FOR AGENDA

SM/83/76

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May 11, 1983

To: Members of the Executive Board

From: The Secretary

Subject: Guatemala - Staff Report for the 1983 Article IV Consultation

Attached for consideration by the Executive Directors is the staff report for the 1983 Article IV consultation with Guatemala, which will be brought to the agenda for discussion on a date to be announced.

If Executive Directors have technical or factual questions relating to this paper prior to the Board discussion, they should contact Mr. Elson, ext. 73811.

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INTERNATIONAL MONETARY FUND

GUATEMALA

Staff Report for the 1983 Article IV Consultation

Prepared by the Staff Representatives for the
1983 Article IV Consultation with Guatemala

Approved by Eduardo Wiesner and Manuel Guitian

May 10, 1983

I. Introduction

The 1983 Article IV consultation discussions with Guatemala were held in Guatemala City during the period February 24-March 10, and in Washington, D.C. during the week of April 11-15, 1983.1/ The representatives of Guatemala included the Ministers of Finance, Economy, and Agriculture, the Executive Secretary of the National Planning Office (CONAPLAN), the President of the Bank of Guatemala and other senior officials of the Central Government, the Bank of Guatemala, and the rest of the public sector. The staff representatives were R. A. Elson (Head), C. Cha and C. de Rosa (all WHD), S. Lurie (STAT), and M. Fawcett (Secretary-ERD); Mr. Y. Baran (IBRD) accompanied the mission. Mr. S. Conrado, Advisor to the Executive Director for Guatemala, participated in some of the meetings.

II. Recent Developments and Performance Under Under the Last Stand-By Arrangement

During the three-year period through 1981, the economic and financial situation of Guatemala deteriorated sharply because of an adverse turn in its terms of trade, mounting political tension in the Central American region, and expansionary demand policies. The rate of economic growth decelerated significantly, and large external imbalances emerged which drained the net international reserves of the Bank of Guatemala by over US$300 million in both 1980 and 1981. During this period, fiscal policy was particularly expansionary, as the overall deficit on central government operations rose from 1 per cent of GDP to 7-1/2 per cent of GDP, reflecting both a decline in revenues (as a ratio to GDP) and a sharp increase in development expenditures (Table 1). The bulk of these deficits was financed by central bank credit.

1/ Guatemala has accepted the obligations of Article VIII, Sections 2, 3, and 4 of the Fund Agreement.

Table 1. Guatemala: Selected Economic Indicators

	1978	1979	1980	1981	SBA 1982	Est. 1982	Proj. 1983
I. National Accounts							
(Percentage change)							
Nominal GDP	10.8	13.7	14.1	9.9	14.0	2.7	4.3
Real GDP	5.0	4.7	3.7	0.9	2.5	-3.5	-2.3
GDP deflator	5.5	8.6	10.0	8.9	11.2	6.5	6.8
II. Savings and Investment							
(As a per cent of GDP)							
Investment	21.6	18.7	15.9	17.4	17.0	15.7	14.9
External savings	6.0	4.4	3.0	6.6	4.6	3.6	1.7
Domestic savings	15.6	14.3	12.9	10.8	12.4	12.1	13.2
Of which: public sector	(4.1)	(3.1)	(2.2)	(1.1)	(3.9)	(1.3)	(2.0)
III. Balance of Payments							
(As a per cent of GDP)							
Current account balance	-4.3	-2.6	-2.2	-6.5	-4.6	-4.2	-3.3
Net private capital	3.9	0.2	-3.6	-0.1	0.6	-3.2	—
Net official capital	1.5	1.8	1.2	1.2	2.5	0.9	1.2
Net financial capital	0.1	0.2	0.5	1.4	1.0	2.1	2.0
Overall balance	1.2	-0.4	-4.0	-4.0	-0.5	-4.4	—
IV. Central Government Operations							
(As a per cent of GDP)							
Revenue	11.0	9.7	9.5	8.6	8.9	8.2	8.1
Current expenditure	7.7	7.7	8.3	8.4	7.4	7.9	7.6
Savings	3.2	2.0	1.2	0.2	1.5	0.3	0.5
Capital expenditure and net lending	4.4	4.6	5.9	7.5	5.7	5.3	4.2
Overall deficit	-1.1	-2.6	-4.7	-7.4	-4.2	-5.0	-3.7
Net external financing	1.5	1.6	1.2	1.2	2.2	0.9	1.1
Net internal financing	-0.4	1.0	3.5	6.2	2.0	4.1	2.6
V. Banking System							
(Percentage change)							
Net domestic assets	17.5	16.7	45.5	40.8	20.3	18.6	...
Credit to private sector	25.5	20.2	22.5	12.2	16.2	7.1	...
Liabilities to private sector	14.9	7.4	9.8	12.4	14.5	14.2	...

Sources: Staff report on recent economic developments; and Fund staff estimates.

