Euler Hermes Economic Research

Country Report

Guatemala

Public finances remain fragile

General Information

GDP	USD50.806bn (World ranking 76, World Bank 2012)
Population	15.08 million (World ranking 66, World Bank 2012)
Form of state	Constitutional Democratic Republic
Head of government	Otto Fernando PEREZ MOLINA (PP)
Next elections	2015, presidential and legislative

Strengths

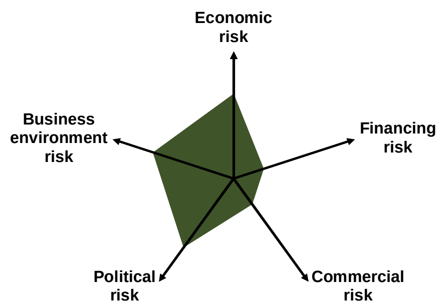
- Generally conservative macroeconomic policy framework
- Moderate debt ratios and adequate external balance
- Access to international finance support likely, if needed (IMF precautionary standby completed in 2009-10 during height of global financial crisis)
- Functioning democratic process; four handovers of power since end of 36-year civil war in 1996)
- Adequate business environment
- Trade agreement with US (DR-CAFTA)

Weaknesses

- Low growth of medium-term real per capita GDP and highly skewed income distribution
- High dependency on primary commodities and the U.S. (trade and workers' remittances), though exports are diversified
- Large informal economy
- Weak institutional framework, legacy of history of political instability
- Low security and high levels of violent crime, regional hub for illegal drug trade

Country Rating

B1



Source: Euler Hermes

Trade Structure

By destination / origin (% of total)

Exports		Rank		Imports
United States	40%	1	41%	United States
El Salvador	10%	2	12%	Mexico
Honduras	7%	3	8%	China
Mexico	5%	4	5%	El Salvador
Nicaragua	4%	5	4%	Panama

By product (% of total)

Exports		Rank		Imports
Coffee, tea, cocoa, spices	15%	1	17%	Petroleum products
Articles of apparel & clothing	13%	2	6%	Textile and related products
Vegetables and fruits	12%	3	6%	Road vehicles
Sugar and honey	9%	4	4%	Cereals
Metalliferous ores and metal	5%	5	4%	Telecom. apparatus

Sources: Chelem, UNCTAD (2012)

Economic Overview

Economic growth to remain stable and inflation under control

The real economy accelerated slightly in 2013 and grew by +3.7% against +3% in 2012. Domestic demand, particularly private consumption, was the main engine of growth due in part to dynamic credit growth (+14% on average in 2013).

Available data for 2014 suggests that the economy continues to grow at a stable pace. Real GDP expanded by +3.4% y/y in Q1, while the Macroeconomic Activity Index (IMAE) has advanced by +4.2% y/y over the first seven months of the year, a similar pace was recorded in 2013 over the same period. Euler Hermes expects Guatemala to grow by +3.5% in both 2014 and 2015.

In 2013, the Central Bank adjusted the inflation target range downwards by -0.5pp to 4% +/-1pp. During 2013, consumer prices increased within the target range, by +4.3% on average, after +3.8% in 2012. As price increases steadily slowed down during H1-2014 (+3.1% y/y in June against +4.4% in January), the Central Bank decided to lower the key interest rate by -0.25pp in April and again in June, to 5%. Inflation has slightly increased since then to +3.7% in July, and is expected to pursue this upward trend until the end of the year. However, inflationary pressures should remain broadly contained in 2014 and 2015.

