

Credit Analysis

Moody's Global Sovereign

December 2008

Guatemala

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	Foreign Currency	Local Currency
Government Bond Rating	Ba2-Stable	Ba1-Stable
Country Ceiling	Ba1-Stable	A3-Stable
Bank Deposit Ceiling	Ba3-Stable	A3-Stable

[Moody's sovereign rating list](#)

Summary Rating Rationale

Guatemala's Ba2 foreign currency and Ba1 local currency ratings reflect the country's low institutional strength, which balances the country's commitment to macroeconomic stability and prudent fiscal and monetary policies with more widespread concerns about government effectiveness and the country's social infrastructure. The country has a long track record of fiscal responsibility. Deficits have averaged a manageable 1.7% of GDP since 2002. The manageable debt burden, and reduced debt rollover risk given the prevalence of multilateral funding, also support the rating. But the ratings are limited by the government's historical difficulties raising tax revenues over 10% of GDP, and its significant social and infrastructure needs, both of which limit fiscal flexibility and lead to a low government financial strength.

The ratings are further limited by a low level of economic strength. Guatemala's GDP per capita, at \$2700 for 2008, is lower than its rating peers. Despite recent above-trend growth, Guatemala's economy is lagging similarly rated sovereigns, limiting upside rating potential. The poorer and less diversified an economy is, the greater risk of shocks and the lower the ability to deal with those shocks. Political, economic, and financial stability support the low susceptibility to event risk, the risk of a sudden mult notch change to the ratings.

This Credit Analysis provides an in-depth discussion of credit rating(s) for Guatemala and should be read in conjunction with Moody's most recent Credit Opinion and rating information available on Moody's website. [Click here to link.](#)



Moody's Investors Service

Guatemala

Outlook and Scenarios

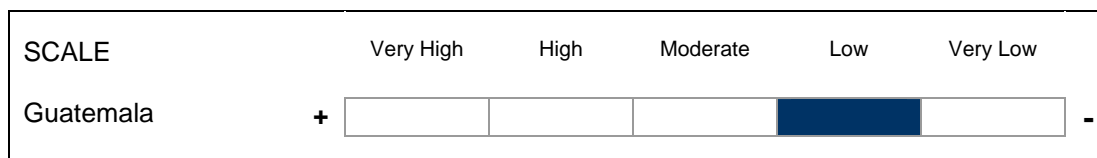
On December 2008 Moody's changed its outlook on Guatemala's ratings from Positive to Stable, indicating reduced expectations of an upgrade given Guatemala's relative credit slippage compared to similarly rated countries. The outlook change also took into account the worsening domestic and international economic conditions, which make further credit improvements more difficult. Our credit risk scenarios for the next 1-2 years are the following, in order of likelihood¹:

Stable Outlook (60%): This is the most likely scenario. In this scenario the economic slowdown reduces revenue growth and increases expenditures, but even with higher deficits the government faces few problems covering its financing needs. Multilateral support adds another layer of protection to the economy and fiscal accounts. The deficit may rise a bit over the recent 1.7% of GDP average but the debt burden remains largely unchanged.

Negative Outlook (30%): The second most likely scenario is a negative outlook. In this scenario the world crisis impacts Guatemala harder than expected, and could even result in negative growth for 2009. The fiscal deficit overshoots the recent trend, coming closer to 3%-5% of GDP. External conditions worsen, leading to reserve losses to finance the external accounts. The larger deficit, and increased concerns about the economy and the government's financing options, lead to a negative outlook, signaling a possible downgrade.

Positive Outlook (10%): The world financial crisis impact on Guatemala is not as severe as expected, and the economy grows faster than the 3% forecast. Higher revenues lead to a smaller fiscal deficit and concerns about the regulation and supervision of the banking sector diminish. In this scenario Guatemala's slide in relative credit metrics is halted and the comparison with other Ba credits improves.

Factor 1 – Economic Strength: Low



Guatemala's low level of economic development is one of the country's main rating constraints. Economic growth in Guatemala tends to be much less volatile than in many other Latin American countries. That's good. But growth rates are relatively low, around 3.5% a year since 1990, which is not so good. With population growth of about 2.5% annually, the per capita growth rate is even lower. Guatemala is still recovering from decades of political violence and has large unmet social needs, making continued growth an important priority. Moderate growth rates mean that Guatemala remains a relatively poor country, with a per capita GDP in 2007 of only \$2700, below the Ba category median. Its small economy, estimated at \$37 billion in 2008 and almost half the average size of similarly-rated countries, further supports Moody's view that Guatemala has a low level of economic strength². The poorer and smaller an economy is, the greater the vulnerability to shocks and the lower the potential rating.

