Positive outlook for growth

By NICK LYNE
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Guatemala remains Central America's economic centre, accounting for 35 per cent of the region's GDP

President Otto Pérez Molina took office January 2012 after an election campaign in which he pledged to tackle rampant crime and poverty, as well as to woo foreign investors to Central America's largest economy. Now past the half-way point of his term in office, his popularity rating remains high at home, while he has succeeded in raising Guatemala's profile abroad.

As President Pérez Molina insisted throughout the campaign, security and economic development are closely linked. Guatemala has suffered from the so-called War on Drugs, as President Pérez noted in a speech last year at Davos: "Drug traffickers have been able to penetrate the institutions in this country by employing the resources and money they have. We are talking about the security forces, public prosecutors, judges. Drug money has penetrated these institutions and it is an activity that directly threatens the institutions and the democracy of countries."

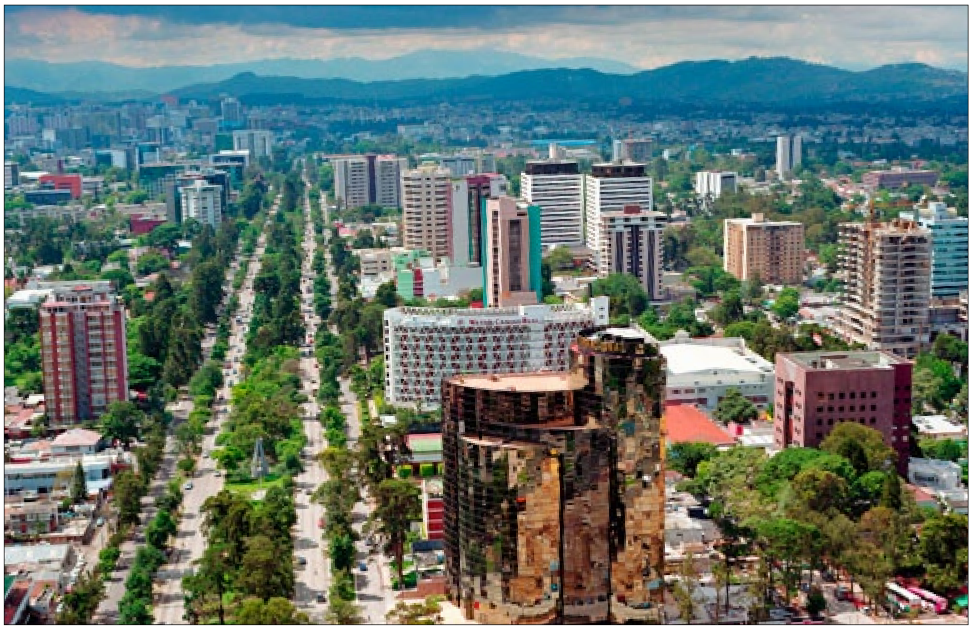
The new administration's response has been to call on world leaders to re-evaluate current drug policy. Guatemala's role has been to elevate the discussion to governmental and multilateral level. Foreign Minister Luis Fernando Carrera has travelled throughout Latin America to garner support for a new approach: "It's a matter of how to combine the strategies. Traditionally it has been said that what must be done is "law enforcement," application of the law, and that is what was called the war on drugs. Which is a punitive focus on trafficking, on production, and in general a violent response by the state towards the cartels. This, what has been done in Latin America, has increased the violence, and because of that we are a continent with so much violence, with so many homicides. What we're trying to find is a different focus, more humane, more preventive, more oriented towards trying to reduce violence, and through this way we will succeed in reducing consumption and production as well as the human cost."

A former military intelligence chief, President Pérez Molina has set about improving the security situation in the country. Over the past two years, the government has undertaken root and branch legal reform, working closely with a UN anti-impunity unit investigating and prosecuting malfeasance by senior officials, while vetting judicial appointments. Security Minister Héctor Mauricio López Bonilla has launched an overhaul of the police and judiciary, and given the attorney general's office greater resources.

