



# HONDURAS

November 2016

## 2016 ARTICLE IV CONSULTATION, THIRD AND FOURTH REVIEWS UNDER THE STAND-BY ARRANGEMENT AND THE ARRANGEMENT UNDER THE STANDBY CREDIT FACILITY—PRESS RELEASE AND STAFF REPORT

In the context of the 2016 Article IV Consultation, Third and Fourth Reviews under the Stand-By Arrangement and the Arrangement under the Standby Credit Facility, the following documents have been released and are included in this package:

- A **Press Release** issued at the completion of the Third and Fourth Reviews.
- A **Press Release** including a statement by the Chair of the Executive Board.
- The **Staff Report** prepared by a staff team of the IMF for the Executive Board's consideration on October 26, 2016, following discussions that ended on June 13, 2016, with the officials of Honduras on economic developments and policies.
- An **Informational Annex** prepared by the IMF staff.
- A **Statement by the Executive Director** for Honduras.

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

Selected Issues and Analytical Notes

Letter of Intent sent to the IMF by the authorities of Honduras\*

Memorandum of Economic and Financial Policies by the authorities of Honduras\*

Technical Memorandum of Understanding\*

\*Also included in Staff Report

The IMF's transparency policy allows for the deletion of market-sensitive information and premature disclosure of the authorities' policy intentions in published staff reports and other documents.

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INTERNATIONAL MONETARY FUND



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November 2, 2016

International Monetary Fund  
Washington, D.C. 20431 USA

### **IMF Completes Third and Fourth Reviews Under SBA and SCF with Honduras**

On October 26, 2016, the Executive Board of the International Monetary Fund (IMF) completed the combined third and fourth reviews of Honduras' performance under an economic program supported by a three-year Stand-By Arrangement (SBA) and a two-year arrangement under the Stand-By Credit Facility (SCF). This blended program was approved on December 3, 2014 in the amount of about US\$188.6 million (SDR 129.5 million), the equivalent of 100 percent of Honduras' quota in the IMF at that time (see [Press Release No. 14/545](#)).

The Executive Board also approved a rephrasing of the SBA to take into account the increase in Honduras' First Credit Tranche as a result of its quota increase (from SDR 129.5 million to SDR249.8 million) under the [Fourteenth General Review of Quotas](#). The completion of the reviews enables the authorities to access resources in the total amount of about US\$168.20 million (SDR 121.875 million). The authorities have expressed their intention to continue to treat the arrangements as precautionary.

The Board granted a waiver of the end-December 2015 performance criterion on the ceiling of the stock of net domestic assets (NDA) as the authorities have corrected the deviation by observing the end-June 2016 target. In addition, on the basis of corrective policy measures taken, the Board also granted a waiver on the non-observance of the end-June performance criterion on net lending by the public pension funds and on the arrears from state electricity company (ENEE).

Following the Executive Board's discussion of the reviews, Mr. Mitsuhiro Furusawa, Acting Chair and Deputy Managing Director, said:

“Honduras's economic reform program supported by the Fund's blended Stand-By Arrangement and Standby Credit Facility has made considerable progress in restoring macroeconomic stability, reducing the fiscal deficit, and tackling some structural issues. At

the same time, the external current account deficit has narrowed, private credit is expanding at a sustainable pace, and net international reserves have risen. Together, these favorable developments have contributed to a systematic improvement in Honduras's international sovereign debt credit ratings.

“The authorities have signaled their intention to institutionalize hard-won fiscal discipline. The adoption in April 2016 of the fiscal responsibility law, which over the medium term would cap public spending and change its composition in favor of investment, is a significant step. The steadfast implementation of this law and other planned measures to increase public sector efficiency are critical to ensure that public debt ratios decrease over the medium term. The consolidation of the reforms in the electricity sector are crucial to further strengthen public finances and foster competition in the electricity market.

“Reforms to the monetary policy framework and exchange rate regime are needed to give the central bank the necessary tools to effectively respond to external shocks. To support these reforms and the ongoing process of de-dollarization and financial market development, measures to strengthen the central bank need to be fast tracked. At the same time, financial stability should be reinforced by enhancing the bank resolution framework and strengthening prudential regulations on household debt.

“Honduras's poverty level and informality remain high, while potential growth and employment remain relatively low. While social spending has been protected, structural reforms to boost growth and employment should focus on reducing crime and violence; closing infrastructure gaps, especially in energy; and increasing financial market access for poor households and the efficiency of public spending.”



INTERNATIONAL MONETARY FUND



Press Release No. 16/518  
FOR IMMEDIATE RELEASE  
November 22, 2016

International Monetary Fund  
700 19<sup>th</sup> Street, NW  
Washington, D. C. 20431 USA

## **IMF Completes 2016 Article IV Consultation with Honduras**

On October 26, 2016, the Executive Board of the International Monetary Fund (IMF) concluded the Article IV Consultation with Honduras<sup>1</sup>.

In 2015, real output grew at 3.6 percent, slightly higher than projected. From the demand side, growth was supported by the recovery in private consumption—which responded positively to a reduction in gasoline prices and strong remittances inflows—and a boost in investment. On the supply side, the recovery in manufacturing and agriculture supported greater activity. At the same time, headline inflation decelerated to 2.4 percent from 5.8 percent in the previous year, well below the inflation target of 4.5 percent—owing to strong demand management policies and lower fuel prices. The fiscal position also improved, as the primary balance moved into surplus, implying an impressive fiscal adjustment of 6.5 percentage points of GDP relative to 2013. This fiscal adjustment, along with lower oil imports, helped to narrow the external current account deficit to 6.3 percent of GDP in 2015. As a result, net international reserves increased by US\$307 million, supported by private capital inflows. Together, these favorable developments have contributed to a systematic improvement in Honduras' international sovereign debt credit ratings.

The outlook for 2016 remains favorable. Real GDP through 2016 Q2 grew by 4.1 percent (y/y) broadly consistent with staff's projection of 3.6 percent for the year. This projected growth performance is supported by scaled up public infrastructure investment and a supportive monetary policy stance. Inflation through August 2016 was 2.5 percent (y/y), and is projected to remain low. In line with the existing program and the Fiscal Responsibility Law (FRL), the nonfinancial public sector deficit is expected to widen to 1.5 percent of GDP from 1.0 percent to accommodate planned investment in infrastructure. At the same time, consistent with expanding real sector activity and greater private sector confidence, credit to the private sector is expected to grow by 10 percent in nominal terms, in line with a sustainable pace of financial deepening.

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<sup>1</sup> Under Article IV of the IMF's Articles of Agreement, the IMF holds bilateral discussions with members, usually every year. A staff team visits the country, collects economic and financial information, and discusses with officials the country's economic developments and policies. On return to headquarters, the staff prepares a report, which forms the basis for discussion by the Executive Board.

Program performance remains satisfactory. The authorities have advanced important reforms to help create the conditions for sustained medium-term economic performance and poverty reduction. These reforms include, most notably, the adoption of caps on expenditure and the prioritizing of public investment under the FRL, reforms to tax administration, a social protection framework, and an overhaul of the electricity sector. In addition, the authorities have embarked on a comprehensive reform of the framework for bank resolution, comprising extensive legal amendments and a significant strengthening of the authorities' capacity for dealing with financial sector distress.

### **Executive Board Assessment<sup>2</sup>**

Executive Directors commended the authorities' improved macroeconomic policy mix under their Fund-supported program, which has stabilized the economy and has resulted in higher economic growth, low inflation, stronger fiscal and external positions, and progress in implementing social policies. Noting that important economic and social challenges remain ahead, Directors encouraged the authorities to press forward with their prudent policies and reform momentum to achieve stronger and more inclusive growth while safeguarding macroeconomic and financial stability.

Directors welcomed the authorities' fiscal consolidation efforts and the recent adoption of the fiscal responsibility law (FRL). They encouraged the authorities to work assiduously to quickly operationalize the law's provisions and clarify its implications for extra-budgetary programs. While also welcoming the authorities' decision not to renew ineffective tax exemptions once they have expired, Directors urged a more proactive approach to rationalizing tax exemptions in general. On the spending side, they supported the authorities' plan to adopt a results-based approach to spending programs in health and education, which is an initial step to increase spending efficiency. Directors called for additional reforms in the electricity sector to strengthen public finances and foster competition in the electricity market.

Directors agreed that the supportive monetary policy stance remains appropriate. Given a more neutral policy rate, the closing output gap, and the planned recovery of the real electricity costs, they urged the Central Bank of Honduras (BCH) to be cautious against further easing in the near term. Directors called on the BCH to remain vigilant and be ready to tighten policy if inflation or credit growth were to accelerate and signs of overheating were to emerge.

Directors welcomed the authorities' decision to move toward a more flexible exchange rate regime and an inflation targeting framework. To support these decisions, they encouraged the authorities to press ahead with plans to develop domestic and foreign exchange markets, reform

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<sup>2</sup> At the conclusion of the discussion, the Managing Director, as Chairman of the Board, summarizes the views of Executive Directors, and this summary is transmitted to the country's authorities. An explanation of any qualifiers used in summings up can be found here: <http://www.imf.org/external/np/sec/misc/qualifiers.htm>.

the central bank law to give the BCH a clear mandate to achieve price stability, and speed up the de-dollarization process.

Directors recommended focusing on key medium-term reform priorities to achieve higher growth and employment now that the economy has stabilized. They encouraged the authorities to press ahead with efforts to improve the rule of law, competitiveness, and the business climate. Directors welcomed the recently launched new medium-term economic development strategy *Honduras 2020*.

## Honduras: Selected Economic Indicators

	2011	2012	2013	2014	Prel. 2015	Proj. 2016	Proj. 2017
(Annual percentage change, unless otherwise indicated)							
<b>National income and prices</b>							
GDP at constant prices	3.8	4.1	2.8	3.1	3.6	3.6	3.7
GDP deflator	7.8	3.6	1.4	5.5	6.3	3.0	3.1
Consumer prices (eop)	5.6	5.4	4.9	5.8	2.4	4.0	4.5
<b>Exchange rate (eop, depreciation -)</b>							
Lempiras per U.S. dollar 1/	19.1	20.0	20.7	21.6	22.4	22.9	...
Real effective rate 2/	1.8	-1.7	0.4	3.6	1.6	-0.7	...
<b>Money and credit</b>							
Private sector credit	9.6	16.9	11.2	10.7	10.4	10.8	11.1
Broad money	12.7	6.6	8.4	13.2	8.7	9.1	9.4
Lending rate (eop, in percent) 3/	14.2	16.7	16.9	15.9	14.0	12.3	...
Deposit rate (eop, in percent) 3/	7.4	11.4	11.0	10.4	8.8	7.6	...
<b>Nonfinancial public sector</b>							
Primary balance	-3.4	-4	-7.0	-3.5	0.1	-0.2	-0.1
Overall balance	-3.2	-4.4	-7.5	-3.9	-1.0	-1.2	-1.5
<b>Nonfinancial Public Sector gross debt</b>							
<i>Of which:</i> External debt	25.5	30.2	40.2	40.9	40.9	41.9	43.2
Public sector external debt service (in percent of nonmaquila exports)	18.3	20.2	28.5	29.3	29.5	30.7	32.3
	4.4	3.0	3.6	4.4	8.6	8.3	8.6
<b>Savings and investment</b>							
Gross fixed capital formation	24.4	24.4	21.8	22.1	25.2	26.4	26.8
Gross national savings	16.5	15.8	12.2	14.6	18.8	20.5	21.1
<b>External sector</b>							
Gross international reserves (millions of dollars)	3,043	2,778	3,255	3,698	3,992	4,385	4,648
GIR (In months of imports) 4/	3.6	3.3	3.8	4.3	4.5	4.7	4.7
Change in net international reserves (increase -)	50	367	-546	-264	-307	-222	-245
External current account balance	-8.0	-8.6	-9.6	-7.4	-6.3	-5.9	-5.7
Exports, f.o.b. (annual percentage change)	27.3	4.8	-6.6	3.4	-0.4	2.0	6.1
Imports, f.o.b. (annual percentage change)	24.9	2.2	-3.7	1.1	0.2	2.3	5.3

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

1/ 2016 data as of August 29.

2/ 2016 data as of July.

3/ 2016 data as of June.

4/ Refers to the following year's imports of nonmaquila goods and nonfactor services.



# HONDURAS

## STAFF REPORT FOR THE 2016 ARTICLE IV CONSULTATION, THIRD AND FOURTH REVIEWS UNDER THE STAND-BY ARRANGEMENT AND THE ARRANGEMENT UNDER THE STANDBY CREDIT FACILITY

October 13, 2016

### KEY ISSUES

**Context:** Since the last Article IV consultation in 2014, the Honduran economy has stabilized and macroeconomic conditions have improved considerably. Looking ahead, the Honduran economy is expected to grow just below potential, at about 3.6 percent in 2016, before gradually converging to potential (3.8 percent) over the medium term. Inflation is projected to rise somewhat, but remain in line with the BCH inflation target of 4.5 percent. The external position has strengthened and prudent fiscal policy is being institutionalized with the recent enactment of the fiscal responsibility law (FRL). The banking system appears sound, and private credit growth is expanding at a sustainable pace. On the political front, the next Presidential elections are scheduled for November 2017.

**Risks are tilted to the downside.** A sharper-than-expected slowdown in global growth could significantly reduce growth, triggering a reversal in capital inflows, a reduction in international reserves and/or a depreciation of the currency thus increasing credit risk from unhedged FX borrowing. Additional risks come from the potential withdrawal of correspondent banking relationships, disrupting international financial flows, and failure to address deep-rooted problems affecting competitiveness.

**Program issues:** Program performance remains satisfactory. The authorities have met most performance criteria and all of the indicative targets for end-December 2015 and end-June 2016. Staff recommends completing the third and fourth reviews under the SCF/SBA arrangements. Staff supports granting a waiver on the PC on the NDA ceiling for end-December 2015, on the grounds that the deviation was corrected by end-June 2016, and also supports the authorities' request for a waiver on the non-observance of the end-June PCs on net lending by the public pension funds and on the arrears from ENEE on the basis of corrective policy measures that are being taken. Honduras's SBA arrangement needs to be rephased to incorporate the increase in Honduras's quota under the Fourteenth General Review of Quotas, and the resulting increase in its first credit tranche.

**Article IV discussions:** With the economy stabilized, the reform momentum should focus on increasing potential growth, lowering unemployment and poverty, and fighting corruption. To support these efforts, the authorities would have to improve the efficiency of public spending, reduce the energy infrastructure deficit, and facilitate financial development. Most recommendations from previous Article IV Consultations have been adopted.



Approved By  
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**and Z. Murgasova**  
**(SPR)**

Discussions took place in Tegucigalpa during June 2-13, 2016. The mission comprised R. Garcia-Saltos (Head), G. Nicholls, M. Dehesa, D. Plotnikov (all WHD), J. Kapsoli (FAD) and D. Cerdeiro (SPR).

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## CONTEXT

**1. Significant macroeconomic challenges have affected Honduras' economy.** The country has been, for decades, afflicted by a combination of volatile growth and weak public finances, and recently by high crime. The peak of this unstable situation occurred in 2013 when the relaxation of fiscal policy led to a rapid increase in public debt and to cash-flow pressures, resulting in the combined public sector (CPS) deficit rising to 7.6 percent of GDP, from 2.8 percent of GDP in 2011. At the same time, a real appreciation of the exchange rate and less favorable terms of trade led to a sizeable increase in the external current account deficit and limited reserve coverage.

**2. In 2014, the authorities adopted an IMF-supported program to achieve macroeconomic stability and improve the conditions for sustainable and inclusive growth.** After 2½ years in office the government is succeeding in improving domestic security, stabilizing the economy, and institutionalizing fiscal discipline with the approval of the Fiscal Responsibility Law (FRL). It is paving the way to combat corruption—for which the country signed an agreement with the Organization of American States (OAS) to establish a support mission against corruption and impunity. In April 2016, the Supreme Court cleared the legal hurdles to presidential reelection in the upcoming general elections in November 2017.

**3. Since the last Art. IV consultation in 2014, near-term macroeconomic conditions have improved considerably.** Coupled with better performance on growth and inflation, the reduction in the fiscal deficit by 6½ percentage points of GDP in the two years ending in 2015 improved fiscal sustainability and thus confidence—as indicated by the systematic improvement of international sovereign debt credit ratings. These elements have also bolstered the demand for domestic assets thus contributing to rebuild private sector balance sheets, lowered the cost of capital for domestic investors, and strengthened international reserves.

**4. The key priorities for the medium-term are to raise potential growth and reduce unemployment, poverty and crime.** To support these efforts, strategies would be needed to improve the efficiency of public spending, upgrade the energy infrastructure, and strengthen financial development.

## RECENT DEVELOPMENTS

**5. Economic performance in 2015 was better than expected.** Real output grew at 3.6 percent, slightly more than projected. From the demand side, growth was supported by the recovery in private consumption—which responded positively to a reduction in gasoline prices and strong remittances inflows—and a boost in investment.<sup>1</sup> Growth of exports of goods and services accelerated on the back of stronger U.S. demand. On the supply side, recovery in manufacturing—mostly textile and food processing—and agriculture—mainly coffee and banana—which benefited

<sup>1</sup> By distinguishing among all possible drivers of oil price movements, staff analysis found that lower oil prices may have raised GDP growth by ½ percent in 2015 (see Selected Issues Paper: Macroeconomic Impact of Oil Prices).

from introduction of plague and weather resistant species, supported growth. Financial intermediation also continued to grow steadily, benefiting from higher revenues from mortgages and consumption credit (Figure 1). Real GDP through 2016Q2, grew by 4.1 percent (y/y), supported by expansions in net exports and private consumption. This growth performance for 2016 thus far is broadly consistent with staff's projection of 3.6 percent growth for the year.

