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June 7, 2020

**Statement by Mr. Villar and Mr. Tabora Munoz on Guatemala  
Executive Board Meeting  
June 10, 2020**

On behalf of our Guatemalan authorities, we would like to thank Mrs. Perez Ruiz and her team for their hard work and proactive engagement during the pandemic. Our authorities also thank the Board and Management for their prompt and effective attention to Guatemala's request for the Rapid Financing Instrument (RFI) which they plan to use to help mitigate the economic and social effects of the spread of COVID-19.

The Government is requesting emergency financing under the RFI of 100 percent of quota equivalent to SDR 428.6 million to support the swift response to the humanitarian, health, and socio-economic emergency and the policies adopted to mitigate the pandemic impact on the population and economy. Guatemala has not made use of Fund resources since the late 80's. The Authorities broadly agree with the staff assessment, and greatly value the IMF's technical and financial cooperation.

Guatemala has a sound track record of macroeconomic stability which has helped to build a strong economy resilient to different kind of shocks, both external and domestic, underpinned by a prudent fiscal stance and credible monetary policy reflected in steady rates of economic growth (around 3.5 percent during the last decade), stable exchange rate and interest rate, low and stable inflation, low fiscal deficit, a solid, solvent and liquid banking system, and the lowest level of public debt (at 26.6 percent of GDP) of the Central American region. Despite these robust economic fundamentals, the COVID-19 pandemic has inflicted a heavy toll on the economic and social situation, and it has the potential to curb the new government's efforts to foster inclusive growth and reduce poverty, as well as sharpen the structural vulnerabilities associated with food insecurity and malnutrition.

**Impact of COVID-19**

In this context, the Government of Guatemala took decisive measures to contain the spread of the virus in the country, implementing a steadfast and comprehensive policy response. With ample Congress support, the Government declared the State of Calamity on March 13<sup>th</sup>, and started implementation of the National Emergency and Economic Recovery Plan, comprising firm containment actions, targeted fiscal measures, monetary policy easing, expanded liquidity provision, and supportive prudential measures.

The first COVID-19 case in the country was reported on March 13, 2020. Considering the fragility of the health system, the authorities swiftly implemented a lockdown and other strong containment and mitigation measures, suspending non-essential activities and mass gatherings, closing the borders with neighbor countries, imposing a national curfew and a global travel ban, quarantining everyone entering the country, implementing physical distancing and sanitation protocols, and applying tight mobility restrictions. As of June 6, there are 6,485 COVID-19 reported cases, 216 deaths and 1053 already recovered. Testing and monitoring virus cases, particularly in rural areas, remain an important challenge, but health authorities are gradually increasing capacity. Transformation of some hospitals and health centers and construction of new quarantine facilities throughout the country to assist the population are also in progress.

Implementing the lockdown at an early stage of the virus outbreak was a timely and consistent decision, but it has taken a heavy toll on economic activity, particularly considering the fundamental role that the micro, small and medium-sized enterprises play in the economy. Containment measures have affected not only companies' revenues but also significant levels of employment and families' income given the high level of informality in the labor market (about 70 percent). To mitigate this economic impact, the authorities have devised a set of specific measures and policies aimed at helping the most vulnerable sectors.

Growth is projected to slow down to -2.0 percent in 2020, from a strong 3.8 percent observed in 2019. The economy is expected to be hit by negative external shocks through lower export growth, as economic conditions deteriorate in the main trade partners, remittances contraction mainly due to the high unemployment levels in the U.S., and a sharp decline in tourism revenues. The lockdown is also generating significant local disruptions in the supply and distribution chains, impacting negatively the economic activity. A gradual recovery is envisaged for the second half of the year, with a stronger rebound to 4.0 percent — above last decade average of 3.5 percent— in 2021, but significant downside risks remain. A protracted outbreak, with a prolonged impact on global growth and financial conditions,

would have severe health and social consequences, and it would also delay the recovery and affect the fiscal stance.

Initial estimates envisage the fiscal deficit will increase to -6.1 percent from -2.1 percent (Pre-COVID19), due to the largest fiscal stimulus on record in the country's recent economic history—Guatemala's fiscal deficit has not exceeded 2.0 percent of GDP on average in decades— Revenues could deteriorate by about 0.9 percent of GDP in the short term, mainly due to the economic recession and temporary mitigation measures, and additional COVID19-related spending needs are estimated at 3.1 percent of GDP in 2020. Inflation to May 2020 is at 1.8 percent (yoy), while the current account balance is envisaged to deteriorate from 2.4 percent of GDP in 2019—and from 1.5 percent of GDP envisaged Pre-COVID19—to -0.5 percent of GDP in 2020, mainly due to the fall in remittances and the collapse in tourism and exports which will be only partially offset by lower oil prices and imports reduction.

The unprecedented change in Guatemala's external position—almost 3.0 percent of GDP— together with higher financing needs in the public sector have opened a BOP financing need of 2.0 percent of GDP—about US\$1.5 billion—in 2020. This gap is to be financed by drawing on the RFI and additional financing from multilateral development banks of US\$489 million, thus preserving the reserve cushions. Authorities do not expect the exchange rate to be under pressure due to the pandemic, but they reaffirm their commitment to maintain a flexible exchange rate and act only to smooth volatility.