At the same time, there has also been a focus on social programmes, with President Pérez Molina pledging US$160 million for cash-transfer and anti-hunger initiatives. The president plans to continue social programmes from the previous administration that provide financial aid to low-income families who send their children to school and health clinics. The government has also invested nearly US$17 million in a new social programme called 'Hambre Cero' (Zero Hunger) to combat child malnutrition.

Tax reform is helping to fund these social programmes. Current tax rates are some of the lowest in Latin America, but will rise to 5 per cent for middle-income earners and 7 per cent for high-income earners. Salaried workers will no longer be able to offset VAT payments against income tax by presenting receipts they gather during the year. Along with other changes to the income tax rules, Guatemala will introduce measures to tackle abusive transfer pricing through

Guatemala City: the nation's capital



which companies trading across borders manipulate their accounts to shift profits to jurisdictions levying little or no tax.

A new 5 per cent capital gains tax will also be introduced, and some foreign income will now be liable for tax under "reinforced national income taxation". The Economy Ministry estimates tax revenue should increase from around 10 per cent to 12.5 per cent as a result of the new measures.

Putting the economy back on track

The first signs that the international community recognised the changes underway in Guatemala came by September of 2012, when ratings agency Standard & Poor's revised its outlook from negative to stable, noting the "gradually improving prospects for GDP growth and tax revenue in Guatemala and the implications these factors could have on Guatemala's fiscal prospects over the next few years." GDP growth took off in 2011, averaging aound 3.3 per cent since.

Guatemala emerged from four decades of civil war in 1996 and seemed set for rapid economic growth until it was hit by the 1998 financial crisis. The subsequent collapse of coffee prices left what was once the country's leading export sector in depression and had a severe impact on rural income. A decade later, economic growth fell again as export demand from US and other Central American markets declined and foreign investment slowed amid the global recession.

Nevertheless, Guatemala remains Central America's economic centre, representing 35 per cent of the region's GDP, and is the business hub in the Mesoamerica region.

The task facing the government now is how to leverage the competitive advantages Guatemala has to offer, such as geographical location, wealth of resources, high quality in labour and a high performance in logistics, while further developing its solid infrastructure and technology base.

Since 2003, despite the global downturn and its own internal problems, Guatemala has shown a growth of 375.6 per cent in Foreign Direct Investment (FDI), "a fact that demonstrates the strength of our economy and the confidence of big foreign and multinational companies," says Economy Minister Sergio de la Torre

He points out Guatemala's strategic geographical location as the perfect platform for the largest markets in the World. "We have privileged access to both the Atlantic and the Pacific Oceans, facilitating direct commerce with Asia, North America and Europe, through modern seaports. Furthermore, Guatemala serves as the hinge of Mesoamerica, a region with great potential due to over 50 urban centres, 25 of which are located in Central America, its population of 68 million inhabitants and an economy of US$319 billion."

Reflecting its commitment to regional integration, Guatemala has reduced customs barriers: trade agreements are already in place with the United States, Mexico and the rest of Central America, including Panama, as well as Colombia, Taiwan, and Chile. Guatemala also has partial agreements with Belize, Cuba and Venezuela. Aside from helping attract direct foreign investments, these initiatives enable the promotion of greater and better opportunities for local consumers and provide broader access for Guatemalan products to international markets. It is also worth mentioning that Guatemala is presently in the process of negotiating free trade agreements with

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the European Union and Canada.

The first two years of the Pérez Molina administration have seen intense activity to attract foreign investment and expand employment in various sectors, including BPO, oil, energy, agri-business, tourism, and infrastructure.