**6. Lower international oil prices have helped to reduce headline inflation, and narrow the external current account deficit.** In 2015, headline inflation decelerated to 2.4 percent from 5.8 percent in the previous year, well below the inflation target of 4.5 percent. Inflation through August 2016, remained temporarily low at 2.5 percent (y/y). This performance reflected lower international oil prices and a still negative output gap.<sup>2</sup> Meanwhile, the external current account deficit narrowed to 6.3 percent of GDP in 2015, because of lower oil imports. As a result, NIR increased by US\$307 million, supported by private capital inflows in excess of program projections. Meanwhile reserves have fallen slightly after meeting program targets last June, but remain adequate at about 4.5 months of imports at over US\$2.6 billion.

**7. The external position is moderately weaker than the level consistent with medium-term fundamentals and desired policies.** The assessment is based on the strength of the real effective exchange rate (REER), and robust non-oil import growth. This partly reflects the effects of terms of trade shifts on the appreciation of the USD relative to the currencies of some trading partners. Going forward, the full pass-through to inflation of some partner's nominal depreciations may partially reverse the recent appreciation, and planned steady fiscal consolidation will help improve competitiveness. The impact of these policies would be enhanced by continued wage moderation and reforms that address weaknesses in the business environment (Box 1).

**8. The fiscal position remains strong.** The public sector posted a deficit of 1 percent of GDP in 2015. The primary balance moved to the surplus side, implying an impressive fiscal adjustment of 6½ percentage points of GDP relative to the pre-program outcome. This result is mainly explained by a reduction of about 5½ percentage points of GDP in spending since 2013, chiefly in the wage bill and in the purchases of goods and services. With this result, the public sector debt reached 41 percent of GDP. During the first semester of 2016, the public sector posted a surplus of 1.5 percent of GDP, ½ percent of GDP higher relative to the same period of 2015. This result is explained by better results of decentralized institutions and local governments.

**Fiscal Consolidation, 2013-2015**

(In percent of GDP)

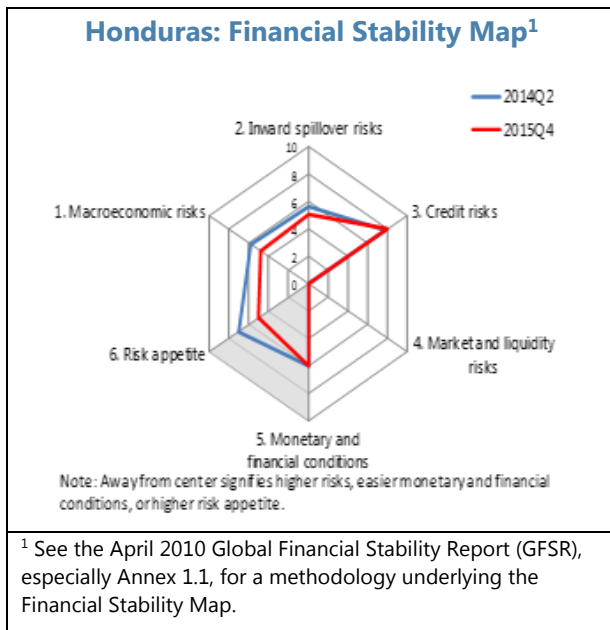
<b>Fiscal consolidation</b>	<b>6.5</b>
Revenue	1.2
<i>Of which: taxes</i>	2.6
Expenditure	5.3
<i>Of which: compensation of employees</i>	2.3

Sources: Honduran authorities and Fund staff estimates.

<sup>2</sup> Staff estimates that a ten percent oil price decrease leads to approximately 0.3 percent decrease in inflation.

**9. Recent financial sector indicators for 2015 suggest that the banking system remains sound.**

Against the backdrop of improved financial conditions and lower risks, balance sheet buffers appear adequate (Table 1). Nonperforming loans to total loans remain relatively low, profitability is high, and the leverage ratio, at 10 percent, is well below crisis threshold rating. Meanwhile, balance sheet risks remain moderate. Specifically, liquidity remains ample, and credit dollarization has fallen by 1½ percentage points to 33.2 percent, mainly because of tighter regulations on foreign exchange exposure. At the same time, credit cycle risk remains low, as private sector credit, currently at about 56 percent of GDP, has been expanding at a sustainable rate, well below the threshold that defines a credit boom.<sup>3</sup> In line with this, household and private sector balance sheets remain sound, although a wider net foreign currency deficit of the private sector makes it more vulnerable to exchange rate risks.



**Box 1. External Balance Assessment**

The Fund’s multilaterally consistent estimates under the External Balance Assessment (EBA) methodology, indicate that the external position is moderately weaker than the level consistent with fundamentals and desirable policies given Honduras’s low income level, young population and strong remittances inflow. The REER regression predicts a REER about 7 percent lower (i.e. more depreciated), considering Honduras terms of trade, trade openness, and other fundamentals. The current account regression finds virtually no misalignment, but this is partly due to a lower than desirable fiscal deficit that accounts for most of the identified policy gap. At the same time, some signs of structural competitiveness problems, such as low human capital as well as other impediments to doing business, including high crime and corruption, and low physical capital and weak infrastructure highlight the need for productivity-enhancing reforms.

**Table. Honduras External Assessment**

	Actual CA/Y	Underlying CA/Y	CA/Y norm	CA/Y gap (Actual or Underlying - Norm)	REER gap
CA model	-6.3		-6.7	0.3	-1.1
REER model					7.1
ES approach		-5.1	-3.1	-2.0	7.0

Source: IMF Staff calculations based on External Balance Assessment methodology.

**10. Private sector credit is expanding amid a decline in lending rates.** The gradual easing of monetary policy that followed the implementation of the SBA/SCF-supported program has

<sup>3</sup> See Dell’Ariccia and others “Policies for Macrofinancial Stability: How to Deal with Credit Booms,” IMF SDN/12/06, for a methodology describing the computation of these thresholds.

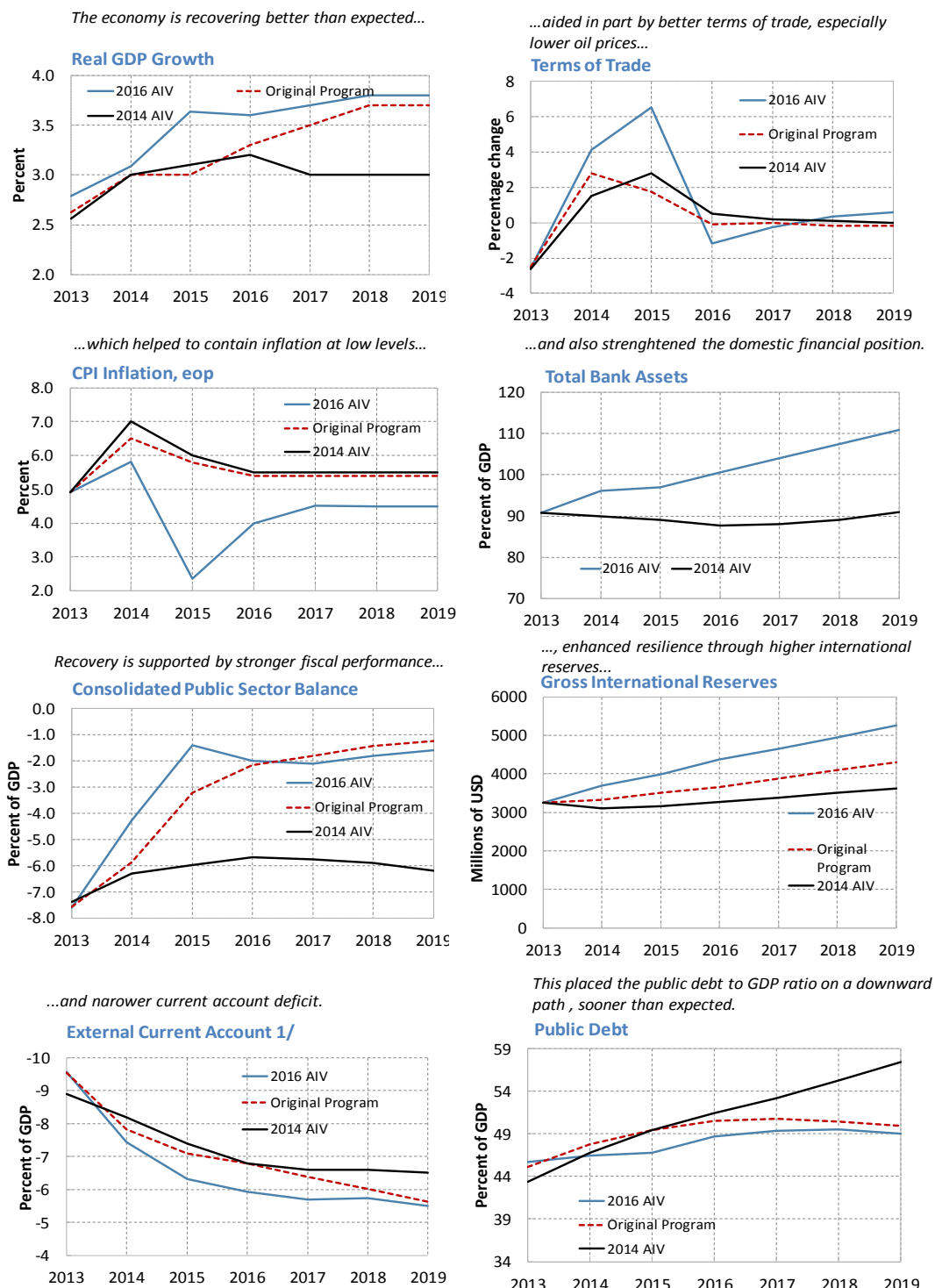
contributed to a steady expansion in total credit growth and more importantly to a gradual pickup in credit denominated in domestic currency as lending rates inched lower with a lag. As inflation moved further below the central bank's inflation target, additional policy rate reductions were made, the last being in June 2016. Lower policy rates have broadly influenced the direction of interbank rates (although the movements have been sluggish) and lending rates by commercial banks. In addition, banking spreads have begun to inch lower with improved conditions and lower risks in the economy. These two factors have created easier financial conditions leading to a reduction in credit dollarization.

**Table 1. Honduras: Financial Stability Heat Map and Credit Cycle**

Honduras	2013Q4	2014Q1	2014Q2	2014Q3	2014Q4	2015Q1	2015Q2	2015Q3	2015Q4	2016Q1	2016Q2
<b>Overall Financial Sector Rating</b>	M	M	M	M	M	M	M	M	M	M	M
<b>Credit cycle</b>	M	L	L	L	L	L	L	L	L	L	L
Change in credit / GDP ratio (pp, annual)	3.4	2.8	2.2	1.6	1.0	0.9	0.9	0.9	0.1	0.5	0.8
Growth of credit / GDP (% , annual)	6.7	5.4	4.1	2.9	1.8	1.7	1.7	1.6	0.2	0.9	1.5
Credit-to-GDP gap (st. dev)	1.3	0.9	0.4	-0.1	-0.8	-1.5	-1.7	-1.8	-2.1	-1.6	-1.3
<b>Balance Sheet Soundness</b>	M	M	M	M	M	M	M	M	M	M	M
<b>Balance Sheet Structural Risk</b>	M	M	M	M	M	M	M	M	M	M	M
Deposit-to-loan ratio	94.8	95.9	95.0	93.8	96.2	98.8	99.0	97.5	97.3	98.2	98.0
FX liabilities % (of total liabilities)	37.2	37.0	36.9	37.1	38.0	36.2	36.5	36.4	36.1	36.0	35.3
FX loans % (of total loans)	32.9	34.2	34.0	33.5	34.0	34.9	33.6	32.9	32.5	32.9	31.4
<b>Balance Sheet Buffers</b>	L	L	L	L	L	L	L	L	L	L	L
<b>Leverage</b>	L	L	L	L	L	L	L	L	L	L	L
Leverage ratio (%)	9.1	8.9	9.4	9.3	9.2	9.0	8.8	8.9	8.7	8.7	8.6
<b>Profitability</b>	L	L	L	L	L	L	L	L	L	L	L
ROA	1.4	1.4	1.4	1.4	1.4	1.3	1.3	1.3	1.4	1.2	1.3
ROE	14.5	13.8	13.4	13.3	13.4	12.5	13.1	13.5	14.6	11.8	13.5
<b>Asset quality</b>	L	M	L	M	L	L	L	L	L	M	M
NPL ratio	3.4	3.6	3.7	4.0	3.3	3.4	3.4	3.7	3.1	3.7	3.6
NPL ratio change (% , annual)	3.2	9.2	-0.7	7.7	-3.6	-7.7	-10.0	-7.4	-6.6	10.9	6.9
<b>Memo items:</b>	<b>2013Q4</b>	<b>2014Q1</b>	<b>2014Q2</b>	<b>2014Q3</b>	<b>2014Q4</b>	<b>2015Q1</b>	<b>2015Q2</b>	<b>2015Q3</b>	<b>2015Q4</b>	<b>2016Q1</b>	<b>2016Q2</b>
Credit-to-GDP (%)	54.3	54.6	54.8	55.0	55.3	55.5	55.7	55.9	55.4	56.0	56.5
Credit-to-GDP gap (%; HP filter)	1.3	1.2	1.1	0.9	0.8	0.6	0.5	0.3	-0.6	-0.3	-0.2
Credit growth (%; annual)	11.2	11.0	10.9	10.8	10.7	10.6	10.6	10.5	10.4	9.8	10.3
CAR (in %)	14.5	14.2	14.9	14.5	14.6	14.5	14.0	14.1	14.0	13.9	13.7

Sources: National Banking and Insurance Commission (CNBS), and IMF staff calculations.

**Figure 1. Honduras: Economic Performance since 2014 Article IV Consultation**



**11. During 2015 and the first nine months of 2016, economic policies responded to falling inflation, financial sector stability priorities and laid the framework for inclusive growth.**

- **On monetary policy**, the BCH commenced in 2015 a gradual easing of the policy stance, reducing the policy rate by 75 basis points (bp) to 6.25 by end-December. In March 2016, it continued the easing path, with a 50 bp reduction to 5.75 percent, and a further 25 bp cut in June, on account of lower headline inflation. At the same time, by August 2016 the BCH depreciated the Lempira by 4 percent on an annual basis against the US dollar, broadly in line with the program. In September 2016, in an attempt to absorb excess domestic liquidity, the Central bank also increased the reserve requirement for banks.
- **On the financial sector**, to maintain public confidence in the banking system the CNBS liquidated Banco Continental and paid out depositors after it was listed by the U.S. Treasury under the Kingpin Act. Overall, the impact on real activity was insignificant. Following this event, the CNBS has also moved swiftly to propose new regulations to reform the bank resolution framework, and strengthen its AML/CFT procedures.
- **On fiscal policy**, in April 2016 the authorities enacted the FRL to serve as an anchor for fiscal policy. The law places a cap on the size of the overall deficit (as a share of GDP) and imposes limits to the increase in current spending. It also introduces ambitious measures to control, quantify and disseminate the size and impacts of the generous amount of tax expenditures.<sup>4</sup> The 2017 budget was prepared in line with program commitments prioritizing social spending and includes an infrastructure stimulus package to boost employment and competitiveness alongside a medium term fiscal-framework.
- **On structural policies**, in March 2016, the government launched a new medium-term economic development strategy – Honduras 2020—to tackle high unemployment and promote more inclusive growth. This program would guide national economic development over the next five years and aims to create 600 thousand new formal jobs (20 percent increase in formal employment) and increase exports by 20 percent.<sup>5</sup> To achieve these objectives, the Honduras 2020 plan will focus on expanding, with the help of FDI, the tourism, textiles, manufacturing of intermediate goods, back office support and agro-industrial sectors.

## OUTLOOK AND RISKS

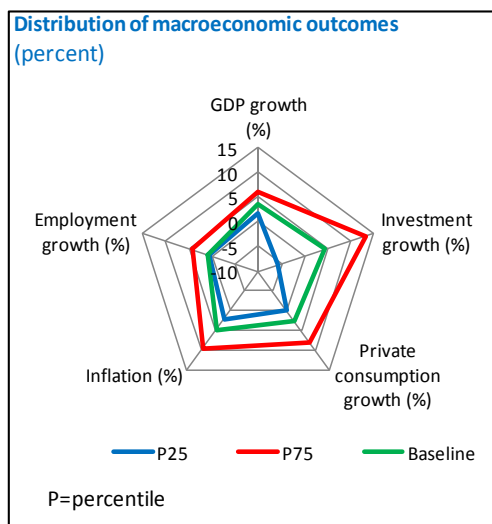
**12. The outlook for growth is broadly favorable, amid low inflation, steady credit growth and an increase in net international reserves.** Real output is projected to grow by 3.6 percent in 2016 (the same as in 2015), supported by scaled up public sector infrastructure investment (which partly offsets a slowdown in the import-intensive private investment associated with the completion of several solar electricity plants in 2015) and a supportive monetary policy stance. After the significant fiscal over performance of 2015, and in line with the existing program and the FRL, the

<sup>4</sup> The amount of tax expenditures in Honduras is estimated at 6½ percent of GDP, one of the largest in the region.