In 2020, debt-to-GDP ratio is projected to increase from 26.6 to 32.5 percent as a result of negative economic growth, increase in pandemic-related spending and loss of tax revenues. However, the Debt Sustainability Analysis shows that Guatemala remains at low risk of debt distress. The RFI represents only 0.8 percent of GDP, and the country's capacity to repay the Fund is not at risk. Guatemala has the lowest and most stable EMBI spread in the Central American region—353 b.p. at June 3— and its increase (100b.p.) during the last few months reflects a general trend in emerging economies rather than a country-specific situation. Authorities remain fully committed to pursue appropriate economic policies that ensure continued macroeconomic stability and debt sustainability as well as to maintaining the authorities' excellent track record of debt servicing.

The authorities concur with the Staff's overarching macroeconomic outlook on Guatemala and that, given the current circumstances, a very adverse prospective scenario for the remaining of this year is highly plausible. In this sense, remittances—which are one of

the main drivers of private consumption and household income— may be further reduced considering that economic activity in the U.S. (origin of more than 97 percent of remittances) may continue to deteriorate, affecting furthermore Guatemala’s future fiscal stance and external position.

## **Policy Response**

Measures are targeted to support the most vulnerable, and the efforts are concentrated on shoring up the fragile health system: delivering food and health supplies to needy families, providing risk bonus pay for healthcare personnel as well as temporary cash transfers to informal workers and SME’s. Temporary relief measures to support firms are also included, particularly expedited tax credit refunds, deferral of tax payments and social security contributions.

Despite a reduction in nonpriority current spending through budget reallocations to finance the provision of other public services, the authorities envisage a loosening in the fiscal stance by 4.0 percent of GDP in 2020 required to finance the National Emergency and Economic Recovery Plan and cover critical spending to mitigate the impact of the pandemic, as well as the loss of fiscal revenue associated with the decline in economic activity. The fiscal stimulus is estimated at 3.1 percent of GDP in 2020 covering among others: emergency healthcare expenditures (0.2 percent of GDP) and additional social spending, including direct cash transfers to the most vulnerable (1.2 percent of GDP), salary subsidies (0.3 percent of GDP), financing to SME’s (0.6 percent of GDP). The authorities plan to use the RFI resources as budget support for COVID-19 related spending.

Guatemala’s Government is strongly committed to swiftly return to the fiscal consolidation from 2021 onwards, the fiscal balance is expected to improve through a reduction in the deficit to 3.0 percent of GDP in 2021 and continue its gradual adjustment to reach the historic average (2 percent of GDP) in the following years. In that vein, the authorities recognize that more progress is required on the revenue side to strengthen capacity of the tax administration and gradually broaden the tax base. They continue fully committed to the revenue mobilization agenda that will increase fiscal space to foster growth and reduce poverty over the medium term.

The authorities are also implementing monetary and financial sector measures to provide liquidity and soften the impact of the COVID-19 pandemic, preserving the proper functioning of the payments systems while maintaining financial stability. Monetary policy

has maintained an adequate accommodative position through reductions in the monetary policy interest rate to a historic low of 2.0 percent. They have also designed and implemented temporary measures to increase liquidity levels in the financial system, both domestic and in foreign currency, knowing that in junctures like the current one the credit channels tend to be interrupted, just when companies and families need more financial support to weather the crisis.

Guatemala's Central Bank (BANGUAT) is firmly committed to sterilizing any monetary surplus that originates from said injection of primary liquidity in order to avoid pressure on the main macroeconomic prices—inflation, interest rates and the nominal exchange rate—and it is closely monitoring developments in order to adjust its monetary stance to secure price stability, if necessary. BANGUAT authorities consider that invoking the extraordinary constitutional provision to monetize the fiscal deficit, following Congress' approval as stated in Article 133 of the Constitution, should not be used on a recurring basis. BANGUAT is committed to contain the monetization of the fiscal deficit and seek alternative financing sources if more resources are needed. In that regard, BANGUAT and the Ministry of Public Finance (MINFIN) will maintain the historic close inter-institutional coordination to continue preserving macroeconomic stability and discipline on monetary and fiscal policies.

The Bank Superintendence (SIB) has temporarily eased credit risk regulations to alleviate the impact of the COVID-19 pandemic, sustaining economic activity while preserving financial stability using flexibility provided by the current regulatory and supervisory framework. Banks liquidity, Non-Performing Loans and capital adequacy are currently adequate. The authorities are closely monitoring the prudent, transparent and targeted implementation of these measures in line with best practices, and they are firmly committed to act to prevent any financial risk and moral hazard.

The authorities have taken measures to guarantee transparency and accountability of the emergency spending during the pandemic. They have already implemented the “State of Calamity Dashboard” for tracking and controlling all pandemic-related expenditure. They also adopted regulations to ensure that those expenditures are channeled through the electronic government procurement system (Guatecompras). MINFIN is fully committed to expeditiously publish quarterly reports on pandemic-related spending, and to carry out and publish an ex-post independent audit of the RFI-financed spending. In line with the IMF's safeguard policy, authorities are also committed to undergo a safeguards assessment of BANGUAT once the pandemic recedes.

The Guatemalan government is utterly committed to strengthen domestic institutions to foster the fight against corruption and enhance transparency and accountability. The Financial Intelligence Unit (IVE) continues strengthening its analytical capabilities to enforce the AML/CFT regulations.