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Honduras: Request for a Stand-By Arrangement and an Arrangement Under the Standby Credit Facility—Staff Report; Press Release on the Executive Board Discussion; and Statement by the Executive Director for Honduras

In the context of the Request for a Stand-By Arrangement and an Arrangement Under the Standby Credit Facility, the following documents have been released and are included in this package:

- The staff report for a Stand-By Arrangement and an Arrangement Under the Standby Credit Facility, prepared by a staff team of the IMF, following discussions that ended on September 10, 2010, with the officials of Honduras on economic developments and policies. Based on information available at the time of these discussions, the staff report was completed on September 17, 2010. The views expressed in the staff report are those of the staff team and do not necessarily reflect the views of the Executive Board of the IMF.

- A Press Release summarizing the views of the Executive Board as expressed during its October 1, 2010 discussion of the staff report that completed the request and/or review.

- A statement by the Executive Director for Honduras.

The documents listed below have been or will be separately released.

Letter of Intent, Memorandum of Economic and Financial Policies, and Technical Memorandum of Understanding sent to the IMF by the authorities of Honduras*

*Also included in Staff Report

The policy of publication of staff reports and other documents allows for the deletion of market-sensitive information.

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INTERNATIONAL MONETARY FUND

HONDURAS

Request for a Stand-By Arrangement and an Arrangement Under the Standby Credit Facility

Prepared by the Western Hemisphere Department
(In consultation with other departments)

Approved by Miguel A. Savastano and Jan Kees Martijn

September 17, 2010

Executive Summary

- **Background**. The economy is recovering slowly from the impact of the global slowdown and the political crisis of 2009. Real GDP is projected to increase by 2.4 percent in 2010, following a decline of 2 percent last year. At the 2010 Article IV consultation discussion, Executive Directors recommended starting a gradual process of fiscal consolidation to bring the overall fiscal deficit to about 2 percent of GDP by 2012, and reining in central bank credit. They also supported fiscal reforms to improve the composition of public expenditure and strengthen the financial position of public enterprises and pension funds.

- **SBA/SCF**. The Honduran authorities are requesting Fund support in the form of 18-month blended SBA/SCF arrangements (each equivalent to 50 percent of quota) in the amount of SDR 129.5 million. An initial disbursement (combined SBA/SCF) of SDR 35.61 million (27.5 percent of quota) would become available upon Board approval. The authorities plan to treat the arrangement as precautionary.

- **The Economic Program**. The program seeks to provide financial buffers against downside risks stemming from continued uncertainty in the global economic environment, provide a framework for implementing key reforms, and catalyze donor budgetary assistance. Fiscal policy will aim at reducing the overall deficit of the public sector, control current spending and improve the composition of public expenditure. Central bank credit will be restrained; the monetary and exchange rate management frameworks will be upgraded and geared at maintaining low inflation and protecting the external position.

- **Discussions**. A staff team comprising P. Gajdeczka (Head), F. Frantischek, C. Pérez (all WHD), and M. Arena (SPR) visited Tegucigalpa during August 2–11 and September 7–11. Mr. Garza (Resident Representative) assisted the mission. Mr. J. Gramajo (OED) attended key meetings. The team met with President Porfirio Lobo, Minister of the Presidency de Bogran, Finance Minister Chong Wong, Central Bank President Mondragón, and other senior officials.

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I. Background

1. **The government of President Porfirio Lobo took office in January 2010 in the context of a difficult social and economic situation**. The economy was contracting, largely as a result of the global economic slowdown, while social tensions were high, as internal polarization intensified in the aftermath of the political crisis of 2009. In the first half of 2010, the government focused on diffusing social and political tensions, regaining full international recognition, and restoring macroeconomic stability.

2. **In the economic policy area, the authorities gave priority to strengthening the financial position of the public sector and restarting the external assistance that had been interrupted in 2009**. In April, the government secured Congress' approval of a budget that targeted a reduction in the overall deficit of the public sector of almost 1 percent of GDP. Congress also approved an important tax reform, which, by broadening the tax base and improving tax administration, is expected to yield additional revenues of 1½-2½ percent of GDP by 2012. At the same time, the authorities resumed full relations with bilateral and multilateral donors to restart social and investment programs.

3. **In the July 12, 2010 discussion of the Article IV consultation with Honduras, the Executive Board recommended that the authorities undertake fiscal consolidation to create space for higher public investment and social spending**. It supported a fiscal strategy that keeps public sector deficits at below 2 percent of GDP over the medium term and improves expenditure composition through effective control of the wage bill. The Board also recommended reforms of public enterprises and public pension funds to improve their efficiency and reduce vulnerabilities. In addition, Directors recommended reining in central bank credit to protect international reserves and keep inflation under control. They also noted that some exchange rate flexibility, combined with wage moderation and prudent monetary policy, would be important to safeguard competitiveness.

4. **The authorities consider that a Fund-supported program would help bolster the credibility of an economic program consistent with the above noted objectives**. They are requesting an arrangement with the Fund to strengthen investor confidence, provide a framework for implementing key reforms, and help secure donor support. The economic program would be anchored on a strict restraint on government spending and on revenue measures to arrest the deterioration of the overall fiscal position and return public debt to a sustainable path.

II. Recent Developments And Policies

5. **Recent macroeconomic developments are broadly in line with what was envisaged in the 2010 Article IV staff report**. The monthly index of economic activity through June recorded an increase of 3.6 percent (yoy), consistent with a gradual recovery, while private sector credit remains subdued. End-August CPI inflation (12-month) was 4.5 percent (up from 3 percent at end-2009), while net international reserves stood at US$2.1 billion at mid-September, broadly unchanged from the level at end-2009 (which, in turn, was US$400 million below the level of end-2007).

6. **Central bank credit is being restrained**. Although the policy rate and reserve requirements remain at their mid-2009 levels, central bank's monetary operations (including placement of its instruments) have helped reverse the expansion of its net domestic assets during 2009. In addition, the central bank stopped providing credit to the public sector bank.

7. **Revenue performance in the first half of 2010 was somewhat weak**. According to data through June, central government tax revenue was 2 percent lower than in the same period in 2009; this outcome was caused by a lagged effect of the 2009 contraction on income taxes, delays in implementing the April tax reform, and reorganization of the tax revenue office (DEI). However, total spending in the first semester also was some 3 percent lower than the outturn in the first half of 2009, reflecting subdued public investment and tight control over non-wage current expenditure.

8. **The authorities have continued taking measures to strengthen the fiscal position**. In particular:

- **Wage bill control**. In June, the authorities approved a plan to verify the number of government employees in the education and health sectors, suspend the hiring of new workers, and eliminate all redundant or irregular positions. In addition, they took steps to ensure that the increase in the wage bill in 2010 only reflects contractual obligations on wages in the education sector; nominal wages of government employees in other sectors have remained broadly unchanged.

- **Energy subsidies**. In June, energy subsidies were eliminated, except for the consumers with electricity consumption below 150 kWh. The measure is expected to yield savings of up to 0.15 percent of GDP annually.

- **Public sector tariffs**. Tariffs in the electricity (ENEE), telephone (Hondutel), and water (SANAA) companies have been raised with a view to eventually cover the projected cost of their services.

- **Domestic arrears**. With IDB assistance, the authorities are finalizing the search for an internationally reputable company to audit overdue government payments to private suppliers, estimated at about 1.3 percent of GDP.

III. THE ECONOMIC PROGRAM FOR 2010–11

9. **The government's economic program for 2010–11 seeks to restore macroeconomic stability by strengthening public finances and protecting the external position**. The program is anchored on fiscal consolidation (to be achieved through strict control of current spending and higher tax revenues) and aims at reallocating public expenditure to priority areas. The program also envisages a strengthening of the operating balance of public sector enterprises through occasional tariff adjustments and efficiency improvements. Monetary and exchange rate policies will be geared at maintaining low inflation, safeguarding competitiveness, and strengthening the external reserves position. Structural measures aimed at improving public sector efficiency are also part of the program.

10. **The authorities are confident that a Fund-supported program would bolster investor confidence and help catalyze external financing from official creditors**. In addition, they see the program with the Fund as providing a liquidity buffer in the context of still fragile global recovery. Given the good prospects for securing external financing from the World Bank and the IADB for projects and budget support, the authorities do not foresee a financing need and intend to treat the Fund arrangement as precautionary.

A. Macroeconomic Framework

11. **The program envisages a gradual economic recovery**. The rebound in economic activity in Honduras' main trading partners will have a lagged effect on domestic demand, while remaining political uncertainties and social pressures will preclude a rapid recovery of investor and consumer confidence. As a result, real GDP is projected to grow by 2½-3½ percent in 2010–11, before stabilizing at its long-term historic rate of 4 percent. At the same time, inflation is expected to remain below 6 percent during 2010–11 and converge towards 5 percent in the medium term.

Medium-Term Scenario

		Prel.	Projections					
	2008	2009	2010	2011	2012	2013	2014	2015
	(annual percentage change)							
Output and inflation								
Real GDP	4.0	-1.9	2.4	3.5	4.0	4.0	4.0	4.0
CPI inflation (eop)	10.8	3.0	5.7	5.8	5.5	5.3	5.3	5.3
	(in percent of GDP, unless otherwise indicated)							
Public Sector								
Overall public sector balance	-1.7	-4.6	-3.7	-3.1	-2.0	-1.9	-1.9	-1.8
Overall central government balance	-2.4	-6.2	-4.5	-3.4	-2.8	-2.2	-2.2	-2.1
Public sector debt	20.2	23.7	26.1	27.2	27.7	28.2	28.5	28.4
Total public investment	6.0	5.9	5.1	5.8	6.2	6.4	6.4	6.5
of which public sector enterprises	0.7	0.4	0.6	0.7	0.9	1.0	1.0	1.1
External sector								
External current account balance	-8.0	-3.2	-6.3	-6.9	-7.1	-6.9	-6.9	-6.8
Gross international reserves (US$ millions) 1/	2,691	2,331	2,385	2,606	2,856	3,068	3,299	3,567
(in months of non-maquila imports)	4.7	3.6	3.4	3.5	3.6	3.7	3.7	3.7

Sources: Central Bank of Honduras; Ministry of Finance; and Fund staff estimates.

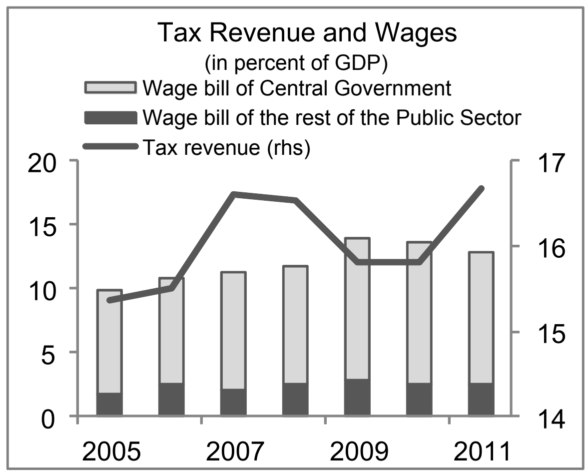
1/ Includes possible budget support loans.

12. **The external current account deficit is projected to increase to 6-7 percent of GDP in 2010–11**. Following the sharp contraction of trade flows in 2009, exports and non-oil imports are expected to recover but, given the weak external demand, would remain below their pre-crisis levels until 2013. Oil imports, however, are projected to increase to the equivalent of 10–10½ percent of GDP in 2010–11 mainly on account of higher oil prices. Net capital inflows are also expected to rebound gradually from the extremely low levels of 2009, mainly as a result of an increase in government external borrowing and a pickup in FDI flows.

B. Fiscal Policy

13. **The authorities' main fiscal objective is to reduce the overall deficit of the public sector to levels consistent with a public debt-to-GDP ratio of about 30 percent**. A resolute implementation of the tax reform approved in April and strict control of current spending would be critical to achieving that goal (see MEFP ¶5). In the near term, adherence to these policies would result in a reduction in the deficit of the overall public sector of more than 1½ percent of GDP during 2010–11 (the reduction in the central government deficit would be significantly larger). Thereafter, expenditure restraint combined with measures to continue to strengthen tax administration, reduce subsidies, and improve the operating balance of public sector enterprises would further lower the overall public sector deficit to 2 percent of GDP.

14. **Fiscal policy in 2010 will halt the deterioration in the public finances observed in 2009**. The program envisages that implementation of the April tax reform will result in higher revenue in the second half of the year, that, combined with new controls on the wage bill and tariff increases in public sector enterprises, will bring down the overall deficit of the public sector to 3.7 percent of GDP in 2010 (see text Table above).[1] The projected reduction in the deficit of the central government will be larger as lower net income from interest revenue of public pension funds and higher investment by public enterprises would reduce the surplus of the rest of the public sector.[2]



15. **The draft budget for 2011 submitted to Congress in September targets further progress in fiscal consolidation**. The budget incorporates somewhat conservative revenue projections, partly to reflect uncertainties related to gains from improvements in tax administration. In addition, the budget sets ceilings on current expenditure, including one that keeps the central government wage bill at the projected 2010 level, while allowing for higher public investment and anti-poverty spending. Key elements of the program for 2011 include:

- **Revenue**. The tax reform of last April, together with improvements in tax administration, are expected to yield central government revenue by the

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[1] Key tax measures of the April reform included the elimination of the zero VAT rate, widening of the base and increasing of rates of several taxes, establishing an income tax on dividends and housing rent, and increasing taxes on "sin" goods.

[2] The decline in the interest income of the combined public sector is due to the projected increase in the share of central government bonds in the investment portfolio of public pension funds.

equivalent 1 percent of GDP, with the full revenue impact of the reform expected in 2012. Measures to strengthen tax administration will include steps to enhance the operations of the DEI and facilitate the implementation of the tax reform (MEFP ¶7).

- **Expenditure control**. The authorities' strategy hinges critically on reducing the public sector wage bill to 12.8 percent in 2011 (from 13.9 percent of GDP in 2009), largely by keeping the nominal wage bill of the central government in 2011 at the same level as in 2010. Closing redundant positions as well as those created without budget authorization and exercising strict control on nominal wages and reducing allocations for current spending will be key to achieving these targets (MEFP ¶7). Undoing the large increase in spending recorded in 2009 will also be important. The savings on current expenditure will enable the authorities to increase public investment and anti-poverty spending (see below).

- **Public sector enterprises**. The operating balances of public sector enterprises are expected to improve as a result of implementing a tariff policy aimed at cost recovery and greater efficiency of public services.[3] In addition, central government arrears to ENEE (about 0.1 percent of GDP) will be repaid during 2010. Comprehensive plans for restoring financial and operational viability of key public sector enterprises will be prepared in early 2011(MEFP ¶7).

- **Public pension funds**. Major reforms are being prepared to correct the growing actuarial deficits of key public pension funds.[4] A draft law to enable changes in the determination of benefits from and contributions to public pension funds will be submitted to Congress by end-2010 (MEFP ¶7).

- **Domestic arrears**. The government intends to regularize domestic arrears to private sector suppliers and among public sector entities. Arrears to the private sector that are validated by the audit will be settled with a combination of cash and bonds. A plan to regularize intra-public sector arrears will also be developed before year end.

16. **Financing mix**. The authorities' fiscal strategy aims at reversing the heavy reliance on domestic financing of budget deficits observed in 2009 (MEFP ¶7). In line with this, nearly 80 percent of financing of the deficits projected in 2010-11 is expected to come from external

[3] In 2009, public enterprises, as a whole, recorded an operating surplus of 1.3 percent of GDP, largely as a result of the lagged impact of electricity tariffs increase in 2008 (which were not reduced following the decline in oil prices).

[4] In 2010, public pension funds are expected to record operating surpluses but will have deficits in actuarial terms.

sources (including US$220 million budget support from World Bank and the IDB, and US$50 million from Taiwan, Province of China), while there will be no new credit from the central bank. The staff and authorities agreed that the proposed external program financing would contribute to easing pressures in the domestic financial system, and be consistent with preserving debt sustainability (Appendix I).

C. Monetary and Exchange Rate Policies

17. **The economic program envisages a tightening of monetary conditions to safeguard the inflation and external objectives**. Specifically, the authorities plan to continue placing central bank instruments to mop up excess liquidity and are committed to not resume central bank lending to the public sector or to any public sector bank. Moreover, the authorities stand ready to increase the policy interest rate and intensify open market operations if the inflation or external objectives are compromised (MEFP ¶8).

18. **The program also contemplates an upgrading of the monetary policy framework**. Building on recommendations of past technical assistance missions from the Fund, the authorities plan to reform the operational framework for monetary policy and set up the infrastructure for a well functioning foreign exchange market. In support of these reforms, a Fund technical assistance mission will visit Honduras later this year to assess the institutional capacity of the central bank, make recommendations to strengthen it, and establish a timetable for implementing reforms in this area (MEFP ¶9). In addition, the authorities intend to develop a plan to recapitalize and strengthen institutionally the central bank to enhance its ability to conduct independent monetary policy (MEFP ¶10).

D. Anti-Poverty Spending

19. **Increasing social spending is a key goal of the authorities' program**. In cooperation with other multilaterals, the government plans to consolidate most of its anti-poverty spending in a conditional cash transfer program (*Bono 10 mil*). This program, modeled on successful experiences in Brazil and Mexico, aims at covering a large share of families living in extreme poverty by providing cash benefits conditional on regular monitoring of child growth and use of health and education services. The improved targeting of electricity subsidies is also part of the anti-poverty strategy. In addition, the economic program envisages that some of the savings generated from expenditure restraint in other areas would be allocated to social spending. To signal their commitment to protect social expenditure, the authorities proposed including a floor on such expenditure as part of the Fund program (MEFP ¶12). Although at present the authorities are focused on effective implementation of the cash transfer program, they intend to update their medium-term anti-poverty strategy during the arrangement period.

E. Financial Sector

20. **A further strengthening of the financial system and enhancing enhance crisis preparedness are also part of the authorities' program** (MEFP ¶11). Although Honduras' financial system weathered relatively well the global financial crisis and the ensuing slowdown in activity, the authorities plan to further strengthen its resilience by: (i) focusing supervision on the control of risks rather than only on adherence to standard banking norms;

(ii) enforcing more effectively the capital charges and provisioning; (iii) requiring banks to develop business plans consistent with the borrowers' ability to repay; (iv) enhancing liquidity monitoring; (v) re-activating the Early Warning Committee; and (vi) assessing the capital need of the deposit guarantee fund (FOSEDE) and Capitalization Fund. The authorities are developing an action plan for this reform program, and will begin its implementation later this year.

F. Risks

21. **The authorities' economic program is subject to several risks**. First, the program's balance of payments objectives would be jeopardized if the global economic recovery is slower than currently envisaged, world oil prices are higher than projected, or if there are delays in budgetary assistance expected in 2010 (US$140 million). Second, the relatively high degree of domestic dollarization increases the risk of uncovered foreign exchange positions in the economy. And, third, the inability to implement the fiscal and monetary measures contemplated in the program would result in a financing gap that would undermine the stabilization effort.

22. **The authorities would need to adopt additional measures if any of these risks were to materialize**. The authorities acknowledge this and are exploring the measures that could be implemented if, for example, the projected external financing were not to materialize fully or if political pressures thwarted the attempt to keep the nominal wage bill unchanged.

IV. Program Modalities

23. **Staff proposes to support the authorities' economic program with blended 18-month arrangements under the SCF and SBA with total access of 100 percent of quota (SDR129.50 million)**. The proposed duration would provide a reasonable time to re-establish confidence in the government's commitment to macroeconomic stability, while the rationale for blended arrangements is based on the fact that Honduras meets the income criterion for blending PRGT and GRA resources as its per capita income is above IDA's operational cutoff. Although the baseline balance of payments scenario does not contain financing gaps, staff consider that an access of 100 percent of quota (under precautionary arrangements), with about a third of the resources available in the first six months of the program, would provide sufficient financial buffers to withstand adverse shocks (Tables 10 and 11). (The proposed schedule of disbursements and purchases is provided in Table 9.)

24. **Program conditionality would be streamlined and focused on macro-critical areas**:

- **Prior action**. The submission to Congress of a budget for 2011 targeting a deficit of the central government of 3.4 percent of GDP (and consistent with the overall deficit of the public sector of 3.1 percent of GDP) would be a prior action.

- **Quantitative performance criteria**. The program contains numerical quarterly ceilings (through December 2011) on (i) the overall public sector deficit; (ii) the net domestic financing of the public sector; (iii) the net domestic assets of the central bank; and (iv) the contracting and guaranteeing of nonconcessional external public sector debt. In addition, the program will contain a floor on the NIR of the central bank and ceilings of zero on new credit from the central bank to the government and the public banks (see MEFP Table 1).

- **Structural benchmarks**. The structural conditionality under the program will focus on measures critical to fiscal consolidation, for improving the composition of public expenditure, and for upgrading the monetary framework (see MEFP Table 2).

25. **Safeguards assessment**. The proposed arrangements require an update of the earlier assessment of safeguards (2004 and 2008). Accordingly, a mission will visit Honduras in December of 2010 to conduct such an assessment (to be completed by the time of the first program review).

V. Capacity to Repay the Fund

26. **Honduras has a strong capacity to repay the Fund**. Its current obligations to the Fund are low (SDR 20.3 million at end-August 2010), the proposed access would not affect significantly the level of total external debt (24 percent of GDP), and the risk of debt distress is low according to the most recent Debt Sustainability Analysis and its present update. Even if all disbursements and purchases under the proposed arrangement were made, the maximum repayment in any one year (2012) would represent only 2.9 percent of exports of goods and services and 7.6 percent of the projected level of gross reserves (Table 8).

VI. Staff Appraisal

27. **The economy of Honduras is recovering gradually from the impact of the global recession and the political crisis of 2009**. Last year, output declined in real terms, unemployment increased, and revenues fell sharply. In 2010, real GDP is expected to grow by 2½ percent, while inflation is projected to rise to about 6 percent (yoy). However, the overall position of the public sector remains weak, disbursements of external e[illegible] been slow to recover, and international reserves are below pre-crisis lev[illegible].

Modified: 10/5/10

28. **The government that took office in January 2010 recognized early on the need to take decisive measures to restore macroeconomic stability and strengthen public finances**. The revised 2010 budget and the April tax reform package approved by Congress sought to arrest the deterioration of the fiscal position. In addition, tariffs in key public enterprises were raised to ensure cost-recovery, and a plan was approved to strengthen control over current spending, in particular over employment and wages. The authorities also decided to initiate an audit of government's arrears to the private sector.

29. **Resolute adherence to the program of fiscal consolidation will be critical to the success of the government's economic strategy**. The authorities' objective of reducing the overall public sector deficit to 3.1 percent of GDP in 2011 is appropriately ambitious.

Increasing revenues required to attain this deficit target will require full implementation of the tax reform of April 2010 and a substantial strengthening of tax administration. In addition, strict control over current expenditure would be critical to the success of the fiscal consolidation strategy. Staff supports the authorities' objective of controlling the public sector wage bill, in particular after the education and health sectors benefited from significant wage and employment increases in recent years. Controlling these outlays will help create space for increasing anti-poverty spending and public investment. Fiscal consolidation needs to continue beyond 2011 to stabilize the debt-to-GDP ratio at below 30 percent of GDP.

30. **Reforms of public enterprises and pension funds are key components of the authorities' fiscal strategy**. Recent tariff increases in public sector enterprises are an important step toward restoring their financial viability. Going forward, tariff adjustments should adhere to the criteria set by domestic legislation, and plans should be developed to enhance the operational efficiency and competitiveness of these enterprises. Staff welcomes the authorities' plan to submit to Congress reform proposals for public pension funds later in 2010. The proposals should seek to rationalize the scope of benefits and set parameters for the funds' investment policies that restore their solvency.

31. **Monetary and exchange rate policies should be geared at keeping inflation low, protecting competitiveness, and strengthening the external position**. In line with these objectives, the central bank is committed to controlling the expansion of its net domestic assets through active placement of its bills and adjusting its policy interest rate. Staff welcomes the central banks' decision to stop extending credit to the government and public sector banks. The authorities are encouraged to take early steps to modernize their monetary policy framework in line with recommendations of past Fund technical assistance.