At the same time, monetary policy was relaxed through reductions in legal reserve requirements and increases in central bank rediscounts, while the banks experienced a decline in the rate of their deposit growth. Thus, the expansion in net domestic credit of the banking system accelerated to a rate in excess of 40 per cent in 1981, whereas the growth of private sector savings channeled through the domestic banking system decelerated to around 10 per cent. Both an erosion of private sector confidence and uncompetitive interest rates discouraged the growth of domestic financial savings. During the period 1978-81, when deposit rates in the Eurodollar market rose from an annual average of around 9 per cent to 16-1/2 per cent, the legal maximum deposit rate in Guatemala was maintained at 9 per cent.

In response to large private capital outflows and the attendant decline in net official international reserves which began in mid-1979, the monetary authorities established exchange controls in early 1980 to restrict private capital transactions and transfers of capital disguised as current transactions. Despite these controls, the overall balance of payments deficit rose from US$27 million in 1979 to around US$320 million in 1980. In 1981, a deficit of similar magnitude was registered; short-term private capital outflows continued and a sharp deterioration occurred in the current account balance on account of a decline in coffee and mineral exports and a sharp growth in imports of goods and nonfactor services.

To check the deterioration in Guatemala's financial performance, the authorities framed an adjustment program for 1982 which was supported by a one-year stand-by arrangement in the first credit tranche.1/ The main objective of the program was to hold the loss in net official international reserves in 1982 to no more than US$50 million. This objective was to be achieved by restrained monetary and fiscal policies, accompanied by an increase in domestic interest rates. The program also envisaged larger recourse to medium-term foreign borrowing to finance the public investment program. The overall deficit of the Central Government was to be reduced to about 4 per cent of GDP; together with an increase in foreign financing, this reduction would have allowed for a decline in net central bank financing of the Central Government's deficit of more than 1-1/2 per cent of GDP. The rate of growth of the net domestic assets of the Bank of Guatemala also was to be reduced through a cutback in its net credit accommodation of the rest of the banking system, a cutback expected to be compensated by the impact of an upward adjustment of domestic interest rates on the growth of deposits in the banks.

1/ The starting point of the financial program was early October 1981, and the stand-by arrangement was approved by the Fund's Executive Board in mid-November 1981, along with a request for a purchase under the compensatory financing facility equivalent to 100 per cent of Guatemala's quota (EBS/81/212 and 213).

Performance under the program was mixed. Contrary to program assumptions, exports fell in 1982 for the second consecutive year, and real economic activity declined by an estimated 3-1/2 per cent, instead of a projected growth of 2-1/2 per cent. The drop in exports in 1982 was related to lower prices and volumes of cotton and sugar exports, as well as a substantial decline in exports of manufactures reflecting weak regional and international demand. This export performance, as well as a significant reduction in public investment, were the main factors which accounted for the decline in economic activity last year.

By contrast, price performance was better than expected in 1982, as domestic prices (measured by the GDP deflator) rose by around 6-1/2 per cent, compared with a program projection of 11 per cent; according to the consumer price index, there was no change in the domestic price level in 1982, but this result may be biased by certain defects in the cost of living index which is in the process of revision.1/ Foreign inflation turned out to be lower than projected, but domestic factors also played a role in the deceleration in the rate of inflation last year. There was a large production of basic grains in 1981/82 and local electricity tariffs were lowered early in 1982 in connection with the substitution of new hydroelectric power for thermal sources. At the same time, weak internal demand put downward pressure on rents, while a decline in foreign demand may have led to an excess supply of certain manufactured goods in the domestic market.

The weakness of the domestic and foreign sectors of the economy affected government revenue in 1982. Central government revenues declined from 8-1/2 per cent of GDP in 1981 to 8 per cent of GDP in 1982 (compared with a program target of nearly 9 per cent), mainly because of a decline in customs duties and petroleum taxes along with sluggish growth in income and sales taxes. To a large extent, however, this shortfall in revenues was offset by a cutback in government expenditures, with the result that the overall deficit on central government operations turned out to be very close to the target, although it was somewhat higher in relation to GDP than in the program because of the weaker GDP.

Total government expenditures in 1982 were 17 per cent below the level in 1981 as a result of cutbacks in both current and capital spending. In accordance with decisions taken in April 1982, current expenditure was held to a level 10 per cent below the 1982 budget, mainly through a freeze in government salaries, reductions in personnel, and cuts in budget allocations for goods and services. In the area of capital expenditures, substantial cuts were made in the context of a major revision of the public investment program. Some projects were scaled down, others were postponed pending the arrangement of suitable external financing, and still others were eliminated altogether for lack of strong economic justification. As a result of these efforts, investment spending of the Central Government (including capital transfers to the

1/ For more details, see the report on recent economic developments.

rest of the public sector) was reduced by the equivalent of some 2 per cent of GDP in 1982. All in all, total government outlays declined from 16 per cent of GDP in 1981 to 13 per cent of GDP in 1982.

