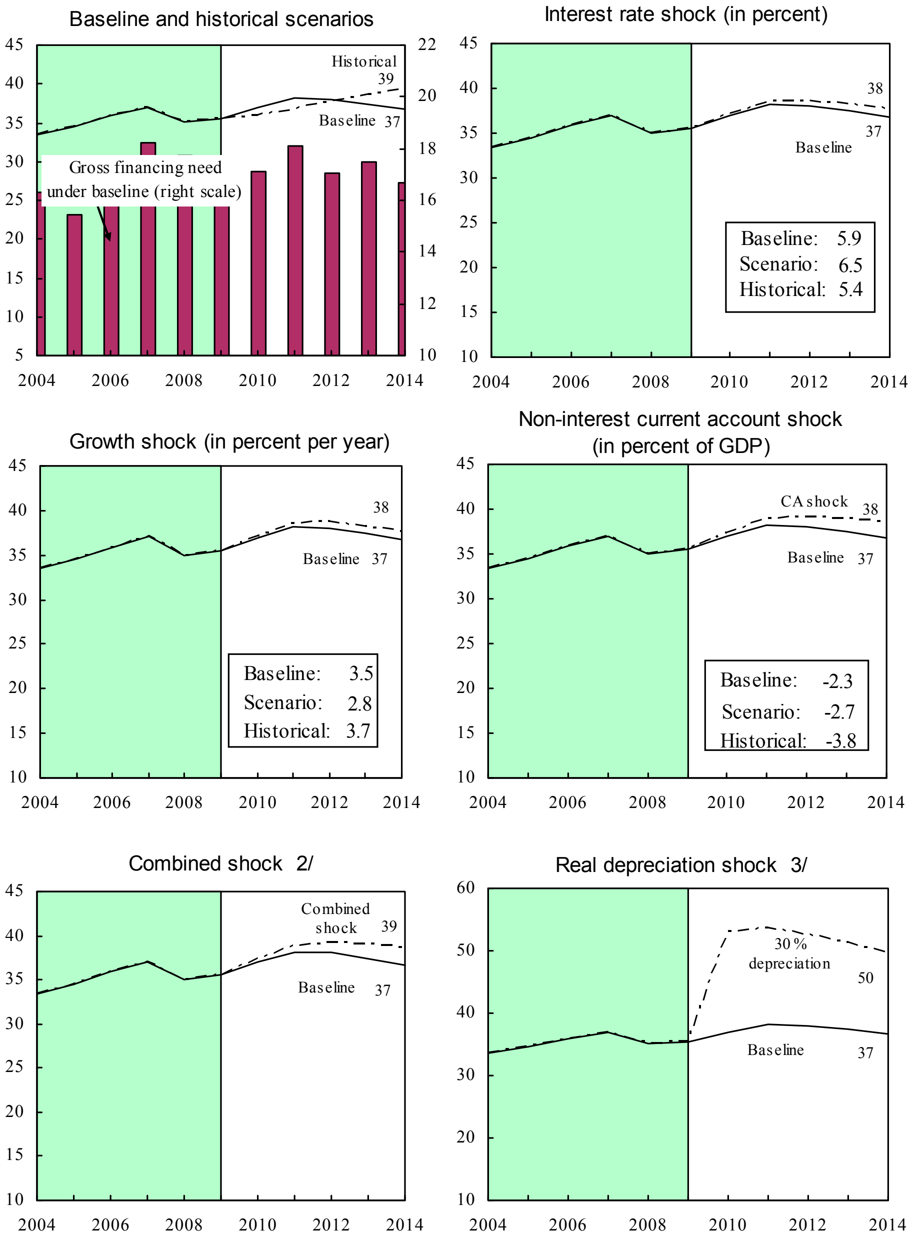
Sources: International Monetary Fund, Country desk data, and Fund staff estimates.

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

2/ Permanent 1/4 standard deviation shocks applied to real interest rate, growth rate, and primary balance.

3/ A 5 percent of GDP shock to contingent liabilities is assumed.

Figure 7. Guatemala: External Debt Sustainability: Bound Tests 1/
(External debt in percent of GDP)



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

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

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

3/ One-time real depreciation of 30 percent occurs in 2007.

Table 1. Guatemala: Selected Economic and Social Indicators

I. Social and Demographic Indicators

Population 2006 (millions)	13.0	Gini index (2002)	55.1
Percentage of indigenous population (2006)	38.4	Life expectancy at birth (2005)	69.7
Percentage of population below the poverty line (2006)	51.0	Adult illiteracy rate (2005)	28.2
Rank in UNDP development index (2008)	121 of 179	GDP per capita (US$, 2007)	2,550

II. Economic Indicators

				Proj.					
	2006	2007	2008	2009	2010	2011	2012	2013	2014
			(Annual percentage change, unless otherwise indicated)						
Income and prices									
Real GDP	5.4	6.3	4.0	1.0	1.8	3.5	4.0	4.0	4.0
Real per-capita income growth	2.7	3.6	1.4	-1.7	-0.9	0.8	1.3	1.3	1.3
Consumer prices (end of period)	5.8	8.7	9.4	5.5	4.7	4.5	4.5	4.0	4.0
Monetary sector									
Credit to private sector	28.8	26.0	11.0	6.2	7.1	7.3	8.6	8.3	9.1
Liabilities to private sector	18.8	10.6	8.3	6.1	6.5	8.5	9.0	9.1	8.9
External sector									
Exports	14.2	20.3	15.5	-11.5	4.7	7.0	7.3	7.7	8.0
Imports	15.0	16.7	8.6	-14.6	7.2	9.9	8.2	7.4	7.5
Terms of trade	-2.7	-0.2	-1.6	4.8	-2.3	-1.3	-1.2	-0.6	-0.8
Real effective exchange rate 1/	3.2	0.1	5.8	…	…	…	…	…	…
				(In percent of GDP, unless otherwise indicated)					
Current account	**-5.0**	**-5.2**	**-4.8**	**-4.0**	**-4.9**	**-4.8**	**-4.3**	**-4.2**	**-4.1**
Trade balance	-16.1	-16.1	-14.2	-11.9	-12.8	-13.9	-14.4	-14.4	-14.5
Exports	16.6	17.7	17.9	16.2	16.6	17.0	17.2	17.3	17.5
Traditional	4.3	4.8	5.0	4.3	4.4	4.6	4.6	4.6	4.6
Nontraditional	12.3	12.9	12.9	11.9	12.1	12.4	12.5	12.7	12.9
Imports	-32.6	-33.8	-32.1	-28.1	-29.4	-30.9	-31.5	-31.7	-32.0
o/w Oil Imports	-5.8	-6.7	-6.8	-4.2	-4.9	-5.3	-5.6	-5.6	-5.7
Other (net)	11.0	10.9	9.4	7.9	8.0	9.1	10.1	10.3	10.3
o/w Remittances	12.1	12.3	11.3	9.9	9.9	11.1	12.1	12.4	12.5
Capital and financial account	**4.5**	**4.7**	**4.3**	**2.7**	**3.6**	**4.0**	**3.5**	**3.4**	**3.4**
Public sector (including official capital transfers)	1.1	0.7	0.3	1.6	1.6	0.4	0.5	0.2	0.4
Private sector	2.9	4.0	4.0	1.0	1.9	3.7	3.1	3.2	2.9
Of which: FDI	1.8	2.1	2.1	1.5	1.6	1.7	1.8	1.9	2.0
Errors and Omissions	1.4	1.1	1.3	1.3	1.3	1.3	1.3	1.3	1.3
Net international reserves (in millions of U.S. dollars)	**3,878**	**4,098**	**4,421**	**4,416**	**4,409**	**4,609**	**4,821**	**5,052**	**5,379**
(Stock in months of next year imports of goods and services)	3.4	3.2	4.2	3.9	3.5	3.4	3.3	3.2	…
(Stock over total external short term debt)	1.0	0.9	0.9	1.0	0.9	0.8	0.9	0.8	...
Gross domestic investment 2/	**20.8**	**20.7**	**17.6**	**15.8**	**17.2**	**20.0**	**20.0**	**20.0**	**20.0**
Public sector	4.9	5.0	4.8	5.1	5.1	5.0	5.0	5.0	5.0
Private sector	15.9	15.7	12.8	10.6	12.2	15.0	15.0	15.0	15.0
Gross national saving	**15.8**	**15.5**	**12.8**	**11.8**	**12.3**	**15.2**	**15.7**	**15.8**	**15.9**
Public sector	3.2	3.3	2.7	1.5	1.7	2.2	2.3	2.3	2.3
Private sector	12.6	12.2	10.1	10.2	10.7	13.0	13.4	13.5	13.6
External saving	**5.0**	**5.2**	**4.8**	**4.0**	**4.9**	**4.8**	**4.3**	**4.2**	**4.1**
Central Government									
Revenues	**12.7**	**12.9**	**12.0**	**11.3**	**11.5**	**12.1**	**12.2**	**12.3**	**12.3**
Of which: Tax revenues	11.9	12.1	11.3	10.5	10.6	11.2	11.3	11.4	11.4
Expenditures	**14.7**	**14.7**	**13.7**	**14.1**	**14.1**	**14.1**	**14.2**	**14.2**	**14.3**
Of which: Social spending	5.0	4.6	4.4	5.0	5.0	5.0	5.0	5.0	5.0
Interest payments	1.4	1.5	1.4	1.5	1.6	1.7	1.8	1.8	1.8
Expenditure Overruns	…	0.3	…	…	…	…	…	…	…
Overall balance	**-1.9**	**-1.8**	**-1.7**	**-2.8**	**-2.6**	**-2.1**	**-2.0**	**-2.0**	**-2.0**
Overall balance of the nonfinancial public sector	-1.3	-0.7	-0.7	-2.4	-2.1	-1.6	-1.5	-1.6	-1.6
Combined public sector balance, including central bank	**-1.5**	**-0.6**	**-0.5**	**-2.2**	**-2.0**	**-1.5**	**-1.5**	**-1.5**	**-1.6**
Nonfinancial public debt (in percent of GDP)	**21.8**	**21.7**	**20.2**	**22.5**	**24.2**	**24.8**	**25.0**	**25.1**	**25.1**
Of which: external	13.1	12.5	11.3	13.1	14.4	14.1	13.8	13.2	12.8
domestic	8.7	9.2	8.9	9.4	9.8	10.7	11.2	12.0	12.4
Foreign currency denominated (as percent of total)	64.2	61.7	59.2	61.3	62.6	60.3	58.6	56.2	54.3
Financing of the NFPS	**1.3**	**0.7**	**0.7**	**2.4**	**2.1**	**1.6**	**1.5**	**1.6**	**1.6**
External financing	1.2	1.2	0.3	1.6	1.6	0.3	0.5	0.2	0.4
Domestic financing	0.1	-0.5	0.4	0.8	0.5	1.2	1.1	1.3	1.1
Memorandum items:									
GDP (US$ millions)	30,231	34,029	38,983	38,020	38,982	40,772	43,243	46,122	49,219

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

1/ Average annual change; a positive change indicates an appreciation.

2/ Includes changes in inventories.

Table 2. Guatemala: Monetary Sector Survey

(Stocks in millions of quetzales)

				Est.	Proj.	
	2005	2006	2007	2008	2009	2010
Bank of Guatemala (BOG)						
Net international reserves 1/	**27,404**	**29,459**	**31,271**	**34,405**	**37,457**	**38,919**
(In millions of U.S. dollars) 1/	3,607	3,878	4,098	4,421	4,416	4,409
Net domestic assets	**-14,885**	**-14,714**	**-14,085**	**-17,653**	**-19,391**	**-19,640**
Net claims on nonfinancial public sector	-11,893	-12,490	-15,185	-13,074	-13,007	-12,073
Central government (CG)	-7,131	-7,551	-9,581	-8,100	-7,641	-6,290
Rest of nonfinancial public sector	-4,762	-4,939	-5,604	-4,974	-5,366	-5,784
Bank of Guatemala losses	14,879	15,258	14,986	14,377	13,907	13,572
Net credit to banks	-7,596	-9,834	-10,646	-11,285	-13,073	-13,936
Of which: legal reserves	-9,663	-11,900	-12,710	-13,347	-15,135	-15,998
Open market operations 2/	-11,411	-9,796	-6,172	-10,848	-7,306	-5,768
Other assets (net)	1,135	2,148	2,933	3,177	88	-1,435
Currency in circulation	**12,519**	**14,745**	**17,186**	**16,753**	**18,066**	**19,279**
Banking Sector						
Net foreign position	**-6,193**	**-7,753**	**-10,387**	**-9,607**	**-9,310**	**-9,152**
(in millions of U.S. Dollars)	-815	-1,021	-1,361	-1,235	-1,098	-1,037
Net claims on Bank of Guatemala	**17,539**	**18,094**	**15,474**	**20,899**	**19,066**	**18,302**
Legal reserves	9,663	11,900	12,710	13,347	15,135	15,998
BOG securities	9,936	8,253	4,821	9,606	5,986	4,359
Liabilities to BOG	-2,060	-2,059	-2,057	-2,054	-2,054	-2,054
Net domestic assets	**54,437**	**68,127**	**81,612**	**85,361**	**93,314**	**100,401**
Net credit to the NFPS	2,597	2,641	2,958	-411	1,589	1,834
Net credit to Central Government	6,828	8,273	8,979	7,225	9,314	9,560
Net credit to the rest of NFPS	-4,231	-5,632	-6,021	-7,635	-7,726	-7,726
Official capital and reserves	-811	-1,101	-2,097	-2,932	-3,092	-3,211
Credit to the private sector	48,428	62,357	78,567	87,210	92,639	99,241
Other items net	4,223	4,230	2,184	1,495	2,177	2,536
Medium- and long-term foreign liabilities	**70**	**96**	**521**	**1,214**	**1,144**	**1,106**
Liabilities to private sector	**65,714**	**78,372**	**86,178**	**95,439**	**101,926**	**108,445**
Demand deposits	23,812	28,341	33,442	35,710	36,222	38,938
Time and savings deposits	35,090	41,769	44,229	50,176	55,506	58,874
Securities	2,699	3,175	2,220	1,561	1,772	1,881
Capital and reserves (private banks)	4,113	5,087	6,287	7,992	8,426	8,751
Monetary Survey						
Net foreign assets	**21,211**	**21,706**	**20,883**	**24,798**	**28,148**	**29,768**
(In millions of U.S. dollars)	2,792	2,857	2,737	3,187	3,319	3,372
Net domestic assets	**58,561**	**73,046**	**84,351**	**89,849**	**93,359**	**99,498**
Net claims on nonfinancial public sector	-9,296	-9,849	-12,228	-13,485	-11,418	-10,239
Bank of Guatemala losses	14,879	15,258	14,986	14,377	13,907	13,572
Credit to private sector	48,435	62,365	78,574	87,217	93,120	99,862
Other assets (net)	4,542	5,272	3,018	1,740	-1,684	-2,984
Medium- and long-term foreign liabilities	**70**	**96**	**521**	**1,214**	**1,144**	**1,106**
Liabilities to the private sector	**79,702**	**94,656**	**104,713**	**113,433**	**120,363**	**128,159**
Money	32,758	38,842	44,662	45,888	49,060	52,354
Quasi-money	46,944	55,813	60,051	67,545	71,302	75,806
Memorandum items:			(Percent change)			
Currency in circulation	11.8	17.8	16.6	-2.5	7.8	6.7
M2	15.2	18.8	11.8	8.2	6.0	6.7
Net credit of the banking sector to the CG	76.7	21.2	8.5	-19.5	28.9	2.6
Credit to private sector	21.9	28.8	26.0	11.0	6.2	7.1
			(In percent of GDP)			
Currency in circulation	6.0	6.4	6.6	5.7	5.8	5.8
M2	34.4	36.9	36.3	34.8	34.7	34.7
Net credit of the banking sector to the CG	3.3	3.6	3.4	2.5	3.0	2.9
Credit to private sector	23.3	27.1	30.1	29.6	29.6	29.7
			(In percent of bank liabilities to the private sector)			
Bank liquidity assets	45.9	41.5	34.7	35.8	33.7	31.2
Demand deposits	36.2	36.2	38.8	37.4	35.5	35.9
Time and savings deposits	53.4	53.3	51.3	52.6	54.5	54.3
Capital and reserves (private banks)	6.3	6.5	7.3	8.4	8.3	8.1

