FOR AGENDA

EBS/88/202

CONFIDENTIAL

September 22, 1988

To: Members of the Executive Board

From: The Acting Secretary

Subject: Guatemala - Staff Report for the 1988 Article IV Consultation and Request for Stand-By Arrangement

Attached for consideration by the Executive Directors is the staff report for the 1988 Article IV consultation with Guatemala and its request for a stand-by arrangement equivalent to SDR 54 million. Draft decisions appear on page 21. This paper, together with Guatemala's request for a purchase under the compensatory financing facility (EBS/88/203, 9/22/88), will be brought to the agenda for discussion on a date to be announced.

Mr. Linde (ext. 8500) or Mr. Berengaut (ext. 8479) is available to answer technical or factual questions relating to this paper prior to the Board discussion.

Att: (1)

CONFIDENTIAL

INTERNATIONAL MONETARY FUND

GUATEMALA

Staff Report for the 1988 Article IV Consultation and Request for Stand-by Arrangement

Prepared by the Western Hemisphere Department

(In consultation with the Exchange and Trade Relations, Fiscal Affairs, Legal, Research, and Treasurer's Departments)

Approved by S. T. Beza and Eduard Brau

September 20, 1988

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I. Introduction

The 1988 Article IV consultation discussions with Guatemala were held in Guatemala City during the period July 6-22, 1988. Discussions of an economic program that could serve as a basis for an upper credit tranche arrangement with the Fund took place on various occasions in the latter part of 1987 and early 1988 and were concluded concurrently with the 1988 Article IV consultation discussions. The representatives of Guatemala included the Ministers of Finance, Economy, and Energy and Mines, the Executive Secretary of the National Planning Office, the President of the Bank of Guatemala, and other senior officials of public sector agencies. 1/

The previous Article IV consultation discussions with Guatemala were held in April 1987 and the staff papers were considered by the Executive Board on July 31, 1987. 2/ On that occasion, Directors commended the authorities for their success in reducing the fiscal deficit and the rate of credit expansion while simplifying the exchange system. At the same time, Directors stressed the need for a further strengthening of the public finances through new revenue measures, and urged the authorities to unify the exchange system and allow greater flexibility in domestic interest rates and the exchange rate.

In the attached letter of intent dated August 17, 1988 (Attachment I), the Minister of Finance and the President of the Bank of Guatemala request a 15-month stand-by arrangement in the amount of SDR 54 million, equivalent to 50 percent of Guatemala's quota of SDR 108 million (annual access at 40 percent). The proposed stand-by arrangement would be financed from ordinary resources. The phasing of purchases under this arrangement is set out in Table 1. The first purchase of approximately SDR 23.2 million will increase the use of Fund credit under the regular tranche policy to 25 percent of quota (i.e., through the first credit tranche); the remaining amount of the arrangement would be phased in five equal purchases of approximately SDR 6.2 million. A purchase under the compensatory financing facility in the amount of SDR 21.6 million (20 percent of quota) also is being requested.

As of July 31, 1988, Fund holdings of Guatemalan quetzales amounted to SDR 137.6 million, equivalent to 127.4 percent of quota, of which 21.2 percent of quota corresponds to purchase under the enlarged access and 6.2 percent of quota under the regular tranche policy. Taking into account scheduled repurchases, full utilization of the amount available under the stand-by arrangement and the compensatory financing facility

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1/ The staff representatives were Messrs. A. Linde (Head), J. Berengaut, J. Martelino, G. Pastor, S. Umana, and Mrs. I. Weikert (Secretary) (all WHD).

2/ Guatemala's relations with the Fund are summarized in Attachment II. Guatemala has accepted the obligations of Article VIII, sections 2, 3, and 4.

Table 1. Guatemala: Position with the Fund During Period of Proposed Arrangement

	Outstanding Sept. 30, 1988	1988 Oct.-Dec.	1989 Jan.-Mar.	1989 Apr.-June	1989 July-Sept.	1989 Oct.-Dec.	1990 Jan.-Mar.
(In millions of SDRs)							
Transactions under tranche policies (net)		18.45	2.69	2.91	3.89	4.11	3.89
Purchases 1/		23.16	6.17	6.17	6.17	6.17	6.16
Repurchases 2/		-4.71	-3.48	-3.26	-2.28	-2.06	-2.28
Ordinary resources		-2.64	-1.20	-1.20	--	--	--
Enlarged access resources		-2.06	-2.28	-2.06	-2.28	-2.06	-2.28
Transactions under special facilities (net) 3/		21.60	--	--	--	--	--
Purchases		21.60	--	--	--	--	--
Repurchases		--	--	--	--	--	--
Total Fund credit outstanding (end of period)	26.54	66.59	69.28	72.19	76.08	80.19	84.08
Under tranche policies 2/	26.54	44.99	47.68	50.59	54.48	58.59	62.48
Special facilities 3/	--	21.60	21.60	21.60	21.60	21.60	21.60
(As percent of quota)							
Total Fund credit outstanding (end of period)	24.6	61.7	64.1	66.8	70.4	74.3	77.9
Under tranche policies 2/	24.6	41.7	44.1	46.8	50.4	54.3	57.9
Special facilities 3/	--	20.0	20.0	20.0	20.0	20.0	20.0

Source: IMF Treasurer's Department.

1/ From ordinary resources only.
2/ Includes outstanding use under EAR, SFF, and EFF.
3/ Compensatory financing facility.

would raise Fund holdings of quetzales to 178 percent of quota by the end of the arrangement. Relations with the World Bank Group are presented in Attachment III. 1/

II. Economic Background

In contrast with the period of substantial growth and financial stability in the 1970s, in the first half of the 1980s Guatemala experienced serious economic and financial difficulties evidenced by falling income, output, investment, and exports. In part, this deterioration reflected the existing economic and political situation in the Central American region, a slowdown in worldwide trade, and a decline in the terms of trade. However, lax fiscal and credit policies, discontinuity in the implementation of economic policy, and an inappropriate exchange rate regime were also contributing factors. The large external imbalances that developed as a consequence were financed mainly through resort to heavy commercial borrowing abroad, loss of reserves, and a large accumulation of external payments arrears.

Adjustment efforts in 1983 supported by a Fund stand-by arrangement were undermined by slippages in the implementation of fiscal policy. The continued deterioration in the economy prompted the authorities to abandon in late 1984 the traditional fixed parity of the quetzal vis-a-vis the U.S. dollar in favor of a three-tier exchange rate system. However, this multiple exchange rate system gave rise to large exchange losses which were absorbed by the Bank of Guatemala. These losses, added to the failure to restrain spending and to the adverse effect of rising inflation on tax collections, increased the combined public sector deficit (before grants) up to 8 percent of GDP in 1985. Meanwhile, the recession that had started in 1981 deepened further. By 1985 output had fallen below its 1980 level, and in the period 1981-85 there was an overall balance of payments deficit of nearly US$1.2 billion, including an accumulation of US$0.6 billion in external payments arrears (Table 2 and Attachment V).

In a renewed effort to stabilize the economy and to lay the basis for sustained economic growth, the administration that took office at the beginning of 1986 2/ introduced a comprehensive adjustment program ("Programa de Reordenamiento Economico y Social") that called for: (1) a simplification and gradual unification of the exchange system; (2) a reduction in the combined fiscal deficit by means of increased taxation; (3) a slowdown in the rate of overall credit expansion; and (4) a liberalization of price controls.

1/ Starting in late August 1988, Guatemala has incurred arrears to the World Bank which has resulted in the suspension of Bank disbursements; as of mid-September 1988 such arrears amounted to US$22.8 million.

2/ Following democratically held elections after more than 30 years of military rule.

Table 2. Guatemala: Selected Macroeconomic Indicators

	1984	1985	1986	1987	Proj. 1988	Proj. 1989
	(Percentage changes)					
Nominal GDP	4.6	17.5	42.3	11.1	17.8	12.9
Real GDP	0.5	-0.6	0.1	3.1	4.0	4.5
GDP deflator	4.1	18.2	42.1	7.7	13.3	8.0
Consumer prices						
Annual average	3.7	18.6	36.9	12.3	12.0	8.0
End of year	5.2	31.5	25.7	10.1	13.0	8.0
	(As a percent of GDP)					
Gross domestic investment	11.6	11.6	10.3	13.8	13.3	13.0
Public	2.9	2.7	1.9	2.1	2.6	2.7
Private 1/	8.7	8.9	8.4	11.7	10.7	10.3
Gross savings	11.6	11.6	10.3	13.8	13.4	13.0
External 2/	6.2	3.7	1.2	8.4	6.5	5.5
Internal	5.4	7.8	9.1	5.4	6.9	7.5
Public 3/	-1.2	-3.2	-0.7	-1.1	-0.5	--
Private	6.6	11.0	9.8	6.5	7.4	7.5
Combined public sector deficit	4.1	5.9	2.6	3.3	3.2	2.6
Nonfinancial public sector	3.4	1.4	0.7	1.3	1.7	1.8
Bank of Guatemala losses	0.7	4.5	1.9	2.0	1.5	0.8

Source: Data provided by the Guatemalan authorities and staff estimates.

1/ Includes inventory changes.
2/ Current account balance of payments deficit (excluding official transfers).
3/ Includes Bank of Guatemala.

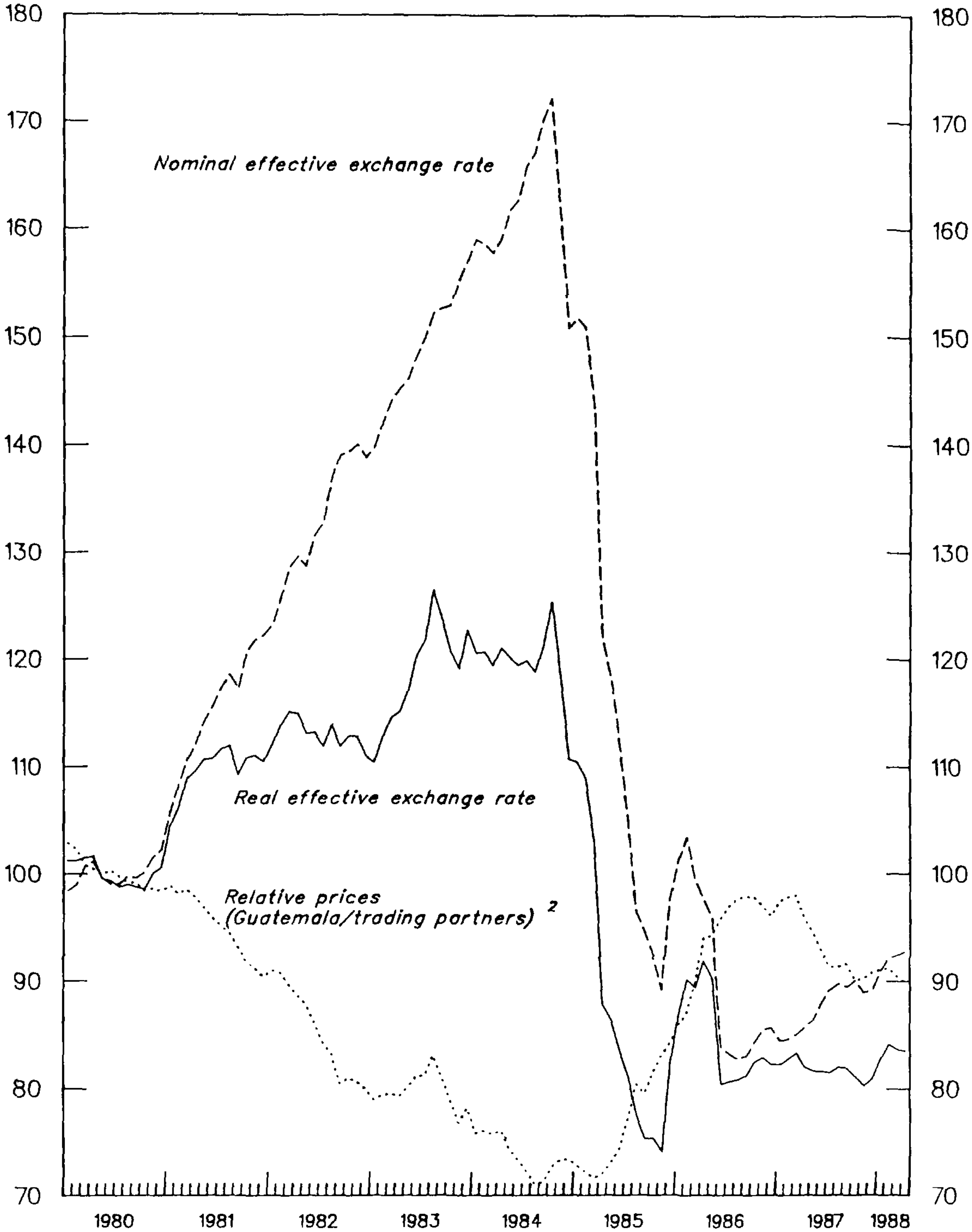
In June 1986 the existing three-tier exchange rate system was simplified into a reduced official market (in which the rate continued to be fixed at Q 1=US$1) mainly for service payments on debt contracted prior to June 1986, a new regulated market at a rate initially set at Q 2.50=US$1 for most trade transactions, and a banking market rate at which the exchange rate was free to fluctuate, mainly for private

CHART

GUATEMALA

EFFECTIVE EXCHANGE RATE INDICES, JANUARY 1980–JUNE 1987[1]

(1980=100)



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

[1] In Guatemalan quetzales per unit of foreign currency. A fall (rise) in the index indicates depreciation (appreciation) of the quetzal. The index is based on 1980 trade weights excluding oil. From late 1984, the exchange rate of the quetzal has been calculated using a weighted average of the exchange rates in the official, auction (regulated), and banking markets;

[2] Based on consumer price indices.

invisibles and capital flows. 1/ The reform implied an exchange rate devaluation of about 15 percent. At the same time a temporary tax on exports was established, commercial banks' reserve requirements were raised and the yields on government bonds and the ceilings applied to commercial bank deposits and lending rates were increased. In addition, the number of consumer items subject to price control was decreased sharply from 450 items to around 50, reducing by half the coverage of controlled items in the basic consumer price basket.

