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EX POST EVALUATION OF EXCEPTIONAL ACCESS UNDER THE 2009 STAND-BY ARRANGEMENT

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GUATEMALA

Ex Post Evaluation of Exceptional Access Under the 2009 Stand-By Arrangement

Prepared by an Interdepartmental Team[1]

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and the Strategy, Policy, and Review Department

July 25, 2011

Contents Page

I. Introduction and Summary ... 2
II. Overview of Developments Prior to the 2009 Program ... 3
III. Program Design and Exceptional Access Policy ... 7
    A. Assessment of the Program Design ... 7
    B. Exceptional Access Policy ... 14
IV. Assessment of Program Performance and Policy Implementation ... 15
V. Conclusions ... 22

Boxes

1. Estimates of Private External Debt ... 8
2. Recent Revenue Initiatives ... 10

Tables
1. Guatemala: Selected Economic and Social Indicators ... 18
2. Guatemala: Financial Soundness Indicators ... 21

Appendices
1. Gauging the Appropriateness of the Fiscal Stimulus ... 23
2. Views of the Authorities ... 26

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I. INTRODUCTION AND SUMMARY

1. **In mid-2008, Guatemala experienced the initial effects of the deteriorating global economic environment, and the downside risks to the economic outlook were substantial**. Although substantial progress had been made in consolidating macroeconomic stability in the earlier years, vulnerabilities remained, particularly in the banking sector, which could have been unmasked in the economic downturn and give rise to a confidence crisis. Moreover, the external financing requirements in 2009 were large, with significant risks from a more severe impact of the global financial crisis on Guatemala's trading partners.

2. **In the circumstances, the authorities requested a Stand-By Arrangement (SBA) in April 2009 with access of SDR 630.6 million (300 percent of quota), which they intended to treat as precautionary**. The program aimed at safeguarding macroeconomic and financial stability, anchoring investor confidence, and providing a cushion for the downside risks from a worsening of the external environment. This was the third high access precautionary arrangement (HAPA) to be approved since the inception of the crisis, and in the wake of the March 2009 reform of the Fund's lending toolkit.[2]

3. **This report assesses the effectiveness of Guatemala's SBA, in light of the requirement for evaluating exceptional access arrangements after their expiration**.[3] As stipulated in the Guidance Note, the report focuses on two questions: (i) were the macroeconomic strategy, program design, and financing appropriate and consistent with Fund policies?; and (ii) did outcomes meet program objectives?

4. **The strong program implementation and a more favorable-than-envisaged external environment allowed the program's primary objective to be achieved**. All quantitative performance criteria (PCs) under the program were met, signaling the authorities' commitment to sound macroeconomic policies and helping to anchor investor confidence. The external financing requirements were also lower than initially envisaged, and the downside risks from the external environment—with the related need for making purchases under the SBA—did not materialize. In the event, macroeconomic and financial stability was safeguarded, and macroeconomic performance was relatively strong.

5. **Despite the progress achieved during the program, however, some important vulnerabilities were not eliminated**. In particular, the banking system's prudential and legal framework were not strengthened as envisaged, as political resistance in Congress thwarted the approval of amendments to banking legislation and regulations; there was little progress in tax reform, precluding a much needed increase in social and infrastructure spending; and the recurrence of domestic arrears persisted, symptomatic of weak budgetary control. Eliminating these vulnerabilities should continue to be policy priorities.

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[2] Guatemala's SBA was approved within days of the HAPAs for El Salvador and Costa Rica. The proximity of these other HAPAs may have influenced the choice of lending instrument and other aspects of Guatemala's SBA.

[3] *Ex Post Evaluations of Exceptional Access Arrangements—Revised Guidance Note* (IMF Policy Paper, 2/25/10).

6. **Other conclusions of the evaluation include**:

- The Fund's financing strategy was appropriate, and the high-access precautionary SBA proved a valuable preventive instrument to deal with the effects of the global crisis.
- The program's design was coherent and conditionality appropriately focused, though it could have been improved in a few areas.
- The Board's involvement was in line with the policy on exceptional access.

II. Overview of Developments Prior to the 2009 Program

7. **Guatemala had made substantial progress in consolidating macroeconomic stability and implementing structural reforms in the years prior to the global financial crisis**. Reflecting strong policies and a favorable external environment, the economy was growing at a vigorous pace (averaging 5.5 percent per year during 2006–07, much higher than potential), while exhibiting a moderate current account deficit and historically high levels of net international reserves (NIR). Prudent fiscal policy had created some fiscal space for the government's developmental priorities, and reduced public debt ratios to among the lowest in the region. To address the persistently low revenue effort—which limited the scope to satisfy large social and infrastructure needs—the government was planning to submit to Congress a revenue-enhancing tax reform. Following the failure and effective resolution of two large banks in 2006 and 2007, the need to strengthen the banking system's prudential and regulatory framework was accentuated.

8. **The deterioration in the global economic environment started to affect economic activity and financial conditions in Guatemala relatively early**. By late 2008, leading indicators of economic activity pointed to a rapid deceleration. While the direct impact of the global financial crisis on Guatemalan banks was not expected to be large—since banks had no exposure to risky subprime mortgage assets in the United States, and the participation of foreign banks in the system was small—financial conditions for emerging market economies (EMEs) were tightening as spreads on sovereign and corporate external debt increased sharply, and external credit lines dried up (Figure 1).[4] The adverse external conditions were expected to affect Guatemala mainly through three channels (see also Figure 2):

- **Lower demand for exports combined with lower export prices**, on account of Guatemala's strong trade links with the United States and other countries that are dependent on U.S. demand. Merchandise exports in 2008:Q4 were largely unchanged from the preceding year, and were expected to fall marginally as a share of GDP in 2008, in part due to a decline in the average export price. Exports were projected to decline further as a share of GDP in 2009.

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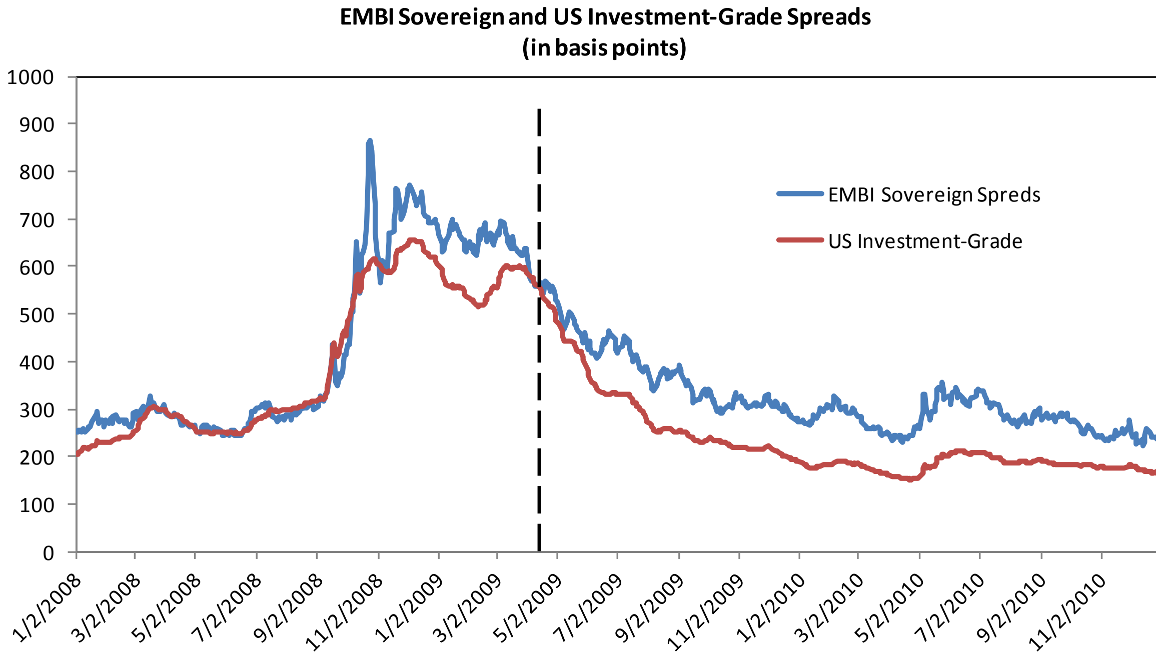
[4] The amount of Guatemalan government securities in international markets is quite limited, and they are largely private placements with very little secondary trading. There is a large amount of domestically issued sovereign debt, but the bulk of the secondary trading is in repo transactions of a few days, and therefore they do not provide a meaningful benchmark.

