



QUARTERLY REPORT

GUATEMALA

Monetary Intervention Plus Monetary Expansion Equals Risk

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BUSINESS CYCLE INDICATORS

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Financial sector liquidity position

No deterioration of liquidity

Credit volume

Negative, although slightly recovering, growth in consumer credit

Trade balance

Current account has been positive over the year

Economic activity

Slowdown in GDP growth continues

Public sector

Increase in tax revenues, fiscal spending and public debt

Money supply

Increase in the monetary base without any effect on broader monetary aggregates

Prices

Low inflation, within the boundaries of the inflation target

Interest rates

Gradually rising, even with slowdown in credit growth

General outlook

Positive economic growth, but slowing down; increase in monetary base left unanswered by economic agents; significant slowdown in credit to consumption



General Outlook

1. Economic Activity

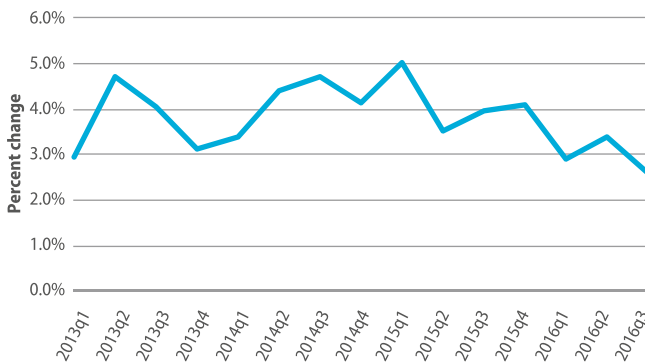
a. Gross Domestic Product (GDP)

Third quarter economic growth, with some exceptions, tends to be higher than second quarter growth. However, this was not the case for the third quarter of 2016, which came in at 1.2% lower than the average third quarter growth of the past four years (3.8%) and 1.4% lower than last year's third quarter. In our previous report, we projected a growth of 2.4% for the third quarter, which was not far off the mark.

- Annualized quarterly GDP growth (Q3 2016): 2.6% (Q3 2015: 4.0%)

Chart 1

Annualized quarterly GDP growth

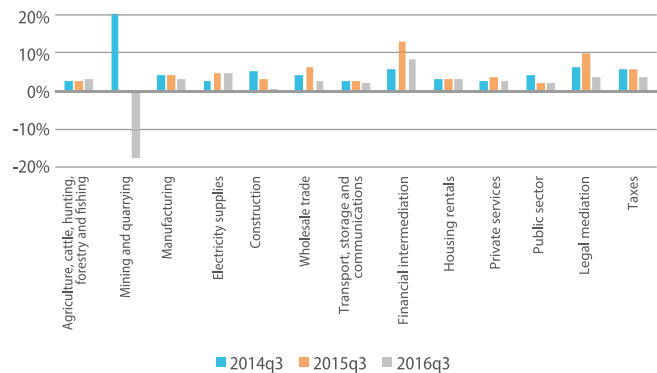


Source: Bank of Guatemala, data modified by the author

Chart 2 shows the performance of individual production sectors over the last three third quarters, with mining and quarrying as the most remarkable sector. In 2014, mining and quarrying showed an annualized quarterly growth of 73%, while in 2016, to the contrary, the same sector showed a decline of 17%. The decline in mining and quarrying activity in 2016 was largely responsible for the overall decline in economic activity. At the same time, exports of goods and services fell by 0.5%. Even though the decline in exports was not significant, all other sectors grew at an equal or slower pace, with the agriculture, cattle, hunting, forestry and fishing industry as the only exception.

Chart 2

Annualized quarterly change in growth by industry



Source: Bank of Guatemala, data modified by the author

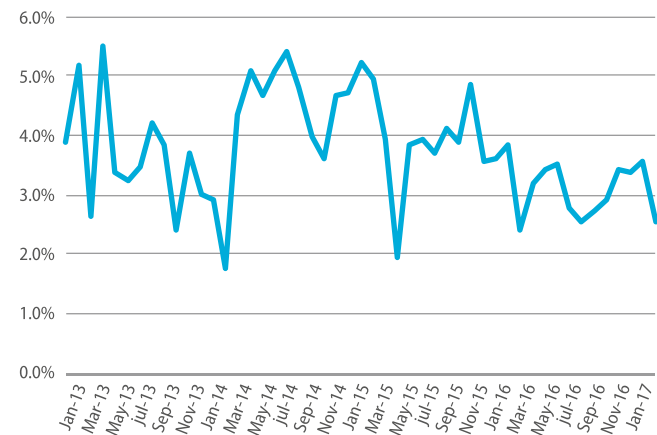
b. Monthly Economic Changes

In order to understand how GDP growth evolved in the last quarter of 2016, we resort to the Monthly Economic Activity Index (IMAE for its acronym in Spanish), which will provide us with more up-to-date insights. In the last quarter of 2016, growth was slowest in the month of October, compared to the same month in the three previous years. Despite all this, November and December showed a growth rate on par with last year. Given these developments, we would expect a growth rate of approximately 3.4% for the fourth quarter of 2016, of which no estimate has been published yet.