<sup>5</sup> Many of these jobs would be the result of the formalization of workers currently in the informal labor market.



nonfinancial public sector (NFPS) deficit is expected to widen to 1.5 percent of GDP from 1.0 percent, to accommodate planned investment in infrastructure. Consistent with expanding real sector activity and greater private sector confidence, credit to the private sector is expected to grow by 10 percent (or about 2 percentage points of GDP), in line with a sustainable pace of financial deepening, as judged by observed trends in other low-income countries.<sup>6</sup> Meanwhile, as the negative output gap closes, combined with the projected rise in international oil prices and electricity tariffs, inflation risks may intensify. Against this background, following the reduction of 25 bp in the policy rates adopted last June, monetary policy is expected to remain vigilant.



**Table 2. Honduras: Medium-Term Scenario**

	2014	Prel. 2015	Proj.					
			2016	2017	2018	2019	2020	2021
(Annual percent change)								
<b>Output and Inflation</b>								
GDP at constant prices	3.1	3.6	3.6	3.7	3.8	3.8	3.8	3.8
CPI inflation (eop)	5.8	2.4	4.0	4.5	4.5	4.5	4.5	4.5
(In percent of GDP, unless otherwise stated)								
<b>Public sector</b>								
Net Lending (balance)	-3.9	-1.0	-1.2	-1.5	-1.2	-1.0	-1.0	-1.0
Net Lending minus net interest payments (Primary balance)	-3.5	0.1	0.1	-0.1	0.3	0.6	0.6	0.3
Gross debt	40.9	40.9	42.0	43.5	44.3	44.6	44.8	42.7
<b>External Sector</b>								
Current account balance	-7.4	-6.3	-5.9	-5.7	-5.7	-5.5	-5.2	-4.9
GIR (in months of non maquila imports) 1/	4.3	4.5	4.7	4.7	4.8	4.9	5.1	5.3

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

1/ Refers to the following year's imports of nonmaquila goods and non-factor services.

**13. Over the medium-term, growth is expected to converge to its potential (3.8 percent).** The implementation of the FRL and the planned reforms to the monetary policy framework and exchange rate regime could improve business confidence and private sector

<sup>6</sup> This conclusion is based on the use of an excel-based toolkit to assess the likelihood and consistency between real sector and financial sector forecasts based on historical patterns for low income countries. In the simulation for Honduras, the real sector variables are conditioned by real private sector credit growth.

outlook. In addition, the planned expansion in the *maquila* sector—could be a fillip for job creation and higher exports. The continued projected steady growth in the U.S. would continue to serve as an important pull factor in Honduras' growth performance going forward. From the supply side, growth is likely to come from higher capital accumulation and broad-based gains in productivity as a result of the government's high priority infrastructure investment program, and policy reforms to improve economy-wide efficiency, reduce transactions costs and promote regional integration. Inflation is projected to increase slowly as oil prices rise, but remain in line with the central bank's target. Growth in private credit is consistent with a sustainable pace of financial deepening, which could support growth without causing financial sector instability. Over the medium term credit growth is expected to come primarily from the agricultural, industrial and construction sectors as the authorities move to improve the allocation of credit away from foreign currency credits, while simultaneously promoting more credit to the productive sectors.

**14. Risks are predominantly on the downside, because of global uncertainties and potentially volatile domestic conditions** (see RAM in Annex III).

- **External risks.** A sharper-than-expected global growth slowdown could significantly reduce growth, triggering a reversal in capital inflows and, given the crawling-peg regime, a reduction in international reserves and/or a depreciation of the currency thus increasing credit risk from unhedged FX borrowing. The Trans-Pacific Partnership (TPP) could also potentially challenge Honduras competitive position, as significant tariff reductions in textiles would come into effect immediately once the TPP is ratified.<sup>7</sup> Withdrawal of correspondent banking relationships by foreign banks may interrupt international financial flows, including remittances inflows.
- **Domestic risks.** Failure to address problems of structural competitiveness, such as low human capital as well as other impediments to doing business, including high crime and corruption, and low physical capital and weak infrastructure would retard productivity gains and growth. Reform fatigue, capacity constraints, sluggishness in obtaining faster job creation, and the thin parliamentary majority of the current government could pose challenges to implementing key reforms. Failure to maintain the course on fiscal prudence during a potentially charged electoral cycle would undermine policy credibility and affect investor confidence and thus growth. Finally, in the near term, a worsening of the Zika epidemic and adverse weather conditions, consequent on the advance of "El Niño" phenomenon, could impact labor supply and production and through this, short-term growth.

**15. The authorities broadly concurred with the outlook and risks.** The authorities' median growth forecast is 3.6 percent in 2016, with slower-than-expected investment growth being the main risk. The authorities have not yet quantified the impact of the Honduras 2020 strategy on growth over the medium term, but expect to raise it to 4 percent, supported by a recovery in commodity exports, the planned implementation of the large investment projects in energy and

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<sup>7</sup> A number of factors could lessen the impact of TPP on the textile sector, including tariff phase-out periods for some of Honduras key exports products, and the country's geographic proximity to the U.S. market. See *Annex IV* on the potential effects of the TPP on Honduras.

infrastructure and ongoing negotiations for FDI in textiles, manufacturing and tourism. The authorities are, however, concerned about capacity constraints of the government, which could delay reform implementation.

## PROGRAM PERFORMANCE AND PAST FUND ADVICE

**16. The SBA needs to be rephased.** Given the increase in Honduras' quota under the Fourteenth General Review of Quotas, the SBA needs to be rephased to take into account the increase in Honduras' first credit tranche. As a result of its quota increase, Honduras' first credit tranche has increased to SDR62.450 million from SDR32.3750 million. The remaining SDR15.250million (of the original SBA of SDR77.70 million) has been equally distributed over four reviews (Table 16).

**17. Program performance remains satisfactory.** The third review under the SCF will be governed by end-December 2015 PCs, while the third review under the SBA will be governed by end-June 2016 PCs. At the same time, the fourth review under the SCF and the SBA will be governed by end-June 2016 PCs.

**18. The authorities have met most of the performance criteria and all of the indicative targets for end-December 2015.** The over performance of the fiscal targets was sizeable. The authorities also observed the performance criteria of net lending by public pension funds and public debt, along with the indicative fiscal targets. That said, the NDA target was missed by a small margin. Staff also supports the authorities' request for a waiver of the end-December 2015 PC on the ceiling of the stock of NDA as the deviation was corrected by end-June 2016 and does not affect the successful implementation of the program.

**19. The authorities have met most of the end-June 2016 targets.** In particular, the monetary targets on the NDA and NIR were met with comfortable margins. On the fiscal targets, the overall balance for the nonfinancial public sector, the central government and the ENEE were all met with wide margins. This was also the case for the indicative targets. However, the performance criterion on net lending from the public pension funds was missed by a wide margin. The net lending PC was missed due to the implementation of a subsidized lending program for teachers (as part of a wider package of measures announced in June) from the teachers' pension fund that substantially raised loan demand. This program sought to consolidate/refinance obligations of its affiliates with private financial institutions (banks and cooperatives). The low interest rate offered by this program relative to private institutions has been creating a massive demand for these loans which resulted in net lending well above the program's ceiling (L2.4 billion compared to a target of L0.2 billion). The authorities also failed to observe the end-June 2016, performance criterion on the accumulation of new arrears by ENEE. This temporary increase in domestic arrears occurred as ENEE transitioned to a new management team in the first half of 2016. Staff supports the authorities' request for a waiver on the end-June 2016 PC on the ceiling on net lending from public pension funds and also of the end-June PC (ceiling) on accumulation of new arrears by ENEE, as they are implementing strong corrective measures so that these non-observances do not affect the successful implementation of

the program. Additionally, considering revised projections, staff supports the request for modification of the end-December 2016, PCs on NDA and the present value of net external debt contracted.

**20. Two structural benchmarks for end-September 2016 are proposed for modification.**

- The structural benchmark on public sector domestic arrears is proposed to be moved from end-June 2016 to end-December 2016. This was necessary, as the ongoing audit to verify these arrears is behind schedule owing to delays in the operation of the audit firm.
- The structural benchmark on the approval by congress of a law to reform the social security institute (IHSS) is proposed to be moved from end-December 2015 to end-December 2016 as the authorities prioritized the passing of the FRL during the first-half of 2016. The authorities however remain committed to enact an IHSS law consistent with the program fiscal targets.

**Box 2. Response to 2014 Article IV Consultation's Key Recommendations**

**In December 2014, the authorities' program included several components of staff's advice contained in the 2014 Article IV consultation.**

**Apply fiscal consolidation measures—relying more on lower expenditures and a cut in electricity losses.** The authorities have implemented fiscal consolidation measures, which have put the public finances on a firmer footing.

**Adopt a more flexible exchange rate regime over the medium-term.** The central bank is preparing a plan to eliminate the surrender requirements for foreign exchange and allow for greater exchange rate flexibility over the medium-term.

**Modernize the monetary policy framework.** The authorities are preparing a plan to modernize the monetary policy framework that would form the basis for increased exchange rate flexibility.

**Implement measures to reduce currency mismatches by un-hedged borrowers.** The regulatory commission has implemented additional capital requirements for unhedged borrowers in foreign currency.

**Amend the public-private partnerships (PPPs) legislation in line with fund recommendations.** The PPP framework has been revamped to grant the ministry of finance a leading role in the evaluation and approval of PPP projects. For such purpose, a special unit was created in the ministry of finance and currently is providing mandatory assessments on the fiscal risks involved in PPP projects. Sovereign guarantees for third parties operating PPP projects were also repealed.

**Reform the social security institute (IHSS).** The authorities have sent to the congress the IHSS draft law.

## PROGRAM REVIEW

### A. Building Stronger Fiscal Institutions to Reduce Fiscal Dominance

**21. The 2016 fiscal program focuses on institutionalizing the hard-won gains, while creating the fiscal space to finance high-quality infrastructure projects.** Consistent with a higher public investment spending on high priority infrastructure projects, the primary balance of the NFPS is projected to widen by 0.3 percent of GDP. A floor equivalent to 2 percent of GDP has been defined for social spending and an increase in this floor is projected for 2017 as the revenue envelope expands.

**22. The authorities have adopted a FRL to institutionalize the hard-won fiscal consolidation, increase accountability, transparency and stability.** The law sets out a medium-term ceiling for the fiscal deficit (1 percent of GDP) and a transitional path to achieve it. The FRL also seeks to reverse the current bias against public investment in the composition of public spending. During the transition period, 2016–17, and consistent with the authorities' economic program, a deficit ceiling of 1.5 percentage points of GDP has been targeted. This target accommodates an increase in public investment, which is also reflected in the medium-term fiscal projections. The law also includes escape clauses for the cases of economic emergency or natural disasters. A clear convergence path is also included to guide the return of fiscal aggregates to the mandated parameters, if the escape causes are used. On transparency and accountability, the law formalizes the introduction of the medium-term fiscal framework (MTFF) over the medium-term as the main guideline for the evaluation of policy proposals. It also requires a formal assessment of the central bank on the consistency of the MTFF with the monetary and exchange rate policies. In September 2016, the authorities submitted to Congress the 2017 budget in accordance with the FRL.

**23. The FRL should be a catalyst for additional fiscal reforms.** Now that the FRL has become the overarching framework that underpins fiscal policy, the authorities need to address the short and medium-term challenges to its implementation. In the short term, the unity of the budget needs to be restored by limiting the use of trust funds. Trust funds should operate under the budgetary framework and their operations should be properly disclosed, recorded, and audited. Building a track record of implementing such restrictions will be critical to assessing the commitment of the authorities to the FRL, particularly during the upcoming electoral cycle, which customarily in Honduras has been associated with the abandonment of fiscal discipline. Additionally, the authorities need to ensure the consistency of the FRL with initiatives such as the Honduras 2020 plan. In sum, strengthening fiscal institutions is required to support an improved external debt risk rating and keep public debt on a sustainable path over the medium term.

**24. The new tax administration authority should protect the hard-won gains in tax collection.** With the assistance of the IADB, a new tax administration was created in February 2016, (*Servicio de Administración de Rentas, SAR*) and is currently being staffed through a specialized firm. During this transition process, tax collection, particularly for large taxpayers, is being supervised and protected by a new unit in the SAR. Additionally, to strengthen compliance, the SAR has increased

the number of field inspections. It is expected that the SAR will be fully operational by March next year.

**25. The social protection framework law (SPL) should continue to be implemented according to the fiscal program.** So far the implementation of the SPL has been slow, owing to the difficulties in expanding the cash-transfer program “*Vida Mejor*”. On expanding the health coverage, however, the main challenge is to introduce a subsidized public insurance scheme. The plan is to fund it with resources coming from the expiration of tax exemptions.<sup>8</sup>

**26. Additional reforms in the energy sector are required to strengthen ENEE’s finances and foster competition in the electricity market.** Over the last 2 years, ENEE’s financials have improved considerably. In 2015 ENEE achieved a balance relative to the 2 percent of GDP deficit obtained in 2013. Last June, the energy regulatory commission (CREE) introduced a new tariff scheme based on cost recovery, which is in line with international best practices. During the first half of 2016, ENEE increased its domestic arrears during the transition to a new management team. Thus far, half of these additional arrears have been cleared and actions have been taken to clear the remainder of arrears before end-December 2016. Reducing the nontechnical losses from the high level of 33 percent (March 2016), however, is the main pending issue, which is expected to be tackled once a new private operator assumes control of electricity distribution. With the rightsizing process of ENEE basically concluded, next steps in the reform of the electricity market need to prioritize the participation of private companies in distribution, transmission, and system operation aiming at foster competition and reducing energy costs.

## B. Modernizing Monetary and Exchange Rate Policy

**27. Staff noted that the current supportive monetary policy stance was broadly appropriate.** Inflation has remained below the central bank’s 4.5 percent target, owing to a still negative output gap and low fuel prices. At the same time, net international reserves have fallen slightly after meeting program targets last June, but remain broadly on track to achieve the end-December 2016 NIR target of US\$3,005 million (4.7 months of imports). With the policy rate now broadly in-line with the estimated neutral policy rate—staff cautioned against further easing in the near term (see Box 3).

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<sup>8</sup> Health coverage remains low by regional and international standards (see SIP on Benchmarking Public Spending).

### Box 3. Estimates of the Neutral Interest Rate

**For 2016, the range of estimates for the neutral policy interest rate fluctuates between 4.7 percent and 9.8 percent in nominal terms.** Staff used several approaches to measure the neutral interest rate: the uncovered interest rate parity; the small-monetary policy model; the expected-inflation augmented Taylor rule; the consumption-based CAPM; and an H-P filter on ex-post real interest rates (see Magud and Tsounta (2012)).<sup>1</sup> In nominal terms, the current policy interest rate of 5.5 percent falls within the neutral rate range. Going forward, however, the current level could be on the low side if the slack vanishes quickly or if the rise in inflation, on account of higher energy costs, turns out higher than expected. Given the range of estimates for the neutral interest rate, staff considers the current monetary policy stance to be broadly appropriate. That said, the central bank should stand ready to act should inflationary pressures emerge.

Method	Expected Inflation: December 2016		4
	Neutral Real Interest Rate NRIR	Neutral Nominal Interest Rate (NNIR)	Actual Monetary Policy rate as at June 2016 5.5
			Nominal Monetary Policy Rate Gap (bps)
New Keynesian Model 2/	0.7	4.7	-76.6
Uncovered interest parity 3/	5.8	9.8	430.0
Expected-Inflation Augmented Taylor Rule 4/	0.8	4.8	-67.7
Consumption based CAPM 5/	3.4	7.4	188.6
HP-Filter 6/	2.5	6.5	97.7
<b>Average</b>	<b>2.6</b>	<b>6.6</b>	<b>114.4</b>

Source: IMF staff calculations

1/Magud, N.E., and E.Tsounta (2012). To Cut or Not to Cut? That is the (Central Bank's) Question IMF Working paper, 12/243, (Washington D.C.: International Monetary Fund).

2/A rational expectations model based on four basic behavioural equations--aggregate demand, a short-term aggregate supply, the uncovered interest rate parity condition, and a monetary policy rule.

3/This calculated as the sum of the US policy rate (.375%), the expected change in the nominal exchange rate (5 %)and EMBI spread (4.4 %) as a proxy for country risk.

4/ This is calculated using the following equation:  $rn = f1*rn_{-1} + (1-f1)*(rn\_neutral + f2*(\dot{cpi}_{+4} - target_{+4}) + f3*lgdp\_gap) + e\_rn$ ; Target=4.5; f1=0.7;f2=2;f3=0.8;rn<sub>-1</sub>=5.75;rn<sub>neutral</sub>=5;( $\dot{cpi}_{+4}$ )=3.59;lgdp<sub>gap</sub>=-0.65

5/ This is calculated is based on the sum of the log of the discount factor plus the relative risk aversion, multiplied by the expected growth in percapita potential GDP, less the volatility of potential percapita growth :  $\ln(r)=-\ln(b)+vg-(1/2)v(1-e)$ .

6/ In this method, we run a standard Hodrick-Prescott (HP) filter to the nominal interest rate series from 2000Q1 to 2015Q4.