Figure 1. Guatemala: Global Financial Market Developments, 2008–10



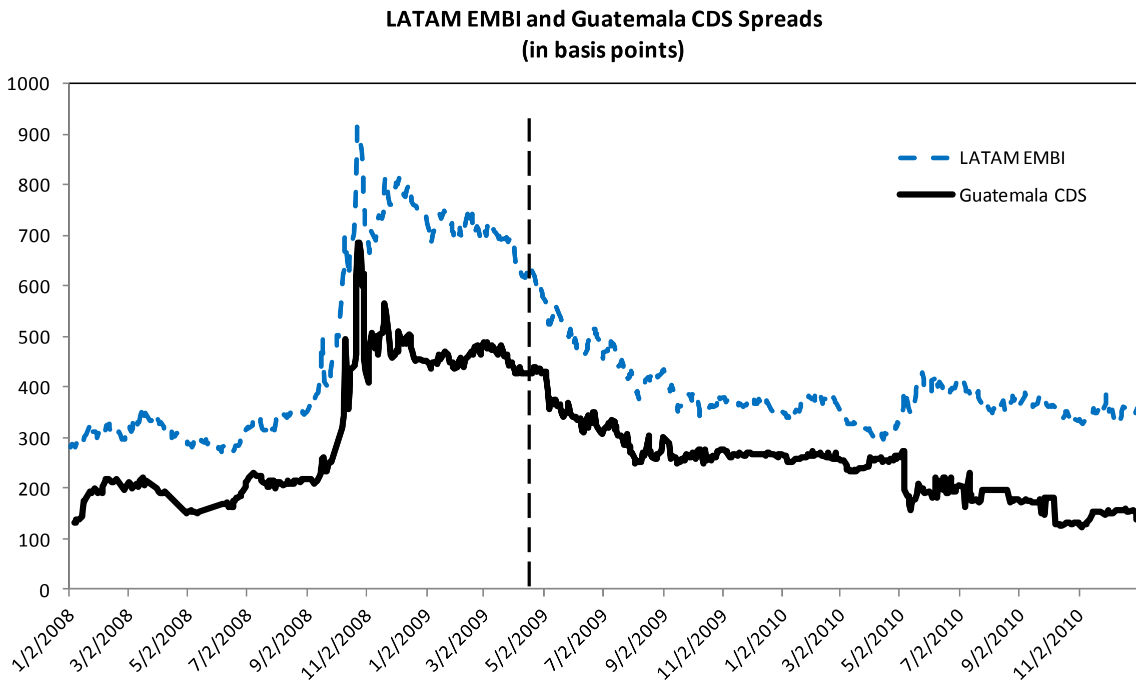
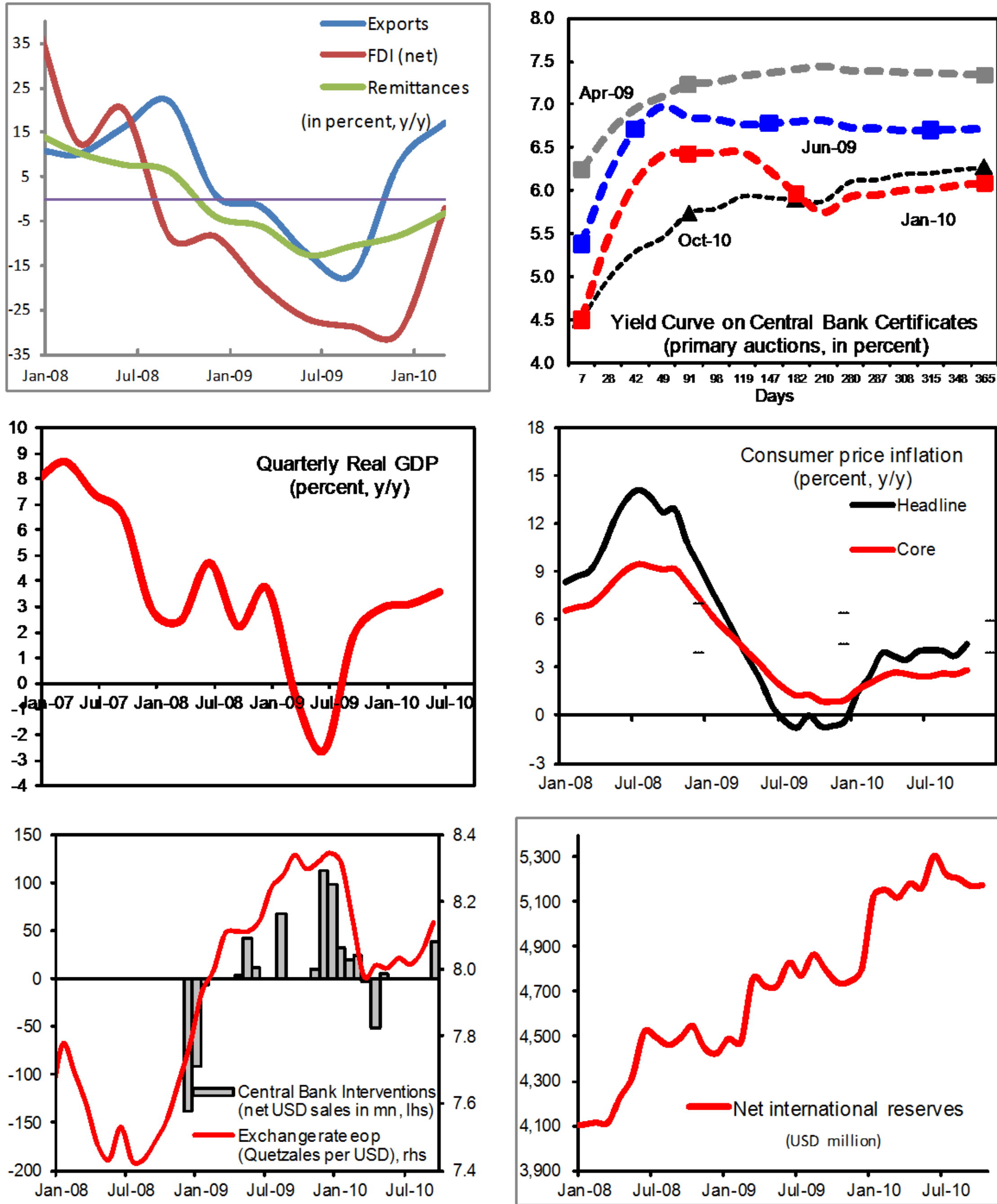


Figure 2. Guatemala: Selected Indicators



Source: Fund staff based on national authorities.

- **A decline in remittances**, most of which originate in the United States and finance over three-fourths of the trade deficit. With the onset of the crisis, remittances declined in 2008:Q4 compared to a year before, and were expected to fall as a share of GDP in 2008 (to 11.3 percent from 12.5 percent in 2007). A further decline was projected in 2009 (to 9.9 percent) with a further weakening of the U.S. economy.
- **A sharp slowdown of private capital flows**, of which foreign direct investment (FDI) had accounted for over half of private capital flows. FDI was projected to decline as a share of GDP, from 2.1 percent in 2008 to 1.5 percent in 2009, while other private capital flows were projected to fall by more than 2.5 percent of GDP.

9. **Despite the incipient downturn, several macroeconomic indicators remained strong**. Real GDP growth slowed appreciably in 2008 but was still resilient—estimated at 4.0 percent and subsequently revised down to 3.3 percent. Similarly, based on the data available in early 2009, the central government's overall deficit in 2008 had increased modestly to 1.7 percent of GDP, and public debt stood at 20 percent of GDP. The current account deficit narrowed in 2008 by 0.4 percent of GDP—revised subsequently to 0.7 percent of GDP—as imports contracted disproportionately. Accordingly, despite the decline in remittances and capital inflows, international reserves at end-March 2009 were at a record US$4.8 billion. Annual inflation also declined from its peak of 14 percent in mid-2008 to 5 percent in March 2009. In view of the worsening economic slowdown and the low inflationary pressures, the authorities reduced the policy rate by 100 bps to 6.25 percent.

10. **To mitigate the impact of the external shock and preserve macroeconomic stability, the authorities took a number of measures starting in 2008**. Initially, the authorities allowed the automatic stabilizers to operate, and took some measures to reduce financial sector risks. As the global crisis deepened after September 2008, the authorities intensified their policy dialogue with IMF staff on the key elements of a policy response, and along with other Central American economies, started to consider requesting IMF support. In January 2009, the authorities took another round of measures aimed at safeguarding macroeconomic and financial stability.[5] These measures were debated actively, especially the suitability of the countercyclical fiscal stance that was proposed.

11. **However, the downside risks to the economic outlook were substantial**. There were significant risks of a worsening of external conditions due to a more severe impact of the global financial crisis on Guatemala's trading partners, particularly the United States. The external financing requirement in 2009 was large (estimated at 16 percent of GDP) with large roll-over risks in the corporate sector. Vulnerabilities in the financial sector also could have worsened sharply, leading to a confidence crisis.

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[5] The measures were part of the authorities' *"Programa Nacional de Emergencia y Recuperación Económica"* launched in January 2009.

12. **In the circumstances, in March 2009, the authorities and staff reached agreement on an 18-month SBA with access of SDR 630.6 million (300 percent of quota)**. The program's main objective was to signal endorsement by the Fund of the package of measures adopted by the authorities to safeguard macroeconomic and financial stability, anchor investor confidence, and provide a cushion against the downside risks from a worsening of the external environment. From the outset, the authorities made clear their intention to treat the arrangement as precautionary.

13. **In line with the authorities' policy response to the crisis, the main elements of the SBA program were**: (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 were to be complemented with a refocusing of public expenditures to expand the social safety net and undertake labor-intensive public works.

III. Program Design and Exceptional Access Policy

14. **Given the program's objectives, this section assesses the appropriateness of the program design**. Three broad themes are addressed: (i) the coherence of the macroeconomic and structural policies; (ii) whether the focus of the program's conditionality was on addressing the underlying weaknesses and supporting the achievement of program objectives; and (iii) the appropriateness of the Fund's financing strategy. The extent to which the procedures on exceptional access were followed is also assessed.

A. Assessment of Program Design

15. **The large external financing requirement projected for 2009 was fully covered in the program's baseline scenario, and financing gaps emerged only in the more adverse scenarios**. The staff's baseline scenario envisaged a marked decline in remittances and capital inflows, yielding an external financing requirement—current account deficit plus total debt amortization—of US$6.2 billion (16.2 percent of GDP). This estimate included an assumption of full rollover of US$4.4 billion (11.6 percent of GDP) of private sector short-term debt. Of this total about US$2.7 billion were assumed to consist of corporate sector's short-term debt (mainly commercial credits).[6] An adverse scenario also was presented, incorporating even sharper declines in remittances and capital inflows and a lower rollover rate on short-term private sector debt. This scenario yielded a financing gap of US$0.9 billion (2.5 percent of GDP)—which could have been covered by purchases under the SBA. In addition, the report

[6] This estimate was based on new information on the corporate sector's external liabilities, contained in the International Investment Position (IIP) that was published for the first time at end-2008. Subsequent revisions yielded substantially lower estimates of private sector external debt (see Box 1).

mentioned an extreme scenario, entailing a sharper economic downturn, substantial capital outflows, and worsening conditions in the banking sector. These attempts to quantify the external financing requirements were broadly consistent with the qualitative assessment of vulnerabilities and with the precautionary nature of the SBA.