Sources: Bank of Guatemala; and Fund staff estimates.

1/ Program definition nets out foreign currency liabilities of the central bank to financial institutions.

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

Table 3. Guatemala: Summary Balance of Payments

(In millions of U.S. dollars)

					Projected	
	2005	2006	2007	2008	2009	2010
Current account	**-1,241**	**-1,524**	**-1,769**	**-1,861**	**-1,511**	**-1,894**
Trade balance	-4,191	-4,852	-5,487	-5,541	-4,517	-4,998
Exports, f.o.b.	4,393	5,014	6,030	6,967	6,169	6,458
Imports, f.o.b.	-8,583	-9,866	-11,516	-12,508	-10,686	-11,457
Of which: oil and lubricants	-1,491	-1,765	-2,277	-2,670	-1,602	-1,909
Services	-142	-260	-293	-387	-335	-353
Rent	-485	-680	-843	-932	-990	-1,006
Current transfers (net)	3,577	4,268	4,854	4,999	4,331	4,463
of which , remittances	3,011	3,645	4,200	4,403	3,753	3,866
Capital and financial account	**669**	**1,355**	**1,611**	**1,686**	**1,015**	**1,386**
Capital account	0	142	0	0	0	0
Financial account	669	1,213	1,611	1,686	1,015	1,386
Central Bank	-1	10	20	-13	0	0
Public sector	-86	326	233	121	618	630
Bonds (net)	-42	-30	-160	-1	0	0
Loans	-44	356	393	122	618	630
Disbursements	143	584	598	382	860	894
Amortization	-187	-228	-205	-260	-242	-264
Private sector	755	877	1,358	1,578	398	756
FDI	470	552	719	815	553	624
Portfolio investment	-35	-53	-24	39	-27	-28
Other investment	320	378	663	724	-128	160
Errors and Omissions	811	421	374	508	496	508
Overall balance	**239**	**252**	**216**	**333**	**0**	**0**
			(In percent of GDP)			
Current account	-4.6	-5.0	-5.2	-4.8	-4.0	-4.9
Trade balance	-15.4	-16.1	-16.1	-14.2	-11.9	-12.8
Exports, f.o.b.	16.1	16.6	17.7	17.9	16.2	16.6
Imports, f.o.b.	-31.5	-32.6	-33.8	-32.1	-28.1	-29.4
Of which: oil and lubricants	-5.5	-5.8	-6.7	-6.8	-4.2	-4.9
Services	-0.5	-0.9	-0.9	-1.0	-0.9	-0.9
Rent	-1.8	-2.3	-2.5	-2.4	-2.6	-2.6
Current transfers (net)	13.1	14.1	14.3	12.8	11.4	11.4
of which , remittances	11.1	12.1	12.3	11.3	9.9	9.9
Capital and financial account	2.5	4.5	4.7	4.3	2.7	3.6
Capital account	0.0	0.5	0.0	0.0	0.0	0.0
Financial account	2.5	4.0	4.7	4.3	2.7	3.6
Public sector	-0.3	1.1	0.7	0.3	1.6	1.6
Bonds (net)	-0.2	-0.1	-0.5	0.0	0.0	0.0
Loans	-0.2	1.2	1.2	0.3	1.6	1.6
Disbursements	0.5	1.9	1.8	1.0	2.3	2.3
Amortization	-0.7	-0.8	-0.6	-0.7	-0.6	-0.7
Private sector	2.8	2.9	4.0	4.0	1.0	1.9
FDI	1.7	1.8	2.1	2.1	1.5	1.6
Portfolio investment	-0.1	-0.2	-0.1	0.1	-0.1	-0.1
Other investment	1.2	1.3	1.9	1.9	-0.3	0.4
Errors and Omissions	3.0	1.4	1.1	1.3	1.3	1.3
Overall balance	0.9	0.8	0.6	0.9	0.0	0.0
Memorandum items:						
Value of exports, f.o.b. percentage change)	12.9	14.2	20.3	15.5	-11.5	4.7
Value of imports, f.o.b. (percentage change)	14.1	15.0	16.7	8.6	-14.6	7.2
NIR in months of next-year NFGS imports	3.7	3.4	3.3	4.1	3.9	3.5
Stock of NIR (in millions of U.S. dollars) 2/	3,607	3,878	4,098	4,421	4,416	4,416
NIR over short-term debt on residual maturity	1.2	1.0	0.9	0.9	1.0	0.9
Nominal GDP (in millions of U.S. dollars)	27,218	30,231	34,029	38,983	38,020	38,982

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

Table 4. Guatemala: Combined Public Sector Balance

(In percent of GDP)

	2005	2006	2007	2008	2009	2010
					Projected	
Total revenues	**12.0**	**12.7**	**12.9**	**12.0**	**11.3**	**11.5**
Tax revenues	11.2	11.9	12.1	11.3	10.5	10.6
Direct taxes	3	3.3	3.3	3.3	3.3	3.0
Indirect taxes	8	8.5	8.8	8.0	7.2	7.4
Nontax revenues	0.8	0.9	0.8	0.7	0.8	0.8
Total expenditures	**13.7**	**14.7**	**14.7**	**13.7**	**14.1**	**14.1**
Current expenditures	9.1	9.4	9.5	9.2	9.7	9.7
Capital expenditures	4.6	5.3	5.2	4.5	4.4	4.4
Expenditure overruns	…	…	0.3	…	…	…
Overall balance	**-1.7**	**-1.9**	**-1.8**	**-1.7**	**-2.8**	**-2.6**
Primary balance	**-0.3**	**-0.6**	**-0.3**	**-0.3**	**-1.2**	**-1.0**
Financing	**1.7**	**1.9**	**1.8**	**1.7**	**2.8**	**2.6**
External financing	**-0.2**	**1.2**	**1.2**	**0.3**	**1.6**	**1.6**
Foreign loans (net)	-0.2	1.2	1.2	0.3	1.6	1.6
Disbursements	0.5	1.9	1.8	0.9	2.3	2.3
Amortizations	-0.7	-0.7	-0.6	-0.6	-0.6	-0.7
Bonds	0.0	0.0	0.0	0.0	0.0	0.0
Domestic financing	**1.9**	**0.7**	**0.6**	**1.4**	**1.2**	**1.0**
Central bank deposits	0.5	-0.2	-0.7	0.8	0.1	0.4
Commercial banks	1.3	1.5	0.7	-0.4	0.7	0.1
Bonds, domestic, nonfinancial sector	0.0	0.0	0.0	1.1	0.3	0.5
o/w Bonds purchased by public sector	0.0	0.0	0.0	0.7	0.3	0.4
Other	0.5	-0.1	0.0	0.0	0.0	0.0
Change in floating debt	0.0	0.0	0.3	0.0	0.0	0.0
Rest of NFPS balance	1.1	0.7	1.1	1.0	0.4	0.5
Financing	-1.1	-0.7	-1.1	-1.0	-0.4	-0.5
External financing	-0.1	0.0	0.0	0.0	0.0	0.0
Domestic financing	-1.1	-0.7	-1.1	-1.0	-0.4	-0.5
Bank of Guatemala	-0.4	-0.1	-0.3	0.2	-0.1	-0.1
Commercial banks	-0.7	-0.6	-0.1	-0.5	0.0	0.0
Central government bonds	0.0	0.0	-0.7	-0.7	-0.3	-0.4
Central Bank Balance	-0.6	-0.2	0.1	0.2	0.2	0.1
Combined Nonfinancial Public Sector, Overall Balance	-0.6	-1.2	-0.7	-0.7	-2.4	-2.1
Combined Nonfinanical Public Sector, Primary Balance	0.8	0.1	0.8	0.7	-0.8	-0.5
Memorandum item						
Central government gross borrowing requirements	3.7	4.6	3.5	3.1	4.0	4.2
Nonfinancial public sector debt	20.8	21.8	21.7	20.2	22.5	24.2
NFPS external debt	13.1	13.1	12.5	11.3	13.1	14.4
NFPS domestic debt	7.7	8.7	9.2	8.9	9.4	9.8
Social Expenditure	4.8	5.0	4.6	4.4	5.0	5.0

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

Table 5. Guatemala: Indicators of Vulnerability

	2005	2006	2007	2008	Proj. 2009
Banking system indicators					
On-shore Banks					
Statutory capital to risk-weighted assets	13.4	12.8	12.3	13.5	…
Noninterest expenses to gross income	62.9	60.7	62.5	52.9	…
Nonperforming loans to total gross loans	3.8	3.4	2.6	2.3	…
Nonperforming loans net of provisions to capital	9.7	7.5	6.2	3.6	…
Return on assets	1.3	1.2	1.5	1.7	…
Return on equity	15.2	15.0	16.8	16.3	…
Cash to total deposits	20.1	21.2	20.8	19.7	…
Net open position in foreign exchange to capital	28.2	22.0	22.8	22.4	…
Foreign currency-denominated loans to total loans	27.6	30.2	33.2	33.6	…
Foreign currency-denominated liabilities to total liabilities	21.1	21.6	25.1	24.3	…
Off-shore Banks					
Statutory capital to risk-weighted assets	12.8	14.2	15.0	14.7	…
Non-performing loans to total gross loans	2.9	2.9	2.9	2.2	…
Return on assets	1.4	2.0	2.2	1.5	…
Return on equity	15.2	18.8	19.4	14.2	…
Liquid assets to total assets	30.6	21.1	19.0	21.6	…
Total assets off-shore banks to total assets on-shore banks	23.0	18.9	16.8	16.1	…
External indicators					
Merchandise exports (12-month percentage change)	12.9	14.2	20.3	15.5	-11.5
Traditional merchandise exports (12-month percentage change)	23.7	5.0	26.7	18.5	-16.3
Nontraditional merchandise exports (12-month percentage change)	9.2	17.7	18.0	14.5	-9.6
Merchandise imports (12-month percentage change)	14.1	15.0	16.7	8.6	-14.6
Imports of oil and lubricants (12-month percentage change)	46.4	18.4	29.0	17.2	-40.0
Non-oil imports (12-month percentage change)	9.0	14.2	14.0	6.5	-7.7
Terms of trade (12-month percentage change)	-1.3	-2.9	-0.2	-1.6	4.8
Current account balance (in percent of GDP)	-4.5	-5.0	-5.2	-4.8	-4.0
Capital account balance (in percent of GDP)	2.4	4.5	4.7	4.3	2.7
Net international reserves					
In millions of U.S. dollars	3,607	3,878	4,098	4,421	4,416
In percent of M2	39.2	36.4	33.3	33.5	34.4
In percent of base money	123.4	111.0	105.2	114.3	112.8
In percent of short-term external debt on a remaining maturity basis	116.5	101.1	88.1	90.1	97.6
In months of next-year's imports of goods and nonfactor services	3.7	3.4	3.3	4.1	3.9
Commercial banks foreign assets (in millions of U.S. dollars)	292	393	447	422	334
Commercial banks foreign liabilities (in millions of U.S. dollars)	1108	1410	1808	1656	1432
External indebtness indicators					
Total external debt (in percent of GDP)	34.7	36.1	37.1	35.3	36.1
External private sector debt (in percent of GDP)	21.6	23.0	24.6	24.0	23.0
External public sector debt (in percent of GDP)	13.1	13.1	12.5	11.3	13.1
Public sector external interest payments in percent of exports of goods and nonfactor services	4.5	4.4	4.5	3.4	3.8
Public sector external amortization payments in percent of exports of goods and services	4.3	4.1	3.4	3.6	3.9

Sources: Bank of Guatemala; and Fund staff estimates.