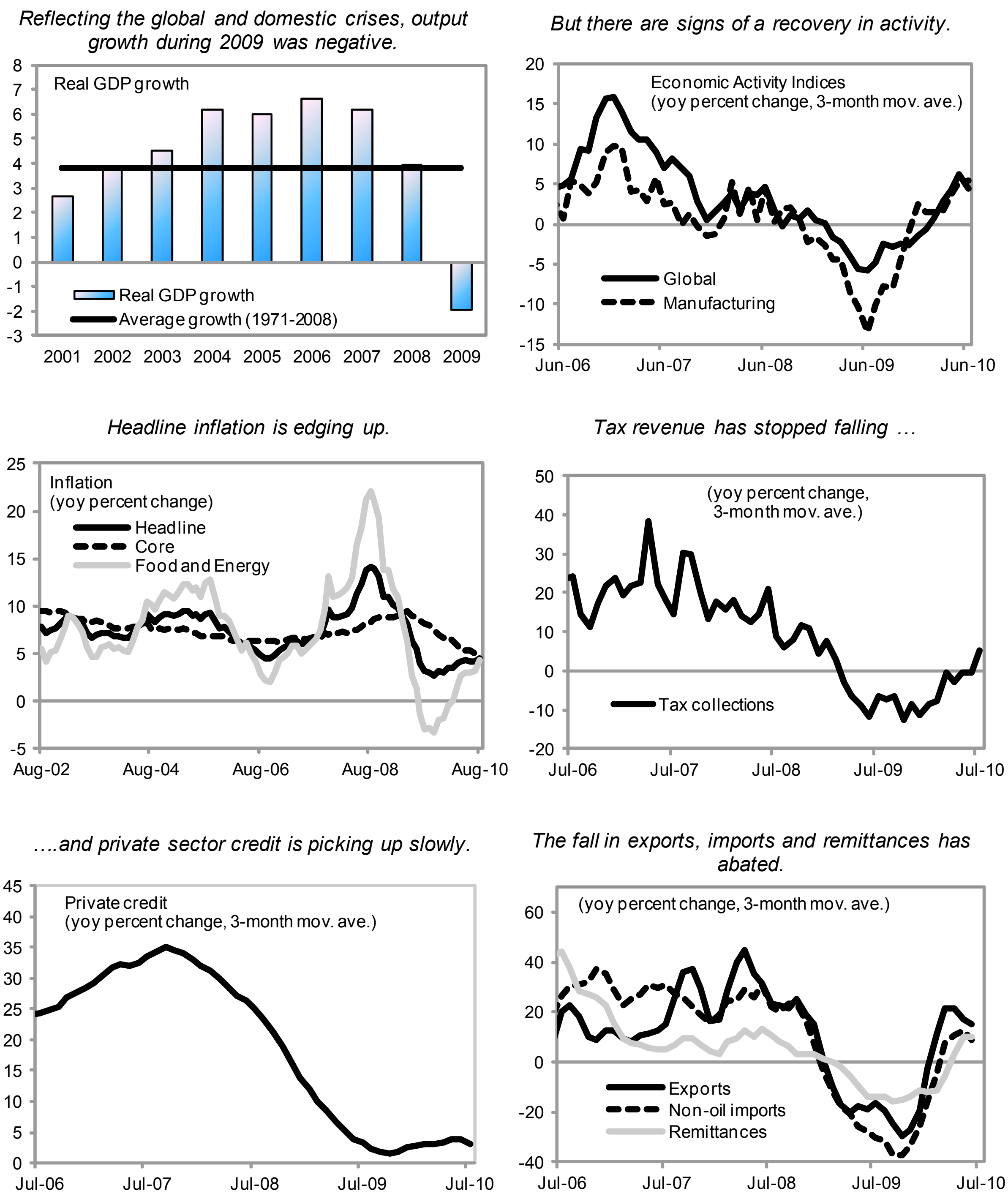
32. **The authorities are committed to advancing financial sector reforms**. Staff welcomes the authorities' plans to improve the regulatory framework, supervisory practices, and strengthen the financial safety net as recommended in the 2009 update to the Financial Sector Assessment Program (FSAP). In particular, introduction of new norms for risk assessment by supervisors and for risk management by banking institutions, as well as restoration of the early warning committee and recapitalization of the deposit guarantee fund will help increase resilience of the system. The authorities' intention to improve access to financial services through effective implementation of the secured transaction law, establishment of a public registry of movable collateral, and implementation of new norms to increase transparency, information disclosure, and protection to users of financial services, are also welcome.

33. **A slower-than-expected economic recovery and less favorable external conditions are significant risks**. The economic program is based on relatively conservative assumptions regarding the pace of recovery and the increase in fiscal revenues, and the key policies received support of Congress but shocks to export revenues and oil prices could weaken the balance of payments outlook. In addition, delays in adoption of critical measures included in the program would jeopardize achievement of program objectives. The authorities are encouraged to identify contingency measures, especially in the fiscal area, to enable them to respond to some of these shocks.

34. In view of the strength of the authorities' economic program, staff supports their request for SBA/SCF arrangements of SDR 129.5 million.

Figure 1. Honduras: Real Sector Developments

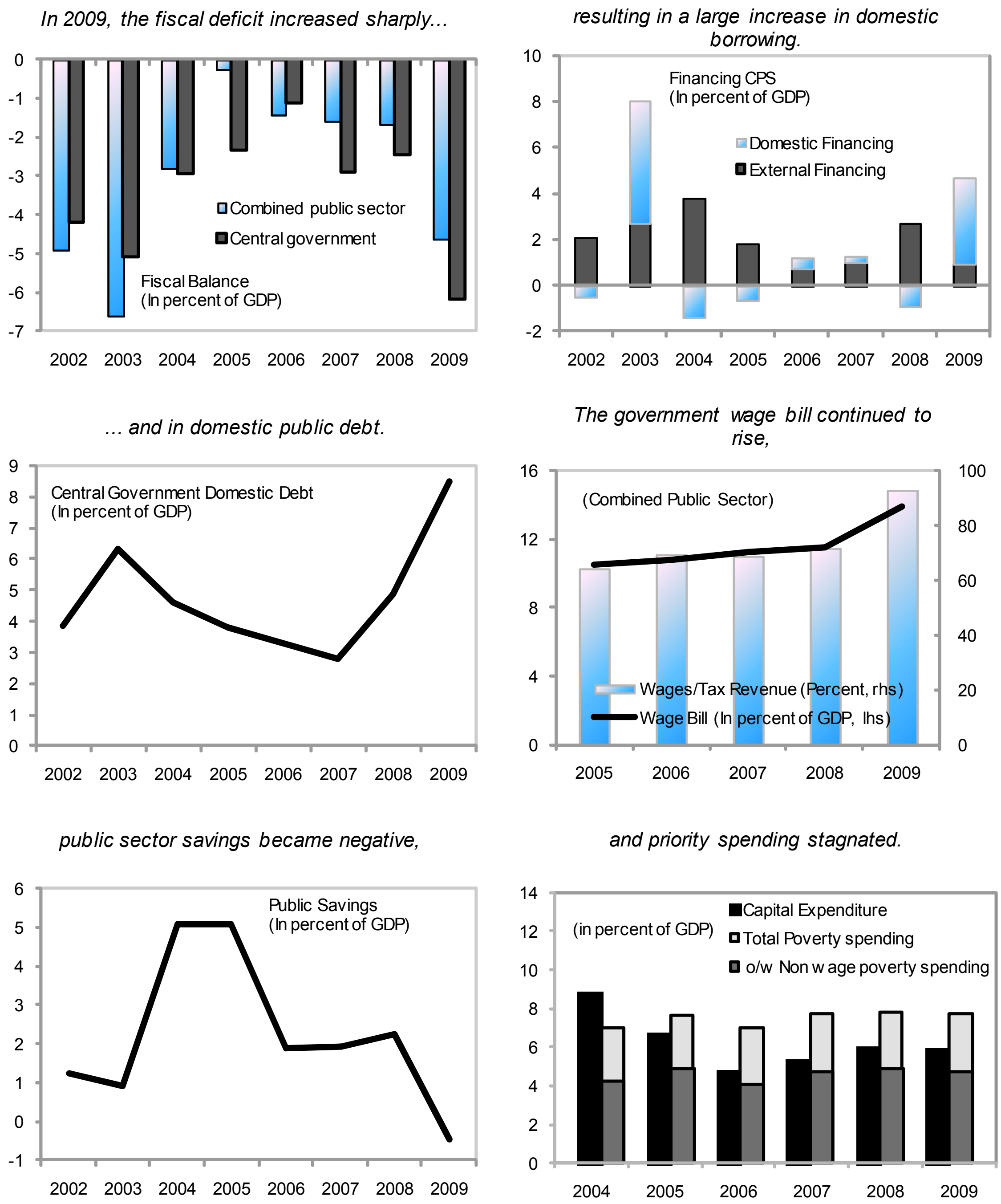
Following a sharp decline in economic activity during 2009, there are signs of economic recovery.



Sources: Central Bank of Honduras; Ministry of Finance; and Fund staff estimates.

Figure 2. Honduras: Fiscal Developments

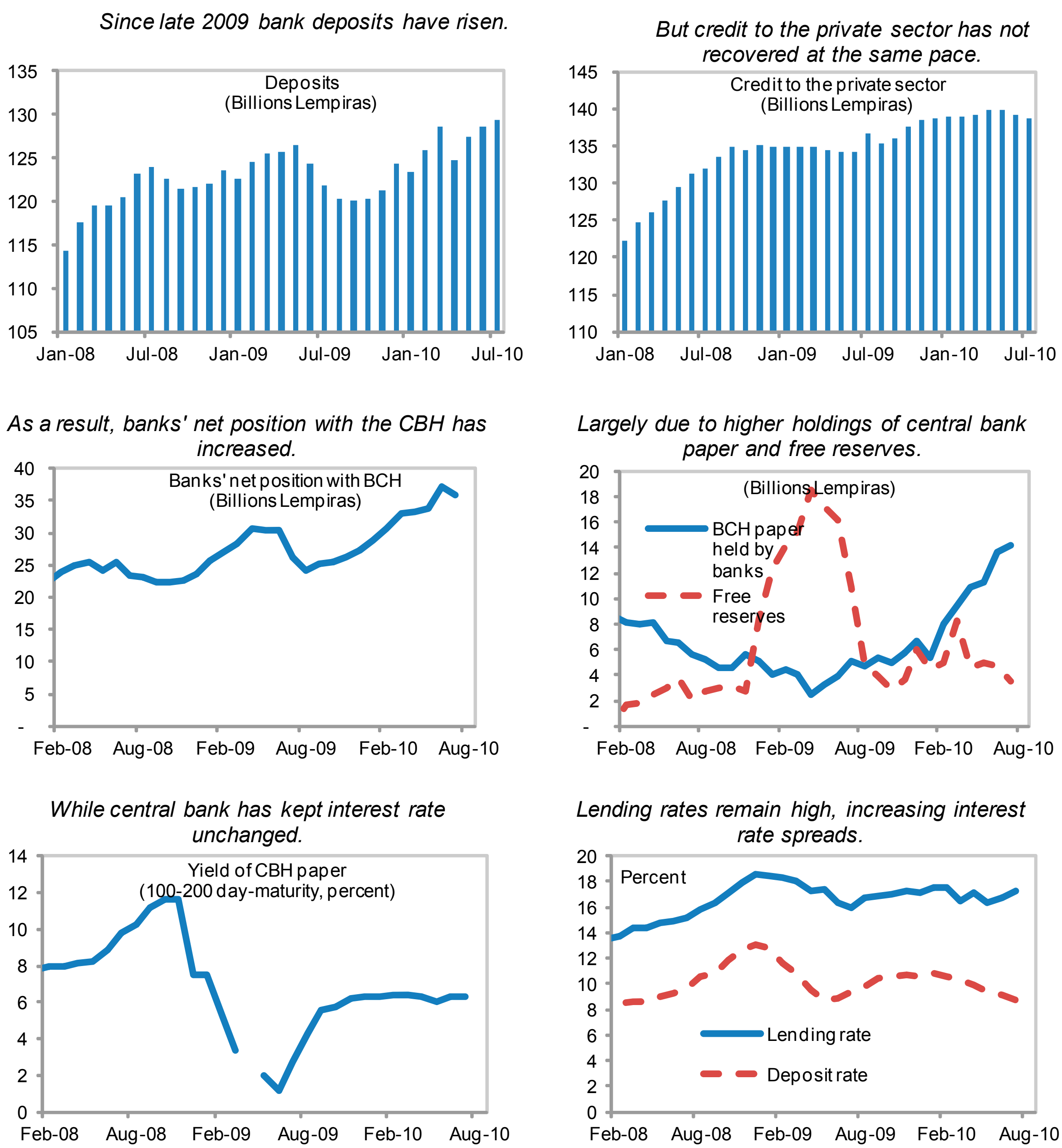
The fiscal position deteriorated in 2009, as a result of lower taxes and higher current expenditure, and the higher deficit was financed domestically.



Sources: Ministry of Finance; and Fund staff estimates.

Figure 3. Honduras: Monetary and Financial Developments

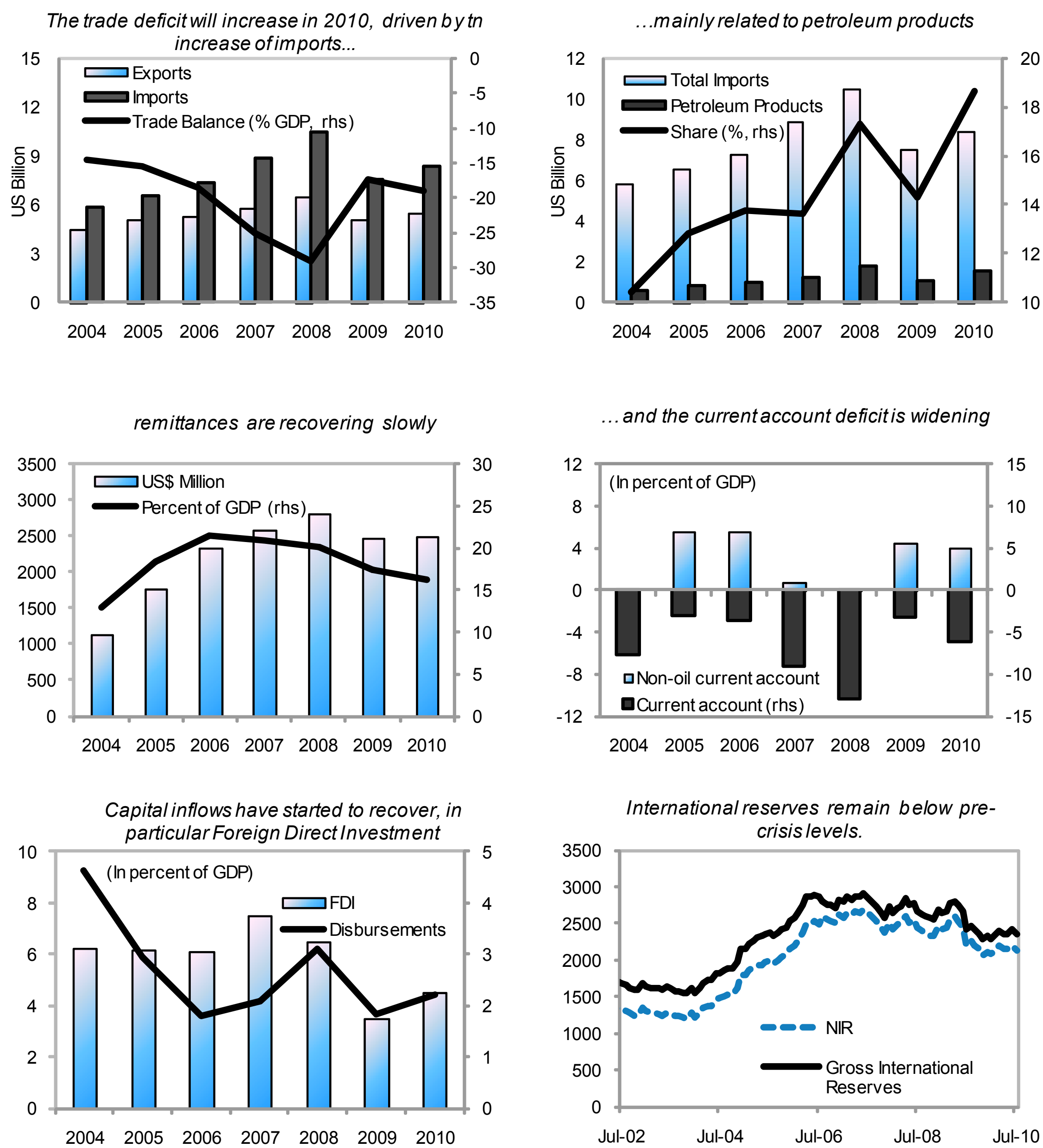
With growing deposits but sluggish credit, banks have increased their net position at the central bank, helping to offset central bank net credit to the public sector.



Source: Central Bank of Honduras; and Fund staff estimates.

Figure 4. Honduras: External Sector Developments

A sharp rise in oil prices and a slow recovery in remittances will widen the current account deficit, while gross international reserves will not recover to pre-crisis levels.



Source: Central Bank of Honduras, and Fund staff estimates.

Table 1. Honduras: Selected Economic Indicators

I. Social Indicators

Population	7.47 million	Life expectancy at birth in years (2007)	70
Per capita income in U.S. dollars (PPP, 2009)	4,151	Adult literacy (ages 15 and above, 2007)	83.6 percent
Rank in UNDP Development Index (2009)	112 of 182	Percent of pop. below poverty line (2007)	64
Unemployment rate (2009)	4.3	Gini index	55
Underemployment rate (2009)	36.0	Oil imports (2008 actual)	US$ 1.8 billion
Net FDI (as percent of GDP, 2009)	3.5	Main exports	coffee, bananas, shrimp, and maquila

II. Economic Indicators

	2006	2007	2008	Prel. 2009	Prog. 2010	Prog. 2011
	(Annual percentage change, unless otherwise indicated)					
National income and prices						
GDP at constant prices	6.6	6.3	4.0	-1.9	2.4	3.5
GDP deflator	5.3	6.9	8.5	4.4	4.9	4.0
Consumer prices (end of period, eop)	5.3	8.9	10.8	3.0	5.7	5.8
Exchange rate (eop, depreciation -)						
Lempiras per U.S. dollar	0.0	0.0	0.0	0.0	...	...
Real effective rate	1.7	2.2	5.5	7.5	...	...
Money and credit						
Net domestic assets of the financial system 1/	28.9	41.0	8.6	8.8	5.1	6.1
Combined public sector credit 2/	-9.0	2.1	4.8	15.0	5.8	8.5
Private sector credit	28.1	32.4	9.8	4.9	4.1	6.6
Broad money	21.6	18.2	5.3	0.9	5.6	8.3
Lending rate (eop, in percent)	13.8	13.4	17.6	17.1	...	...
Deposit rate (eop, in percent)	7.6	8.1	9.2	10.6	...	...
	(In percent of GDP)					
Combined public sector						
Noninterest revenue and grants	22.5	23.0	24.6	23.2	23.1	23.3
Noninterest expenditure	24.8	25.2	27.3	28.7	27.2	26.2
Primary balance	-2.3	-2.2	-2.7	-5.5	-4.1	-3.0
Net interest payments	-0.4	-0.6	-1.0	-0.9	-0.4	0.1
Savings	2.6	2.2	2.7	-0.9	-0.3	1.5
Capital expenditure	4.8	5.3	6.0	5.9	5.1	5.8
Overall balance	**-1.9**	**-1.6**	**-1.7**	**-4.6**	**-3.7**	**-3.1**
External financing	1.9	1.0	2.7	0.9	3.1	2.8
Domestic financing	0.5	0.3	-0.9	3.8	0.6	0.3
Savings and investment						
Fixed capital formation	27.3	32.4	32.6	22.6	22.0	23.4
Gross national savings	23.6	23.4	19.7	19.4	15.9	16.5
	(In millions of U. S. dollars, unless otherwise indicated)					
Balance of payments						
Gross international reserves 3/	2,824	2,733	2,691	2,331	2,385	2,606
(in months of imports) 4/	4.4	3.5	4.7	3.6	3.4	3.5
Change in net international reserves (increase -) 1/ 3/	-449	102	57	344	-60	-227
Change in net international reserves (increase -) 1/ 3/ 5/	-460	123	119	655	-50	-220
External current account balance (percent of GDP)	-3.7	-9.0	-12.9	-3.2	-6.3	-6.9
(excluding official transfers)	-5.5	-10.2	-14.1	-4.0	-7.8	-7.7
Exports, f.o.b. (annual percentage change) 6/	4.5	9.6	11.7	-21.2	7.1	7.4
Imports, f.o.b. (annual percentage change) 6/	11.6	21.7	18.2	-28.1	6.7	6.3
Public sector debt (in percent of GDP) 7/	31.7	19.6	20.2	23.7	26.1	27.2
Public sector external debt (in percent of GDP) 7/	27.9	16.4	16.7	17.2	17.6	19.0
Public sector external debt service (in percent of exports of goods and services) 8/	2.5	1.6	1.1	3.2	1.4	1.6

Sources: Central Bank of Honduras; Ministry of Finance; and Fund staff estimates.

1/ Includes adjustments made for NIR and NDA due to Fund MDRI debt relief granted in January 2006 ($155 million).
2/ In relation to base money at the beginning of the period.
3/ Includes the one-off allocation of SDR 104.8 million in August, 2009.
4/ Refers to the following year's imports of nonmaquila goods and nonfactor services.
5/ Excluding foreign currency reserve requirements, obligatory investments, as well as deposits by Hondutel.
6/ Goods only.
7/ Includes medium- and long-term public and publicly guaranteed external debt after HIPC, beyond HIPC, and MDRI. All external debt is denominated in foreign currency.
8/ Debt service paid.

Table 2. Honduras: Operations of the Central Government

(In millions of Lempiras)

	2007	2008	2009	2010	2010	2011
			Prel.	Prel. Jun.	Prog.	Prog.
Total revenue and grants	**44,702**	**52,241**	**47,007**	**22,752**	**52,469**	**57,340**
Current revenue	41,000	46,789	41,987	21,210	47,645	54,252
Tax revenue	38,270	42,329	39,035	19,908	44,054	50,322
Grants	3,701	5,452	5,020	1,541	4,824	3,088
Total expenditure	**51,506**	**58,683**	**63,669**	**27,903**	**65,568**	**68,068**
Current expenditure	42,204	45,982	51,351	23,833	54,275	54,633
Wages and salaries	21,490	24,511	29,938	14,900	32,235	32,235
Goods and services	6,912	6,885	8,235	2,665	7,390	7,702
Transfers	12,244	12,974	11,169	4,353	9,578	8,712
Interest payments	1,559	1,612	2,009	1,399	3,069	4,061
External	867	831	837	424	771	856
Domestic	692	781	1,172	976	2,298	3,205
Other current expenditure	0	0	0	515	2,003	1,922
Capital expenditure	9,595	12,879	14,145	4,085	10,755	13,435
Net lending	-294	-179	-1,827	-15	538	0
Overall balance	**-6,804**	**-6,442**	**-16,662**	**-5,151**	**-13,099**	**-10,728**
Financing	**6,804**	**6,442**	**16,662**	**5,151**	**13,099**	**10,728**
External financing	**2,608**	**7,090**	**2,632**	**1,077**	**8,826**	**8,375**
Disbursements 2/	4,273	7,675	5,851	1,442	8,773	8,708
Amortization	-2,297	-1,470	-3,129	-545	-901	-1,068
Zero coupon bonds	-97	-103	-109	-57	-115	-125
Exceptional financing 3/	729	989	560	281	1,069	860
Change in arrears	0	0	-541	-44	0	0
Domestic financing	**4,351**	**-757**	**14,086**	**4,180**	**4,273**	**2,352**
Financial system	-521	-393	6,218	3,993	1,715	8,261
Rest of the financial system	-635	1,699	2,027	-266	4,472	3,709
Central bank	115	-2,093	4,191	4,259	-2,757	4,552
Bonds outside the financial system	877	4,317	2,188	2,066	8,100	-509
Rest of the NFPS	846	3,864	2,168	1,830	7,283	409
Other	185	527	94	275	817	-918
Financial stabilization bonds	-155	-74	-74	-38	0	0
Floating debt 4/	3,845	-6,243	5,680	-1,879	-5,542	-5,400
Statistical discrepancy	-155	109	-56	-106	…	…

Sources: Honduran authorities; and Fund staff estimates.

