

GUATEMALA

2004

Key issues

- As it is usual during the first year of government, 2004 distinguished itself for the adjustment of the new authorities. During the first six months, eyes were fixed on the past, trying to deactivate the “depth bombs” planted by the previous administration, including the failure to approve the budget, while a tax reform was simultaneously being pushed, and finally approved in part by the Legislative Branch, in which the Executive does not have a majority. The anticipated results of such reform are poor, while; according to the polls of public opinion the political attrition was high.
- The narrow margin of movement, as a result of the restrictions imposed by Congress, which determined that a prior authorization by Congress was required for the approval of the list of works, caused the reactivation of public investment by well advanced the last six months of the year. On the other hand, fiscal income went up only 3.2%, much less than the inflation rate. However, a strong contention of current expenses is added to a zero growth in public investment, and that will make possible that the goal for the reduction of the fiscal deficit is exceeded more than enough. An exception in the reduction of expenses is the item of interest and commissions on public debt that will increase in more than 40%.
- In the scope of macro prices, a constant pressure was made on the general level of prices. The inflation rate is estimated to be around 8.5% (far above the goal ranging from 4% to 6%) affected by an overhang in liquid assets, but mainly by the imported inflation, which is a result of the world impact caused by the price increase of some “commodities” such as iron, but mainly oil, that have rocketed unprecedented levels. The upward price movement could have been greater had it not been diminished by the continuous exchange appreciation, exacerbated from April, which in turn had material adverse effects in the competition of exports in the Dollar area. On the other hand, the price of money remain unchanged; with no variations in the borrowing rates (on savings and investment), and still with a slight tendency to a reduction in the lending rates (on loans).
- Notwithstanding the above, the continuity of a strengthened foreign demand that began in 2003 allowed a change of tendency to a slight growth of the economic activity, going from a growth of 2.1% in 2003 to an estimated 2.3% in 2004, after five years of continuous deceleration. Remittance families, intermingled with hot money, will be exceeding US\$ 2.5 billion, clearly reinforcing domestic consumption. Exports will be growing slightly less than 10% as compared to 8% for last year. Certainly an appreciated currency continues stimulating imports, with a variation rate estimated to be exceeding 9% as compared to 6% for the previous year.
- On the other hand, the handling of the monetary policy remained relatively on line with the achievement of the goal for price stability (regardless of the external impact), while the financial reform continued to make gradual progress, including the approval of the “financial groups” with the incorporation of offshore banking.
- Finally, it is estimated that the International Monetary Reserves by the end of the year will be approximately US\$ 3.5 billion, partly as a result of the placement of sovereign debt for US\$ 330 million.

2005

Outlook

- Generally, it would be expected that the moderate economic reactivation that began last year would continue over the course of 2005, to achieve GNP in real terms of approximately 2.9%.
- Unlike 2004, the Berger Administration will begin 2005 with financial funds available and with a full definition of the infrastructure and social investment works to be executed. Besides, with the presence of a tax burden that does not exceed 10%, there is a political decision of resorting to the concessions file to undertake the mega projects. The Puebla Panama Plan will also be enlivened.
- Although it is difficult to maintain high growth rates in exports, because of the foreign demand, it is estimated that the exports growth rates will be around 10%, somehow less strong but still vigorous (see the report of international economy in this document). A deceleration of the growth rate for imports is foreseen to be around 8%.
- Notwithstanding it should be borne in mind, in real terms, because the total imports more than double the exports, including the value added as a result of the inbound assembly industry, that the growth of imports would be 70% more over the price of exports. That in part is a result of a highly rated currency. On the other hand, it is estimated that the CAFTA effects between winners and losers during the first stage will not be materialized during 2005. Thus, the dynamics of the external sector will continue to register a high trade gap, largely neutralized by a mass influence of remittance families which intermingled with hot money, will continue to grow above the more than US\$ 2.5 billion expected by the end of 2004. By the end of 2005, it is estimated that the NIR will again be around US\$ 3.5 billion.
- In fiscal matters, it is expected that income will have a moderate recovery, below the inflation rate anticipated by COPADES for 2005 in approximately 6.5%, therefore, according to the foreseen level of expenditure, deficit may be around 2.0%. Based on the tax restrictions the Administration will continue facing, the possibility of instituting a new tax reform is not at all excluded, and it, in turn, may include the motion of a 1% increase in the VAT rate to 13%. That would be more in agreement with the customs merger that has already began with El Salvador. From the political point of view, it is considered that the Administration could attempt to do so in the last year of government.
- The concern and discussion regarding the appreciation of the rate of exchange was present over the course of 2004. For the time being, extreme measures seem to be excluded, such as the system of mini-devaluations implemented by Costa Rica with its circular effect on inflation. Rather, eliminating the discretionary authority of the central bank to take control of the market outlines a development of the current system. In any event, the systems under analysis are structured to soften movements but not to change tendencies. Therefore, under the circumstances of a surplus foreign exchange market, facing a moderate activation of the demand, linked to a greater economic activity, only a fairly small devaluation of the nominal rate of exchange in approximately 1% would be expected. It should be borne in mind that the average devaluation of the last five years has been around 0.29%. In any event, it is not a prospective that during 2005, it will reach a parity of Q8.00 against US\$ 1.00. There is always a possibility of an extreme change on the current system, but it would be complicated, even with an eventual substitution of the authorities in the central bank.
- On the other hand, a slight recovery in the rates of exchange would be expected in less than the international recovery, in order to reduce the differentials of foreign and domestic interest rates, and discourage the flows of hot money that are believed to play a part in a currency arbitration, and partially explain the exchange appreciation phenomenon.
- Finally, the high level of inflation expected by the end of 2004 cannot pass unnoticed as it anticipates the reappearance in 2005 of new social disputes in various sectors, such as public transportation and education, apart from of the difficult problem dragged by the controversial payment to be made to the former Civil Squad Members (Former CTM).