Table 6. Implementation of the Main FSAP Update Recommendations

FSAP Update Recommendations	Status
A. Banking Sector	
(i) Resolve the situation of CHN or consider restricting its activities (no deposits from the public).	Significant improvement. The bank has started to report operating profits and was recently recapitalized.
(ii) Establish effective firewalls between onshore banks and their offshore affiliates.	Included in draft amendments to the banking law (Program structural benchmark, June 2009).
(iii) Strengthen risk management practices at supervised institutions.	Significant progress in implementation.
(iv) Elimination of any ambiguity regarding illegal banking.	Superintendency considers that it has sufficient tools to combat illegal banking including through active monitoring.
B. Prudential Supervision and Regulation	
(i) Upgrade loan classification and provisioning rules; create classification for restructured loans.	Implemented with the objective of securing full provisioning of non performing loans by mid 2011.
(ii) Develop guidelines for the prudential treatment of restructured loans.	Implemented. Restructured loans classification (in terms of their credit quality rating) will be improved only after 3 months of good performance after the restructuring.
(iii) Define eligible collateral more conservatively and improve the legal framework for execution.	Partially implemented. Legal framework for execution of movable collateral approved.
(iv) Introduce an overall limit for total loans to all shareholders to control credit concentration.	Included in draft amendments to the banking law (Program structural benchmark).
(v) Issue regulation to induce banks to identify, measure, and internalize FX indirect credit risk.	Draft regulation to be prepared (Program structural benchmark).
(vi) Require disclosure of audit reports of financial institutions in their websites; revise role of auditors.	Significant progress in implementation.
(vii) Strengthening the supervisor's capacity to request regularization plans and issue cease and desist orders.	Included in draft amendments to the banking law (Program structural benchmark).
C. Financial Conglomerates (FC)	
(i) Integrate offsite and onsite activities under a senior supervisor in charge of each FC.	Already implemented
(ii) Strengthen information infrastructure (including database to monitor related lending and aggregate risk).	Already implemented
(iii) Assess FC and controlling members' contribution to risks and capital-performance analysis system.	Significant progress in implementation.
(iv) Track (on examinations) funds lent to actual/suspected parties, and capital disbursed to FC.	Already implemented
(v) Reform capital adequacy regulations, including deductions from consolidated capital of excess risk with shareholders, directors, and their respective related parties.	Included in draft amendments to the banking law (Program structural benchmark).
(vi) Extend current risk limits to offshore banks, as well as to the overall FC on a consolidated basis.	Included in draft amendments to the banking law (Program structural benchmark).
(vii) Legislate economic groups to enhance disclosure practices and require nominative shares; amend banking legislation to include a maximum combined risk limit with the group of shareholders, directors, and related parties and a combined maximum risk limit with large risk exposures.	Included in draft amendments to the banking law (Program structural benchmark). Elimination of stock in bearer form included in proposed changes to Commerce Code, under consideration by congress.

Table 7. Guatemala: External Debt Sustainability Framework, 2004–2014
(In percent of GDP, unless otherwise indicated)

		Actual					Projections						
		2004	2005	2006	2007	2008	2009	2010	2011	2012	2013	2014	Debt-stabilizing non-interest current account 6/
1	**Baseline: External debt**	**33.5**	**34.5**	**35.9**	**37.0**	**35.3**	**36.0**	**37.6**	**39.0**	**39.1**	**38.6**	**37.9**	**-2.0**
2	Change in external debt	0.9	1.0	1.4	1.1	-1.8	0.8	1.6	1.4	0.0	-0.5	-0.6	
3	Identified external debt-creating flows (4+8+9)	-0.1	-0.5	0.1	-1.2	-0.8	2.2	2.7	1.8	1.0	0.7	0.5	
4	Current account deficit, excluding interest payments	3.4	3.0	3.4	3.5	3.3	2.5	3.5	2.9	1.8	1.6	1.5	
5	Deficit in balance of goods and services	15.2	15.3	16.0	16.1	14.2	11.8	12.8	13.9	14.3	14.3	14.3	
6	Exports	16.2	16.1	16.6	17.7	17.9	16.2	16.5	16.9	17.1	17.3	17.5	
7	Imports	31.4	31.4	32.6	33.8	32.1	28.0	29.3	30.8	31.4	31.6	31.9	
8	Net non-debt creating capital inflows (negative)	-1.1	-1.7	-1.8	-2.1	-2.1	-1.4	-1.6	-1.7	-1.8	-1.9	-2.0	
9	Automatic debt dynamics 1/	-2.4	-1.9	-1.5	-2.6	-2.0	1.1	0.8	0.6	1.0	1.0	1.0	
10	Contribution from nominal interest rate	1.4	1.5	1.7	1.7	1.5	1.5	1.4	1.9	2.5	2.5	2.5	
11	Contribution from real GDP growth	-0.9	-1.0	-1.7	-2.0	-1.3	-0.4	-0.6	-1.3	-1.5	-1.5	-1.4	
12	Contribution from price and exchange rate changes 2/	-2.9	-2.4	-1.5	-2.3	-2.2	…	…	…	…	…	…	
13	Residual, incl. change in gross foreign assets (2-3) 3/	1.0	1.6	1.3	2.3	-0.9	-1.4	-1.1	-0.5	-0.9	-1.2	-1.2	
	External debt-to-exports ratio (in percent)	206.1	214.8	216.8	209.0	197.4	222.9	227.9	230.6	228.0	222.7	216.5	
	Gross external financing need (in billions of U.S. dollars) 4/	3.9	4.2	5.2	6.2	6.9	6.2	6.7	7.4	7.4	8.1	8.3	
	in percent of GDP	16.3	15.4	17.0	18.2	17.7	16.2	17.2	18.2	17.1	17.6	16.8	
	Scenario with key variables at their historical averages 5/						**36.0**	**36.6**	**37.7**	**38.8**	**39.8**	**40.9**	**-2.6**
	Key Macroeconomic Assumptions Underlying Baseline												
	Nominal GDP (U.S. dollars)	24.0	27.3	30.3	34.0	39.0	38.2	39.1	40.9	43.3	46.1	49.2	
	Real GDP growth (in percent)	3.2	3.3	5.4	6.3	4.0	1.0	1.8	3.5	4.0	4.0	4.0	
	GDP deflator in U.S. dollars (change in percent)	9.8	7.8	4.5	6.8	6.4	-3.1	0.6	1.0	1.9	2.5	2.6	
	Nominal external interest rate (in percent)	5.0	5.1	5.3	5.3	4.5	4.1	4.1	5.2	6.7	6.8	6.8	
	Growth of exports (U.S. dollar terms, in percent)	10.8	12.9	14.2	20.3	15.5	-11.5	4.7	7.0	7.3	7.7	8.0	
	Growth of imports (U.S. dollar terms, in percent)	16.2	14.1	15.0	16.7	8.6	-14.6	7.2	9.9	8.1	7.3	7.5	
	Current account balance, excluding interest payments	-3.4	-3.0	-3.4	-3.5	-3.3	-2.5	-3.5	-2.9	-1.8	-1.6	-1.5	
	Net non-debt creating capital inflows	1.1	1.7	1.8	2.1	2.1	1.4	1.6	1.7	1.8	1.9	2.0	

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

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

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

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

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

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

Table 8. Guatemala: Public Sector Debt Sustainability Framework, 2003–2014

(In percent of GDP, unless otherwise indicated)

	Actual								Projections						
	2003	2004	2005	2006	2007	2008			2009	2010	2011	2012	2013	2014	**Debt-stabilizing primary balance 9/**
1 **Baseline: Public sector debt 1/**	21.6	21.9	20.8	21.8	21.7	20.2			**22.5**	**24.2**	**24.8**	**25.0**	**25.1**	**25.1**	**-0.2**
o/w foreign-currency denominated	18.9	18.8	15.8	14.9	13.9	11.6			13.5	14.8	14.5	14.2	13.5	13.1	
2 Change in public sector debt	2.1	0.3	-1.1	1.0	-0.1	-1.6			2.4	1.6	0.6	0.2	0.1	0.0	
3 Identified debt-creating flows (4+7+12)	1.9	-1.4	-0.4	0.0	-0.7	-1.0			1.2	0.9	0.0	-0.3	-0.4	-0.4	
4 Primary deficit	1.3	-0.3	0.3	0.6	0.3	0.3			1.2	1.0	0.4	0.2	0.1	0.1	
5 Revenue and grants	12.5	12.3	12.0	12.7	12.9	12.0			11.3	11.5	12.1	12.2	12.3	12.3	
6 Primary (noninterest) expenditure	13.8	12.0	12.3	13.3	13.2	12.3			12.5	12.5	12.5	12.4	12.4	12.4	
7 Automatic debt dynamics 2/	0.6	-1.1	-0.8	-0.5	-1.0	-1.3			0.0	-0.1	-0.4	-0.5	-0.5	-0.5	
8 Contribution from interest rate/growth differential 3/	0.0	-0.5	-0.4	-0.6	-1.1	-1.1			0.0	-0.1	-0.4	-0.5	-0.5	-0.5	
9 Of which contribution from real interest rate	0.5	0.1	0.2	0.4	0.1	-0.3			0.2	0.3	0.4	0.4	0.4	0.5	
10 Of which contribution from real GDP growth	-0.5	-0.6	-0.7	-1.0	-1.2	-0.8			-0.2	-0.4	-0.8	-0.9	-0.9	-0.9	
11 Contribution from exchange rate depreciation 4/	0.6	-0.6	-0.4	0.1	0.1	-0.2			...	...	...	...	...	...	
12 Other identified debt-creating flows	0.0	0.0	0.0	0.0	0.0	0.0			0.0	0.0	0.0	0.0	0.0	0.0	
13 Privatization receipts (negative)	0.0	0.0	0.0	0.0	0.0	0.0			0.0	0.0	0.0	0.0	0.0	0.0	
14 Recognition of implicit or contingent liabilities	0.0	0.0	0.0	0.0	0.0	0.0			0.0	0.0	0.0	0.0	0.0	0.0	
15 Other (specify, e.g. bank recapitalization)	0.0	0.0	0.0	0.0	0.0	0.0			0.0	0.0	0.0	0.0	0.0	0.0	
16 Residual, including asset changes (2-3) 5/	0.3	1.7	-0.6	1.0	0.6	-0.6			1.2	0.7	0.6	0.5	0.4	0.4	
Public sector debt-to-revenue ratio 1/	172.0	177.5	173.4	171.3	168.5	167.7			199.5	210.9	205.6	206.0	204.7	204.7	
Gross financing need 6/	5.5	2.5	2.7	3.3	2.9	1.8			3.5	3.1	3.9	3.0	3.8	2.8	
in billions of U.S. dollars	1.2	0.6	0.7	1.0	1.0	0.7			1.3	1.2	1.6	1.3	1.8	1.4	
Scenario with key variables at their historical averages 7/									**22.5**	**23.1**	**23.6**	**24.1**	**24.4**	**24.7**	**-0.3**
Scenario with no policy change (constant primary balance) in 2008–2013									**22.5**	**24.6**	**26.2**	**27.6**	**28.9**	**30.2**	**0.0**
Key Macroeconomic and Fiscal Assumptions Underlying Baseline							10-Year Historical Average	10-Year Standard Deviation							
Real GDP growth (in percent)	2.5	3.2	3.3	5.4	6.3	4.0	3.7	1.3	1.0	1.8	3.5	4.0	4.0	4.0	
Average nominal interest rate on public debt (in percent) 8/	7.2	6.9	7.0	7.4	7.8	7.1	7.5	0.6	6.6	6.4	6.4	6.8	6.9	7.0	
Average real interest rate (nominal rate minus change in GDP deflator, in percent)	2.7	0.9	1.4	2.4	0.9	-1.4	1.2	1.4	0.9	1.6	2.0	2.0	2.1	2.2	
Nominal appreciation (increase in US dollar value of local currency, in percent)	-3.6	3.5	2.0	-0.5	-1.0	1.5	-0.9	4.3	...	...	...	...	...	...	
Inflation rate (GDP deflator, in percent)	4.5	6.1	5.6	5.0	6.9	8.5	6.2	1.3	5.7	4.7	4.4	4.8	4.9	4.9	
Growth of real primary spending (deflated by GDP deflator, in percent)	13.7	-10.1	5.5	13.7	5.4	-2.7	3.8	8.4	2.6	1.2	3.5	3.4	4.0	4.0	
Primary deficit	1.3	-0.3	0.3	0.6	0.3	0.3	0.5	0.6	1.2	1.0	0.4	0.2	0.1	0.1	

1/ Central Government.

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

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

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

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

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

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

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

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

Table 9. Guatemala: Indicators of Fund Credit 2006-2014

	2005	2006	2007	2008	Projections 2009	2010	2011	2012	2013	2014	2015
Stocks from prospective drawings 1/											
Fund credit in millions SDR	0.0	0.0	0.0	0.0	504.5	630.6	630.6	520.3	236.5	31.5	0.0
In percent of quota	0.0	0.0	0.0	0.0	240.0	300.0	300.0	247.5	112.5	15.0	0.0
In percent of GDP	0.0	0.0	0.0	0.0	2.0	2.4	2.3	1.8	0.8	0.1	0.0
In percent of exports of goods and services	0.0	0.0	0.0	0.0	9.6	11.4	10.6	8.1	3.4	0.4	0.0
In percent of gross reserves 2/	0.0	0.0	0.0	0.0	16.4	20.4	19.5	15.3	6.6	0.8	0.0
Flows from prospective drawings 3/ 4/											
Principal (Millions SDR)	0.0	0.0	0.0	0.0	0.0	0.0	0.0	110.4	283.8	205.0	31.5
Interest and charges (Millions SDR)	0.0	0.0	0.0	0.0	6.0	10.0	11.4	10.9	6.5	2.1	0.3
Total (Millions SDR)	0.0	0.0	0.0	0.0	6.0	10.0	11.4	121.3	290.2	207.0	31.8
In percent of quota	0.0	0.0	0.0	0.0	2.9	4.7	5.4	57.7	138.1	98.5	15.1
In percent of GDP	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.4	0.9	0.6	0.1
In percent of exports of goods and services	0.0	0.0	0.0	0.0	0.1	0.2	0.2	1.9	4.2	2.7	0.4
In percent of gross reserves 2/	0.0	0.0	0.0	0.0	0.2	0.3	0.4	3.6	8.1	5.5	0.8

Sources: Bank of Guatemala; IMF Finance Department; and Fund staff estimates

1/ End of period

2/ Excludes IMF purchases.