Box 1. Estimates of Private External Debt

Official estimates of external debt of the nonfinancial private sector became available for the first time in November 2008 with the release of the first estimate of Guatemala's International Investment Position (IIP). According to those estimates, the stock of commercial credits to exporters as of end-2007 was US$2.88 billion (8.5 percent of GDP). This estimate, which staff regarded as high, was used in the computation of the external financing requirements presented at the request of the SBA.

A revised IIP released in the second half of 2009 showed substantially lower estimates of private external debt. Concretely, the end-2007 stock of commercial credit to exporters was revised down to US$2.29 billion (about 6.7 percent of GDP). The revision reflected improvements in the survey used to compile commercial credits, and in the estimates of the duration of the financing. In particular, the survey had been revised to distinguish between commercial credit of direct investment enterprises with (i) headquarters and branches, and (ii) suppliers and clients. The much lower estimate of private commercial debt in 2008 resulted in a concomitantly lower projection of commercial credit falling due, and therefore lower external financing requirements in 2009.

The central bank has continued to refine and revise its estimates of private commercial debt. Following recommendations from STA a new methodology—using information obtained from a new firm-level survey of importing and exporting companies—was adopted in 2010. According to this methodology, the stock of commercial credit as of end-2009 was US$1.95 billion, significantly lower than the earlier estimates.

16. **The program's conditionality was fairly streamlined, focused on short-term macroeconomic performance and financial stability, with minimal emphasis on persistent structural vulnerabilities**. The quantitative performance criteria (PCs) applied to the overall balance of the central government, NIR, and external arrears, with an indicative floor on central government deposits at the central bank. A consultation clause on inflation also was included, and structural conditionality was focused on strengthening the banking sector. Significant steps towards addressing the structural vulnerabilities, e.g., the low revenue effort, were not made subject to conditionality. Data reporting and monitoring was adequate—based on daily, weekly, and monthly data—with a focus on timely high-frequency financial and banking sector data, and any changes in policy stance. The Fund's Resident Representative also facilitated very close interaction with the authorities.

Fiscal policy

17. **The original program envisaged a prudent countercyclical fiscal stance with a moderate fiscal stimulus in 2009, which was to be unwound starting in 2010**. For 2009, the program envisaged a relaxation of the central government's primary balance of 1 percentage point of GDP in 2009—which implied a deterioration in the primary balance of the nonfinancial public sector of 1½ percentage points. Given the fiscal space created by the strong

fiscal performance of the previous years and the low levels of public debt, it was judged that a moderate expansionary stance could be accommodated without jeopardizing long-term fiscal sustainability. The fiscal impulse was to be unwound starting in 2010—when the central government's primary balance was expected to improve by ¼ percent of GDP, and the central government's overall deficit was to decline to 2.6 percent of GDP. Thereafter, the fiscal deficit was expected to stabilize at about 2 percent of GDP, and the public debt-to-GDP ratio was expected to remain low at about 26 percent of GDP over the medium term.[7] However, a medium-term fiscal anchor consisting of a low debt-to-GDP ratio that could have helped strengthen credibility of the program's fiscal stance, was not publicized or made an explicit target of the program. Staff judged that placing too much weight on a medium term debt target would not have enhanced program credibility, given Guatemala's history of prudent fiscal policies. Nevertheless, it could have been useful in further reassuring markets and investors particularly in the context of the more adverse scenarios that were envisaged in the program.

18. **The higher fiscal deficit was to result from higher spending and a cyclical decline in revenues**. Expenditures were envisaged to rise by 0.5 percent of GDP in 2009—reaching 14.1 percent of GDP in 2009 and 2010—with social spending increasing by 0.6 percent of GDP. With the expected contraction in the tax base, particularly imports, government revenues in 2009 were expected to decline by 0.7 percentage points to 11.3 percent of GDP. However, recognizing the uncertain global outlook and the potential downside risks on revenues, in order to protect social expenditures, the program allowed a further increase in the fiscal deficit of up to 0.2 percentage points provided that the authorities secured additional external financing.

19. **The program contemplated measures to strengthen revenues, but there was no conditionality on a revenue-generating tax reform**. At the start of the program, Congress was considering measures to reform indirect taxes, which were expected to be approved by end-2009 and to increase revenues by 0.2 percentage points of GDP. The SBA also envisaged that the tax authority would continue implementing its medium-term plan to reduce tax evasion, correctly identified as a key factor behind the weak revenue collection. However, the SBA did not include conditionality on these or similar initiatives aimed at remedying Guatemala's longstanding inability to raise the tax-to-GDP ratio (Box 2). Inclusion of such conditionality could have provided a strong signal of commitment to medium-term fiscal solvency and to increasing social and infrastructure expenditures to meet developmental objectives. Staff judged that political consensus for a comprehensive tax reform was difficult to obtain, especially in the 18-month period covered by the SBA, and was concerned that placing conditionality on tax reform risked undermining political support for the authorities' program. In the circumstances, however, an alternative approach of attaching conditionality to a few critical and politically feasible elements of a more comprehensive reform could have strengthened the SBA.

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[7] The projected debt levels were within what the literature regards as "safe" for a typical emerging market country (under 30–35 percent of GDP). See, for instance, Carmen M. Reinhart, Kenneth S. Rogoff, and Miguel A. Savastano *Debt Intolerance*, NBER Working Paper, No. 9908 (2003).

Box 2. Recent Revenue Initiatives

Guatemala's tax-to-GDP ratio remains one of the lowest in Latin America. The goal of raising the ratio to 13¼ percent—as stipulated in the 1996 Peace Accords—seemed to be within reach at the time of the 2008 Article IV consultation but is now, again, a medium-term objective. The low tax revenues prevent a sustainable increase in expenditures that are necessary to address Guatemala's large social and infrastructure needs.

Selected Central American and Caribbean Countries: Tax Revenue Structure, 2003–07

	Total	PIT	CIT	VAT	Excises	Imports	Exports	Others
				(percent of GDP)				
Guatemala	11.6	0.2	1.9	4.5	1.2	1.4	0.0	2.4
Bahamas, The	14.7	0.0	0.0	0.0	0.6	7.0	0.2	6.9
Barbados	30.8	6.3	4.1	9.7	3.3	3.3	0.0	4.2
Costa Rica	14.4	0.6	3.0	5.2	1.4	0.9	0.0	3.3
Dominican Republic	13.6	0.8	1.4	3.8	3.2	1.6	0.1	2.6
El Salvador	12.6	1.8	2.1	6.6	0.6	1.1	0.0	0.4
Honduras	15.6	2.3	1.8	5.4	3.5	1.2	0.0	1.5
Jamaica	21.0	1.3	2.2	4.4	1.8	2.4	0.1	8.9
Nicaragua	15.5	...	...	6.3	4.0	1.0	0.0	4.2
St. Kitts and Nevis	23.1	0.0	4.5	0.1	1.7	10.9	0.0	5.8
St. Vincent & Grens.	24.8	3.4	3.4	0.0	4.7	11.9	0.0	1.3
Trinidad and Tobago	24.7	0.2	14.1	3.3	1.1	1.5	0.0	4.4

Sources: Government Finance Statistics (IMF); International Financial Statistics (IMF); and World Economic Outlook (IMF).

Tax policy

Guatemala's tax revenues are low as a result of widespread tax exemptions—some of which are enshrined in the Constitution—and relatively low tax rates. Staff has recommended increasing the VAT rate (most recently, during the 2008 Article IV consultation) but the authorities have not followed the advice citing concerns about potentially adverse distributional effects. With the development of cash transfers and other targeted transfers, renewed consideration could be given to the recommendation.

A tax reform proposal submitted by the authorities in 2008 comprised the creation of a tax on vehicle registration, a higher tax rate on vehicles in circulation, and legislation to strengthen tax administration. However, the proposal was withdrawn from Congress in September 2009 when it was clear that the revenue enhancing measures had been removed from the initiative. The government submitted another bill comprising higher rates on corporate income taxes and a new tax on mobile phone calls in November 2009, but this draft bill also failed to pass.

Tax administration

Tax administration has improved significantly in recent years, with support from the IMF's technical assistance. The anti-evasion laws of 2005 and 2007 sought to broaden the tax base and capture segments of the informal economy. Following the adoption of these laws the authorities focused on improving taxpayer registration and taxpayer current account system. In the context of the SBA, the authorities undertook further action against tax evasion and smuggling, notably through strengthened controls (VAT reimbursements, VAT exemptions, transit controls).

Guatemala also faces challenges in tax administration related to the implementation of the Central American Customs Union (CACU), which includes Costa Rica, El Salvador, Honduras, and Nicaragua.

20. **Appropriately, the higher fiscal deficit was to be financed almost entirely from external multilateral sources**. Additional external financing was expected from the World Bank, the Inter-American Development Bank (IDB), the Central American Bank for Economic Integration (BCIE), and some bilateral sources. While the financing strategy aimed at avoiding a crowding out of the private sector, it also served to limit the size of the fiscal stimulus. Importantly, the authorities were concerned that Congress would not support an increase in the fiscal deficit.

21. **Additional social protection was to be provided by increasing social spending through the existing programs targeted for the most needy**. Access to a minimum of nutrition, health, and education services was to be ensured through these programs, helping to offset the effect of the crisis on the most vulnerable. One specific program targeted extreme poverty and provided conditional cash transfers aimed at securing poor children attend school and visit health centers regularly.

Monetary and Exchange Rate Policies

22. **Monetary policy was aimed at anchoring low inflation within an inflation targeting (IT) framework**. The authorities had started to conduct monetary policy under an IT framework in 2005, and had strengthened the framework gradually in the years prior to the SBA. While the IT framework still needed further strengthening—e.g., to bolster the transmission mechanism, or anchor inflation expectations more firmly—since domestic financial conditions were relatively stable, the inclusion of the IT framework in the SBA aimed at reinforcing the credibility of monetary policy. Accordingly, the program adopted a reviews-based approach on the inflation outcomes—i.e., consultation with Fund staff or the Executive Board would be triggered if annual inflation deviated from target by more than the set limits. The central bank was committed to adjust the policy interest rate as developments warranted, and to continue strengthening the IT framework during the program period.