**28. The central bank should stand ready to tighten monetary policy if the balance of risks to inflation tilts to the upside.** Upside risks include potentially rapid vanishing of the economic slack coming from faster than programmed pace of economic recovery, cost pressures from planned recovery of real electricity costs, the recent wage increase in the public sector, the dissipation of low commodity price effects and faster growth in net domestic assets. At the same time, the uncertainty associated with the US election and a softening of the U.S. growth call for increased vigilance given Honduras' close trade and remittances links with the U.S.

**29. The authorities have decided to adopt inflation targeting as the monetary policy framework.** With the recent enactment of the FRL, an inflation targeting framework could give the authorities the necessary tools to respond to external shocks. To facilitate this, the authorities plan to start building domestic and foreign exchange interbank markets, and reform the central bank law to give it a clear mandate to maintain price stability. This framework builds on reforms already



undertaken to improve the monetary policy operational framework, including: i) better forecasting of liquidity; (ii) upgrade of existing plans to develop the interbank market; (iii) increase the signaling content of the monetary policy rate; (iv) better coordination on liquidity management with the Ministry of Finance; and, (v) gradual phasing-out of banks' use of government bonds to meet a portion of reserve requirements.

**30. Staff welcomes the authorities' decision to increase exchange rate flexibility as this would improve the monetary transmission mechanism and provide a shock absorber to external shocks.** Consistent with this commitment, the authorities would issue the necessary regulations to establish a foreign exchange interbank market, and gradually relax the surrender requirements on foreign exchange earnings during the program period.<sup>9</sup> A more flexible FX market should also be supported by a code of conduct for market participants, transparent criteria for FX transactions including reporting arrangements for FX dealers, strengthened guidelines for banks FX exposures, enhanced reporting arrangements for authorized dealers and the elimination of the system of commissions.

**31. The institutional framework of the BCH needs to be strengthened in line with the 2015 safeguards assessment.** An updated safeguards assessment, completed in April 2015, found that the Central Bank Law poses significant risks to the bank's autonomy and also does not provide for sound governance arrangements. In addition, the assessment noted that the bank's financial reporting framework is not aligned with international standards. The implementation of safeguards recommendations to address these risks has been slow, but the authorities plan to submit to congress reforms to the Central Bank Law to align it with good international practices. The Central Bank also plans to adopt International Financial Reporting Standards from FY2017.

**32. The success of monetary reform would depend on the continuation of de-dollarization.** Since 2014 an improved policy mix and favorable external conditions have facilitated a rapid re-monetization and a slow de-dollarization process in Honduras. From a monetary policy perspective, de-dollarization could facilitate a stronger transmission of policy rate adjustments to domestic asset prices. In particular, lower liability dollarization and higher lending in domestic currency could improve the credit channel for the transmission of monetary policy. It could also help to reduce the pass-through from exchange rate changes to inflation. In sum, a continuous process of de-dollarization would reduce vulnerability of the overall economy to episodes of larger exchange rate volatility. Against, this background the authorities are encouraged to remain steadfast in their

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<sup>9</sup> Staff have identified two exchange measures subject to Fund approval under Article VIII, Section 3 in Honduras. These arise from the lack of a mechanism to prevent potential spreads in excess of 2 percent emerging (i) between successful bids within the BCH's foreign exchange auction; and (ii) between the official exchange rate (TCR) of the day and the exchange rates at which foreign exchange is sold at the auction on that day, giving rise to multiple currency practices. In practice the allocation (adjudication) of foreign exchange in the foreign exchange auction has been given to a single price. The authorities have requested temporary approval of these measures, which are maintained for non-balance of payments reasons. Staff supports this request as they do not materially impede Honduras's balance of payments adjustment, do not harm the interests of other members and do not discriminate between Fund members. Staff additionally note that the authorities' planned reform to the monetary policy framework should ultimately eliminate these measures.



implementation of higher capital requirements for foreign currency borrowing by unhedged borrowers.

### C. Creating a More Resilient Financial Sector

**33. A moderately concentrated banking sector dominates the financial system.** In 2015, the financial system contained 15 private banks, where total bank assets represent 97 percent of GDP and 77 percent of total assets of the financial system. In a process driven by a series of mergers and acquisitions to reduce costs and improve efficiencies, the banking system has become more consolidated over time. Most banks are part of economic holding companies which typically include other financial services such as an insurance company and other non-financial companies with increasingly stronger cross-border links and exposures. Given the need to mitigate potential contagion risks the staff advised to strengthen the cross border and consolidated regulatory and supervisory practices.

**34. Since 2014, banking system credit to the private sector has been expanding at a pace well below credit boom metrics, but current sectoral allocation may exacerbate vulnerabilities.** Credit has expanded at about 1 percentage point of GDP per year since 2014, much lower than the credit boom threshold of 5 percentage points of GDP. Meanwhile the sectoral allocation of the loan portfolio at end-2015 is well diversified, with about 60 percent of loans comprising consumption, real estate and corporate sectors, and the loan-portfolio exposure to households continues to grow at a steady pace of 12.8 percent per year.

**35. The high level of un-hedged borrowers in foreign currency across some sectors remains a source of concern.** The loan-portfolio exposure to foreign exchange risks remains high. In 2015, the share of foreign currency loans to unhedged borrowers in the corporate and real estate sectors stood at 46 and 80 percent, respectively. This increases the vulnerability of the financial sector to foreign exchange rate risks, and requires sustained efforts from the bank supervisory body to mitigate it.

**36. The banking system's high lending spreads are restricting credit intermediation.** Although falling somewhat, bank lending spreads, at 10.2 percent in 2015, remain high.<sup>10</sup> Overhead costs, which at 40 percent of income are high by regional standards, are a key driver of high spreads. Other elements explaining high spreads are the high reserve requirements and banks' business model of placing a large share of resources (16 percent of total bank assets) at the central bank.<sup>11</sup> High spreads can lead to high profits, and thus to capital. More frequently, however, high spreads increase intermediation costs and restrict overall credit growth. Given the importance of bank credit in Honduras, a restricted credit intermediation is likely to lower investment and saving, and through

<sup>10</sup> During 2011-2015 ex post spreads have averaged 10.6 percent. In 2011, they were 11.4 percent, but has gradually inched lower each year.

<sup>11</sup> A recent study on net interest margins suggests that operating costs are the most important determinant of banks' interest margins. Other key determinants are high provisions for nonperforming loans and high liquidity ratios, see Koffie Ben Nassar, Edder Martinez, Anabel Pineda "Determinants of Banks' Net Interest Margins in Honduras" IMF Working Papers, WP/14/163, 2014.

these channels output growth. To improve credit intermediation, the authorities would need to implement measures to reduce costs in the financial system. These measures could include procedures for minimizing the cost of credit information, legal reforms to facilitate easier recoveries and lower reserve requirements. Much smaller spreads would improve credit intermediation and through this, the monetary policy transmission mechanism.

**37. Stress tests reveal that the banking sector is broadly resilient to most shocks.** Stress tests conducted by staff confirm the banking sector's relative strength in managing market and liquidity risks, which may arise from a reduction in correspondent banking relationships (see Table 3). Specifically, the system can tolerate shocks such as, deposit withdrawals, and a large depreciation of the currency, suggesting that, liquidity and foreign exchange risks are contained.<sup>12</sup> The system is also able to absorb a widespread increase in NPLs. Note that, when confronted with tail-risk scenarios originating from slower global growth in advanced economies plus tighter financial conditions, the system does not appear to have sufficient capital buffers to fully absorb such shocks. The tail risk scenarios could manifest itself as: i) a credit concentration shock where the three largest borrowers default, or ii) a combination (multiple) shock. In both scenarios, the banking system's CAR is likely to be substantially impacted. That said, rollover risks associated with foreign funding remain manageable even under scenarios of extreme stress in international banking systems. In particular, a 10 percent shock to US banks would reduce credit in Honduras by only 1.3 percent of GDP.<sup>13</sup>

**38. In light of the stress test results, the mission advised the authorities to closely monitor developments in the following areas:**

- **Concentration risks.** Given that the default of the three largest borrowers of each bank would impact the banking system's capital, there is a need to strengthen monitoring and ensure strict compliance with regulations to avoid risks posed by credit concentration.
- **High dollarization.** About 30 percent of deposits and 33 percent of loans are denominated in USD. Credit dollarization has decreased recently, in part owing to stronger enforcing of prudential regulations such as: limits on net open position in foreign currency; requirements that foreign exchange loans be granted to borrowers with foreign currency earnings; and stronger limits to the loan-to-deposit ratio in foreign exchange. In particular, since mid-2015, the authorities have adjusted the risk-weighted capital asset ratios to 150 percent for mortgage loans, where debt-to-collateral ratio exceeds 85 percent, and to 175 percent for consumer loans (including credit cards).
- **Household debt.** Total household indebtedness as a share of GDP reached 19 percent in 2015 from 15.0 percent in 2011. In this category, credit card debt has grown to about 25 percent of

<sup>12</sup> All shocks, except for the liquidity and interest rate shocks, are calibrated as two standard deviations over the mean for the period 1997 to 2015. The liquidity shock is equivalent to the maximum one-month deposit withdrawal faced by individual banks during 2000–08, as stated in the 2009 FSAP report, SM/09/93. On interest rate, staff simulated a 3.3 percentage points increase in the nominal policy interest rate (similar to the one-year cumulative change during December 2008 to December 2009).

<sup>13</sup> For instance, the total impact on foreign credit availability in Honduras from a 10 percent shock to asset values of BIS reporting banks is about 3.3 percent of GDP (see SIP, Banking Sector Stability in Honduras).

total household debt (or 5 percent of GDP). At the same time, non-performing credit card and housing debt is increasing, following a trend decline from the spike of the global financial crisis in 2009. Against this background, to mitigate vulnerabilities in this area, the authorities have agreed to adopt regulations to keep household indebtedness within prudent margins and increase financial literacy programs.

- **Reduction in correspondent banks relationships.** Although the Honduran authorities do not, currently, see this as a source of concern, they should continue to work to prevent this becoming an issue, or stand ready to act if the risk does materialize. In any case, given that Honduran banks operate in jurisdictions that are affected by a reduction in correspondent banking relationships, the parent banks in Honduras could be indirectly impacted.

**Table 3. Summary of The Combination Scenario Stress Test**

	All Banks		Domestic Banks	Foreign Banks
	Indicator	Ratings 1/		
<b>Summary of Results</b>				
<i>Solvency</i>				
Pre-shock CAR	14.0	2	13.6	14.6
Impact of (percentage points of the original RWA)	-7.8		-7.9	-7.8
Increase in provisioning	-0.4	2	-0.1	-1.0
Increase in NPLs	-3.5	2	-3.3	-3.8
Increase in interest rates	-3.4		-3.9	-2.6
Exchange rate change (+ depreciation, - appreciation)	-0.5	2	-0.5	-0.4
Post-shock CAR	6.2	4	5.7	6.7
<i>Liquidity</i>				
Liquid assets/total assets				
Pre-shock	24.6	2	28.4	21.9
Post-shock	17.3	3	19.7	13.8
Liquid assets/short-term liabilities				
Pre-shock	69.5	1	74.1	62.6
Post-shock	56.1	2	62.6	46.0
Overall Rating				
Pre-Shock Rating		2		
Post Shock Rating		3		
Source: IMF staff calculations				
1/ 1=Low risk, 2=increased risk, 3=High risk, 4=Very high risk.				

**39. The authorities have embarked on a comprehensive reform of the framework for bank resolution, comprising extensive legal amendments and a significant strengthening of the authorities' capacity for dealing with financial sector distress.** This reform is a significant step forward, in light of the weaknesses which became apparent during the liquidation of Banco Continental in the fall of 2015. The broad objective of this reform is to establish a robust framework that allows for the resolution of banks, while preventing systemic disruption and the exposure of taxpayers to losses. Notably, the reform encompasses legal underpinnings for the scope, objectives, institutional arrangements, powers and tools for resolution and revisions to the liquidation regime.

**40. Further reforms should aim to strengthen the AML/CFT framework.** In light of the weaknesses which became apparent in the context of the liquidation of Banco Continental in the fall

of 2015, stepping-up AML/CFT supervision of the banking sector and effectively implementing fit and proper requirements for beneficial ownership and control of financial institutions would be a significant step forward.

## D. Other Program Issues

**41. The program remains fully financed.** All financing needs are covered for the next 12 months based on external and domestic operations. The authorities have successfully re-profiled about US\$400 million in 2015, extending the average maturity of domestic debt from 3.3 to 4.3 years. The domestic financial system, especially pension funds, currently possess ample liquidity to support the financing plans. The authorities remain open to the possibility of tapping international capital markets to undertake liability management operations to smooth debt service. Their extended investment plan will require about US\$750 million for 2016–17 in external financing which they plan to obtain mainly from multilateral institutions, with most new debt contracted to be allocated to infrastructure and social spending (Table 4).

**Table 4. Summary Table of Projected External Borrowing Program**

PPG external debt	Volume of new debt in 2016		PV of new debt in 2016 (program purposes)	
	USD million	Percent	USD million	Percent
<b>By sources of debt financing</b>	<b>299.8</b>	<b>100</b>	<b>236.9</b>	<b>100</b>
<b>Concessional debt, of which</b>	<b>68.0</b>	<b>23</b>	<b>12.6</b>	<b>5</b>
Multilateral debt	68.0	23	12.6	5
Bilateral debt	0.0	0	0.0	0
Other	0.0	0	0.0	0
<b>Non-concessional debt, of which</b>	<b>231.8</b>	<b>77</b>	<b>224.3</b>	<b>95</b>
Semi-concessional	37.4	12	29.9	13
Commercial terms	194.4	65	194.4	82
<b>By Creditor Type</b>	<b>299.8</b>	<b>100</b>	<b>236.9</b>	<b>100</b>
Multilateral	292.4	98	231.7	98
Bilateral - Paris Club	0.0	0	0.0	0
Bilateral - Non-Paris Club	0.0	0	0.0	0
Other	7.4	2	5.2	2
<b>Uses of debt financing</b>	<b>299.8</b>	<b>100</b>	<b>236.9</b>	<b>100</b>
Infrastructure	132.4	44	108.0	46
Social Spending	77.4	26	52.4	22
Budget Financing	30.0	10	24.7	10
Other	60.0	20.0	51.8	21.9
<b>Memo Items</b>				
Indicative projections				
Year 2	350.5		254.8	

Sources: Ministry of Finance, Honduras

**42. Capacity to repay the fund remains adequate and the balance of risks is manageable.** Honduras' capacity to repay the Fund remains adequate. Potential access under the program would have only a modest effect on external debt (29 percent of GDP at end-2015), and the risk of debt distress is considered moderate according to the latest debt sustainability analysis.

**43. The debt sustainability analysis shows improved prospects relative to the previous review** (Annex I). The medium-term fiscal projections show a declining path in the public debt over GDP ratio, a significant improvement relative to the recent past. These projections are consistent with the parameters of the FRL and reflect the stronger macroeconomic policies underpinned by structural reforms that have been adopted. While the risk of external debt distress remains as moderate, proper implementation of fiscal and monetary reforms will be key to move the risk assessment to a low distress rating. The authorities broadly agreed with this assessment.

## MAIN THEMES OF THE ARTICLE IV POLICY DISCUSSIONS

### A. Increasing Inclusive Growth and Reducing Crime and Violence

**44. Progress on inclusive growth reforms have been good and are set to continue.** Staff analysis shows that while some measures needed to improve the fiscal situation have been regressive, such as the increase in the VAT rate, the authorities were effective in redistributing additional resources through direct transfers such as the program *Vida Mejor*. The joint effect of the two measures alone had a small but negative effect on aggregate output. However, fiscal stabilization also brought macroeconomic stability and lower interest rates, which translated into new business opportunities, especially in the rural sector, thus boosting GDP and decreasing poverty and inequality further. As a result, staff estimates that the economic reforms implemented over the last two years have helped to reduce poverty and income inequality. To lower poverty and inequality further, structural reforms on the labor market to improve labor mobility across sectors will be key (Box 5).

**45. Growth-enhancing reforms can break the vicious cycle of high crime and low growth.** Macroeconomic simulations done by staff using a structural model calibrated to Honduras data, in which economic performance, the crime rate and the decision to become a criminal are endogenous, reveal that higher growth is associated with lower crime. In particular, over the medium term a one percent increase in economic growth could reduce the crime rate by about one percent. This leads to a virtuous cycle, where, as growth increases employment opportunities increase and there is less incentive to become a criminal. Lower crime reduces the perception of high crime, and this encourages productive economic activity, generating more employment opportunities. Higher growth also provides more resources to fight crime and violence. And as Honduras recent experience shows, a combination of increased economic activity supported by enhanced anti-crime strategies has reduced the homicide rate by more than 30 percent in three years. To sustainably reduce the still high crime rates further, the authorities will need to focus on

crime prevention measures, including by mobilizing the AML/CFT framework to assist in detecting, prosecuting and recovering the proceeds of crime, as well as improving labor mobility to make job creation more attractive and accessible and further strengthening anti-corruption efforts.