3/ Assumes a constant 1.47 percent rate of charge.

4/ Excluding commitment charges.

Table 10. Guatemala: Proposed Access, 2009–2010

		High Access Cases 1/				Normal Access Cases			
	Proposed Arrangement	Proposed Arrangement	20th Percentile	80th Percentile	Average	Proposed Arrangement	20th Percentile	80th Percentile	Average
		(Percentile)	(Ratio)			(Percentile)	(Ratio)		
Access									
In millions of SDRs	630.6	11	1,620	12,821	7,773	89	36	408	353
Average annual access (percent of quota)	200	44	120	456	281	100	21	51	39
Total access in percent of: 2/									
Quota	300	17	300	900	628	100	30	75	63
Gross domestic product	2.5	9	3	10	10	77	1	3	2
Gross international reserves	20.5	11	27	90	86	62	5	41	41
Exports of goods and nonfactor services	13.7	25	12	39	32	91	2	7	6
Imports of goods and nonfactor services	7.6	9	11	51	32	84	2	6	5
Total debt stock									
Of which: Public 3/	12.5	54	7	36	23	…	…	…	…
External	6.9	20	7	17	13	82	2	6	4
Short term	20.1	21	20	107	93	…	…	…	…
M2	7.4	28	5	24	25	72	1	12	101

Sources: Executive Board documents; MONA database; and Fund staff estimates.

1/ High access cases include all available data at approval and on augmentation for the 36 requests to the Board since 1994 which involved the use of the exceptional circumstances clause or SRF resources. Exceptional access augmentations are counted as separate observations. For the purpose of measuring access as a ratio of different metrics, access includes augmentations and previously approved and drawn amounts.

2/ The data used to calculate ratios is the actual value for the year prior to approval for public and short-term debt, and the projection at the time of program approval for the year in which the program was approved for all other variables.

3/ Defined as debt of the central government and debt guaranteed by the central government.

Attachment I. Letter of Intent

Guatemala City, April 13, 2009

Mr. Dominique Strauss-Kahn
Managing Director
International Monetary Fund
Washington, D.C., 20431

Dear Mr. Strauss-Kahn:

1. Guatemala's economy has performed well in recent years. Sound macroeconomic policies and structural reforms have delivered high economic growth, a declining public debt-to-GDP ratio, and a stable external position, with international reserves rising to comfortable levels. Apart from a period of sharp increases in commodity prices, inflation has been low and stable. The global financial turmoil and the ensuing global recession, however, have tightened external financing conditions considerably, and our open economy has started to feel their impact. Against this backdrop, the Government of Guatemala is determined to continue implementing sustainable macroeconomic policies to safeguard macroeconomic and financial stability, while pursuing an agenda of reforms to achieve sustained high growth and poverty reduction over the medium term.

2. The attached Memorandum of Economic and Financial Policies (MEFP) presents the plans and policies of the authorities of Guatemala for 2009 and 2010. In support of this economic program, Guatemala requests a Stand-By Arrangement (SBA) from the International Monetary Fund totaling SDR 630.6 million (300 percent of quota), covering the period through October 21, 2010. Our intention is to treat the arrangement as precautionary. We expect that the SBA would support our commitment to continued sound macroeconomic policies, anchor investor confidence, and provide a larger liquidity cushion to face the downside risks in the global environment, if they were to materialize. The program summarizes the government's announced policies and thus benefits from strong ownership and political support.

3. We believe that the policies described in the attached MEFP are sufficient to meet the objectives of our program, and stand ready to take additional measures that may be needed for this purpose. In this respect, we will maintain a close and proactive policy dialogue with the Fund, in accordance with Fund policies on such consultations. We will continue our close dialogue with IMF staff on our economic policies after the expiration of the arrangement, for as long as there are any outstanding purchases in the upper credit tranches. During the

program, we will continue to comply with all obligations of Article VIII of the IMF's Articles of Agreement.

4. Program implementation will be monitored through quarterly reviews, with the first review to be completed on or after September 15, 2009 and the second review on or after December 15, 2009. The phasing of access, performance criteria, and structural benchmarks under the program are set out in Tables 1–3 of the MEFP.

5. We authorize the IMF to publish this Letter of Intent and its attachments, and the related staff report.

Sincerely yours,

/s/

Juan Alberto Fuentes Knight
Minister of Finance

/s/

Maria Antonieta del Cid Navas de Bonilla
President, Central Bank of Guatemala

Attachments

Attachment II. Memorandum of Economic and Financial Policies for 2009–2010

1. **Over the past several years, Guatemala has made progress in consolidating macroeconomic stability and in implementing important structural reforms**. Reflecting this progress and favorable external conditions, the economy has been expanding at rates above historical records, averaging 4¾ percent in 2005–08. This outcome was attained without a deterioration of the underlying external and fiscal positions.

2. **Volatile external conditions, however, are having a strong impact on the Guatemalan economy**. Up until mid-2008, higher commodity prices put upward pressure on inflation and the external current account deficit. We reacted timely, tightening monetary conditions, enhancing exchange rate flexibility, and strengthening the social safety net, while maintaining a prudent fiscal stance. The global economic and financial crisis, however, is now changing the scenario significantly, and our economy has started to feel its impact, through a deceleration of economic activity and tightening of domestic financial conditions.

3. **The Guatemalan economy is well prepared to face the adverse external outlook**. As the global slowdown is likely to be protracted and significant downside risks still remain, we are adjusting our policies to minimize the domestic effects of the external shock and to be better prepared in case downside risks materialize. At the same time, we remain committed to addressing the medium-term development challenges facing Guatemala, and we will implement necessary reforms to ensure sustainable medium-term growth, continued progress in reducing poverty, and protection of the neediest.

I. Program Objectives and Strategy

4. **Our program aims at safeguarding macroeconomic and financial stability.** The deterioration in the global economic and financial environment will affect the Guatemalan economy through three main channels: a lower external demand for our exports combined with a decline in export prices, a decline in remittances, and a significant slowdown of private capital inflows. Despite the rapid decline in oil prices, which should provide important relief to the external current account, these three factors are likely to require real and financial adjustments. Our policies aim at minimizing the cost of economic adjustment while preserving financial stability and confidence in the policy framework. By implementing these policies, we aim at maintaining growth in a range between 1 and 2 percent in 2009 and 1.7–2.7 percent in 2010.

5. **Our strategy is based on the following key pillars**: (i) a moderate countercyclical fiscal policy to support domestic demand, financed largely through external resources to minimize crowding out the private sector; (ii) a monetary policy focused on reducing inflation and a flexible exchange rate to facilitate economic adjustment; and (iii) financial sector policies aimed at (a) strengthening bank regulation and supervision to increase the resilience of the banking system; and (b) enhancing the banking sector safety net and the effectiveness of

bank resolution procedures. These macro-financial policies will be complemented with a refocusing of public expenditures to expand the social safety net and undertake labor-intensive public works. Over the medium term, we remain committed to increasing economic integration at the regional and global levels as a way to ensure efficient resource allocation and encourage growth.

II. Macrofinancial Policies

A. Fiscal Policy

6. **Guatemala's strong fiscal position provides space for a countercyclical fiscal policy**. Prudent fiscal policy has been a key feature of Guatemalan economic policy, with the central government deficit averaging 1.8 percent of GDP in 2004–08. As a result, Guatemala boasts the lowest public debt level in the region, 21 percent of GDP. We seek to maintain the sustainability of fiscal policy over the medium term, protecting the room for maneuver of fiscal policy in the face of shocks.

7. **Accordingly, a moderate fiscal impulse in 2009–10 is envisaged to prevent an excessive decline of domestic demand**. Public expenditure will increase by 0.4 percent of GDP with respect to 2008, to 14.1 percent of GDP, to help offset the expected retrenchment of private consumption and investment. To maximize the impact on aggregate demand, the increase in public expenditure is focused on labor-intensive public works and social spending targeted to poor households (section II) with a large propensity to consume. Tax collections are expected to decrease in the short term, by about 0.8 percent of GDP with respect to 2008, due to a decline in imports (VAT on imports and customs duties account for about 40 percent of tax collections) and a decline in oil royalties related to lower oil prices and a secular reduction in production. As a result, the fiscal deficit of the central government could increase to 2.8 percent of GDP in 2009 and then decline to 2.6 percent of GDP in 2010. The deficit of the consolidated public sector, in turn, could reach 2.4 percent of GDP in 2009 and 2.2 percent in 2010. The envisaged gradual recovery of tax collections over the medium term and the maintenance of the expenditure to GDP ratio would yield sustainable debt dynamics, anchoring public debt at a safe level.

8. **The larger deficits in 2009–10 will be financed mainly by external sources, mostly multilateral institutions.** We have secured new loans for almost US$1 billion from the World Bank and the IDB, which would allow us to meet this objective. Our domestic financing strategy envisages net domestic debt placements of 1 percent of GDP in 2009 and of 0.6 percent of GDP in 2010, and a drawdown of deposits accumulated at the Central Bank of 0.1 percent of GDP in 2009 and 0.4 percent of GDP in 2010. We aim to conduct our financing policy with the objective of prefinancing spending, building liquidity cushions in the meantime. We will not incur external arrears at any time during the program period.

9. **In the event economic developments require an adjustment of fiscal policy, our priority will be to protect social spending**. The room for maneuver of our fiscal policy is not

unlimited, and if downside risks materialize, we may need to adjust fiscal policy to maintain confidence. If tax collections come in lower than projected, we expect to finance up to 0.2 percent of GDP with additional external financing to avoid compressing expenditures in 2009. In the context of program reviews, we will analyze the need for compensatory measures, granting priority to social protection and labor-intensive public works.

10. **Tax policy measures are being discussed to strengthen the revenue base, allowing for a sustainable expansion of government spending**. Despite an increase of about 3 percent of GDP over the last 10 years, the tax ratio remains among the lowest in the region. We have reduced downside risks to tax collections by establishing the Solidarity tax, which replaces the temporary IETAAP as a minimum tax on income of individuals and corporations. Congress is considering a reform to indirect taxation that includes a new tax on the registration of vehicles, a graduated increase in the tax rate on vehicles in circulation, and legislation to strengthen tax administration. This legislation has been presented to Congress and it is expected to yield 0.2 percent of GDP annually once approved.

11. **In the short term, the tax authority, SAT, will continue implementing its medium-term plan to achieve a consistent decline of tax evasion rates**. Starting in 2009, SAT will complement its Annual Operations Plan with stronger and wider actions against tax evasion and smuggling. These additional efforts will help reduce the projected fall in tax collection, with an expected impact of 0.2 percent of GDP in 2009 and 2010. The main actions envisaged by SAT include: (i) stricter control of VAT tax exemptions (ExenIVA) and of workers' income tax withholdings (RetenISR); (ii) intensive crosscheck of VAT and income tax returns data; (iii) stricter control of VAT credit reimbursements to exporters; (iv) effective control of certain activities like sports clubs, cattle owners, transport, and exporters; (v) coordination and intensification of actions against smuggling through the Inter-institutional Commission for Smuggling and Customs Fraud Prevention and Fight (which includes the Army and police forces, and tax administration, health, and prosecution authorities); (vi) technological improvements for container transit control through the compulsory use of new state of the art GPS device (GPSAT); and (vii) control of vehicle circulation taxes.

12. **A number of measures to continue increasing the transparency of public spending have been introduced, in the context of the 2009 budget and as part of the overall policy program under the coordination of the Transparency Commission, headed by the Guatemalan Vice-President**.

- We have created the Vice-ministry for Fiscal Transparency and Evaluation at the Ministry of Finance. The vice-ministry will promote transparency by setting new policies and developing a map of corruption risks in the public sector.
- We are setting stricter conditions for the use of trust funds for expenditure management, and introducing reporting requirements by decentralized units and trust funds before budgetary transfers are approved.

- We have reduced the number of activities and entities exempted from the use of GUATECOMPRAS (online public procurement system), and have augmented the information required to be submitted to this system to increase transparency.
- We will improve the coordination between the Ministry of Finance, the Planning Secretary, and the Ministry of Communications, Infrastructure, and Housing in the preparation of the capital expenditure budget and its monitoring, aiming at expanding the coverage of the National Public Investment System to include all investment projects being executed with public resources.
- To better assess and conduct fiscal policy we will elaborate above-the-line consolidated general government accounts with technical assistance from the IMF.

B. Monetary and Exchange Rate Policies

13. **Monetary policy will focus on achieving a gradual reduction of inflation, toward a medium-term target of 4 percent, with a tolerance margin of +/- 1 percent.** We remain committed to strengthening the inflation-targeting regime, which we judge appropriate for Guatemala. The transmission of policy decisions to overall monetary conditions, and thus to aggregate demand, has been strengthening in recent times, especially as commercial bank rates have been more responsive to changes in the short-term policy rate. We have made important progress developing models to forecast inflation and plan to introduce further refinements, such as the effects on inflation of external commodity prices, exchange rate movements, and fiscal impulses.

14. **For 2009, the Monetary Board has targeted a decline of inflation to 5½ percent, with a tolerance margin of +/- 1 percent**. In light of the downside risks to inflation and economic activity, the Monetary Board has started an easing cycle reducing the policy interest rate; in the future, the rate will be managed as needed to meet the inflation target. If inflation were to deviate from its expected path beyond the established band in the program (+/- 2 percent), we would discuss with the IMF on the policy response.

15. **Efforts will continue to develop secondary markets for central bank and government paper**. More liquid and deeper secondary markets will improve price signals, help better guide policy decisions, and enhance the policy transmission mechanism. In this regard, we have started the dematerialization of debt instruments, the standardization of their maturities, a reduction in the number of weekly auctions, and an increase in the number of market participants allowed to bid in such auctions. Supported by technical assistance from the IMF and the U.S. Treasury, we are preparing further measures.

