Guatemala and the IMF

Press Release:

IMF Executive Board Concludes 2009 Article IV Consultation with Guatemala, January 20, 2010

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Guatemala: Letter of Intent

November 20, 2009

Letter of Intent

Guatemala City, November 20, 2009

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

Dear Mr. Strauss-Kahn:

1. The Stand-By Arrangement agreed in April 2009 continues to be implemented successfully. All end-September quantitative performance criteria have been met (Table 1). The targets on net international reserves and the overall deficit of the central government were met by a wide margin. Government deposits at the central bank were above the indicative target for end-September. Consumer price inflation stood at zero percent (year-over-year) as of end-September 2009, within the inner band agreed under the program.

2. The Guatemalan economy has been affected by the global crisis, but has proved to be more resilient than neighboring countries. Moderately countercyclical fiscal and monetary policies have helped mitigate the effects of the economic slowdown and protect the neediest segments of the population, while preserving macroeconomic and financial stability. At present, Guatemala's economy is recovering. Exports, remittances, and net private capital flows are stabilizing, and imports are picking up. We remain confident that economic growth will be moderately positive in 2009 and rise to within a range of 1.3 to 2.1 percent in 2010.

3. The proposed fiscal stance for the remainder of 2009 and 2010 strikes an appropriate balance between supporting domestic demand and keeping public debt dynamics in check. We are maintaining the target for the fiscal deficit of the central government in 2009 at 3.4 percent of GDP and aim for a deficit of about 3.0 percent of GDP in 2010. The deficit of the consolidated public sector is expected to reach 3.0 percent of GDP in 2009 and about 2.6 percent of GDP in 2010. The deficits will be partly financed from external sources, mainly from multilaterals.

4. We remain firmly committed to maintaining medium-term fiscal sustainability. While tax revenues may pick up in line with the economic recovery, we are aware that an additional effort is needed to reduce the fiscal deficit to pre-crisis levels and stabilize debt dynamics. Thus, to ensure an adequate provision of public goods, we will seek support to increase public revenues to gradually fulfill the goals of the 1996 Peace Accords.

5. As inflation and inflation expectations declined, the Monetary Board reduced the policy interest rate by an additional 25 basis points in September (275 basis points since end-2008) to 4.50 percent. We foresee a benign inflation outlook in the near term and have revised our inflation projections to below 1 percent by end-2009 and 4 percent by end-2010. The revised quarterly consultation bands for CPI inflation under the program are consistent with these

projections. Monetary policy will continue to focus on meeting the inflation target in the context of a flexible exchange rate regime. Intervention in the foreign exchange market will remain geared at smoothing out excessive volatility, while allowing for movements driven by fundamentals. We expect international reserves to remain at comfortable levels.

6. Our financial system has been resilient to the economic slowdown. We will continue strengthening the regulatory framework, including by finalizing new regulations on banks' liquidity management and foreign currency credit risk by end-December 2009, with their implementation beginning in the first quarter of 2010. We will maintain our close dialogue with Congress to seek approval of the amendments to the banking legislation in the first semester of 2010, which is at the core of our strategy to strengthen further the banking sector.

7. In light of this performance and our continued commitment to the program, we request completion of the second review under the Stand-By Arrangement. Our intention is to continue treating the arrangement as precautionary. To help avoid slowing down spending execution during the first semester of 2010, we request revising upwards the performance criterion on the overall fiscal deficit for end-March 2010. Given the inflation outlook, we also request lowering the inflation consultation bands for end-December 2009 and for end-March and end-June 2010. Moreover, since risks to the program have declined, we ask for program implementation to be monitored through semiannual reviews, while maintaining quarterly test dates and purchases. We also request bringing forward to February 15, 2010 the fourth purchase that becomes available subject to relevant conditions, including observance of end-December performance criteria. The quarterly performance criteria (including new performance criteria for June 2010), inflation consultation clause, and indicative targets under the program are set out in Table 1.

8. We believe that the policies set forth in this letter, which supplements our letter and the attached Memorandum of Economic and Financial Policies (MEFP) of April 13, 2009, as well as our letter of September 4, 2009, are adequate to meet the objectives of our economic program. We stand ready to take additional measures that may be needed for this purpose and will maintain the usual close and proactive policy dialogue with the Fund.

Sincerely yours,

/s/

Juan Alberto Fuentes Knight
Minister of Finance

/s/

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

Attachment

Table 1. Guatemala: Quantitative Performance Criteria, Indicative Targets, and Inflation Consultation Clause

	2009				2010					
	End-Sep		End-Dec		End-Mar		End-Jun		End-Sept	
	Prog. 4/	Actual	Prog. 4/	Proposed	Prog. 4/	Proposed	Prog. 4/	Proposed	Prog. 4/	Proposed
Performance Criteria (for end-Sept and end-Dec 2009, and end-Mar and end-Jun 2010; indicative targets otherwise)										
Overall balance of the central government, floor (millions of quetzales)	-7,700	-5,410	-10,600	-10,600	-2,500	-3,000	-4,100	-5,000	-7,600	-8,000
Net international reserves, floor (millions of US$)	4,200	4,792	4,000	4,000	4,000	4,000	4,000	4,000	4,000	4,000
Accumulation of external arrears 2/	0	0	0	0	0	0	0	0	0	0
Indicative Targets										
Central government deposits at Banguat, floor (millions of quetzales)	5,000	7,897	4,900	4,900	6,000	4,900	4,500	6,300	3,500	4,400
Consultation clause on inflation 3/										
Outer band, upper limit	3.0	3.0	5.5	3.8	7.5	6.5	8.5	7.5	8.5	7.5
Inner band, upper limit	2.0	2.0	4.5	2.8	6.5	5.5	7.5	6.5	7.5	6.5
Inner band, lower limit	-2.0	-2.0	0.5	-1.2	2.5	1.5	3.5	2.5	3.5	2.5
Outer band, lower limit	-3.0	-3.0	-0.5	-2.2	1.5	0.5	2.5	1.5	2.5	1.5

1/ Cumulative from end of preceding year.
2/ Continuous performance criterion.
3/ Deviations from the band's limits will trigger consultations with the Fund as indicated in the TMU.
4/ IMF Country Report No. 09/305.

Technical Memorandum of Understanding

1. **This technical memorandum of understanding (TMU) updates and replaces the TMU included in the IMF Board document for the April 2009 Stand-By Arrangement (IMF Country Report No. 09/143)**. It 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 (CG) 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;* (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; *and minus* (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 (Q800 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. Nonaccumulation 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.[1]

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 +/– 3 percentage points (outer band) are established around the projected 12-month rate of inflation in consumer prices (LOI Table 1). Inflation will be measured by the 12-month rate of change of the headline

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[1] 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.

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 weeks lag)

16. **The monthly consumer price index** will be sent with a lag of no more than 2 weeks.

17. **The Bank of Guatemala will send the following monthly information** with a lag of no more than 4 weeks:

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

(ii) Monthly accounts of the central bank.

(iii) Analysis of inflationary developments

(iv) Updated inflation projections by the Bank of Guatemala.

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

18. **The Ministry of Finance will send the following monthly information** with a lag of no more than 4 weeks:

(i) The overall balance of the central government as defined in paragraph 2.

(ii) Total central government revenue measured on a cash basis, and divided between tax revenue and nontax revenue, transfers and grants on the form the authorities have been providing to IMF staff 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).

(iii) 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.

(iv) 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.

(v) 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.

(vi) 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.