The tax reform fiasco threatens public finances in the longer term

During 2013 there were major difficulties in implementing the fiscal reform adopted in late-2012. Various measures were faced with resistance from the private sector, who are seeking legal action at the Constitutional Court. Numerous amendments were adopted in 2013, thus reducing the effectiveness of the initial tax reform. For instance, the tax on the primary registration of land motor vehicles was halved, while an amnesty for the payment of tax arrears was granted. The National Custom Law, which aimed to fight against tax evasion mainly in customs, was significantly changed: the new regulations eliminated the accumulation of tax evasion fines and removed the imposed credit insurance (equivalent to 2% of the merchandise value). Consequently, the government did not obtain its objective of increasing the public revenues/GDP ratio by +0.1pp in 2012 and by +1pp in 2013. Fiscal revenues have stagnated at 11.6% of GDP since 2011.

The fiscal deficit slightly improved to -2.1% of GDP in 2013 against -2.4% in 2012 as public spending as a percentage of GDP decreased. However, this was not the result of the fiscal consolidation envisioned by the government, but rather the consequence of a political impasse in the Congress that delayed loan approval and thus forced spending cuts by the end of 2013.

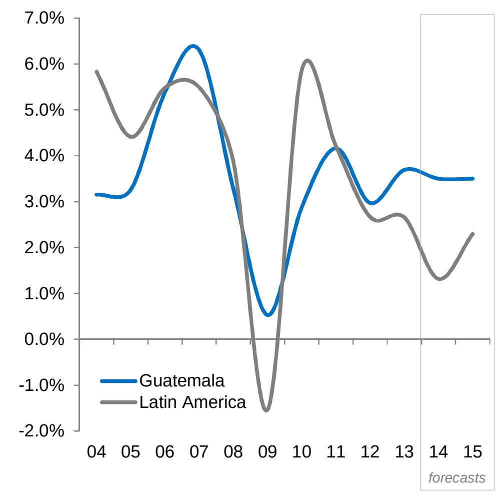
Key economic forecasts

	2012	2013	2014f	2015f
GDP growth (% change)	3.0	3.7	3.5	3.5
Inflation (%, yearly average)	3.8	4.3	3.6	4.0
Fiscal balance* (% of GDP)	-2.4	-2.1	-2.3	-2.3
Public debt* (% of GDP)	24.4	24.4	25.2	25.9
Current account (% of GDP)	-2.6	-2.7	-2.6	-2.6
External debt (% of GDP)	34.2	32.7	31.3	29.8

** Central Government;*

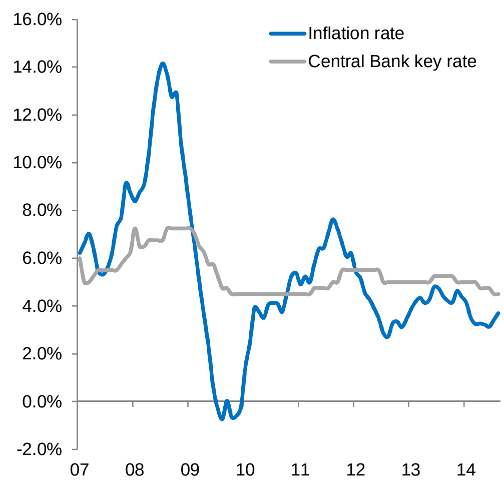
Sources: National sources, IHS, Euler Hermes

GDP growth (%)



Sources: National sources, IHS, Euler Hermes

Monetary policy interest rate (%) and inflation rate (y/y, %)



Sources: National sources, IHS, Euler Hermes

Euler Hermes expects the fiscal balance to deteriorate to -2.3% of GDP in 2014 and to remain at this level in 2015 on the eve of presidential elections. Public debt should increase slightly up to +26% of GDP in 2014.

The developments in public finances which took place in 2013 demonstrate the fragility of fiscal institutions and complexity of the rule of law. Given the low level of fiscal revenues (less than 12% of GDP), the tax reform debacle raises doubts about the sustainability of public finances, especially as public spending is fairly inflexible. Current expenses account for more than 75% of total spending, of which 45% are for functional expenses, 10% for payment of interest associated with public debt and 20% for subsidies and other transfers.