The Government's economic program succeeded in curbing the acceleration of inflation and improving the balance of payments with the external current account deficit declining markedly and the overall balance shifting to a small surplus. Aided by sharply higher world coffee prices, the combined public sector deficit was more than halved, to less than 3 percent of GDP in 1986. The losses of the Bank of Guatemala were reduced sharply by the simplification of the exchange system and the deficit of the nonfinancial public sector was halved to 3/4 percent of GDP largely because of the temporary tax on exports.

In 1987 there was a resumption of economic growth (real GDP rose by 3 percent), and inflation declined, on an end-of-period basis, to 10 percent from 37 percent in 1985 and 26 percent in 1986, as the rate of domestic credit expansion was reduced markedly. The combined deficit of the public sector, however, increased somewhat to around 3 1/3 percent of GDP in 1987, owing to a decline in export tax collections that resulted from the decline in international coffee prices and to a substantial increase in central government current expenditure, partly offset by an increase in other government revenue that stemmed from improvements in tax administration.

The external current account deficit widened from about 1 percent of GDP in 1986 to 8 1/2 percent of GDP in 1987, due mainly to a deterioration in the terms of trade and a sharp increase in imports. Despite a rise of 35 percent in nontraditional exports, the U.S. dollar value of total exports declined by over 6 percent as coffee prices fell by 30 percent. After falling by over 18 percent in 1986, imports grew by about 50 percent in 1987, reflecting the recovery in economic activity, large scale restocking of inventories, and increased availability of foreign trade financing. As regards the capital account, in 1987 Guatemala secured exceptional financing from bilateral sources of US$113 million and debt relief on principal obligations to commercial banks and to bilateral creditors of US$116 million. In addition, there were some US$400 million of private capital inflows, compared with about US$60 million in 1986. 2/ The overall balance of payments registered a deficit of US$45 million in 1987 compared with a US$10 million surplus in 1986.

1/ See SM/87/147 (07/01/87) for a more detailed description of this reform.

2/ Figures on private capital flows include errors and omissions.

In early 1988 economic activity continued to expand and inflation moderated further. The growth of imports in the first half of the year was faster than had been envisaged, while inflows of private capital were affected adversely by delays in implementing the exchange rate unification. As a consequence, the net official reserve position remained under pressure throughout the period.

III. The Economic Program through 1989 and Performance Criteria

While the authorities were generally satisfied with the response of the economy to the adjustment measures, they recognized that sustaining the improvements in economic growth and inflation required redressing the deteriorating external position. Accordingly, in June 1988 the authorities reinforced their adjustment effort by introducing a series of measures aimed at restoring balance of payments viability. This package, described in detail below, included fiscal actions to control the combined deficit of the public sector, measures to limit bank credit expansion, an exchange rate unification that entailed a devaluation of some 10 percent, and structural measures to promote exports and more efficient use of resources.

1. Domestic financial policies

The main objective of the Government's domestic financial policies is to reduce further the combined public sector deficit in order to make sufficient room for expanding credit to the private sector thus allowing for the continuation of the economic recovery without rekindling inflation.

a. Fiscal policy

The Government's fiscal policies for 1988 were conceived with two main objectives in mind: first, to generate the additional resources needed to offset the revenue losses from lower world coffee prices and the phase-out of the export tax, and second, within the confines of a relatively small budget, to reorient spending toward agricultural activities, basic social services, and regional development.

The program envisages a modest reduction in the combined public sector deficit to 3.2 percent of GDP in 1988, with a further adjustment to 2.6 percent in 1989 (Table 3). To attain these objectives, the program relies on a combination of revenue measures introduced in late 1987 and expenditure restraint, together with the elimination of the exchange losses of the Bank of Guatemala in the second half of 1988.

The centerpiece of the central government's revenue effort is the tax package introduced October 1987 with an estimated annual yield of 1.4 percent of GDP. This included a major revamping of the income tax system, and changes in the value added, property, stamp, and vehicle taxes. In addition to raising additional revenues immediately, these

Table 3. Guatemala: Summary Central Government Operations

	1984	1985	1986	1987	Proj. 1988	Proj. 1989
	(In millions of quetzales)					
Central government revenue	689.9	865.7	1,406.7	1,659.2	2,093.8	2,305.2
Tax revenue	536.1	679.5	1,102.2	1,396.7	1,744.0	1,989.3
Direct taxes	120.2	128.0	188.6	272.8	407.1	501.6
Domestic indirect taxes	301.7	405.0	517.9	700.1	804.2	981.1
Taxes on international trade	114.2	146.5	395.7	423.8	532.7	506.6
Nontax revenue	129.7	151.9	248.0	189.1	238.1	243.1
Transfers	24.1	34.3	56.5	73.4	103.1	65.8
Capital revenue	--	--	--	--	8.6	7.0
Central government expenditure 1/	1,041.7	1,068.3	1,704.8	2,093.2	2,612.8	2,923.0
Current	764.8	837.7	1,406.5	1,715.1	2,114.9	2,337.4
Wages and salaries	413.5	452.2	625.6	775.9	915.6	1,005.0
Goods and services	150.1	162.8	278.1	344.1	365.9	398.3
Interest	82.8	76.6	207.5	244.9	318.0	355.5
Transfers	118.4	146.1	295.3	350.2	515.4	578.6
Capital and net lending	276.9	230.6	298.3	378.1	497.9	585.6
Current account balance	-75.1	27.3	--	-55.9	-29.7	-39.2
Overall deficit (-)/commitment basis	-351.8	-202.6	-298.1	-434.0	-519.0	-617.8
Change in arrears	8.2	14.4	37.9	20.0	-57.7	--
Change in floating debt	--	-38.4	146.4	96.9	56.8	--
Overall deficit (-)/cash basis	-343.6	-226.6	-113.3	-317.1	-519.9	-617.8
External financing (net)	25.7	63.2	78.3	49.5	42.9	341.3
Foreign assistance 2/	0.1	0.9	60.0	198.6	190.8	216.0
Domestic financing (net)	317.8	162.5	-25.0	69.0	286.2	60.5
Memorandum items						
Combined public sector deficit and losses of Bank of Guatemala	-388.5	-658.9	-403.9	-586.9	-654.2	-617.8
Nonfinancial public sector deficit (Commitment basis)	-312.5	-150.9	-116.9	-240.2	-355.0	-418.9
Losses of Bank of Guatemala	-67.0	-508.0	-287.0	-346.7	-299.2	-198.9
	(As percent of GDP)					
Central government revenue	7.3	7.8	8.9	9.4	10.1	9.8
Tax revenue	5.7	6.1	6.9	8.0	8.4	8.4
Direct taxes	1.3	1.1	1.2	1.6	2.0	2.1
Domestic indirect taxes	3.2	3.8	3.4	3.9	3.9	4.1
Taxes on international trade	1.2	1.2	2.3	2.5	2.5	2.2
Nontax revenue	1.4	1.4	1.6	1.0	1.1	1.1
Transfers	0.2	0.3	0.4	0.4	0.5	0.3
Central government expenditure 1/	11.0	9.6	10.8	11.9	12.6	12.4
Current	8.1	7.5	8.9	9.7	10.2	10.0
Wages and salaries	4.4	4.0	4.0	4.4	4.4	4.3
Goods and services	1.6	1.5	1.8	2.0	1.8	1.7
Interest	0.8	0.7	1.3	1.4	1.5	1.5
Transfers	1.3	1.3	1.8	2.0	2.5	2.5
Capital and net lending	2.9	2.1	1.9	2.2	2.4	2.4
Current account balance	-0.8	0.2	--	-0.3	-0.1	-0.2
Overall deficit(-)/commitment basis	-3.7	-1.8	-1.9	-2.5	-2.5	-2.6
Change in arrears	0.1	0.1	0.2	0.1	-0.3	--
Change in floating debt	--	-0.3	0.9	0.6	0.3	--
Overall deficit (-)/cash basis	-3.6	-2.0	-0.8	-1.8	-2.5	-2.6
External financing (net)	0.3	0.6	0.5	0.3	0.2	1.5
Foreign assistance 2/	--	--	0.4	1.1	0.9	0.9
Domestic financing (net)	3.3	1.4	-0.1	0.4	1.4	0.2
Memorandum items						
Combined public sector deficit and losses of Bank of Guatemala	-4.1	-5.9	-2.6	-3.3	-3.2	-2.6
Nonfinancial public sector deficit (Commitment basis)	-3.4	-1.4	-0.7	-1.3	-1.7	-1.8
Losses of Bank of Guatemala	-0.7	-4.5	-1.9	-2.0	-1.5	-0.8

Source: Data provided by the Guatemalan authorities and staff estimates.

1/ Expenditures are on a commitment basis.
2/ Special U.S. assistance for budgetary support (grants).

measures rationalized the structure of the tax system by reducing its regressiveness and broadening its base. Also, a surcharge of 4 percentage points was applied on certain imports.

Changes introduced in the personal and corporate income tax schedules simplified highly differentiated structures that had previously existed. Specifically, the new personal income tax schedule provides for a reduction in the number of brackets from 63 to 16 as well as for a revision of tax exemptions. Also, certain deductions that had been allowed previously were eliminated and a tax on presumptive income was applied to self-employed professionals and nonresident firms generating income in Guatemala. The base for the corporate income tax was broadened by narrowing the scope of certain deductions and the number of brackets was reduced. These changes, together with improvements in tax administration, are expected to raise collections of income taxes by the equivalent of about two thirds of a percentage point of GDP. As regards the property tax, the existing differentiated rate structure was simplified, and property assessments were updated to reflect more closely current market values. The coverage of the value added tax was extended by means of a reduction in exemptions, and the tax rate for several luxury items was raised from 7 percent to 15 percent. The tax on motor vehicles was also modified to increase its yield, while an additional surcharge of 4 percentage points was established for all imports other than petroleum, goods imported from the Central American Common Market, and on pharmaceutical products. In addition, most of the specific stamp tax rates were doubled and the scope of the stamp tax was broadened.

Central government expenditure is projected to rise from about 11 percent at GDP in 1986 to 13 percent in 1988; spending on health, education, and rural development have been accorded priority, with their combined share increasing to 29 percent in 1988 from 23 percent in 1986. The shares of interest payments and transfers to the municipalities also have increased, the latter in accordance with constitutionally mandated expenditures for education and social services. 1/ The share of outlays for defense declined somewhat while those for public works, transport and communications were reduced markedly.

