Statement by Mr. Moreno, Executive Director and Mr. Cartagena Guardado, Advisor to the Executive Director on Guatemala
June 9, 2021

On behalf of our Guatemalan authorities, we would like to thank Mrs. Perez Ruiz and her team for their open and candid discussions during the mission, their proactive engagement, and the comprehensive and well-balanced report. Our authorities broadly share the staff's assessment.

Background information

Guatemala has enjoyed a prolonged record of macroeconomic stability. Before the COVID-19 pandemic hit the country in 2020, Guatemala had built a strong economy, resilient to external and domestic shocks, underpinned by a prudent fiscal stance and a credible monetary policy. This was reflected by a steady economic growth of 3.5 percent between 1999-2019, stable exchange and interest rates, low and stable inflation (4.2 percent average between 2010-2020), low fiscal deficit (2.0 percent of GDP, average between 1999-2019), and a sound and liquid banking system. Guatemala's public debt levels have remained among the lowest shares of GDP in the Latin American region, also with the lowest weighted spreads (Averages December 2019: 182 basis points; December 2020: 184 bp; May 2020: 184 bp), according to the IMF's Sovereign Spread Monitor Report. Guatemala has also been addressing longstanding structural vulnerabilities, including fostering inclusion, reducing poverty, and addressing the informality of labor markets. These challenges have been tightened as a consequence of the pandemic.

The policy response to the pandemic

Guatemala adopted swift fiscal measures to protect human life and to reduce the negative impact caused by the pandemic shock. The fiscal impulse boosted by the authorities during the pandemic year elevated the fiscal deficit to 4.9 percent of GDP, one of the largest in the country's recent economic history. The countercyclical fiscal measures included family bonus for vulnerable households (1.0 percent of GDP), the employment protection fund (0.3 percent of GDP), working capital fund (0.4 percent of GDP) and a food support program (0.1 percent of GDP). According to Central Banks´ (Banguat) estimates, the economic contraction could have been 2.5 percentage points higher without these fiscal measures.

The fiscal impulse was accompanied by monetary easing, additional liquidity and debt relief in the financial sector. Given the extraordinary nature of the pandemic, and the need to swiftly support the financing needs, Banguat monetized part of the fiscal deficit in April 2020, following Congress' approval and invoking the extraordinary provision in Article 133 of the Constitution, given the fact that it is forbidden for the Central Bank to provide credit to the government. Banguat sterilized the monetary surpluses originated from the injection of primary liquidity to avoid pressure on the main macroeconomic prices. In the financial sector, the authorities introduced additional liquidity measures, such as flexibilization of the liquidity requirements for banks during the pandemic emergency and the easing of credit conditions, which helped keep the flow of resources to businesses and households and preserved the proper functioning of the payments system.

Outlook and policy priorities

Guatemala's economic contraction was one of the lowest in Latin America in 2020 and the authorities expect to restore GDP growth close to the pre-COVID average in 2021. The effective countercyclical measures have helped Guatemala to soften the economic impact of the crisis. In 2020, GDP growth has contracted by only 1.5 percent (the first negative GDP growth since 1983), which is the second lowest contraction among all the Latin American countries (according to last April´s WEO). In 2021, the authorities anticipate that the economy will reach a GDP growth above 3 percent (with a central scenario of 4 percent), which could improve up to 5 percent, depending on the acceleration of the vaccination process and the materialization of other upside risks. The authorities are projecting a positive trend in all economic sectors, which is being confirmed by the latest figures of short-term economic indicators, including the Monthly Index of Economic Activity, the Confidence Index Economic Activity, the high growth of family remittances, the higher external demand, and an increase in imports.