1/ Includes electricity and urban transport subsidies, and Bonochenta.

2/ Projection for 2010-11 includes possible budget support from multilateral banks.

3/ Includes debt forgiveness, accumulation, rescheduling, payment and/or forgiveness of arrears.

4/ Wage and suppliers arrears and other unsettled payments in 2010-11.

Table 2a. Honduras: Operations of the Central Government

(In percent of GDP)

	2007	2008	2009	2010	2010	2011
			Prel.	Prel. Jun.	Prog.	Prog.
Total revenue and grants	**19.1**	**19.8**	**17.4**	**7.8**	**18.0**	**18.3**
Current revenue	17.5	17.7	15.5	7.3	16.4	17.3
Tax revenue	16.3	16.0	14.4	6.8	15.1	16.1
Nontax revenue	0.8	1.3	1.1	0.5	1.1	1.3
Transfers 1/	0.3	0.4	0.0	0.0	0.1	0.0
Capital revenue	0.0	0.0	0.0	0.0	0.0	0.0
Grants	1.6	2.1	1.9	0.5	1.7	1.0
Of which: Millennium Challenge Corporation	0.1	0.3	0.6	0.0	0.5	0.0
Total expenditure	**22.0**	**22.2**	**23.5**	**9.6**	**22.5**	**21.7**
Current expenditure	18.0	17.4	19.0	8.2	18.7	17.4
Wages and salaries	9.2	9.3	11.1	5.1	11.1	10.3
Goods and services	3.0	2.6	3.0	0.9	2.5	2.5
Transfers	5.2	4.9	4.1	1.5	3.3	2.8
Interest payments	0.7	0.6	0.7	0.5	1.1	1.3
External	0.4	0.3	0.3	0.1	0.3	0.3
Domestic	0.3	0.3	0.4	0.3	0.8	1.0
Other current expenditure	0.0	0.0	0.0	0.2	0.7	0.6
Capital expenditure	4.1	4.9	5.2	1.4	3.7	4.3
Overall balance	**-2.9**	**-2.4**	**-6.2**	**-1.8**	**-4.5**	**-3.4**
Financing	**2.9**	**2.4**	**6.2**	**1.8**	**4.5**	**3.4**
External financing	**1.1**	**2.7**	**1.0**	**0.4**	**3.0**	**2.7**
Disbursements 2/	1.8	2.9	2.2	0.5	3.0	2.8
Amortization	-1.0	-0.6	-1.2	-0.2	-0.3	-0.3
Exceptional financing 3/	0.3	0.4	0.2	0.1	0.4	0.3
Domestic financing	**1.9**	**-0.3**	**5.2**	**1.4**	**1.5**	**0.8**
Financial system	-0.2	-0.1	2.3	1.4	0.6	2.6
Rest of the financial system	-0.3	0.6	0.7	-0.1	1.5	1.2
Central bank	0.0	-0.8	1.5	1.5	-0.9	1.5
Bonds outside the financial system	0.4	1.6	0.8	0.7	2.8	-0.2
Floating debt 4/	1.6	-2.4	2.1	-0.6	-1.9	-1.7
Privatization / deposits abroad	0.1	0.6	0.0	0.0	0.0	0.0
Nominal GDP (billion of Lempiras)	234.2	264.1	270.5	290.9	290.9	313.1

Sources: Honduran authorities; and Fund staff estimates.

1/ Includes electricity and urban transport subsidies, and Bonochenta.

2/ Projection for 2010-11 includes possible budget support from multilateral banks.

3/ Includes debt forgiveness, accumulation, rescheduling, payment and/or forgiveness of arrears.

4/ Wage and suppliers arrears and other unsettled payments in 2010-11.

Table 2b. Honduras: Operations of the Central Government, 2010-2011 (Quarterly Data)
(In millions of Lempiras)

	Jun-10	Sep-10	Dec-10	Mar-11	Jun-11	Sep-11	Dec-11	Sep-10	Dec-10	Mar-11	Jun-11	Sep-11	Dec-11
	Program (cummulative)							Program (quarterly flows)					
Total revenue and grants	**22,752**	**36,079**	**52,469**	**10,927**	**28,136**	**42,336**	**57,340**	**13,328**	**16,390**	**10,927**	**17,209**	**14,200**	**15,003**
Current revenue	21,210	33,279	47,645	10,221	27,012	40,293	54,252	12,069	14,366	10,221	16,791	13,282	13,959
Tax revenue	19,908	30,828	44,054	9,298	25,268	37,558	50,322	10,920	13,226	9,298	15,970	12,290	12,764
Grants	1,541	2,800	4,824	706	1,125	2,043	3,088	1,259	2,024	706	418	919	1,045
Total expenditure	**27,903**	**46,247**	**65,568**	**14,871**	**31,744**	**48,462**	**68,069**	**18,344**	**19,322**	**14,871**	**16,872**	**16,719**	**19,606**
Current expenditure	23,833	38,590	54,275	11,780	25,789	39,613	54,634	14,758	15,685	11,780	14,009	13,824	15,020
Wages and salaries	14,900	23,103	32,235	6,716	15,580	23,054	32,235	8,203	9,132	6,716	8,865	7,474	9,181
Goods and services	2,665	5,223	7,390	1,733	3,081	5,444	7,702	2,558	2,167	1,733	1,348	2,363	2,258
Transfers	4,353	7,039	9,578	1,998	4,370	6,882	8,713	2,686	2,539	1,998	2,372	2,513	1,830
Interest payments	1,399	2,000	3,069	953	1,990	3,058	4,061	601	1,069	953	1,036	1,068	1,003
External	424	615	771	239	414	678	856	192	156	239	175	265	178
Domestic	976	1,385	2,298	714	1,576	2,379	3,205	409	913	714	862	803	826
Other current expenditure	515	1,225	2,003	381	769	1,175	1,923	710	779	381	388	407	747
Capital expenditure	4,085	7,342	10,755	3,091	5,954	8,849	13,435	3,257	3,413	3,091	2,863	2,895	4,586
Net lending	-15	314	538	0	0	0	0	0	0	0	0	0	0
Overall balance	**-5,151**	**-10,168**	**-13,099**	**-3,944**	**-3,607**	**-6,126**	**-10,729**	**-5,016**	**-2,931**	**-3,944**	**337**	**-2,518**	**-4,602**
Financing	**5,151**	**10,168**	**13,099**	**3,944**	**3,607**	**6,126**	**10,729**	**5,016**	**2,931**	**3,944**	**-337**	**2,518**	**4,602**
External financing	**1,077**	**3,879**	**8,826**	**847**	**3,555**	**6,078**	**8,375**	**2,802**	**4,947**	**847**	**2,708**	**2,523**	**2,297**
Disbursements 2/	1,442	3,902	8,773	985	3,934	6,322	8,708	2,460	4,872	985	2,948	2,389	2,385
Amortization	-545	-658	-901	-224	-476	-723	-1,068	-112	-244	-224	-252	-247	-344
Zero coupon bonds	-57	-115	-115	-61	-61	-124	-125	-58	0	-61	0	-64	-1
Exceptional financing 3/	281	750	1,069	146	159	603	860	469	319	146	12	445	257
Change in arrears	-44	0	0	0	0	0	0	44	0	0	0	0	0
Domestic financing	**4,180**	**6,289**	**4,274**	**3,097**	**52**	**47**	**2,353**	**2,108**	**-2,015**	**3,097**	**-3,045**	**-5**	**2,305**
Financial system	3,993	2,945	1,716	4,650	3,672	5,015	8,261	-1,048	-1,229	4,650	-978	1,343	3,247
Rest of the financial system	-266	713	4,472	3,956	1,933	2,718	4,552	-2,027	-4,989	3,956	-2,023	785	1,835
Central bank	4,259	2,232	-2,757	694	1,739	2,297	3,709	979	3,759	694	1,045	558	1,412
Bonds outside the financial system	2,066	5,804	8,100	-53	-620	-467	-509	3,738	2,296	-53	-567	153	-41
Rest of the NFPS	1,830	5,825	7,283	0	0	0	409	3,995	1,459	0	0	0	409
Other	275	-20	817	-178	-993	-260	-918	-295	837	-178	-815	733	-658
Financial stabilization bonds	-38	0	0	0	0	0	0	38	0	0	0	0	0
Floating debt 4/	-1,879	-2,461	-5,542	-1,500	-3,000	-4,500	-5,400	-582	-3,081	-1,500	-1,500	-1,501	-900
Statistical discrepancy	-106	0	0	0	0	0	0	0	232	-338	0	0	0

Sources: Honduran authorities; and Fund staff estimates.

1/ Includes electricity and urban transport subsidies, and Bonochenta.

2/ Projection for 2010 includes possible budget support from multilateral banks.

3/ Includes debt forgiveness, accumulation, rescheduling, payment and/or forgiveness of arrears.

4/ Wage and suppliers arrears and other unsettled payments.

Table 3. Honduras: Operations of the Combined Public Sector, 1/

(In millions of Lempiras)

	2007	2008	2009	2010	2010	2011
			Prel.	Prel. Jun.	Prog.	Prog.
Total revenue and grants	**57,167**	**69,398**	**67,151**	**32,910**	**71,341**	**76,618**
Current revenue	52,823	63,359	61,570	31,072	65,860	72,814
Tax revenue	38,352	43,641	40,575	20,783	45,987	52,244
Nontax revenue	9,668	13,488	13,259	6,937	14,494	14,728
Interest earnings 2/	3,346	4,480	4,254	2,231	4,212	3,699
Operating balance of public enterprises	1,457	1,749	3,481	1,121	1,167	2,143
Capital revenue	633	573	545	285	619	701
Grants	3,711	5,466	5,036	1,553	4,862	3,103
Total expenditure	**60,851**	**73,849**	**79,645**	**36,323**	**82,241**	**86,318**
Current expenditure	46,686	56,098	63,890	29,925	66,829	68,066
Wages and salaries	26,407	31,208	37,673	19,224	39,742	40,222
Goods and services	8,896	10,019	12,691	4,111	10,576	11,208
Transfers	8,192	9,231	7,561	3,652	8,878	8,008
Operating losses of the central bank	-41	714	788	334	807	1,014
Interest payments	1,912	1,870	1,884	1,539	3,070	4,140
External	877	840	845	452	880	972
Domestic	1,035	1,030	1,039	1,088	2,190	3,168
Other	1,321	3,055	3,294	1,064	3,756	3,474
Capital expenditure	12,518	15,750	16,075	6,085	14,873	18,253
Net lending	1,646	2,001	-320	313	538	0
Overall balance	**-3,684**	**-4,451**	**-12,494**	**-3,413**	**-10,900**	**-9,700**
Financing	**3,684**	**4,451**	**12,494**	**3,413**	**10,900**	**9,700**
External financing	**2,394**	**7,096**	**2,440**	**979**	**9,141**	**8,778**
Disbursements 3/	4,296	7,855	5,851	1,442	9,089	9,111
Amortization	-2,536	-1,645	-3,323	-643	-901	-1,068
Zero coupon bonds	-97	-103	-109	-57	-115	-125
Exceptional financing 4/	731	989	562	283	1,069	860
Domestic financing	**618**	**-2,350**	**10,280**	**2,008**	**1,759**	**922**
Financial system	-768	-402	8,337	2,007	2,987	4,486
Central bank	2,063	660	7,931	4,113	-2,207	4,568
Net credit to the NFPS	2,104	-54	7,143	4,117	-3,014	4,625
Operating balance of the central bank	-41	714	788	334	807	1,014
Rest of the financial system	-2,831	-1,061	406	-2,106	5,194	-82
Bonds outside the financial system	318	527	369	282	817	-918
Financial stabilization bonds	-87	-18	-18	-18	0	0
Floating debt 5/	1,141	-5,459	969	-485	-2,045	-2,646
Privatization proceeds / deposits abroad 6/	14	3,001	623	222	0	0
Statistical discrepancy 7/	672	-296	-226	426	0	0

Sources: Honduran authorities; and Fund staff estimates.

1/ Includes Central Government, Social Security Institutions, Public Enterprises, Local Governments and Decentralized agencies

2/ Interest earned on public pension funds personal and housing loans to their affiliates.

3/ Projection for 2010-11 includes possible budget support from multilateral banks.

4/ Includes debt forgiveness, accumulation, rescheduling, payment and/or forgiveness of arrears.

5/ Wage and suppliers arrears and other unsettled payments in 2010-11.

6/ Includes proceeds of the sale of a cellular band license in 2008.

7/ For 2008 discrepancies are due to methodological differences between the Ministry of Finance and the Central Bank.

Table 3a. Honduras: Operations of the Combined Public Sector,[1/]

(In percent of GDP)

	2007	2008	2009	2010	2010	2011
			Prel.	Prel. Jun.	Prog.	Prog.
Total revenue and grants	**24.4**	**26.3**	**24.8**	**11.3**	**24.5**	**24.5**
Current revenue	22.6	24.0	22.8	10.7	22.6	23.3
Tax revenue	16.4	16.5	15.0	7.1	15.8	16.7
Nontax revenue	4.1	5.1	4.9	2.4	5.0	4.7
Interest earnings 2/	1.4	1.7	1.6	0.8	1.4	1.2
Operating balance of public enterprises	0.6	0.7	1.3	0.4	0.4	0.7
Capital revenue	0.3	0.2	0.2	0.1	0.2	0.2
Grants	1.6	2.1	1.9	0.5	1.7	1.0
Of which: Millennium Challenge Corporation	0.1	0.3	0.6	0.0	0.5	0.0
Total expenditure	**26.0**	**28.0**	**29.4**	**12.5**	**28.3**	**27.6**
Current expenditure	19.9	21.2	23.6	10.3	23.0	21.7
Wages and salaries	11.3	11.8	13.9	6.6	13.7	12.8
Goods and services	3.8	3.8	4.7	1.4	3.6	3.6
Transfers	3.5	3.5	2.8	1.3	3.1	2.6
Operating losses of the central bank	0.0	0.3	0.3	0.1	0.3	0.3
Interest payments	0.8	0.7	0.7	0.5	1.1	1.3
External	0.4	0.3	0.3	0.2	0.3	0.3
Domestic	0.4	0.4	0.4	0.4	0.8	1.0
Other	0.6	1.2	1.2	0.4	1.3	1.1
Capital expenditure	5.3	6.0	5.9	2.1	5.1	5.8
Net lending	0.7	0.8	-0.1	0.1	0.2	0.0
Overall balance	**-1.6**	**-1.7**	**-4.6**	**-1.2**	**-3.7**	**-3.1**
Financing	**1.6**	**1.7**	**4.6**	**1.2**	**3.7**	**3.1**
External financing	**1.0**	**2.7**	**0.9**	**0.3**	**3.1**	**2.8**
Disbursements 3/	1.8	3.0	2.2	0.5	3.1	2.9
Amortization	-1.1	-0.6	-1.2	-0.2	-0.3	-0.3
Exceptional financing 4/	0.3	0.4	0.2	0.1	0.4	0.3
Domestic financing	**0.3**	**-0.9**	**3.8**	**0.7**	**0.6**	**0.3**
Financial system	-0.3	-0.2	3.1	0.7	1.0	1.4
Central bank	0.9	0.2	2.9	1.4	-0.8	1.5
Net credit to the NFPS	0.9	0.0	2.6	1.4	-1.0	1.5
Operating balance of the central bank	0.0	0.3	0.3	0.1	0.3	0.3
Rest of the financial system	-1.2	-0.4	0.2	-0.7	1.8	0.0
Bonds outside the financial system	0.1	0.2	0.1	0.1	0.3	-0.3
Financial stabilization bonds	0.0	0.0	0.0	0.0	0.0	0.0
Floating debt 5/	0.5	-2.1	0.4	-0.2	-0.7	-0.8
Privatization proceeds / deposits abroad 6/	0.0	1.1	0.2	0.1	0.0	0.0
Statistical discrepancy 7/	0.3	-0.1	-0.1	0.1	0.0	0.0
Memorandum items:						
Nominal GDP (billion of Lempiras)	234.2	264.1	270.5	290.9	290.9	313.1

Sources: Honduran authorities; and Fund staff estimates.

1/ Includes Central Government, Social Security Institutions, Public Enterprises, Local Governments and Decentralized agencies.
2/ Interest earned on public pension funds personal and housing loans to their affiliates.
3/ Projection for 2010-11 includes possible budget support from multilateral banks.
4/ Includes debt forgiveness, accumulation, rescheduling, payment and/or forgiveness of arrears.
5/ Wage and suppliers arrears and other unsettled payments in 2010-11.
6/ Includes proceeds of the sale of a cellular band license in 2008.
7/ For 2008 discrepancies are due to methodological differences between the Ministry of Finance and the Central Bank.

Table 3b. Honduras: Operations of the Combined Public Sector, 1/ 2010-2011 (Quarterly Data)
(in millions of lempiras)

	Jun-10	Sep-10	Dec-10	Mar-11	Jun-11	Sep-11	Dec-11	Sep-10	Dec-10	Mar-11	Jun-11	Sep-11	Dec-11
	Program (cummulative)							Program (quarterly flows)					
Total revenue and grants	**32,910**	**50,401**	**71,341**	**14,733**	**36,873**	**56,020**	**76,618**	**17,491**	**20,940**	**14,733**	**22,140**	**19,147**	**20,598**
Current revenue	31,072	47,102	65,861	13,858	35,402	53,461	72,814	16,030	18,758	13,858	21,544	18,059	19,353
Tax revenue	20,783	32,290	45,987	9,793	26,096	38,944	52,244	11,506	13,698	9,793	16,303	12,848	13,300
Nontax revenue	6,937	10,788	14,494	3,402	7,042	10,719	14,728	3,851	3,706	3,402	3,640	3,677	4,008
Interest earnings 2/	2,231	3,265	4,212	836	1,798	2,779	3,699	1,034	947	836	961	982	920
Operating balance of public enterprises	1,121	760	1,167	-174	466	1,018	2,143	-361	408	-174	640	552	1,125
Capital revenue	285	466	619	164	337	501	701	180	153	164	173	164	200
Grants	1,553	2,833	4,862	711	1,134	2,057	3,103	1,281	2,028	711	423	923	1,045
Total expenditure	**36,323**	**58,502**	**82,241**	**19,448**	**41,117**	**62,075**	**86,318**	**22,179**	**23,739**	**19,448**	**21,669**	**20,958**	**24,243**
Current expenditure	29,925	47,915	66,830	15,073	32,920	49,645	68,066	17,991	18,914	14,851	17,688	16,511	18,001
Wages and salaries	19,224	29,047	39,742	8,488	19,867	29,048	40,222	9,823	10,695	8,488	11,380	9,181	11,174
Goods and services	4,111	7,711	10,576	2,361	4,671	7,863	11,208	3,599	2,865	2,361	2,310	3,192	3,346
Transfers	3,652	5,988	8,878	2,263	4,374	6,613	8,008	2,335	2,890	2,263	2,110	2,239	1,395
Operating losses of the central bank	334	443	807	222	381	595	1,014	109	364	222	159	214	419
Interest payments	1,539	2,177	3,070	1,018	2,115	3,185	4,140	638	893	1,018	1,097	1,070	955
External	452	675	880	321	515	780	972	223	205	321	194	265	192
Domestic	1,088	1,502	2,190	697	1,600	2,404	3,168	414	689	697	902	805	763
Other	1,064	2,550	3,757	722	1,513	2,343	3,474	1,486	1,207	722	792	829	1,132
Capital expenditure	6,085	10,272	14,873	4,375	8,197	12,430	18,253	4,188	4,601	4,375	3,822	4,233	5,823
Net lending	313	314	538	0	0	0	0	1	224	0	0	0	0
Overall balance	**-3,413**	**-8,101**	**-10,900**	**-4,715**	**-4,244**	**-6,055**	**-9,700**	**-4,688**	**-2,799**	**-4,715**	**471**	**-1,811**	**-3,645**
Financing	**3,413**	**8,101**	**10,900**	**4,715**	**4,244**	**6,055**	**9,700**	**4,688**	**2,799**	**4,715**	**-471**	**1,811**	**3,645**
External financing	**979**	**3,879**	**9,141**	**847**	**3,555**	**6,078**	**8,778**	**2,900**	**5,262**	**847**	**2,708**	**2,523**	**2,700**
Disbursements 3/	1,442	3,902	9,089	985	3,934	6,322	9,111	2,460	5,187	985	2,948	2,389	2,788
Amortization	-643	-658	-901	-224	-476	-723	-1,068	-15	-244	-224	-252	-247	-344
Zero coupon bonds	-57	-115	-115	-61	-61	-124	-125	-58	0	-61	0	-64	-1
Exceptional financing 4/	283	750	1,069	146	159	603	860	467	319	146	12	445	257
Domestic financing	**2,008**	**4,222**	**1,759**	**3,868**	**689**	**-23**	**922**	**2,214**	**-2,463**	**3,868**	**-3,179**	**-712**	**945**
Financial system	2,007	3,688	2,987	3,332	1,952	1,995	4,486	1,682	-701	3,332	-1,381	44	2,491
Central bank	4,113	2,446	-2,207	3,598	2,076	2,799	4,568	-1,667	-4,653	3,598	-1,522	723	1,769
Net credit to the NFPS	4,117	2,568	-3,014	3,974	1,905	2,772	4,625	-1,549	-5,582	3,974	-2,069	867	1,853
Operating balance of the central bank	334	443	807	222	381	595	1,014	109	364	222	159	214	419
Rest of the financial system	-2,106	1,243	5,194	-266	-124	-804	-82	3,349	3,951	-266	142	-679	722
Bonds outside the financial system	282	-20	817	-178	-993	-260	-918	-302	837	-178	-815	733	-658
Financial stabilization bonds	-18	0	0	0	0	0	0	18	0	0	0	0	0
Floating debt 5/	-485	554	-2,045	714	-270	-1,758	-2,646	1,039	-2,599	714	-983	-1,489	-888
Privatization proceeds / deposits abroad 6/	222	0	0	0	0	0	0	-222	0	0	0	0	0
Statistical discrepancy 7/	426	0	0	0	0	0	0	0	0	0	0	0	0

Sources: Honduran authorities; and Fund staff estimates.

1/ Includes Central Government, Social Security Institutions, Public Enterprises, Local Governments and Decentralized agencies.
2/ Interest earned on public pension funds personal and housing loans to their affiliates.
3/ Projection for 2010 includes possible budget support from multilateral banks.
4/ Includes debt forgiveness, accumulation, rescheduling, payment and/or forgiveness of arrears.
5/ Wage and suppliers arrears and other unsettled payments.
6/ Includes proceeds of the sale of a cellular band license in 2008
7/ For 2008 discrepancies are due to methodological differences between the Ministry of Finance and the Central Bank.