23. **Commitment to a flexible exchange rate regime was seen as an effective way of addressing some external vulnerabilities and strengthening the IT framework**. Exchange rate flexibility was expected to help cushion the impact of the global crisis, while discouraging dollarization and excessive risk-taking by unhedged borrowers, and support focusing monetary policy on the inflation objective. However, the authorities also attached importance to avoiding excessive exchange rate volatility and decided, prior to the SBA, to supplement the flexible exchange rate regime with an intervention rule.[8]

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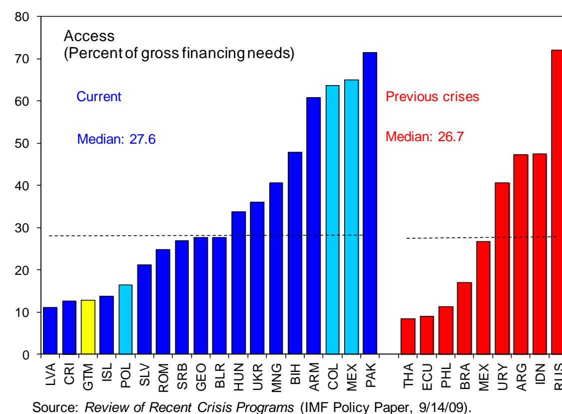
[8] The rule stipulated that the central bank would intervene symmetrically in the foreign exchange market, up to US$24 million a day, when the exchange rate deviated from its 5-day moving average by 0.75 percent. The central bank also reserved the right to conduct additional discretionary intervention to avoid sudden changes in the exchange rate.

Financial Sector Policies

24. **The program's focus on correcting weaknesses in the banking system's legal and regulatory framework was appropriate**. Specifically, the program envisaged a further strengthening of the regulatory and supervision framework, as well as improvements in the banking sector safety net and resolution procedures. Following the 2006–07 banking crisis and the subsequent consolidation, financial sector policies were being strengthened as the authorities addressed the most critical risks: banking supervision had been enhanced, including through continuous on-site supervision and regular dialogue with banks; flexibility of the reserve requirements had been increased and reverse repos in foreign currency were introduced to provide temporary liquidity; and the provisioning requirements were changed to strengthen bank solvency, with the full-provisioning of nonperforming loans (NPLs) required by mid-2011. Given the close supervision of banks, and the relatively strong financial soundness indicators at end-2008, the program's focus was appropriate.

25. **The remedial measures envisaged built upon the authorities' work and the Fund's technical assistance (TA), and represented the only structural conditionality of the SBA**. Following up on the recommendations from various IMF TA missions and the 2007 Financial System Stability Assessment (FSSA),[9] the authorities had prepared a set of draft law amendments aimed at enhancing (i) prudential norms and banking supervision; (ii) the regulatory treatment of offshore banks; and (iii) bank resolution procedures. An MCM/LEG mission in early 2008 reviewed these proposals and made several recommendations. Subsequent MCM missions had also recommended strengthening further the banking law in other areas, for instance, by introducing provisions against the financing of terrorism, putting small financial institutions under the scope of the superintendency of banks, and tightening the definition of informal banking. The program's conditionality, therefore, envisaged (i) submitting to Congress (by June 2009) banking legislation amendments to strengthen the enforcement powers of the superintendency, reduce connected lending, reduce the risk from offshore banks, and improve the bank resolution framework; and (ii) elaboration of regulations on bank's liquidity management and foreign currency credit risk (by December 2009).



Source: *Review of Recent Crisis Programs* (IMF Policy Paper, 9/14/09).

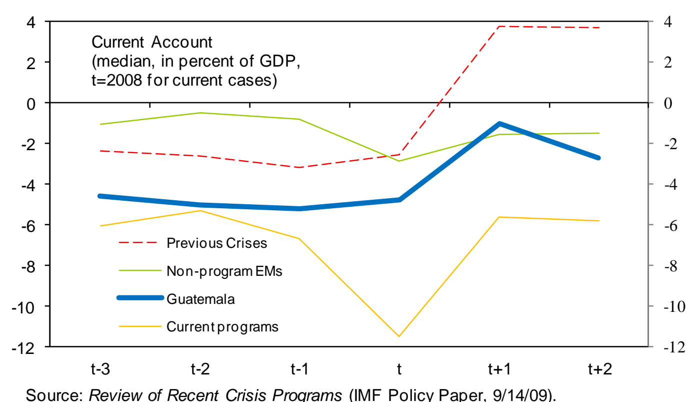
Was the Fund's Financing Strategy Appropriate?

26. **Fund financing under the program was in line with other HAPA cases but lower than in other high access cases**. While the baseline projection

[9] The 2007 FSSA had identified several weaknesses in the banking system that required legal amendments, including aspects such as: (i) aggregate credit limits to insiders; (ii) tools to effectively ring-fence onshore banks from losses in offshore affiliates; (iii) generic loan loss provisions; and (iv) large risk exposures and measures to enhance consolidated supervision.

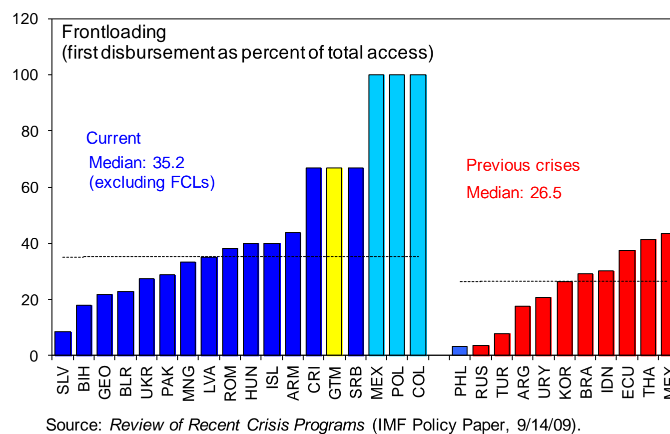
for 2009–10 did not envisage an external financing gap, ex ante risks to the outlook were significant and could have called for a higher access level in light of the considerable external liabilities of the corporate sector, and the sizable gross external financing requirements—access of 300 percent of quota was sufficient to cover about 15 percent of gross external financing needs in 2009. Nonetheless, it became clear early on that the most pessimistic scenario was unlikely to materialize, also due to the strong program implementation and a financial system that held up relatively well. Moreover, the risk associated with the corporate sector's external liabilities turned out to have been overstated, as revised IIP data showed that the external liabilities of the corporate sector were smaller than initially projected.

27. **The ex ante balance between financing and macroeconomic adjustment under the program was broadly appropriate**. Typically, the amount of financing is inversely related to the size of the necessary current account adjustment. In the case of Guatemala, the level of access under the program provided an additional liquidity cushion, keeping Fund exposure manageable, while facilitating a smooth correction in the current account. While pre-crisis external imbalances were similar to those in other program countries, Guatemala did not experience the sharp deterioration in the current account observed in other program countries in 2008, and behaved more like a nonprogram EME. The adjustment in the current account also took place at a measured pace.



Source: *Review of Recent Crisis Programs* (IMF Policy Paper, 9/14/09).

28. **In light of the substantial downside risks, Fund resources under the program were heavily frontloaded**. In order to bolster confidence in the country's ability to withstand large balance of payments shocks, access under Guatemala's SBA was more frontloaded than in other cases. The rationale for this was the need to avoid large private capital outflows and a sharp depreciation in the event of a shock, as those would have had severe effects on the corporate sector and banks. The substantial frontloading of access was therefore appropriate, and access during the first 12 months was set at 260 percent of quota.



Source: *Review of Recent Crisis Programs* (IMF Policy Paper, 9/14/09).

B. Exceptional Access Policy

29. **In line with the applicable procedures, the SBA request was assessed to meet the four criteria for exceptional access**.[10] Although overall access was below the new cumulative access limit set in March 2009 (500 percent of quota), the proposed access during the first 12 months exceeded the annual limit of 200 percent of quota, triggering the procedures for exceptional access. The four criteria were adequately assessed:

- **First criterion**—*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.* Exceptional balance of payments pressures could have emerged quickly from a combination of factors: a worsening of domestic conditions reflecting a more severe impact of the global financial crisis; a worsening of the vulnerabilities in the financial sector, leading to a confidence crisis; and the large rollover risks in the corporate sector—estimated at the start of the program at 9.4 percent of GDP.
- **Second criterion**—*a rigorous and systematic analysis indicates that there is high probability that a member's public debt is sustainable in the medium term.* Guatemala's external and public debt levels were low at the onset of the crisis, and were projected to remain low over the medium term if the program was successful. The standard bound tests in the debt sustainability analysis framework also indicated that debt would remain sustainable under a range of plausible shocks.
- **Third criterion—***the member has prospects of gaining or regaining access to private capital markets within the timeframe that Fund resources are outstanding*. While Guatemala's private sector had maintained access to international capital markets, borrowing terms had worsened since the onset of the crisis—e.g., sovereign spreads had widened by 360 basis points from September 2008 to April 2009. The terms of Guatemala's access to the capital markets would be expected to improve as the global financial crisis abated.
- **Fourth criterion**—*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.* Guatemala's strong track-record of sound policies to support macroeconomic stability, and the authorities' proactive response to the external crisis suggested strong prospects for the program's success. The implementation of key policy measures ahead of the program's approval also provided confidence in the authorities' capacity to implement the program.

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[10] The applicable criteria when Guatemala's SBA request was approved are detailed in *GRA Lending Toolkit and Conditionality—Reform Proposals—Revised Proposed Decisions* (IMF Policy Paper, 3/19/09). The second criterion was modified in May 2010, at the Board's consideration of Greece's request for an SBA involving exceptional access.