A recent program of reclassifying civil service positions which was originally not contemplated to result in adverse budgetary developments, is now expected to lead to upward pressures on the public sector wage bill. Accordingly, to safeguard the attainment of the fiscal objectives of the program in July 1988 the Government has taken a number of offsetting measures including imposing a 10 percent cut in certain

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1/ The Constitution that was adopted in 1986 has mandated that the central government transfer to certain decentralized public sector agencies (primarily, universities and municipalities) fixed proportions of its ordinary revenue. The scheme is described in more detail in SM/87/147 (07/01/87).

categories of discretionary nonwage current expenditure and instituting a freeze of unspent budgetary allocations as of June 30, 1988. In addition, a thorough review of staffing levels throughout the public sector was started. Also, spending guidelines have been imposed on the recipient entities of constitutionally mandated transfers that limit their spending to the amount of the transfers.

As regards the rest of the nonfinancial public sector, the authorities' medium-term objective is to maintain the current revenue of state enterprises at a level sufficient to cover their operating costs (including the increased local currency costs of servicing the external debt that resulted from the unification of the exchange system), as well as a share of their investment outlays. The review of staffing levels referred to above is expected to contribute to the containment of costs. As already noted, the tariffs of the electricity authority were raised (by 25 percent) in March 1988. In all, it is projected that the rest of the nonfinancial public sector will maintain a surplus position through 1988 and 1989 of about 0.8 percent of GDP.

The losses of the Bank of Guatemala are projected to decline from 2 percent of GDP in 1987 to 1.4 percent of GDP in 1988 and 0.8 percent in GDP in 1989. Exchanges losses have ceased with the unification of the exchange rate system in June 1988 and other losses, which result primarily from servicing past external borrowing and bonds issued in 1983-84 to refinance import arrears, would decline as a proportion of GDP during the program period.

b. Monetary policy

Monetary and credit policy has been designed to limit the rate of inflation to 12 percent in 1988 and to reduce it to 8 percent in 1989, while maintaining the growth of output of about 4 percent and strengthening net international reserves including the elimination of external payments arrears. These objectives are to be achieved by limiting public sector recourse to domestic financing to allow an adequate supply of bank credit to the private sector, and promoting financial savings with an appropriate interest rate policy.

The improvement in the fiscal position described above, given the expected external financing, appears to be consistent with a domestic financing requirement of the nonfinancial public sector of no more than Q 135 million in 1988 (0.7 percent of GDP). In view of the expected placement of government bonds outside the domestic banking system, net bank financing of the nonfinancial public sector would be limited to no more than Q 85 million in 1988 (0.4 percent of GDP) and no recourse to bank credit is projected for 1989. In line with the price and balance of payments objectives of the program, and consistent with the conservatively projected growth of private financial savings, the growth of the net domestic assets of the banking system is programed to fall from 10 percent in 1988 to about 4 1/2 percent during 1989. Accordingly, the net domestic assets of the Bank of Guatemala would increase by no more than 10 1/2 percent during 1988 and decline by 34 percent during 1989 (Table 4). 1/

To achieve its objectives for the credit aggregates, the Bank of Guatemala intends actively to pursue open market operations. The use of this instrument of credit control is expected to be facilitated by the establishment of a stock exchange, which has recently been authorized, through a deepening of the market for government bonds and other financial instruments. In addition, the level and distribution of public enterprise deposits between the central bank and the banking system will be managed with a view to achieving monetary objectives. Central bank discount rates and legal reserve requirements will also be kept under review to ensure the achievement of the program targets.

To provide adequate incentives for the growth of private financial savings, improve credit allocation, and foster the development of the newly created domestic capital market, the authorities intend to pursue a flexible interest rate policy to enable rates to reach positive levels in real terms. As a first step, in June 1988 the Monetary Board raised interest rate ceilings from 11 percent a year to 13 percent for savings and time deposits, with corresponding increases in lending rates. However, rediscount rates of the Bank of Guatemala remained unchanged. Subsequently, in September 1988 the yield on central bank bonds was raised from 9 percent a year to 11 percent.

2. External sector and structural policies

a. Exchange rate and other external policies

The program seeks to achieve medium-term external viability in the context of policies supportive of export-led growth. A key measure of the Government's program was the reunification of the exchange system. On June 23, 1988 transactions that had previously been conducted in the three separate markets (official, regulated, and banking) noted earlier, were shifted to a single exchange market with the rate initially set at Q 2.70=US$1. The unification implied a devaluation of the exchange rate of about 10 percent. 2/ 3/

The authorities have indicated that the exchange rate for the quetzal would be adjusted in accordance with balance of payments developments. Under the program, the external current account deficit is

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1/ These percentage rates of change are measured in relation to the liabilities to the private sector at the beginning of each period.
2/ In the period June 1986-June 1988, the real effective exchange rate of the quetzal had remained broadly unchanged (Chart 1).
3/ Under the Constitution, the National Congress has sole authority to change the official parity. For this reason, certain foreign exchange operations of the Bank of Guatemala will continue to be accounted for at Q 1=US$1.

Table 4. Guatemala: Summary Accounts of the Banking System 1/

	End December				Proj.	
	1984	1985	1986	1987	1988	1989
	(In millions of quetzales)					
	I. Banking System					
Net international reserves	-518	-535	-579	-639	-658	-224
Net domestic assets	3,516	4,356	5,236	5,600	6,109	6,224
Public sector	1,554	1,670	1,402	1,137	1,222	1,222
Private sector	1,936	2,135	2,351	2,926	3,248	3,452
Arrears counterpart	22	105	166	186	147	--
Other 2/	4	446	1,317	1,351	1,492	1,550
Medium- and long-term foreign liabilities	518	554	487	430	447	450
Liabilities to the private sector	2,480	3,267	4,169	4,530	5,004	5,550
Money	847	1,322	1,562	1,746	1,916	2,050
Quasi-money 3/	1,633	1,945	2,608	2,784	3,088	3,500
	II. Monetary Authorities 4/					
Net international reserves	-422	-531	-531	-582	-598	-149
Official	68	55	172	129	50	251
Arrears 5/	-490	-587	-703	-711	-648	-400
Net domestic assets	919	1,279	1,397	1,587	1,694	1,322
Public sector	1,688	1,753	1,136	931	966	785
Net credit to banks	-204	-431	-594	-471	-567	-647
Medium- and long-term foreign liabilities	-488	-517	-450	-394	-417	-520
Arrears counterpart	22	105	166	186	147	--
Other 2/	-100	368	1,140	1,336	1,566	1,704
Currency issue	497	798	866	1,006	1,096	1,173
	(Changes in percent)					
Banking system						
Net domestic assets 6/	20.1	21.7	19.3	6.8	10.1	4.4
Credit to public sector	24.8	7.5	-16.1	-18.9	7.5	--
Credit to private sector	11.3	10.2	10.1	24.5	11.0	6.3
Liabilities to private sector	12.0	31.8	27.6	8.7	10.5	10.9

Source: Data provided by the Guatemalan authorities and staff estimates.

1/ Foreign assets and liabilities are valued at an accounting rate of Q 1=US$1 throughout the period.
2/ Includes Bank of Guatemala losses.
3/ Includes private capital and reserves.
4/ Bank of Guatemala and Securities Regulation Fund.
5/ Includes stabilization bonds.
6/ Excluding domestic counterpart of external arrears.

targeted to decline from 8 1/2 percent of GDP in 1987 to 6 1/2 percent in 1988 and to 5 1/4 percent in 1989 (Table 5). In addition, quarterly targets for the net international reserves of the Bank of Guatemala (including payments arrears) have been established that are consistent with an overall balance of payments deficit of US$40 million in 1988 and a surplus of US$60 million in 1989. All external debt service arrears and import arrears of the public sector are to be eliminated either by rescheduling and/or cash payment before end-June 1989.

In July 1988 the authorities proposed the rescheduling into long-term dollar-denominated securities of the maturing stabilization bonds that were issued in 1983-84 to regularize outstanding arrears of the private sector. 1/ The holders of these securities were offered a menu of options, including the possibility of early redemption through debt-equity swaps. Under the rescheduling program, early redemption is subject to case-by-case approval by the Bank of Guatemala. The monetary and external projections underlying the economic program provide for a limited amount of redemption in 1988-89 (some US$20 million per annum); if the demand for early redemptions exceeds the programmed amounts, approvals will only be granted in conjunction with additional adjustment measures to mobilize the necessary resources.

Guatemala's external financing needs through 1989 are expected to be covered primarily by private capital inflows, balance of payments support loans and grants from bilateral and multilateral sources, and a rescheduling of current and past due principal obligations to commercial banks, for which the authorities aim at reaching agreement by June 1989. In addition, debt reschedulings with Guatemala's few bilateral creditors are envisaged. 2/

b. Structural policies

The authorities have emphasized export promotion as a key element of their economic strategy. A number of concrete steps have already been taken in this direction and further initiatives are being implemented especially to promote the export of nontraditional products to new markets. Steps already taken include the establishment of a "one-stop" agency in the Ministry of Economy to deal with all the legal and documentary requirements in the export field that previously were handled by several different government agencies. In addition, in 1986 the Government constituted a special export council (CONAPEX), comprising representatives of the public and private sectors, to advise the Government on issues affecting exports. As a result of the recommendations of this council, the Government has taken steps to improve shipping and air freight facilities for exporters and to establish

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1/ While originally these bonds were primarily issued to foreign suppliers, over time the bulk of them has come to be held by Guatemalan residents, both individual and corporate.
2/ These comprise mainly Canada, Spain, Mexico, and Venezuela.

Table 5. Guatemala: Summary Balance of Payments

	1984	1985	1986	1987	Proj. 1988	1989
	(In millions of U.S. dollars)					
Current account	-385.7	-237.9	-75.9	-600.4	-502.0	-444.0
Trade balance	-146.3	-62.9	84.2	-469.3	-365.0	-309.0
Exports, f.o.b.	1,132.2	1,112.1	1,043.7	977.9	1,140.0	1,286.0
Imports, c.i.f.	-1,278.5	-1,175.0	-959.5	-1,447.2	-1,505.0	-1,595.0
Net factor receipts	-209.8	-209.4	-223.7	-205.4	-210.0	-215.0
Tourism and travel	-50.1	-10.2	13.9	18.1	29.0	35.0
Other services (net)	-8.2	24.9	-1.7	-11.1	-18.0	-20.0
Private transfers (net)	28.7	19.7	51.4	67.3	62.0	65.0
Capital account	199.2	143.7	87.3	556.7	462.0	504.0
Private capital 1/	18.5	229.6	58.3	399.0	265.0	207.0
Nonfinancial public sector 2/	20.6	6.0	76.0	146.7	151.0	249.0
Financial sector	160.1	-91.9	-47.0	11.0	46.0	48.0
Bank of Guatemala	104.1	23.1	-51.0	-7.8	23.0	30.0
Other 3/	56.0	-115.0	4.0	18.8	23.0	-18.0
Overall balance	-186.5	-94.2	11.4	-43.7	-40.0	60.0
Change in arrears	204.0	95.6	115.9	8.6	...	...
Net official reserves (increase -)	-17.5	-1.4	-127.3	35.1	...	...
	(As percent of GDP)					
Current account	-6.2	-3.7	-1.1	-8.4	-6.4	-5.2
Trade balance	-2.4	-1.0	1.3	-6.6	-4.7	-3.6
Exports, f.o.b.	18.3	17.5	15.7	13.7	14.6	15.1
Imports, c.i.f.	-20.6	-18.5	-14.4	-20.3	-19.3	-18.7
Net factor receipts	-3.3	-3.3	-3.4	-2.9	-2.6	-2.5
Tourism and travel	0.3	-0.1	0.2	0.3	0.3	0.4
Other services and private transfers (net)	-0.8	0.7	0.7	0.8	0.6	0.5
Capital account	3.2	2.3	1.3	7.8	5.9	5.9
Private capital 1/	0.3	3.6	0.9	5.6	3.4	2.4
Nonfinancial public sector 2/	0.3	0.1	1.1	2.1	1.9	2.9
Financial sector	2.6	-1.5	-0.7	0.1	0.6	0.6
Overall balance	-3.0	-1.5	0.2	-0.6	-0.5	0.7

Source: Data provided by the Guatemalan authorities and staff estimates.

1/ Including net errors and omissions.
2/ Including official grants.
3/ Including short-term capital of commercial and development banks.

export credit insurance. A revision of the export incentives law has been prepared that would broaden the basis for duty-free imports used in production for exports and to introduce a rebate scheme for indirect domestic taxes paid on exported goods. A temporary tax on exports that was introduced in June 1986 is being phased out gradually over a period of 33 months that began in June 1987.

The Government is also committed to reducing the levels and dispersion of import tariff rates, beginning with a reduction in the top rate of 70 percent (currently in effect for most items) to 40 percent by 1990. The details of this trade reform are being worked out with technical assistance from the World Bank in the context of an Export Promotion Loan.