Table 4. Honduras: Summary Accounts of Central Bank and Financial System

(end December)

	2006	2007	2008	2009	Proj. 2010	Proj. 2011
			(In millions of Lempiras)			
			I. Central Bank			
Net International Reserves 1/	**49,386**	**47,508**	**46,482**	**39,988**	**41,128**	**46,775**
(in millions of US$)	2,614	2,514	2,460	2,116	2,177	2,403
Net International Reserves (in millions of US$, TMU) 2/	2,404	2,282	2,162	1,507	1,557	1,777
Net Domestic Assets	**-35,793**	**-31,145**	**-30,014**	**-22,283**	**-22,784**	**-26,871**
Credit to the public sector (net)	-5,053	-2,014	-344	6,196	3,935	8,523
Other depository institutions (net)	-23,260	-22,780	-23,608	-27,368	-27,572	-34,838
Other financial institutions	-3,531	-2,339	-2,019	4,956	6,916	6,616
Nonfinancial private sector	-1,848	-1,055	-472	-135	-252	-252
Medium and long-term net foreign assets	825	699	604	949	746	792
Other items net	-2,926	-3,658	-4,173	-6,880	-6,558	-7,711
Currency	**13,593**	**16,363**	**16,468**	**17,706**	**18,344**	**19,904**
			II. Other Depository Institutions			
Net Foreign Assets	**2,040**	**328**	**1,213**	**3,246**	**4,864**	**5,090**
(in millions of US$)	108	17	64	172	257	262
Foreign assets (million Lempiras)	13,555	14,498	15,359	12,129	13,057	12,875
Foreign liabilities (million Lempiras)	-11,515	-14,170	-14,146	-8,883	-8,194	-7,785
Net Domestic Assets	**95,508**	**116,971**	**123,552**	**122,434**	**128,013**	**138,648**
Credit to the monetary authorities (net)	26,410	0	0	32,103	31,869	39,397
Credit to other financial institutions (net)	-2,668	-4,646	-7,967	-15,670	-19,403	-21,736
Credit to the combined public sector	-1,210	-3,324	-2,789	-2,346	2,946	2,896
Central government	-4,404	-7,330	-5,994	-5,539	-248	-497
Other nonfinancial public sector	1,321	1,738	648	656	656	656
Local governments	1,873	2,268	2,557	2,537	2,537	2,737
Credit to the private sector	91,048	120,815	134,807	138,651	144,553	154,263
Local currency	64,332	90,809	101,385	109,893	114,768	125,269
Foreign currency	26,715	30,006	33,422	28,758	29,785	28,994
Other items net	-18,072	-23,109	-28,719	-30,304	-31,952	-36,173
Liabilities	**97,547**	**117,299**	**124,765**	**125,680**	**132,876**	**143,738**
of which: Deposits in domestic currency	68,782	84,032	87,595	87,927	93,183	101,387
of which: Deposits in foreign currency	28,091	32,523	35,989	36,497	38,588	41,246
			III. Financial System			
Net Foreign Assets	**51,708**	**47,966**	**47,744**	**41,098**	**43,855**	**49,729**
(in millions of US$)	2,737	2,539	2,527	2,175	2,321	2,555
Net Domestic Assets	**58,495**	**82,334**	**89,409**	**97,306**	**102,238**	**108,519**
Credit to the nonfinancial combined public sector	-6,262	-5,338	-3,133	3,851	6,880	11,419
Credit to the private sector	93,317	123,551	135,621	142,280	148,183	157,893
Local currency	66,059	92,932	101,385	112,515	117,368	127,869
Foreign currency	27,258	30,619	34,236	29,765	30,815	30,024
Other assets net	-3,385	-4,982	-6,107	-7,614	-9,404	-10,722
Other items net 3/	-25,175	-30,897	-36,972	-41,210	-43,422	-50,072
Broad Money (M4)	**110,203**	**130,300**	**137,153**	**138,404**	**146,093**	**158,248**
			(Rate of growth 12 months)			
Currency issue	22.3	20.4	0.6	7.5	3.6	8.5
Currency in circulation	17.3	14.0	-0.4	9.4	4.5	10.6
Broad money	21.6	18.2	5.3	0.9	5.6	8.3
Liabilities in Lempiras	25.3	20.7	3.7	1.5	1.5	1.5
Liabilities in foreign currency	15.6	15.3	10.2	1.3	1.3	1.3
Credit to the private sector	28.1	32.4	9.8	4.9	4.1	6.6
M1	23.5	15.3	2.0	5.0	4.8	9.4
Memorandum item						
NDA (millions Lempiras, TMU)	-31,839	-26,748	-24,387	-10,773	-11,080	-13,676

Sources: Central Bank of Honduras; and Fund staff estimates.

1/ Includes allocation of SDR 104.8 million in August, 2009.

2/ Excluding domestic liabilities in foreign currency and deposits of Hondutel.

3/ Includes the revaluation account reflecting changes in the value of assets due to exchange rate fluctuations.

Table 4a. Honduras: Summary Accounts of Central Bank and Financial System
Quarterly Data

	Mar-10	Jun-10	Sep-10	Dec-10	Mar-11	Jun-11	Sep-11	Dec-11
			Projections					
				(In millions of Lempiras)				
				I. Central Bank				
Net International Reserves 1/	**41,464**	**41,719**	**40,132**	**41,128**	**42,469**	**45,162**	**46,646**	**46,775**
(in millions of US$)	2,194	2,208	2,124	2,177	2,231	2,355	2,415	2,403
Net International Reserves (in millions of US$, TMU) 2/	1,534	1,598	1,462	1,557	1,606	1,751	1,783	1,777
Net Domestic Assets	**-24,893**	**-26,206**	**-25,741**	**-22,784**	**-24,980**	**-28,154**	**-29,960**	**-26,871**
Credit to the public sector (net)	8,292	10,497	8,691	3,935	7,547	5,973	6,723	8,523
Other depository institutions (net)	-32,893	-37,139	-34,716	-27,572	-31,998	-33,432	-35,751	-34,838
Other financial institutions	5,786	6,545	6,513	6,916	6,597	6,668	6,629	6,616
Nonfinancial private sector	-109	-184	-228	-252	-247	-247	-247	-252
Medium- and long-term net foreign assets	949	1,000	1,031	746	752	809	845	792
Other items net	-6,918	-6,926	-7,032	-6,558	-7,631	-7,926	-8,158	-7,711
Currency	**16,571**	**15,513**	**14,390**	**18,344**	**17,489**	**17,007**	**16,686**	**19,904**
				II. Other Depository Institutions				
Net Foreign Assets	**4,250**	**4,530**	**4,522**	**4,864**	**4,478**	**4,376**	**3,975**	**5,090**
(in millions of US$)	225	240	239	257	235	228	206	262
Foreign assets (million Lempiras)	12,604	12,534	12,867	13,057	12,781	12,817	12,603	12,875
Foreign liabilities (million Lempiras)	-8,354	-8,003	-8,345	-8,194	-8,303	-8,442	-8,627	-7,785
Net Domestic Assets	**125,438**	**125,197**	**126,777**	**128,013**	**131,322**	**132,624**	**135,330**	**138,648**
Credit to the monetary authorities (net)	37,066	41,298	38,256	31,869	35,853	37,486	39,823	39,397
Credit to other financial institutions (net)	-17,614	-18,374	-19,196	-19,403	-20,379	-20,725	-21,218	-21,736
Credit to the combined public sector	-2,869	-5,241	-936	2,946	2,820	3,174	2,114	2,896
Central government	-5,932	-8,443	-4,129	-248	-373	-19	-1,079	-497
Other nonfinancial public sector	611	709	656	656	656	656	656	656
Local governments	2,452	2,493	2,537	2,537	2,537	2,537	2,537	2,737
Credit to the private sector	139,187	139,197	140,711	144,553	146,750	146,788	149,099	154,263
Local currency	108,870	108,870	111,307	114,768	116,788	116,431	118,991	125,269
Foreign currency	30,317	30,327	29,404	29,785	29,962	30,357	30,108	28,994
Other items net	-30,330	-31,683	-32,057	-31,952	-33,722	-34,100	-34,487	-36,173
Liabilities	**129,688**	**129,727**	**131,299**	**132,876**	**135,800**	**137,000**	**139,306**	**143,738**
of which: Deposits in domestic currency	90,145	91,977	91,526	93,183	94,854	97,180	96,943	101,387
of which: Deposits in foreign currency	38,446	36,622	38,667	38,588	39,841	38,714	41,257	41,246
				III. Financial System				
Net Foreign Assets	**43,711**	**44,268**	**42,650**	**43,855**	**44,810**	**47,401**	**48,485**	**49,729**
(in millions of US$)	2,313	2,343	2,257	2,321	2,354	2,472	2,510	2,555
Net Domestic Assets	**98,874**	**97,443**	**98,659**	**102,238**	**103,761**	**101,674**	**102,566**	**108,519**
Credit to the nonfinancial combined public sector	5,422	5,257	7,755	6,880	10,367	9,147	8,836	11,419
Credit to the private sector	142,933	143,172	144,341	148,183	150,380	150,418	152,729	157,893
Local currency	111,626	111,811	113,907	117,368	119,388	119,031	121,591	127,869
Foreign currency	31,307	31,362	30,434	30,815	30,992	31,387	31,138	30,024
Other assets net	-7,322	-7,465	-9,436	-9,404	-10,421	-10,326	-10,462	-10,722
Other items net 3/	-42,160	-43,521	-44,001	-43,422	-46,566	-47,565	-48,537	-50,072
Broad Money (M4)	**142,585**	**141,711**	**141,310**	**146,093**	**148,571**	**149,075**	**151,051**	**158,248**
				(Rate of growth 12 months)				
Currency issue	13.6	3.3	0.6	3.6	5.5	9.6	16.0	8.5
Currency in circulation	12.2	-0.1	1.4	4.5	6.9	10.6	16.5	10.6
Broad money	2.8	3.1	7.2	5.6	4.2	5.2	6.9	8.3
Liabilities in Lempiras	1.5	1.5	1.5	1.5	1.5	1.5	1.5	1.5
Liabilities in foreign currency	1.3	1.3	1.3	1.3	1.3	1.3	1.3	1.3
Credit to the private sector	3.8	4.3	3.7	4.1	5.2	5.1	5.8	6.6
M1	5.9	4.4	10.0	4.8	5.6	10.8	9.4	9.4
Memorandum item								
NDA (millions Lempiras, TMU)	-12,407	-14,679	-13,231	-11,080	-12,855	-16,083	-17,004	-13,676

Sources: Central Bank of Honduras; and Fund staff estimates.

1/ Includes allocation of SDR 104.8 million in August, 2009.

2/ Excluding domestic liabilities in foreign currency and deposits of Hondutel.

3/ Includes the revaluation account reflecting changes in the value of assets due to exchange rate fluctuations.

Table 5. Honduras: Balance of Payments

(In millions of U.S. dollars, unless otherwise indicated)

			Prel.	Projections					
	2007	2008	2009	2010	2011	2012	2013	2014	2015
Current account	**-1,116**	**-1,800**	**-450**	**-964**	**-1,131**	**-1,215**	**-1,238**	**-1,307**	**-1,358**
Trade balance	-3,104	-4,051	-2,471	-2,827	-3,088	-3,264	-3,401	-3,534	-3,684
Exports	5,784	6,458	5,090	5,571	5,943	6,368	6,835	7,342	7,893
Of which: maquila	3,241	3,560	2,772	2,909	3,084	3,307	3,485	3,677	3,883
Imports	-8,888	-10,509	-7,560	-8,398	-9,031	-9,632	-10,236	-10,876	-11,577
Of which: maquila	-2,180	-2,282	-1,797	-1,859	-1,949	-2,075	-2,164	-2,262	-2,368
Of which: petroleum products	-1,211	-1,819	-1,082	-1,565	-1,725	-1,843	-1,937	-2,057	-2,191
Services	-288	-310	-143	-239	-198	-133	-133	-131	-143
Of which: tourism receipts	546	619	611	650	707	730	770	814	854
Income (net)	-395	-420	-489	-541	-545	-595	-580	-619	-612
Of which: payments on direct investments	-535	-460	-472	-477	-536	-593	-565	-597	-713
Of which: public sector interest payments	-46	-45	-46	-58	-46	-50	-56	-63	-57
Current transfers (net)	2,671	2,982	2,652	2,644	2,701	2,777	2,876	2,978	3,082
Public sector	142	160	126	112	118	122	132	136	132
Private sector	2,529	2,822	2,526	2,531	2,583	2,655	2,744	2,842	2,949
Capital account	**1,207**	**80**	**121**	**131**	**118**	**110**	**78**	**60**	**60**
Financial account	**59**	**1,278**	**313**	**696**	**1,153**	**1,315**	**1,372**	**1,478**	**1,566**
Direct investment (net)	926	901	500	687	790	884	970	1,055	1,134
Of which: FDI to maquila	220	102	57	225	142	147	159	172	184
Portfolio investments (net)	-22	-27	56	-15	-12	-6	-4	-4	-4
Other investments	-844	403	-243	24	375	437	407	426	436
Commercial credit (net)	34	23	-19	-22	2	41	37	39	41
Currency and deposits (net)	3	-5	89	-69	13	20	20	20	21
Public sector long-term borrowing (net)	-1,057	302	9	213	326	296	268	268	263
Disbursements	256	433	261	348	395	356	341	346	349
Amortization	-1,313	-131	-252	-135	-69	-61	-72	-77	-85
Other medium and long-term borrowing (net)	128	57	-114	-26	34	44	32	41	49
Other and short-term borrowing (net)	47	26	-208	-72	1	36	49	57	62
Errors and omissions	-326	299	-398	58	0	0	0	0	0
Overall balance	**-176**	**-143**	**-414**	**57**	**140**	**210**	**212**	**230**	**268**
Net international reserves (- increase)	**99**	**54**	**343**	**-60**	**-220**	**-250**	**-212**	**-230**	**-268**
Reserve assets	91	42	360	-55	-221	-250	-212	-230	-268
Of which: SDR allocation									
Reserve liabilities	8	12	-16	-6	-5	0	0	0	0
Exceptional financing	**77**	**89**	**71**	**3**	**0**	**0**	**0**	**0**	**0**
Of which: debt relief (excluding MDRI from IMF)	49	83	29	44	0	0	0	0	0
Program loans 1/	**0**	**0**	**0**	**140**	**80**	**40**	**0**	**0**	**0**
World Bank	0	0	0	80	40	40	0	0	0
IADB	0	0	0	60	40	0	0	0	0
Other	0	0	0	0	0	0	0	0	0
Bilaterals and other multilaterals	0	0	0	0	0	0	0	0	0
IMF	0	0	0	0	0	0	0	0	0
Unidentified financing	0	0	0	0	0	0	0	0	0
Memorandum items:									
Terms of trade (percent change)	-2.6	0.9	14.0	-2.2	-1.3	-2.5	0.2	-0.3	0.6
Terms of trade, excluding maquila (percent change)	-2.6	-0.3	15.4	-3.3	-1.5	-2.7	-0.1	-0.9	-1.5
Exports of goods and services (percent change)	9.0	11.7	-17.8	9.1	7.1	6.8	7.2	7.2	7.3
Of goods only	9.6	11.7	-21.2	9.5	6.7	7.1	7.3	7.4	7.5
Imports of goods and services (percent change)	19.4	17.5	-26.1	11.6	7.1	5.7	6.2	6.2	6.4
Of goods only	21.7	18.2	-28.1	11.1	7.5	6.7	6.3	6.3	6.4
Current account (in percent of GDP)	-9.0	-12.9	-3.2	-6.3	-6.9	-7.1	-6.9	-6.9	-6.8
Excluding official transfers	-10.2	-14.1	-4.0	-7.0	-7.7	-7.8	-7.7	-7.7	-7.4
Overall balance (in percent of GDP)	-1.4	-1.0	-2.9	0.4	0.9	1.2	1.2	1.2	1.3
Non-oil current account (percent of GDP)	0.8	0.1	4.4	3.9	3.6	3.7	3.9	4.0	4.2
Gross reserves (end of period) 2/	2,733	2,691	2,331	2,385	2,606	2,856	3,068	3,299	3,567
In months of next year imports	2.8	3.7	2.9	2.8	2.9	3.0	3.0	3.0	3.1
In months of next year imports (excluding maquila)	3.5	4.7	3.6	3.4	3.5	3.6	3.7	3.7	3.7
Outstanding public external debt	2,026	2,387	2,458	2,694	3,099	3,435	3,704	3,972	4,234
External Public Debt to GDP ratio (in percent)	16.4	17.1	17.2	17.6	19.0	20.1	20.8	21.1	21.1
Public sector debt service paid to exports (in percent)	1.6	1.1	3.2	1.4	1.5	1.4	1.5	1.6	1.5
Nominal GDP (millions of U.S. dollars)	12,349	13,925	14,268	15,340	16,308	17,108	17,820	18,820	20,031

Sources: Central Bank of Honduras; and Fund staff estimates and projections.

1/ Budgetary support dependent on reaching agreement on a Fund program.

2/ Includes foreign currency deposits of financial institutions at the central bank for reserve requirements.

Table 6. Honduras: Structure and Performance of the Banking Sector
(In percent, unless otherwise indicated)

	2005	2006	2007	2008	2009 1/	June 2010
Total assets (in millions of Lempiras) 2/	**126,737**	**157,941**	**191,612**	**213,486**	**220,277**	**231,258**
(In percent of GDP)	69.0	76.6	81.8	80.8	81.4	85.6
Number of banks	**16**	**16**	**18**	**17**	**17**	**17**
Domestic	9	8	8	8	8	8
Foreign	7	8	10	9	9	9
Bank concentration						
Number of banks accounting for at least						
25 percent of total assets	2	2	2	2	2	2
75 percent of total assets	6	7	9	6	6	6
Bank rating (CAMEL)						
Number of banks (Category IV and V)	1	1	2	1	1	1
Share of total assets	2.1	2.6	3.5	1.8	2.0	2.0
Capital adequacy						
Regulatory capital to risk-weighted assets	14.6	13.2	12.9	14.0	14.3	14.8
Capital (net worth) to assets	8.4	8.4	8.3	9.1	9.3	9.1
Asset quality and composition						
Nonperforming loans(NPLs) to total loans 3/	6.6	3.9	3.0	4.3	4.7	4.8
NPLs net of provisions to capital	11.2	4.1	2.1	4.6	4.2	3.5
Restructured loans to regulatory capital	2.8	1.3	0.8	0.5	9.0	7.6
Nonperforming assets net of provisions						
to regulatory capital	68.6	57.6	48.7	44.5	47.2	48.8
Provisions to total loans	3.4	3.2	2.8	3.6	4.1	4.2
Provisions to NPLs	66.8	81.5	90.4	84.3	86.5	88.5
Sectoral distribution of loans to total loans:						
Commerce	18.8	17.8	17.8	11.1	11.6	12.1
Construction and real estate	19.1	23.3	26.2	31.9	33.5	34.7
Agriculture and related sectors	5.9	5.5	4.5	4.9	5.1	4.6
Manufacturing	19.1	19.0	16.0	16.5	15.4	15.2
Consumption	13.5	15.1	16.5	16.6	15.7	15.6
Other	23.6	19.4	19.0	19.0	18.7	17.9
Profitability						
Return on assets (ROA) 4/	1.6	1.8	1.9	1.6	1.2	1.4
Return on equity (ROE)	19.0	21.7	23.1	18.8	12.6	13.9
Interest margin to total income	47.0	49.1	50.0	48.4	48.1	48.1
Personnel expenses to administrative expenses	37.3	36.0	40.8	42.3	39.6	40.9
Liquidity 5/						
Liquid assets to total assets	29.2	26.2	22.4	20.8	21.1	24.2
Liquid assets to total short-term liabilities	64.3	56.6	49.6	50.5	52.2	59.9
Dollarization						
Deposits in foreign currency in percent of total	32.0	29.4	28.1	29.6	30.0	30.1
Credit in foreign currency in percent of total	34.8	36.3	30.7	29.3	25.1	26.1

Sources: National Commission of Banking and Insurance.

1/ Preliminary.
2/ Includes contingent assets.
3/ NPLs exclude restructured loans, mostly to the agricultural sector.
4/ Assets include off-balance sheet items.
5/ Includes cash, public sector securities, and other liquid assets.

Table 7. Honduras: External Vulnerability Indicators

	2006	2007	2008	Prel. 2009	Projections 2010	2011	2012	2013	2014	2015
					(percent change)					
Exports of goods and services, U.S. dollars	4.8	9.0	11.7	-17.8	9.1	7.1	6.8	7.2	7.2	7.3
Imports of goods and services, U.S. dollars	11.6	19.4	17.5	-26.1	11.6	7.1	5.7	6.2	6.2	6.4
Terms of trade (deterioration -)	-3.7	-2.6	0.9	14.0	-2.2	-1.3	-2.5	0.2	-0.3	0.6
Real effective exchange rate, end-of-period	1.5	1.6	4.9	7.7	…	…	…	…	…	,,,
					(In percent of GDP, unless otherwise indicated)					
Current account balance	-3.7	-9.0	-12.9	-3.2	-6.3	-6.9	-7.1	-6.9	-6.9	-6.8
Capital and financial account	9.3	10.3	9.7	3.0	5.4	7.8	8.3	8.1	8.2	8.1
External public debt	27.8	16.4	17.1	17.2	17.6	19.0	20.1	20.8	21.1	21.1
External public debt										
(in percent of exports of goods and services)	50.3	30.9	32.6	40.8	41.0	44.0	45.6	45.9	45.9	45.6
Debt service on external public debt										
(in percent of exports of goods and services)	2.4	1.6	1.1	3.2	1.4	1.5	1.4	1.5	1.6	1.5
Gross official reserves										
in millions of U.S. dollars	2823.9	2732.7	2690.5	2330.5	2385.2	2606.5	2856.5	3068.2	3298.6	3566.7
in percent of short-term external debt	396	339	459	641	751	808	796	788	772	766
in months of next year's imports 1/	4.4	3.5	4.7	3.6	3.4	3.5	3.6	3.7	3.7	3.7
NIR										
in millions of U.S. dollars	2,614	2,514	2,460	2,117	2,177	2,403	2,653	2,865	3,095	3,363
in percent of short-term external debt	367	312	419	582	685	745	739	736	724	722
in months of next year's imports 1/	3.2	2.6	3.4	2.6	2.5	2.6	2.7	2.8	2.8	2.9

Sources: Central Bank of Honduras, and Fund staff estimates.

1/ Imports of goods and non-factor services excluding maquila.

Table 8. Honduras: Indicators of Fund Credit
(In units indicated)

	2008	2009	Projections 2010	2011	2012	2013	2014	2015
Existing Fund credit								
Stock, in millions of SDRs 1/	20.3	20.3	19.3	16.3	12.2	8.1	4.1	1.0
Obligations, in millions of SDRs	0.7	0.7	1.0	3.1	4.2	4.1	4.1	3.1
Proposed SCF								
Stock, in millions of SDRs 1/	…	…	3.2	51.8	64.8	64.8	64.4	55.8
Obligations, in millions of SDRs 2/	…	…	0.0	0.0	0.3	0.3	0.7	8.9
Principal	…	…	0.0	0.0	0.0	0.0	0.4	8.6
Interest and charges	…	…	0.0	0.0	0.3	0.3	0.3	0.3
Proposed SBA								
Stock, in millions of SDRs 1/	…	…	32.4	58.3	64.8	64.8	43.7	12.1
Obligations, in millions of SDRs 3/	…	…	0.2	0.7	0.8	0.8	21.8	32.0
Principal	…	…	0.0	0.0	0.0	0.0	21.0	31.6
Interest and charges	…	…	0.2	0.7	0.8	0.8	0.7	0.4
Stock of existing and prospective Fund credit 1/								
In millions of SDRs	20.3	20.3	54.9	126.3	141.7	137.6	112.2	68.9
In percent of quota	15.7	15.7	42.4	97.6	109.4	106.3	86.6	53.2
In percent of exports of goods and services	0.4	0.5	1.3	2.7	2.9	2.6	2.0	1.1
In percent of external debt	1.3	1.3	3.1	6.2	6.3	5.7	4.3	2.5
In percent of gross reserves	1.1	1.4	3.5	7.4	7.6	6.8	5.2	3.0
Obligations to the Fund from existing arrangements and prospective Fund arrangements								
In millions of SDRs	0.7	0.7	1.2	3.8	5.3	5.3	26.6	44.0
In percent of quota	0.5	0.5	0.9	2.9	4.1	4.1	20.5	34.0
In percent of exports of goods and services	0.0	0.0	0.0	0.1	0.1	0.1	0.5	0.7
In percent of external debt	0.0	0.0	0.1	0.2	0.2	0.2	1.0	1.6
In percent of gross reserves	0.0	0.0	0.1	0.2	0.3	0.3	1.2	1.9

1/ End of period.