30. **The Board's involvement, including advance notification of the SBA request, was in line with the policy on exceptional access**. The Board was informed at an informal briefing on March 13, 2009, of Guatemala's interest in a precautionary SBA that could involve exceptional access. At the Board's consideration of the authorities' request, a companion Board paper assessing the risks to the Fund and the Fund's liquidity position was also discussed, consistent with the policy on exceptional access.[11]

IV. Assessment of Program Performance and Policy Implementation

31. **Although the government demonstrated a strong ownership of the program, political dissonance prevented reaching consensus on some key legislation**. Against a backdrop of high inequality, polarized social conditions, strong interest groups, and a minority government, garnering political consensus for economic reforms posed significant challenges. Congress delayed the approval or rejected several key legislation during the program period, and the holdup weakened the administration's ability to implement policies effectively. Political tensions eased appreciably around mid-2009, when Congress approved some legislation, including the authorization for additional government borrowing to finance the deficit. However, other key draft laws stalled in Congress (e.g., the proposed tax reform submitted in 2009), and the draft 2010 budget submitted in late 2009 was not approved.[12] Frustration from the lack of progress in tax reform was a factor in the resignation of Finance Minister Fuentes-Knight in June 2010. Staff's outreach during the program could not overcome the difficulties in building a political consensus for the reforms.[13]

32. **All quantitative PCs under the program were met, most with comfortable margins**. The quantitative PCs set at the onset of the program were adjusted during the first review (September 2009) to accommodate a higher fiscal deficit in 2009, and at the second review (December 2009) to provide room for front-loading of spending in 2010. Reflecting more benign external conditions, as well as a strong program implementation and no signs of a deterioration of confidence, all PCs were met, some (such as for NIR) with large margins. The structural benchmarks were also met. No purchases were made under the SBA and it remained precautionary.

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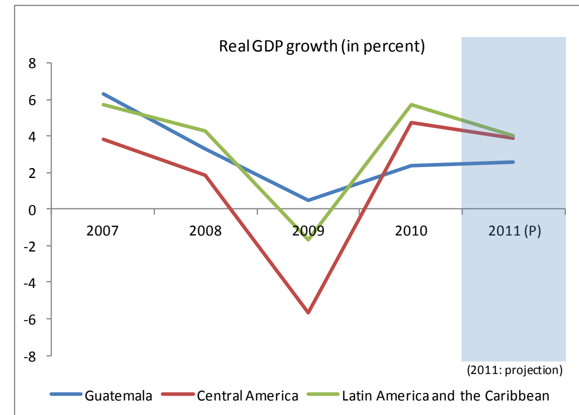
[11] *Guatemala—Assessment of the Risks to the Fund and the Fund's Liquidity Position* (IMF Country Report No. 09/143, Staff Supplement, 4/13/09).

[12] Lacking Congress approval of the draft 2010 budget, the administration had to resort to issuing Executive Orders to authorize spending plans for a few months at a time during the year.

[13] Staff met with President Colom in the context of the first and second reviews. In addition, staff met on several occasions with academics, private sector representatives, the press, and members of Congress.

33. **Despite weak support from Congress, macroeconomic performance under the program was relatively strong (Table 1)**. Real GDP increased by 0.5 percent in 2009—lower than envisaged at the start of the program but stronger than projected during the first review—contrasting favorably with other economies in the region. The recovery firmed up in 2010, when real GDP is estimated to have risen by 2.4 percent. The external current account deficit narrowed in 2009 as imports declined—due to lower oil and food prices, and lower domestic activity—and a stronger exports performance, resulting in a smaller-than-anticipated deficit. Remittances declined but were marginally stronger than expected, and FDI was largely in line with program projections. However, credit growth remained sluggish—credit to the private sector increased by 1.1 percent in 2009 and 4.6 percent in 2010, compared to program projections of 6.2 and 7.1 percent, respectively.



34. **The relatively benign external environment, strong program implementation and lower underlying debt vulnerabilities, resulted in lower-than-projected external financing requirements**. By the first review (in September 2009), the baseline estimate of the external financing requirements for 2009 was revised down by US$1.7 billion (4.2 percent of GDP). This reflected a sharp narrowing of the current account deficit (by US$0.9 billion) due to lower oil and food prices, and a contraction of non-oil imports due to sluggish investments. Amortization of corporate short-term external debt also was lower than initially envisaged (by US$0.7 billion), as new data led to a downward revision of the outstanding stock of corporate external debt, and the contraction in trade flows reduced the demand for trade credit (Box 1). By the time of the second review (in December 2009), risks from the balance of payments were greatly diminished, and the revised baseline scenario projected lower external financing requirements for 2010, stemming from a lower current account deficit and lower external debt amortization.

35. **Overall, the program's primary objective was achieved**. The timely completion of the reviews under the SBA made available a large liquidity cushion to mitigate downside risks—which did not materialize—from the external environment. It also signaled the authorities' commitment to maintain sound macroeconomic policies in the aftermath of the global crisis. Nevertheless, while macroeconomic and financial stability was broadly safeguarded, some significant vulnerabilities were not fully addressed as the associated policy measures were not implemented during the SBA.

Fiscal Policy

36. **In the event, the fiscal stimulus was higher than initially envisaged both in 2009 and 2010 (Table 1)**. By the time of the first review in September 2009, revenues were well below target due to a steeper-than-expected economic downturn and a sharp decline in imports. Program targets were revised at that time to maintain a countercyclical stance by accommodating a larger deterioration in the cyclically-adjusted balance in 2009 (about ½ percent of GDP) and 2010 (about 1 percent of GDP). Relative to the original program targets, the revisions implied an increase in the size of the stimulus by about 1 percent of GDP in 2009, while maintaining a neutral stance in 2010 as opposed to a withdrawal of the stimulus (Appendix 1). The additional stimulus was financed by a larger-than-projected drawdown of government deposits at the central bank, which limited recourse to debt issuance.[14] Following some delays by Congress in approving the elements of the financing package, external financing was broadly in line with projections. As a result, by end-2010 public debt was very close to the level envisaged at the program's approval.

37. **The lack of political consensus hindered progress on tax reforms**. The proposed legislation on tax reform faced strong political resistance in Congress. In addition, and against staff's recommendations, Congress passed legislation on free trade zones (ZOLIC), which broadened the list of tax exemptions. In August 2009, the government withdrew the draft legislation to reform indirect taxes, and sent another more modest bill proposing increases in income and stamp tax rates; that bill also was not approved. Submission to Congress of legislation to reform corporate and personal income tax regime and reduce tax exemptions also was deferred. While not given much attention at the program reviews, the Fund's TA missions have noted some progress on tax administration. However, a draft law to help reduce tax evasion was still under discussion at the end of the program. More information during the program reviews about the reasons for the delays in passing proposed legislation would have helped guide the potential remedial measures.

38. **The recurrence of domestic arrears during the program reflected weaknesses in expenditure control, which were not addressed effectively in the program**. Persistent domestic payments arrears in the public sector had been acknowledged as a problem at the time of the program's approval, and measures to strengthen expenditure management and transparency were included in the authorities' Letter of Intent. Moreover, strong budgetary control systems were regarded as essential, especially in view of Guatemala's vulnerability to natural disasters that require flexibility to quickly reallocate budgetary resources. However, arrears continued to build up during the program period— at the time of the second review (December 2009) they were estimated at about ¼ percent of GDP and were regarded as transitory, but by the end of the program the estimate had risen to 1–2 percent of GDP.

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[14] Following the SDR allocations in August and September 2009 (Guatemala received SDR 155.8 million under the general allocation and SDR 17.4 million under the special allocation) the authorities considered using part of these SDRs for budgetary financing but decided against it because domestic legislation required Congress to approve the transfer of SDRs from the central bank to the government.

Table 1. Guatemala: Selected Economic and Social Indicators

I. Social and Demographic Indicators

Population 2009 (millions)	14.3	Gini index (2006)	53.7
Percentage of indigenous population (2006)	38.4	Life expectancy at birth (2007)	70.1
Population below the poverty line (Percent, 2006)	51.0	Adult illiteracy rate (2007)	26.8
Rank in UNDP development index (2009)	122 of 182	GDP per capita (US$, 2008)	2,850