To ensure an efficient allocation of resources, the authorities intend to limit price controls to a few essential consumer products and medicines and maintain flexible pricing policies by the state enterprises. In addition, to promote a more efficient use of energy resources and reduce cross product subsidies, the prices of gasoline and diesel products were raised by 8 and 38 percent, respectively, in July 1988. Following this increase, prices for transport services were raised.

3. Medium-term outlook

The Government's economic program over the medium term is designed to consolidate the progress achieved under the stabilization effort started in 1986. In this connection, the authorities' propose to lower the rate of inflation gradually to a rate no higher than that projected for Guatemala's major trading partners (around 3-4 percent) and to sustain economic recovery so as to allow Guatemala to regain by the beginning of the next decade annual rates of growth similar to those achieved prior to 1980 (in the range of 5-8 percent). The main stimulus to growth in the future would be from an expansion of nontraditional exports and an increase in investment mainly by the private sector. The program calls for a substantial strengthening of domestic savings with a significant contribution from the public sector. It is envisaged that public savings would rise from zero in 1987 to over 3 percent of GDP in 1994, and that the overall fiscal deficit would be reduced to about 1 percent of GDP, which was typical for Guatemala in the two decades prior to 1980 and which could be financed mainly with long-term foreign assistance.

Consistent with these assumptions, it is expected that Guatemala's external current account deficit would be reduced gradually to about 2 percent of GDP over the projection period (Table 6). Such an outcome would allow for a reduction in the ratio of total external indebtedness to GDP from 37 percent in 1987 to around 28 percent in 1994.

Table 6. Guatemala: Medium-Term External Outlook

	1986	1987	1988	1989	1990	1991	1992	1993	1994
			Projections						
(In millions of U.S. dollars)									
Current account	-76	-601	-503	-444	-458	-401	-320	-304	-276
Trade balance	84	-469	-366	-309	-319	-268	-196	-183	-160
Exports, f.o.b.	1,044	978	1,139	1,286	1,435	1,591	1,812	1,986	2,182
Imports, c.i.f.	-960	-1,447	-1,505	-1,595	-1,754	-1,859	-2,008	-2,169	-2,342
Services (net)	-211	-199	-199	-200	-210	-211	-211	-216	-221
Nonfactor	12	7	11	15	20	25	30	35	40
Factor	-223	-206	-210	-215	-230	-236	-241	-251	-261
Private transfers (net)	51	67	62	65	71	78	87	95	105
Capital account	87	557	462	504	476	423	365	349	321
Nonfinancial public sector 1/	30	34	71	89	68	69	80	90	90
Financial intermediaries	-249	-105	-47	-15	-75	-63	-70	-67	-110
Bank of Guatemala	-253	-124	-70	-12	-75	-74	-81	-88	-131
Other	4	19	23	-3	--	11	11	21	21
Private medium- and long-term	69	91	90	90	100	110	110	110	110
Other (including errors and omissions)	-12	308	175	117	120	75	50	50	50
Exceptional balance of payments support	249	229	173	223	263	232	195	166	181
Of which:									
Rescheduling of principal payments to commercial banks	202	116	93	42	75	74	81	88	131
Balance of payment support	47	91	80	160	160	150	114	78	50
Grants from bilateral sources	47	91	80	80	...	...	...	...	...
Loans from multilateral sources	--	--	--	80	...	...	...	...	...
Overall balance	11	44	-41	60	18	22	45	45	45
Net international reserves	-127	35	60	...	...	...	...	...	...
Arrears	116	9	-17	...	...	...	...	...	...
(In percent of GDP)									
Current account	-1.1	-8.4	-6.5	-5.2	-4.9	-3.9	-2.8	-2.4	-2.0
Trade balance	1.3	-6.6	-4.7	-3.6	-3.4	-2.6	-1.7	-1.5	-1.2
Stock of debt plus arrears outstanding	40.6	37.1	37.5	35.8	35.0	33.5	31.8	30.0	27.9
(As a percent of exports of goods and services)									
Debt service 2/	59.0	44.5	39.8	25.9	25.5	22.7	24.3	24.9	27.3
Interest payments 2/	18.3	16.4	13.3	12.7	12.5	11.7	11.8	12.4	12.9
(In months of merchandise imports)									
Gross official reserves	6.1	3.2	2.8	3.1	2.9	2.9	3.0	3.0	3.1

Sources: Data provided by the Guatemalan authorities; and Fund staff estimates.

1/ Including official tranfers.
2/ Including arrears and obligations to the Fund.

Exports are projected to rise at an annual rate of about 12 percent to reach some US$2.2 billion by 1994. Price assumptions for the major primary exports are consistent with the recent WEO commodity price forecasts; for coffee the projection is based on an increase from US$1.10 per pound in 1987 to US$1.52 per pound in 1994. Nontraditional exports are projected to grow at a annual rate of 24 percent in value terms and about 20 percent in volume terms. These projections are similar to those contained in the Government's five-year plan, which has made use of detailed studies of export potential in the agricultural and manufacturing sectors and take into account the fairly low base of 1987. Imports are expected to keep pace with nominal GDP growth during the projection period. To finance the external current account gap and allow a reduction in the Bank of Guatemala's net external liability position, exceptional financing needs would continue to exist throughout the projection period. These are expected to be met by a mix of rescheduling of principal of existing commercial loan and inflows of bilateral grants and multilateral loans, the latter mainly from the IBRD and IDB.

The base scenario presented above is fairly insensitive to changes in key assumptions. For example, if the price of coffee remained constant in nominal terms throughout the projection period instead of rising by about 3 1/2 percent annually in line with the WEO assumptions, by 1994 the debt service ratio would be higher by about 2 percentage points. To maintain the base scenario debt service ratio with lower coffee prices, the rate of growth of nontraditional exports, for instance, would have to increase from about 24 percent to about 27 percent on an annual basis. Changes in international interest rates would have little effect on the baseline projections because of the fairly small proportion of commercial debt in the total external indebtedness of Guatemala. If the LIBOR were 1 percentage point higher throughout the projection period, the debt service ratio by 1994 would be only about one tenth of a percentage point higher.

Guatemala is not expected to experience difficulties in making repurchases to the Fund in respect of its purchases under the prospective stand-by arrangement and compensatory financing facility. The gross foreign reserves of the Bank of Guatemala declined moderately in 1987 following a significant build-up during the coffee boom year of 1986, and would remain almost unchanged in 1988. Thereafter, the gross official international reserves would increase in line with the prospective overall balance of payments surpluses.

4. Performance criteria

Guatemala's progress toward the goals of its 1988-89 financial program will be monitored by performance criteria that have been incorporated into the proposed stand-by arrangement. The quantitative criteria, presented in Table 7 are: (1) quarterly target for the net international reserves of the Bank of Guatemala; (2) quarterly limit on

Table 7. Guatemala: Limits, Ceilings, and Targets Under the Program for 1988-89

Variables and Periods	Amounts
I. Targets for the net international reserve position of the Bank of Guatemala 1/	(in millions of U.S. dollars)
July 1, 1988-Sept. 30 1988 2/	36
Oct. 1, 1988-Dec. 31, 1988	33
Jan. 1, 1989-Mar. 31, 1989	36
Dec. 31, 1989 2/	93
II. Ceilings on the stock of the net domestic assets of the Monetary Authorities 3/	(in millions of quetzales)
July 1, 1988-Sept. 30 1988 2/	910
Oct. 1, 1988-Dec. 31, 1988	1,010
Jan. 1, 1989-Mar. 31, 1989	1,010
Dec. 31, 1989 2/	920
III. Ceilings on cumulative changes in the net domestic financing of the nonfinancial public sector 4/	(cumulative changes in millions of quetzales)
Jan. 1, 1988-Sept. 30, 1988 2/	-142
Jan. 1, 1988-Dec. 31, 1988	135
Jan. 1, 1989-Mar. 31, 1989	--
Jan. 1, 1989-Dec. 31, 1989 2/	-48
IV. Limits on the stock of external payment arrears 5/	(in millions of U.S. dollars)
July 1, 1988-Sept. 30, 1988 2/	250
Oct. 1, 1988-Dec. 31, 1988	250
Jan. 1, 1989-Mar. 31, 1989	250
June 1, 1989 2/	--
V. Ceilings on the contracting of public and publicly guaranteed external debt (1-12 years) 6/	(cumulative changes in millions of U.S. dollars)
Through Dec. 31, 1988	50
Through Mar. 31, 1989	90
Through Sept. 30, 1989 2/	100
Through Dec. 31, 1989 2/	110
VI. Ceilings on the contracting of public and publicly guaranteed external debt (1-5 years) 6/	(cumulative changes in millions of U.S. dollars)
Through Dec. 31, 1988	40
Through Mar. 31, 1989	80
Through Sept. 30, 1989 2/	90
Through Dec. 31, 1989 2/	90
VII. Ceilings on the stock of public and publicly guaranteed short-term external debt 7/	(in millions of U.S. dollars)
Through Dec. 31, 1988	30
Through Mar. 31, 1989	30
Through Sept. 30, 1989 2/	30
Through Dec. 31, 1989 2/	30

Source: Guatemala: Memorandum on Economic Policy (Attachment I).

1/ The difference between foreign assets of the Bank of Guatemala and short-term liabilities, including net position with the Fund, commercial and external debt service arrears, but excluding restructurable amounts.

2/ Indicative.

3/ The difference between currency issue and the net international reserves of the Bank of Guatemala, including the Securities Regulation Fund; foreign assets and liabilities vauled at Q 2.70=US$1.

4/ Net credit of the banking system to the nonfinancial public sector plus net sales of central government bonds outside of the banking system.

5/ Includes commercial payments arrears, external debt service payment arrears, and all requests for foreign exchange pending after five working days.

6/ Excludes new loans directly related to the refinancing or rescheduling of external debt.

7/ Excludes reserve liabilities at the Bank of Guatemala and normal trade credits.

the stock of external payments arrears; (3) quarterly ceiling on cumulative changes in the net domestic financing of the nonfinancial public sector (defined as net banking system credit plus net domestic bond placements of the central government outside the banking system); (4) quarterly limit on the net domestic assets of the monetary authorities; (5) limits on the contracting of external debt by the public sector and the stock of short-term indebtedness of the public sector. These performance criteria have been established for December 1988 and March 1986 with indicative targets for September 1988 (i.e., prior to the Board discussion of the program) and December 1989 (i.e., the end point of the policy planning period). The customary clauses on overdue financial obligations to the Fund and on exchange restrictions, multiple currency practice, bilateral payment agreements inconsistent with Article VIII, and import restrictions for balance of payments purposes are applicable during the program period. A review with the Fund to assess the progress made in implementing the program and to establish quarterly performance criteria for the period of the arrangement beyond March 1989 is also a performance criterion; such a review is scheduled to take place before June 15, 1989.

IV. Staff Appraisal

The Government which came to office in early 1986 introduced in the middle of that year a comprehensive stabilization program aimed at laying the basis for sustained economic growth, which included a reduction in the combined public sector deficit, a decline in the rate of credit expansion, a reform of the exchange system, and the liberalization of price controls. As a result of these measures and aided by favorable coffee price developments, the declining trend of output was arrested, inflation fell, and the external current account deficit narrowed considerably.

In 1987 there was a resumption of growth and a substantial moderation of inflation, but the combined deficit of the public sector widened somewhat owing mainly to a large decline in coffee prices and rising current expenditures. The external current account deficit also increased, but Guatemala received substantial debt relief and exceptional financing which helped contain the overall balance of payments deficit. Partial data on economic developments in the first half of 1988 indicate that the performance of output and prices continued to be broadly satisfactory, but there were some slippages in the implementation of the budget, credit to the private sector expanded rapidly, and the external position deteriorated further. In this situation the authorities took action in mid-1988 to reinforce their adjustment efforts by unifying the exchange rate system, raising interest rates, and implementing additional fiscal measures.

The fiscal component of the economic program is based on the budget for 1988 which was framed with a view to offsetting the adverse effects of lower coffee prices, the phase out of the export tax, and constitutionally mandated expenditures. To this effect, several new tax measures (including reforms of income, property, value added, stamp, and vehicle taxes) were introduced in late 1987 and a program to improve tax administration was developed. On the expenditure side, emphasis is placed on strict control over government spending, especially current expenditures. In addition, tariff adjustments for certain state enterprises, including those for the power authority (INDE), were adopted earlier in the year with a view to ensuring that the nonfinancial public sector other than the central government maintains a surplus position throughout 1988 and 1989. In all, the program calls for a modest reduction in the combined public sector deficit in 1988, with further progress envisaged in 1989.