Business Process Outsourcing

The information technology and BPO sectors generated more than 3,000 jobs in Guatemala in 2013, with the sector piling up more than US$326 million in service export revenue, an increase of 11 per cent on the previous year, according to export promotion agency Agexport. The new positions take the total number of jobs created by the sector over the past few years to 35,000. The majority of outsourcing firms in Guatemala are based in its capital city but the government is working to entice outsourcers to smaller, regional cities. The agency stated that in 2013 three jobs fairs were held to introduce graduates and job seekers to the outsourcing industry, which features several top global BPO firms such as Capgemini, Xerox and Telus International. Low labour costs and a growing number of US expatriates are driving growth in Guatemala's offshoring sector. Some 25,000 Guatemalans return home every year to seek re-employment or to launch a business.

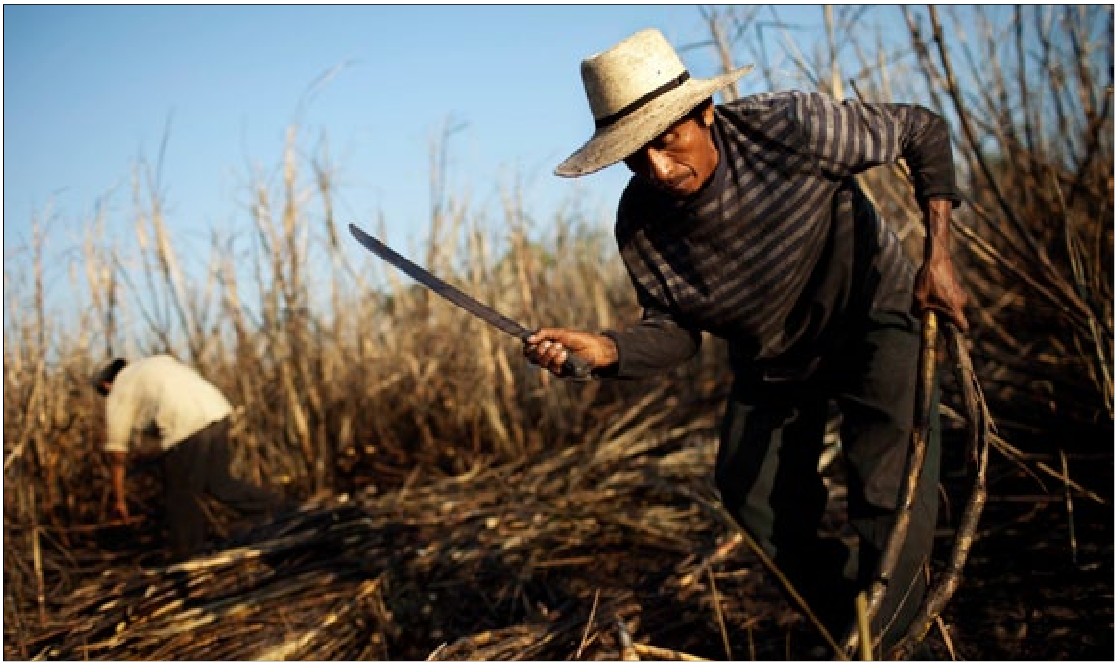
Oil

This is one of the strongest and soundest sectors in Guatemala. In 2011, it attracted 32.2 per cent of total inward investment. Guatemala's current oil production averages 14,000 b/d, more than 90 per cent of which is produced by Anglo-French company Perenco from the Xan Field in the Petén region in the north of the country. "Xan is a mature, operationally challenging field, the type of project that suits Perenco's operational strength and strategy, so we are at home in this environment, working with this type of asset. Added to this, the business climate in Guatemala is positive, and Perenco values our relationships and strategic agreements with the Guatemalan authorities. The quality of local employees is very high, and so all these factors contribute to the importance of Guatemala to Perenco," says the company's country manager in Guatemala, Emmanuel Colombel.

Although small, the government has plans to expand the oil sector. Guatemala's Ministry of Energy and Mines has already awarded three-year exploration contracts for six of seven areas to six small, foreign oil firms. The aim is to boost production to 51,000 barrels per day by 2020. Lacking a major refinery, most of Guatemala's oil, which is heavy crude, is exported to the United States and Canada. However, the Refinería del Motaga project (Zacapa, in the east of the country) is aiming to cover the national needs of hydrocarbons with a small surplus forecast to be exported. Currently, this project is seeking international investors to formally start operations. Contracts for oil and gas are commonly issued for a 20-25 years period, with an option to renew.