Although the overall fiscal deficit was in line with program projections, the share of the deficit financed with domestic bank resources was well in excess of the program targets because of a shortfall in external financing. Net domestic bank credit to the Central Government increased by Q 320 million in 1982, compared with a program target of Q 200 million. Despite this excess, the growth in total banking system credit was in line with program projections because of a much weaker than expected expansion in credit to the private sector associated with the sharp downturn in business activity last year. Private sector deposits in the banking system increased strongly last year, despite the deceleration in the growth of national income, but a substantial share of this growth may have reflected the accumulation of payments arrears for foreign commercial transactions. Some of the growth in the banks' resources may have also been due to an increase in deposit rates last year. In October 1981 the authorities raised the legal ceilings on loan and deposit rates by 4 percentage points to 15 per cent and 13 per cent, respectively. However, effective deposit rates in the commercial banking system rose by only around 2 percentage points last year, in part because of certain legal rigidities in the interest rate structure which prevented the banks from increasing interest rates on existing loan contracts.

In the external sector, the objective for net official international reserves was achieved in 1982 (i.e., a decline of no more than US$50 million), but not without an intensification of exchange restrictions, the imposition of import controls and a large accumulation of payments arrears. Despite a decline in exports, the current account deficit declined from 6-1/2 per cent of GDP in 1981 to about 4 per cent of GDP last year, compared with 4-1/2 per cent in the program, because of a large contraction of imports. The decline of imports in 1982 can be associated with the decline in real economic activity, but it also reflected the policy of foreign exchange rationing applied by the Bank of Guatemala during the year which was formalized into a system of import quotas in November 1982.

The buildup of payments arrears in 1982--estimated at US$344 million--was precipitated by a large net outflow of private capital. This outflow can be explained primarily as a repayment of foreign commercial lines of credit which reflected, in part, a hardening of credit terms by foreign banks and suppliers and, in part, a speculative move on the part of local importers and manufacturers induced by fears of a devaluation of the quetzal last year. The accumulation of arrears in 1982 also reflected the near-exhaustion of Guatemala's gross liquid foreign reserves, as the Bank of Guatemala accumulated substantial nonliquid claims on other members of the Central American Common Market which were unable to pay for Guatemalan exports because of their own weak financial position.

III. Report on Discussions

In view of the difficult balance of payments position of Guatemala, the Article IV consultation discussions stressed the issues of short-run stabilization policy. The economic measures taken since the expiration of the stand-by arrangement in November 1982 were assessed, and new policy initiatives to be developed in the framework of an adjustment program covering 1983 and 1984 were explored. In the latter connection, the Guatemalan authorities made known their intention to request later this year the use of Fund resources under a stand-by arrangement which would extend through the end of 1984. In these discussions, the Guatemalan authorities emphasized both the reform aspects of their policy program, as well as the adjustment effort involved.

1. External sector policies

The most immediate concern of the authorities at the present time is the elimination of the payments arrears accumulated during 1982. Since November 1982 the authorities have been negotiating with domestic importers and foreign suppliers specific terms for the liquidation of these arrears. According to present plans, about two thirds of the arrearage would be settled during the balance of this year and in 1984, mostly in the form of cash payments, but also through refinancing arrangements with foreign commercial banks. In an effort to verify as accurately as possible the true extent of payments arrears, the Guatemalan authorities agreed with the staff on the need to establish a domestic currency deposit in the Bank of Guatemala as a guarantee against exchange requests pending authorization. Such deposits would also provide a means of monitoring the orderly payment of any arrears that may arise in the future. In exchange for the local currency counterpart of the external arrears, importers would receive government bonds from the portfolio of the Bank of Guatemala which bear interest at an annual rate of 8 per cent, and are convertible into U.S. dollars at the existing official exchange rate (US$1 = Q 1).

In an effort to minimize the accumulation of payments arrears in the future, the authorities introduced an import quota system in November 1982. This system, which was established temporarily for the remainder of 1982 and for 1983, is designed to link the authorization of exchange for import payments more closely with the authorization of permits for essential imports. Imports under the system have been classified into six different categories of essentiality for which quotas ranging from 20 per cent to 100 per cent of the value of imports in 1981 will be granted. Imports from the Central American region and those paid for with foreign credits or with foreign exchange held by an importer abroad are exempt from the system.

The authorities recognized the distortions which import quotas create and confirmed their intention to begin to phase them out during the period of their adjustment program, i.e., before the end of 1984.

One possible device under consideration which would facilitate the elimination of these restrictions is the substitution of temporary import surcharges for import quotas. Such surcharges would involve fewer distortions than quantitative restrictions if they were set at fairly uniform rates, and would have the added advantage of strengthening government revenues at a time when a larger tax effort was needed.