2/ Expected repayment schedule, assuming full drawings and a constant 0.50 percent rate of charge. The Honduran authorities have expressed their intention to treat the arrangement as precautionary, since balance of payment pressures have not materialized. No interest payments until December 2011.

3/ Expected repayment schedule, assuming full drawings and a rate of charge of 1.29 percent. The Honduran authorities have expressed their intention to treat the arrangement as precautionary, since balance of payment pressures have not materialized.

Table 9. Disbursements, Purchases, and Timing of Reviews under the SCF/SBA Arrangements

Date of availability	Conditions	Amount (millions of SDRs)			Percent of quota		
		Total	SCF	SBA	Total	SCF	SBA
Upon Board approval	Board approval of the arrangements	35.613	3.2375	32.375	27.50	2.50	25.00
February 15, 2011	Observance of end-December 2010 performance criteria and structural benchmarks and completion of first review	16.188	9.7125	6.475	12.50	7.50	5.00
May 15, 2011	Observance of end-March 2011 performance criteria and structural benchmarks and completion of second review	19.425	12.950	6.475	15.00	10.00	5.00
August 15, 2011	Observance of end-June 2011 performance criteria and structural benchmarks and completion of third review	19.425	12.950	6.475	15.00	10.00	5.00
November 15, 2011	Observance of end-September 2011 performance criteria and structural benchmarks and completion of fourth review	19.425	12.950	6.475	15.00	10.00	5.00
February 15, 2012	Observance of end-December 2011 performance criteria and structural benchmarks and completion of fifth review	19.425	12.950	6.475	15.00	10.00	5.00
	Total	129.50	64.75	64.75	100.00	50.00	50.00

Honduras' quota is SDR 129.5 million.

Table 10. Balance of Payments: Baseline and Stress Scenarios, 2009-11
(In millions of U.S. dollars)

	2009	2010	2011	Stress 1/ 2011
Current account deficit	450	964	1,131	1,187
Exports	5,090	5,571	5,943	5,866
Remittances	2,526	2,501	2,551	2,501
Imports (non-oil)	6,478	6,833	7,306	7,245
Payments on direct investments	472	477	536	526
Public sector (amortization)	252	135	69	69
Private sector (amortization)	396	205	133	133
S-T debt original maturity	396	205	133	133
Banks				
Non-bank Private Sector				
S-T debt remaining maturity				
Sub-total (requirements)	**1,098**	**1,304**	**1,333**	**1,389**
Net FDI	500	690	790	726
Gross M-T, L-T borrowing (public sector)	261	481	475	475
S-T debt	205	133	133	93
New borrowing	126	-106	5	3
Portfolio	56	-15	-12	-12
Other Inv.	70	-91	15	15
S-T private sector borrowing (new)			1	0
Other capital flows	-342	166	151	122
Change in reserves (+ = decrease)	347	-60	-220	-220
Sub-total (sources)	**1,098**	**1,304**	**1,333**	**1,199**
Financing gap	**0**	**0**	**0**	**190**
IMF Financing				190
Remaining gap				**0**
Memorandum items				
Assumptions:				
Growth rate of exports		9.4	6.7	5.3
Growth rate of FDI		38.0	14.5	5.2
Growth rate of remittances		-1.0	2.0	0.0
Roll over of S-T debt (in percent)			100	70

Sources: Central Bank of Honduras and Fund staff estimates.

1/ Stress scenario assumes lower exports, imports, remittances, and lower and lower FDI (around US$61 million).

Table 11. Potential Foreign Currency Drains and Buffers in 2010-11

(In millions of U.S. dollars)

	2010	2011
A. Potential liquidity drains	**3,346**	**3,455**
Prospective current account deficit	964	1,131
Maturing external debt obligations	340	205
Commercial bank FX deposits 1/	2,042	2,119
B. Liquidity buffers	**2,434**	**2,665**
Commercial banks' net external assets	257	262
Net International Reserves	2,177	2,403
C. Potential liquidity shortfall (A-B)	**912**	**790**
D. Additional liquidity from official financing	**140**	**270**
IADB	60	40
World Bank	80	40
IMF	0	190
E. Coverage of potential drains (percent)		
Liquidity buffers (B/A)	72.7	77.1
Liquidity buffers and Official financing (B+D)/A	76.9	84.9
Memorandum items:		
Commercial bank local currency deposits	4,932	5,209
Currency in circulation	718	769
IMF lending (percent of GDP)	0.0	1.2
IMF lending (percent of NIR)	0.0	7.9
IMF lending (percent of FX deposits)	0.0	9.0
IMF lending (percent of commercial banks deposits)	0.0	2.6

Sources: Central Bank of Honduras and Fund staff estimates.

1/ Foreign currency deposits of residents at domestic banks. These deposits correspond to about 30 percent of total deposits, and have been volatile during periods of loss of confidence.

Table 12. Honduras: External Borrowing Requirements 2010-2015
(in millions of U.S. dollars)

	2009	2010	2011	2012	2013	2014	2015
Current account deficit	450	964	1,131	1,215	1,238	1,307	1,358
Exports	5,090	5,571	5,943	6,368	6,835	7,342	7,893
Remittances	2,526	2,501	2,551	2,616	2,705	2,803	2,906
Imports (non-oil)	6,478	6,833	7,306	7,789	8,299	8,820	9,386
Oil imports	1,082	1,565	1,725	1,843	1,937	2,057	2,191
Payments on direct investments	472	477	536	593	565	597	713
Public sector (debt amortization)	252	135	69	61	72	77	85
Private sector (debt amortization)	396	205	133	133	169	218	275
Sub total (requirements)	**1,098**	**1,304**	**1,333**	**1,409**	**1,479**	**1,602**	**1,718**
Net foreign direct investment	500	690	790	884	970	1,055	1,134
Long-term gross public sector borrowing	261	488	475	396	341	346	349
Of which : World Bank	58	139	94	130	93	95	95
Of which : IADB	24	148	178	100	100	100	98
Short-term debt (inflow)	205	133	133	169	218	275	337
New borrowing (private sector)	126	-106	5	55	53	55	58
Other capital flows	-342	159	151	155	109	101	108
Change in reserves (+ = decrease)	347	-60	-220	-250	-212	-230	-268
Sub total (sources)	**1,098**	**1,304**	**1,333**	**1,409**	**1,479**	**1,602**	**1,718**
Financing gap	**0**	**0**	**0**	**0**	**0**	**0**	**0**
IMF Financing	0	0	0	0	0	0	0
Remaining gap	0	0	0	0	0	0	0

Source: Central Bank of Honduras and Fund staff estimates.

Appendix I. Debt Sustainability Analysis-Update[5]

October 15, 2010

This updated debt sustainability analysis (DSA) yields results similar to those reported in the June 2010 DSA—the risk of debt distress continues to be regarded as low. The analysis continues to be based on the assumptions that macroeconomic policies will be strengthened to stabilize the external current account deficit at sustainable levels and that a prudent borrowing strategy will be maintained. Under those assumptions Honduras' debt would remain low and sustainable, with all debt indicators remaining below their indicative thresholds and robust under various stress tests. However, debt dynamics would weaken if policies deviate from the program and/or a permanent adverse shock to GDP growth.

KEY ASSUMPTIONS

Strengthened macroeconomic policies. As in the 2010 Article IV consultation documents, the scenario continues assuming that macroeconomic policies are strengthened starting in the second half of 2010, and remain strong over the medium term. In addition to a tax reform approved last April that would yield revenue equivalent to 1½–2½ percent of GDP (on an annual basis) over three years, the baseline also assumes the adoption of additional measures, which the authorities are currently considering. These include controlling the wage bill, reduce subsidies, and adjust electricity tariffs to reduce the public sector deficit to about 2 percent of GDP over the medium term.

Real GDP will grow by 4 percent per year helped by improved performance in exports of commodities, in the *maquila*[6] sector, and remittances. Also, growth prospects are assumed to be enhanced by higher public investment, which is assumed to reach 6.5 percent of GDP over the medium term (compared to 5.3 percent in 2007–09).

The overall fiscal deficit of the public sector will stabilize at about 2 percent of GDP.[7] Public sector revenues and grants are projected to increase to around 25 percent of GDP by 2012. The composition of expenditure would be tilted toward investment and poverty reduction, and after 2013 would increase broadly in line with nominal GDP. The fiscal deficit would be financed mostly by concessional resources from multilateral and bilateral creditors.

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[5] The DSA update has been prepared jointly by the IMF and World Bank staff.

[6] A *maquila* or *maquiladora* is a manufacturing plant that imports and assembles duty-free components for export. Maquila exports represent 50 percent of total exports and are mainly related to textiles and confections.

[7] The consolidated public sector includes the central government, local governments, decentralized agencies, social security institutions, the central bank, and public enterprises.

The noninterest external current account deficit is projected to decline below 6 percent of GDP in the long term. This would be the result of favorable dynamics in the trade balance, tourism, and remittances. The current account deficit would be largely financed by official sources and foreign direct investment (FDI), and support the projected expansion in *maquila* and tourism.

Annual export growth would reach nearly 8 percent over the long run. A projected decline in the prices of Honduras' main commodities exports (coffee and bananas) is expected to be offset by continued productivity gains and higher access to international markets (through CAFTA and a trade agreement with the European Union, which would become effective in 2012).

Annual import growth would stabilize at about 7 percent per year. Nonfuel imports are projected to increase moderately, in line with domestic demand growth and *maquila* activity. Fuel imports volumes are assumed to grow in line with real GDP.

Non-concessional financing. The program for October 2010-March 2012 envisages a continuous ceiling for contracting non-concessional financing of US$350 million;[8] of the total, US$280 million corresponds to a new multi-sector loan from the Central American Bank for Economic Integration (CABEI).[9] Also, as in the 2010 Article IV, it is assumed that Honduras would progressively tap additional non-concessional sources of financing (which would rise from 5 percent to 23 percent of total disbursements in the long-run), mostly loans from bilateral (Paris Club and non-Paris Club countries) and commercial sources.

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[8] Honduras is classified as a low-capacity, low-vulnerability country, and is allowed to have untied non-concessional financing.

[9] Lending from CABEI is on non-concessional terms. However, recently CABEI lending to Honduras for some projects (e.g. infrastructure) was combined with concessional lending from the other institutions (e.g. World Bank and IADB) in order to reach of concessionality of 35 percent. For the purpose of this DSA update, however, the US$280 million lending has been considered non-concessional.

Fund arrangements. The Honduran authorities are requesting Fund support in the form of 18-month SBA/SCF blended arrangements in the amount of SDR129.5 million (100 percent of quota). An initial disbursement (combined SBA/SCF) of SDR35.61 million (27.5 percent of quota) would become available upon Board approval. Even though the authorities plan to treat the arrangements as precautionary, it will be assumed for this DSA update that the country uses all Fund resources as programmed.

EXTERNAL DEBT SUSTAINABILITY ANALYSIS

Honduras' external debt would remain sustainable. All external debt indicators remain below their thresholds[10], with the PV of external debt projected to stay at below 22 percent of GDP over the entire horizon of the analysis (Table 3a and Figure 1).

External debt indicators remain below their indicative, policy-related thresholds under all stress tests and alternatives scenarios (Figure 1). Under the historical scenario, debt burden indicators are lower than those under the baseline scenario because the projected averages (from 2011) of FDI and real GDP growth are higher than the estimated values for 2010. On the other hand, the noninterest current account average is lower than the one for 2010.

PUBLIC SECTOR DEBT SUSTAINABILITY ANALYSIS

Honduras' public sector debt would remain low and sustainable. Public sector debt would remain at about 25 percent of GDP (21 percent in PV terms). As the fiscal deficit would progressively decline to about 2 percent of GDP and growth rebounds to its long-term rate, the sustainable primary deficit would be about 1 percent of GDP.

Stress Tests

The alternative scenarios and stress tests show that public sector debt dynamics are vulnerable to adverse shocks (exogenous or policy-related). The status quo stress test, which assumes a primary fiscal deficit at the 2011 level in terms of GDP until the end of the projection period, as well as a permanent decline in real GDP growth, would place the PV of public debt-to-GDP ratio on an upward trend (Table 2a). Also, a one-time real depreciation of 30 percent (e.g. under a severe balance of payments correction) or a 10 percent of GDP increase in other debt-creating flows (e.g. in case of severe financial sector distress that leads to the realization of contingent liabilities) would rise the PV of public debt-to-revenue ratio over 100 percent in the long term, compared to 85 percent under the baseline scenario.

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[10] Based on the recent update, the three-year average of the Honduras' CPIA index (between 2007 and 2009) is 3.69. In this context, the debt burden thresholds correspond to the ones associated with a medium policy performance (a rating above 3.75 corresponds to strong performance). The latter represents a deterioration compared to the previous average (2006-2008), which was 3.8 and was associated with a strong policy performance.

CONCLUSION

Based on the above analysis, Honduras' debt is assessed to be at low risk of debt distress. Assuming consistent pursuit of strengthened macroeconomic policies, Honduras' debt indicators would remain below their indicative thresholds and broadly resilient to adverse shocks. Under alternative policies, however, public sector debt dynamics would weaken. Honduras' favorable debt outlook reflects the low initial levels of public debt, which resulted in large debt relief granted to Honduras during 2000s.

Given that Honduras would progressively tap more nonconcessional sources of financing, it will be important to build on the existing capacity to manage debt and to formulate a strategy linked to medium-term fiscal framework. Authorities are committed to strengthen their debt management capacity, including with additional new technical assistance.

Table 1a.Honduras: Public Sector Debt Sustainability Framework, 2007-2030
(In percent of GDP, unless otherwise indicated)

	Actual			Average	Standard Deviation	Estimate	Projections								
	2007	2008	2009			2010	2011	2012	2013	2014	2015	2010-15 Average	2020	2030	2016-30 Average
Public sector debt 1/	19.7	20.6	23.7			27.7	29.4	29.9	30.4	30.4	30.0		27.1	25.0	
o/w foreign-currency denominated	16.4	17.1	17.2			19.2	21.3	22.5	23.1	23.1	22.8		20.5	17.7	0.71
Change in public sector debt	-12.0	0.9	3.1			4.0	1.7	0.5	0.5	0.0	-0.4		-0.4	-0.1	
Identified debt-creating flows	-3.0	-1.4	4.3			2.1	1.6	0.6	0.4	-0.1	-0.2		-0.1	-0.2	
Primary deficit	0.1	0.2	4.0	0.7	2.4	2.6	1.7	0.6	0.5	0.5	0.5	1.1	0.7	0.7	0.6
Revenue and grants	24.4	26.3	24.8			24.5	24.5	25.0	25.0	25.0	25.0		25.0	25.1	
of which: grants	1.6	2.1	1.9			1.7	1.0	1.5	1.5	1.5	1.5		0.6	0.7	
Primary (noninterest) expenditure	24.5	26.5	28.9			27.2	26.2	25.6	25.6	25.5	25.6		25.7	25.8	
Automatic debt dynamics	-3.0	-1.5	0.2			-0.6	-0.1	0.0	-0.2	-0.6	-0.7		-0.7	-0.8	
Contribution from interest rate/growth differential	-2.0	-0.6	0.8			0.1	-0.2	-0.5	-0.6	-0.6	-0.7		-0.7	-0.8	
of which: contribution from average real interest rate	-0.1	0.1	0.4			0.7	0.7	0.6	0.6	0.6	0.5		0.4	0.2	
of which: contribution from real GDP growth	-1.9	-0.8	0.4			-0.6	-0.9	-1.1	-1.2	-1.2	-1.2		-1.1	-1.0	
Contribution from real exchange rate depreciation	-1.0	-0.9	-0.5			-0.7	0.1	0.5	0.4	0.0	-0.1		...	...	
Other identified debt-creating flows	-0.1	-0.1	0.0			0.0	0.0	0.0	0.0	0.0	0.0		0.0	0.0	
Privatization receipts (negative)	0.0	0.0	0.0			0.0	0.0	0.0	0.0	0.0	0.0		0.0	0.0	
Recognition of implicit or contingent liabilities	0.0	0.0	0.0			0.0	0.0	0.0	0.0	0.0	0.0		0.0	0.0	
Debt relief (HIPC and other)	-0.1	-0.1	0.0			0.0	0.0	0.0	0.0	0.0	0.0		0.0	0.0	
Other (specify, e.g. bank recapitalization)	0.0	0.0	0.0			0.0	0.0	0.0	0.0	0.0	0.0		0.0	0.0	
Residual, including asset changes	-9.1	2.3	-1.2			1.9	0.1	0.0	0.1	0.1	-0.2		-0.4	0.1	
Other Sustainability Indicators															
PV of public sector debt	19.1	17.8	18.9			22.4	24.0	24.6	25.1	25.2	25.0		22.8	21.4	
o/w foreign-currency denominated	15.9	14.3	12.4			13.9	16.0	17.2	17.8	17.9	17.7		16.1	14.1	
o/w external	15.9	14.3	12.4			13.9	16.0	17.2	17.8	17.9	17.7		16.1	14.1	
PV of contingent liabilities (not included in public sector debt)	...	...	...			...	...	...	...	...	...		...	...	
Gross financing need 2/	2.8	1.6	7.9			5.9	6.0	4.8	4.6	4.7	4.8		4.8	4.6	
PV of public sector debt-to-revenue and grants ratio (in percent)	78.4	67.6	76.0			91.1	98.2	98.4	100.4	100.5	99.7		90.9	85.0	
PV of public sector debt-to-revenue ratio (in percent)	83.8	73.4	82.1			97.8	102.4	104.7	106.9	106.9	106.0		93.3	87.5	
o/w external 3/	69.5	59.0	54.0			60.7	68.0	73.0	75.8	76.2	75.4		66.1	57.6	
Debt service-to-revenue and grants ratio (in percent) 4/	11.1	5.4	13.9			13.5	17.5	16.8	16.4	16.9	17.2		16.7	15.9	
Debt service-to-revenue ratio (in percent) 4/	11.9	5.8	15.0			14.5	18.3	17.9	17.5	18.0	18.3		17.1	16.3	
Primary deficit that stabilizes the debt-to-GDP ratio	12.1	-0.7	1.0			-1.4	0.0	0.1	0.1	0.5	0.9		1.1	0.8	
Key macroeconomic and fiscal assumptions															
Real GDP growth (in percent)	6.2	4.0	-1.9	3.8	2.9	2.4	3.5	4.0	4.0	4.0	4.0	3.7	4.0	4.0	4.0
Average nominal interest rate on forex debt (in percent)	1.5	2.2	1.9	1.8	0.4	2.3	1.7	1.8	1.8	2.0	1.9	1.9	2.0	2.1	2.0
Average real interest rate on domestic debt (in percent)	5.8	3.8	6.6	7.6	6.9	6.9	8.2	8.2	8.5	8.2	7.2	7.9	5.0	2.0	4.2
Real exchange rate depreciation (in percent, + indicates depreciation)	-3.7	-5.8	-3.1	-0.6	8.3	-4.1	...	...	...	...	...	...	...	...	...
Inflation rate (GDP deflator, in percent)	6.9	8.5	4.4	6.5	9.5	4.9	4.0	5.6	5.1	5.2	5.5	5.1	5.3	5.3	5.3
Growth of real primary spending (deflated by GDP deflator, in percent)	11.6	12.6	6.7	8.9	13.7	-3.6	-0.1	1.7	3.7	3.8	4.2	1.6	4.2	4.1	4.1
Grant element of new external borrowing (in percent)	...	...	...	…	…	24.2	21.2	24.8	23.8	23.7	23.1	23.5	23.0	20.2	...

Sources: Country authorities; and staff estimates and projections.

1/ The consolidated public sector includes the central government, local governments, decentralized agencies, social security institutions, central bank, and public enterprises. Net debt is used.

2/ Gross financing need is defined as the primary deficit plus debt service plus the stock of short-term debt at the end of the last period.

3/ Revenues excluding grants.

4/ Debt service is defined as the sum of interest and amortization of medium and long-term debt.

5/ Historical averages and standard deviations are generally derived over the past 10 years, subject to data availability.

Table 2a.Honduras: Sensitivity Analysis for Key Indicators of Public Debt 2010-2030

	Projections							
	2010	2011	2012	2013	2014	2015	2020	2030
PV of Debt-to-GDP Ratio								
Baseline	22	24	25	25	25	25	23	21
A. Alternative scenarios								
A1. Real GDP growth and primary balance are at historical averages	22	23	24	24	25	25	23	22
A2. Primary balance is unchanged from 2010	22	25	28	30	32	34	42	57
A3. Permanently lower GDP growth 1/	22	24	25	26	27	28	32	55
B. Bound tests								
B1. Real GDP growth is at historical average minus one standard deviations in 2011-2012	22	25	28	30	31	32	36	46
B2. Primary balance is at historical average minus one standard deviations in 2011-2012	22	25	28	29	29	29	26	25
B3. Combination of B1-B2 using one half standard deviation shocks	22	24	27	28	28	29	30	34
B4. One-time 30 percent real depreciation in 2011	22	30	31	31	31	31	29	30
B5. 10 percent of GDP increase in other debt-creating flows in 2011	22	34	35	35	35	35	32	29
PV of Debt-to-Revenue Ratio 2/								
Baseline	91	98	98	100	101	100	91	85
A. Alternative scenarios								
A1. Real GDP growth and primary balance are at historical averages	91	94	94	97	98	98	93	89
A2. Primary balance is unchanged from 2010	91	102	110	121	129	137	167	226
A3. Permanently lower GDP growth 1/	91	99	101	106	109	111	129	219
B. Bound tests								
B1. Real GDP growth is at historical average minus one standard deviations in 2011-2012	91	103	111	119	124	128	145	185
B2. Primary balance is at historical average minus one standard deviations in 2011-2012	91	103	113	115	115	114	105	98
B3. Combination of B1-B2 using one half standard deviation shocks	91	100	106	111	113	115	119	135
B4. One-time 30 percent real depreciation in 2011	91	123	123	125	124	123	116	120
B5. 10 percent of GDP increase in other debt-creating flows in 2011	91	139	139	141	141	139	128	117
Debt Service-to-Revenue Ratio 2/								
Baseline	13	18	17	16	17	17	17	16
A. Alternative scenarios								
A1. Real GDP growth and primary balance are at historical averages	13	17	16	15	17	17	17	16
A2. Primary balance is unchanged from 2010	13	18	18	19	21	23	27	37
A3. Permanently lower GDP growth 1/	13	18	17	17	18	19	22	35
B. Bound tests								
B1. Real GDP growth is at historical average minus one standard deviations in 2011-2012	13	18	18	19	21	21	24	31
B2. Primary balance is at historical average minus one standard deviations in 2011-2012	13	18	18	20	20	19	19	18
B3. Combination of B1-B2 using one half standard deviation shocks	13	18	17	18	19	20	20	23
B4. One-time 30 percent real depreciation in 2011	13	18	18	18	19	20	22	24
B5. 10 percent of GDP increase in other debt-creating flows in 2011	13	18	25	26	23	22	22	21

Sources: Country authorities; and staff estimates and projections.
1/ Assumes that real GDP growth is at baseline minus one standard deviation divided by the square root of the length of the projection period.
2/ Revenues are defined inclusive of grants.