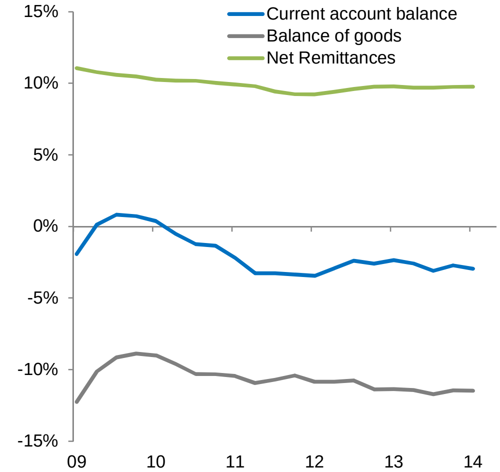
The external position is sound

Export performance was disappointing in 2013 (+0.3%) on the back of stagnating prices (notably sugar and coffee). Imports expanded by +3.3%, resulting in a widening of the trade deficit to -USD6.2 bn, which represents -11.6% of GDP. However, this deterioration was offset by an increase in worker's remittances (+5.6% y/y), which represent about 10% of GDP. All in all, the current account deficit stood at -2.7% of GDP (against -2.6% in 2012) and should remain broadly stable in 2014 and 2015.

The external deficit is largely financed by public borrowing and FDI inflows. These are expected to remain strong in coming years due to ongoing investment projects in agriculture, mining and the banking sector. FX reserves also are expected to continue growing, allowing the monetary authorities to defend the managed float of the exchange rate against the USD. As of July 2014, international reserves (minus gold) amounted to USD6.8 bn (+6.4% y/y), which represents about 4 months of goods and services imports.

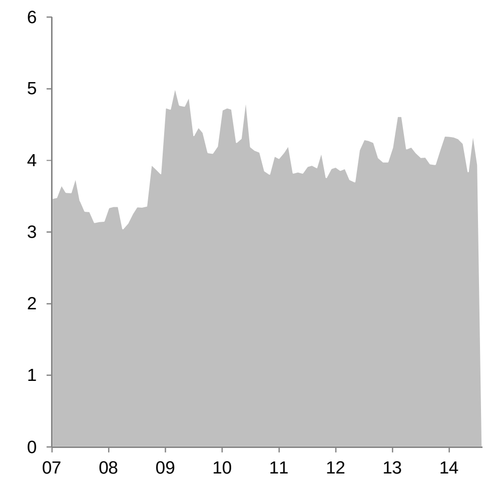
External debt is moderate at 33% of GDP in 2013, and has been on a downward trend since 2009. Euler Hermes expects it a continued decrease, reaching 30% of GDP in 2015.

Current account breakdown (% of GDP)



Sources: National sources, IHS, Euler Hermes

Foreign exchange reserves import cover (months)



Sources: National sources, IHS, Euler Hermes

DISCLAIMER
These assessments are, as always, subject to the disclaimer provided below.

This material is published by Euler Hermes SA, a Company of Allianz, for information purposes only and should not be regarded as providing any specific advice. Recipients should make their own independent evaluation of this information and no action should be taken, solely relying on it. This material should not be reproduced or disclosed without our consent. It is not intended for distribution in any jurisdiction in which this would be prohibited. Whilst this information is believed to be reliable, it has not been independently verified by Euler Hermes and Euler Hermes makes no representation or warranty (express or implied) of any kind, as regards the accuracy or completeness of this information, nor does it accept any responsibility or liability for any loss or damage arising in any way from any use made of or reliance placed on, this information. Unless otherwise stated, any views, forecasts, or estimates are solely those of the Euler Hermes Economics Department, as of this date and are subject to change without notice. Euler Hermes SA is authorised and regulated by the Financial Markets Authority of France.

© Copyright 2014 Euler Hermes. All rights reserved.

Last review: 2014-09-15
Country Risk Analyst:
Daniela Ordóñez
daniela.ordonez@eulerhermes.com