**46. Once fully articulated within the overall macroeconomic framework, the Honduras 2020 investment plan could help to generate sustainable output growth.** The Honduras 2020 plan, launched last April, aims to create 600 thousand jobs and increase exports by 20 percent in five years, but it has not yet been included in the macroeconomic framework amid a lack of details to facilitate a full assessment. If implemented, this plan could have significant implications for Honduras over the medium term, and therefore it is important for the authorities to carefully consider the requirements for its success, the resource needs and the relevant changes that are needed in other public policies. Additionally, it is critical to ensure the consistency of the reduction in tax exemptions envisaged in the FRL and in the Social Protection Law (SPL) with potential fiscal measures included in the Honduras 2020 plan.

**47. Authorities' views.** The authorities broadly agreed with staff's overall assessment of inclusive growth. They noted that the macroeconomic adjustment program had freed-up resources for the social program *Vida Mejor* to tackle poverty and any fall-out from the economic stabilization program. It also provided resources for increased spending on citizen security, particularly in vulnerable and at-risk-neighborhoods. The authorities noted the program to overhaul the national police as an initiative to address deep rooted corruption issues. These reforms along with the steady improvement in economic growth would help to further reduce criminal activity and poverty. The authorities acknowledged the need to assess the macroeconomic implications of the Honduras 2020 plan and its coherence with other public policies. At present the plan is being implemented with a high level of coordination with the private sector. For its part, the government is looking to invest more in education and affordable housing over the medium term in support of this initiative.

#### Box 4. Fiscal Reforms in Honduras: A Foundation for Inclusive Growth

**The fiscal adjustment has restored macro stability, reduced sovereign spreads, and provided resources for expanding social programs.** After a long tradition of fiscal excesses, the government embarked on a path to restore sound public finances. Over the last 2½ years the CPS deficit has been reduced by 6½ percentage points of GDP. This result has been achieved by a combination of spending and revenue measures, including a VAT tax reform. Since VAT increases are potentially regressive, the government also decided to allocate some of the additional revenues to expanding their targeted cash transfers program. Improved public finances and other reforms have reduced economic uncertainties, as reflected in the more than 400 basis points reduction in sovereign spreads.

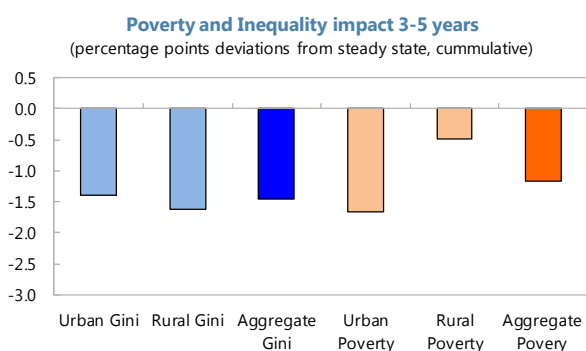
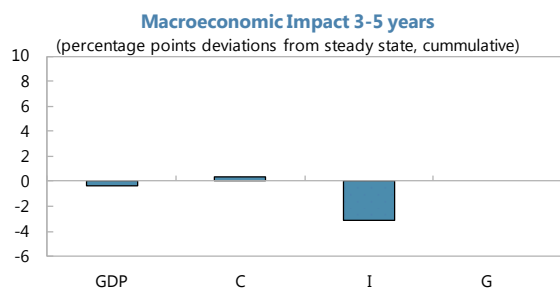
**To understand the expected impact of the fiscal reform on output, poverty and inequality, staff developed a general equilibrium model tailored to key characteristics of the Honduran economy.** The model reproduces qualitatively and quantitatively key macroeconomic and distributional features of Honduras household level data. Drawing on Honduras household expenditure survey, the baseline year in the model captures the size of the agricultural (13%), services (40%) and manufacturing (20%) sectors as fractions to GDP. It also captures the effective collection of VAT, personal income, and other taxes as fractions of total government revenues. To match these characteristics, the differences in total factor productivity across sectors in the economy, as well as the sector specific parameters of the production functions, and implicit tax rates are calibrated. The model simulates thousands of individual households with diverse incomes, thus producing insights into income, wealth, and consumption distributions. The persistence and variance of the households' particular income shocks are calibrated to reproduce measures of inequality (GINI of 0.55) and poverty (rates of about 60%) observed in Honduras' household surveys. In addition, the model is calibrated to match households' consumption patterns with the objective of capturing the distributional implications of the policy changes.

**The analysis reveals a positive impact of the reform on macroeconomic fundamentals.** On its own, an increase in VAT is potentially regressive and may depress aggregate demand and worsen poverty and inequality. However, if the reform is combined with compensatory measures such as cash transfers, private consumption expands and poverty is reduced. Cash transfers are assumed to have modest positive impact (1%) on the productivity of households that receive them. These households tend to have a large marginal propensity to consume, which boosts private consumption. The boost in private consumption is not enough to compensate for the depressing effect on overall aggregate demand that results from the taxes in isolation. However, once we also incorporate a decrease in the marginal cost of capital (due to macroeconomic stability) private investment substantially increases, creating a virtuous cycle that translates into higher GDP (2%), private consumption (1.5%), and private investment (9%), which improve household's incomes and bring additional tax revenues to finance cash transfers. Urban poverty and inequality fall by more than two percentage points. These results are enhanced with a more efficient and competitive financial sector. Productivity growth in the agricultural sector, combined with targeted training could increase labor mobility and further enhance overall gains from the reform.

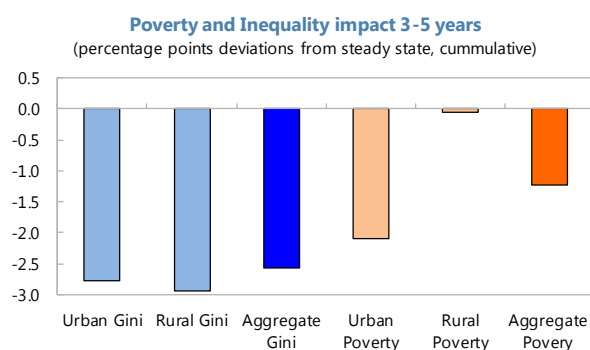
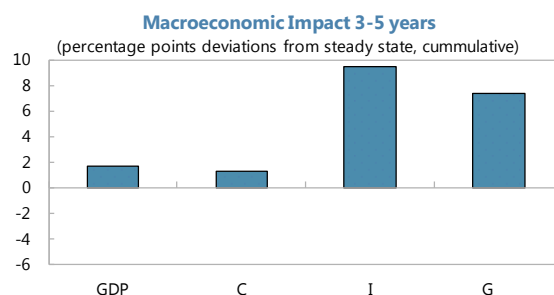
### Box 4. Fiscal Reforms in Honduras: A Foundation for Inclusive Growth (concluded)

#### Fiscal Reform Scenarios

##### Higher VAT + Cash Transfers



##### VAT + Cash Transfers + Lower Risk Premia



## B. Increasing Public Expenditure Efficiency and Improving Energy Infrastructure

**48. Increased efficiency of public spending can free-up resources for additional growth enhancing public programs.** Given the constraints on spending imposed by the FRL and the already high tax effort, additional resources for priority spending over the medium term will depend on efficiency gains in public spending (Box 6). Preliminary estimates by staff show that the potential efficiency gains in spending on health and education can be substantial. A large proportion of these efficiency gains in spending on education can be derived from rightsizing the wage bill. Against this backdrop, staff urged the authorities to take a comprehensive look at public spending with a view to adopting measures to increase efficiency in public spending, particularly in these two areas.

**49. Another key priority over the medium term is to streamline tax expenditures.** At 6½ percent of GDP, Honduras has one of the largest levels of tax expenditures in the region. This situation was compounded recently with the granting of concessions (total removal) from VAT to the agricultural sector (0.3 percent of GDP). Clearly, some of these tax expenditures have been ineffective in helping to foster inclusive growth and reduce poverty. On the contrary, they foster



rent-seeking behavior in powerful interest groups. The authorities have already committed to gradually eliminate tax exemptions to finance the implementation of the social protection law. In addition, the FRL makes provisions to modernize tax expenditure management by administering tax incentives and improving the control of beneficiaries.

**50. Further reforms in the electricity market in line with the 2014 energy framework law would be crucial for raising medium-term potential growth.** The 2014 law aims to promote a more efficient and transparent electricity sector and encourage additional private sector participation in transmission and distribution of electricity. Against this backdrop, as a first step in the process, the electricity energy regulatory commission (CREE) have established a new tariff scheme based on the cost recovery, and plan to issue new regulations to improve the functioning of the electricity market.

**51. Authorities' views.** The authorities noted the issues raised by staff on the efficiency of public spending. They are planning to do a comprehensive study of the different compensation schemes existing in the education and health sectors by benchmarking them against other public employees and private sector comparators. Apart from this, they are also working on improving efficiency in other areas. On the electricity reform, they acknowledged that reforms had been slower than originally anticipated, but they are aware of the need to get the reforms in the sector right and are pressing ahead with this endeavor.

### Box 5. The Efficiency of Social Spending in Honduras

**The new fiscal framework creates a need for increasing the efficiency of public spending.** The fiscal responsibility law sets out an ambitious fiscal consolidation path. Additionally, the authorities have implemented 2½ percent of GDP in tax measures leaving limited room for more gains. However, with 65 percent of the population living in poverty, Honduras still has a pressing need to expand public social services. Increasing the efficiency of public spending is the way to provide more services in a consolidation scenario.

**Benchmarking techniques could be used to measure the efficiency of public spending.**

Benchmarking is the comparison of the performance of one unit against others. It is intimately related to the concept of efficiency. In the benchmarking literature, once a model based on inputs and outputs is defined, the efficiency is measured by identifying the best performing units and use them to build an efficiency frontier. The performance of all units is assessed relative to that efficiency frontier. For this exercise, we estimate frontiers for health and education spending using a sample of emerging and low income countries then we estimate individual efficiency scores.

**Efficiency scores can be calculated based on output-oriented or input-oriented models.** In input-oriented models, the scores are the proportional amount by which input consumption could be reduced while leaving outputs unchanged. Scores from output-oriented models are defined as the proportional amount by which outputs could be increased while leaving inputs consumption unchanged.

**Based on the estimated scores, we found there is ample room for the generation of savings, particularly in health and education spending.** For health, we use health-adjusted life expectancy (HALE) as output, public spending, private spending and the educational level of adults as inputs. For education, we use net enrollment rates as output and public spending and the teacher-pupil ratio as inputs. In health, we found an input-oriented score of 0.955 showing limited room for getting better outcomes by using inputs efficiently, however, the output-oriented score is 0.840 meaning that all inputs could be reduced by around 15 percent without a reduction in the output. In education, Honduras performed poorly in secondary education (input-oriented score 0.208) ranking last among 88 countries in the sample and 66/88 in the output-oriented measure (0.522). The results are better in primary education with scores of 0.307 for the input-oriented and 0.948 for the output-oriented measure. These results imply potential efficiency savings in educational inputs between 70–80 percent.

**Tackling inefficiencies requires structural reforms aimed at introducing a performance culture in the delivery of social services.** In both sectors, the priority is to tackle the discrepancies between compensation and productivity. The wage bill represents 80 percent of the education budget and 60 percent of that for health; therefore, there is no way to achieve savings without reforming the compensation policies. The main problem is fragmentation, which is not a result of performance-based evaluations but of the negotiations with powerful interest groups. In education, the priority should be reforming the teachers' *estatuto* and implementing the quality evaluations stated in the law. The health sector has six of the eight existing compensation frameworks. These frameworks should be revised in light of the need to expand coverage as stated in the law of social protection.

## C. Financial Development

**52. Financial development is progressing steadily, but should be balanced with the need to maintain financial stability.** Financial development in Honduras, as measured by financial deepening and inclusion indicators, is broadly in line with its peers in the region (Table 5). At the same time, the rise in household debt and credit card debt in particular, underscores the need to balance the desire for financial deepening and inclusion with the requirements of financial stability. The recent growth in credit card use is thought to have permitted financial access to certain groups that would not otherwise have access to financial services, but has now come to represent a key vulnerability for the household sector given the rise in household credit card debt. In this context, additional efforts at financial literacy need to be pursued.

**53. Recent initiatives on advancing financial inclusion are welcome.** The national financial inclusion strategy has focused on access, prudential standards, education and consumer protection. In line with this, there have been advances in retail e-payments system, especially for the receipt of remittances, helping to broaden access. On the regulatory side, regulations covering payments and the operation of electronic money by non-bank institutions have been recently adopted. That said, there is a strong need to adopt regulation to govern mobile financial services and also increase the provision of banking and payment services, particularly in the rural areas and to lower income groups.

**54. Financial sector development initiatives need to be broadened to include the role of capital markets.** The development of capital market in Honduras would provide a mechanism for long-term financing and risk sharing. This is especially relevant for Honduras given the existence of pension funds with large financial surpluses and limited investment options, and the banking sector's preference for holding central bank bills, financing consumption and other short-term loans. The development of a wider range of long-term financial instruments could permit issuers to match their funding needs with the investment guidelines of investors like pension funds and insurers. It could also facilitate a reduction in the net foreign currency exposure.

**Table 5. Central America: Selected Indicators of Financial Development**

	Source	Year	Regional Central		Dominican					
			America Average	Honduras	Costa Rica	Republic	El Salvador	Guatemala	Nicaragua	Panama
<b>BANKING</b>										
<b>Access</b>										
Accounts Per Thousand Adults, Commercial Banks	IMF	2014	1019	948	1327	766	816	1640	273	1360
Number of Branches Per 100,000 Adults, Commercial Banks	IMF	2014	19	23	22	11	12	37	8	23
Percent of Adults with an Account at a Formal Institution (%)	FIN	2014	40	30	65	54	35	41	19	
<b>Depth/Size</b>										
Domestic Bank Deposits / GDP (%)	IFS	2014	41	49	23	22	40	41	33	77
Private Credit / GDP (%)	IFS	2014	47	55	55	25	42	32	31	86
Financial Deepening Index	WDI	2013	0.20	0.18	0.21	0.13	0.23	0.21	0.12	0.31
Financial Inclusion Index	WDI	2014	0.38	0.23	0.60	0.43	0.40	0.31	0.28	0.42
<b>Efficiency/Structure</b>										
3 Bank Asset Concentration (%)	BKSC	2014	66	48	67	75	56	67	85	62
Cost to Income Ratio (%)	BKSC	2014	60	66	64	72	53	62	52	52
Net Interest Margin (%)	BKSC	2014	7	7	4	9	10	6	8	3
Non-Interest Income / Total income (%)	BKSC	2014	23	24	25	30	10	20	30	24
Overhead Costs / Total Assets (%)	BKSC	2014	4	5	3	7	3	4	5	2
Return on Assets (%)	BKSC	2014	2	1	1	2	1	2	2	1
Return on Equity (%)	BKSC	2014	15	12	8	19	11	18	22	14
Credit to Government and SOEs / GDP (%)	IFS	2014	4	4	6	4	2	8	2	5
Lending-Deposit Spread (%)	IFS	2014	9	10	12	7	-	8	12	5
<b>External position</b>										
Consolidated Foreign Claims of BIS-Reporting Banks / GDP (%)	BIS	2014	41	12	23	12	27	10	8	194
<b>OTHER</b>										
Average Cost of Sending USD200 to Selected Country (%)	RPW	2014	5	5	-	6	4	5	5	5

Sources: IMF International Financial Statistics (IFS); The Global Financial Inclusion (Global Findex) Database (FIN); Bank for International Settlements (BIS); Bankscope (BKSC); World Development Indicators (WDI); Remittance Prices Worldwide database (RPW).

**55. The strong macroeconomic performance under the SCF/SBA-supported program has laid the foundation for further financial market development.** Building on the progress already made in the reforming the money market infrastructure, the key priorities going forward should be the development of the inter-bank money market, and repo market; government domestic securities market; and the full development of the government yield curve. The development of the local capital markets could also benefit from the introduction of changes in the legal framework to strengthen financial disclosure requirements, the code of corporate governance, and the bankruptcy framework.

**56. Authorities' views.** The authorities broadly agreed with staff's assessment of the financial sector. In particular, they noted that the efficiency of the banking system is a key public policy concern—where relatively high returns of the banking system and equally high administrative costs exist side by side. A second area of concern is about the level of competition in the banking system, along with the level of credit card indebtedness of households, and the potential risks that this poses to the stability of the banking system. Against this backdrop, to further strengthen the financial system, the authorities requested MCM to conduct a Financial Sector Stability Review (FSSR). The authorities plan to use the findings of this TA to further strengthen regulatory and supervisory practices, develop the financial sector market infrastructure, and improve financial inclusion.

## STAFF APPRAISAL

**57. Program performance remains good amid steadfast implementation, strong ownership, and domestic support.** The authorities met most performance criteria along with all the indicative targets through end-December 2015 and end-June 2016. The authorities did not observe the end-December 2015, PC on net domestic assets (NDA), the net lending PC for end-June 2016 and the PC of no accumulation of domestic arrears in ENEE, but has since adopted policy measures to maintain the integrity of the program. The structural reform agenda is proceeding steadily. That said, the SBA needs to be rephrased to take into account the increase in Honduras's first credit tranche as a result of the increase in Honduras's quota under the Fourteenth General Review of Quotas.

**58. The economy continues to expand in 2016, and the outlook for the medium term remains favorable, broadly in line with program projections.** The improved policy mix under the program is enabling a process of inclusive growth, greater coverage of the social safety net, and better foundations for fiscal sustainability—including additional resources to improve citizens' security. These achievements will anchor the strategy to obtain higher growth and better social conditions over the medium-term.