Table 3a.: External Debt Sustainability Framework, 2007-2030 1/
(In percent of GDP, unless otherwise indicated)

	Actual			Historical 0 Average	0 Standard Deviation	Projections									
	2007	2008	2009			2010	2011	2012	2013	2014	2015	2010-2015 Average	2020	2030	2016-2030 Average
External debt (nominal) 1/	**25.8**	**25.3**	**22.9**			**24.1**	**26.1**	**27.4**	**28.2**	**28.4**	**28.2**		**26.9**	**25.8**	
o/w public and publicly guaranteed (PPG)	16.4	17.1	17.2			19.2	21.3	22.5	23.1	23.1	22.8		20.5	17.7	
Change in external debt	-10.3	-0.5	-2.5			1.2	2.0	1.3	0.8	0.2	-0.2		-0.3	0.0	
Identified net debt-creating flows	-2.7	3.8	-1.5			1.2	1.3	0.9	0.5	0.3	0.1		-0.4	-1.7	
Non-interest current account deficit	**8.4**	**12.4**	**2.6**	**5.3**	**3.2**	**5.6**	**6.5**	**6.5**	**6.4**	**6.4**	**6.2**		**5.9**	**4.9**	5.7
Deficit in balance of goods and services	27.5	31.3	18.3			19.9	20.2	19.9	19.8	19.5	19.1		17.8	12.8	
Exports	53.2	52.7	42.2			42.7	43.0	44.0	45.3	46.0	46.3		48.8	57.8	
Imports	80.6	84.0	60.6			62.6	63.2	63.8	65.1	65.4	65.4		66.6	70.5	
Net current transfers (negative = inflow)	-21.5	-21.7	-19.3	-15.9	5.7	-17.2	-16.6	-16.2	-16.1	-15.8	-15.4		-14.3	-11.3	-13.3
o/w official	-1.2	-1.9	-1.4			-0.7	-0.7	-0.7	-0.7	-0.7	-0.7		-0.8	-0.4	
Other current account flows (negative = net inflow)	2.4	2.8	3.6			3.0	2.8	2.9	2.7	2.7	2.5		2.4	3.4	
Net FDI (negative = inflow)	**-7.5**	**-6.3**	**-4.2**	**-5.4**	**1.3**	**-4.5**	**-4.8**	**-5.2**	**-5.4**	**-5.6**	**-5.7**		**-5.9**	**-6.3**	-6.0
Endogenous debt dynamics 2/	**-3.6**	**-2.3**	**0.0**			**0.0**	**-0.3**	**-0.5**	**-0.5**	**-0.4**	**-0.4**		**-0.4**	**-0.3**	
Contribution from nominal interest rate	0.7	0.6	0.6			0.5	0.5	0.5	0.6	0.6	0.6		0.6	0.7	
Contribution from real GDP growth	-2.0	-0.9	0.5			-0.5	-0.8	-1.0	-1.1	-1.1	-1.1		-1.0	-1.0	
Contribution from price and exchange rate changes	-2.3	-2.0	-1.1			...	...	...	...	...	...		...	...	
Residual (3-4) 3/	**-7.6**	**-4.3**	**-1.0**			**0.1**	**0.7**	**0.3**	**0.3**	**-0.1**	**-0.3**		**0.1**	**1.8**	
o/w exceptional financing	-1.0	-1.2	1.9			-0.1	0.0	0.0	0.0	0.0	0.0		0.0	0.0	
PV of external debt 4/	...	...	18.0			18.8	20.7	22.1	22.9	23.2	23.2		22.5	22.2	
In percent of exports	...	...	42.7			43.9	48.2	50.2	50.6	50.4	50.1		46.1	38.5	
PV of PPG external debt	**...**	**...**	**12.4**			**13.9**	**16.0**	**17.2**	**17.8**	**17.9**	**17.7**		**16.1**	**14.1**	
In percent of exports	**...**	**...**	**29.3**			**32.5**	**37.1**	**39.0**	**39.4**	**39.0**	**38.3**		**33.1**	**24.4**	
In percent of government revenues	**...**	**...**	**54.0**			**60.7**	**68.0**	**73.0**	**75.8**	**76.2**	**75.4**		**66.1**	**57.6**	
Debt service-to-exports ratio (in percent)	**4.1**	**5.0**	**9.1**			**5.2**	**4.7**	**4.6**	**4.5**	**4.7**	**4.9**		**4.7**	**3.0**	
PPG debt service-to-exports ratio (in percent)	**1.7**	**1.1**	**3.7**			**1.9**	**1.6**	**1.7**	**1.8**	**2.1**	**2.4**		**2.8**	**1.9**	
PPG debt service-to-revenue ratio (in percent)	**3.9**	**2.4**	**6.7**			**3.6**	**3.0**	**3.2**	**3.4**	**4.2**	**4.8**		**5.7**	**4.6**	
Total gross financing need (Billions of U.S. dollars)	0.7	1.6	0.8			0.7	0.8	0.8	0.8	0.8	0.9		1.1	1.3	
Non-interest current account deficit that stabilizes debt ratio	18.7	12.9	5.1			4.4	4.5	5.3	5.6	6.1	6.4		6.2	4.9	
Key macroeconomic assumptions															
Real GDP growth (in percent)	6.2	4.0	-1.9	3.8	2.9	2.4	3.5	4.0	4.0	4.0	4.0	3.7	4.0	4.0	4.0
GDP deflator in US dollar terms (change in percent)	6.9	8.5	4.5	6.5	9.5	4.9	2.7	0.9	0.2	1.5	2.3	2.1	2.1	2.1	2.1
Effective interest rate (percent) 5/	2.1	2.7	2.4	2.2	0.5	2.6	2.2	2.2	2.2	2.4	2.3	2.3	2.5	2.7	2.5
Growth of exports of G&S (US dollar terms, in percent)	9.0	11.7	-17.8	12.2	23.2	8.8	7.0	7.3	7.2	7.2	7.3	7.5	7.4	8.5	7.8
Growth of imports of G&S (US dollar terms, in percent)	19.4	17.5	-26.1	12.6	19.6	11.2	7.3	5.9	6.2	6.2	6.4	7.2	6.6	7.2	6.7
Grant element of new public sector borrowing (in percent)	...	...	...	...	...	24.2	21.2	24.8	23.8	23.7	23.1	23.5	23.0	20.2	22.1
Government revenues (excluding grants, in percent of GDP)	22.8	24.2	23.0			22.9	23.5	23.5	23.5	23.5	23.5		24.4	24.4	24.3
Aid flows (in Billions of US dollars) 7/	0.5	0.7	0.5			0.6	0.4	0.5	0.5	0.5	0.5		0.4	0.8	
o/w Grants	0.2	0.3	0.3			0.3	0.2	0.3	0.3	0.3	0.3		0.2	0.3	
o/w Concessional loans	0.3	0.4	0.3			0.3	0.3	0.2	0.2	0.2	0.2		0.3	0.4	
Grant-equivalent financing (in percent of GDP) 8/	...	...	...			2.5	1.8	2.1	2.0	1.9	1.9		1.0	1.0	1.2
Grant-equivalent financing (in percent of external financing) 8/	...	...	...			48.8	38.2	53.1	57.3	58.0	58.7		43.2	43.9	46.4
Memorandum items:															
Nominal GDP (Billions of US dollars)	12.3	13.9	14.3			15.3	16.3	17.1	17.8	18.8	20.0		27.1	49.5	
Nominal dollar GDP growth	13.5	12.8	2.5			7.5	6.3	4.9	4.2	5.6	6.4	5.8	6.2	6.2	6.2
PV of PPG external debt (in Billions of US dollars)			1.8			2.1	2.6	2.9	3.1	3.3	3.5		4.3	6.7	
(PVt-PVt-1)/GDPt-1 (in percent)						2.5	2.8	1.8	1.4	1.1	0.9	1.8	0.6	0.8	0.7
Gross remittances (Billions of US dollars)	2.6	2.8	2.5			2.4	2.5	2.6	2.7	2.8	3.0		3.8	6.5	
PV of PPG external debt (in percent of GDP + remittances)	...	...	10.6			12.0	13.8	14.9	15.5	15.6	15.4		14.1	12.4	
PV of PPG external debt (in percent of exports + remittances)	...	...	20.8			23.7	27.3	28.9	29.4	29.3	29.0		25.7	19.8	
Debt service of PPG external debt (in percent of exports + remittances)	...	...	2.6			1.4	1.2	1.3	1.3	1.6	1.8		2.2	1.6	

Sources: Country authorities; and staff estimates and projections.

1/ Includes both public and private sector external debt.
2/ Derived as [r - g - ρ(1+g)]/(1+g+ρ+gρ) times previous period debt ratio, with r = nominal interest rate; g = real GDP growth rate, and ρ = growth rate of GDP deflator in U.S. dollar terms.
3/ Includes exceptional financing (i.e., changes in arrears and debt relief); changes in gross foreign assets; and valuation adjustments. For projections also includes contribution from price and exchange rate changes.
4/ Assumes that PV of private sector debt is equivalent to its face value.
5/ Current-year interest payments divided by previous period debt stock.
6/ Historical averages and standard deviations are generally derived over the past 10 years, subject to data availability.
7/ Defined as grants, concessional loans, and debt relief.
8/ Grant-equivalent financing includes grants provided directly to the government and through new borrowing (difference between the face value and the PV of new debt).

Table 3b.Honduras: Sensitivity Analysis for Key Indicators of Public and Publicly Guaranteed External Debt, 2010-2030
(In percent)

	Projections							
	2010	2011	2012	2013	2014	2015	2020	2030
PV of debt-to GDP ratio								
Baseline	14	16	17	18	18	18	16	14
A. Alternative Scenarios								
A1. Key variables at their historical averages in 2010-2030 1/	14	14	13	12	11	10	8	11
A2. New public sector loans on less favorable terms in 2010-2030 2	14	17	18	19	20	20	21	22
B. Bound Tests								
B1. Real GDP growth at historical average minus one standard deviation in 2011-2012	14	16	18	18	18	18	16	14
B2. Export value growth at historical average minus one standard deviation in 2011-2012 3/	14	22	34	35	34	34	28	18
B3. US dollar GDP deflator at historical average minus one standard deviation in 2011-2012	14	17	18	19	19	19	17	14
B4. Net non-debt creating flows at historical average minus one standard deviation in 2011-2012 4/	14	22	29	29	29	28	24	16
B5. Combination of B1-B4 using one-half standard deviation shocks	14	22	31	31	31	31	25	17
B6. One-time 30 percent nominal depreciation relative to the baseline in 2011 5/	14	22	24	24	25	24	22	18
PV of debt-to-exports ratio								
Baseline	32	37	39	39	39	38	33	24
A. Alternative Scenarios								
A1. Key variables at their historical averages in 2010-2030 1/	32	32	29	26	24	22	16	18
A2. New public sector loans on less favorable terms in 2010-2030 2	32	39	41	43	44	44	42	39
B. Bound Tests								
B1. Real GDP growth at historical average minus one standard deviation in 2011-2012	32	37	38	38	38	37	32	23
B2. Export value growth at historical average minus one standard deviation in 2011-2012 3/	32	61	112	111	108	105	82	44
B3. US dollar GDP deflator at historical average minus one standard deviation in 2011-2012	32	37	38	38	38	37	32	23
B4. Net non-debt creating flows at historical average minus one standard deviation in 2011-2012 4/	32	50	65	64	63	61	49	28
B5. Combination of B1-B4 using one-half standard deviation shocks	32	52	77	76	75	73	57	32
B6. One-time 30 percent nominal depreciation relative to the baseline in 2011 5/	32	37	38	38	38	37	32	23
PV of debt-to-revenue ratio								
Baseline	61	68	73	76	76	75	66	58
A. Alternative Scenarios								
A1. Key variables at their historical averages in 2010-2030 1/	61	59	55	51	47	43	33	43
A2. New public sector loans on less favorable terms in 2010-2030 2	61	71	77	82	85	86	85	92
B. Bound Tests								
B1. Real GDP growth at historical average minus one standard deviation in 2011-2012	61	69	75	78	78	77	67	57
B2. Export value growth at historical average minus one standard deviation in 2011-2012 3/	61	93	145	147	146	143	113	72
B3. US dollar GDP deflator at historical average minus one standard deviation in 2011-2012	61	71	78	81	81	80	69	59
B4. Net non-debt creating flows at historical average minus one standard deviation in 2011-2012 4/	61	92	121	124	123	121	97	66
B5. Combination of B1-B4 using one-half standard deviation shocks	61	92	130	133	132	130	104	69
B6. One-time 30 percent nominal depreciation relative to the baseline in 2011 5/	61	95	100	104	105	103	89	76

Table 3b.Honduras: Sensitivity Analysis for Key Indicators of Public and Publicly Guaranteed External Debt, 2010-2030 (continued)
(In percent)

Debt service-to-exports ratio

Baseline	2	2	2	2	2	2	**3**	2
A. Alternative Scenarios								
A1. Key variables at their historical averages in 2010-2030 1/	2	2	1	1	2	2	**1**	1
A2. New public sector loans on less favorable terms in 2010-2030 2	2	2	2	2	2	2	**3**	3
B. Bound Tests								
B1. Real GDP growth at historical average minus one standard deviation in 2011-2012	2	2	2	2	2	2	**3**	2
B2. Export value growth at historical average minus one standard deviation in 2011-2012 3/	2	2	3	4	5	5	**7**	4
B3. US dollar GDP deflator at historical average minus one standard deviation in 2011-2012	2	2	2	2	2	2	**3**	2
B4. Net non-debt creating flows at historical average minus one standard deviation in 2011-2012 4/	2	2	2	3	3	3	**4**	3
B5. Combination of B1-B4 using one-half standard deviation shocks	2	2	2	3	3	4	**5**	3
B6. One-time 30 percent nominal depreciation relative to the baseline in 2011 5/	2	2	2	2	2	2	**3**	2

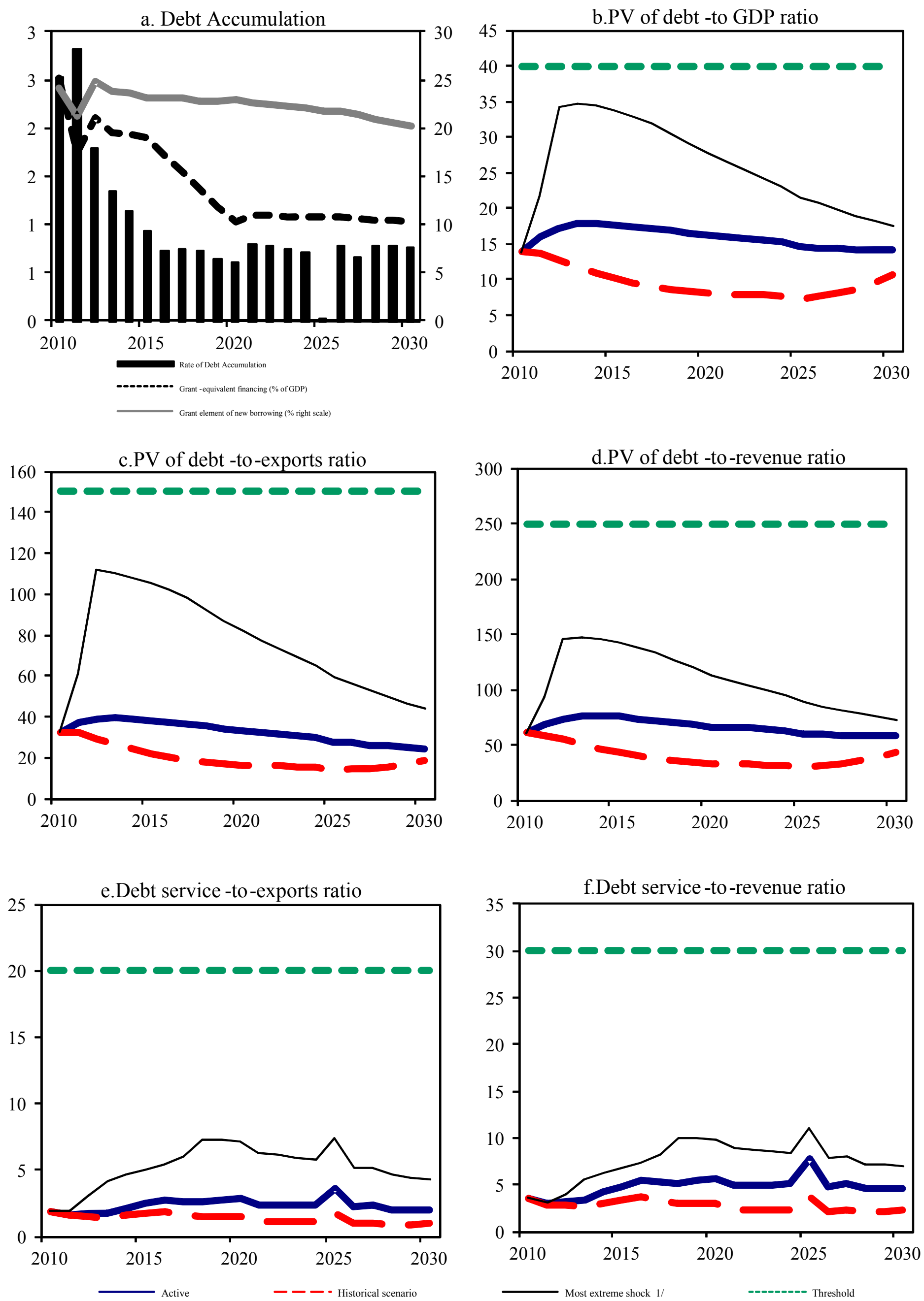
Debt service-to-revenue ratio

Baseline	4	3	3	3	4	5	**6**	5
A. Alternative Scenarios								
A1. Key variables at their historical averages in 2010-2030 1/	4	3	3	3	3	3	**3**	2
A2. New public sector loans on less favorable terms in 2010-2030 2	4	3	3	4	4	4	**6**	7
B. Bound Tests								
B1. Real GDP growth at historical average minus one standard deviation in 2011-2012	4	3	3	4	4	5	**6**	5
B2. Export value growth at historical average minus one standard deviation in 2011-2012 3/	4	3	4	6	6	7	**10**	7
B3. US dollar GDP deflator at historical average minus one standard deviation in 2011-2012	4	3	4	4	5	5	**6**	5
B4. Net non-debt creating flows at historical average minus one standard deviation in 2011-2012 4/	4	3	4	5	6	6	**9**	6
B5. Combination of B1-B4 using one-half standard deviation shocks	4	3	4	5	6	6	**9**	7
B6. One-time 30 percent nominal depreciation relative to the baseline in 2011 5/	4	4	5	5	6	7	**8**	6
Memorandum item:								
Grant element assumed on residual financing (i.e., financing required above baseline) 6/	16	16	16	16	16	16	**16**	16

Sources: Country authorities; and staff estimates and projections.

1/ Variables include real GDP growth, growth of GDP deflator (in U.S. dollar terms), non-interest current account in percent of GDP, and non-debt creating flows.
2/ Assumes that the interest rate on new borrowing is by 2 percentage points higher than in the baseline., while grace and maturity periods are the same as in the baseline.
3/ Exports values are assumed to remain permanently at the lower level, but the current account as a share of GDP is assumed to return to its baseline level after the shock (implicitly an offsetting adjustment in import levels).
4/ Includes official and private transfers and FDI.
5/ Depreciation is defined as percentage decline in dollar/local currency rate, such that it never exceeds 100 percent.
6/ Applies to all stress scenarios except for A2 (less favorable financing) in which the terms on all new financing are as specified in footnote 2.

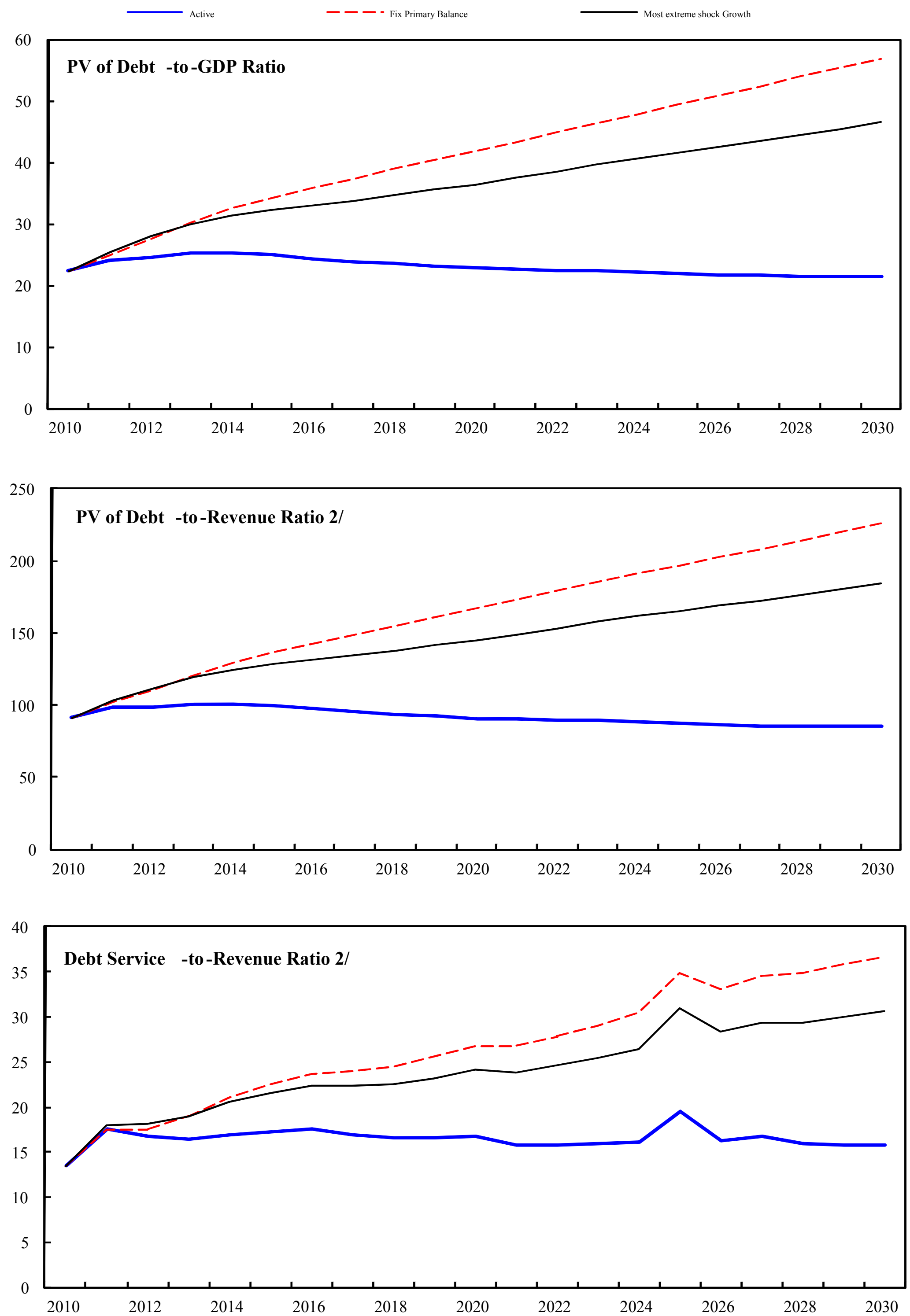
Figure 1a. Honduras: Indicators of Public and Publicly Guaranteed External Debt under Alternatives Scenarios, 2010-2030 1/



Sources: Country authorities; and staff estimates and projections.

1/ The most extreme stress test is the test that yields the highest ratio in 2020. In figure b. it corresponds a Exports shock; in c. to a Exports shock; in d. to a Exports shock; in e. to a Exports shock and in figure f. to a Exports shock

Figure 2a.Honduras: Indicators of Public Debt Under Alternative Scenarios, 2010-2030 1/



Sources: Country authorities; and staff estimates and projections.
1/ The most extreme stress test is the test that yields the highest ratio in 2020.
2/ Revenues are defined inclusive of grants.

Attachment I. Letter of Intent

Tegucigalpa, September 10, 2010

Mr. Dominique Strauss-Kahn
Managing Director
International Monetary Fund
Washington, D.C. 20431

Dear Mr. Strauss-Kahn,

1. During 2009, the Honduran economy was severely affected by the global slowdown and a domestic political crisis. Real GDP declined by almost 2 percent and unemployment rose significantly. In addition, the fiscal position deteriorated markedly and international reserves declined by about US$360 million, to the lowest level since 2006. Although external conditions have begun to improve in 2010, economic growth is still weak and the recovery faces risks.

2. To establish the conditions for robust and sustainable growth in the medium term, the Government has started to implement key reforms, and has developed an economic program for 2010–11 aimed at reducing macroeconomic imbalances and strengthening the finances of the public sector. We expect that strong implementation of this program will help bolster investor confidence and strengthen the support of the international community. In support of this program, we are requesting 18-month arrangements with the Fund, in the total amount of SDR129.5 million, equivalent to 100 percent of Honduras' quota at the Fund (with a blend of resources from the Stand-By and Standby Credit Facilities, of SDR 64.75 million each). We intend to treat the arrangement as precautionary.