16. **Consistent with our monetary policy framework, we have allowed greater exchange rate flexibility to facilitate economic adjustment to shocks**. To this end, we have amended the foreign-exchange intervention rule to set symmetric and limited intervention. While fully committed to a rule-based approach, the central bank stands ready to prevent

excessive and disruptive volatility in the foreign exchange market. To maintain an appropriate external liquidity cushion, the program sets a floor on net international reserves.

C. Financial Sector Policies

17. **Our financial sector features very moderate exposure to the sources of the global financial crisis**. The participation of foreign banks is limited and our banks have not invested in high-risk instruments related to the U.S. mortgage market. Moreover, our financial system underwent a significant consolidation process in the aftermath of two bank failures in late 2006 and early 2007, with weaker institutions being absorbed by more solid ones. Thus, the banking system is better capitalized, liquidity remains adequate, and profitability has been maintained at healthy levels.

18. **However, we have introduced preemptively a number of measures to reduce risks arising from the global downturn**:

- ***Continuous and enhanced on-site supervision*** has been put in place since June 2008, to identify risks earlier, facilitate discussions of developments and contingency plans with banks' Boards of Directors, and allow rapid enforcement of corrective actions.

- ***Temporary and limited measures to ensure adequate banking sector liquidity*** have been introduced by the central bank. Banks have been allowed to make limited use of liquid assets (other than deposits at the central bank) to meet reserve requirements until March 2009, thus allowing a relaxation of reserve requirements from 14 percent to about 13 percent. In addition, the central bank introduced reverse repos to provide liquidity in dollars, to address concerns about cuts in external credit lines. The overall assistance, in place until May 30, 2009 is limited to $290 million (about 15 percent of the stock of external credit lines). These facilities could be rolled over or expanded within prudent limits, if needed.

- ***Stronger capital cushions*** *are being built. Provisioning requirements* have been revamped, to ensure that by mid-2011 all nonperforming loans are fully provisioned. This gradual approach is justified by the need to avoid undue procyclicality in the requirements, while strengthening banks' capital adequacy. In addition, we have injected new capital to Banco de Crédito Hipotecario Nacional to restore its capital adequacy.

19. **Building on this progress, we will further strengthen the regulatory framework to ensure adequate risk-management and continue improving supervision**. We will introduce regulatory changes to ensure that banks strengthen liquidity management through the use of liquidity gap measurement and that credit risk arising from borrowers' foreign-currency exposures are properly internalized through higher provisions or capital requirements (the timing of these changes will be set at the time of the first program review). We will also aim to improve consolidated supervision of regional financial groups, including through closer coordination with foreign supervisors, and further develop our stress-testing methodologies.

20. **A key element of our strategy is to introduce changes to our banking legislation in order to strengthen regulation and supervision and enhance the current bank resolution framework**. To this end, we plan to submit amendments to the banking legislation in the first half of 2009. Based on the lessons from our past experience and key recommendations from IMF technical assistance, the amendments to the law will aim to reduce connected lending, reduce risks from offshore operations, and strengthen enforcement powers of the Superintendency of Banks. Also, we will seek to improve the bank resolution framework to increase the strength, effectiveness, and flexibility of resolution tools, on the basis of strict and transparent principles. Envisaged reforms include the expansion of the central bank's lender-of-last-resort function and higher deposit insurance premia.

21. **We will continue making progress with the recovery of failed-bank assets and in implementing our anti-money laundering strategy**. Assets under recovery after the failure of Bancafe have been sufficient to cover all the liabilities assumed by private banks in its resolution, and the deposit insurance fund (FOPA) has started to recover part of its contribution to that resolution. While it is unlikely that remaining assets will be enough to cancel all debts with FOPA, we plan to accelerate asset disposal in the coming months. Anti-money laundering policy implementation has been strengthened with the enlargement of the Financial Intelligence Unit within the superintendency of banks, and more controls in a number of activities, including cash transactions, large remittances, and gaming. Soon, control procedures will be established for other activities, including real estate.

III. Protecting the Poor and Encouraging Medium-Term Growth

22. **Our social protection policy aims at enhancing current programs to offset the effect of the crisis on the neediest**. We have a strong commitment to safeguard the individuals' access to economic opportunities ensuring the minimum requirements for human development. Thus, securing nutrition, health, and basic education are pillars of our strategy. Social expenditure is expected to reach 5 percent of GDP in 2009, up from 4.7 percent of GDP on average in 2005–2008. To attend to extreme poverty, the emphasis will be put on a new government program of conditional cash transfers, whose progress will be monitored closely to assess their impact. The program, *Mi familia progresa,* aims at securing that poor children attend school and visit health centers regularly. The program, initiated in 2008, covers 281,000 families. In 2009, the program will be expanded to reach 500,000 families and its budget is expected to reach about US$150 million. Other important social programs include *Bolsa solidaria*; *Escuelas abiertas*; and *Comedores Solidarios*, with a budget of around US$7 million in 2009.

23. **Sustained growth and significant poverty reduction require enhancing productivity and raising investment.** Long-term growth has been low and insufficient to reduce poverty, which declined only moderately in recent years and remains high at 51 percent.

24. **In order to raise productivity and investment, a number of efforts are required**. Assessments of the business environment conclude that, to facilitate the development of

private sector activity, there is a need to improve health and education so as to increase the productivity of the labor force, combat crime, and reduce the cost of energy. We are addressing these issues while continuing with our strategy to increase openness and reduce the cost of doing business. The main policies that are being undertaken include:

- Deepening Economic Integration, including progress in the implementation of a Central American Customs Unions, beginning with El Salvador, and advancing with the negotiation of an association agreement with the European Union. We expect that free trade agreements with Colombia and Panama will take effect in 2009. We also expect Congress to consider the ratification of Free Trade Agreements with Chile, already signed.

- Developing infrastructure. We are working with Congress to enact a law on public-private partnerships (Alianzas para el Desarrollo) to overcome capacity constraints in the public sector while ensuring sound management of fiscal contingencies.

- Improving access to finance. We have implemented the new law on movable collateral, with the opening of the public registry of loans with such guarantees.

- Combating crime. The fight against fraud, money laundering, and contraband will require a coordinated effort by various ministries, SAT, and the Superintendency of Banks.

- Improving the framework for creditors' rights and insolvency proceedings. Current mechanisms are long and inefficient and these weaknesses are widely acknowledged. Since addressing them involves complex legal issues, including constitutional provisions, we will set up a high-level commission with participation of private sector and legal experts to explore solutions. We expect to have the support of multilateral institutions in this endeavor.

IV. Safeguards Assessment

25. **We recognize the importance of completing an updated safeguards assessment of the central bank of Guatemala before the first review of the Stand-By Arrangement**. To facilitate this, we have authorized the central bank's external auditors to provide IMF staff with all necessary information and to hold discussions directly with IMF staff. We also commit to receiving a safeguards mission and to providing that mission with all necessary information without delay.

V. Program Monitoring

26. **Progress in the implementation of policies under this program will be monitored quarterly through quantitative performance criteria and indicative targets, an inflation consultation clause, and structural benchmarks**. The phasing of access under the arrangement and the review schedule are set out in Table 1. The quantitative performance criteria, indicative targets, and parameters of the inflation consultation clause are set out in Table 2. Structural benchmarks are presented in Table 3. Program conditionality is further specified in the accompanying TMU.

Table 1. Guatemala: Purchase Schedule and Terms Under the Stand-By Arrangement

Date	Conditions for purchase	Purchase: Million SDR	Million US$ 1/	Percent of Quota	Percent of Total Access
April 22, 2009	Board approval of the SBA	420.40	634.27	200.00	66.67
September 15, 2009	First review, based on end-June 2009 performance criteria	42.04	63.43	20.00	6.67
December 15, 2009	Second review, based on end-September 2009 performance criteria	42.04	63.43	20.00	6.67
March 15, 2010	Third review, based on end-December 2009 performance criteria	42.04	63.43	20.00	6.67
June 15, 2010	Fourth review, based on end-March 2010 performance criteria	42.04	63.43	20.00	6.67
September 15, 2010	Fifth review, based on end-June 2010 performance criteria	42.04	63.43	20.00	6.67
Total		630.60	951.40	300.00	100.00

Source: Fund staff estimates.

1/ US$/SDR exchange rate of 0.662813 as of March 26, 2009.

Table 2. Guatemala: Quantitative Performance Criteria, Indicative Targets, and Consultation Clause

	2009 end-June	2009 end-Sept	2009 end-Dec	2010 end-Dec
Performance Criteria (for end-June and end-Sept 2009; indicative targets otherwise)				
Overall balance of the central government, floor (millions of Q) 1/	-3,075	-6,946	-8,720	-8,742
Net International Reserves, floor (millions of US$)	4,400	4,200	4,000	4,000
Accumulation of external arrears 2/	0	0	0	0
Indicative Targets				
Central Government Deposits at Central Bank, floor (millions of Q)	10,899	7,695	7,642	6,290
Consultation Clause on inflation 3/				
Outer band, upper limit 4/	7.5	7.5	8.5	8.0
Inner band, upper limit 5/	6.5	6.5	7.5	7.0
Inner band, lower limit 5/	2.5	2.5	3.5	3.0
Outer band, lower limit 4/	1.5	1.5	2.5	2.0

1/ Cumulative from end of preceding year.

2/ Continuous performance criterion.

3/ Deviations outside the inner and outer bands' limits for inflation will trigger consultations with the Fund, as set out in the TMU

4/ Band of +/- 3 percent around central inflation point.

5/ Band of +/- 2 percent around central inflation point.

Table 3. Guatemala: Structural Benchmarks

	Test Date
Submission of amendments to Banking Law to Congress	end- June 2009
Elaboration of draft regulations on bank's liquidity management	end- December 2009
Elaboration of draft regulations on bank's foreign currency credit risk	end- December 2009

Attachment III. Technical Memorandum of Understanding

1. **This technical memorandum of understanding (TMU) further describes the understandings** reached between the authorities of Guatemala and IMF staff for the monitoring of performance during the requested 18-month Stand-By Arrangement. The TMU describes the quarterly quantitative performance criteria and corresponding adjusters, the indicative target, the consultation clause on inflation, and reporting requirements.

I. Quantitative Performance Criteria

A. Overall Balance of the Central Government

2. **The overall balance of the central government is measured on an accrual basis from above the line**. It is defined as the difference in total revenue and total expenditure as defined in Guatemala's Budget Law. The information on revenue and expenditure will be obtained from the public sector accounting system (SICOIN).

3. At the time of the reviews, the authorities and IMF staff will undertake a process of reconciliation of above-the-line and below-the-line (as defined below) measurements of the central government deficit, aiming to progressively reduce differences between them.

4. The below-the-line deficit is defined as net external financing of the central government plus net domestic financing of the central government. The net external financing of the central government is defined as (i) disbursements of external loans *plus;* (ii) proceeds from the issues of government bonds abroad *minus;* (iii) amortization payments *minus; and* (iv) debt buy-backs or any other prepayments of debt. Net domestic financing is defined as (i) the net increase in the stock of domestic central government bonds *minus* (ii) net changes in the stock of deposits of the National Treasury at the central bank and commercial banks *plus;* (iii) net changes in other liabilities of the central government, *minus; and* (iv) net changes in other assets of the central government.

5. **Adjuster**. The floor on the overall balance of the CG for 2009 has been calculated assuming net external financing totaling US$637 million (Q5093 million at an exchange rate of Q8 per dollar). If net external financing exceeds that level, the floor will be adjusted downwards by up to US$100 million (Q 800 million).

B. Net International Reserves (NIR) of the Central Bank

6. **For the purpose of the program, the stock of NIR of the Central Bank is defined as** the difference between the U.S. dollar value of gross liquid foreign assets, and short-term foreign liabilities as defined below.

7. **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** include monetary gold, holdings of SDRs, any reserve position in the Fund, and holdings of foreign exchange in convertible currencies. Excluded from gross 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 illiquid assets.

- **Short-term foreign liabilities** of the central bank are defined as the sum of (i) all foreign currency-denominated liabilities of the central bank with an original maturity of one year or less; (ii) liabilities to the Fund; (iii) any foreign currency liabilities of the central bank to residents, including financial institutions; and (iv) any short-term liability converted into a medium-term liability during the program period.

- As per these definitions, on March 23, 2009, gross foreign assets of the central bank stood at US$5046 million and NIR stood at US$4781 million.

C. Non accumulation of External Arrears

8. **Guatemala will maintain its stated policy of not incurring external payment arrears**. This performance criterion applies on a continuous basis. For the purposes of this performance criterion, an external debt payment arrear will be defined as a payment by the central government, which has not been made within seven days after falling due under the contractual agreement, unless specified otherwise.

II. Indicative Target

9. **Central Government deposits at the Bank of Guatemala are defined as** all the account balances of the central government held at the Bank of Guatemala, currently under the summary account 22106001.[6]

III. Consultation Clause

10. **Reflecting the Bank of Guatemala's inflation targeting approach to monetary policy**, quarterly consultation bands of +/– 2 percentage points (inner band) and +/–

[6] The authorities will inform IMF staff in case the account number of the central government at the Bank of Guatemala changed or other accounts had to be taken into consideration for the purpose of assessing compliance with the indicative targets established in the program.

3 percentage points (outer band) are established around the projected 12-month rate of inflation in consumer prices (MEFP Table 2). Inflation will be measured by the 12-month rate of change of the headline consumer price index (IPC - *Indice de precios al consumidor*), as published by the National Statistics Institute (INE).

11. Should the 12-month rate of IPC inflation fall outside the inner band specified above, the authorities will discuss with Fund staff on the policy response. Should the 12-month rate of IPC inflation exceed the upper limit of the outer band specified above, the authorities will also consult with the IMF Executive Board prior to resuming their purchases.

IV. Reporting requirements

12. **The authorities will provide the necessary information to the Fund staff** 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 indicated lag. The Bank of Guatemala and the Ministry of Finance will send the information by e-mail, or by fax if electronic delivery is impossible.

13. **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.

14. **A daily electronic mail** will be sent with a lag of no more than 2 working days unless otherwise agreed, and will contain:

(i) The level of gross international reserves and net international reserves, including short-term foreign currency liabilities.