- Year-on-year growth in the Monthly Economic Activity Index (IMAE) (December 2016): 4.3% (December 2015: 3.5%)

Chart 3

Monthly Economic Activity Index (IMAE, seasonally adjusted)



Source: Bank of Guatemala, data modified by the author

Inflation and Monetary Aggregates

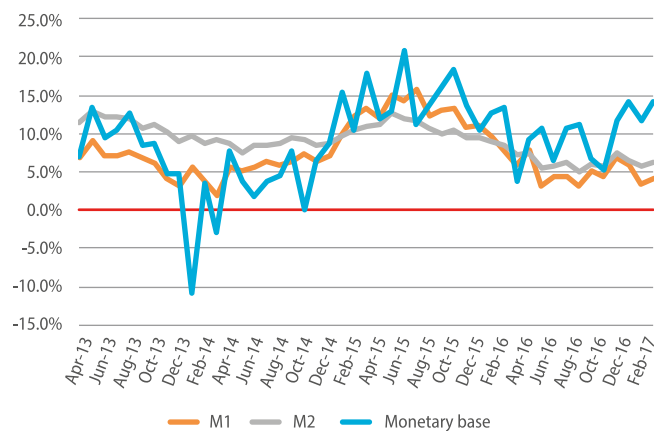
1. Monetary Base and Monetary Aggregates

Given the low and stable growth in all monetary aggregates since May 2016, the Bank of Guatemala decided that increasing the monetary base was urgently needed to boost the economy. Nevertheless, after increasing the monetary base for four months in a row, the other monetary aggregates have remained largely unresponsive to the stimulus by the monetary authorities, and therefore remain subdued or even, as has happened in January 2017, slowed down even further.

- Annual growth in the monetary base (February 2017): 14.1% (February 2016: 13.4%)
- Annual growth in M1 (February 2017): 4.2% (February 2016: 7.8%)
- Annual growth in M2 (February 2017): 6.2% (February 2016: 8.3%)

Chart 4

Year-on-year growth in monetary aggregates



Source: Bank of Guatemala, data modified by the author

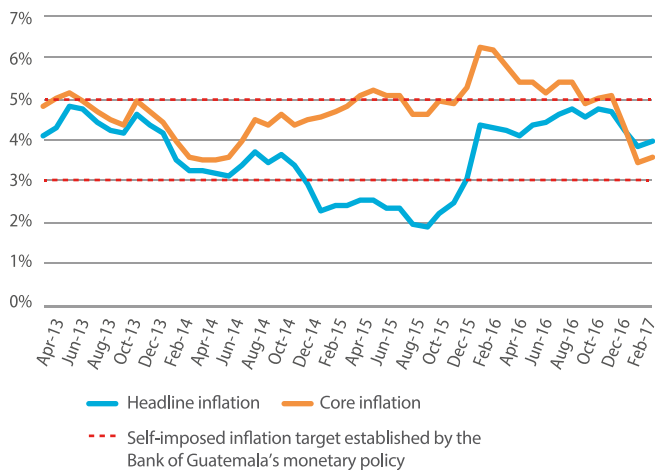
2. Inflation

In December, inflation came in 1.16% higher than a year earlier. Moreover, inflation in the last quarter of 2016 reached a level just 25 percentage points below Banguat's self-imposed inflation target. Despite all this, a reversal in the inflation rate can be observed in December 2016 from its upward trend that began in August 2016. In the first months of 2017, inflation fell below 4%.