The imposition of import quotas last year was accompanied by an intensification of existing exchange restrictions. In November 1982 the authorities reduced the limits for exchange payments in respect of tourist travel and study abroad, and increased the deposit requirement for exchange requests for tourist expenditures from 25 per cent to 50 per cent. Limits for family remittances and other personal services remained unchanged. When these limits were first introduced in April 1980, they were deemed not to constitute exchange restrictions within the meaning of Article VIII of the Fund Agreement because the limits were applied flexibly and were considered ample enough to cover legitimate requests. Subsequently, when the limits were lowered in September 1981, the authorities introduced a bona fide clause in their regulations which allowed for exceptions to the stipulated limits in duly authenticated requests. However, in practice this bona fide clause has not been applied and thus the following restrictions on payments and transfers for current international transactions exist: (1) a system of quotas for import payments; (2) a deposit requirement for foreign exchange requests related to tourist travel abroad; (3) limits on tourist expenditures abroad; (4) limits on student expenditures abroad; (5) limits on family remittances abroad; (6) limits on the remittance of earnings in Guatemala of Guatemalan residents abroad; (7) limits on the remittance abroad of earnings of foreign workers in Guatemala; and (8) arrears on payments and transfers for current international transactions.1/ The Guatemalan authorities confirmed that the exchange control regime continues to be a temporary measure which they intend to remove as soon as conditions permit.

Despite the recent deterioration in the balance of payments position of Guatemala and the resort to exchange and trade restrictions, the authorities expressed their strong intent to maintain the existing parity of the quetzal (US$1 = Q 1) which has remained unchanged for nearly 60 years. It was recognized that the quetzal has experienced overvaluation since 1980 because of the strong appreciation of the U.S. dollar and the emergence of an illegal parallel market where the dollar is selling at a premium over the official rate of 20 per cent to 30 per cent.2/ In the authorities' view, however, the maintenance of the existing parity is essential to internal financial discipline. Except

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1/ A fuller description of the exchange and trade system is provided in Appendix B of the staff report on recent economic developments.

2/ The trade-weighted effective exchange rate, adjusted for price changes in Guatemala and abroad, appreciated by 10 per cent in 1981 and by 2-1/2 per cent in 1982, but these changes were preceded by a period of four years in which the real effective exchange rate depreciated by 8 per cent (Appendix I).

in very recent years, Guatemala's financial policies have been restrained, and there was a clear determination expressed on the part of the authorities to return to that standard. The authorities also pointed to the substantial reduction in Guatemala's rate of inflation last year and the absence of strong pressures on domestic labor costs as further justification for maintaining the existing parity with the U.S. dollar.

The staff representatives noted that the recent performance of exports appeared to cast some doubt on the adequacy of the exchange rate. Cotton is one export crop which apparently has problems of competitiveness; however, other factors such as the deterioration in the Central American regional market, the limitations of international commodity arrangements (e.g., coffee and sugar) and the recession in the industrial countries were viewed by the authorities as more powerful influences on recent export performance than the exchange rate. Nevertheless, the Guatemalan authorities were reinforcing their policy of export promotion; they pointed to efforts under way by the Guatemalan Export Promotion Agency (GUATEXPRO) to establish new markets outside Central America for Guatemalan agricultural and industrial exports, and they noted that in September 1982 a new export incentive law was promulgated which grants tax exemptions to firms whose exports have a high content of domestic value added.

Over the medium term, the authorities projected the current account deficit of the balance of payments to stabilize at around 3-4 per cent of GDP. Even in the absence of a recovery of foreign private capital inflows, net long-term official external borrowing equivalent to 3 per cent of GDP was not viewed as a problem in view of the country's relatively low debt burden. At the end of 1982, Guatemala's external public debt of one-year maturity or more amounted to US$1.2 billion, or the equivalent of 13-1/2 per cent of GDP. As of the same date, the service payments on this debt amounted to about 1 per cent of GDP, or 8-1/2 per cent of exports of goods and nonfactor services. The authorities pointed out that they would like to increase the share of external financing in their public investment program over the next four years (1983-86) which could lead to a more than doubling of the outstanding external public debt by the end of the period. Such a level was projected to be the equivalent of 24 per cent of GDP at the end of 1986, and the service payments on the debt were projected to be equivalent to 2-1/2 per cent of GDP, or around 15 per cent of exports of goods and nonfactor services.

2. Fiscal policy

The Government's fiscal policy will be focused mainly on a further compression of the overall public sector deficit. Primary emphasis in this effort will be given to expenditure restraint, but the authorities also indicated their intention to raise revenues through a strengthening of tax administration and the introduction of new tax measures.