3. The main objective of this program is to restore macroeconomic stability, strengthen public finances, help establish the conditions for sustainable economic growth and increase resources for investment. In the attached Memorandum of Economic and Financial Policies (MEFP), we outline the economic program and set out the policies of the Government for 2010–11. These policies reflect the Government's commitment to fiscal consolidation, improvements in revenue mobilization and tax administration, combined with improvements in the composition of public sector expenditure, strict control of the public sector wage bill, that enable an increase in anti-poverty programs and public investment. The government believes that the policies contained in the MEFP are adequate to achieve the objectives of its program, and it is committed to take any further measures that may be needed for this purpose. We will consult with the Fund on the adoption of these measures as needed, and in advance of revisions to the policies contained in the MEFP, in accordance with IMF policies on such consultation.

4. During the program, the Government will not introduce or intensify any exchange rate restrictions, multiple currency practice, and import restrictions for balance of payments purposes, and will continue to comply with all obligations of Article VIII of the IMF's Articles of Agreement.

5. Program implementation will be monitored through five quarterly reviews, with the first one to be completed on or after February 15, 2011. The quantitative performance criteria and structural benchmarks under the program are set out in Tables 1 and 2 of the attached MEFP. Consistent with the commitment to keep the public informed, the Government will publish the program documents and will report periodically on progress under the program.

Sincerely yours,

/s/

Maria Elena Mondragón de Villar
President, Central Bank of Honduras

/s/

William Chong Wong
Minister of Finance

Attachments

Attachment II. Memorandum of Economic and Financial Policies for 2010–11

I. Background and Program Objectives

1. During 2009, the economy of Honduras was severely affected by the global slowdown and a domestic political crisis. Real GDP declined by 1.9 percent, resulting in a significant loss of employment. The impact of these developments, combined with domestic macroeconomic policies in place, resulted in a deterioration in the external position, as net capital inflows (FDI and official assistance) contracted by more than the external current account deficit, and gross international reserves fell by 15 percent to US$2.3 billion (3½ months of imports).

2. The government of President Porfirio Lobo, which took office in January 2010, inherited a weak economic situation and large fiscal imbalances. In 2009, the overall deficit of the public sector rose sharply to 4.6 percent of GDP (from 1.7 percent in the previous year), reflecting a large widening in the deficit of the central government (from 2.4 percent of GDP in 2008 to 6.2 percent last year). A strong increase in government spending (mostly public sector wages) and weaker tax revenue were the main contributors to the higher deficit, which was financed with a combination of short-term domestic debt, central bank credit, and domestic arrears. The financial position of public sector enterprises and pension funds also worsened.

3. Since taking office, the new government has taken several measures to restore macroeconomic stability and strengthen the public finances. Last April, Congress approved a comprehensive tax reform that is expected to yield revenues by up to 2½ percent of GDP (on an annual basis). In June, we initiated a process of employment verification in the education and health sectors (which account for the bulk of the government wage bill), eliminated subsidies to all users with electricity consumption above 150 kWh per month, and improved the targeting of the energy subsidy to the poor, and public enterprises adjusted their tariffs to better reflect operating costs. These measures will contribute to reduce fiscal disequilibrium.

4. Consistent with the goals stated in the *Visión de País 2010-2038* and the strategic elements of the *Plan de Nación 2010-2022*, our economic policy's main objectives will be to restore macroeconomic stability, strengthen public finances, help establish the conditions for sustained economic growth, and increase resources for investment. In line with these objectives, our economic program aims at bolstering confidence in the government's policies, strengthening the fiscal position of the central government and key public sector entities, raising the level and efficiency of social spending, and boosting our international reserves. We expect that prompt adoption and steadfast implementation of this program will help mobilize official external financing to support its objectives.

5. We believe that a large and sustainable reduction in fiscal deficits and improvement in the composition of public expenditure are critical to the success of our economic program.

To this end, the program targets a reduction in the deficit of the central government of almost 3 percent of GDP during 2010-11 (from 6.2 percent of GDP in 2009). During this period, the overall fiscal deficit of the consolidated public sector would be lowered by1.6 percent of GDP; higher investment by public sector enterprises would be the main reason for the smaller decline in the consolidated public sector deficit. The projected reduction in the fiscal deficit will be driven by higher tax revenues resulting from the implementation of the April 2010 reform, improved tax administration and collection, and, importantly, strict control of current spending. Monetary and exchange rate policies will be consistent with our inflation and external objectives. The program also envisages structural reforms which are critical to its success, mostly in public finances and the financial sector.

II. Macroeconomic Policies for 2010–11

6. Our program envisages a gradual economic recovery, with real GDP growth in the range of 2½-3½ percent during 2010-11. Inflation is expected to rise, largely reflecting higher prices of imported goods (mostly petroleum), but will be kept below 6 percent throughout the program period. The deficit in the external current account is projected to rise to 6-7 percent of GDP (from 3.2 percent in 2009) owing to higher prices of imported commodities (mostly oil) and strong import demand for public and private investment. A strong pickup in foreign direct investment and in official external financing is expected to be more than sufficient to cover the current account deficit and, as a result, gross international reserves are expected to increase gradually throughout the program period.

A. Fiscal Policy

7. Our fiscal policy aims at improving the quality of public expenditure, reducing the overall deficit of the public sector to 2 percent in the medium term, and keeping the debt-to-GDP ratio at below 30 percent. In line with these objectives, the overall deficit of the consolidated public sector for end-2010 will be lowered to 3.7 percent of GDP (0.9 percent less than in 2009), on account of higher tax revenue and expenditure restraint. The 2011 budget that we plan to submit to Congress by mid-September 2010 (prior action) will target an overall fiscal deficit of the central government of 3.4 percent of GDP, consistent with the overall deficit of the consolidated public sector of 3.1 percent of GDP. The budget will accommodate higher spending in priority areas, mostly poverty reduction and public investment. To achieve this objective we plan to fully implement the tax measures approved last April, and exercise strict control of public sector current spending, especially of the wage bill. In addition, we plan to adopt measures to strengthen the operating balance of public sector enterprises. The key elements of our program for 2010–11 include:

- ***Improvements in tax policy and administration***. In support of the tax reform, we plan to further strengthen the institutional framework for tax collections. In particular, we will: (i) submit to the National Congress the necessary reforms, including to the tax code, to enforce tax compliance; (ii) maintain unchanged the rules, regulations, resolutions and technical directives related to the proper implementation of the reform to the zero tax rate, taxes on income and sales, and excise taxes contained in Decree 17-2010; iii) review the tax exemptions established in various laws in order to ensure their proper application and strengthen their respective controls by the Ministry of Finance and the tax collection agency (DEI) by June 2011; (iv) continue the institutional upgrading of the DEI, strengthening its capacity to control, analyze, and collect revenue; and (v) improving management of human resources in the areas of training programs and internal wage policy, to facilitate the implementation of the civil service career path and incentives plan. At the same time, we will improve the administrative capacity of the DEI, we will strengthen the large taxpayers unit with equipment and qualified personnel, and we will develop a manual of job description and salaries (March 2011).

- ***Control of expenditure on goods and services***. For 2011, we will maintain the ceiling established in the 2010 budget on central government expenditure on goods and services. In addition, we will start using reverse auctions and online purchases to reduce costs and increase availability of medicine, fuels, and other goods in the public sector.

- ***Control of the wage bill***. Our policies will aim at reining in the growth of the wage bill of the central government, which is projected to decline to 10.3 percent of GDP in 2011 (from 11.1 percent of GDP in 2010). Payroll control will be tightened by: (i) completing, by end-September 2010, the process of employment verification in the education and health sectors (by the Ministry of Finance and with the support of Ministry of Planning and External Cooperation), based on the information available from the 2009 census and the employment audit carried out by the Government Audit Office (TSC), and the findings of the joint Government/Teachers commission envisaged in the August 28, 2010 agreement, and detailed employment records provided by the respective ministries; (ii) eliminating all redundant and irregular positions identified by the TSC; (iii) setting-up a centralized unit for payroll monitoring at the Ministry of Finance by end- 2010; (iv) linking payroll management modules for the education and health ministries to the integrated system of financial management (SIAFI) by October 2010 and fully incorporating it into SIAFI by March 2011; (v) requiring prior approval by the Ministry of Finance for any modification of the budgeted payroll of the central government; and (vi) integrating payments to day laborers into SIAFI and the financial system.

- ***Improved public investment management***. We will develop by March 2011 a plan to strengthen the management of investment projects at the institutional and project execution levels, through the simplification of the mechanisms and processes for the procurement, implementation, and monitoring of public investment.

- ***Strengthening of the operating balance of key public enterprises***. We plan the following measures to strengthen the operating balance of public enterprises: (i) raise electricity tariffs by 3 percent by end-September 2010 and thereafter adjust electricity tariffs periodically in line with fuel costs as stipulated in the law; (ii) regularize overdue payments of other public sector entities (December 2010) to the electricity company (ENEE) so as to enable the repayment of ENEE's overdue obligations to the private sector by March 2011; and (iii) prepare by March 2011 comprehensive plans to restore the financial viability and enhance the operational efficiency of the public enterprises.

- ***Strengthening the financial position of public pension funds***. The pension funds together with the Banking and Securities Commission (CNBS) have developed an action plan for reforming the law that would reduce the actuarial deficit of the pension system (INPREMA, INJUPEMP, INPREUNAH) by changing the bases of defined benefits. We will present a draft law based on this action plan to the National Congress by December 2010. We are also reviewing and reforming regulations to allow pension funds to diversify their investment instruments within the limits that guarantee their liquidity, profitability and safety (December 2010).

- ***Audit of government arrears to private sector suppliers***. By January 2011, a contract will be signed with a reputable international audit company to undertake an audit of accumulated domestic arrears to the private sector. Based on this audit, we will develop a plan to only clear arrears generated from contracts that adhered to existing regulations and procedures.

- ***Reform of the civil service law***. By December 2011, the government, with the support of the Inter-American Development Bank (IADB), will review the legislation that regulates recruitment and selection processes, and recruitment procedures for all existing regimes in the public administration. This diagnosis will be the basis of a plan to reform the Civil Service Law, which will be later presented to Congress for its discussion and approval.

- ***Budget financing***. Our strategy will encompass a lower reliance on domestic financing and refraining from using central bank financing to the budget. In line with this objective, we have requested budget support from the World Bank and the IADB totaling US$220 million for 2010–11. In addition, the Central American Bank for Economic Integration (CABEI) approved a non-concessional loan of US$280 million, which remains within the limit on the contracting of nonconcessional debt

(US$350 million). We will not incur external arrears at any time during the program period.

- ***Use of higher-than-projected revenue and external disbursements of budget support***. Our fiscal projections for 2010-11 are based on conservative assumptions for output and revenue growth. If tax revenues were to be higher than projected, we will use up to 50 percent of the excess revenue to repay domestic debt, and allocate the rest to counterpart financing of social investment projects (TMU, paragraph 7, Table B). Also, if external disbursements for budget support exceed the amount projected, we will save the total amount of the excess in the net international reserves of the central bank, which will also reduce the ceiling on net domestic assets.

- ***Improved public debt management***. With the objective of strengthening the capacity to manage to public debt and link government borrowing plans to a sound, multiyear fiscal framework, we will update the Guidelines for Public Sector Borrowing (*Propuesta de Lineamientos de Política de Endeudamiento Público*) *2011–2014* in the following areas: (i) establish a borrowing ceiling for the central government, based on the debt sustainability analysis prepared by the public credit department of the Ministry of Finance; (ii) properly record and administer domestic arrears and contingencies resulting from public-private partnerships (PPPs) and other contracts; (iii) strengthen the fiscal risks unit of the Ministry of Finance to improve debt profile; and (iv) establish by February 2011 specific norms for controlling and managing the outstanding debt of local governments.

B. Monetary and Exchange Rate Policies

8. Our monetary policy will aim at keeping inflation at single digits and maintaining an adequate level of international reserves. Accordingly, we will seek to keep annual inflation in the range of 5½-6 percent in 2010-11 (plus/minus one percentage point). The central bank's monetary program for the program period is consistent with a prudent expansion of bank credit to the private sector to support the growth objectives of the government. We will control the growth of net domestic credit through active placements of central bank bills, and will not extend new credit to the public banks and to the central government. We will monitor monetary conditions and assess the appropriateness of interest rate levels throughout the program period, and will adjust our policy rate (TPM) as necessary to achieve our inflation target and protect the external position. In addition, the program envisages that net international reserves will increase by US$50 million in 2010 and by US$220 million in 2011, and establishes a ceiling for the net domestic assets of the central bank.

9. Our exchange rate policy will be transparent, predictable, and consistent with the objective of safeguarding competitiveness and strengthening the external position. The

central bank will take measures to foster the development of an active interbank market and secondary markets for central bank and government paper, refine monetary instruments, and enhance policy signaling. The central bank will undertake a comprehensive reform of its operational framework for conducting monetary policy. The reform will include: (i) moving toward a system of liquidity forecasting and liquidity management on a daily basis; (ii) improving market-based repo operations for liquidity management, (iii) increasing the signaling content of the policy rate (TPM); (iv) revamping the system of primary auctions of central bank paper to allow for price discovery by market participants, and (v) simplifying the current system of reserve requirements. We are requesting assistance from the IMF to strengthen the central bank's institutional capacity for designing and implementing these reforms, and for developing a timetable for their adoption.

10. To enhance the central bank's ability to pursue effective monetary policy, we will develop a plan for its recapitalization and institutional strengthening by December 2011. We will request technical assistance from the IMF for this purpose.

C. Financial Sector Policies

11. Building on the progress achieved in recent years, we are fully committed to further improve our regulatory framework and supervisory practices in the financial system, and to strengthen the financial safety net, as recommended in the update to the Financial Sector Assessment Program (FSAP). In particular, we plan to: (i) issue new norms for loan classifications and reserve coverage in line with international best practices, by December 2010; (ii) approve regulations for measuring and monitoring liquidity risks in line with international best practices; (iii) strengthen the capacity for risk-based supervision, (iv) re-activate the Early Warning Committee; (v) strengthen the risk-based supervision framework for saving and loans cooperatives, (vi) review bank resolution procedures to ensure that they follow the best practices, and (vi) strengthen the deposit guarantee fund (FOSEDE) and the Capitalization Fund. We are also committed to improve access to financial services. To this effect, we expect that the Chamber of Commerce and Industry of Tegucigalpa will be able to implement, by January 2011, the "secured transactions" Law and to have in place a public registry of movable collateral. Furthermore, the CNBS will modify regulations for appraisers, extraordinary assets, bonded warehouses, and credit bureau (February 2011). We will also design and adhere to new norms to increase transparency, information disclosure, and protection to users of financial services (September 2011).

D. Poverty Reduction Policy

12. ***Targeting social spending to the poor.*** With the assistance of the multilateral banks and donors, the government plans to consolidate its anti-poverty expenditure in a conditional cash transfer program (*Bono 10 mil*). This program aims at covering a large share of the families living in extreme poverty and providing cash benefits conditional on periodic

monitoring of child growth and use of health and education services. In particular, we plan to: (i) increase the coverage of the conditional transfer program by 150,000 additional families by end-2011; (ii) strengthen the monitoring and control mechanisms of the *Bono 10 mil*; and (iii) expand the provision and access to health and education services to the program's beneficiaries. The government has committed resources equivalent to 1.6 percent of GDP to all social investment programs in 2011.

E. Reforms to Improve the Investment Climate

13. We are committed to improving the business climate in Honduras in order to increase foreign and domestic investment, in particular in infrastructure. To facilitate this, Congress approved a draft law for public-private partnerships (PPP) and is considering a draft law on investment protection and promotion. We also plan to improve the regulatory framework for creditors' rights and insolvency proceedings. To improve the safety of transactions and facilitate commercial and administrative operations, we will make legal the use of electronic signatures.

III. Safeguards Assessment

14. We recognize the importance of completing an updated safeguards assessment of the Central Bank of Honduras before the first review of the program. To facilitate this, we have authorized the central bank's external auditors to provide IMF staff with all necessary information and to hold discussions directly with IMF staff. The central bank will work with IMF staff to ensure the smooth completion of the updated safeguards assessment before the first review. The central bank intends to fully implement the recommendations resulting from that assessment.

IV. Program Monitoring

15. The program with the IMF will cover the period October 2010–March 2012 and will be monitored on a quarterly basis, by quantitative performance criteria and indicative targets, and structural benchmarks. The first program review will be completed on or after February 15, 2011, the second one on or after May 15, 2011, and the third one on or after August 15, 2011. The quantitative performance criteria and indicative targets for December 2010 and March 2011 are set out in the attached table, and those for the period April 2011-March 2012 will be established in the first review of the program. Structural benchmarks are set out in Table 2. The definitions and reporting procedures are further specified in the accompanying Technical Memorandum of Understanding.

Table 1. Honduras - Proposed Performance Criteria 1/

(Cumulative flows; millions of Lempiras, unless specified)

	2010			2011			
	Prel.	Proj.	PC	PC	Indicative Targets		
	end-Jun.	end-Sep.	end-Dec.	end- Mar.	end- Jun.	end- Sep.	end- Dec.
QUANTITATIVE PERFORMANCE CRITERIA							
Fiscal targets 2/							
Deficit of the combined public sector (ceiling)	3,413	4,688	7,487	4,715	4,244	6,055	9,700
Net domestic financing of the combined public sector (ceiling)	2,008	2,214	-250	3,868	689	-23	922
Monetary targets							
Stock of net international reserves (floor, in millions of US$)	1,598	1,462	1,557	1,606	1,751	1,783	1,777
Stock of net domestic assets of the central bank (ceiling)	-14,679	-13,231	-11,080	-12,855	-16,083	-17,004	-13,676
Public debt targets 2/							
Contracting or guaranteeing of non-concessional external debt (continuous ceiling, in million of US$)			350	350	350	350	350
New arrears of ENEE with the private sector (continuous ceiling)		0	0	0	0	0	0
External payment arrears of the combined public sector (continuous ceiling)			0	0	0	0	0
INDICATIVE TARGETS 2/							
Central government current primary expenditure (ceiling)	22,433	14,157	28,773	10,827	23,800	36,555	50,572
Social investment related spending (floor)	1,536	213	1,197	442	954	1,532	3,477
Wage bill of the central government (ceiling)	14,900	8,203	17,335	6,716	15,580	23,054	32,235
Memo Items 2/							
Central government tax revenues 3/	19,908	10,920	24,146	9,298	25,268	37,558	50,322
Budget support external loans (in million of US$)	0	0	190	0	0	40	80

1/ Definitions as specified in the Technical Memorandum of Understanding.

2/ Cummulative starting on July 1 for 2010 and on January 1 for 2011.

3/ Does not constitute a Performance Criterion, Indicative Target or Structural Benchmark.

Table 2. Honduras: Structural Benchmarks

	Date	Rationale
A. Fiscal		
Present to Congress a 2011 Budget consistent with a combined public sector deficit of 3.1 percent of GDP.	Prior action	Anchoring the macroeconomic program
Improve human resources management and administrative capacity of the DEI; strengthen a Large Taxpayer Unit with adequate staff; and develop a job and pay description manual.	March 2011	Critical to strengthen tax revenue collections
Transfer the control over Education payroll to the Ministry of Finance.	March 2011	Critical to control the wage bill
Sign a contract to audit public sector arrears with the private sector.	January 2011	Definitely establish government obligations
Adjust electricity tariffs in line with fuel costs.	Continuous	Improve the financial position of ENEE
Present a law reform proposal that allows changing the bases of defined benefits, to reduce the actuarial deficit of IMPREMA, INJUPEMP and INPREUNAH	December 2010	Strengthen the financial sustainability of pension regimes
B. Financial Sector		
Issue norms for loan classifications, reserve coverage and approve regulations for measuring and monitoring liquidity risks in line with international best practices.	December 2010	Strengthen the stability of the financial system
C. Monetary and External		
Prepare a plan to recapitalize the central bank.	December 2011	Strengthen the financial position and independence of the CBH

Attachment III. Technical Memorandum of Understanding

1. This memorandum sets out technical understandings between the Honduran authorities and the Fund staff for monitoring of the economic program agreed for the period October 2010–March 2012. It defines the concepts used to assess observance of quantitative performance criteria, structural benchmarks, and indicative targets specified in Tables 1 and 2 of the Memorandum of Economic and Financial Policies (MEFP). It also specifies the frequency of the data to be provided to the Fund to monitor the developments under the program.

I. Program Assumptions

2. For program monitoring purposes, unless otherwise indicated, U.S. dollar denominated components of the balance sheet of the Central Bank of Honduras will be valued at the exchange rate of L18.8951/US$. Amounts denominated in other currencies will be converted for program purposes into U.S. dollar amounts using the cross-rates as of end-June 2010 published on the IMF website http://www.imf.org.

II. Fiscal Targets

3. **The deficit of the combined public sector (CPS)** will be measured from the financing side (i.e., “below the line”), and will correspond to the net borrowing of the CPS, from both external and domestic sources. The CPS comprises the nonfinancial public sector (NFPS) and the operating result (quasi-fiscal balance) of the central bank. The NFPS covers the central government, local governments and decentralized agencies, the social security institute (IHSS), the pension institutes (INJUPEMP, INPREMA, IPM), and the public enterprises.

4. **The deficit of the central government** also will be measured from the financing side. The central government includes the executive, judicial, and legislative branches, and the so-called decentralized agencies (*desconcentradas*).

5. **The current primary expenditure of the central government** is defined as total current expenditure less interest payments.

6. **The central government wage bill** is defined as all central government wages and salaries, including severance payments, plus employer social security and pension contributions; other remunerations (such as bonus payments) are also included in the definition.

7. **Social investment spending** is defined as the programs and projects of social content that are financed with domestic resources, debt relief, grants and loans. (See Table B).

8. **The operating balance of the public enterprises** is defined as the difference between the operating revenue (excluding interest earnings and transfers) and the operating expenditure (excluding interest payments and transfers) of the enterprises.

9. **Net domestic financing of the CPS** will be measured as the operating result of the central bank and the change (relative to end-June 2010) in the stocks of: (1) outstanding indebtedness of the NFPS (direct bank credit plus bank holdings of public sector bonds less deposits) to the domestic financial system (central bank, commercial banks, and other financial institutions); (2) outstanding public sector bonds held outside the financial system; (3) repatriation of deposits held abroad; and (4) outstanding suppliers' credit and floating debt (un-cashed and undelivered checks, and unpaid invoices and orders) of the central government, and unpaid orders of the rest of the NFPS. For the purposes of the program, domestic financial system is defined as comprising all depositary institutions, according to the Monetary and Financial Statistics Manual (MFSM) definitions.

10. **Discrepancies**. The authorities will undertake periodic reconciliations to minimize discrepancies between above-the-line and below-the-line financing data. As needed, such reconciliations must be carried out prior to completion of the program reviews.

11. **Adjustor**. If tax revenues were to exceed those projected under the program for 2010 and 2011 during each year, up to 50 percent of the excess revenue will be used to amortize domestic debt (and thus reduce fiscal deficit and its domestic financing) and the residual will be allocated as counterpart to social investment projects (Paragraph 7, Table B).

III. Monetary Targets

12. **Net International Reserves (NIR) of the central bank (program definition)**. For program purposes, the NIR of the central bank will be measured as gross international reserves that are readily available minus (i) short-term reserve liabilities (including purchases and credits from the Fund), as described in the international reserves table prepared by the central bank according to the MFSM); (ii) foreign assets that are counterpart of foreign currency deposits of financial institutions at the central bank and of any other liability of the central bank with residents that is payable in foreign currency; (iii) any conversion of short-term reserve liabilities; and (iv) the transfer to the central bank of foreign currency deposits held abroad by HONDUTEL, INJUPEMP, and IHSS, which amounted to US$73.4 million at end-June 2010. Readily available reserves also exclude those assets that are pledged or otherwise encumbered, including but not limited to reserve assets used as collateral or guarantee for a third-party external liability. NIR will be valued at program accounting exchange rates.