The slow vaccination process is one of the drivers of downside risks. With around 3.3 doses per 100 habitants up to Jun 1st, 2021, Guatemala is facing an important challenge vaccinating its population. The scarcity of supply is the main reason for the low vaccination rate. Although the government has contracted and preordered vaccines for a substantial share of the population, the supply received is considerably low. As many international instances have urged, it will be important that the international community make an additional effort to ensure a more equitable global vaccine distribution. On the positive side, COVID-19 contagion remains low following an effective policy on social distancing, use of facemasks, and cleaning protocol measures.

The authorities remain fully committed to ensuring fiscal stability and debt sustainability, as well as maintaining their good debt servicing track record. The fiscal deficit, that reached 4.9 percent of GDP in 2020 following the necessary countercyclical measures, is already expected to start a reducing trend from 2021, reaching levels closer to its historical average of 2 percent of GDP in the following years. The staff's debt analysis confirms the medium-term sustainability of debt levels, with the debt-to-GDP ratio increasing only by 5 percentage points in 2020, caused by the pandemic, up to 31.6 percent in 2020 (2019: 26.5 percent). The debt-to-GDP ratio is also expected to stabilize in the medium term at around 34 percent. Authorities concur that more progress is required on the revenue side, strengthening the capacity of the tax administration and gradually broadening the tax base to gain fiscal space to foster growth and reduce poverty over the medium term. Current efforts of the tax administration have prospered, and Guatemala is experiencing a double-digit increase in revenues, which can be associated not only to the economic recovery, but also with improvements in the tax administration.

Guatemala's monetary policy will remain accommodative as inflation remains under Banguat' s target. The monetary policy has been consistent with a policy mix to support the economy through the pandemic, while inflation has remained under the inflation target. The monetary policy´s interest rate was reduced to a historic low of 1.75 percent in June 2020 and has been kept at this level according to the last revision from May 26th. This policy rate is negative in real terms and well-below Guatemala's neutral interest rate. The monetary authorities will closely monitor inflation expectations as well as the balance of inflation risks steaming from both the external and domestic economic conditions. Inflation forecasts and expectations for the current year and the next, anticipate that inflation will remain within target (4.0% +/- 1 percentage point). The average inflation rate for this year (April 2021: 5.6 percent) shows the effect of both a comparison base effect and some supply shocks, particularly in transportation and food.

Temporary measures have helped to maintain exchange rate expectations more stable. Authorities concur that the international reserve accumulation mechanism is a transitory measure that has helped to keep exchange rate expectations stable and it has avoided abrupt capital outflows or reductions of external foreign currency financing. Building on the gains already achieved in the macroeconomic soundness, the authorities acknowledge that more progress towards greater exchange rate flexibility is needed. However, a gradual process is preferred as it fosters a competitive and transparent foreign exchange market. While the authorities concur that the current account surplus has been stronger than anticipated, they don't see a significant misalignment with fundamentals once temporary factors are accounted for. It has been boosted by the net current transfers, mainly family remittances, that have more than compensated for the deficit of the goods and services balance. Authorities expect the real exchange rate to depreciate as temporary strong remittance inflows normalize and terms of trade deteriorate.

The financial system remains resilient. Despite the challenges posed by the pandemic, the banking system has remained sound and has continued to finance the economic recovery. Credit to the private sector has increased (2020: 6.1 percent; May 20th, 2021: 5.0 percent), financed by the growth in customer deposits (2020: 15.4 percent; April 2021: 16.2 percent), which benefited from the easing of the monetary policy and the significant growth in family remittances (2020: 7.2 percent; May2021: 43.1 percent). The banking system maintains sound with solvency rates well above the regulatory levels (2020: 16.1 percent; April 2021: 16.4 percent; regulatory requirement: 10 percent), and sound profitability. (ROA April 2021: 1.6 percent and ROE: 16.6 percent). The liquidity of the banking system remains adequate.

Guatemala's authorities remain committed to strengthening the structural reforms on fiscal transparency and governance benefiting from the Fund's technical assistance. The authorities are also assessing policies to improve the business climate, address labor market informality and strengthen resilience to climate change.