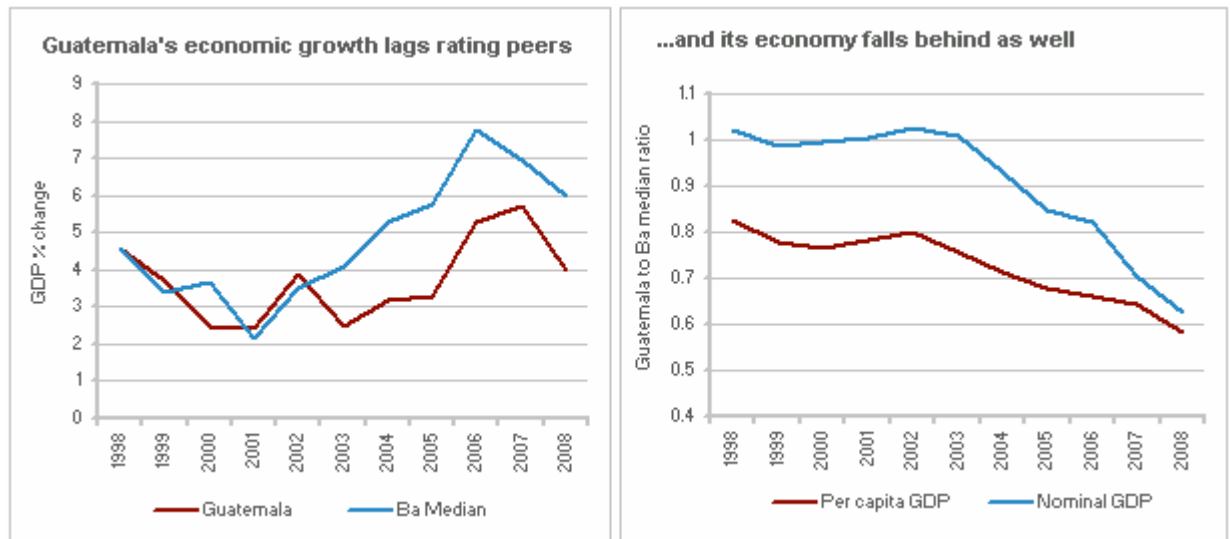
Guatemala's ratings are also limited by the fact that many other countries in the same rating category are growing faster. Over time differences in quantity can lead to qualitative changes. Lower growth relative to other Ba category countries resulted in a per capita GDP for Guatemala equivalent to 58% of the Ba median in 2007, compared to 82% ten years ago. Similarly the ratio of Guatemala's nominal GDP to the median of Ba nations fell from 1.01 to .62 in the same period. Since ratings are indications of relative credit standing this drop makes further upgrades more difficult. Guatemala is becoming poorer and smaller relative to other Ba nations.

¹ Each scenario has a probability attached. The probabilities represent our assessment of relative likelihoods.

² Moody's sovereign ratings are based on assessing the economic, institutional and government financial strength of all rated nations, compared to each other, as well the sovereign rating's susceptibility to event risk. The full methodological process is explained in our report, "Sovereign Bond Ratings".

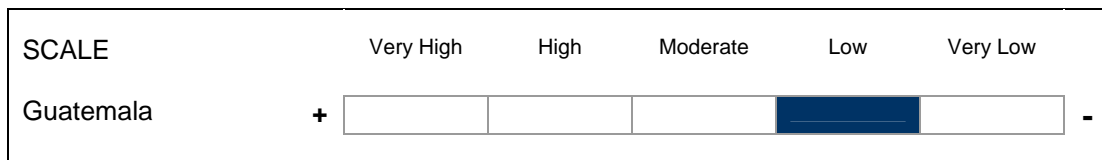
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Raising long-term growth will not be easy, given the country's relatively low investment levels and human capital needs. Difficulties raising tax revenues over 10% of GDP, among the lowest in the region, further limit the ability of the government to invest to raise economic growth. Non-traditional exports, mainly in the soft-manufacturing *maquila* sector, may help diversify the economy over time, and the country's membership in DR-CAFTA³ has opened new markets. Economic growth picked up since Guatemala joined the free trade agreement but the current world crisis will reduce growth this year and next. Moody's expects Guatemala's GDP growth to fall to 3% in 2009 due to a combination of a slowdown in family remittances, reduced external demand, and worsened international and domestic credit conditions. If the crisis deepens beyond current expectations growth may be lower, but we consider a formal recession unlikely. Inflation peaked on July 2008, at over 14%. But oil and food prices, a key reason for the inflation uptick, have fallen dramatically and we expect inflation to trend towards 8% at the end of 2009 as commodity prices fall from historic highs.