**59. The recent adoption of the FRL is welcome.** The authorities are now focused on operationalizing the provisions of the law and clarifying its implications for handling extra-budgetary programs (trust funds). The FRL together with the medium-term fiscal framework (MTFF), is expected to fundamentally change the governance of fiscal policy and set the tone for the adoption of other macro policy reforms over the medium-term.

**60. Over the medium-term the reduction in the public sector debt ratio expected from the adoption of the FRL should be regarded as a minimum, since further gains from improvements in efficiency are likely to be large.** The FRL defines a fiscal anchor which aims to strengthen the fiscal position by reducing public debt in the medium term. That said, a more accelerated pace of debt reduction could be achieved, without harming short-term growth, if the authorities were to implement additional efficiency-enhancing revenue and spending measures. On the revenue side, the main task is streamlining the generous and ineffective system of tax exemptions. The authorities' plan, based on the non-renewal of such benefits, is welcome, but much more can be achieved by actively rationalizing those that are already known to be ineffective. On the spending side, increasing the efficiency of health and education spending is the main medium term task. A key element on the spending side is to revise the compensation framework to align it with a results-based approach.

**61. The supportive monetary policy stance remains broadly appropriate in the near-term.** Nonetheless, the BCH should remain vigilant and be ready to tighten if inflation or credit growth were to accelerate and there are signs of overheating. With the policy rate now broadly in-line with the estimated neutral rate, coupled with the baseline projection showing a closing output gap, along

with planned recovery of the real electricity costs—likely to stoke inflationary pressures—the BCH should avoid further easing in the near term.

**62. Staff supports the decision to move towards an inflation targeting framework to guide monetary policy.** This reform would give the authorities the tools to respond to external shocks. The immediate priorities are to develop domestic and foreign exchange interbank markets, while reforming the central bank law to give it a clear mandate to achieve price stability.

**63. The decision to move towards a more flexible exchange rate regime is welcome.** Increased exchange rate flexibility would help to absorb external shocks and increase macroeconomic resilience. With the adoption of the inflation targeting framework, the exchange rate flexibility would have a central role in the adjustment to external shocks. To support this, it would be important to issue the necessary regulations to establish an interbank foreign exchange rate market, and start relaxing the surrender requirements on foreign exchange earnings. The move towards a more flexible exchange rate regime will also need to be supported by a code of conduct for market participants, transparent criteria for FX transactions including reporting arrangements for FX dealers, strengthened guidelines for banks FX exposures, enhanced reporting arrangements for authorized dealers and the elimination of the system of commissions.

**64. Staff cautioned, however, that success of monetary reform would depend on the pace of de-dollarization.** Without a serious de-dollarization program, the adoption of a more flexible exchange rate regime could lead to macroeconomic instability, given the central role of the exchange rate in price and monetary stability. De-dollarization would improve the transmission of monetary policy, by opening up the balance sheet, credit and interest rate channels.

**65. The financial system appears resilient, but vulnerabilities within the system need to be closely monitored.** Staff analysis shows that the financial system is expanding credit below credit boom metrics. Banks have ample liquidity and capital appears adequate. At the same time, tail risk scenarios suggest that banks' capital may not be adequate to absorb the resulting losses. In this regard, it is important for the authorities to monitor closely credit concentration and buildup of household debt.

**66. Staff is encouraged by the progress made thus far in reforming the bank resolution framework.** The recent draft law submitted to congress substantially strengthens the authorities' capacity for dealing with financial sector distress without systemic disruption, or exposing taxpayers to losses. In particular, the reform encompasses legal underpinnings for the scope, objectives, institutional arrangements, powers and tools for resolution and revisions to the liquidation regime.

**67. Now that the economy has been stabilized, the authorities are encouraged to focus on key medium-term priorities.** In particular, the incidence of poverty, crime and violence needs to fall more, infrastructure gaps, especially in energy, need to close and financial market access for poor households, and the efficiency of public spending (especially in health and education) need to improve, and the financial sector needs further development. With the adoption of the medium

term fiscal policy framework and the FRL, along with the planned reforms to the monetary policy framework, the government has a good platform to push ahead with its medium term reforms firmly to achieve its targets for growth and employment while maintaining macroeconomic and financial stability.

**68. Consistent with the authorities' strong commitment, program risks have subsided.** The macroeconomic performance continues to be favorable and the outlook remains positive, given the domestic policy mix and the still positive external environment. Staff considers risks to the 2016 program as titled slightly to the downside both on the economic growth and the policy agenda. The key external risks are a sharper than expected global growth slowdown. On the domestic front, failure to address problems of structural competitiveness, along with an ill-defined Honduras 2020 plan could retard productivity gains and output growth. The authorities remain committed to rolling out the provisions of the recently enacted FRL. They are also pressing ahead with the electricity sector reform agenda albeit at a slow pace. These efforts would be supported by the authorities' plan to adopt an inflation targeting framework for monetary policy and the recent bank resolution framework submitted to Congress.

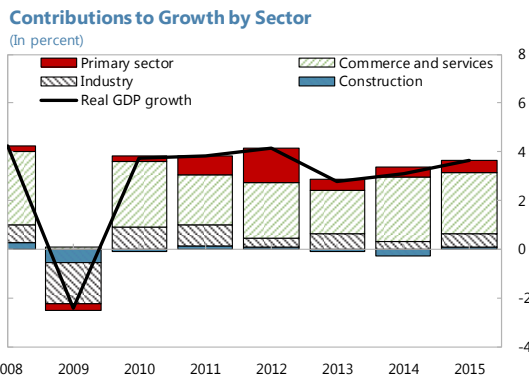
**69. Staff supports the completion of the third and fourth reviews under the SBA and the SCF arrangements.** Staff also supports the authorities' request for a waiver of the end-December 2015 PC on the ceiling of the stock of NDA as they have corrected the deviation by observing the end-June 2016 target. In addition, on the basis of corrective policy measures taken, staff also supports the authorities' request for a waiver on the non-observance of the end-June PCs on net lending by the public pension funds and on the arrears from ENEE. Staff additionally supports the authorities' request for a rephrasing of the SBA.

**70. Staff supports the authorities' request for temporary approval of the exchange measures identified above.**

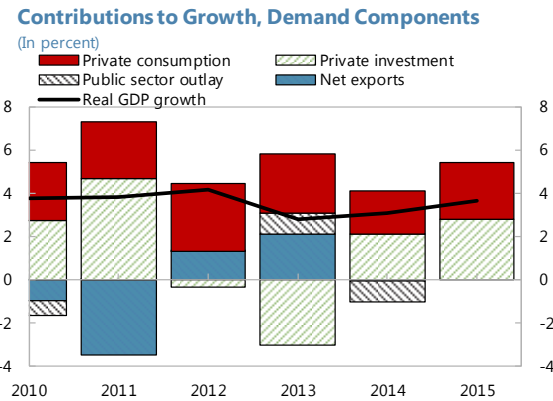
**71. It is expected that the next Article IV Consultation with Honduras would take place on the 24-month cycle, subject to the Decision on Consultation Cycles.**

**Figure 2. Honduras: Growth is Strengthening Amid Stable Macro Policies and Better External Conditions**

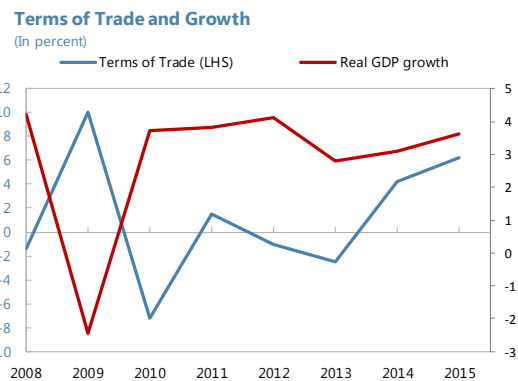
The service sector led the recovery in activity...



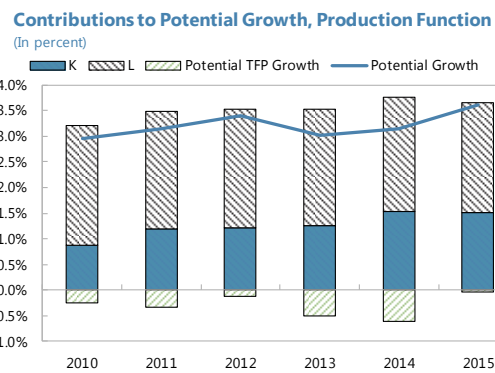
and private investment led demand growth.



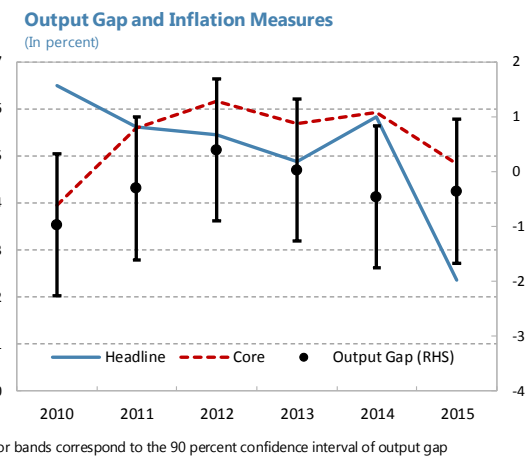
The recent improvement in the terms of trade also helped to sustain activity



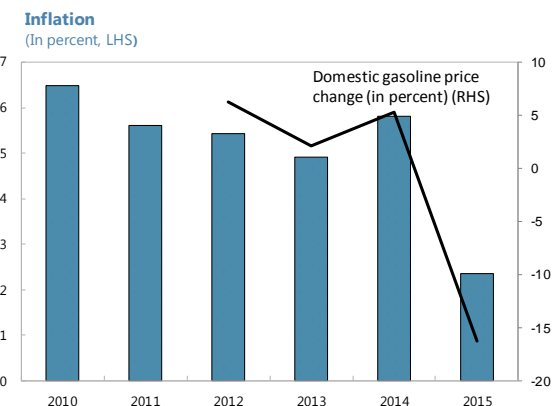
The recovery contributed to closing the output gap, but potential growth remains subdued



With a negative output gap, although shrinking, inflation has remained under control



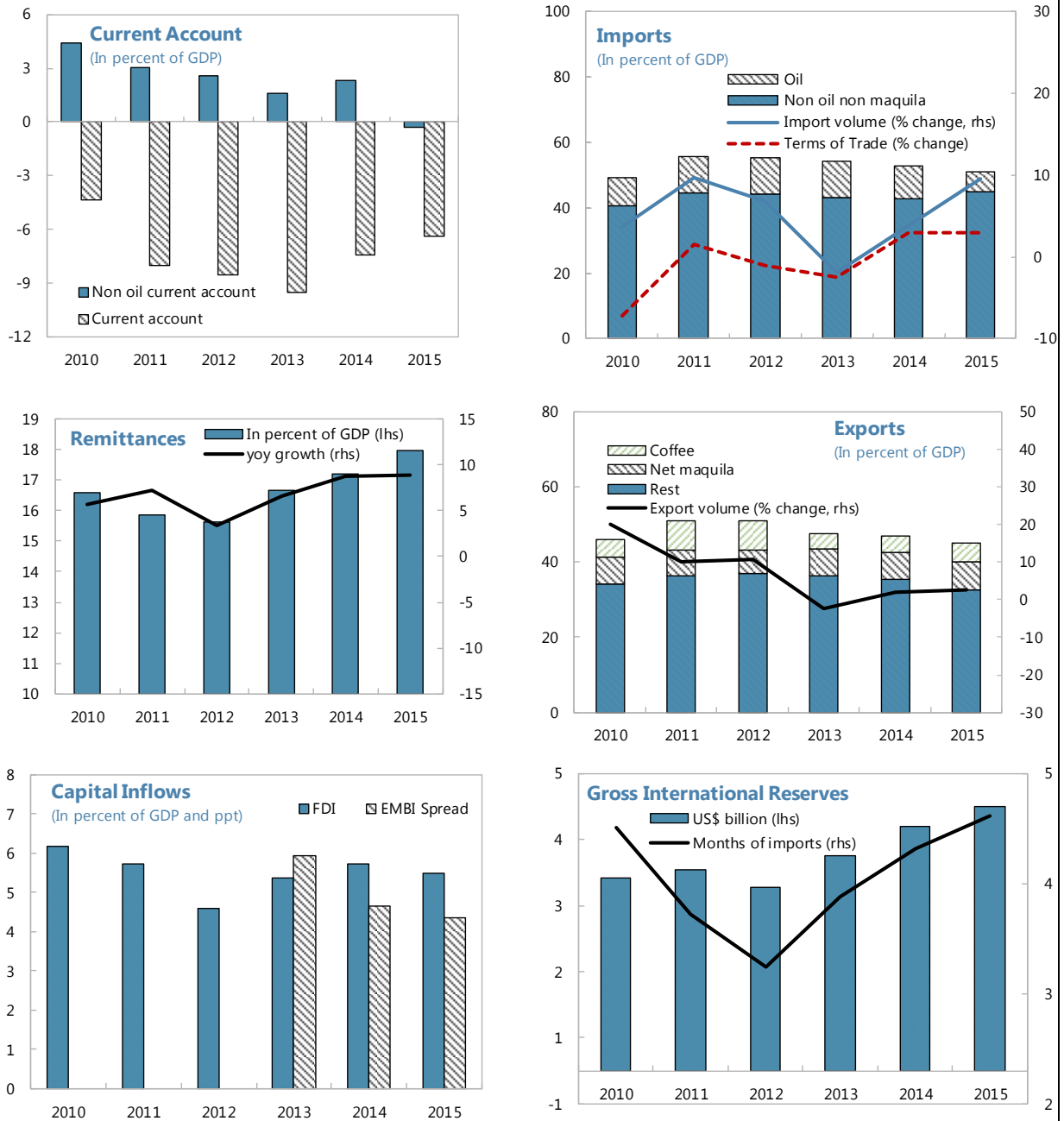
The reduction in inflation was also influenced by a decrease in gasoline prices that responded to the fall in international oil prices.



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



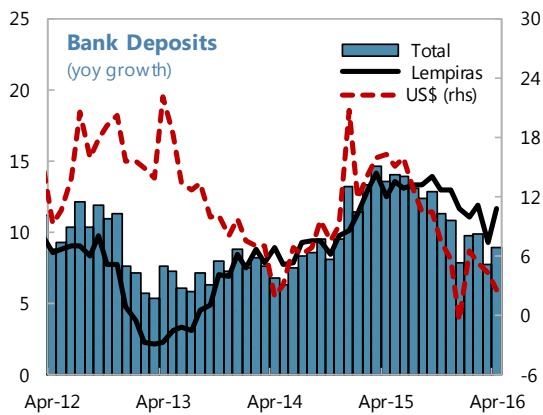
**Figure 3. Honduras: The External Position Has Strengthened on The Back of Favorable Terms of Trade Movements**



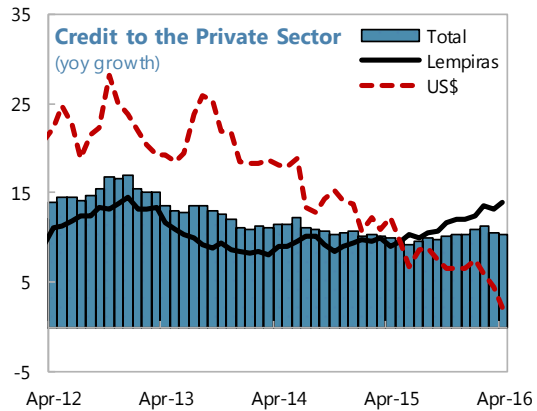
Sources: Central Bank of Honduras and Fund staff estimates and projections.