As it became evident that a program of reclassification of public sector positions adopted in 1987 resulted in unexpected increases in the central government wage bill, additional fiscal measures were implemented in mid-1988, as part of the corrective package referred to above, including across-the-board cuts in certain categories of discretionary programs. These measures appear to be sufficient to keep the overall public sector deficit within the programmed limit. However, given that the fiscal plan is an essential element of the program and that it does not provide room for slippages, it is important that the authorities stand ready to take any further measures that may be needed to safeguard the achievement of the program's fiscal objectives.

The implementation of the fiscal plan will facilitate a policy of monetary restraint consistent with the maintenance of low inflation and a strengthening of the balance of payments, while ensuring that adequate financial resources are available to the private sector. Domestic mobilization of financial savings is a crucial element for increased private investment and a resumption of economic growth. The recent creation of a stock exchange may be expected to be helpful in this regard, since it would broaden the market for government bonds and other financial instruments, thereby increasing the efficiency of financial intermediation.

Greater interest rate flexibility also is important. In June 1988 the authorities raised lending and deposit interest rates by 2 percentage points but further steps in this direction may be needed. The increase of yields on central bank bonds by 2 percentage points in September 1988 should result in a tightening of the liquidity position of the banking system by facilitating the transfer of public sector enterprises' deposits to the central bank. Adjustments of central bank rediscount rates would be advisable to strengthen control over bank credit expansion.

The reduction in inflation which has occurred in recent years has facilitated a substantial lifting of price controls. As provided in the program, it is important to apply the remaining controls in a flexible manner so as not to create supply distortions. Wage restraint by the central government is essential not only because of its contribution to the achievement of the objectives as regards the public finances but also to provide a guide to wage decisions in the rest of the public sector and in the private sector, consistent with the objective of reducing inflation. It is particularly important to monitor closely wage developments in the public enterprises to ensure that they are kept in line with those in the central administration.

The staff welcomes the reunification of the exchange system as a major component of the authorities' export-oriented growth strategy. The staff also attaches a great deal of importance to the authorities' intention to manage the exchange rate in a flexible manner, keeping in mind the balance of payments objectives of the program. To reduce further the anti-export bias of the trade system, the program provides for the phasing out of the temporary export tax and the authorities also intend to reduce the level and dispersion of import duties.

In order to normalize relations with external creditors it will be important that the authorities adhere to the objective of eliminating all debt and commercial arrears by mid-1989. For the same purpose, the authorities are endeavoring to refinance the outstanding stabilization bonds; in this respect it should be emphasized that early redemptions of these bonds in excess of the amounts envisaged in the program will need to be matched by additional adjustment measures in order to preserve the balance of payments objectives of the program.

In view of the strong measures already adopted and those that the authorities intend to implement in the course of 1988-89, the staff believes that the program for which the Guatemalan authorities have requested Fund assistance, in the form of a stand-by arrangement in an amount equivalent to SDR 54 million (40 percent of quota on an annual basis), justifies Fund support. In addition, owing to the temporary nature of the measures giving rise to restrictions, the staff recommends approval of the exchange restrictions arising from the export taxes and the external payments arrears until the conclusion of the next Article IV consultation, or the midterm review, whichever is earlier.

It is proposed that the next Article IV consultation take place on the standard 12-month cycle.

V. Proposed Decisions

The following draft decisions are proposed for adoption by the Executive Board:

I. Stand-by Arrangement

1. The Government of Guatemala has requested a stand-by arrangement for the period of 15 months for an amount equivalent to SDR 54 million.

2. The Fund approves the stand-by arrangement attached to EBS/88/202.

II. Exchange System

The Fund grants approval for the retention by Guatemala of the exchange restrictions described in EBS/88/202 until June 15, 1989 or the completion of the next Article IV consultation, whichever is earlier.

Guatemala City, Guatemala
August 17, 1988

Mr. Michel Camdessus
Managing Director
International Monetary Fund
Washington, D.C., 20431

Dear Mr. Camdessus:

1. The attached Memorandum on Economic Policy describes the economic program that the Government of Guatemala intends to pursue during the period July 1988-December 1989 with the objectives of maintaining a low rate of inflation, reactivating the economy, and strengthening the balance of payments.

2. In support of this program, we herewith request a stand-by arrangement for 15 months from the International Monetary Fund in an amount of SDR 54 million.

3. During the period of the arrangement, the Government of Guatemala does not intend to introduce any new or intensify existing restrictions on payments and transfers for current international transactions, introduce any new or intensify existing multiple currency practices, conclude any bilateral payments agreement which is inconsistent with Article VIII of the Fund's Articles of Agreement, or introduce any new or intensify existing restrictions for balance of payments reasons.

4. The Government of Guatemala believes that the policies set out in the attached Memorandum on Economic Policy are adequate to achieve the objectives of its program, but will take further measures that may become appropriate for this purpose. The Government will consult with the Fund on the adoption of any measures that may be appropriate, in accordance with the Fund's policies on such consultations.

5. Performance criteria for the period April-December 1989 will be established in a review of the program with the Fund that shall take place prior to June 15, 1989. In this context, the appropriateness of fiscal, monetary, and exchange rate policies will be assessed with a view toward assuring the attainment of the objectives of the program.

Sincerely,

/s/
Jose Miguel Gaitan Alvarez
President, Bank of Guatemala

/s/
Rodolfo Paiz Andrade
Minister of Finance

Guatemala: Memorandum on Economic Policy

1. In the period 1981-85 Guatemala experienced serious economic and financial difficulties that can be traced to both adverse external factors and domestic policy developments. On the external front, Guatemala's terms of trade deteriorated while the Central American Common Market collapsed due in part to political instability in the region. The effects of these external shocks were exacerbated by the failure to make appropriate adjustments in economic policies on a timely basis. As a result, export income and domestic output declined, inflation accelerated, the country experienced capital outflows, the net international reserves of the Bank of Guatemala dropped sharply, and there was a marked accumulation of external arrears. Unemployment reached very high levels and the fall in real incomes affected most severely around 70 percent of the population with the lowest per capita income, especially those who live in rural areas. Furthermore, public investment programs were not sufficiently geared toward the maintenance of physical capital or development of human capital, and the resulting deterioration in basic public services, such as education, health, environmental protection, and housing, adversely affected the country's development prospects.

2. The administration that took office at the beginning of 1986, following democratically held elections, launched a program of reforms ("Programa de Reordenamiento Economico y Social") that aimed at setting the country on a path of financial stability, economic recovery, and balance of payments viability, while seeking to reduce unemployment and expand social and economic opportunities for all income groups. To this end, the economic program called for: (a) a simplification and gradual unification of the three-tier exchange rate system that had been established at the end of 1984; (b) a significant reduction in the combined fiscal deficit and losses of the Bank of Guatemala, mainly through better revenue effort; (c) a marked slowdown in the rate of overall bank credit expansion; and (d) a liberalization of price controls. The social aspects of the program involved: (a) policies to promote employment, mainly in rural areas; (b) special lines of credit for purchases of agricultural inputs and medicines; and (c) incomes policies designed to increase productivity and reduce inflation.

3. In June 1986 the existing three-tier exchange rate system was reorganized into a reduced official market (in which the quetzal continued to be fixed at Q 1=US$1) for debt service payments registered with the Bank of Guatemala prior to June 1986; a new regulated market for most trade transactions and the remainder of debt service payments, in which the quetzal was initially set at Q 2.50=US$1; and a banking market without central bank intervention for private invisibles and capital flows. The modifications in the exchange system and a tightening of fiscal policies (the combined deficit of the public sector fell from 5.9 percent of GDP in 1985 to 2.6 percent of GDP in 1986) led to a major improvement of economic performance in 1986, especially with

respect to inflation and the balance of payments. Also, the decline in economic activity was arrested; after falling for several years, real GDP in 1986 remained unchanged from the preceding year.

4. In 1987 Guatemala's economic performance was mixed. Real GDP grew by about 3 percent, and the rate of increase in the consumer price index fell from 37 percent in 1986 to about 12 percent. The combined deficit of the public sector increased to about 3.3 percent of GDP, as the adverse effect of lower coffee export prices on tax receipts were only partially offset by improvements in other revenues while central government current expenditures increased substantially. The deterioration in the terms of trade, together with the pickup in economic activity, including large-scale inventory replenishment, led to a sharp widening of the external current account deficit from 1 percent of GDP in 1986 to an estimated 8 1/2 percent of GDP in 1987. A decline in coffee exports on account of lower prices was largely offset by an increase of nearly 35 percent in nontraditional exports, but imports rose by about 50 percent from the depressed level of 1986. Guatemala was able to secure in 1987 significant amounts of debt relief on commercial and official credits (US$116 million) and economic assistance from bilateral sources (US$113 million). In addition, there was a marked increase in net inflows of private capital. Nonetheless, the overall balance of payments deteriorated from a small surplus in 1986 to a US$46 million deficit in 1987 while the stock of external arrears (including stabilization bonds) remained broadly unchanged. Discussions with commercial banks on the rescheduling of past-due principal (which comprises the bulk of the debt arrears) have been held intermittently since 1986 and the Bank of Guatemala has remained current on interest payments on its external debt.

5. Partial data on economic performance in the first half of 1988 indicate that growth and inflation performance has continued to be satisfactory but that the needed tightening of credit and fiscal policies had not been fully realized. The external position came under heavy pressure and net official international reserves fell sharply.

6. In June 1988, in order to assure the continued expansion of the economy in an environment of low inflation and strengthened balance of payments position, the Government of Guatemala decided to reinforce its adjustment effort. As part of this plan, the Government has virtually completed the process of exchange rate unification initiated in 1986, has taken measures to reduce the combined fiscal deficit and losses of the Bank of Guatemala, has boosted interest rates and prices of petroleum products, and is implementing a program of export promotion and diversification consonant with an outwardly-oriented economic strategy. The Government also attaches great importance to the need not only to create conditions for sustained growth, but also to deepen the growth process by decentralizing government services and by reorienting spending priorities toward regional development, the maintenance of key infrastructure, and investment in human capital. In order to help

implement these policies, the Government has established a Social Investment Fund to provide resources as part of what in Guatemala has been referred to as the settlement of the "Social Debt", which represents an effort on the part of both the Government and the private sector to expand and improve the provision of basic social services. The details of the economic program, including specific targets for the period through March 1989, are set out in the following paragraphs of this memorandum. Performance criteria for the remainder of the period of the arrangement will be established in a review of the program with the Fund that shall take place prior to June 15, 1989.

7. On June 23, 1988 a virtual unification of the exchange rate system was implemented. Transactions that had been conducted in three distinct markets (official, regulated, and banking) were shifted to a single exchange market with a rate set initially at Q 2.70=US$1. The unification implied a devaluation of the exchange rate of about 10 percent in foreign currency terms. Owing to legal constraints, certain foreign exchange operations of the Bank of Guatemala will continue to be accounted for at Q 1=US$1 which would not have economic consequences. The unification is expected to reduce price distortions, promote both exportables and efficient import substitution, and virtually eliminate exchange losses of the Bank of Guatemala. Following the unification the authorities intend to manage the exchange rate flexibly in the light of developments in the balance of payments in order to achieve the external objectives of the program. The Government has established quarterly targets for the net international reserves of the Bank of Guatemala (including payments arrears) which are consistent with limiting the overall balance of payments deficit to US$40 million in 1988 and achieving a surplus of US$60 million in 1989 (Table 1). These targets include the complete elimination of the remaining external arrears by June 30, 1989 (Table 2).

8. It is the intention of the Government to continue to make promptly all payments for current international transactions on a timely basis. To this effect, all bona fide requests for foreign exchange are being approved within a maximum period of five working days, which is the normal time period required for document verification. Any foreign exchange request not acted upon within five working days will be considered as a payment arrear for purposes of the targets mentioned above.

9. A key objective of the Government's economic program is to promote a vigorous expansion of exports and to decentralize the government's decision-making process so as to create a basis for economic growth and development over the medium term. In addition to maintaining an adequate exchange rate, this objective requires improvements in administrative procedures that affect export activity, a rationalization of fiscal incentives and a reduction in tariff protection. By way of institutional reforms, the Government has established a "one-stop" agency in the Ministry of Economy to deal with all the legal and documentary requirements in the export field that had been handled previously by several separate agencies. In addition, in 1986 the Government

established the National Council for Export Promotion (CONAPEX), comprising representatives of the private and public sectors, to advise the Government on policies and issues affecting export activity. As a result of recommendations of this council, the Government has taken steps to improve shipping and air freight facilities for exporters and to establish export credit insurance. The Government is also streamlining the export promotion law with a view to broadening the basis for duty-free imports of inputs used in exports. At the same time, the temporary tax on exports introduced in June 1986 is being phased out over a period of 33 months which began in June 1987.