Guatemala's external position is characterized by large but stable current account deficits, of about 5% of GDP, financed by a mix of foreign direct investment and debt flows. Remittances help finance the very large trade deficit, which last year was over 16% of GDP. Guatemala, like most other Central American nations, is highly dependent on worker's remittances, representing about 10% of GDP last year. The full impact of the US recession still remains to be felt, and remittance growth in 2008 has already begun to slow down. The country's external position has improved in recent years but so has that of similarly rated countries. Guatemala's external debt, measured as a percentage of current account receipts or as a percentage of foreign exchange reserves has halved since 1990 but remains close to the Ba median in both measures.

Factor 2 – Institutional Strength: Low



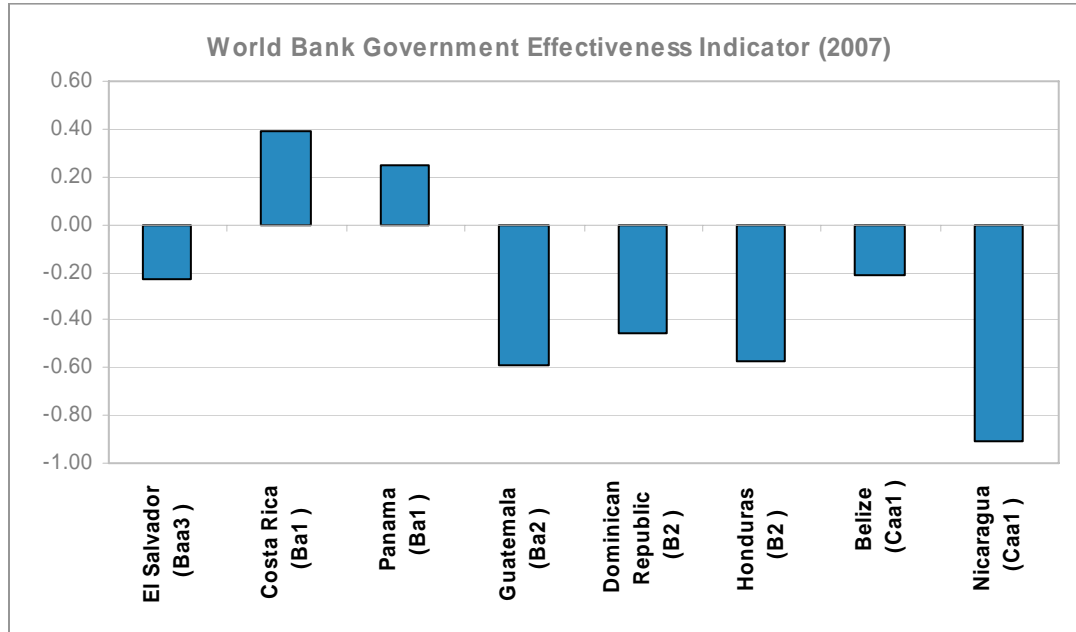
Moody's assessment of Guatemala's Low institutional strength balances the strength of the main economic and financial policy institutions and the general weakness of other government and social institutions.

On January 2008, Alvaro Colom became Guatemala's first center-left president since the 1996 peace accords that ended more than three decades of civil war. The change in administration underscored the strong policy consensus that has developed in the country. The new administration lacks its own majority in the Legislature, increasing the importance of pursuing policies that can be agreed with opposition parties. The central bank

³ DR-CAFTA is the free trade agreement between the Dominican Republic, Central America and the United States. It went into effect in Guatemala on 2006.

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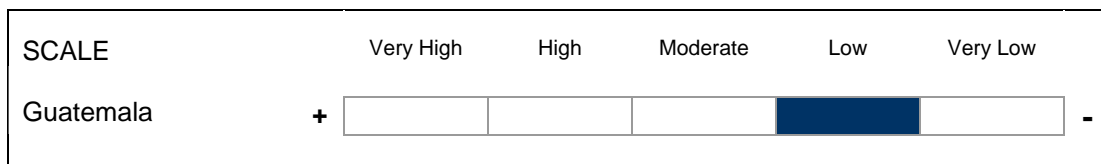
remains relatively independent and has been able to maintain inflation in the single digits for years, with the exception of the recent commodity price fuelled increase. Fiscal discipline is supported by low fiscal deficits which have remained below 3% of GDP since 1983.