**Figure 4. Honduras: Monetary Conditions Have Remained Favorable**

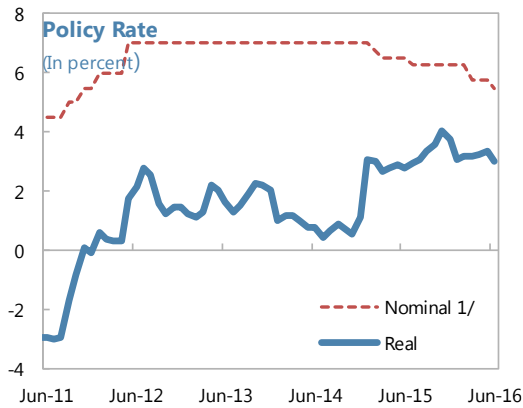
*Deposits growth has slowed, somewhat,, in early 2016...*



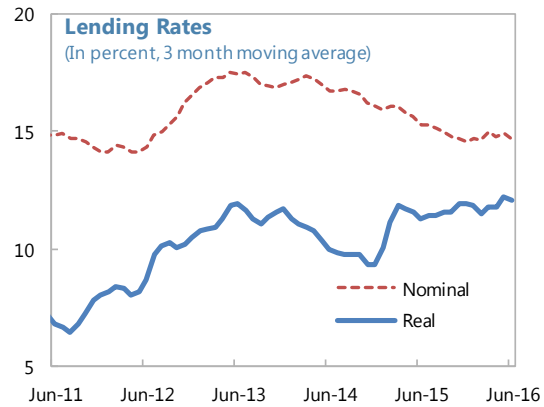
*...while growth of total credit to the private sector has increased.*



*In June 2016, the Central Bank reduced the policy rate by 25 basis points, continuing its easing cycle...*

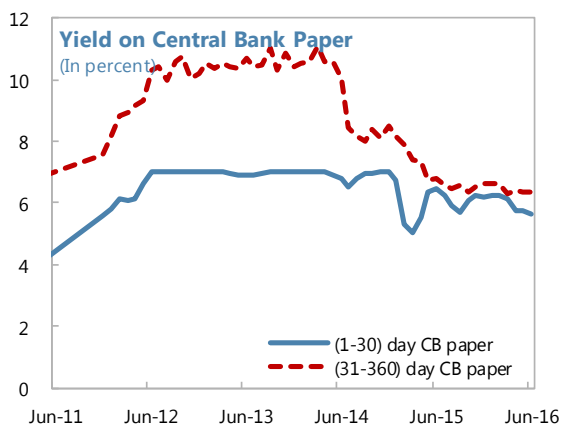


*...and nominal lending rates continue to inch lower...*

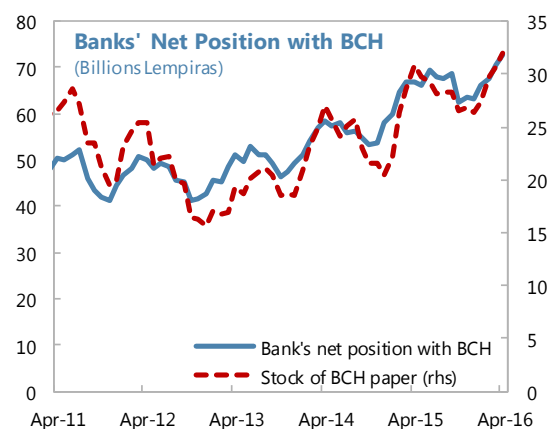


*1/ In June 2016, the Central Bank lowered its policy rate to 5.5 from 5.75 percent .*

*Yields on central bank paper have declined recently...*

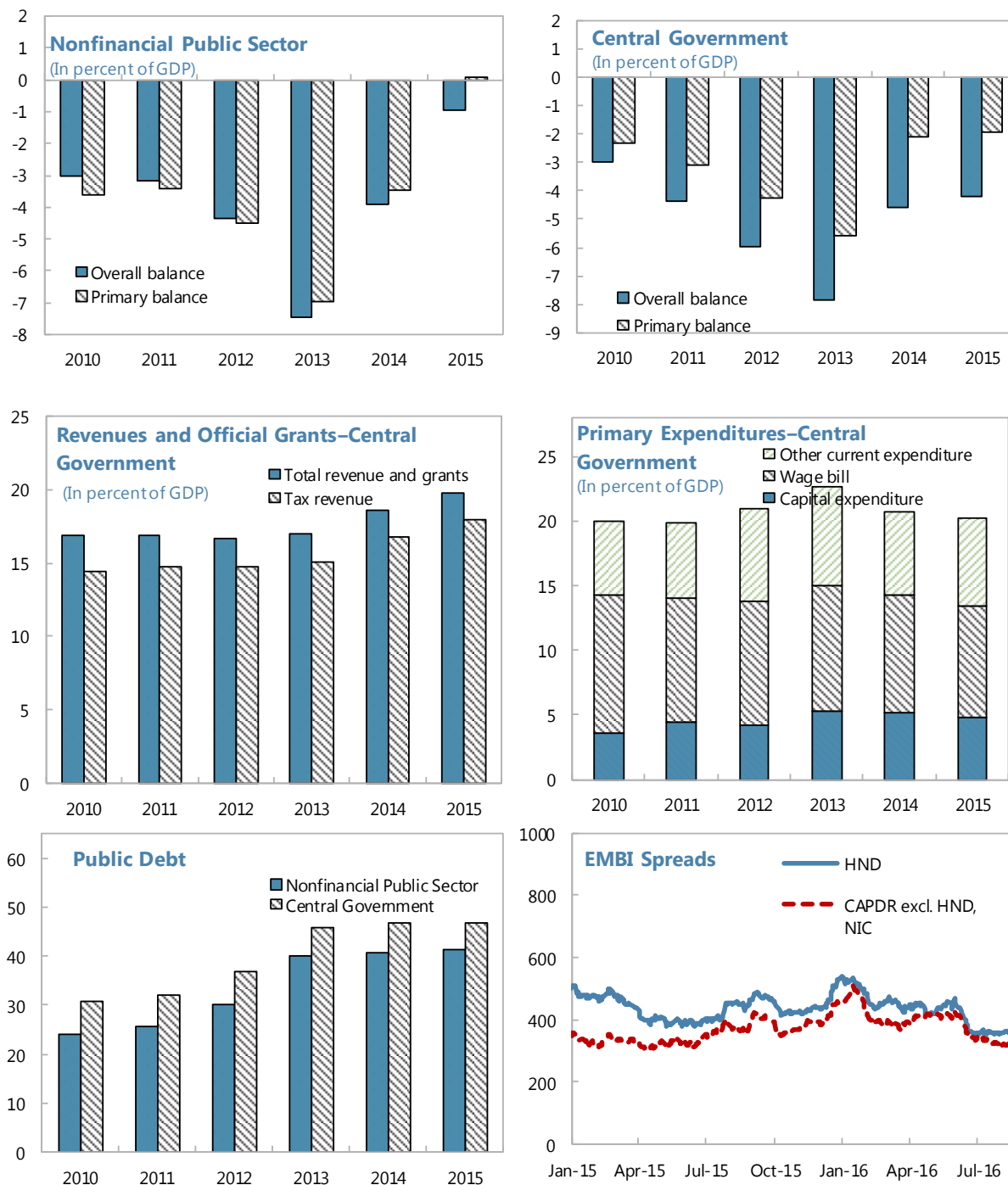


*...but the central bank continues to mop up liquidity.*



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

**Figure 5. Honduras: Fiscal Consolidation Has Moved Ahead of Schedule**



Sources: Ministry of Finance and Fund staff estimates and projections.

**Table 6. Honduras: Selected Economic Indicators**

<b>I. Social Indicators</b>									
Population (2015)	8.6 million					Life expectancy at birth in years (2014)			73
Per capita income in U.S. dollars (PPP, 2015)	4,869					Adult literacy (ages 15 and above, 2014)		87.2 percent	
Rank in UNDP Development Index (2014)	131 of 188					Percent of pop. below poverty line (2014)		62.8	
Unemployment rate (2014)	3.9					Gini index (2013)		54	
Underemployment rate (2012)	54.1					Oil imports (2015)		US \$1.2 billion	
Net FDI (as percent of GDP, 2015)	5.4					Main exports: coffee, bananas, palm oil, and maquila.			
<b>II. Economic Indicators</b>									
	2011	2012	2013	2014		2015		2016	2017
				Prog.	Prel.	Rev. Prog.	Prel.	Rev. Proj.	Rev. Prog.
<b>Real Sector (percentage changes in contributions to growth)</b>									
<b>Real GDP</b>	3.8	4.1	2.8	3.0	3.1	3.5	3.6	3.6	3.7
Domestic demand	7.3	2.8	0.7	3.9	3.1	4.9	6.0	3.6	4.0
Consumption	2.5	3.5	3.2	-1.5	1.8	2.6	2.8	2.3	2.5
Private	2.7	3.1	2.8	-1.7	2.0	1.9	2.6	2.2	1.9
Public	-0.1	0.3	0.5	0.2	-0.2	0.8	0.2	0.0	0.5
Investment	3.3	0.8	-0.4	3.1	-0.3	2.0	1.8	1.4	1.6
Statistical discrepancy & inventories	1.5	-1.5	-2.1	2.4	1.6	0.2	1.3	0.0	0.0
Net exports	-3.5	1.3	2.1	-0.9	0.0	-1.4	-2.3	0.0	-0.3
Exports	4.6	5.6	-0.8	4.4	0.9	1.7	0.9	3.6	2.9
Imports	-8.0	-4.3	2.9	-5.4	-1.0	-3.0	-3.2	-3.6	-3.2
<b>Prices (annual percentage change)</b>									
GDP deflator	7.8	3.6	1.4	5.3	5.5	3.6	6.3	3.0	3.1
<b>Consumer prices (eop)</b>	5.6	5.4	4.9	6.5	5.8	4.2	2.4	4.0	4.5
Consumer prices (average)	6.8	5.2	5.2	6.2	6.1	3.5	3.2	3.0	3.6
<b>Saving and Investment (percent of GDP)</b>									
<b>Gross domestic investment</b>	<b>24.4</b>	<b>24.4</b>	<b>21.8</b>	<b>25.6</b>	<b>22.1</b>	<b>21.8</b>	<b>25.2</b>	<b>26.4</b>	<b>26.8</b>
Private sector	21.1	21.4	17.9	22.3	19.2	19.3	19.7	20.1	20.3
Public sector	3.4	3.0	3.9	3.3	2.8	2.5	5.5	6.3	6.5
<b>Gross national savings</b>	<b>16.5</b>	<b>15.8</b>	<b>12.2</b>	<b>17.8</b>	<b>14.6</b>	<b>15.8</b>	<b>18.8</b>	<b>20.5</b>	<b>21.1</b>
Private sector	15.4	16.3	14.9	18.7	14.0	13.7	15.7	16.6	17.2
Public sector	1.1	-0.5	-2.7	-1.0	0.6	2.2	3.2	3.9	3.9
<b>Nonfinancial public sector (percent of GDP)</b>									
Primary balance	-3.4	-4	-7.0	-4.7	-3.5	-0.4	0.1	-0.2	-0.1
Overall balance	-3.2	-4.4	-7.5	-5.4	-3.9	-1.7	-1.0	-1.2	-1.5
<b>Public sector gross debt</b>	<b>25.5</b>	<b>30.2</b>	<b>40.2</b>	<b>43.0</b>	<b>40.9</b>	<b>42.7</b>	<b>40.9</b>	<b>41.9</b>	<b>43.2</b>
<b>Balance of payments</b>									
External current account balance (percent of GDP)	-8.0	-8.6	-9.6	-7.8	-7.4	-6.0	-6.3	-5.9	-5.7
Exports, f.o.b. (annual percentage change)	27.3	4.8	-6.6	4.7	3.4	0.4	-0.4	2.0	6.1
Imports, f.o.b. (annual percentage change)	24.9	2.2	-3.7	3.2	1.1	-0.2	0.2	2.3	5.3
Worker's Remittances (percent of GDP)	15.9	15.7	16.7	17.1	17.2	18.3	17.8	18.6	19.3
Net International Reserves (millions of dollars)	2,032	1,665	2,211	2,271	2,475	2,730	2,783	3,005	3,250
GIR (In months of imports) 1/	3.6	3.3	3.8	3.7	4.3	4.5	4.5	4.7	4.7
M1 to Net International Reserves (ratio)	1.3	1.3	1.6	1.5	1.7	1.7	1.6	1.8	1.8
Terms of Trade (annual percent change)	1.5	-1.0	-2.4	2.8	4.2	3.9	6.5	-1.2	-0.2
Real effective exchange rate (eop, depreciation -) 2/	1.8	-1.7	0.4	1.2	3.6	4.1	1.6	-0.7	...
<b>Money and Financial</b>									
Broad money (percentage change)	12.7	6.6	8.4	10.2	13.2	12.8	8.7	9.1	9.4
Private sector credit (percentage change)	9.6	16.9	11.2	9.9	10.7	9.6	10.4	10.8	11.1
Bank Assets (percent of GDP)	80.9	83.6	88.9	...	104.6	...	97.0	99.2	102.6
Private Credit (percent of GDP)	46.9	50.9	54.3	...	55.3	...	55.4	57.5	59.8
Non-Performing Loans to total loans(ratio) 3/	2.9	3.3	3.4	...	3.3	...	3.0	3.6	3.5
Capital Adequacy (percent)	14.9	14.7	14.5	...	14.6	...	14.0	...	...
Lending rate (eop, in percent)	14.2	16.7	16.9	16.9	15.9	15.9	14.0	12.3	13.6
Deposit rate (eop, in percent)	7.4	11.4	11.0	9.9	10.4	10.4	8.8	7.6	9.3

Sources: Central Bank of Honduras, Ministry of Finance, and Fund staff estimates and projections.  
1/ Based on following year's imports of goods and services, excluding maquila.  
2/For 2016, this represent actual data as at end July.  
3/For 2016, this represent actual data as at end July.

**Table 7a. Honduras: Operations of the Central Government**  
(In millions of Lempiras)

	2013	2014	2015		2016		2017	2018	2019	2020	2021
			Prog.	Prel.	Prog.	Proj.					
<b>Revenue</b>	<b>64,119</b>	<b>75,978</b>	<b>81,527</b>	<b>88,175</b>	<b>91,385</b>	<b>92,169</b>	<b>99,064</b>	<b>107,131</b>	<b>117,031</b>	<b>127,420</b>	<b>138,608</b>
Taxes	56,727	68,598	73,626	79,863	82,974	84,000	90,300	97,967	106,923	116,662	127,262
Taxes on income	19,597	21,722	23,252	25,324	27,409	26,283	28,450	30,958	34,185	37,736	41,643
Taxes on property	298	275	296	298	316	318	340	368	400	434	470
Taxes on goods and services	33,069	41,781	44,932	48,501	49,619	51,792	55,381	59,939	65,017	70,524	76,498
Taxes on foreign trade	2,651	2,974	3,160	3,541	3,345	3,308	3,668	4,041	4,437	4,838	5,255
Other taxes	1,112	1,846	1,985	2,198	2,285	2,299	2,461	2,661	2,886	3,130	3,396
Social contributions	0	0	0	0	0	0	0	0	0	0	0
Grants	2,873	3,213	3,421	4,107	3,433	3,371	3,477	3,443	3,752	3,865	3,869
Other revenue	4,520	4,166	4,480	4,205	4,978	4,798	5,287	5,722	6,355	6,893	7,477
<b>Expenditure</b>	<b>94,211</b>	<b>94,769</b>	<b>98,428</b>	<b>101,967</b>	<b>107,685</b>	<b>107,173</b>	<b>117,064</b>	<b>126,474</b>	<b>136,854</b>	<b>148,176</b>	<b>160,703</b>
<b>Expense</b>	<b>84,378</b>	<b>85,908</b>	<b>91,674</b>	<b>92,591</b>	<b>96,568</b>	<b>93,586</b>	<b>102,387</b>	<b>112,178</b>	<b>121,113</b>	<b>130,419</b>	<b>139,804</b>
Compensation of employees	36,807	37,251	38,456	38,594	39,800	39,965	43,300	48,256	52,344	56,778	61,588
Purchases of goods and services	11,289	10,297	11,382	13,841	11,500	12,200	14,000	13,731	14,894	16,155	17,524
Interest	8,615	10,205	12,926	12,123	16,078	12,606	15,630	17,506	19,997	20,772	20,904
Domestic	6,583	6,499	8,398	7,963	10,817	8,040	11,000	11,910	13,838	14,164	13,884
Foreign	2,032	3,706	4,528	4,160	5,261	4,566	4,630	5,596	6,160	6,608	7,020
Subsidies	128	75	754	111	100	63	63	66	69	72	75
Grants	18,800	16,205	13,941	15,133	14,657	14,881	16,400	17,750	17,949	19,469	21,118
Current	10,245	10,319	8,231	9,881	9,246	9,714	10,101	10,932	10,554	11,448	12,418
Capital	8,555	5,886	5,710	5,252	5,411	5,167	6,299	6,817	7,395	8,021	8,701
Social benefits	5,625	3,808	6,289	5,013	5,947	4,205	4,315	4,670	5,066	5,495	5,961
Other expense	3,113	8,067	7,927	7,776	8,487	9,665	8,679	10,199	10,794	11,676	12,634
Current	1,799	1,549	1,946	1,451	1,332	1,534	1,351	1,462	1,348	1,462	1,586
Capital	1,314	6,518	5,980	6,325	7,155	8,131	7,328	8,736	9,446	10,214	11,048
<b>Net acquisition of nonfinancial assets</b>	<b>9,833</b>	<b>8,861</b>	<b>6,754</b>	<b>9,377</b>	<b>11,117</b>	<b>13,587</b>	<b>14,677</b>	<b>14,296</b>	<b>15,741</b>	<b>17,758</b>	<b>20,899</b>
<b>Gross Operating Balance</b>	<b>-20,258</b>	<b>-9,931</b>	<b>-10,146</b>	<b>-4,416</b>	<b>-5,183</b>	<b>-1,417</b>	<b>-3,323</b>	<b>-5,046</b>	<b>-4,082</b>	<b>-2,998</b>	<b>-1,196</b>
<b>Net lending/borrowing</b>	<b>-30,091</b>	<b>-18,792</b>	<b>-16,900</b>	<b>-13,793</b>	<b>-16,300</b>	<b>-15,004</b>	<b>-18,000</b>	<b>-19,342</b>	<b>-19,823</b>	<b>-20,756</b>	<b>-22,095</b>
<b>Net financial transactions</b>	<b>-30,091</b>	<b>-18,792</b>	<b>-16,900</b>	<b>-13,793</b>	<b>-16,300</b>	<b>-15,004</b>	<b>-18,000</b>	<b>-19,342</b>	<b>-19,823</b>	<b>-20,756</b>	<b>-22,095</b>
<b>Net acquisition of financial assets</b>	<b>4,292</b>	<b>-1,324</b>	<b>-5,550</b>	<b>2,433</b>	<b>649</b>	<b>-8,490</b>	<b>-15,942</b>	<b>82</b>	<b>-353</b>	<b>22</b>	<b>-22,631</b>
Foreign	0	0	0	0	0	0	0	0	0	0	0
Currency and deposits	0	0	0	0	0	0	0	0	0	0	0
Loans	0	0	0	0	0	0	0	0	0	0	0
Other accounts receivable	0	0	0	0	0	0	0	0	0	0	0
Domestic	4,292	-1,324	-5,550	2,433	649	-8,490	-15,942	82	-353	22	-22,631
Currency and deposits	4,719	-1,324	-5,550	2,433	649	-8,490	-15,942	82	-353	22	-22,631
Debt securities	0	0	0	0	0	0	0	0	0	0	0
Loans	-427	0	0	0	0	0	0	0	0	0	0
Other accounts receivable	0	0	0	0	0	0	0	0	0	0	0
<b>Net incurrence of liabilities</b>	<b>34,383</b>	<b>17,468</b>	<b>11,350</b>	<b>16,225</b>	<b>16,949</b>	<b>6,514</b>	<b>2,057</b>	<b>19,424</b>	<b>19,470</b>	<b>20,778</b>	<b>-536</b>
Foreign	31,435	10,414	12,427	3,242	4,664	6,428	9,527	6,841	1,921	17,495	5,674
Currency and deposits	0	0	0	0	0	0	0	0	0	0	0
Loans	31,262	10,381	12,478	3,207	4,589	6,380	9,562	6,941	2,079	17,662	5,749
Disbursement	32,507	12,553	15,442	6,256	8,004	9,271	13,024	10,951	7,872	24,790	27,291
Amorizations	-1,245	-2,171	-2,964	-3,049	-3,415	-2,891	-3,462	-4,010	-5,793	-7,128	-21,541
Other accounts payable	0	0	0	0	0	0	0	0	0	0	0
Exceptional financing 1/	321	195	100	216	276	249	176	149	120	125	125
Other external	-149	-163	-151	-180	-201	-201	-211	-249	-277	-291	-200
Domestic	2,948	7,054	1,032	12,984	12,284	86	-7,470	12,583	17,549	3,283	-6,210
Currency and deposits	0	0	0	0	0	0	0	0	0	0	0
Adjustment for HIPC debt relief 2/	-1,567	-1,728	-2,109	-1,815	-2,189	-2,189	-2,298	-2,303	-2,526	-2,652	-2,630
Other	0	0	0	0	0	0	0	0	0	0	0
<b>Memorandum items:</b>											
Net lending minus interest payments	-21,476	-8,587	-3,975	-1,670	-222	-2,398	-2,369	-1,836	174	16	-1,191
Gross debt	172,510	192,214	210,771	207,687	239,476	232,491	259,503	289,054	322,555	340,996	364,120
Excluding BCH recapitalization	162,983	180,181	198,738	192,101	227,444	216,905	243,918	273,468	306,969	325,410	348,534
Nominal GDP (in billions of Lempiras)	376.5	409.6	440.5	451.3	470.8	481.3	514.7	557.1	604.2	655.4	710.9