II. Economic Indicators

	2007		2008		2009			2010	
	Program 2/	Actual 3/	Program 2/	Actual 3/	Program 2/	1st Rev 1/	Actual 3/	Program 2/	Proj. 3/
	(Annual percent change)								
Income and prices									
Real GDP	6.3	6.3	4.0	3.3	1.0	0.4	0.5	1.8	2.4
Consumer prices (end of period)	8.7	8.7	9.4	9.4	5.5	1.5	-0.3	4.7	5.5
Monetary sector									
Credit to the private sector	26.0	26.0	11.0	11.0	6.2	4.3	1.1	7.1	4.6
	(In percent of GDP, unless otherwise indicated)								
Savings and investment									
Gross domestic investment	20.7	20.8	17.6	16.4	15.8	15.0	12.9	17.2	15.9
Private sector	15.7	17.2	12.8	13.2	10.6	11.4	9.9	12.2	12.7
Public sector	5.0	3.6	4.8	3.2	5.1	3.5	3.1	5.1	3.2
Gross national saving	15.5	15.6	12.8	11.8	11.8	13.3	12.4	12.3	13.0
Private sector	12.2	12.3	10.1	9.4	10.2	13.2	12.1	10.7	12.9
Public sector	3.3	3.3	2.7	2.5	1.5	0.1	0.3	1.7	0.2
External saving	5.2	5.2	4.8	4.5	4.0	1.7	0.6	4.9	2.9
External sector									
Current account balance	-5.2	-5.2	-4.8	-4.5	-4.0	-1.7	-0.6	-4.9	-2.9
Trade balance (goods)	-16.1	-16.1	-14.2	-14.2	-11.9	-9.7	-8.8	-12.8	-10.5
Exports	17.7	20.5	17.9	20.0	16.2	18.8	19.5	16.6	20.1
Imports	-33.8	-36.6	-32.1	-34.3	-28.1	-28.5	-28.2	-29.4	-30.6
of which: oil & lubricants	-6.7	-6.7	-6.8	-6.8	-4.2	-5.1	-5.5	-4.9	-5.8
Other (net)	10.9	10.9	9.4	9.7	7.9	8.0	8.2	8.0	7.6
of which: remittances	12.3	12.3	11.3	11.2	9.9	10.3	10.6	9.9	10.2
Capital and financial account	4.7	4.7	4.3	3.1	2.7	2.3	-0.2	3.6	3.6
Public sector	0.7	0.7	0.3	0.3	1.6	1.3	2.1	1.6	1.9
Private sector	4.0	4.0	4.0	2.8	1.0	0.9	-2.3	1.9	1.7
of which: FDI	2.1	2.1	2.1	1.9	1.5	1.8	1.4	1.6	1.6
Errors and omissions	1.1	1.2	1.3	2.3	1.3	0.1	2.1	1.3	0.5
Overall balance	0.5	0.6	0.8	0.8	0.0	0.7	1.3	0.0	1.2
Net international reserves									
(Stock in months of next-year NFGS imports)	3.2	3.2	4.2	4.2	3.9	4.1	4.0	3.5	4.0
(Stock over short-term debt on residual maturity)	0.9	1.0	0.9	1.0	1.0	1.2	1.4	0.9	1.4
Public finances									
Central government									
Revenues	12.9	12.8	12.0	12.0	11.3	10.6	11.1	11.5	11.3
Expenditures	14.7	14.3	13.7	13.6	14.1	14.0	14.2	14.1	14.7
Current	9.5	9.5	9.2	9.2	9.7	9.9	10.1	9.7	10.6
Capital	5.2	4.8	4.5	4.5	4.4	4.2	4.1	4.4	4.1
Primary balance	-0.3	0.0	-0.3	-0.3	-1.2	-1.9	-1.7	-1.0	-1.8
Overall balance	-1.8	-1.4	-1.7	-1.6	-2.8	-3.4	-3.1	-2.6	-3.4
Overall balance (without reconstruction)	n.a.	n.a.	n.a.	n.a.	n.a.	n.a	n.a.	n.a.	-3.1
Financing of the central government balance	0.7	1.4	0.7	1.6	2.4	3.4	3.1	2.1	3.4
Net external financing	1.2	1.2	0.3	0.3	1.6	1.3	1.3	1.6	1.9
Net domestic financing	-0.5	0.3	0.4	1.3	0.8	2.1	1.8	0.5	1.5
Rest of nonfinancial public sector balance	1.2	1.1	1.2	0.9	0.6	0.4	0.4	0.6	0.5
Combined nonfinancial public sector	-0.6	-0.3	-0.5	-0.7	-2.2	-3.0	-2.8	-2.0	-2.8
Nonfinancial public sector debt	**21.7**	**21.3**	**20.2**	**19.9**	**22.5**	**23.2**	**23.0**	**24.2**	**24.5**
External	12.5	12.1	11.3	11.0	13.1	13.3	13.0	14.4	13.8
Domestic	9.2	9.2	8.9	8.9	9.4	9.9	10.0	9.8	10.7
Memorandum items:									
GDP (US$ billions)	34.0	34.1	39.0	39.1	38.0	37.7	37.7	39.0	40.8

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

1/ Investment excludes changes in inventories, and its breakdown between public and private is taken from the national accounts. Investments in IMF Country Report No. 09/143 included changes in inventories, and its breakdown in public and private was based on Fund staff estimates from fiscal data. See IMF Country Report No. 09/305.

2/ Source: IMF Country Report No. 09/143.

3/ Source: IMF Country Report No. 10/309.

Following staff's advice, in mid-2010 the authorities requested an FAD TA mission to examine the sources of domestic arrears and make recommendations for their permanent elimination. In hindsight, a program ceiling on domestic arrears would have facilitated a stronger budgetary control and stricter adherence to the deficit targets. In addition, assessing the effectiveness of the agreed measures to improve expenditure management and transparency would have been beneficial, including identifying corrective measures.

39. **There was little information about the effectiveness of the increased social spending**. More information at the program reviews, particularly on assessments of the supported social programs, would have helped in evaluating the increased social spending.

Monetary and Exchange Rate Policies

40. **The flexible exchange rate supported the external adjustment**. The quetzal was allowed to adjust smoothly, depreciating by about 6 percent in the first half of 2009. This depreciation helped to mitigate the impact of the lower balance of payments inflows and contributed to eliminate the small overvaluation of the quetzal. Volatility in the foreign exchange market and large losses of international reserves were also avoided. In September 2009 the central bank amended its intervention rule, by allowing intervention when the exchange rate deviates by 0.5 percent (instead of 0.75 percent) from its 5-day average, as well as intra-day intervention. Later, the intervention rule was amended again to allow the central bank to intervene by up to US$32 million a day.

41. **Inflation was more volatile than anticipated, plummeting sharply and triggering the consultation clause included in the program**. The economic downturn and the sharp decline in commodity prices early in the program brought inflation below the target floor defined in the consultation clause—2½ percent for the inner band and 1½ percent for the outer band. By end-July 2009, annual inflation had fallen to -0.3 percent though it returned to positive territory quickly thereafter. The sharp decline in inflation led the central bank to lower the policy rate by 275 bps from April 2009 to September 2009. The decline also triggered the consultation clause, where staff concluded, correctly, that the base effects from the lower commodity prices would dissipate quickly and inflation would soon return to the official target band. The consultation band was modified at the first review. As the economy began to recover and inflation started to pick up, the authorities shifted gears and adopted a wait-and-see approach, standing ready to hike rates if called for by developments in inflation expectations and capital flows.

42. **The IT framework was strengthened, but the transmission of changes in the policy interest rate to overall monetary conditions remained weak**. The gradual decline in the policy rate early in the program did not translate into lower market interest rates—which may have mitigated the decline in the growth rate of bank credit and domestic demand. This weakness in the transmission channel was due in part to the excess liquidity in the system and the absence of a yield curve to help gauge the current and expected stance of monetary policy.

With support of the Fund's TA, the authorities are addressing these shortcomings, and have recently taken steps to enhance the monetary policy framework, for example, by reducing the number of auctions and issuing only standard maturity instruments. Nevertheless, more fundamental reforms are needed, such as developing the public debt and private security markets.

Financial Sector Policies

43. **Guatemala's financial system was resilient, as liquidity pressures dissipated and bank deposits grew steadily**. The issuance of new regulations—e.g., on bank liquidity management and foreign currency credit risk—and the stagnation of credit growth combined to reduce liquidity pressures as bank deposits increased. The superintendency of banks remained vigilant, including through on-site supervision, and there was a modest improvement in the financial soundness indicators (Table 2). Progress was made in certain areas—e.g., plans towards full-provisioning of NPLs, implementing regulations on liquidity and foreign currency risk management, and approval of a new insurance law—all of which served to strengthen the financing system.

44. **The nonapproval by Congress of the proposed amendments to the banking laws was disappointing**. While the structural benchmarks in the financial area were met, the legislative amendments that were submitted to Congress in June 2009 had not been approved when the SBA expired. Approval of these amendments would have been an important first step towards the adoption of recommendations of IMF TA missions. As a result, the strengthening of the banking system's prudential and legal framework envisaged under the SBA did not materialize (including through the additional measures that would have followed the approval of these amendments). The lack of progress in amending banking legislation and the resultant persistence of the related vulnerabilities in the financial system is a drawback of the SBA.

Table 2. Guatemala: Financial Soundness Indicators

	2006	2007	2008	2009				2010	
				March	June	Sept.	Dec.	March	June
On-shore banks									
Statutory capital to risk-weighted assets	13.6	13.8	13.5	15.3	15.8	14.8	15.4	15.1	15.1
Nonperforming loans net of provisions to capital	7.5	6.2	3.6	4.1	5.2	5.5	1.8	-0.3	0.0
Nonperforming loans to total gross loans	3.4	2.6	2.3	2.6	3.0	3.2	2.7	2.7	2.8
Cash to total deposits	21.2	20.8	19.4	20.3	19.8	20.6	21.6	20.6	22.3
Return on assets	1.2	1.5	1.7	2.3	2.0	2.0	1.6	1.9	1.9
Return on equity	15.0	16.8	16.3	22.6	20.3	19.2	15.7	18.9	18.1
Foreign currency-denominated loans to total loans	30.2	33.2	33.6	33.6	32.4	32.1	30.6	29.0	28.5
Foreign currency-denominated liabilities to total liabilities	21.6	25.1	24.3	24.2	23.9	24.1	23.9	24.0	24.1
Loan to deposit ratio	65.4	79.4	76.6	74.1	72.6	72.0	70.2	67.9	66.3
Liquid asset to total asset ratio	30.9	25.1	26.1	26.9	28.1	27.7	28.6	29.7	29.9
Off-shore banks									
Statutory capital to risk-weighted assets	14.2	15.0	14.7	16.1	16.7	17.7	18.1	18.3	17.0
Nonperforming loans to total gross loans	2.9	2.9	2.2	2.5	2.0	2.7	2.3	2.0	2.3
Return on assets	2.0	2.2	1.5	1.7	1.8	1.7	1.4	1.4	1.3
Return on equity	18.8	19.4	14.2	15.7	16.2	19.2	12.8	13.3	12.5
Total assets off-shore banks to total assets on-shore banks	18.9	16.8	16.1	16.4	16.3	16.6	16.5	16.2	15.8

Sources: Superintendency of Banks; Bank of Guatemala; and Fund staff estimates.

V. CONCLUSIONS

45. **The 2009 SBA with Guatemala helped mitigate the impact of the global financial crisis and safeguard macroeconomic and financial stability**. The relatively strong program implementation and benign external environment contributed to the attainment of the program's primary objectives. All quantitative PCs under the program were met and all reviews were completed on time, reflecting the authorities' commitment to maintain sound macroeconomic policies.