But while the economic policy framework reflects the institutional strength of the budget process and monetary policy, government institutions beyond the Ministry of Finance and the Central Bank are not as strong. Guatemala ranks at the bottom in most of the internationally comparable indicators, such as the World Bank's government effectiveness indicator, a proxy for how well a country delivers services to its citizens. Weak institutions contribute to lower growth as they deter investment and may increase contingent liabilities for the sovereign. In Guatemala's case, poor banking regulations were contributing factors to Guatemala's banking problems in 2006 and 2007. The government costs related to the banking problems were rather limited, but the event reflects the potential cost that the government could incur. Guatemala also ranks among the lowest in corruption indexes such as the one compiled by Transparency International, where Guatemala is among the 20% lowest of the countries that Moody's rates. Corruption is present at many levels of the government. A former president, Alfonso Portillo Cabrera, awaits trial for embezzlement accusations.

Improvements to our view of Guatemala's institutional strength will be contingent on broader improvements to institutions across the country. In particular, Guatemala's high levels of violence and crime can impact investment and political stability. Crime is common across Latin America but, given Guatemala's violent past, a continued inability to reduce high crime rates can threaten public support for, and the legitimacy of, the Guatemalan body politic.

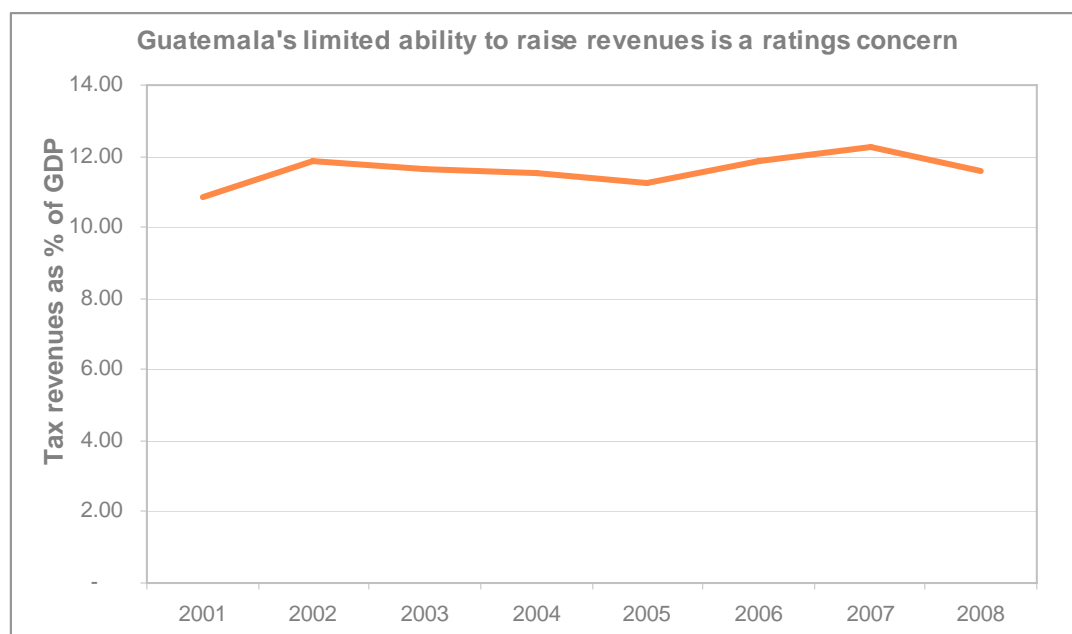
Factor 3 – Government Financial Strength: Low



Guatemala's low government financial strength reflects the high percentage of foreign currency debt, which increases balance sheet vulnerability to devaluations, and the government's limited financing options. It also takes into account the government's relatively strong fiscal position, favorable debt profile, relative low rollover risk, and low debt levels.