(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.

(vi) Principal accounts of the balance sheet of the central bank

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

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

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

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

(iv) Foreign currency cash flow of the central bank.

(v) Daily liquidity information (excess and required reserves) in foreign and local currency, by bank (2 week lag)

16. **Monthly information** will be sent with a lag of no more than 4 weeks and will contain, unless otherwise specified:

(i) Main monthly accounts of the commercial and development banks, including their offshore operations.

(ii) Monthly accounts of the central bank.

(iii) Monthly consumer price index (2 week lag)

(iv) Analysis of inflationary developments

(v) Updated inflation projections by the Bank of Guatemala

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

17. **The Ministry of Finance will send every month by e-mail the following information:**

(i) Total central government revenue measured on a cash basis, and divided between tax revenue and nontax revenue, transfers and grants as on the form the authorities have been supplying IMF staff with in the recent past. Tax revenue will be divided between direct taxes (income tax, oil royalties, ISO, other) and indirect taxes (domestic VAT, VAT on imports, excise taxes on oil, alcohol and beverages, stamp taxes, vehicle taxes, import taxes, other taxes) (finalized revenues will be sent with a lag of no more than 3 weeks).

(ii) Total government expenditure measured both on an accrual 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. Capital expenditure will be divided between direct investment and capital transfers.

(iii) Total government social expenditure, defined as expenditure in education, science and culture; health care and social assistance; and housing, including information on key social programs such as Mi Familia Progresa.

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

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

INTERNATIONAL MONETARY FUND

Guatemala—Assessment of the Risks to the Fund and the Fund's Liquidity Position

Prepared by the Finance and Strategy, Policy, and Review Departments

(In consultation with other Departments)

Approved by Andrew Tweedie and Dominique Desruelle

April 13, 2009

1. **This note assesses the risks to the Fund arising from the proposed Stand-By Arrangement (SBA) for Guatemala and its effects on the Fund's liquidity, in accordance with the policy on exceptional access.**[1] The authorities are requesting an 18-month SBA with access of SDR 630.6 million (300 percent of quota). The arrangement would be front-loaded with a first purchase of SDR 420.4 million (200 percent of quota) upon approval, followed by five purchases each of SDR 42.04 million (20 percent of quota). Access during the first year would reach 260 percent of quota and the last purchase under the arrangement would be available in September 2010 (Table 1). The authorities intend to treat the arrangement as precautionary.

Table 1. Guatemala: Proposed SBA—Access and Phasing

			Percent of quota	
Availability	Date 1/	SDR mn.	Purchase	Cumulative
2009	April (approval)	420.40	200.0	200.0
	September	42.04	20.0	220.0
	December	42.04	20.0	240.0
2010	March	42.04	20.0	260.0
	June	42.04	20.0	280.0
	September	42.04	20.0	300.0
	Total	630.60	300.0	300.0

Source: Finance Department.

1/ Starting in September 2009, purchases will depend on the completion of a review.

[1] See *The Acting Chair's Summing Up of the Review of Access Policy Under the Credit Tranches and the Extended Fund Facility, and Access Policy in Capital Account Crises—Modifications to the Supplemental Reserve Facility and Follow-Up Issues Related to Exceptional Access Policy* (3/5/03).

I. Background

2. **Guatemala has had several Fund arrangements, but has not drawn on Fund resources since the late 1980s.** In total, six SBAs and two uses of the Compensatory Financing Facility were approved during the period November 1981 to June 2003, with the three most recent SBAs treated as precautionary (Table 2). Access under all arrangements was relatively low, ranging from 25 percent to 150 percent of quota. The most recent arrangement was requested in support of the authorities' program for 2003 and was designed to ensure macroeconomic stability and progress with key structural reforms ahead of presidential elections in November 2003. While many of the objectives of the 2003 SBA were achieved, the arrangement went off track and expired without the completion of the mid-term review. There has been no Fund credit outstanding to Guatemala since late 1993 and all obligations to the Fund have been met in a timely manner.

Table 2. Guatemala: IMF Financial Arrangements, 1981–2015
(In millions of SDRs)

Year	Type of Arrangement	Date of Arrangement	Date of Expiration or Cancellation	Amount of New Arrangement	Amount Drawn	Purchases	Repurchases	Fund Exposure 1/
1981	SBA, CFF	13-Nov-81	12-Nov-82	19.1	19.1	95.6 2/	--	95.6
1982						--	--	95.6
1983	SBA	31-Aug-83	31-Dec-84	114.8	57.4	38.3	--	133.9
1984						19.1	--	153.0
1985						--	47.8	105.2
1986						--	48.0	57.2
1987						--	15.5	41.6
1988	SBA, CFF	26-Oct-88	28-Feb-90	54.0	23.2	44.8 3/	21.0	65.4
1989						--	9.9	55.5
1990						--	8.7	46.8
1991						--	2.1	44.8
1992						--	22.4	22.4
1993	SBA	18-Dec-92	17-Mar-94	54.0	0.0	--	22.4	--
1994						--	--	--
1995						--	--	--
1996						--	--	--
1997						--	--	--
1998						--	--	--
1999						--	--	--
2000						--	--	--
2001						--	--	--
2002	SBA	1-Apr-02	31-Mar-03	84.0	0.0	--	--	--
2003	SBA	18-Jun-03	15-Mar-04	84.0	0.0	--	--	--
…						--	--	--
2009 4/	*SBA*	*15-Apr-09*		*630.6*		*504.5*	--	*504.5*
2010 4/						*126.1*	--	*630.6*
2011 4/						--	--	*630.6*
2012 4/						--	*110.4*	*520.3*
2013 4/						--	*283.8*	*236.5*
2014 4/						--	*205.0*	*31.5*
2015 4/						--	*31.5*	--

Source: Finance Department.

1/ As of end-December.
2/ Includes a purchase of SDR 76.5 million under the Compensatory and Contingency Financing Facility.
3/ Includes a purchase of SDR 21.6 million under the Compensatory and Contingency Financing Facility.
4/ Figures under the proposed program in italics.

3. **Guatemala's external debt is moderate, but the substantial share of short-term debt increases external financing requirements.** At end-2008, Guatemala's total external debt was estimated at 35 percent of GDP, of which about two-thirds was owed by the private sector (Table 3). The private sector debt, at 24 percent of GDP, is mainly owed to non-monetary institutions and about half of it is short-term debt. Public sector external debt, at 11 percent in 2008, is in turn owed mainly to multilateral institutions (Figure 1). External debt ratios for both total- and public sector debt compare favorably with the corresponding ratios for most of the exceptional access cases since the exceptional access framework was put in place in 2003 (Figure 2, Panels A and B).[2] Likewise, Guatemala's external medium and long-term debt service ratio to exports of goods and services is low vis-à-vis other exceptional access cases, reflecting the country's relatively low debt stock (Figure 2, Panel C).

4. **Public debt is relatively low and about half is owed to external creditors.** Over the past four years external debt of the public sector has declined by over 4 percentage points of GDP, to 11 percent in 2008, while total public debt has been stable in the 20-22 percent of GDP range. At end-2008, the latter was estimated at about 22 percent of GDP, which is below the corresponding ratios for most of the previous exceptional access cases (Figure 2, Panel D).

[2] The previous exceptional access cases used as comparators in this paper are four of the five arrangements approved since the exceptional access framework was put in place (Argentina, Brazil, Turkey, and Uruguay), and the recent cases approved in 2008–09. In contrast to most newly approved arrangements, Guatemala's authorities intend to treat the arrangement as precautionary, as balance of payments pressures have not materialized. The 2008 extended arrangement for Liberia also involved exceptional access. However, this arrangement was different from other exceptional access cases since, in this case, exceptional access was granted in the context of Liberia's clearance of arrears to the Fund.

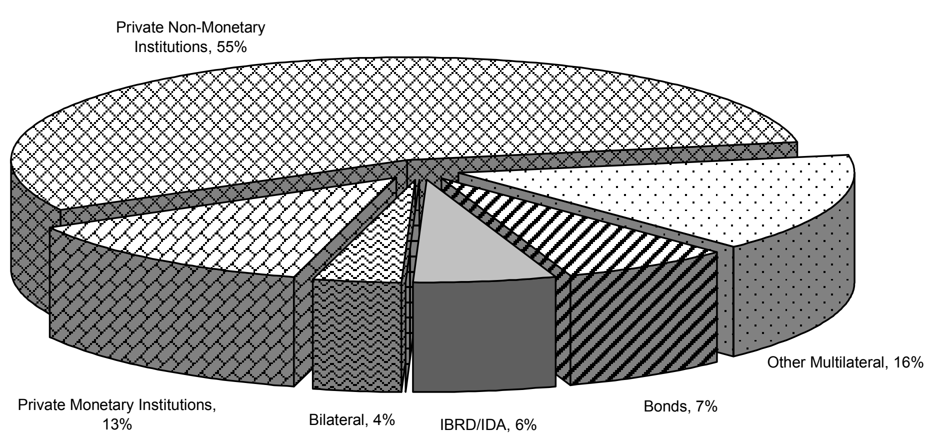
Table 3. Guatemala: Total External Debt, 2004–2009 1/

	2004	2005	2006	2007	2008	2009 2/
	(In Millions of US Dollars)					
Total External Debt	8,018	9,434	10,872	12,601	13,748	14,478
of which:						
Public	3,713	3,592	3,958	4,249	4,384	5,727
Loans	2,487	2,416	2,820	3,265	3,434	4,826
Multilateral	2,114	2,030	2,435	2,887	2,945	4,247
Bilateral	373	386	384	378	490	579
Bonds	1,226	1,176	1,139	984	950	900
Private						
Loans	4,306	5,841	6,913	8,352	9,364	8,751
	(In Percent of GDP)					
Total External Debt	33.5	34.5	35.9	37.0	35.3	38.0
of which:						
Public	15.5	13.1	13.1	12.5	11.3	15.0
Loans	10.4	8.8	9.3	9.6	8.8	12.7
Multilateral	8.8	7.4	8.0	8.5	7.6	11.1
Bilateral	1.6	1.4	1.3	1.1	1.3	1.5
Bonds	5.1	4.3	3.8	2.9	2.4	2.4
Private						
Loans	18.0	21.4	22.8	24.5	24.0	22.9

Source: Guatemalan authorities and IMF staff estimates.

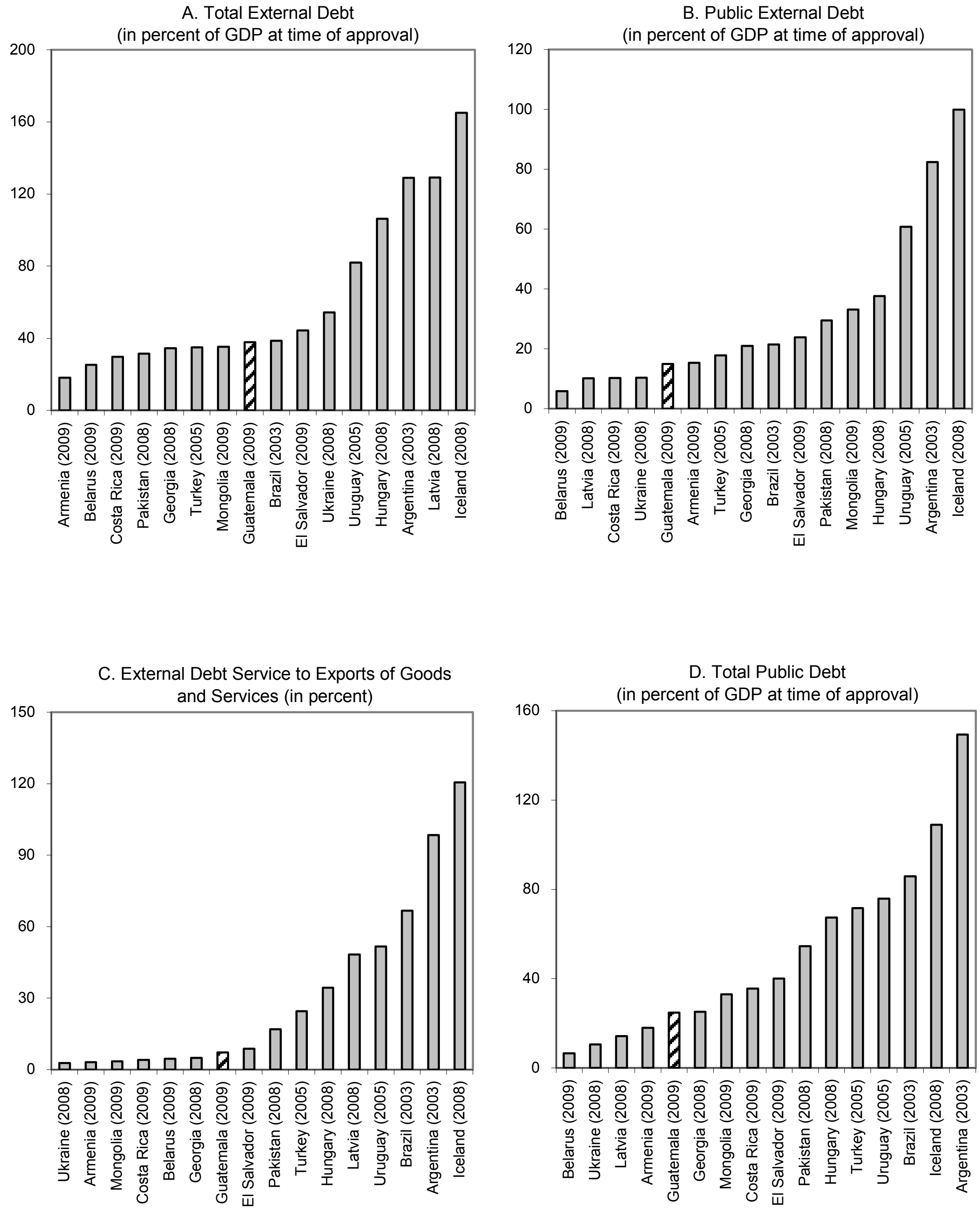
1/ End of year unless otherwise indicated.
2/ Staff projections for end-2009.