The 1983 budget calls for expenditures of Q 1,243 million, or a level about 9 per cent above the actual outcome for 1982. Most of this increase, however, is explained by higher budget outlays for interest payments on domestic bonded debt. Capital expenditures were budgeted at virtually the same level as in 1982. In view of a projected growth in revenues, which is roughly in line with the expected rate of price increase, the overall deficit implicit in the original budget for 1983 is Q 474 million, a level somewhat higher than that registered in 1982, but about the same ratio to GDP as last year (i.e., 5 per cent). About two thirds of the overall budget deficit would be financed by the net placement of domestic bonds, mostly with the banking system. Such an increase in net credit of the banking system to the Central Government would be roughly similar to that of last year.

The authorities indicated that decisions had recently been taken to reduce government expenditures below the budgeted amounts, in similar fashion as last year. Total expenditures would be limited this year to a target of around Q 1,100 million, compared with Q 1,172 million in 1982 and a budgeted amount of Q 1,243 million. Current expenditures would be held to nearly the same level as last year, whereas capital expenditures would be constrained to less than Q 400 million, compared with Q 450 million in 1982 and Q 622 million in 1981. In the area of current expenditure, the authorities pointed out that the policy of the Government was to continue a freeze of government salaries at last year's level and to reduce outlays for other goods and services by 10 per cent. This policy was expected to yield budgetary savings amounting to Q 90 million, or about 1 per cent of GDP. In the area of capital expenditures, no new projects are being initiated, while certain projects in the hydroelectric field will be winding down or postponed.

In the field of tax policy, the authorities recognized that a serious erosion in the tax effort had occurred in the last four years, as government revenues fell from 11 per cent of GDP in 1978 to 8 per cent in 1982. Essentially, the lack of buoyancy of the tax system can be explained by its heavy dependence on specific tax rates and taxes on foreign trade. In an effort to remedy this situation, the authorities are contemplating a number of important changes in the tax system. First, the specific base of certain selective excise taxes will be changed to an ad valorem basis. Second, selective consumption duties, ranging up to a maximum of 60 per cent, will be introduced on certain luxury items. Thirdly, improvements in tax administration, affecting the property tax, the sales (stamp) tax, and customs duties were being introduced. These changes, which are expected to be implemented before midyear, are projected to yield at least Q 50 million during the remainder of the year, or about 1/2 per cent of GDP. The authorities have also announced that they intend to introduce during the second half of the year a new value-added tax (VAT) which would replace the existing stamp tax which is a cascade-type turnover tax. The intention of this reform is not only to replace the yield of the stamp tax with that of the VAT, but also to improve the buoyancy of the tax system in the future. The measures just described are expected to maintain the ratio of government revenues to GDP this year at the same level as last year after four years of decline and would raise the tax ratio to around 9 per cent in 1984.

The result of the expenditure and tax policies outlined by the authorities was expected to be a reduction in the overall deficit on central government operations from Q 442 million, or 5 per cent of GDP in 1982, to around Q 345 million, or 3-1/2 per cent of GDP in 1983. A further reduction in the fiscal deficit was expected in 1984. The share of the deficit financed with domestic bank resources in 1983 was projected at Q 240 million, or about 2-1/2 per cent of projected GDP.

As regards the rest of the public sector, the authorities confirmed their intention to maintain a policy whereby the combined operations of the rest of the general government and the nonfinancial public enterprises would be in overall equilibrium, or yield a small surplus. In this connection, they pointed to efforts under way to cut costs and current outlays throughout the public sector, in line with the directives issued by the Government since early last year. Also, tariffs of the major public enterprises, such as the Electricity Authority (INDE) and the Telecommunications Enterprise (GUATEL), were being reviewed to determine whether price increases were justified.

3. Monetary policy

The domestic financing requirements of the fiscal deficit have complicated the conduct of monetary policy in recent years. Domestic bank credit expansion to the public sector, mainly from the Bank of Guatemala rose to a peak of 5-1/2 per cent of GDP in 1981, and then declined to 3-1/2 per cent of GDP in 1982. During 1983 the authorities anticipated a further reduction in the net financing of the public sector by the Bank of Guatemala, but an increase in its net accommodation of the rest of the banking system. But overall credit policy would be geared to the goal of overall balance of payments equilibrium.

The increase in net central bank credit expansion to the rest of the banking system would result both from the drawdown of excess liquidity in the banking system to constitute deposits against external payments arrears and from the need by the private sector to refinance its indebtedness with the banking system because of the weak financial situation of many enterprises. In view of the depressed state of private sector economic activity, especially in the agricultural sector, the authorities noted that there was substantial political pressure on the Government to declare a general debt moratorium in the banking system. However, they confirmed that the Government's policy was to have the banks deal with their clients on a case-by-case basis without government intervention. Nonetheless, because of the difficult financial condition of many businesses, it was possible that some banks would not be able to repay their lines of credit to the Bank of Guatemala. In December

1982 a special rediscount line of Q 50 million was established to help the banks in refinancing certain credits in the agricultural and manufacturing sectors which needed to be extended.