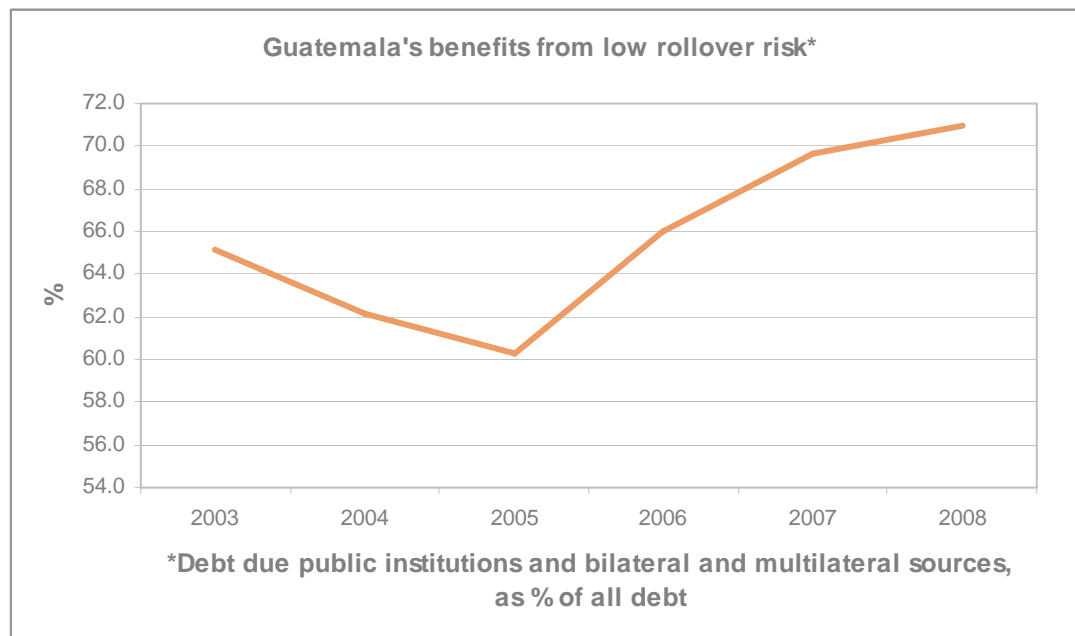
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In recent years Guatemala has run moderate fiscal deficits, averaging 1.7% of GDP in the five years to 2007. Successive administrations have attempted to increase revenues to meet social needs but with limited success. Despite some tax increases total central government revenues in 2007 reached 13% of GDP, compared to 12% in 2005. Difficulties raising tax revenues, even in the face of pressing needs, are an indication of the government's limited ability to deal with potential shocks and a ratings constraint. The revenue increase has been accompanied by a similar increase in capital spending, leaving deficits roughly unchanged. 2008 is in track to a lower deficit, mainly due to lower-than-budgeted capital expenditures as of October. But next year Moody's expects an increase in the overall deficit as the impact of the current crisis feeds through to the real economy and fiscal accounts. The government's aim to raise revenues closer to 14% of GDP by next year appears unlikely given the global slowdown and expectations of lower domestic growth.



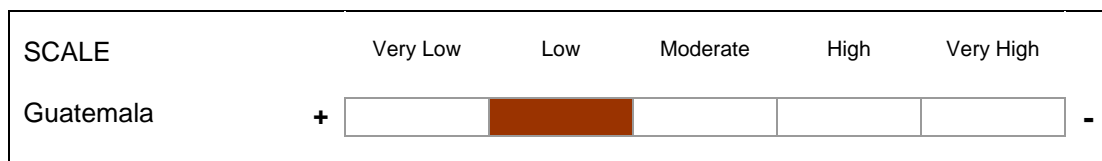
Continued, and stable, economic growth has limited the debt impact of the deficits. Central government debt remains stable around 21% of GDP, which is lower than the median for Ba-rated countries. But debt as percentage of government revenues, a more relevant measure of debt affordability, is relatively higher at an estimated 166% for 2008, above the category median. Bilateral and multilateral lending is close to half of all Guatemala's indebtedness, explaining the country's low rollover risk. A bigger concern is the relatively large percentage of foreign currency debt which, although falling, remains close to 70% of all debt. This is a drop from 91% in 2003 but still leaves the country vulnerable to a sudden exchange rate shock. The vulnerability is reduced by Guatemala's nominal exchange rate stability in recent years.

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Despite increased economic and (potentially) fiscal pressures, given its favorable debt profile the government appears unlikely to face problems covering its financing needs in 2009. Financing needs are likely to be less than 3% of GDP, with amortizations of around 1% of GDP. A significantly higher fiscal deficit could lead to some concerns, due to the limited size of the domestic capital market, but international financial institutions are likely to cover any shortfall. The government is also not as vulnerable to the external bonds market conditions as there are no outstanding bonds that mature in the next two years. The government of Guatemala currently has three external bonds outstanding. One of \$325 million that matures in 2011, another of \$300 million that matures in 2013, and the other one of \$330 million that matures in 2034.