- Headline inflation (February 2017): 3.96% (February 2016: 4.27%)
- Core inflation (February 2017): 3.57% (February 2016: 6.16%)

Chart 5

Consumer Price Index



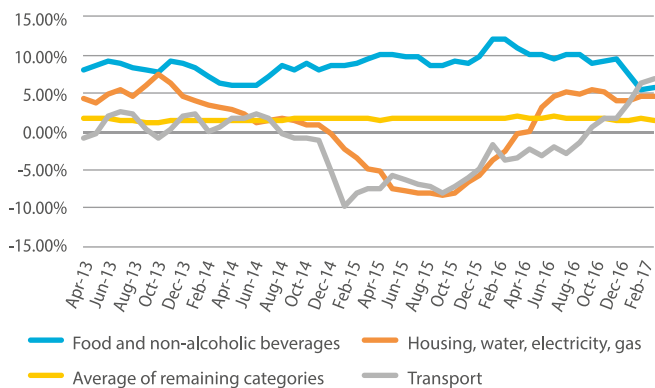
Source: Guatemala National Statistics Institute (INE), data modified by the author

Toward the end of 2016, the gap between core and headline inflation narrowed significantly. This is due to the fact that, on the one hand, the increase in prices in the category housing, water, electricity and gas is stabilizing, while, on the other hand, prices of food and non-alcoholic beverages decreased by 3.5%, as is shown in Chart 7, since November last year, which contributes to a decline of the headline rate.

- Inflation in food and non-alcoholic beverages (February 2017): 5.88% (February 2016: 11.94%)
- Inflation in transport (February 2017): 6.81% (February 2016: -3.80%)
- Inflation in housing, water, electricity and gas (February 2017): 4.74% (February 2016: -2.54%)

Chart 6

Year-on-year inflation by category



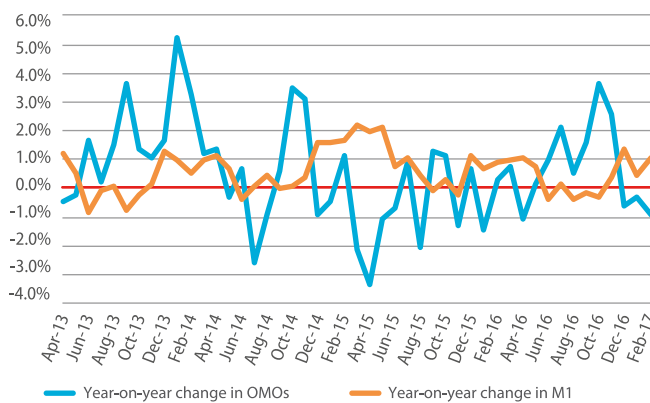
Source: Guatemala National Statistics Institute (INE), data modified by the author

The slowdown in headline inflation reflects the uptick in open-market operations by the central bank which were conducted in October and November 2016. Nevertheless, since December a significant reduction in open-market operations can be observed, which means an increase in liquidity in markets, which explains the increasing monetary base as we have shown earlier. However, if the monetary base continues to grow in the hope of reviving the economy, and in case economic growth does not get up to speed, we might experience significantly higher inflation in the coming months.

- Change in annual open-market operations / OMO (February 2017): -0.88% (February 2016: 0.33%)
- Change in monthly open-market operations / OMO (February 2017): -10.42% (January 2017: 14.23%)

Chart 7

Open-market operations and monetary aggregates



Source: Bank of Guatemala, data modified by the author

Quantitative Breakdown of Credit

As we have mentioned in our previous report, credit growth to activities related to consumption has turned negative in the months October and November 2016. At the same time, December – being one of the months in which consumption is highest – shows an, although still positive, extremely low growth rate in credit to activities related to consumption.

The most affected sectors due to the fall in credit were the manufacturing industries and transport and storage sector. Likewise, the trade sector has been the sector with the weakest growth in credit, as October showed a decline of 6.4% and December, despite a slight improvement, still showed a negative rate of 3.2%, which helps to explain the

slowdown in credit growth to direct consumption. This is an important and dangerous decline, since both consumption categories amount to more than 50% of total lending.

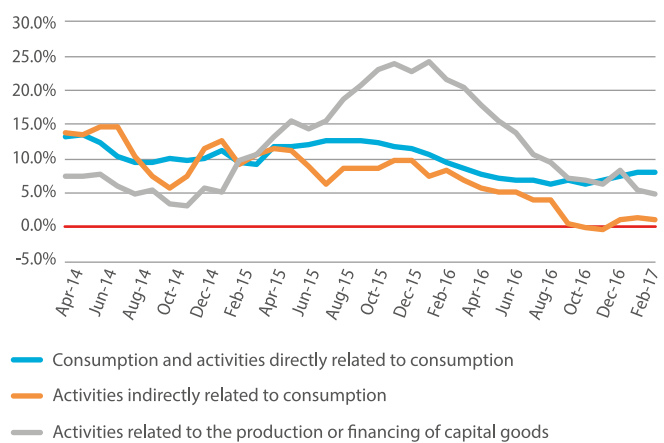
- Year-on-year growth in credit to direct consumption (December 2016): 7.49% (December 2015: 11.45%)
- Year-on-year growth in credit to activities related to consumption (December 2016): 1.17% (December 2015: 9.93%)

Credit to capital goods showed an increase in growth rates in the last three months of last year. The exception is credit to real estate, which despite a slowdown is still growing at a positive rate.