46. **Macroeconomic performance under the program was relatively strong**. Real GDP increased by 0.5 percent in 2009, contrasting favorably with other economies in the region, and growth rebounded in 2010. Inflation remained under control, international reserves increased, and the increase in public debt was contained.

47. **The Fund's financing strategy was appropriate**, and the high-access precautionary SBA proved a valuable preventive instrument to deal with the global crisis. Although the external financing requirements turned out to be lower than initially envisaged and the downside risks of the external environment did not materialize, the ready availability of liquid resources from the Fund contributed to maintain confidence in the soundness of Guatemala's financial system.

48. **The program's design was coherent and conditionality was appropriately focused, though it could have been stronger in some areas**. The program sought to address key vulnerabilities, and conditionality was focused on macroeconomic performance and strengthening financial stability. Data reporting and monitoring was also deemed adequate. Nevertheless, defining a medium-term fiscal anchor in terms of a numerical debt-to-GDP target could have helped in further strengthening the credibility of the fiscal stance, particularly if the more adverse scenarios envisaged in the program came to pass. A program ceiling on the accumulation of domestic arrears could have facilitated stricter adherence to fiscal targets.

49. **Despite strong implementation, lack of support by Congress precluded addressing key vulnerabilities which remain of concern**. Strong resistance by Congress hampered progress in tax reforms during the program period. As a result, prospects for strengthening revenues remain poor and Guatemala continues to have limited scope to increase social and infrastructure expenditure. Weaknesses in budgetary control also remain. On the financial sector, amendments to banking legislation and regulations were not approved, leaving the prudential and regulatory framework with important deficiencies. It is not clear, however, that additional outreach efforts by staff, particularly to the members of Congress, would have facilitated reaching a consensus for these reforms. More information at the SBA reviews on assessments of the supported social programs would also have been beneficial.

50. **TA recommendations have been used to underpin the policy framework**. While implementation of TA recommendations in key areas has been slow, the authorities have generally followed these recommendations in those areas where the policy environment has been strengthened.

Appendix I. Gauging the Appropriateness of the Fiscal Stimulus

While headline fiscal balances are useful for some purposes, they are generally poor indicators of the underlying fiscal stance as they include both discretionary measures (e.g., voluntary fiscal impulse in response to a crisis) and automatic stabilizers (due to the position in the business cycle). For this reason, the cyclically-adjusted balance (CAB), usually estimated by removing the cyclical component of revenue and expenditure, provides a more accurate indication of the underlying fiscal stance.[15] The year-to-year change in the CAB provides an estimate of the fiscal stimulus beyond the simple action of the automatic stabilizers.

- The economy's position in the cycle is ascertained by estimating the output gap, with the potential output derived using the Hodrick-Prescott (HP) filter on output data. A negative output gap indicates that the economy is in a downturn, and suggests that an expansionary stance may be appropriate.

- The cyclical component is estimated using the elasticity of revenue and expenditure with respect to the output gap. Typically, the revenue-to-GDP ratio is assumed to be independent of cyclical fluctuations (elasticity of 1), while the expenditure-to-GDP ratio is assumed to be fully correlated (elasticity of 0), because their level would generally be decided at the time of the budget approval, and thus independent of cyclical factors throughout the year. Specifically, in percent of GDP, the CAB is defined as:

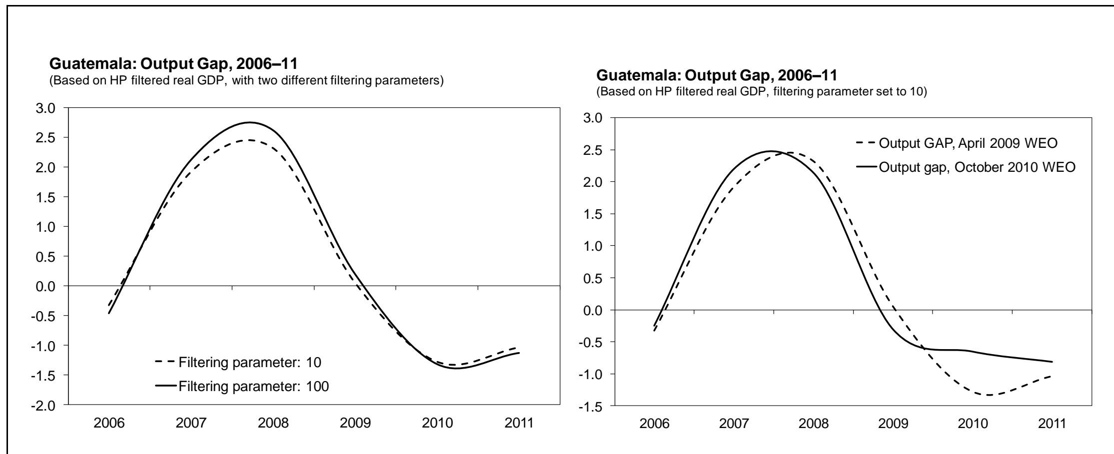
$$\text{CAB} = \text{Headline balance} + revenue(1-\varepsilon)gap - expenditure(1-\gamma)gap$$

where ε and υ are, respectively, the elasticity of revenue and expenditure to GDP, with ε=1 and υ=0 in the computations.

This methodology was applied alternately on the data available at the approval of Guatemala's SBA (April 2009 WEO) and the SBA's completion (October 2010 WEO).

The April 2009 WEO data revealed a decline in Guatemala's output gap in 2010—the output gap was estimated at near zero in 2009, and worsening in 2010 to about -1½ percent of potential GDP. In contrast, the comparable projections of real GDP growth indicated that real GDP growth was expected to be more sluggish in 2009 compared to 2010 (1 percent versus 1¾ percent), following a period of above-average growth in 2007–08. While the program anticipated fiscal tightening in 2010, the worsening output gap suggests that the fiscal stimulus could have been stronger in 2010 compared to 2009 or at least have been more balanced.

[15] This approach is explained by Annalisa Fedelino, Anna Ivanova, and Mark Horton "Computing Cyclically Adjusted Balances and Automatic Stabilizers" *IMF Fiscal Affairs Department Technical Notes and Manuals,* TNM/09/05 (November 2009).



The fiscal impulse calculated from the CAB indicates a different timing of the stimulus than is suggested by the program's headline fiscal balance (see the text table). The CAB estimated with the April 2009 data reveals a weaker impulse in 2009 than indicated by the program's headline balances and a larger withdrawal in 2010. The ex-post (October 2010) data, however, indicate a much stronger impulse in 2009, even compared to what the actual headline balance suggests, and a neutral fiscal stance in 2010. The ex-post data, therefore, suggest that the timing of the stimulus was more aligned with the evolution of the output gap. Nevertheless, the worse output gap in 2010 could have called for a stronger impulse.

Primary Balance, 2008–10

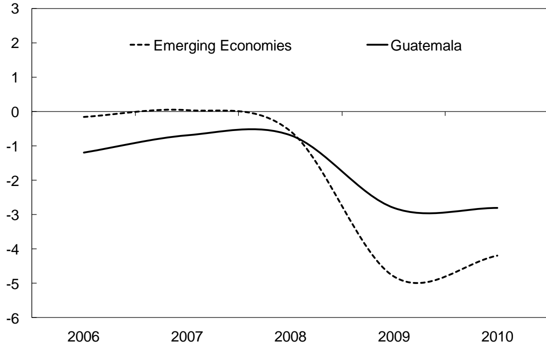
	2008	2009	2010
	(percent of GDP)		
Headline balance			
Program	-0.3	-1.2	-1.0
Actual	-0.3	-1.7	-1.8
Cyclically-adjusted balance			
Apr-09	-0.6	-1.2	-0.8
Fiscal impulse [1]	…	-0.6	0.4
Oct-10	-0.1	-1.7	-1.7
Fiscal impulse [1]	…	-1.6	0.0

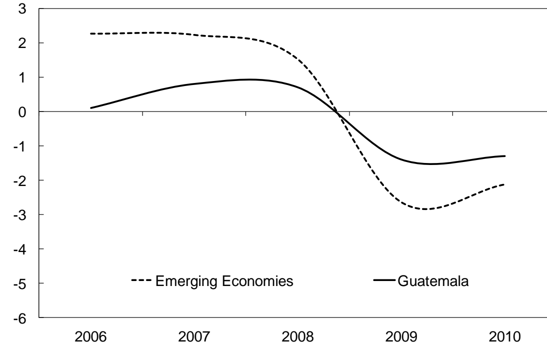
Source: Guatemala authorities, and IMF staff estimates.
[1] Change from the previous year (– = fiscal stimulus).

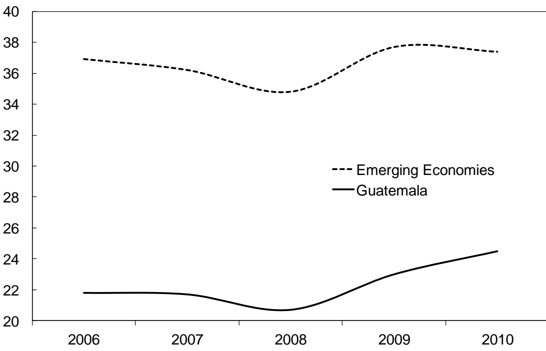
Any consideration of a larger stimulus would need to be weighed against other concerns. The authorities' record of good fiscal management, the relatively low levels of public sector debt, and the need for increased social and infrastructure expenditure would have favored a larger stimulus. However, other factors such as the political feasibility of the additional expenditures, constraints on critical resources, and the available fiscal space, which is limited by a low revenue-to-GDP ratio, weigh against further fiscal loosening.