Factor 4 – Susceptibility to Event Risk: Low



Guatemala is a poor country with many social needs. But stable growth, policy consensus, and reduced fiscal vulnerability, all support Moody's assessment of a low susceptibility to event risk. Compared to the universe of rated countries, Guatemala's risk of a political, financial, or economic shock that results in a multi-notch downgrade today remains low.

Guatemala has a history of political violence, even civil war, but in recent years a strong policy consensus has developed, reducing the chances of a new administration implementing dramatic changes to the basic macroeconomic framework. Since the 1996 peace accords, presidential transitions across the political spectrum have succeeded without major incidents. Social pressures remain high, and the country continues to suffer from high poverty rates, wide income disparity and high crime rates. But this has not resulted in politically destabilizing social unrest common to other Latin American nations.

Over the long-term, the economy will need to grow faster for the country's rating to improve but its relative stability and low historical volatility support the assessment of low economic event risk. In the last three years current account deficits averaged 5% of GDP, financed by foreign direct investment and portfolio inflows. A vulnerability to a sudden stop of capital inflows is limited by high foreign reserves. Financially, the limited fiscal financing needs and rollover risk also reduce the risk of a shock. The banking sector remains a potential

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concern given the mini crisis in 2006 that led to a few bank failures. But Moody's considers that improved banking sector supervision has limited the risk of a widespread banking crisis that impacts fiscal accounts. In the previous crisis the authorities intervened quickly, limiting the decline of confidence in the banking system. While domestic credit has grown in recent years it remains low relative to the economy, at 40% of GDP in 2007.

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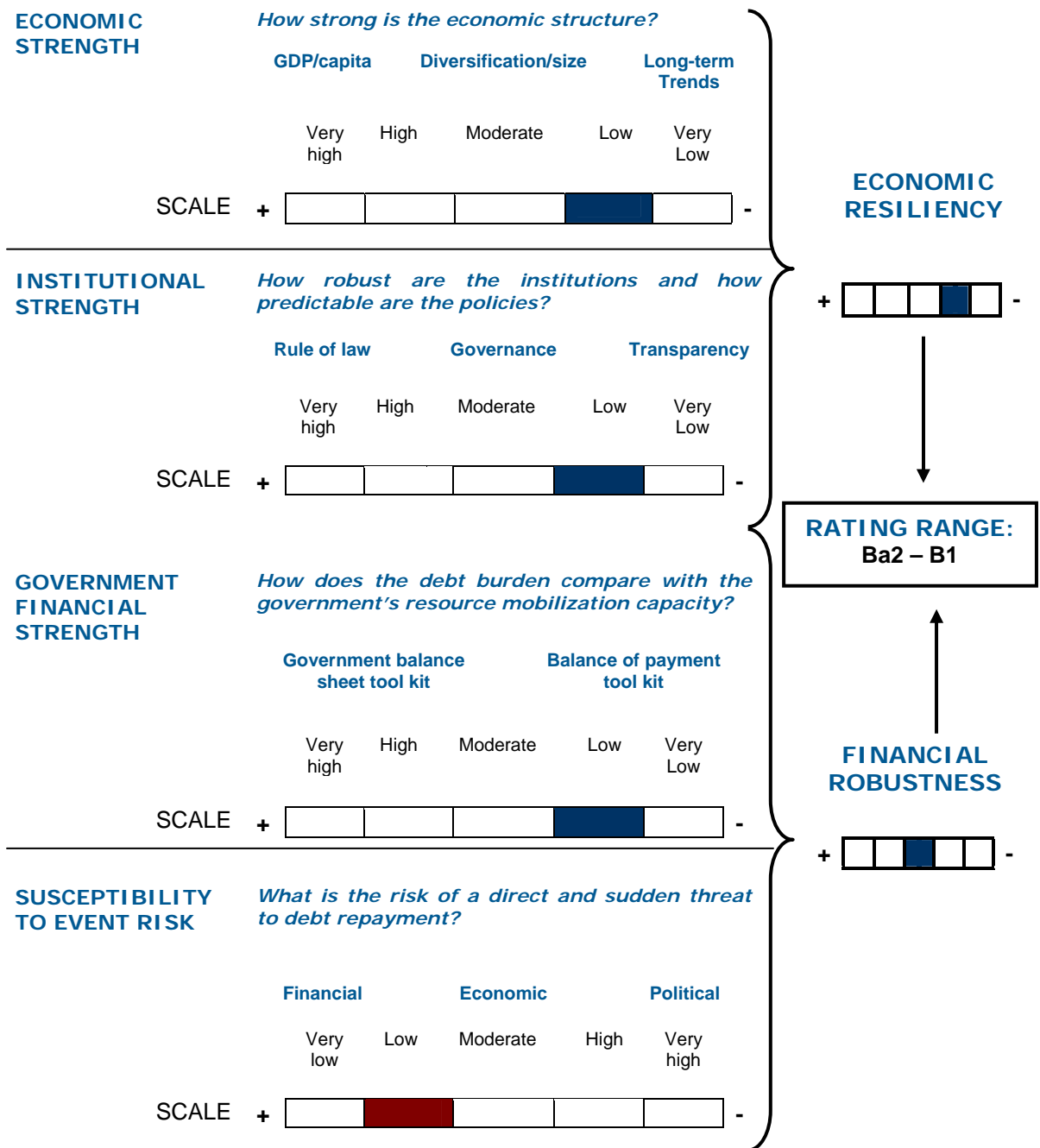
Ratings History