- Year-on-year growth in credit to capital goods (December 2016): 8.21% (December 2015: 22.87%)

Chart 8

Year-on-year growth rate in credit in Guatemala (banking institutions)



Source: Guatemalan Superintendency of Banks, data modified by the author

It appears that consumer credit is falling and this has freed resources to extend credit which aims to increase the capital stock.

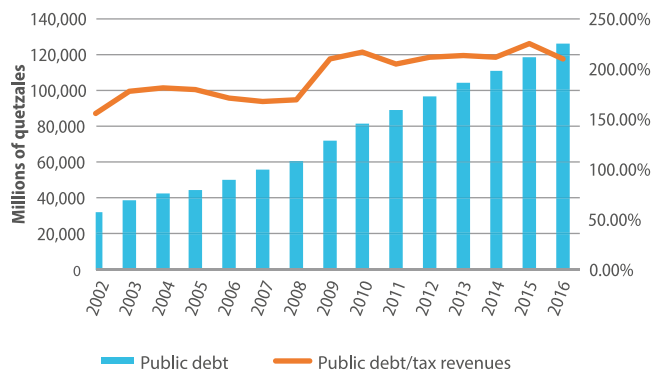
Public Debt

Just as expected, public debt increased in 2016. The surprising part is that public debt as percentage of tax revenues has been declining in the same year. This has not happened since 2011.

- Public debt (2016): Q125,935 million (2015: Q118,789)
- Public debt/tax revenues (2016): 210.27% (2015: 225.19%)

Chart 9

Public debt accumulation



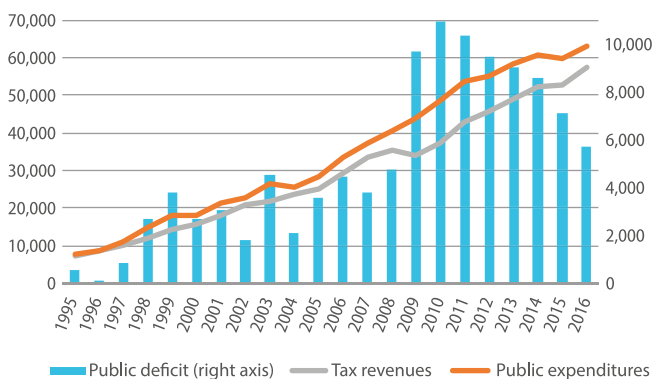
Source: Bank of Guatemala, data modified by the author

The reason behind the decline in debt as percentage of tax revenues can be found in the increase in tax revenues rather than a decline in public debt. The increase in tax revenues can be attributed in large part to nonrecurring income, such as fines and lawsuits. In this context, we cannot omit the first “big fish”, which paid more than Q780 million in taxes, late charges, fines and interest. Likewise, in the course of 2016, various companies were persecuted for fiscal fraud, leading to higher fiscal income.

- Growth in tax revenues (2016): 8.81% (2015: 1.01%)
- Growth in government expenditures (2016): 5.32% (2015: -1.52%)
- Growth in the public deficit (2016): -20.45% (2015: -16.92%)

Chart 10

Fiscal situation



Source: Bank of Guatemala, data modified by the author

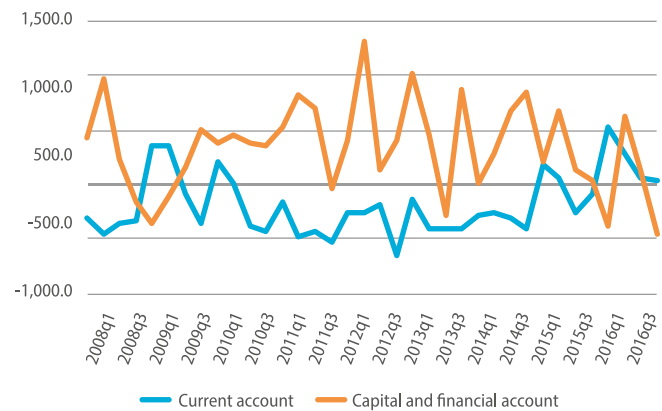
Coupled with the increase in tax revenues, public spending also went up in 2016 even though public spending went down a year earlier. The political and, consequently, economic uncertainty which stills has a grip on Guatemala, seems to be not enough of a reason for the Guatemalan government to embark upon a period of austerity to provide the system with renewed confidence.