Figure 1. Guatemala: Composition of Total External Debt, end-2008
(in percent)



Source: Guatemalan authorities and IMF staff

Figure 2. Debt Ratios for Recent Exceptional Access Arrangements 1/ 2/



Source: Guatemalan authorities and IMF staff estimates, and World Economic Outlook.

1/ Year in parenthesis corresponds to the year of approval. Ratios are for the year indicated in parenthesis, with the exception of Belarus, El Salvador, Armenia, Mongolia and Costa Rica, for which 2008 ratios are shown.
2/ For arrangements approved since September 2008, estimates as reported in each staff report on the request of the Stand-By Arrangement.

II. The New Stand-By Arrangement—Risks and Impact on Fund's Finances

A. Risks to the Fund

5. **Access under the proposed arrangement would exceed by far that in previous arrangements for Guatemala and would surpass the annual access limit.**[3]

- The authorities plan to treat the proposed arrangement as precautionary. However, if all purchases were to be made as scheduled, Guatemala's outstanding use of GRA resources would rise to 200 percent of quota upon approval, to 260 percent of quota during the first year of the arrangement, and then to 300 percent of quota in September 2010–June 2012.[4] In terms of quota, this projected peak exposure would be the same as those of El Salvador, Mongolia, and Costa Rica—the lowest in recent exceptional access cases (Figure 3).

- If the SBA is fully disbursed, GRA credit outstanding to Guatemala would be equivalent to 2.4 percent of GDP by end-2010 and 17 percent of gross international reserves (Table 4). These peak ratios would be lower than in most of the exceptional access cases approved since September 2008.

- In terms of SDRs, the projected peak GRA exposure of SDR 630.6 million would be nearly four times higher than Guatemala's previous peak in Fund credit outstanding reached in 1984–85. Nonetheless, this peak would be among the lowest in recent exceptional access cases (Figure 4, Panel A).

6. **If all purchases under the proposed SBA were to take place as scheduled, the share of the Fund in Guatemala's external debt and debt service would be relatively low.**

- By end-2010, Guatemala's total external debt would rise to 40 percent of GDP, with public external debt following the same pattern to reach 17 percent of GDP. At that time, outstanding use of GRA resources would represent 2.4 percent of GDP, 6 percent of total external debt, and 15 percent of public external debt.

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[3] The proposed access during the first year of the arrangement is 260 percent of quota.

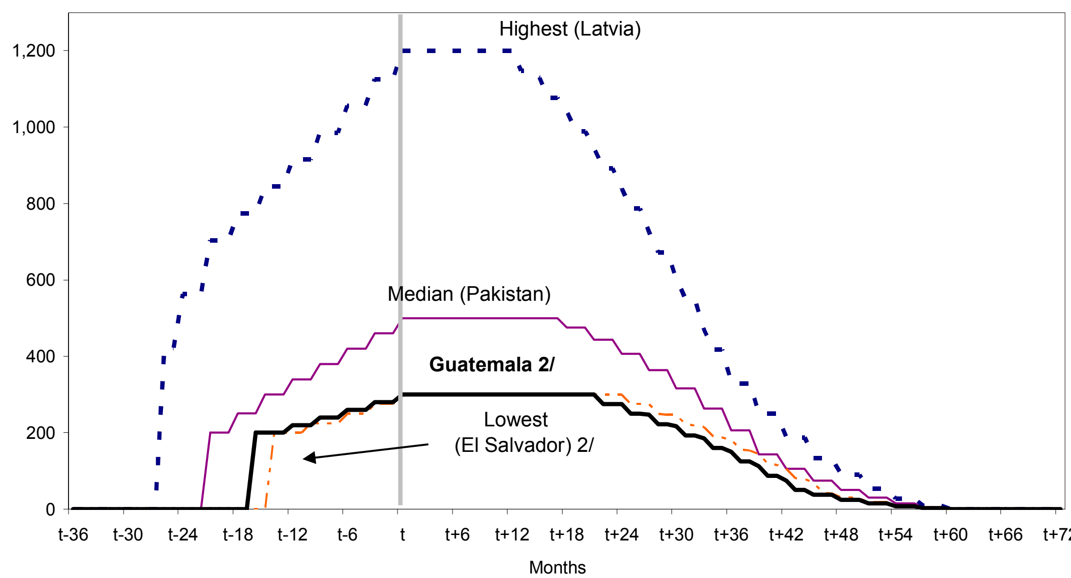
[4] Amortization payments to the Fund are calculated assuming that all repurchases are made as scheduled, i.e., each purchase is repurchased in eight quarterly installments, beginning in 3¼ years after each purchase and ending after 5 years.

- Guatemala's projected debt service to the Fund would peak at about SDR 290 million in 2013, equivalent to over one-quarter of total external debt service and over half of public external debt service in that year.[5]

- In terms of exports of goods and services, Guatemala's external debt service to the GRA would peak at 4.2 percent in 2013, which is close to the median ratio projected for recently approved exceptional access cases. Peak ratios for total- and public external debt service to exports of goods and services of 15 percent and 8 percent, respectively, would also be reached in 2013.

Figure 3. Fund Credit Outstanding in the GRA around Peak Borrowing 1/
(in percent of quota)

Approved and Forthcoming Exceptional Access Cases since September 2008



Source: IFS, Finance Department, and IMF staff estimates.

1/ Peak borrowing 't' is defined as the highest level of credit outstanding for a member. Repurchases are assumed to be on an obligations basis. Repurchases on expectations basis were eliminated on April 1, 2009.
2/ The authorities have expressed their intention to treat the arrangements as precautionary, as balance of payments pressures have not materialized.

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[5] Debt service to the Fund is calculated assuming that all repurchases are made as scheduled, i.e., each purchase is repurchased in eight quarterly installments, beginning in 3¼ years after each purchase and ending after 5 years. As for level-based surcharges, they are calculated according to the current schedule: 100 basis points for credit outstanding over 200 percent of quota and 200 basis points for credit outstanding above 300 percent of quota. The new system of surcharges, which applies to credit outstanding above 300 percent of quota, will go in effect on August 1, subject to grandfathering at the member's request.

Table 4. Guatemala—Capacity to Repay Indicators 1/

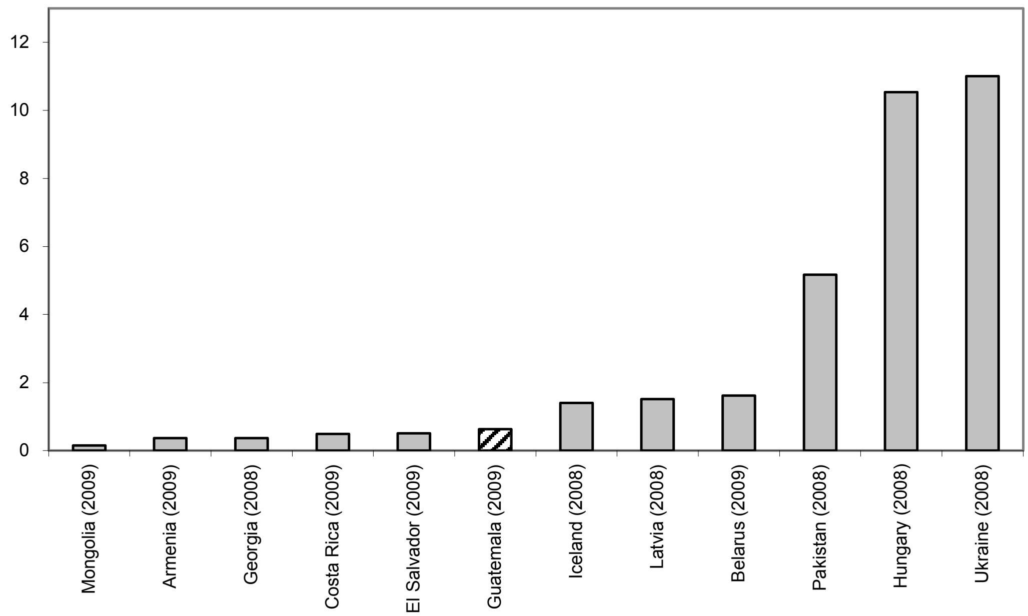
	May-09	2009	2010	2011	2012	2013	2014	2015
Exposure and Repayments (In SDR millions)								
GRA credit to Guatemala 2/	420.4	504.5	630.6	630.6	520.3	236.5	31.5	0.0
(In percent of quota)	(200.0)	(240.0)	(300.0)	(300.0)	(247.5)	(112.5)	(15.0)	(0.0)
Charges due on GRA credit 3/		6.0	10.0	11.4	10.9	6.5	2.1	0.3
Debt service due on GRA credit 3/		6.0	10.0	11.4	121.3	290.2	207.0	31.8
Debt and Debt Service Ratios 4/								
In percent of GDP								
Total external debt	35.3	38.0	40.0	41.3	40.8	39.3	38.0	37.9
External debt, public	11.3	15.0	16.7	16.4	15.5	13.9	12.8	12.7
GRA credit to Guatemala	1.6	2.0	2.4	2.3	1.8	0.8	0.1	0.0
In percent of Gross International Reserves								
Total external debt	295.1	267.4	279.0	289.3	299.2	315.9	327.0	333.1
External debt, public	94.1	105.7	116.7	114.6	113.8	111.4	110.2	111.7
GRA credit to Guatemala	13.6	14.1	17.0	16.4	13.3	6.2	0.8	0.0
In percent of Exports of Goods and Services								
Total external debt service	7.5	7.2	7.0	8.7	12.9	15.2	13.4	11.0
External debt service, public	2.7	3.1	3.4	3.6	5.5	7.7	6.0	3.6
Debt service due on GRA credit		0.1	0.2	0.2	1.9	4.2	2.7	0.4
In percent of Total External Debt								
GRA credit to Guatemala	4.6	5.3	6.1	5.7	4.5	2.0	0.3	0.0
In percent of Total Public External Debt								
GRA credit to Guatemala	14.5	13.3	14.6	14.3	11.7	5.6	0.8	0.0

Sources: Guatemalan authorities, Finance Department, World Economic Outlook, and IMF staff estimates.

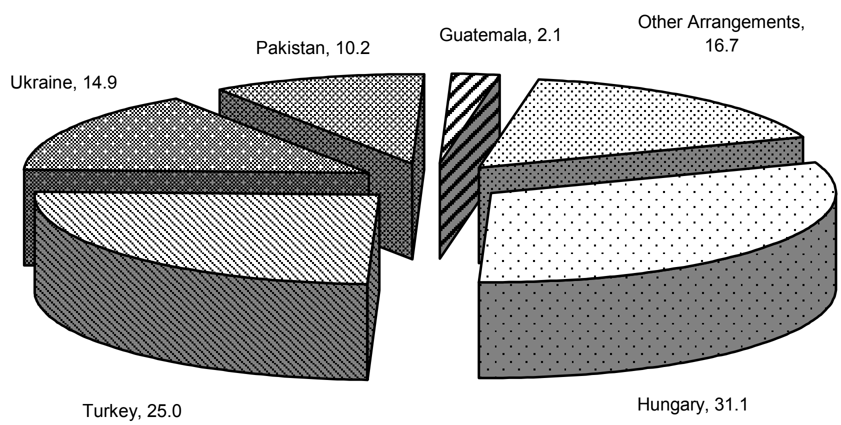
1/ Assumes full drawings. The Guatemalan authorities have expressed their intention to treat the arrangement as precautionary, as balance of payment pressures have not materialized.
2/ Repurchases follow the obligations schedule. Repurchases on expectations basis were eliminated on April 1, 2009.
3/ Includes surcharges and service fees.
4/ Staff projections for external debt, GDP, gross international reserves, and exports of goods and services, as used in the staff report that requests the proposed SBA. For May 2009, projections for external debt, GDP, gross international reserves, and exports of goods and services are as of end-December 2008.

Figure 4. Exceptional Access Levels and Credit Concentration

A. Total Access of Recent Exceptional Access Arrangements 1/
(In billions of SDRs)



B. Credit Concentration of Fund GRA Exposure 2/
(As a percentage of total credit outstanding)



Source: Finance Department.

1/ Commitments as of March 31, 2009. Does not include the potential FCL for Mexico.
2/ Credit outstanding as of March 31, 2009 plus the first purchase under the proposed arrangement with Guatemala.

B. Impact on the Fund's Liquidity Position and Risk Exposure

7. **Given the comparatively low access in nominal terms under the arrangement, the impact on the Fund's liquidity and credit risk exposure is relatively small.**

- **The proposed arrangement would reduce Fund liquidity by less than 0.7 percent**. Commitments under the proposed arrangement would reduce the one-year forward commitment capacity (FCC), which currently stands at SDR 96.1 billion, by about SDR 0.6 billion (see Table 5).[6] [7]

- **If the first purchase were to be made, Fund credit to Guatemala would represent 2.1 percent of total GRA Fund credit (Figure 4, Panel B)**. The share of the top five users of Fund resources of total outstanding credit would decrease by about two percentage points to 84 percent (see Table 5).[8]

- **In the event Guatemala were to fully draw on resources available under the proposed SBA, and to incur arrears on the charges accruing to its GRA obligations, the Fund's burden sharing mechanism would be reduced significantly.**[9] Charges on the GRA obligations would equal about SDR 6 million in 2009, or 30 percent of the current estimated residual burden-sharing capacity (see Table 5).[10] However, the impact on the Fund's burden sharing capacity of potential arrears from this arrangement would be expected to decline to the extent the demand for Fund resources continues to expand.

- **Potential GRA exposure to Guatemala would be modest in relation to the current level of the Fund's precautionary balances**. After the first purchase, Fund

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[6] The FCC is the principal measure of Fund liquidity. The (one-year) FCC indicates the amount of GRA resources available for new financing over the next 12 months.

[7] Data as of March 31, 2009. The FCC is determined on the basis of available quota resources only; in addition, the Fund has access to SDR 34 billion under the NAB/GAB borrowing arrangements and US$100 billion under the borrowing agreement with Japan.

[8] Given the possibility of new financing operations, including some that will involve exceptional access, the concentration of the Fund's lending portfolio is likely to change in coming months.