Guatemala

	Foreign Currency Ceilings				Government Bonds		Outlook	Date
	Bonds & Notes		Bank Deposit		Foreign Currency	Local Currency		
	Long-term	Short-term	Long-term	Short-term				
Outlook Changed	Ba1	--	Ba3	--	Ba2	--	Stable	December-08
Outlook Changed	Ba1	--	Ba3	--	Ba2	--	Positive	July-06
Rating Raised	Ba1	--	--	--	--	--	--	May-06
Rating Assigned	--	--	--	--	--	Ba1	--	November-98
Rating Assigned	--	--	--	--	Ba2	--	--	August-97
Rating Assigned	Ba2	NP	Ba3	NP	--	--	Stable	July-97

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Sovereign Ratings Mechanics⁴: Guatemala



⁴ Link to our Sovereign Bond Rating Methodology

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Annual Statistics

Guatemala	2002	2003	2004	2005	2006	2007	2008F	2009F
Economic Structure and Performance								
Nominal GDP (US\$ Bil.)	23.3	24.0	25.1	27.2	30.2	33.6	37.7	41.2
Population (Mil.)	11.8	12.1	12.4	12.7	13.0	13.4	13.7	14.0
GDP per capita (US\$)	1,975	1,989	2,023	2,141	2,317	2,514	2,754	2,937
GDP per capita (PPP basis, US\$)	4,527	4,605	4,742	4,920	5,175	-	-	-
Nominal GDP (% change, local currency)	10.6	7.1	9.4	9.1	10.5	12.2	11.8	10.5
Real GDP (% change)	3.9	2.5	3.2	3.3	5.3	5.7	4.0	3.0
Inflation (CPI, % change Dec/Dec)	6.3	5.9	9.2	8.6	5.8	8.8	11.0	8.0
Gross Investment/GDP	19.3	18.7	18.3	18.3	20.1	20.5	20.8	21.0
Gross Domestic Saving/GDP	14.0	14.3	13.5	13.2	14.9	15.4	14.8	16.0
Nominal Exports of G & S (% change, US\$ basis)	3.6	3.4	14.5	5.4	10.6	14.1	9.5	6.8
Nominal Imports of G & S (% change, US\$ basis)	6.8	6.7	14.6	10.5	13.5	12.7	9.5	5.5
Openness of the Economy [1]	66.0	66.0	69.1	66.0	66.9	68.1	66.4	64.4
Government Finance								
Gen. Gov. Revenue/GDP [2]	12.8	12.5	12.3	12.0	12.7	13.0	12.3	12.3
Gen. Gov. Expenditure/GDP [2]	13.9	15.1	13.4	13.7	14.7	14.5	13.8	14.1
Gen. Gov. Financial Balance/GDP [2]	-1.1	-2.6	-1.1	-1.7	-1.9	-1.5	-1.5	-1.9
Gen. Gov. Primary Balance/GDP [2]	0.3	-1.3	0.3	-0.3	-0.6	0.0	0.5	-0.3
Gen. Gov. Direct debt (US\$ Bil.) [2]	3.8	4.5	5.3	5.7	6.5	7.3	8.0	8.7
Gen. Gov. Debt/GDP [2]	18.3	20.9	21.4	20.8	21.7	21.7	21.2	21.4
Gen. Gov. Debt/Gen. Gov. Revenue	143.1	166.8	173.7	173.1	170.1	166.2	166.7	171.5
Gen. Gov. Int. Pymt/Gen. Gov. Revenue [2]	10.9	10.4	11.1	11.7	10.9	11.6	10.9	11.3
Gen. Gov. FC & FC-indexed Debt/Gen. Gov. Debt [2]	87.3	91.0	85.4	75.2	70.2	67.0	69.4	71.1
External Payments and Debt								
Nominal Exchange Rate (currency/\$, Dec)	7.8	8.0	7.7	7.6	7.6	7.6	-	-
Current Account Balance (US\$ Bil.)	-1.2	-1.0	-1.2	-1.4	-1.6	-1.7	-2.3	-2.1
Current Account Balance/GDP	-5.3	-4.3	-4.8	-5.1	-5.3	-5.1	-6.0	-5.0
External Debt (US\$ Bil.)	6.2	6.7	7.3	7.5	8.0	8.6	8.9	9.2
Short-Term External Debt/ External Debt	20.0	23.5	22.2	20.8	18.5	18.3	17.4	15.2
External Debt/GDP	26.4	27.8	29.0	27.5	26.6	25.6	23.6	22.3
External Debt/CA Receipts [3]	105.1	97.3	93.3	71.8	67.2	62.0	59.4	60.2
Interest Paid on External Debt (US\$ Bil.)	0.2	0.2	0.2	0.2	0.2	0.2	0.2	0.2
Amortizations Paid on External Debt (US\$ Bil.)	0.2	0.2	0.3	0.3	0.3	0.3	0.3	0.3
Net Foreign Direct Investment/GDP	0.5	0.5	0.6	0.8	1.2	1.6	1.5	1.3
Official Forex Reserves (US\$ Bil.)	2.3	2.8	3.4	3.7	3.9	4.1	4.6	4.5