The authorities regard the present levels of interest rates in Guatemala as adequate. They felt that the reduction in the interest ceilings by 3 percentage points for bank loans, and by 4 percentage points for bank deposits, in November 1982 was justified in the light of the downward trend in foreign interest rates and the significant deceleration in the domestic rate of inflation last year. In view of the outlook for inflation (around 6 per cent for 1983), it was pointed out that all lending rates and most deposit rates in the banking system are now positive in real terms.

The authorities recognized, however, that the structure of interest rates was excessively rigid, as evidenced by the sluggish response of domestic bank interest rates to the increase in interest rate ceilings in October 1981. According to the Central Bank Law (Article 101), any increase in maximum lending rates can only be applied to new loans which limits the ability of the banks to raise their deposit rates. The authorities intend to introduce a provision in the law to allow for floating rate contracts in the context of a general reform of the banking laws to bring about more interest rate flexibility. They also are considering the elimination of the application of the stamp tax to bank credits in the context of the tax reform described earlier, so as to reduce the distortion which this tax creates in the existing interest rate structure.

IV. Staff Appraisal

During the last four years, Guatemala's external position weakened considerably due to a combination of external and internal factors. Political uncertainty in the Central American region eroded confidence both within and outside Guatemala resulting in massive capital flight. At the same time, the world recession, declining terms of trade, and the weakening of the regional economy severely affected Guatemala's exports. On the domestic side, expansionary fiscal and monetary policies, especially in 1980 and 1981, contributed to the deterioration in the balance of payments. The combined result of these factors was a decline in the net official international reserves of over US$600 million and a deceleration in the rate of real economic growth to less than 1 per cent during 1980 and 1981.

During 1982 the Guatemalan authorities implemented an adjustment program which was supported by the Fund with a stand-by arrangement in the first credit tranche. Government expenditures, both current and capital, were cut in nominal terms, in order to reduce the overall fiscal deficit and the amount of financing required by the Bank of Guatemala. Also, domestic interest rate ceilings were raised significantly in an effort to encourage a greater retention of private savings in the domestic banking system and thereby reduce the reliance of the banks on the Bank of Guatemala for refinancing. Despite the continued deterioration in foreign trade and domestic economic activity, some of the main elements of the program were observed. The overall fiscal deficit was reduced by more than 2 percentage points of GDP, after four years of steady increase. Net bank credit expansion to the public sector was larger than programed last year, in part because of a shortfall in external financing, but overall bank credit expansion was within the program targets because private sector credit demand was much weaker than anticipated. The sharp slowdown in the growth of overall credit of the banking system during 1982 was reflected in a small loss of net international reserves of the Bank of Guatemala. However, exchange restrictions were intensified last year, and large payments arrears were accumulated.

This year the Guatemalan authorities have been reinforcing their adjustment effort, mainly by a further strengthening of the public finances. Overall government expenditures will be reduced in nominal terms, for the second year in a row, and new revenue measures will be put into place, including the establishment of a value-added tax to replace the existing stamp tax. The staff welcomes this initiative and believes that the additional tax effort can contribute importantly to both short-run stabilization objectives and a sound execution of the public investment program.

The fiscal program of the authorities is expected to allow for a significant reduction in net bank credit expansion to the public sector. The rate of increase in overall bank credit also is to be reduced consistent with the goal of equilibrium in the overall balance of payments and a significant reduction in payments arrears. Domestic interest rates have been lowered in line with a reduction in the rate of inflation in Guatemala and interest rate levels abroad. However, the staff would encourage the authorities to take steps to allow more flexibility in interest rate movements and to phase out the distortion in the interest rate structure created by the application of the stamp tax to loans of the banking system.