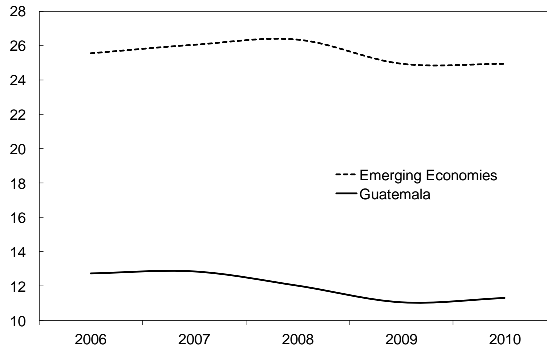
Compared to the emerging economies that are followed in the IMF's *Fiscal Monitor*, the stimulus provided in Guatemala was much less pronounced, despite a prudent fiscal policy prior to the crisis, and a debt-to-GDP ratio lower by about 15 percentage points. While a slightly higher stimulus could have been considered, however, the limited level of revenue warranted a prudent fiscal policy and an ambitious tax policy reform, aimed at providing over the medium term more fiscal space for both development expenditure and counter-cyclical policies. Despite Guatemala's recent low deficits and limited indebtedness, available fiscal space was limited by low revenues.

Guatemala—Fiscal Indicators Compared with Emerging Economies









Appendix II. Views of the Authorities[16]

The authorities assessed that the program was very successful and had achieved its objectives of safeguarding macroeconomic and financial stability. In signaling the Fund's support of the authorities' response to the global financial crisis, investor confidence was sustained, and the SBA had provided a cushion against possible risks from a worsening of the external environment. With the strong program implementation and relatively benign external environment, NIR increased substantially and the SBA remained precautionary. The authorities also noted some consequential benefits from the program—especially in facilitating closer coordination on economic policies between the ministry of finance and central bank, and the very useful recommendations in the context of the safeguards assessment update of the central bank.

The program design was largely appropriate in its focus on the authorities' immediate objectives, but access under the Flexible Credit Line (FCL) would have been preferred to the SBA. The parsimonious approach to conditionality, focused on macroeconomic performance and strengthening financial stability, was welcome. The program's structural conditionality incorporated the authorities' own proposals on tax reform, banking legislation and regulations, and the program's inclusion of the IT framework helped strengthen the credibility of monetary policy. However, while acknowledging that negotiations for the SBA were largely complete in March 2009 when the Fund introduced the FCL, the authorities regretted that the FCL was not available earlier as they would have requested it instead of an SBA. They were of the view that Guatemala would have met the FCL qualification criteria on account of its relatively strong economic fundamentals and track record of good economic performance, and they would have preferred not to have disbursements conditioned to performance criteria as under the SBA. In addition, they noted that the FCL would have helped distinguish Guatemala from other economies that were in crisis or needed stabilization packages supported by the SBA.

The authorities reiterated their commitment to the tax reforms and amendments to the banking laws that were not passed by Congress, and were optimistic that these laws would soon be passed. In hindsight, the strong political resistance to the proposed tax reforms revealed deep-seated sentiments requiring a systematic and more protracted campaign than was envisaged. Amendments to the banking law were also not passed, in part because Congress faced a heavy schedule and was more focused on the fiscal reforms since the risks in the financial sector had continued to abate. The authorities also acknowledged the accumulation of domestic arrears during the program, and noted that this was largely related to emergency expenditures at a time when the budget had not yet been approved.

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[16] The EPE team leader visited Guatemala during April 25–27, 2011, and held discussions with the Minister of Finance Rolando del Cid, the Central Bank President Edgar Barquin, the Intendente of Bank Supervision Eduardo Garrido, and other senior officials.

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IMF Executive Board Discusses the Ex Post Evaluation of Exceptional Access Under the 2009 Stand-By Arrangement for Guatemala

On September, 9, 2011, the Executive Board of the International Monetary Fund (IMF) discussed the Ex Post Evaluation of Exceptional Access Under the 2009 Stand-By Arrangement for Guatemala.[1]

Background

In mid-2008, Guatemala started to be affected by the deteriorating global economic environment, and its economic outlook was subject to large downside risks. Despite the substantial progress in consolidating macroeconomic stability that Guatemala had made in the years prior to the crisis, vulnerabilities remained. In addition, the external financing requirements for 2009 were projected to be large.

In these circumstances, in April 2009 the Guatemalan authorities requested a Stand-By Arrangement (SBA) with access of SDR 630.6 million (about US$990.2 million, 300 percent of quota), and substantially frontloaded. The program aimed at safeguarding macroeconomic and financial stability, anchoring investor confidence, and providing a cushion for the downside risks from a worsening of the external environment.

[1] The requirement for ex post evaluations (EPEs) was agreed by the IMF Executive Board in September 2002 for members using exceptional access in capital account crises, and extended to any use of exceptional access in February 2003. The aim of an EPE is to determine whether justifications presented at the outset of the individual program were consistent with IMF policies and to review performance under the program. To do this, EPEs seek to provide a critical and frank consideration of two key questions: (i) were the macroeconomic strategy, program design, and financing appropriate to address the challenges the member faced in line with IMF policy, including exceptional access policy?; and (ii) did outcomes under the program meet program objectives?

Executive Board Assessment

Executive Directors agreed with the conclusions of the Ex Post Evaluation of Exceptional Access under the 2009 SBA with Guatemala. They noted that the SBA was successful in mitigating the adverse impact of the global financial crisis, safeguarding macroeconomic and financial stability, anchoring investor confidence, and providing a cushion for the downside risks of a worsening external environment.

Directors recognized that the authorities' commitment to the program, the relatively strong implementation of policies, and an improved external environment had contributed to achieving the main objectives of the program. All quantitative performance criteria under the program were met and the planned reviews were completed on time.

Directors concurred that the financing strategy and program design were broadly appropriate, including program conditionality that focused on short-term macroeconomic and financial stability. They also noted that the program provided increased social spending for the most vulnerable segment of the population. Many Directors considered that additional conditionality targeting a revenue-generating tax reform, a medium-term fiscal anchor, and a ceiling on domestic arrears would have strengthened the fiscal framework.

Directors agreed that while program implementation was strong, including complying with conditionality in the financial sector, some important vulnerabilities were not addressed. These included low tax revenues, weak public financial management and budgetary procedures, and weaknesses in the financial system's prudential and regulatory frameworks. Directors concurred that reducing these vulnerabilities should continue to be key policy priorities.

Public Information Notices (PINs) form part of the IMF's efforts to promote transparency of the IMF's views and analysis of economic developments and policies. With the consent of the country (or countries) concerned, PINs are issued after Executive Board discussions of Article IV consultations with member countries, of its surveillance of developments at the regional level, of post-program monitoring, and of ex post assessments of member countries with longer-term program engagements. PINs are also issued after Executive Board discussions of general policy matters, unless otherwise decided by the Executive Board in a particular case.

Statement by Carlos Perez-Verdia, Executive Director for Guatemala
and Johny Gramajo-Marroquin, Alternate Executive Director
September 9, 2011

We would like to thank staff for their balanced paper and constructive dialogue with our authorities. We concur with the staff's main messages and would like to emphasize the following points:

1. We consider the 2009 Stand-By Arrangement a successful case for IMF's support during the global crisis. Although it is not feasible to observe outcomes had a program not been in place, we can ascertain that the program was successful in helping economic agents maintain confidence in the authorities' response to the crisis by increasing existing liquidity buffers and supporting macroeconomic policies aimed at preserving macroeconomic stability. In this sense, we believe that the program allowed Guatemala to take advantage of its strong fundamentals to moderate the negative effects stemming from the global crisis and preserve financial stability.

2. Evidence of the program's success is the fact that the SBA remained precautionary and on track and the financial system stayed strong with ample liquidity throughout.

3. We think the policy mix during the global crisis was adequate. A moderate fiscal impulse, given existing limited fiscal space, and a supportive monetary policy helped the country to face the economic slowdown while preserving the confidence of economic agents. This was one of the main factors that allowed Guatemala to be counted among the countries that did not experience a contraction in economic activity during the crisis. Surely, the effects of the crisis led to an important deceleration in credit and aggregate demand but significant external downside risks did not materialize and the economy began to recover gradually.

4. The authorities' proactive reaction before the intensification of the crisis by securing financing from external multilateral sources was not only appropriate to launch fiscal stimulus and prevent crowding-out of credit to the private sector, but it was also a commitment to limit the size of the fiscal stimulus. We would like to highlight that IMF's support during program discussions and the length of the SBA were instrumental to face the crisis successfully.

5. Monetary policy aimed at anchoring low inflation within an inflation targeting regime and a flexible exchange rate were crucial not only to help cushion the external shock, but also to support fiscal policy.

6. An ex post evaluation of the appropriateness of the stimulus is always likely to reveal weaknesses, but the duration and depth of the global crisis, almost impossible to anticipate, were important factors behind operational and political constraints given the immediate nature of the challenge. Fiscal deterioration was mainly related to a significant decrease in revenues and a slightly larger-than-envisaged increase in public expenditure to support vulnerable groups during the crisis.

7. We think streamlined conditionality in HAPAs allows member countries to achieve short-term goals more effectively. We have no doubt that the 2009 SBA helped Guatemala withstand the crisis more effectively than a traditional SBA would have had by providing substantial liquidity buffers and in that way effectively insuring the country against external risks. Having said this, we believe that more flexible instruments, for instance the Precautionary Credit Line, would have served the country better if available during the program discussion.

8. Although resolution of the 2006-2007 banking crisis was considered successful by several external experts (including the IMF), further strengthening of the regulatory and supervision framework, and improvements in the banking sector safety net and resolution framework, were appropriately envisaged in the program. As agreed under the program, the authorities prepared relevant draft laws that were submitted opportunely to Congress, but legislative approval was not obtained, for the reasons discussed in the staff report. In this context, we would like to underscore that a strong program ownership by authorities was constant throughout its lifespan.

9. Finally, provided the high level of uncertainty during the crisis and the IMF's financial toolkit available during program discussions, we believe the modality, design and implementation of the program were adequate to guarantee its success.