10. In the area of trade policy, the Government is committed to reduce over the medium term the level and dispersion of tariff rates. The first step in this process was taken at the beginning of 1986 when a revised common external tariff for the Central American Common Market was introduced. In addition to reductions in maximum tariffs on consumer goods and the establishment of minimum tariffs on intermediate and capital goods, the regional reform introduced a new (Brussels) tariff nomenclature, converted tariff rates from a specific to an ad valorem basis, and eliminated tariff exemptions except for inputs used in export production. The Government intends to rationalize further the tariff schedule in the context of an export promotion loan that is being negotiated with the World Bank.

11. In order to create an environment for the continuation of economic expansion and a stable value for the quetzal, the Government intends to pursue fiscal and monetary policies conducive to a reduction in domestic financial imbalances and the maintenance of low inflation. Specifically, the combined fiscal deficit and losses of the Bank of Guatemala will be lowered to 3.2 percent of GDP in 1988 and 2.6 percent in 1989. The achievement of the fiscal targets will be based mainly on further improvements in the revenue performance and on expenditure restraint. With respect to revenue, in October 1987 the Government introduced significant reforms in the structure and administration of the income, property, and value-added taxes; raised import duties (by 4 percentage points), stamp taxes, and automobile registration fees; and rationalized certain exemptions. These measures, in addition to broadening the tax base and minimizing tax evasion and noncompliance, are aimed at reducing the regressiveness of the current tax structure. The yield of the tax package has been estimated at about 1.4 percent of GDP, which would more than offset the loss in revenue that would result from the lowering of export tax rates.

12. As regards expenditure policy, the Government's intention is to exercise restraint in order to accommodate constitutionally mandated spending requirements, as well as to absorb the higher debt service costs (in quetzales) stemming from the unification of the exchange rate system. In this regard the highest priority will need to be placed on controlling strictly current expenditures. In particular, the added wage bill expenditures resulting from a program of reclassification of positions in the public sector will be offset through (a) a 10 percent

across-the-board reduction in nonwage current expenditures of the Central Government; (b) a freezing of unspent budgetary allocations as of June 30, 1988; and (c) a review of staffing levels throughout the public sector. At the same time, a key aim of the Government is to reorient spending priorities to address pressing social concerns, especially those of health, education and special local needs, and to assign sufficient resources for the proper maintenance of the existing capital stock. Similarly, the investment budget has been reformulated to focus on those economic and social projects that have quick-yielding results. After the last two years of retrenchment in this area, the Government believes it is necessary to raise gradually public investment in order to support the structural changes and regional development which will lead to sound economic growth over the medium term.

13. As regards the rest of the nonfinancial public sector, the intention of the Government is to ensure that, in the medium-term, the current revenues of the state enterprises are adequate to cover their operating costs (including the increased debt service payments due to the unification of the exchange system) as well as a share of their investment outlays. Accordingly, the Government intends to reduce the level of transfers to the rest of the public sector by either increasing tariff rates, reducing administrative and operating costs, or a combination of both. To promote a more efficient use of energy resources and reduce cross-product subsidies, gasoline and diesel prices were raised by 8 percent and 38 percent, respectively, in early July 1988. The Electricity Authority (INDE)--a major public sector enterprise with substantial foreign indebtedness--is expected to remain in surplus position throughout 1988, owing to a 25 percent average increase in tariffs that took place in early 1988.

14. The losses of the Bank of Guatemala have been targeted to decline from an estimated 2.0 percent of GDP in 1987 to 1.4 percent of GDP in 1988. The elimination of the Bank of Guatemala's exchange losses following the unification of the exchange system will be instrumental in assuring this improvement.

15. The Government intends to strengthen its control over the monetary and credit aggregates in order to reduce pressures on domestic prices and the balance of payments. To this end, as well as to promote an efficient allocation of domestic bank credit, on June 23, 1988 the Monetary Board raised the interest rate ceilings from 11 percent to 13 percent for savings and time deposits, with corresponding increases in lending rates. The Bank of Guatemala will continue to sell government bonds from its portfolio to private, banking, and public sector institutions with a view to controlling monetary aggregates and inducing more flexibility in the interest rate structure. Moreover, the Government has authorized a stock exchange to facilitate private sector transactions in government bonds and other financial instruments and promote thereby the growth of private financial savings.

16. Consistent with the fiscal targets stated earlier, domestic financing (defined as net banking system credit plus net domestic bond placements of the Central Government outside the banking system) of the nonfinancial public sector will not exceed Q 135 million in 1988. To monitor performance with respect to this target, the Government has established quarterly ceilings which are set out in Table 3. In line with the external sector and price objectives of the program, and consistent with the projected growth in private financial savings, total bank credit is targeted to expand by approximately 11 percent in 1988. On the basis of the estimates just mentioned, the Government has established quarterly ceilings on the Bank of Guatemala's net domestic assets which are set out in Table 4.

17. The Government believes that prices should reflect the interplay of market forces. Accordingly, the Government has reduced to a minimum the scope of price controls which are maintained for a few essential consumer goods and medicines. As long as these controls are maintained, they will be administered flexibly to prevent supply shortages. Minimum wage levels are set in consultations among the Government, employers, and employees, but otherwise the Government does not intervene in the wage determination process in the private sector, except as a mediator in collective bargaining.

18. The Government intends to finance the public sector's future borrowing requirements mainly with the proceeds of foreign grants and long-term concessional loans. Guatemala will be facing significant external debt service obligations in 1988, in part because of substantial recourse to foreign commercial loans and the issuance of bonds in the recent past, especially on the part of the Bank of Guatemala. Accordingly, in view of the external current account and overall balance of payments objectives of the program, and assuming the rescheduling of current and past due principal obligations with commercial banks and of the stabilization bonds issued in 1983-84, Guatemala has a need for exceptional balance of payments financing of US$80 million in 1988 and US$181 million in 1989. These financing needs are expected to be met by economic assistance and sectoral program loans from U.S. AID, the World Bank, and the Inter-American Development Bank. No request for new money from bank creditors is anticipated. However, debt reschedulings with our few bilateral creditors may be necesary.

19. In view of Guatemala's current external debt problems, and in order not to weaken Guatemala's relatively favorable debt profile over the medium term, the Government intends to limit the contracting by the public sector (including public financial institutions) of new loans with maturities of over one year and up to and including 12 years to US$110 million during the period of the program. Within this overall ceiling, new commitments with maturities of over one year and up to and including five years will be limited to US$90 million. This ceiling and subceiling also will apply to officially guaranteed private sector loans and suppliers' credits, but will exclude any new loans directly related to the refinancing or rescheduling of existing external public debt and

financing from bilateral sources. The Government also intends not to increase its recourse to short-term foreign borrowing; accordingly, during the program period, the net short-term foreign commercial indebtedness of the public sector (excluding reserve liabilities of the Bank of Guatemala and normal trade credits) will not increase over the balance outstanding at the end of June 1988 (US$30 million). To facilitate management of external debt operations as outlined above, the Government has established quarterly limits on new external borrowing which are set out in Table 5.

20. The Government of Guatemala believes that the program outlined above will provide a basis for sustained growth and durable balance of payments adjustment, and will contribute importantly toward meeting the economic and social needs of the people of Guatemala in the period ahead and over the longer run.

Table 1. Guatemala: Targets for the Stock of the Net International Reserves of the Bank of Guatemala 1/

(In millions of U.S. dollars; end of period)

Period	Stocks Outstanding
December 31, 1987	73
July 1-September 30, 1988 2/	36
October 1-December 31, 1988	33
January 1-March 31, 1989	36
April 1-December 31, 1989 2/	93

1/ Defined as the difference between the gross foreign assets and the short term foreign liabilities, including the net position of the IMF and arrears on commercial payments and external debt service (excluding reschedulable amounts). The gold holdings of the Bank of Guatemala are to be valued at US$42 per troy ounce; non U.S. dollar denominated foreign assets and liabilities are to be converted into U.S. dollars at the market exchange rates for the respective currencies on June 30, 1988; and Guatemala's Fund position and SDR holdings are to be converted into U.S. dollars at the SDR value of the U.S. dollar on June 30, 1988.

2/ Indicative targets.

Table 2. Guatemala: Targets for External Payments Arrears 1/

(Outstanding stocks in millions of U.S. dollars)

Period	Amount
December 31, 1987	260
July 1-September 30, 1988 2/	250
October 1-December 31, 1988 1/	250
January 1-March 31, 1989 1/	250
April 1-June 30, 1989 2/	--

1/ Defined as the sum of nonbonded commercial arrears and debt service arrears including reschedulable amounts, plus any outstanding bona-fide requests for foreign exchange beyond five working days. Arrears incurred by CORFINA are to include unpaid amortization payments falling due after December 31, 1987.

2/ Indicative targets.

Table 3. Guatemala: Ceilings for Cumulative Changes in the Net Domestic Financing of the Nonfinancial Public Sector 1/

(In millions of Quetzales; end of period)

Period	Cumulative change from December 31, 1987
July 1-September 30, 1988 2/	-142
October 1-December 31, 1988	135
January 1-March 31, 1989	135
April 1-December 31, 1989 2/	87

1/ Defined as the sum of net banking system credit to the nonfinancial public sector and net domestic bond placements outside the banking system by the central government.
2/ Indicative targets.

Table 4. Guatemala: Ceilings on the Stock of the Net Domestic Assets of the Monetary Authorities 1/

(In millions of Quetzales; end of period)

Period	Stocks Outstanding
December 31, 1987	810
July 1-September 30, 1988 2/	910
October 1-December 31, 1988	1,010
January 1-March 31, 1989	1,010
April 1-December 31, 1989 2/	920

1/ Includes Bank of Guatemala and the Securities Regulation Fund (FRV). Net domestic assets are defined as the difference between the currency issue and net international reserves (as defined in Table 1). For purposes of calculating net domestic assets, the changes in net international reserves and other foreign currency denominated accounts in each quarter are to be valued at the exchange rate of Q 2.70=US$1.

2/ Indicative targets.

Table 5. Guatemala: Ceilings on Public and Publicly Guaranteed External Debt

(In millions U.S. dollars)

Period	Cummulative Change from July 1, 1988		
	Over 1-12 Years 1/ (Ceilings)	Over 1-5 Years 1/ (Subceilings)	1 Year or Less 2/
Through December 31, 1988	50	40	--
Through March 31, 1989	90	80	--
Through June 30, 1989 3/	100	90	--
Through September 30, 1989 3/	100	90	--
Through December 31, 1989 3/	110	90	--

1/ Includes all new contracts (i.e., gross commitments) on official and publicly guaranteed external debt with original maturities of over one year and up to and including 12 years, with subceilings on the maturity range of over one to five years, excluding new loans directly related to the refinancing or rescheduling of external debt.

2/ Refers to changes in the outstanding amount of debt with original maturities up to and including one year, but excludes reserve liabilities of the Bank of Guatemala and normal trade credits.

3/ Indicative targets.

Guatemala - Fund Relations
(As of July 31, 1988)

I. **Membership Status**

(a) Date of membership: December 28, 1945
(b) Status: Article VIII

A. Financial Relations

II. **General Department**

	Millions of SDRs	Percent of Quota
(a) Quota	108.0	
(b) Total Fund holdings of quetzales:	137.6	127.4
(c) Fund credit: Total	29.6	27.4
of which: - Credit tranche	6.7	6.2
- CFF	--	--
- Enlarged access under SBA	22.9	21.2
(d) Reserve tranche position	--	--
(e) Current operational budget	--	--

III. **Stand-by Arrangement and Special Facilities Over the Last Ten Years**

(a) Current stand-by arrangement: None

(b) Previous stand-by arrangements:

(i)	Duration:	August 31, 1983 to December 31, 1984
(ii)	Amount:	SDR 114.75 million
(iii)	Utilization:	SDR 57.375 million
(iv)	Undrawn balance:	SDR 57.375 million
(i)	Duration:	November 13, 1981 to November 12, 1982
(ii)	Amount:	SDR 19.10 million
(iii)	Utilization:	SDR 19.10 million
(iv)	Undrawn balance:	--

(c) Special facilities
Compensatory financing: SDR 76.5 million, approved by the Executive Board on November 13, 1981 and purchased on November 18, 1981.