13. **Net domestic assets (NDA) of the central bank** will be measured as the difference between currency issue and NIR, both measured on the basis of end-of-period data.

14. **Adjustor**. Starting in 2011, the target floor on NIR will be adjusted downwards (the target ceiling on net domestic assets of the central bank will be adjusted upwards) by up to US$50 million by the shortfall of programmed external disbursements to the budget. In case of an excess during the program period, the target floor on NIR will be adjusted upwards (the target ceiling on domestic assets of the central bank will be adjusted downwards) by full such amount. The external disbursements contemplated in the program are to be received from the World Bank, IADB, and Taiwan, province of China, totaling US$270 million.

IV. External Targets

15. **External debt**. For program purposes, the definition of debt is the one set forth in point No. 9 of the Guidelines on Performance Criteria with Respect to External Debt (Executive Board's Decision No. 6230-(79/140), as amended by Decision No 14416-(09/91, effective December 1, 2009). This definition applies also to commitments contracted or guaranteed for which value has not been received, and to private debt for which official guarantees have been extended and which, therefore, constitute a contingent liability of the public sector. Excluded from this definition are normal import-related credits, defined as liabilities that arise from the direct extension, during the normal course of trading, of credit from a supplier to a purchaser—that is, when payment of goods and services is made at a time that differs from the time when ownership of the underlying goods or services changes. Normal import credit arrangements covered by this exclusion are self-liquidating; they contain pre-specified limits on the amounts involved and the times at which payments must be made; they do not involve the issuance of securities. For the purpose of the program, external debt is defined on the basis of residency.

16. **Debt definition**. The definition of debt set forth in No. 9 of the Guidelines on Performance Criteria with Respect to External Debt in Fund Arrangements reads as follows:

(a) For the purpose of this guideline, the term "debt" will be understood to mean a current, i.e., not contingent, liability, created under a contractual arrangement through the provision of value in the form of assets (including currency) or services, and which requires the obligor to make one or more payments in the form of assets (including currency) or services, at some future point(s) in time; these payments will discharge the principal and/or interest liabilities incurred under the contract. Debts can take a number of forms, the primary ones being as follows: (i) loans, i.e., advances of money to the obligor by the lender made on the basis of an undertaking that the obligor will repay the funds in the future (including deposits, bonds, debentures, commercial loans and buyers' credits) and temporary exchanges of assets that are equivalent to fully collateralized loans under which the obligor is required to repay the funds, and usually pay interest, by repurchasing the collateral from the buyer in the future (such as repurchase agreements and official swap arrangements); (ii) suppliers' credits, i.e., contracts where the supplier permits the obligor to defer payments until sometime after the date on which the goods are delivered or services are provided; and (iii) leases, i.e., arrangements under which property is provided which the lessee has the right to use for one or more specified period(s) of time that are usually shorter than the total expected service life of the property, while the lesser retains the title to the property. For the purpose of the guideline, the debt is the present value (at the inception of the lease) of all lease payments expected to be made during the period of the agreement excluding those payments that cover the operation, repair, or maintenance of the property. (b) Under the definition of debt set out in point 9(a) above, arrears, penalties, and judicially awarded damages arising from the failure to make payment under a contractual obligation that constitutes debt give rise to new debt. Failure to make payment on an obligation that is not considered debt under this definition (e.g., payment on delivery) will not give rise to debt.

17. **Definition of public debt**. For the purpose of the program, public sector debt is defined as the debt of the combined public sector excluding the debt of local governments.

18. For purpose of the program, the guarantee of a debt arises from any explicit legal obligation of the central government or any other agency acting on behalf of the central government to service such a debt in the event of nonpayment by the recipient (involving payments in cash or in kind), or from any implicit legal or contractual obligation to finance partially or in full any shortfall incurred by the debtor.

19. **Concessionality** will be calculated using currency-specific discount rates based on the OECD commercial interest reference rates (CIRRs) and taking into account all details of the loan agreement, including maturity, grace period, payment schedule, upfront commission, and management fees. The ten-year average of CIRRs will be used as the discount rate to assess the concessionality of loans of an original maturity of at least 15 years, and a six-month average of CIRRs will be used to assess the concessionality of loans with original maturities of less than 15 years. To both the ten-year and six-month averages, the following margins will be added: 0.75 percent for repayment periods of less than 15 years; 1 percent for 15–19 years; 1.15 percent for 20–30 years; and 1.25 percent for over 30 years. The grant element of loans can be calculated using the concessionality calculator available at the IMF web site http://www.imf.org.[11] For program purposes, a debt is **concessional** if it includes a grant element of at least 35 percent, calculated as follows: the grant element of a debt is the difference between the present value (PV) of debt and its nominal value, expressed as a percentage of the nominal value of the debt. The PV of debt at the time of its contracting is

[11] Currently available at http://www.imf.org/external/np/pdr/conc/calculator/default.aspx

calculated by discounting the future stream of payments of debt service due on this debt. The discount rates used for this purpose are the CIRRs published by the OECD.

20. **Borrowing on nonconcessional terms**. For the purposes of the program, this continuous ceiling applies to the contracting or guaranteeing of nonconcessional external debt by the CPS or any other agencies on its behalf.[12] Debt denominated in currencies other than the U.S. dollar shall be converted to the U.S. dollars using program assumptions on bilateral exchange rates. The continuous ceiling applies not only to debt as defined above, but also to commitments contracted or guaranteed for which value has not been received. This ceiling will be adjusted downwards by the amount of programmed disbursements that change into concessional resources.

21. **Excluded** from the non-concessional external debt continuous ceiling are: (i) debts classified as international reserve liabilities of the Central Bank, (ii) debts to restructure, refinance, or prepay existing debts, (iii) use of Fund resources (iv) short-term import financing (with a maturity of less than one year), and (v) central bank instruments placed in the domestic market held by nonresidents.

22. **Stock of external debt arrears**. For the purpose of the program continuous ceiling, external debt service arrears are defined as overdue debt service arising in respect of obligations incurred directly or guaranteed by the public sector, except on debt subject to rescheduling or restructuring, as indicated by the respective creditors. The CPS will accumulate no external debt arrears during the program period.

V. Energy Sector

23. **Arrears of ENEE** are defined as overdue payments (capital and interest) of ENEE to private and public entities. During the program period, no new arrears to the private sector will be accumulated, excluding technical delays stemming from the payment process. Technical delays are defined as the maximum period allowed for the payment of suppliers' and/or contractors' invoices to ENEE without incurring arrears, in line with the law on public contracts (Decree 74-2001). This period extends up to 45 days, starting from the submission of appropriate documents for payment.

VI. Monitoring and Reporting Requirements

24. **The information required to monitor the compliance with quantitative and structural benchmarks** specified in the MEFP will be supplied to the Fund at least monthly

[12] This includes short-term external debt (with an original maturity of up to and including one year) and non-concessional medium- and long-term debt with original maturities of more than one year.

(electronically, to the extent possible) and within 45 days of the end of the previous month (unless otherwise noted) according to the following sources:

25. **The ceilings on the deficit of the central government and of the CPS** will be monitored below-the-line on the basis of the monthly reports *Financiamiento de la Administración Central* and *Financiamiento del Sector Público Combinado*, respectively, prepared by the central bank, which contain:

- **Net external financing** of the central government and the NFPS, respectively, with detailed information on disbursements, amortizations, exceptional financing, zero coupon bonds, and accumulation of arrears. This information will be prepared by the central bank and reconciled with the Ministry of Finance.

- **Net domestic financing** of the central government and the NFPS, respectively, with detailed information on: (1) net domestic financing from the central bank and the rest of the financial system to the central government and the NFPS, as contained in the *Panorama Financiero* monthly report; (2) net placement of bonds (including stabilization bonds) by the central government and the NFPS outside the financial system, as reported by the central bank with data from the Public Credit Directorate of the Ministry of Finance; (3) change in foreign currency deposits held abroad by the central government and the NFPS; and (4) change in the outstanding stock of suppliers' credit and floating debt of the central government, as reported by the Treasury, and the rest of the NFPS as reported by the central bank. To monitor the net domestic financing to the CPS, the central bank will provide the Fund with detailed data on a cash basis on the operating revenue and expenditure of the central bank.

26. **The ceilings on the wage bill of the central government** will be monitored monthly on the basis of the Ministry of Finance report: *Información institucional por objeto de gasto - servicios personales y aportes patronales.*

27. To complement the monitoring of fiscal performance, a breakdown of tax revenue by type of tax will also be provided monthly.

28. **Social investment (Table B)** will be monitored quarterly on the basis of financial reports provided by the Ministry of Finance.

29. **The floor on NIR and the ceiling on NDA of the central bank** will be monitored on the basis of information produced by the central bank, in accordance with the new presentation of the MFSM. This information will be provided within two weeks of the end of the previous month.

30. **The ceilings on the contracting of nonconcessional external debt and on the nonaccumulation of external payments arrears** will be monitored with information

provided by the Ministry of Finance. The accounting of non-reschedulable external debt-service arrears by creditor (if any), with detailed explanations, will be transmitted by the Ministry of Finance on a monthly basis within four weeks of the end of each month. Moreover, a loan-by loan accounting of all new loans contracted or guaranteed by the public sector, including detailed information on the amounts, currencies, and terms and conditions, as well as relevant supporting materials, will be transmitted by the central bank on a quarterly basis within four weeks of the end of each quarter.

31. **Implementation of structural measures in the program** will be monitored monthly based on information provided by the central bank, the Ministry of Finance, and the Banking and Securities Commission.

Table A: Data to be Reported to the IMF

Item	Periodicity
I. Fiscal Data	
Net external financing (detailed information on disbursements, amortizations, exceptional financing, zero coupon bond, and accumulation of arrears).	Monthly, within 45 days of the end of each month.
Net domestic financing of the central government and the NFPS detailed information on: (1) net domestic financing from the central bank and the rest of the financial system to the central government and the NFPS, (2) net placement of bonds by the central government and the NFPS outside the financial system, (3) change in foreign currency deposits held abroad by the central government and the NFPS; and (4) change in the outstanding stock of suppliers' credit and floating debt of the central government, as reported by the Treasury, and the rest of the NFPS as reported by the central bank.	Monthly, within 45 days of the end of each month.
Monitoring of net domestic financing to the CPS will require that the central bank provide the Fund with detailed data on a cash basis on the operating revenue and expenditure of the central bank.	Monthly, within 45 days of the end of each month.
Wage bill of the central government.	Monthly, within 45 days of the end of each month.
Breakdown of tax revenue by type of tax.	Monthly, within 45 days of the end of each month.
Social investment	Quarterly, within three weeks of the end of each quarter.
Detailed information on: Revenues and expenditures of the central government. Revenues and expenditures of the NFPS, including the operating balance of public enterprises.	 Monthly, within 45 days of the end of each month. Quarterly, within 45 days of the end of each quarter.

II. Monetary Data	
Detailed information on the Central Bank balance sheet, including Net International Reserves and Net Domestic Assets.	Monthly, within 2 weeks of the end of each month.
Detailed information on domestic liabilities of the central bank payable in foreign currency, including change in foreign currency deposits of public enterprises in the central bank.	Monthly, within 2 weeks of the end of each month.
III. External Debt	
Loan-by loan accounting of all new loans contracted or guaranteed by the public sector, including detailed information on the amounts, currencies, and terms and conditions, as well as relevant supporting materials.	Quarterly basis within four weeks of the end of each quarter.
The accounting of arrears on external debt-service by creditor (if any), with detailed explanations.	Monthly, within four weeks of the end of each month.
IV. Additional Data	
Balance of Payments statistics.	Quarterly, within 3 months of the end of each quarter.

Table B. Social Investment Expenditure

Description
Bono Diez Mil
Bono Diez Mil
Other social investment expenditures
Honduran Social Investment Fund (FHIS)
Community Education Program (PROHECO)
Family allowances program (PRAF)
Healthy schools program (Free school meals)
Free tuition
Social work scholarships
Transportation education bond
Social aid to persons
Patronatos Aldeas y Caseríos
Academic excellence scholarships
Various scholarships
Other scholarships and programs

INTERNATIONAL MONETARY FUND
EXTERNAL RELATIONS DEPARTMENT

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International Monetary Fund
Washington, D.C. 20431 USA

IMF Executive Board Approves US$202 Million in Financial Support for Honduras

The Executive Board of the International Monetary Fund (IMF) approved financing for an 18-month program for Honduras in the amount of SDR 129.5 million (about US$201.8 million) to support the country's efforts to restore macroeconomic stability and advance economic reforms consistent with Honduras's poverty reduction and growth objectives.

The reform program is supported by a blend of resources from two IMF credit lines, the Stand-By Arrangement (SBA) and the Standby Credit Facility (SCF). The SCF was recently created as part of a comprehensive reform of the IMF's facilities for low-income countries and provides financing on concessional terms.

An initial disbursement of SDR 35.61 million will become available immediately after the Board approval, but the Honduran authorities plan to treat the credit as precautionary.

Following the Executive Board's discussion of Honduras, Mr. John Lipsky, First Deputy Managing Director and Acting Chair, made the following statement:

"The Honduran economy is recovering gradually from the effects of the global slowdown and the domestic political crisis of 2009. The authorities' economic program supported by the Fund seeks to strengthen public finances, protect the external position, and rebuild investor confidence, catalyzing donor support and financing from international institutions.

"The fiscal consolidation strategy aims to stabilize the public debt-to-GDP ratio below 30 percent, and create space for increasing anti-poverty spending and public investment. The authorities are strongly committed to implement the tax reform approved in April 2010 and strengthen tax administration. It will also be important to exercise strict control over current expenditure, improve the composition of public spending, and strengthen the financial position of public enterprises and pension funds.

"Monetary policy will remain geared toward safeguarding the inflation and external objectives of the program. The central bank intends to upgrade the monetary policy framework and to strengthen its implementation capacity.

"Honduras's financial system has weathered the global financial crisis and the ensuing downturn in activity relatively well. Efforts will nevertheless continue to enhance the system's resilience by improving the regulatory framework and supervisory practices, and strengthening the financial safety net," Mr. Lipsky said.

Recent Economic Developments

Honduras is gradually recovering from the impact of the global slowdown and political turmoil. In 2009, real GDP declined by 2 percent, the overall public sector deficit widened from 1.7 percent of GDP in 2008 to 4.6 percent, and gross international reserves declined by about US$360 million. The fiscal deterioration was due to a strong increase in current expenditure of the central government, while the financial position of public sector enterprises and pension funds also worsened. The fiscal deficit was financed by costly short-term bonds, central bank credit, and domestic arrears. In 2010, real GDP is projected to increase by 2.4 percent, reflecting the rebound in economic activity of key trading partners and the recovery in domestic confidence. Inflation is projected to increase moderately, to below 6 percent, mostly due to rising international prices and domestic utility price adjustments.

Program Summary

The government's economic program for 2010–11 seeks to restore macroeconomic stability, strengthen public finances, and protect the external position. The support from the Fund is intended to provide liquidity buffers in the context of still fragile global recovery, as well as help establish a framework for key reforms and mobilize donor assistance. The program contemplates the following policies and structural reforms, mostly in the public sector.

Fiscal policy will aim at deficit reduction and improving the composition of public expenditure. The tax reform approved in April 2010 and improvements in tax administration, combined with strict control on current spending, will enable an increase in anti-poverty programs (including *bono 10 mil*) and public investment. Fiscal reforms under the program will seek to restore financial viability of public sector enterprises and strengthen the financial position of public pension funds.

Monetary and financial policies will aim at keeping inflation low, strengthening international reserves and containing external current account deficits. Key financial sector reforms include upgrading the supervisory and regulatory frameworks, strengthening the financial safety net, and improving access to financial services.

The macroeconomic framework targets real GDP growth of 3.5–4.0 percent during 2011–12. Inflation would be kept at below 6 percent. The overall deficit of the public sector would be reduced to 3.7 percent of GDP in 2010 and 3.1 percent of GDP in 2011 and public debt would stabilize below 30 percent of GDP. Imports coverage of international reserves is projected to increase, and the external current account deficit is expected to remain at about 7 percent of GDP.

Honduras joined the IMF as a member on December 27, 1945. Its quota is SDR 129.5 million (about US$201.8 million).

Statement by Ramón Guzmán, Executive Director for Honduras and Johny Gramajo-Marroquin, Senior Advisor October 1, 2010

We would like to thank the staff for a candid and well-balanced report. Our authorities broadly agree with the staff's appraisal and recommendations.

The authorities would also like to thank management and staff for a productive policy dialogue throughout the program negotiations, which was crucial not only to reach agreement on main policy measures, but also to foster Honduras' re-engagement with the Fund. We are also grateful to the Executive Directors for their support during this process.

To bolster their economic program, the authorities request the approval of a combined SBA/SCF arrangement totaling SDR 129.5 million *(each equivalent to 50 percent of quota)*, covering 18 months. Their intention is to treat the arrangement as precautionary.

The new arrangement will provide crucial support to the authorities' commitment to sound macroeconomic policies and will help anchor confidence of depositors, investors (domestic and foreign) and creditors. It will also provide an important liquidity buffer to support the economy in case negative shocks occur. Finally, it will also open the door for additional support from other multilateral institutions.

Recent Developments

During 2009, the Honduran economy was severely affected by the global crisis, as well as domestic political turmoil. Real GDP declined by 1.9 percent and unemployment rose significantly. In addition, the fiscal position deteriorated markedly and international reserves declined by about US$360 million, to the lowest level since 2006. Although external conditions have begun to improve in 2010, economic growth is still weak and the recovery faces risks.

To establish conditions for robust and sustainable growth in the medium term, the Government has started to implement key reforms, and has developed an economic program for 2010–11 aimed at reducing macroeconomic imbalances and strengthening the finances of the public sector. They expect that strong implementation of this program will help bolster investor confidence and build up further support of the international community.

Macroeconomic Policies for 2010–11

The economic program envisages a gradual recovery, with real GDP growth in the range of 2.5-3.5 percent during 2010–11. Inflation is expected to rise, largely reflecting higher prices of imported goods (mostly oil), but authorities will conduct monetary policy in order to maintain inflation below 6 percent throughout the program. The deficit in the external current account is projected to rise to 6–7 percent of GDP (from 3.2 percent in 2009) owing to higher prices of imported commodities (mostly oil) and strong demand for public and private investment. A strong pickup in FDI and in official external financing throughout the program period is expected to be sufficient to cover the current account deficit and, as a result, gross international reserves are expected to increase gradually.

Fiscal Policy

Our authorities' fiscal policy aims at improving the quality of public expenditure, reducing the overall deficit of the public sector to 2 percent in the medium term, and keeping the debt-to-GDP ratio below 30 percent. In line with these objectives, the overall deficit of the consolidated public sector for end-2010 will be lowered to 3.7 percent of GDP (4.6 percent in 2009), provided a higher tax revenue and expenditure restraint. The 2011 budget, submitted to Congress in mid-September 2010, targets an overall fiscal deficit of the central government of 3.4 percent of GDP, in line with the overall deficit of the consolidated public sector of 3.1 percent of GDP. The budget will accommodate higher spending in priority areas, mostly poverty reduction and public investment. To achieve this objective, the authorities plan to fully implement tax measures approved last April, and exercise strict control of public sector current spending. In addition, they plan to adopt the following measures during 2010–11:

Improve tax administration: further strengthening of the institutional framework for tax collections, including submitting to Congress legal reforms to enhance tax administration and introducing institutional upgrading of the tax collection agency (DEI).

Budget financing. Our authorities' strategy includes a lower reliance on domestic financing. In line with this objective, they have requested budget support from the World Bank and the IDB totaling US$220 million for 2010–11. In addition, the Central American Bank for Economic Integration (CABEI) recently approved a non-concessional loan of US$280 million, which remains within the limit on the contracting of non-concessional debt of US$350 million. The authorities maintain constant communication with those multilaterals in order to avoid delays in the disbursements programmed for 2010.

Control of the wage bill. Policies in this area are aimed at reining growth of the wage bill of the central government. In that sense, the authorities approved a plan in June designed to verify the number of public employees in the education and health sectors, suspend hiring of new workers, and eliminate all redundant or irregular positions. They also took actions to guarantee that the increase in the wage bill for 2010 would only reflect contractual obligations in the education sector; nominal wages of government employees in other sectors have remained broadly unchanged. Authorities are resisting pressures from unions to increase the salaries of the public sector employees for 2011.

Control of expenditure in goods and services. For 2011, authorities will maintain the ceiling established in the 2010 budget for central government expenditure in goods and services. In addition, they will start using reverse auctions and online purchases to reduce costs and increase availability of indispensable goods in the public sector.

Improved public investment management. Our authorities will develop, by March 2011, a plan to strengthen management of investment projects at the institutional and execution levels through simplification of the mechanisms and processes for the procurement, implementation, and monitoring of public investment.

Elimination of energy subsidies. In June, energy subsidies were eliminated, except for consumers with electricity consumption below 150 KWh.

Strengthening of the operating balance of key public enterprises. Tariffs in the electricity, telephone, and water companies have been raised with the view of making them gradually compatible with projected costs. Comprehensive plans for restoring financial and operational viability of key public sector enterprises will be prepared during 2011.

Strengthening the financial position of public pension funds. The pension funds together with the Banking and Securities Commission have developed an action plan to reform the law in order to reduce the actuarial deficit of the main public pension funds by redefining benefits and contributions. They will present a draft law based on this action plan to Congress by December 2010.

Audit of government arrears to private sector suppliers. By January 2011, with IDB's assistance, a contract will be signed with a reputable international audit company to undertake an audit of accumulated domestic arrears to the private sector. Based on this audit, authorities will develop a plan to clear only arrears generated from contracts that adhered to existing regulations and procedures.

Monetary and Exchange Rate Policies

Keeping inflation under control, while maintaining an adequate level of international reserves, remains the main goal on monetary policy. Authorities will monitor monetary conditions throughout the program period and will stand ready to change monetary policy stance by adjusting policy interest rate as necessary to maintain inflation between 5.5–6 percent (+/- one percentage point) in 2010–11 and to protect the external position.

It is worth to mention that the authorities have been placing central bank instruments to sterilize excess liquidity and have stopped lending to the financial public sector since last January. They have been analyzing ways to improve the exchange regime administration. Moreover, based on past technical assistance missions from the Fund, the authorities plan to reform the operational framework for monetary policy and set up the infrastructure to enhance functioning of the exchange market.

To boost the Central Bank's ability to pursue effective monetary policy, the authorities will develop a plan for its capitalization and institutional strengthening by December 2011. To this purpose, they will request technical assistance from the IMF.

Financial Sector Policies

The financial system has weathered the crisis well, and remains liquid and solvent. Building on the progress achieved in recent years, our authorities are fully committed to further improve the regulatory framework and supervisory practices in the financial system and to strengthen the financial safety net, as recommended in the update of the Financial Sector Assessment Program (FSAP). The efforts include improvements in risk-based supervision, enforcing capital and provisions requirements effectively, and enhancing liquidity monitoring. To achieve these objectives, the authorities are executing an ambitious reform program to comply with regulations on credit and liquidity risk management according to international standards, improve banking supervision, and consolidate the financial safety net.

Structural Reform Agenda

The priorities in this area are consistent with our authorities' long-term growth strategy and will be implemented in the next four years. In that sense, envisaged reforms include adopting a multi-annual budgetary framework, strengthening debt management capacity, and increasing efficiency of public enterprises. In order to improve the investment climate, Congress is considering a draft law on investment protection and promotion. To enhance transactions safety, and to facilitate commercial and administrative operations, the authorities will make the use of electronic signatures legal.

Finally, we believe that the envisaged policies are adequate to meet the objectives of the authorities' economic and social program and we are certain that authorities stand ready to take additional measures *(in consultation with the Fund)* that should be necessary for that purpose. In this vein, our authorities share the staff's assessment related to the program's risks and, as a prudential measure, have been working on a contingency plan to face a scenario in which some of the risks materialize. We also think that a new program will be instrumental to preserve Honduras' macroeconomic stability and to help support economic recovery.