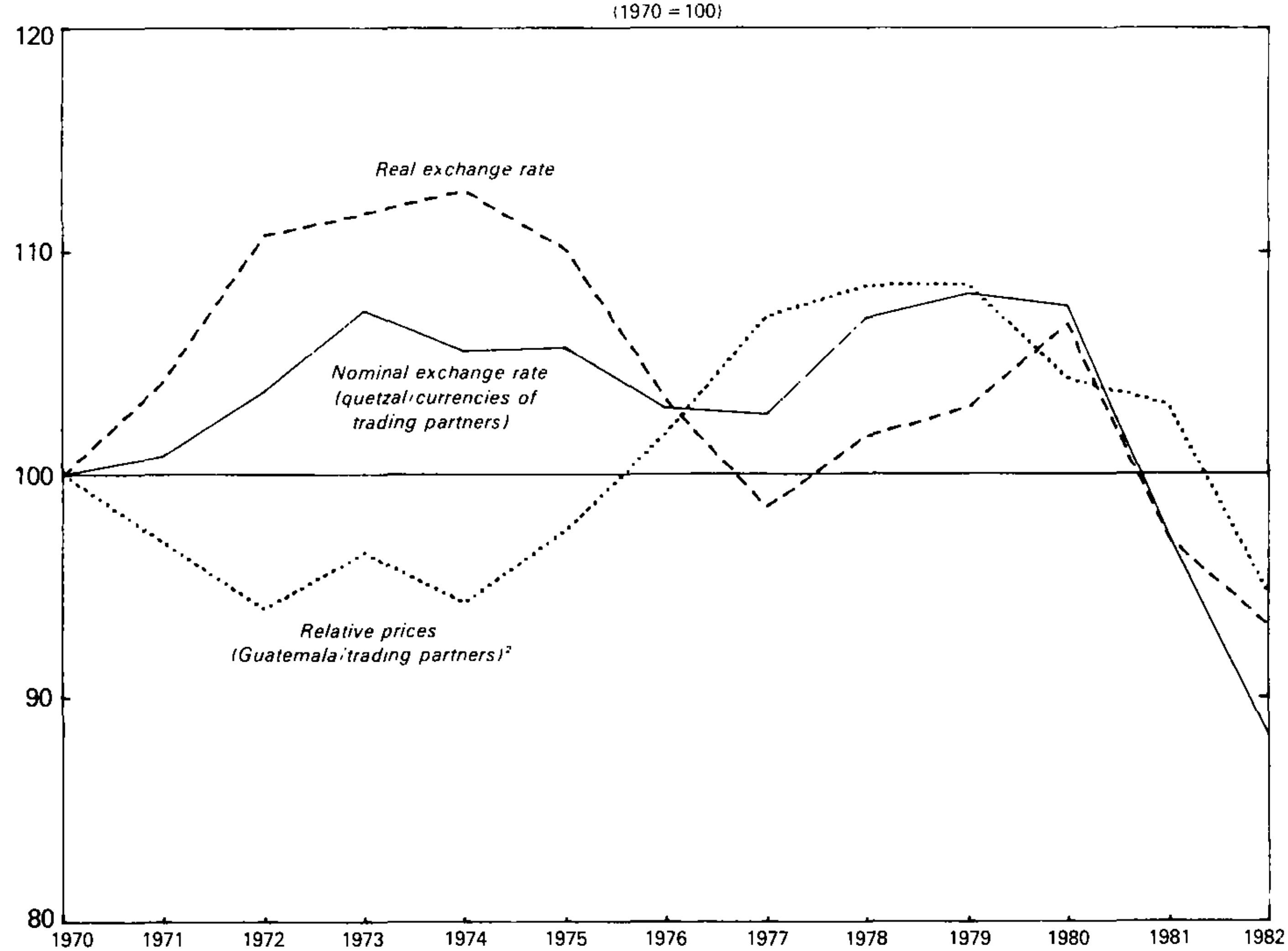
On the external side, the staff believes that overall balance of payments equilibrium is an appropriate target for the medium-term, but in the immediate future, the elimination of payments arrears is a necessary condition for the restoration of Guatemala's external credit standing. These objectives are all the more necessary because of the Government's decision to maintain the existing parity of the quetzal with the U.S. dollar. The staff notes, furthermore, Guatemala's intention to resort to exchange restrictions only as a temporary measure, but would encourage the authorities to eliminate these restrictions as quickly as feasible. Guatemala is expected to request soon that there be discussions on a stand-by arrangement which would have as one of its objectives the phasing out of these restrictions. In the meantime, no approval of Guatemala's exchange restrictions is being recommended.

CHART 1

GUATEMALA

EFFECTIVE EXCHANGE RATE, 1970-82[1]

(1970 = 100)



Sources: IMF, *International Financial Statistics*; and Fund staff estimates.

[1] In Guatemalan quetzales per unit of foreign exchange. The weights are based on the distribution of export and import trade in 1975. Over 96 per cent of trade with partner countries is covered by these weights.

[2] Relative prices were measured by consumer price indices. In 1982 for the case of Guatemala, a proxy based on the GDP deflator was used, because of possible distortions in the consumer price index in that year.

Fund Relations with Guatemala
(March 31, 1983)

Date of membership: December 1945.

Status: Article VIII.

Quota: SDR 76.5 million.

Fund holdings of quetzales:

	Millions of SDRs	Per Cent of Quota
Total	172.1	225.0
Of which: credit tranches	19.1	25.0
compensatory financing	76.5	100.0

SDR Department:

	Millions of SDRs	Per Cent of Allocation
Net cumulative allocation	27.7	100.0
Holdings	0.02	0.1

Direct distribution of profits from gold sales (July 1, 1976-July 31, 1980): US$5.7 million.

Gold distribution: 30,810 fine ounces (four distributions).