IV. SDR Department	Millions of SDRs	Percent of Allocation
(a) Net cumulative allocation:	SDR 27.7	
(b) Holdings:	--	--
(c) Current Designation Plan:	--	--

V. Financial Obligations Due to the Fund

	Overdue Financial Obligations 7/31/88	Principal and Interest Due Aug.-Dec. 1988	1989	1990	1991
Repurchases	--	7.8	11.1	9.6	1.2
Charges and interest including SDR and TF (provisional)	--	1.1	3.3	2.6	2.0
Total	--	8.8	14.4	12.1	3.2

B. Nonfinancial Relations

VI. Exchange Rate Arrangement: Effective June 23, 1988, the exchange rate system was reunified: all transactions were shifted to a single exchange market with exchange rates set initially at Q 2.70 = US$1 (buying) and Q 2.72 = US$1 (selling). Certain foreign exchange transactions of the Bank of Guatemala have continued to be accounted for at Q 1 = US$1 but no transactions take place at that rate. Guatemala maintains a restriction on payments and transfers for current international transactions evidenced by external payments arrears and engages in a multiple currency practice stemming from the collection of the temporary tax on exports through the exchange system. Guatemala's exchange restriction and multiple currency practice are not approved by the Fund.

VII. Last Article IV Consultation: Staff mission during March 30 - April 4, 1987; consultation completed by the Executive Board on July 31, 1987 (EBM/87/113).

VIII. Technical Assistance

a. Bureau of Statistics: Missions in the field of money and banking in September 1987 and June 1988.

b. FAD: Mission in the field of budget management in June-July 1987. Budget advisor is provided for a period of one year through February 1989.

c. CBD: Research advisor is provided in the field of monetary accounts and financial programing.

Guatemala: Relations with the World Bank Group

(In millions of U.S. dollars)

1. Financial relations

A. IBRD/IDA/IFC Operations
(as of June 30, 1988)

	Disbursed	Undisbursed
IBRD/IDA loans		
Agriculture	4.0	--
Education	33.65	9.85
Power	189.95	73.65
Of which: Chixoy	(112.95)	(3.65)
Urban development	20.0	52.00
Transportation	34.30	--
Telecommunications	55.45	16.32
Industry	3.25	16.75
Total	340.60	168.57
Of which: Repaid	132.30	
Outstanding	208.30	
IFC investments	18.2	--

B. IBRD/IDA Loan Disbursements

	1983	1984	1985	1986	1987
Net disbursements	6.5	-0.8	34.4	0.3	2.5
Gross disbursements	20.4	7.9	48.6	17.0	16.3
Amortization	13.9	8.7	14.2	16.7	18.8

2. Recent IBRD technical assistance

The municipal development loan approved in June 1988 includes technical assistance for improving planning and management of municipal finances in Guatemala City.

3. Recent economic and sector missions

Following the most recent report on Guatemala's economic situation and prospects (No. 6434-6U0), substantial additional sector work has been initiated. Reports of a Water Supply Sector mission and Fiscal Management mission were completed in May and August 1988, respectively. The reports of a Financial Sector Mission (April 1988) and Public Sector Expenditure Review Mission (April/May 1988) are under preparation.

Source: IBRD.

Guatemala: Stand-By Arrangement

Attached hereto is a letter, with annexed Memorandum on Economic Policy, dated August 17, 1988, from the Minister of Finance and the President of the Bank of Guatemala requesting a stand-by arrangement and setting forth: (a) the objectives and policies that the authorities of Guatemala intend to pursue for the period of this stand-by arrangement; and (b) understandings of Guatemala with the Fund regarding a review that will be made of progress in realizing the objectives of the program and of the policies and measures that the authorities of Guatemala will pursue for the period of this stand-by arrangement. To support these objectives and policies the International Monetary Fund grants this stand-by arrangement in accordance with the following provisions:

1. For the period from October 15, 1988 to February 28, 1990, Guatemala will have the right to make purchases from the Fund in an amount equivalent to SDR 54 million, subject to paragraphs 2, 3, 4, 5, and 6 below, without further review by the Fund.

2. (a) Purchases under this stand-by arrangement shall not, without the consent of the Fund, exceed the equivalent of SDR 23.16 million until January 31, 1989, the equivalent of SDR 35.50 million until April 30, 1989, the equivalent of SDR 35.50 million until July 31, 1988, the equivalent of SDR 41.67 million until October 31, 1988, the equivalent of SDR 47.84 million until January 31, 1990.

(b) None of the limits in (a) above shall apply to a purchase under this stand-by arrangement that would not increase the Fund's holdings of Guatemala's currency in the credit tranches beyond 25 percent of quota.

3. Purchases under this stand-by arrangement shall be made from ordinary resources only.

4. Guatemala will not make purchases under this stand-by arrangement, other than the initial purchase of SDR 23.16 million that it may request not later than within 15 days from the effective date of this arrangement, that would increase the Fund's holdings of Guatemala's currency in the credit tranches beyond 25 percent of quota

(a) during any period in which

(i) the quarterly target for net international reserves of the Bank of Guatemala described to in paragraph 7 and Table 1 of the Memorandum on Economic Policy annexed to the attached letter;

(ii) the limit on outstanding external payments arrears set forth in paragraph 7 and Table 2 of the Memorandum on Economic Policy annexed to the attached letter;

(iii) the quarterly ceiling on net domestic financing of the nonfinancial public sector set forth in paragraph 16 and Table 3 of the Memorandum on Economic Policy annexed to the attached letter;

(iv) the limit on the net domestic assets of the monetary authorities described to in paragraph 16 and Table 4 of the Memorandum on Economic Policy annexed to the attached letter;

(v) the limits on the amount of new foreign loans with maturities of over 1 to 12 years contracted by or guaranteed the public sector and the outstanding amount of short-term (1 year or less) borrowing by the public sector described in paragraph 19 and Table 5 of the Memorandum on Economic Policy annexed to attached letter,

are not observed; or

(b) during any period after June 15, 1989, until the review contemplated in paragraph 5 of the attached letter has been completed and suitable performance criteria for the remaining period of the arrangement after June 15, 1989 have been established, or after such performance criteria have been established, while they are not being observed; or

(c) during the entire period of this stand-by arrangement if Guatemala:

(i) imposes any new or intensifies existing restrictions on payments and transfers on current international transactions; or

(ii) introduces multiple currency practices; or

(iii) concludes bilateral payments agreements which are inconsistent with Article VIII; or

(iv) imposes or intensifies existing import restrictions for balance of payments reasons.

When Guatemala is prevented from purchasing under this stand-by arrangement because of this paragraph 4, purchases will be resumed only after consultation has taken place between the Fund and Guatemala and understandings have been reached regarding the circumstances in which such purchases can be resumed.

5. Guatemala will not make purchases under this stand-by arrangement during any period of the arrangement in which Guatemala has an overdue financial obligation to the Fund or is failing to meet a repurchase expectation pursuant to the Guidelines on Corrective Action in respect of a noncomplying purchase.

6. Guatemala's right to engage in the transactions covered by this stand-by arrangement can be suspended only with respect to requests received by the Fund after (a) a formal ineligibility, or (b) a decision of the Executive Board to suspend transactions, either generally or in order to consider a proposal, made by an Executive Director or the Managing Director, formally to suppress or to limit the eligibility of Guatemala. When notice of a decision of formal ineligibility or of a decision to consider a proposal is given pursuant to this paragraph 6, purchases under this arrangement will be resumed only after consultation has taken place between the Fund and Guatemala and understandings have been reached regarding the circumstances in which such purchases can be resumed.

7. Purchases under this stand-by arrangement shall be made in the currencies of other members selected in accordance with the policies and procedures of the Fund, and may be made in SDRs if, on the request of Guatemala, the Fund agrees to provide them at the time of the purchase.

8. Guatemala shall pay a charge for this stand-by arrangement in accordance with the decisions of the Fund.

9. (a) Guatemala shall repurchase the outstanding amount of its currency that results from a purchase under this stand-by arrangement in accordance with the provisions of the Articles of Agreement and decisions of the Fund, including those relating to repurchase as Guatemala's balance of payments and reserve position improves.

(b) Any reductions in Guatemala's currency held by the Fund shall reduce the amounts subject to repurchase under (a) above in accordance with the principles applied by the Fund for this purpose at the time of the reduction.

10. During the period of the stand-by arrangement Guatemala shall remain in close consultation with the Fund. These consultations may include correspondence and visits of officials of the Fund to Guatemala or of representatives of Guatemala to the Fund. Guatemala shall provide the Fund, through reports at intervals or dates requested by the Fund, with such information as the Fund requests in connection with the progress of Guatemala in achieving the objectives and policies set forth in the attached letter and annexed Memorandum on Economic Policy.

11. In accordance with paragraph 4 of the attached letter, Guatemala will consult the Fund on the adoption of any measures that may be appropriate at the initiative of the Government or whenever the Managing Director requests consultation because any of the criteria in

paragraph 4 above have not been observed or because he considers that consultation on the program is desirable. In addition, after the period of the arrangement and while Guatemala has outstanding purchases in the upper credit tranches, the Government will consult with the Fund from time to time, at the initiative of the Government or at the request of the Managing Director, concerning Guatemala's balance of payments policies.

Guatemala: Selected Economic and Financial Indicators

	1984	1985	1986	Prel. 1987	Program 1988	Program 1989
Average exchange rate (end of period, quetzales per US$1)	1.53	1.74	2.38	2.47	...	...
(Annual percent changes, unless otherwise specified)						
National income and prices						
GDP at constant prices	0.5	-0.6	0.1	3.1	4.0	4.5
GDP deflator	4.1	18.2	42.1	7.7	13.3	8.0
Consumer prices (annual average)	3.7	18.6	36.9	12.3	12.0	8.0
(end of period)	5.2	31.5	25.7	10.1	13.0	8.0
External sector (on the basis of U.S. dollars)						
Exports, f.o.b.	3.7	-1.8	-6.2	-6.3	16.6	12.9
Imports, c.i.f.	12.6	-8.1	-18.3	50.8	4.0	6.0
Export volume	-1.6	7.9	-14.8	6.5	5.1	2.0
Import volume	10.4	-1.9	-14.8	42.1	-1.0	-2.9
Terms of trade (deterioration -)	3.3	-2.9	15.1	-17.1	5.6	-2.0
Nominal effective exchange rate (depreciation -)	-9.2	-62.1	-14.0	3.9	...	...
Real effective exchange rate (depreciation -)	-10.?	-33.8	-1.0	-1.7	...	...
Government budget						
Total revenue	-2.8	25.4	62.6	18.0	25.7	10.2
Total expenditure	-1.1	5.8	59.6	22.8	24.8	11.9
Of which: interest payments	11.3	-7.5	170.9	18.1	29.8	11.8
Money and credit						
Domestic credit 1/2/	25.7	30.5	25.0	8.3	12.1	4.4
Public sector	14.0	4.7	-8.2	-6.4	1.9	--
Private sector	8.9	8.0	6.6	13.8	7.1	6.3
Money and quasi-money	12.0	31.7	27.6	8.7	10.5	10.9
Velocity 3/	4.0	3.9	4.3	4.0	4.3	4.4
Interest rate (maximum rate on time deposits)	9.0	9.0	11.0	11.0	...	...
(As percent of GDP)						
Combined public sector deficit (including Central Bank losses)	4.1	5.9	2.6	3.3	3.2	2.6
Overall deficit of the nonfinancial public sector	3.4	1.4	0.7	1.3	1.7	1.8
Central government savings	-0.8	0.2	--	-0.3	-0.1	-0.2
Central government budget deficit	3.7	1.8	1.9	2.5	2.5	2.6
Domestic financing	3.4	1.2	1.0	1.1	1.4	0.2
Foreign financing 4/	0.3	0.6	0.9	1.4	1.1	2.4
Gross domestic investment	11.6	11.6	10.3	13.8	13.3	13.0
Gross national savings	5.4	7.8	9.1	5.4	6.9	7.5
External current account deficit	6.2	3.7	1.2	8.4	6.5	5.5
External debt, inclusive of use of Fund credit, arrears, and stabilization bonds	38.7	40.9	40.6	37.1	37.5	36.4
(As percent of exports of goods and services)						
Debt service 5/	23.2	30.1	59.0	44.5	39.8	25.9
Interest payments 5/	13.5	15.8	18.3	16.4	13.3	12.7
(In millions of U.S. dollars)						
Overall balance of payments 6/	-187	-94	-10	-44	-40	60
Gross official reserves (months of imports, c.i.f.)	3.4	4.1	6.1	3.2	2.8	3.1
External payment arrears 7/ 8/	22	104	231	262	222	--
Stabilization bonds 8/	468	482	472	450	...	...