Energy

Guatemala has 27 hydroelectric plants, 27 thermoelectric plants, 12 sugar mills, and two geothermal plants, totalling 2,576 MW of installed power, and 2,186.0 MW of effective power. There is still significant potential for power and distribution



Guatemala is the fourth-largest sugar exporter in the world in rural areas, many of which have only 50 per cent coverage. Guatemala's membership of SIEPAC (System of Electric Interconnection of the Central American Countries) is enabling it to become an important energy exporter to the region.

Jaguar Energy Guatemala, a subsidiary of Houston-based Ashmore Energy International, has invested US$700 million to construct a 300 MW solid-fuel powered plant in the city of Masagua. The plant will allow the country to decrease the proportion of electricity contributed by petroleum derivatives to just 4.6 per cent. "A coal-fired power plant is part of the government's plan to diversify the energy mix of the country. Jaguar Energy will help reduce the cost of energy, generating a direct benefit for the country's population," says Jaguar's General Manager, Ernesto Cordova.

Erick Archila, the Minister for Energy and Mines, says Guatemala wants to move towards cleaner energy sources, with hydro the most competitive, but also to focus on some wind power projects. "However, the cost of producing power from wind farms remains higher than other sources. Biomass represents an interesting opportunity, where Guatemala is already showing significant progress. There is a good opportunity to develop the bio-fuel sector further," he adds.

Guatemala is the strongest potential biofuels producer in Central America, given the country's high yields of sugarcane and palm oil and its efficient local industries. Nearly all of the dehydrated ethanol produced is exported to Europe, and a domestic market for biofuels consumption has yet to be developed. The Guatemalan sugar industry could easily supply the ethanol required for a 10 per cent ethanol-gas blend for domestic consumption. However, there are several obstacles that Guatemala must overcome in order to implement a viable biofuels policy and the various involved sectors need to reach consensus. Guatemala is already producing biodiesel from oil seeds and vegetable waste matter.

Guatemala is also the second largest palm oil producer in the region (after Honduras), with output going exclusively to the international food processing sector, but could also produce biodiesel from palm oil.

Agriculture and foodstuffs

One of the country's strongest sectors, contributing 14 per cent of GDP and 11 per cent of exports, the food processing industry is well developed and sophisticated, with good infrastructure and presents many investment opportunities. The sector generates direct employment for more than 75,000 people and 353,000 indirect jobs.

Guatemala has approximately 11 million hectares of fertile soil of which only 12 per cent is cultivated. The country shows a higher yield in weight in crops like cacao, sugar cane, coconuts, strawberries, apples, and black pepper, than in competitor countries.

Guatemala's sugar industry is acknowledged as the number one in efficiency and productivity in the world thanks to the technology used by its sugar mills. Guatemala has the highest yield in Latin America and the Caribbean region, and is the fourth largest exporter in the world and the second in Latin America.

Coffee

After Colombia, Guatemala ranks second in the world in the amount of high-grade coffee it produces, and has the highest percentage of its crop classified as "high quality" by international buyers. It contributes around 15 per cent of Gross National Product and generates about a third of Guatemala's foreign exchange. In terms of exports, coffee is Guatemala's flagship product: In 2011 and 2012, exports of more than USUS$2.13 billion were recorded.