Contribution to SFF: The equivalent of SDR 30 million in dollars, of which SDR 8.4 million were used and repaid in advance on February 8, 1982 (EBS/82/22). The unused balance (equivalent to SDR 21.6 million) is not being called upon at present as Guatemala's balance of payments and reserve positions are not sufficiently strong.

Exchange system: All transactions take place at the fixed exchange rate of US$1 per quetzal.

Last Article IV consultation: August 1980 completed by the Executive Board on November 21, 1980 (EBM/80/170).

GUATEMALA

Area and population	
Area	108,889 sq. kilometers
Population (mid-1982)	7.4 million
Annual rate of population increase (1973-82)	2.9 per cent
GNP (1982 est.)	SDR 7,956 million
GNP per capita (1982 est.)	SDR 1,075

	1979	1980	1981	1982
		(per cent)		
Origin of GDP				
Agriculture	25	25	25	25
Manufacturing	16	16	16	16
Construction	3	3	4	3
Transportation and communications	7	7	7	7
Commerce	28	27	27	27
Government	5	5	6	6
Other	16	17	15	16
Ratios to GDP				
Balance of payments current account deficit	-2.6	-2.2	-6.5	-4.2
Exports of goods and nonfactor services	21.3	21.9	16.8	14.6
Imports of goods and nonfactor services	25.7	24.8	23.4	18.2
Central government overall deficit	-2.6	-4.7	-7.3	-5.0
Central government revenue	9.7	9.5	8.6	8.2
Central government expenditure	12.3	14.2	15.9	13.2
External public debt (end of year)	8.5	8.8	10.8	13.6
External debt service payments	1.6	0.9	1.1	1.3
Gross domestic saving	14.3	12.9	10.8	12.1
Gross domestic investment	18.8	15.9	17.4	15.7
Money and quasi-money (end of year)	22.7	21.9	22.5	25.2
Annual rates of change in selected economic indicators				
GDP				
Real GDP per capita	1.9	0.7	-1.8	-6.2
Real GDP	4.7	3.7	0.9	-3.5
GDP at market prices	13.7	14.1	10.0	2.7
Domestic expenditure (at current prices)	12.0	12.5	13.9	-0.1
Gross fixed investment	5.6	0.7	11.4	9.5
Consumption	15.4	15.9	12.7	1.2
Prices				
GDP deflator	8.6	10.0	8.9	6.5
Wholesale prices (annual averages)	9.9	15.7	11.9	-7.7
Cost of living (annual averages)	11.5	10.7	11.4	0.2
Central government finances				
Central government revenues	0.8	11.6	-0.8	-2.8
Central government expenditures	15.6	31.6	23.6	-15.1
Money and credit				
Money and quasi-money	7.3	10.1	12.7	14.9
Money	11.1	2.3	4.1	1.4
Quasi-money	4.6	16.2	18.8	23.4
Net domestic bank assets 1/	10.1	29.9	35.5	20.3
Credit to public sector (net)	3.4	18.7	25.1	14.4
Credit to private sector	11.1	13.9	8.4	4.9
Trade				
Merchandise exports (f.o.b., in U.S. dollars)	13.6	22.4	-14.5	-7.7
Merchandise imports (c.i.f., in U.S. dollars)	8.1	6.3	10.1	-17.1

Central government finances	1979	1980	1981	1982
	(millions of quetzales)			
Total revenue and grants	670.4	748.0	742.4	731.0
Total expenditure and net lending	848.1	1,116.5	1,380.0	1,172.0
Current account surplus	135.5	93.2	13.0	27.2
Overall deficit (-)	-177.7	-368.5	-637.6	-441.0
External financing (net)	115.2	92.9	102.1	79.2
Internal financing (net)	62.5	275.6	535.5	361.8

Balance of payments	1979	1980	1981	1982
Merchandise exports (f.o.b.)	1,241.4	1,519.8	1,299.1	1,199.6
Merchandise imports (c.i.f.)	-1,503.9	-1,598.2	-1,673.5	-1,388.0
Factor income (net)	3.1	-55.8	-85.4	-114.7
Other services and transfers (net)	83.0	-42.2	-104.9	-68.0
Balance on current and transfer accounts	-176.4	-176.4	-564.7	-371.1
Official capital (net)	120.9	94.3	107.4	82.4
Financial system medium- and long-term capital (net) 2/	14.2	35.9	120.5	184.7
Private capital (net) and errors and omissions	13.9	-272.5	-12.0	-289.5
Change in net official international reserves (increase-)	27.4	318.7	348.8	393.5 3/

International reserve position (end of year)	1979	1980	1981	1982
	(millions of SDRs)			
Central Bank (gross)	564.5	390.9	255.0	222.0
Central Bank (net)	544.1	312.1	42.3	0.1
Rest of banking system (net)	-13.6	-26.6	-22.1	-25.5

1/ In relation to the stock of liabilities to the private sector at the beginning of the period.

2/ Includes allocations of SDRs.

3/ Includes payments arrears.