Sources: Bank of Guatemala; and Fund staff estimates.

1/ Changes as a percentage of liabilities to the private sector at the beginning of the period.
2/ Excludes counterpart of payment arrears.
3/ GDP relative to two-year average of liabilities to the private sector.
4/ Including foreign assistance grants.
5/ On short-, medium-, and long-term debt, IMF, and bonds.
6/ Including changes in arrears.
7/ Debt and commercial arrears.
8/ Stocks at end of period.

Guatemala: Summary of the Stand-by Program

1. Principal targets

a. To maintain condition for expanding economic activity and export growth while improving the external position and inflation performance.

b. To normalize relationships with external creditors by eliminating external payments arrears by end-June 1989 while limiting the overall balance of payments deficit to US$40 million in 1988 and achieving a surplus of US$60 million in 1989.

c. To reduce the overall deficit of the nonfinancial public sector from 3.3 percent of GDP in 1987 to 3.2 percent in 1988 and 2.6 percent in 1989.

d. To limit domestic financing of the deficit of the nonfinancial public sector to Q 135 million in 1988 and to a net repayment of Q 48 million in 1989 while limiting expansion of the net domestic assets of the monetary authorities to Q 107 million in 1988 and reducing it by Q 372 million in 1989.

e. To lower further the rate of increase in consumer prices from 12 percent in 1987-88 to 8 percent in 1989.

2. Main assumptions

a. Nominal GDP is projected to increase by 18 percent in 1988 (4 percent in real terms) and by 13 percent in 1989 (4.5 percent in real terms).

b. The banking system's liabilities to the private sector are projected to rise by 11 percent in 1988 and in 1989.

c. Exports in U.S. dollar terms are expected to increase by 17 percent in 1988 and by 13 percent in 1989, while imports are projected to rise by 4 percent in 1988 and by 6 percent in 1989. Domestic financial resources in 1988 will be supplemented by US$80 million in bilateral grants and by US$80 million in grants and US$80 million in balance of payments support loans from multilateral development banks in 1989.

3. Principal elements and instruments

a. Fiscal policy

(1) The reduction of the public sector deficit to 3.2 percent of GDP in 1988 and 2.6 percent in 1989 is predicated on an estimated 1.4 percentage points of GDP of additional revenues from the tax package of October 1987. This package included substantial revisions to

the laws governing income taxes, value-added taxes, property taxes, stamp taxes, and vehicle taxes, while an additional 4 percentage points import surcharge was imposed on certain imports.

(2) On the expenditure side, emphasis shall be placed on improving the structure of expenditures while maintaining strict control of current expenditures. In addition to certain accross-the-board cuts and freezes of unspent allocations, the Government intends to slow down the execution of budgeted expenditures. The investment budget has been reformulated to focus only on those economic and social projects that have quick-yielding results.

(3) In the public enterprise sector, significant rate increases have been implemented which included INDE (the electricity authority).

(4) It is the intention of the authorities to finance over the medium term the deficit of the nonfinancial public sector mainly with long-term foreign assistance. To monitor fiscal performance, the program has established quarterly cumulative limits on the amount of domestic financing (defined as the sum of net banking system credit to the nonfinancial public sector and net domestic bond placements of the central government outside the banking system) of the deficit of the nonfinancial public sector.

b. Monetary policy

Consistent with the projected growth in financial savings and balance of payments targets, net domestic assets of the banking system are targeted to increase by 10 percent in 1988 and by 4 percent in 1989. In order to monitor these targets, quarterly ceilings on the net domestic assets of the monetary authorities have been established.

c. External sector policy

After the unification of the exchange system of June, the Government intends to pursue a flexible exchange rate policy; the exchange rate will be adjusted from time to time in accordance with developments in international reserves and in the balance of payments more generally. Included in the program are quarterly targets on net international reserves of the Bank of Guatemala which are programmed to fall by at most US$40 million in 1988 and to increase by at least US$60 million in 1989. A schedule for the elimination of external payments arrears has also been established. A ceiling on the amount outstanding of short-term foreign indebtedness of the public sector and limits on the contracting and guaranteeing by the public sector of foreign borrowing with maturities of 1-12 years and 1-5 years have been included as performance criteria.

d. Other performance criteria

The remaining performance criteria relate to customary clauses on exchange restrictions, arrears to the Fund, and a midterm review to be completed by June 15, 1989.

Guatemala: Schedule of Purchases During Period of Stand-By Arrangement, October 1988-February 1990

Amount (In millions of SDRs)	Scheduled Availability Date	Conditions for Purchase 1/
23.16	October , 1988	Executive Board approval.
6.17	After January 31, 1989	Observance of quantitative performance criteria as of December 31, 1988.
6.17	After April 30, 1989	Observance of quantitative performance criteria as of March 31, 1989.
6.17	After July 31, 1989	Observance of quantitative performance criteria as of June 30, 1989 and completion of a program review.
6.17	After October 31, 1989	Observance of quantitative performance criteria as of September 30, 1989 and any other conditions to be decided upon in the program review.
6.16	After January 31, 1990	Observance of quantitative performance criteria as of December 31, 1989 and any other conditions to be decided upon in the program review.

1/ Other than generally applicable conditions under the arrangement and nonquantitative performance criteria, including the performance clauses on the exchange and trade system.

Guatemala--Basic Data

Area and population	
Area	108,889 sq. kilometers
Population density (1986)	76.2 per sq. kilometers
Distribution of land by farm size	Not available
Income distribution (highest 20 percent)	55.0 percent
Population	8.3 million
Rate of population growth	3.1 percent
Life expectancy at birth	59.8 years
Infant mortality rate	65.6 per thousand
Child death rate	5.1 per thousand
Population per physician	4,717.7
Population per hospital bed	470.4
Population with access to safe water	52.3 percent
Population with access to electricity	37.2 percent
Calorie intake as percent of requirements	94.6 percent
Adult literacy rate	54.0 percent
Primary school enrollment rate	74.0 percent
Unemployment rate	13 percent
GDP (1987)	SDR 5,509
GDP per capita (1987)	SDR 664

	1985	1986	1987	Est. 1988
Origin of GDP		(percent)		
Agriculture	26.0	26.0	26.0	26.0
Manufacturing	16.0	16.0	16.0	16.0
Construction	2.0	2.0	2.0	2.0
Commerce	25.0	25.0	25.0	25.0
Other services	31.0	31.0	31.0	31.0
Ratios to GDP				
Exports of goods and nonfactor services	19.0	17.6	16.0	16.8
Imports of goods and nonfactor services	19.8	16.2	22.6	21.5
Current account of the balance of payments	-3.7	-1.1	-8.4	-6.5
Central government revenues	7.8	8.9	9.4	10.1
Central government expenditures	9.6	10.8	11.9	12.6
Central government savings	0.2	--	-0.3	-0.1
Central government overall surplus or deficit (-)	-1.8	-1.9	-2.5	-2.5
External public debt (end of year)	27.1	27.2	25.2	24.8
Gross national savings	8.2	9.0	3.5	4.6
Gross domestic investment	11.9	10.1	12.0	11.1
Money and quasi-money (end of year)	29.4	26.3	25.7	24.1
Change - Money and quasi-money	7.1	5.7	2.0	2.3
Annual changes in selected economic indicators				
Real GDP	0.6	0.1	3.1	4.0
GDP at current prices	17.5	42.3	11.1	17.9
Domestic expenditure (at current prices)	14.6	39.3	20.1	15.7
Investment	14.1	20.8	31.5	9.2
Consumption	14.7	40.8	18.6	16.8
GDP deflator	18.4	42.1	7.6	13.5
Consumer prices (annual averages)	18.6	36.9	12.3	9.0
Central government revenues	25.4	62.6	18.0	25.7
Central government expenditures	2.6	59.6	22.8	24.8
Liabilities to private sector 1/	31.8	27.6	8.6	10.5
Money	19.2	7.3	4.4	3.8
Quasi-money	12.6	20.3	4.2	6.7
Net domestic bank assets 1/	33.9	26.9	8.7	11.3
Credit to public sector	4.7	-8.2	-6.3	1.9
Credit to private sector	8.0	6.6	13.8	7.1
Merchandise exports (in U.S. dollars)	-1.8	-6.2	-6.3	16.5
Merchandise imports (in U.S. dollars)	-8.1	-18.3	50.8	4.0

	1985	1986	1987	Est. 1988
Central government finances		(millions of quetzales)		
Revenues	865.7	1,406.7	1,659.2	2,093.8
Expenditures	1,068.3	1,704.8	2,093.2	2,612.8
Current account surplus or deficit (-)	27.3	—	-55.9	-29.7
Overall surplus or deficit (-)	-202.6	-298.1	-434.0	-519.0
External financing (net)	64.1	278.3	248.1	233.7
Balance of payments		(millions of U.S. dollars)		
Merchandise exports	1,112.1	1,043.7	977.9	1,140.0
Merchandise imports	-1,175.0	-959.5	-1,447.2	-1,505.0
Investment income (net)	-209.4	-223.7	-205.4	-210.0
Other services and transfers (net)	34.4	63.6	74.3	73.0
Balance on current account	-237.9	-75.9	-600.4	-502.0
Official capital (net)	6.0	76.0	146.7	151.0
Financial system	-91.9	-47.0	11.0	46.0
Private capital (including errors and omissions)	229.6	58.3	399.0	265.0
Overall balance (deficit -)	-94.2	11.4	-43.7	-40.0
Changes in net official reserves (increase -)	-1.4	-127.3	35.1	57.0
Changes in arrears (reduction -)	95.6	115.9	8.6	-17.0
International reserve position		(millions of SDRs)		
Central Bank (net)	50.3	86.9	37.9	66.0
Financial system (net)	47.1	48.1	-2.5	111.0

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

Guatemala: Statistical Issues

1. Outstanding statistical issues

a. Real sector

The base periods for the wholesale price index and for the national accounts components in constant prices which relate to 1950 and 1958, respectively, need to be updated.

b. Government finance

The 1987 Government Finance Statistics Yearbook (GFSY) includes consolidated central government data in the derivation table through 1983 and in the statistical tables through 1986. Data on expenditure and lending minus repayments by function are available only through 1979. The published tables on financing and debt correspond to the budgetary central government only.

The GFSY also includes data on revenue and economic classification of expenditure and lending minus repayments for local governments through 1983. Central government data for 1987 have been recently received for publication in the 1988 GFSY.

c. Monetary accounts

Guatemala is receiving ongoing technical assistance from the Bureau of Statistics to adapt the plan of accounts of the Bank of Guatemala to a common methodology to be used by the five Central American countries. This assistance is being provided in the context of a project of the Central American Monetary Council (CAMC) to construct a comprehensive set of economic indicators for all member countries. Money and banking statistics is the first area to be addressed by the CAMC project.

d. Balance of payments

The existence of a three-tier exchange rate system in Guatemala is causing problems for the conversion of the balance of payments data from quetzales to U.S. dollars. To solve this problem, the Bureau of Statistics has asked the authorities to start reporting these data in U.S. dollars. To effect this change the Bureau is making data in U.S. dollars. To effect this change the Bureau is making the necessary modifications in the report forms.

2. Coverage, currentness, and reporting of data in IFS

The table below shows the currentness and coverage of data published for Guatemala in the August 1988 issue of IFS. The data are based on reports sent to the Fund's Bureau of Statistics by the Bank of Guatemala which during the past year have been provided on a timely basis.

ATTACHMENT IX

Status of IFS Data

		Latest Data in August 1988 IFS
Real Sector	- National Accounts	1986
	- Prices: WPI	Q4 1986
	CPI	December 1987
	- Production	n.a.
	- Employment	n.a.
	- Earnings	n.a.
Government Finance	- Deficit/Surplus	April 1988
	- Financing	April 1988
	- Debt	1986
Monetary Accounts	- Monetary Authorities	April 1988
	- Deposit Money Banks	April 1988
	- Other Financial Institutions	April 1988
Interest Rates	- Discount Rate	April 1988
	- Bank Lending/Deposit Rate	n.a.
	- Bond Yields	n.a.
External Sector	- Merchandise Trade: Values	December 1987
	Prices	December 1987
	- Balance of Payments	Q3 1987
	- International Reserves	June 1988
	- Exchange Rates	June 1988