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	2002	2003	2004	2005	2006	2007	2008F	2009F
Net Foreign Assets of Domestic Banks (US\$ Bil.)	-0.9	0.0	-0.1	-0.5	-0.4	-0.9	-0.4	-
Monetary, External Vulnerability and Liquidity Indicators								
M2 (% change, Dec/Dec)	9.2	47.5	11.5	14.1	13.4	11.3	5.1	-
Short-Term Nominal Interest Rates (%)	6.3	4.2	4.3	4.4	4.7	4.8	5.2	-
Domestic Credit (% change)	9.2	27.6	8.1	24.7	16.1	20.9	8.6	-
Domestic Credit/GDP	27.1	32.3	31.9	36.5	38.4	41.4	-	-
M2/Official Forex Reserves (X)	2.7	3.2	3.0	3.3	3.5	3.7	-	-
External Debt/Net Foreign Exchange Reserves	268.7	236.2	213.0	204.8	205.2	208.2	195.4	206.6
Debt Service Ratio [4]	6.1	6.4	6.3	4.6	4.1	3.4	3.0	2.9
External Vulnerability Indicator [5]	61.1	63.4	54.6	50.2	45.3	45.1	40.0	37.5
Liquidity Ratio [6]	33.7	37.1	39.0	34.4	49.3	55.6	66.5	-
Total Liabilities due BIS Banks/Total Assets Held in BIS Banks (% , DC only)	77.1	78.2	92.1	88.5	98.9	99.0	103.7	-
Dollarization" Ratio [7]"	7.7	10.3	13.2	13.2	13.4	15.3	16.7	-
Dollarization" Vulnerability Indicator [8]"	16.5	14.9	19.3	22.3	25.9	31.3	29.1	-

Notes:

[1] Sum of Exports and Imports of Goods and Services/GDP

[2] Central Government.

[3] Current Account Receipts

[4] (Interest + Current-Year Repayment of Principal)/Current Account Receipts

[5] (Short-Term External Debt + Currently Maturing Long-Term External Debt + Nonresident Foreign Currency Deposits Over One Year)/Official Foreign Exchange Reserves

[6] Liabilities to BIS Banks Falling Due Within One Year/Total Assets Held in BIS Banks

[7] Total Foreign Currency Deposits in the Domestic Banking System/Total Deposits in the Domestic Banking System

[8] Total Foreign Currency Deposits in the Domestic Banking System/(Official Foreign Exchange Reserves + Foreign Assets of Domestic Banks)

Moody's Related Research

Credit Opinion:

- Guatemala, December 2008

Rating Methodology:

- Sovereign Bond Ratings, June 2008 (109490)
- Politics and Sovereign Ratings, November 2008 (112097)
- Survey of Central American Banking June 2008 (109371)

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Report Number: 113465

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