Balance of Payments

During the entire year of 2016, the current account behaved rather odd, as it remained positive over the year. On one hand, this was due to a decline in imports and, on the other hand, due to an unusual uptick in overseas remittances by wire transfer.

Chart 11

Balance of payments

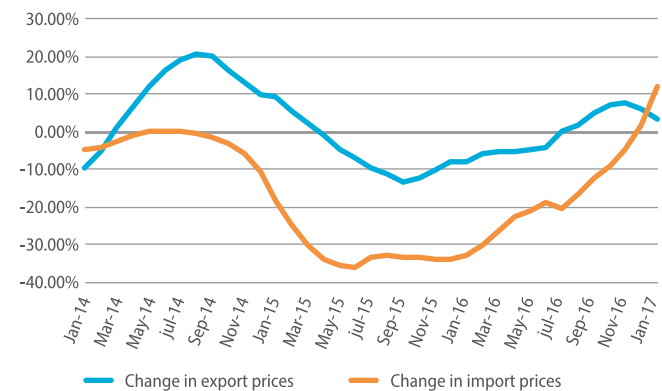


Source: Bank of Guatemala, data modified by the author

Imports have fallen due to the fact that prices of various important imports (such as diesel and gasoline) fell, even though import prices stopped declining or have even begun to rise since December 2016. We would expect to see in the next data release of the first quarter of 2017 that the current account goes back to negative, since import prices increased in the first month of this year.

Chart 12

Import and export prices



Source: Bank of Guatemala, US Bureau of Labor Statistics, St Louis Fed, data modified by the author

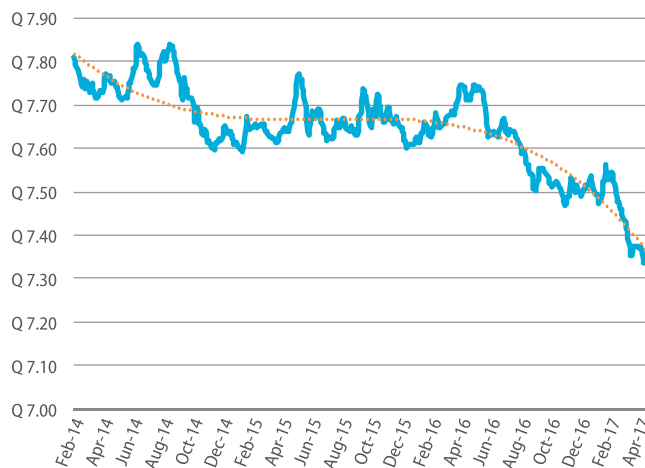
Exchange Rate

The continuing appreciation of the quetzal against the dollar is in line with changes in the balance of payments, where the current account continues to be positive for a prolonged period. The Bank of Guatemala decided, at the end of February 2017, to extend the period to intervene by buying or selling foreign exchange and issue certificates of deposits (CDs) denominated in dollars to control the alleged excess supply of dollars. In the next report, we expect to see the consequences of this intervention in the natural course of supply and demand and the exchange rate.

- Exchange rate (March 31, 2017): Q7.33976/dollar

Chart 13

GTQ/USD exchange rate

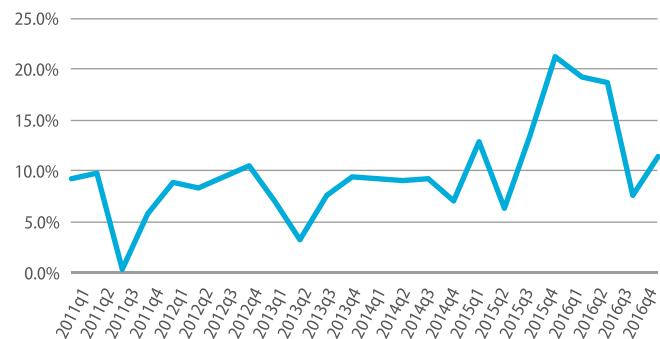


Source: Bank of Guatemala, data modified by the author

The slowdown in growth of foreign exchange through family remittances continues into the last quarter of 2016, but still amounts to a slight increase. This increase is normal for an average fourth quarter. Given the policy changes by the US government, despite not affecting Guatemala directly, it is likely that growth in remittances continues to be irregular and volatile.

Chart 14

Year-on-year growth in foreign exchange due to family remittances



Source: Bank of Guatemala, data modified by the author

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