[9] Under the burden-sharing mechanism, the financial consequences for the Fund that stem from the existence of overdue financial obligations are shared between creditors and debtors through a decrease in the rate of remuneration and an increase in the rate of charge, respectively. The mechanism is used to compensate the Fund for a loss in income when debtors do not pay charges. The Executive Board has set a floor for remuneration at 85 percent of the SDR interest rate. No corresponding ceiling applies to the rate of charge.

[10] Burden sharing capacity has declined recently, despite the increase in credit outstanding, reflecting the steep decline in the SDR interest rate.

credit to Guatemala would be about 6 percent of the Fund's current precautionary balances (see Table 5), and the total access amounts to about 9 percent of current precautionary balances.

Table 5. Guatemala—Impact on GRA Finances

	as of 03/31/2009
Liquidity measures	
One-year Forward Commitment Capacity (FCC) (in millions of SDRs) 1/	96,092.2
Guatemala's impact on FCC 2/	(630.6)
Prudential measures	
Fund GRA credit outstanding to Guatemala (percent of current precautionary balances) 3/	6.1
Guatemala's annual GRA charges (percent of Fund's residual burden sharing capacity)	30.1
Fund GRA credit outstanding to Guatemala (percent of total GRA credit outstanding) 4/	2.1
Memorandum items	
Fund's precautionary balances (in millions of SDRs) 3/	6,938.6
Fund's residual burden sharing capacity (in millions of SDRs) 5/	20.0
Fund GRA credit outstanding to five largest debtors (percent of total GRA credit outstanding) 4/	84.0

Sources: Guatemalan authorities, Finance Department, World Economic Outlook, and IMF staff estimates.

1/ The Forward Commitment Capacity is a measure of the resources available for new financial commitments in the coming year, equal to usable resources minus undrawn balances under existing arrangements plus repurchases one-year forward minus a prudential balance. The FCC is determined on basis of available quota resources only; in addition, the Fund has access to SDR 34 billion under the NAB/GAB borrowing arrangements and $US100 billion under the borrowing arrangement with Japan.
2/ A single country's negative impact on the FCC is defined as the country's sum of Fund credit and undrawn commitments minus repurchases one-year forward.
3/ As of end-April 2008.
4/ Reflects total Fund credit outstanding plus the first purchase by Guatemala.
5/ Burden-sharing capacity is calculated based on the floor for remuneration at 85 percent of the SDR interest rate. Residual burden-sharing capacity is equal to the total burden-sharing capacity minus the portion being utilized to offset deferred charges and takes into account the loss in capacity due to nonpayment of burden sharing adjustments by members in arrears.

III. Assessment

8. **The authorities intend to treat the proposed SBA as precautionary and are requesting it as an additional liquidity cushion in support of their policy program that seeks to preserve macroeconomic and financial stability, mitigate the effects of the global crisis on economic activity and strengthen social protections.** However, if significant balance of payments pressures were to materialize, the authorities are likely to draw on the available resources, entailing some financial risk for the Fund. Although the proposed level of access is four times higher than the previous peak Fund exposure to Guatemala, it is moderate vis-à-vis other exceptional access cases in terms of relevant metrics such as economic size and debt-servicing capacity.

9. **Risks to the outlook are significant and stem from a sharper-than-expected deterioration in the external current or capital accounts.**. Guatemala's large external financing requirements estimated at just over 16 percent of GDP in 2009 could result in a large financing gap even under a relatively benign scenario, in which there is a further decline in remittances and FDI, and private external debt rollover rates decline marginally. If global economic developments are significantly worse than expected, a more severe downturn could increase financial sector vulnerabilities as a sharp depreciation of the currency and capital outflows would adversely affect the banking sector.

10. **The realization of significant downside risks could adversely affect Guatemala's capacity to repay the Fund.** Nevertheless, the impact of such an event in the Fund's finances would be modest in light of the relatively low absolute access level. The authorities' commitment to strong program implementation and to respond promptly to changes in underlying conditions and deviations from the program baseline scenario are essential to mitigate these risks and safeguard Fund resources. The authorities' policy program supported by the Fund, and their track record of implementing prudent and sustainable macroeconomic policies, provide confidence in this regard.

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International Monetary Fund
Washington, D.C. 20431 USA

IMF Executive Board Approves US$935 Million Stand-By Arrangement for Guatemala

The Executive Board of the International Monetary Fund approved on April 22 an 18-month, SDR 630.6 million (about US$935 million, or 300 percent of quota) Stand-By Arrangement for Guatemala. The Guatemalan authorities intend to treat the arrangement as precautionary, meaning that they do not intend to draw on the Fund's resources unless the need arises. Guatemala has no immediate balance of payments need, and this program is part of a comprehensive preventive strategy to strengthen the country's liquidity cushion in the face of an uncertain global environment, thereby enhancing the confidence of investors and market participants.

Guatemala has made substantial progress in consolidating macroeconomic stability and implementing structural reforms. Adverse external conditions, however, are affecting economic activity and financial conditions. The Guatemalan authorities have taken a number of upfront measures to mitigate the impact of the external shock and preserve macroeconomic stability. The program will support the authorities' policies and provide insurance against significant downside risks.

Following the Executive Board discussion on Guatemala, Mr. Murilo Portugal, Deputy Managing Director and Acting Chair, issued the following statement:

"Guatemala has a strong track record of prudent macroeconomic policies and structural reforms, which has helped to solidify the economy in recent years. As in many countries in the region, however, the global crisis has weakened economic conditions. A more prolonged global recession could increase downside risks to Guatemala's outlook in 2009 and 2010. The authorities' economic program, supported by a Stand-by Arrangement with the Fund, which the authorities plan to treat as precautionary, is an appropriate response to mitigate these risks and preserve macroeconomic and financial stability.

"The authorities' strategy entails a moderate fiscal expansion, continued efforts to anchor inflation at low levels in the context of the inflation-targeting framework and a flexible exchange rate regime, a further strengthening of the financial sector, and the mobilization of substantial external financing, including from the World Bank and the Inter-American Development Bank. This financing will boost the economy's foreign currency liquidity buffers, and provide protection against any larger-than-anticipated shocks to the balance of payments.

"The Bank of Guatemala is cautiously easing the monetary policy stance, after succeeding in controlling inflationary pressures that surged in 2008. The authorities plan to strengthen their inflation-targeting framework further, with a view to achieving a medium-term inflation target of 4 percent (+/- 1%). They are committed to maintaining a flexible exchange rate to facilitate the adjustment to external shocks.

"The authorities' fiscal program aims to provide some stimulus to the economy and protect the most vulnerable segment of the population. To achieve these goals, the 2009 budget envisages higher spending on labor-intensive public infrastructure projects and a strengthening of the social safety net. This countercyclical fiscal policy is possible given the low level of public debt, resulting from prudent fiscal policies pursued in the past.

"Guatemala's banking system is not exposed to risky structured financial products and has consolidated in recent years. The authorities are nonetheless taking measures to safeguard the liquidity and capital positions of banks through adequate liquidity-provision arrangements by the central bank and a gradual increase in provisioning requirements. At the same time, continuous on-site supervision has been put in place to monitor developments closely, anticipating risks and corrective actions, if needed. During the program period, the government plans to further strengthen financial sector policies by enhancing supervision and regulation and strengthening the framework for bank resolution," Mr. Portugal said.

ANNEX

Recent Economic Developments

Real GDP growth is estimated to have slowed to 4 percent in 2008, from 6.3 percent in 2007. The decline has been driven by domestic demand, particularly investment, as external demand remained robust through most of 2008.

Annual inflation continues to decline, from its peak of 14 percent in mid-2008, to 9.4 percent by year-end, and further to 5 percent in March 2009. The decline in inflation has become firmly entrenched: various measures of core inflation have declined consistently in the last quarter of 2008; inflation in services and nontradables has moderated substantially; and inflation expectations are declining rapidly.

The external current account narrowed to 4¾ percent of GDP in 2008, already signaling lower domestic absorption, helped by the reversal of the negative terms-of-trade shock from commodity prices in the second half of last year. Since the last quarter of 2008, remittances have been declining, export growth has slowed and imports fell markedly. Private capital inflows have slowed, but nonetheless international reserves increased to US$5 billion by end-March 2009 due to recent disbursements of public external financing.

The strength of the fiscal position was maintained during 2008, with the central government deficit declining to 1.7 percent of GDP, despite a real decline in tax revenue. The drop in revenue has become more severe in early 2009, due to cyclical and structural factors.

Program Summary

The Guatemalan authorities have been proactive in addressing the effects of the global crisis through a comprehensive policy response. Their strategy has four key elements:

- A moderate fiscal stimulus to support domestic demand, financed with substantial external resources from multilaterals to minimize crowding out the private sector;
- A monetary policy focused on consolidating the decline in inflation in the context of a flexible exchange-rate regime to facilitate economic adjustment;
- Strengthening of financial sector policies to increase the resilience of banks and enhance the banking sector safety net and resolution procedures;
- A refocusing of public expenditures towards strengthening social spending and labor-intensive public works.

To complement those efforts, Guatemala is now aiming at building a higher external liquidity cushion to reduce risks from sudden changes in the current and capital account. Fund support is a key element of the strategy to face these risks, not only through the contingent financing provided under the proposed SBA, but also through the endorsement of the authorities' program, which will help maintain investor confidence.

The authorities' social protection policy aims at enhancing current programs to offset the effect of the crisis on the most vulnerable segments of the population. Social spending will increase from 4.4 percent of GDP in 2008 to 5.0 percent of GDP in 2009. To address extreme poverty, emphasis will be placed on four flagship government programs. A key conditional cash transfer program initiated in 2008 will be expanded aiming at reaching 500,000 families in 2009, with a cost of 0.4 percent of GDP.

Statement by Ramon Guzmán, Executive Director for Costa Rica and Alvaro Umaña, Senior Advisor April 20, 2009

We would like to thank the Staff for a comprehensive and well-written set of papers. The Guatemalan authorities broadly agree with the Staff's assessment and fully support its recommendations. They view positively the changes in the Fund's lending framework, in particular because they represent new valuable preventive instruments to deal with the current global crisis. Our authorities consider this high-access precautionary Stand-By Arrangement (HAPA) appropriate for their present needs. They also value the new review-based conditionality and expect that staff monitoring of the program will be guided by this new flexible approach, especially given the present global circumstances.

Guatemala has a long track record of fiscal and monetary discipline that, along with the implementation of important structural reforms, has resulted in the consolidation of macroecomic stability and the acceleration of economic growth, with growth rates close to 5 percent in average in 2005–2008, reaching a high 6.3% in 2007 just before the financial global crisis intensified. In this context, prudent fiscal policies and the lowest level of debt in the region provide space for countercyclical policies. Therefore, the Guatemalan economy is well prepared to face the adverse external environment and to remain committed to its medium-term development challenges including progress in reducing poverty and protection of the neediest.

Notwithstanding the above, given the openness of the economy and its close connection to the United States' economy it is inevitable that the impact of the crisis will be significant. The crisis is expected to affect the Guatemalan economy through three main channels: (i) lower exports and deteriorating export prices; (ii) decline in remittances; and (iii) significant slowdown in private capital flows. Although the external current account has benefited from lower oil prices, the combination of these three transmission channels is likely to require real and financial adjustments. The authorities' program aims at safeguarding macroeconomic and financial stability.

The Guatemalan strategy is based on the following pillars: (i) a moderate countercyclical fiscal policy to support internal demand, financed primarily through external resources; (ii) a monetary policy focused on reducing inflation and a flexible exchange rate; and (iii) a set of financial sector policies to increase the resilience of the system, improve regulation and supervision and enhance the banking sector safety net and the effectiveness of bank resolution procedures.

Prudent fiscal policy has been a key feature of the Guatemalan economic policy. A moderate fiscal impulse in 2009–10 is intended to prevent a large decline in domestic demand. Public expenditure will increase 0.4 percent with respect to 2008. Tax collections are expected to decline by about 0.8 percent of GDP from the 2008 levels and the central government deficit could increase to 2.8 percent and then decline to 2.6 percent in 2010. In the event that fiscal policy may require any adjustment, the authorities' priority will be to protect social spending. These deficits will be mainly financed by a package of almost $1 billion already secured by loans from the IDB and the World Bank.

Monetary policy will focus on achieving a gradual reduction of inflation to 5.5 percent in 2009 and toward a medium-term target of 4 percent (+/- 1 percent). At the same time, the authorities remain committed to exchange rate flexibility to facilitate economic adjustment to shocks. Private capital flows have slowed, but nonetheless net international reserves have increased to US$4.8 billion by the end of March 2009.

The Guatemalan financial sector has had only moderate exposure to the sources of the global financial crisis. The financial system underwent a significant consolidation process in the aftermath of two bank failures in late 2006 and early 2007. However, in order to increase resilience of the system, the authorities have introduced preemptively a number of measures to reduce risks. Continuous and enhanced on-site supervision has been in place since June 2008. The central bank has introduced temporary and limited measures to ensure bank liquidity. Stronger capital cushions are being built and provisioning requirements revamped to ensure that by mid-2011 all nonperforming loans are fully provisioned. Changes to banking legislation will be introduced to strengthen regulation and supervision, and enhance the current bank resolution framework.

A key priority for the authorities is to offset the effect of the current crisis on the neediest sectors of the population and to continue with the mid-term effort to reduce poverty. Securing adequate nutrition, health and education are key to this strategy. To attend extreme poverty, emphasis will be placed on a new government program of conditional cash transfers. The program, *Mi familia progresa*, aims at securing that poor children attend school and visit health centers regularly. In 2009, this program will be expanded to cover 500,000 families with a total budget of US$150 million.

The authorities intend to treat the proposed Stand-By Arrangement as precautionary. They expect that the SBA will support the strong commitment to sound macroeconomic policy, anchor investor confidence and provide a larger liquidity cushion to face the downside risks in the global environment. The Guatemalan authorities view the level of access as sufficient at this time, however, should further downside risks materialize, they would expect the Fund to respond flexibly and reassess the needs.