Guatemala's coffee production has changed over the last 30 years. In 1980, 20 per cent of production was hard and strictly hard beans, the higher quality beans that bring better prices in the market. The lower qualities, prime and extra prime, accounted for 80 per cent of coffee production. Guatemalan coffee producers recognised the problems inherent in relying

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so extensively on lower-quality product, so they made a strategic decision to focus on high-quality coffee. By 2005, 80 per cent of coffee production was hard and strictly hard, while prime and extra prime represented 20 per cent. Although total coffee production has not increased significantly, the financial security of the industry has strengthened. Currently, about 80 per cent of production is carried out on small and medium-sized farms, located in high-altitude zones that produce hard and strictly hard beans. Nineteen out of Guatemala's 22 departments produce coffee, and the sector is the country's largest single employer.

Tourism

Guatemala is a unique destination for tourism, thanks to its magnificent natural resources, and Mayan and colonial history. Visitor numbers have increased steadily over the last five years to around two million a year.

More than half of the country's tourism market comes from Central America and around 30 per cent from North America. Around 10 per cent of arrivals are from Europe.

The Guatemalan Tourism Institute – INGUAT – and the governement agency Invest in Guatemala have identified eight large areas which raise diverse possibilities for investment, and which present the greatest potential for the development of touristic projects.

Infrastructure

Guatemala is the logistics and services centre of the region, thanks to a modern road network and efficient ports on the Pacific and Atlantic oceans, along with a new airport in Guatemala City. The Multimodal Plan of Works of Priority Infrastructure (PMOl) contemplates the development of infrastructure by air, land, and fibre optics to interconnect the country's ports, air, and road systems.

Guatemala is looking to attract more than US$1.3 billion in investments across a portfolio of six Public-Private Partnership infrastructure projects that will see the construction of an industrial park on the border with Mexico; the reconstruction of Champerico port, a food terminal, and three toll roads.

The government has also given its support to the Guatemalan Technological Corridor (GTC), a 372km four-lane highway, two railway routes for freight and passengers, as well as five pipelines, connecting the Pacific and Atlantic Oceans, to be funded privately to the tune of US$12 billion, and that will take up to five years to complete. The two ports will have capacity to unload six vessels simultaneously and receive Panamax vessels. The project is being developed by Odepal Internacional, which holds 5 per cent of Holding Corredor Interoceánico de Guatemala, the company that will own and build the project. The remaining 95 per cent of the holding company is owned by locally constituted companies that will be responsible for awarding the private concessions for the land. Some 46 municipal governments are shareholders in the project and have so far assisted in securing the necessary land for construction.

The future is regional

Regionalisation is now a fact of life for doing business in Central America. Factories and distribution facilities have been and continue to be designed to serve a regional market. Furthermore, rarely do business people visit just one Central American country. New investors weigh the advantages that each country offers as they look to decide where to establish new plants. Regional managers are becoming the norm, with responsibilities for multiple countries within the Central American marketplace. Trade between the countries of Central America has also increased dramatically over recent years, a trend that was accelerated with CAFTA-DR implementation.

Regional efforts have focused on improving infrastructure throughout Central America. The Mesoamerica Project (MP) is a portfolio of nearly 100 projects designed to bring over US$8 billion in investments in energy, telecommunications, and transportation, among other areas. MP's two major projects are the construction and rehabilitation of the International Network of Mesoamerican Highways initiative (RICAM), and the Electric Integration System of Central America (SIEPAC).

It is significant that the keynote speaker at last year's Guatemala Investment Summit, held in Guatemala City, was Mexico's President Enrique Peña Nieto, who at the same time as endorsing President Pérez Molina's policies, highlighted the importance of Central America and Mexico working together, pledging to "expand the mechanisms for cooperation, collaboration and integration between our nations, and ensure that this is reflected in the development of our peoples, who have a great opportunity ahead of us. On the basis of greater integration, we will be able to trigger development for our people, together with progress and better standards of welfare for all the families in our countries."

Guatemala faces the same challenges as its neighbours, and can benefit from the same opportunities. It is the region's logical investment gateway, and has already shown that it is prepared to work internationally for the overall benefit of the region. Over the last two years, its government has made huge progress in laying the foundations for growth and stability, and will, with the support of its neighbours, continue in its task of establishing Guatemala as the economic motor for Central America.