Sources: Honduran authorities, Fund staff estimates and projections.

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

2/ Offsets the HIPC/MDRI debt relief accounted as grants.

**Table 7b. Honduras: Statement of Operations of the Central Government**  
(In percent of GDP)

	2013	2014	2015		2016		2017	2018	2019	2020	2021
	Act.	Act.	Prog.	Prel.	Prog.	Proj.	Proj.	Proj.	Proj.	Proj.	Proj.
<b>Revenue</b>	<b>17.0</b>	<b>18.5</b>	<b>18.5</b>	<b>19.5</b>	<b>19.4</b>	<b>19.1</b>	<b>19.2</b>	<b>19.2</b>	<b>19.4</b>	<b>19.4</b>	<b>19.5</b>
Taxes	15.1	16.7	16.7	17.7	17.6	17.5	17.5	17.6	17.7	17.8	17.9
Taxes on income	5.2	5.3	5.3	5.6	5.8	5.5	5.5	5.6	5.7	5.8	5.9
Taxes on property	0.1	0.1	0.1	0.1	0.1	0.1	0.1	0.1	0.1	0.1	0.1
Taxes on goods and services	8.8	10.2	10.2	10.7	10.5	10.8	10.8	10.8	10.8	10.8	10.8
Taxes on foreign trade	0.7	0.7	0.7	0.8	0.7	0.7	0.7	0.7	0.7	0.7	0.7
Other taxes	0.3	0.5	0.5	0.5	0.5	0.5	0.5	0.5	0.5	0.5	0.5
Social contributions	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Grants	0.8	0.8	0.8	0.9	0.7	0.7	0.7	0.6	0.6	0.6	0.5
Other revenue	1.2	1.0	1.0	0.9	1.1	1.0	1.0	1.0	1.1	1.1	1.1
<b>Expenditure</b>	<b>25.0</b>	<b>23.1</b>	<b>22.3</b>	<b>22.6</b>	<b>22.9</b>	<b>22.3</b>	<b>22.7</b>	<b>22.6</b>	<b>22.6</b>	<b>22.6</b>	<b>22.6</b>
<b>Expense</b>	<b>22.4</b>	<b>21.0</b>	<b>20.8</b>	<b>20.5</b>	<b>20.5</b>	<b>19.4</b>	<b>19.9</b>	<b>20.1</b>	<b>20.0</b>	<b>19.9</b>	<b>19.7</b>
Compensation of employees	9.8	9.1	8.7	8.6	8.5	8.3	8.4	8.7	8.7	8.7	8.7
Purchases of goods and services	3.0	2.5	2.6	3.1	2.4	2.5	2.7	2.5	2.5	2.5	2.5
Interest	2.3	2.5	2.9	2.7	3.4	2.6	3.0	3.1	3.3	3.2	2.9
Domestic	1.7	1.6	1.9	1.8	2.3	1.7	2.1	2.1	2.3	2.2	2.0
Foreign	0.5	0.9	1.0	0.9	1.1	0.9	0.9	1.0	1.0	1.0	1.0
Subsidies	0.0	0.0	0.2	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Grants	5.0	4.0	3.2	3.4	3.1	3.1	3.2	3.2	3.0	3.0	3.0
Current	2.7	2.5	1.9	2.2	2.0	2.0	2.0	2.0	1.7	1.7	1.7
Capital	2.3	1.4	1.3	1.2	1.1	1.1	1.2	1.2	1.2	1.2	1.2
Social benefits	1.5	0.9	1.4	1.1	1.3	0.9	0.8	0.8	0.8	0.8	0.8
Other expense	0.8	2.0	1.8	1.7	1.8	2.0	1.7	1.8	1.8	1.8	1.8
Current	0.5	0.4	0.4	0.3	0.3	0.3	0.3	0.3	0.2	0.2	0.2
Capital	0.3	1.6	1.4	1.4	1.5	1.7	1.4	1.6	1.6	1.6	1.6
<b>Net acquisition of nonfinancial asset</b>	<b>2.6</b>	<b>2.2</b>	<b>1.5</b>	<b>2.1</b>	<b>2.4</b>	<b>2.8</b>	<b>2.9</b>	<b>2.6</b>	<b>2.6</b>	<b>2.7</b>	<b>2.9</b>
<b>Gross Operating Balance</b>	<b>-5.4</b>	<b>-2.4</b>	<b>-2.3</b>	<b>-1.0</b>	<b>-1.1</b>	<b>-0.3</b>	<b>-0.6</b>	<b>-0.9</b>	<b>-0.7</b>	<b>-0.5</b>	<b>-0.2</b>
<b>Net lending/borrowing</b>	<b>-8.0</b>	<b>-4.6</b>	<b>-3.8</b>	<b>-3.1</b>	<b>-3.5</b>	<b>-3.1</b>	<b>-3.5</b>	<b>-3.5</b>	<b>-3.3</b>	<b>-3.2</b>	<b>-3.1</b>
<b>Net financial transactions</b>	<b>-8.0</b>	<b>-4.6</b>	<b>-3.8</b>	<b>-3.1</b>	<b>-3.5</b>	<b>-3.1</b>	<b>-3.5</b>	<b>-3.5</b>	<b>-3.3</b>	<b>-3.2</b>	<b>-3.1</b>
<b>Net acquisition of financial assets</b>	<b>1.1</b>	<b>-0.3</b>	<b>-1.3</b>	<b>0.5</b>	<b>0.1</b>	<b>-1.8</b>	<b>-3.1</b>	<b>0.0</b>	<b>-0.1</b>	<b>0.0</b>	<b>-3.2</b>
Foreign	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Currency and deposits	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Loans	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Other accounts receivable	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Domestic	1.1	-0.3	-1.3	0.5	0.1	-1.8	-3.1	0.0	-0.1	0.0	-3.2
Currency and deposits	1.3	-0.3	-1.3	0.5	0.1	-1.8	-3.1	0.0	-0.1	0.0	-3.2
Debt securities	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Loans	-0.1	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Other accounts receivable	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
<b>Net incurrence of liabilities</b>	<b>9.1</b>	<b>4.3</b>	<b>2.6</b>	<b>3.6</b>	<b>3.6</b>	<b>1.4</b>	<b>0.4</b>	<b>3.5</b>	<b>3.2</b>	<b>3.2</b>	<b>-0.1</b>
Foreign	8.3	2.5	2.8	0.7	1.0	1.3	1.9	1.2	0.3	2.7	0.8
Currency and deposits	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Loans	8.3	2.5	2.8	0.7	1.0	1.3	1.9	1.2	0.3	2.7	0.8
Disbursement	8.6	3.1	3.5	1.4	1.7	1.9	2.5	2.0	1.3	3.8	3.8
Amorizations	-0.3	-0.5	-0.7	-0.7	-0.7	-0.6	-0.7	-0.7	-1.0	-1.1	-3.0
Other accounts payable	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Exceptional financing 1/	0.1	0.0	0.0	0.0	0.1	0.1	0.0	0.0	0.0	0.0	0.0
Other external	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Domestic	0.8	1.7	0.2	2.9	2.6	0.0	-1.5	2.3	2.9	0.5	-0.9
Currency and deposits	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Adjustment for HIPC debt relief 2/	-0.4	-0.4	-0.5	-0.4	-0.5	-0.5	-0.4	-0.4	-0.4	-0.4	-0.4
<b>Memorandum items:</b>											
Net lending minus interest payments	-5.7	-2.1	-0.9	-0.4	0.0	-0.5	-0.5	-0.3	0.0	0.0	-0.2
Gross debt	45.8	46.9	47.8	46.0	50.9	48.3	50.4	51.9	53.4	52.0	51.2
Excluding BCH recapitalization	43.3	44.0	45.1	42.6	48.3	45.1	47.4	49.1	50.8	49.6	49.0
Nominal GDP (in billions of Lempiras)	376.5	409.6	440.5	451.3	470.8	481.3	514.7	557.1	604.2	655.4	710.9

Sources: Honduran authorities, Fund staff estimates and projections.

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

2/ Offsets the HIPC/MDRI debt relief accounted as grants.

**Table 8a. Honduras: Statement of Operations of the Nonfinancial Public Sector**  
(In millions of Lempiras)

	2013	2014	2015		2016		2017	2018	2019	2020	2021
			Prog.	Prel	Prog.	Proj.					
<b>Revenue</b>	<b>114,704</b>	<b>128,693</b>	<b>138,255</b>	<b>142,734</b>	<b>148,677</b>	<b>149,421</b>	<b>160,576</b>	<b>173,441</b>	<b>189,640</b>	<b>209,554</b>	<b>227,568</b>
Taxes	58,781	70,979	75,887	82,213	85,273	86,279	92,563	100,939	110,309	120,192	131,113
Taxes on income	19,597	21,722	23,252	25,324	27,409	26,283	28,450	30,958	34,185	37,736	41,643
Taxes on property	298	275	296	298	316	318	340	368	400	434	470
Taxes on goods and services	33,069	41,781	44,932	48,501	49,619	51,792	55,381	59,939	65,017	70,524	76,498
Taxes on foreign trade	2,651	2,974	3,160	3,541	3,345	3,308	3,668	4,041	4,437	4,838	5,255
Other taxes	3,167	4,227	4,247	4,548	4,584	4,578	4,724	5,633	6,271	6,660	7,246
Social contributions	12,529	12,467	13,555	13,524	14,819	14,573	15,678	17,307	18,961	20,773	22,532
Grants	2,887	3,227	3,437	4,107	3,433	3,375	3,485	3,540	3,852	3,966	3,973
Other revenue	40,506	42,020	45,376	42,890	45,152	45,193	48,850	51,654	56,518	64,623	69,950
Sales of goods and services	25,222	26,542	28,661	26,811	26,977	27,376	30,178	31,446	34,598	40,846	44,159
Interest earnings	5,785	6,772	7,624	5,757	6,968	6,930	7,462	8,076	8,760	9,502	10,307
Capital revenue	1,363	822	793	534	613	603	587	635	689	747	810
Nontax revenue	8,137	7,883	8,298	9,787	10,594	10,285	10,624	11,498	12,472	13,528	14,674
<b>Expenditure</b>	<b>142,831</b>	<b>144,767</b>	<b>147,532</b>	<b>147,085</b>	<b>155,658</b>	<b>155,203</b>	<b>168,376</b>	<b>180,065</b>	<b>195,865</b>	<b>215,878</b>	<b>234,467</b>
<b>Expense</b>	<b>123,861</b>	<b>129,185</b>	<b>133,734</b>	<b>129,480</b>	<b>137,169</b>	<b>132,840</b>	<b>143,672</b>	<b>152,626</b>	<b>166,270</b>	<b>182,854</b>	<b>197,376</b>
Compensation of employees	53,529	52,618	53,718	53,720	56,131	55,390	59,691	65,883	71,464	77,518	84,084
Purchases of goods and services	39,817	38,986	38,845	37,326	36,674	37,186	40,310	42,528	46,765	53,848	58,673
Interest	7,736	8,560	12,355	10,628	15,284	11,860	14,956	16,569	18,677	19,457	19,646
Domestic	5,696	4,807	7,795	6,411	9,978	7,174	10,217	10,973	12,517	12,848	12,626
Foreign	2,040	3,753	4,560	4,216	5,306	4,686	4,739	5,596	6,160	6,608	7,020
Subsidies	85	51	0	69	119	115	46	0	0	0	-
Social benefits	12,724	14,810	15,377	14,839	15,721	14,136	14,322	15,501	16,814	18,238	19,783
Other expense	9,971	14,159	13,440	12,898	13,240	14,154	14,346	12,145	12,550	13,793	15,190
Current	4,973	5,219	4,761	5,354	4,283	4,852	5,086	5,308	5,166	5,570	5,988
Capital	4,998	8,940	8,679	7,544	8,957	9,302	9,260	6,836	7,385	8,223	9,202
<b>Net acquisition of nonfinancial assets</b>	<b>18,969</b>	<b>15,582</b>	<b>13,798</b>	<b>17,605</b>	<b>18,489</b>	<b>22,363</b>	<b>24,704</b>	<b>27,439</b>	<b>29,596</b>	<b>33,024</b>	<b>37,090</b>
<b>Gross Operating Balance</b>	<b>-9,157</b>	<b>-491</b>	<b>4,521</b>	<b>13,254</b>	<b>11,507</b>	<b>16,581</b>	<b>16,904</b>	<b>20,815</b>	<b>23,370</b>	<b>26,700</b>	<b>30,192</b>
<b>Net lending/borrowing</b>	<b>-28,127</b>	<b>-16,073</b>	<b>-9,277</b>	<b>-4,351</b>	<b>-6,981</b>	<b>-5,782</b>	<b>-7,800</b>	<b>-6,624</b>	<b>-6,226</b>	<b>-6,324</b>	<b>-6,899</b>
<b>Net financial transactions</b>	<b>-28,127</b>	<b>-16,073</b>	<b>-9,277</b>	<b>-4,351</b>	<b>-6,981</b>	<b>-5,782</b>	<b>-7,800</b>	<b>-6,624</b>	<b>-6,226</b>	<b>-6,324</b>	<b>-6,899</b>
<b>Net acquisition of financial assets</b>	<b>4,394</b>	<b>746</b>	<b>6,688</b>	<b>-1,090</b>	<b>3,119</b>	<b>-5,795</b>	<b>-4,415</b>	<b>3,711</b>	<b>93</b>	<b>4,334</b>	<b>-18,905</b>
Foreign	0	-27	0	0	0	0	0	0	0	0	0
Currency and deposits	0	-27	0	0	0	0	0	0	0	0	0
Loans	0	0	0	0	0	0	0	0	0	0	0
Other accounts receivable	0	0	0	0	0	0	0	0	0	0	0
Domestic	4,394	773	6,688	-1,090	3,119	-5,795	-4,415	3,711	93	4,334	-18,905
Currency and deposits	5,742	1,178	6,690	-1,634	2,719	-7,495	-5,415	2,911	-547	3,822	-19,314
Debt securities	0	0	0	0	0	0	0	0	0	0	0
Loans	-1,348	-405	-2	544	400	1,700	1,000	800	640	512	410
Other accounts receivable	0	0	0	0	0	0	0	0	0	0	0
<b>Net incurrence of liabilities</b>	<b>32,521</b>	<b>16,819</b>	<b>15,965</b>	<b>3,261</b>	<b>10,100</b>	<b>-13</b>	<b>3,385</b>	<b>10,335</b>	<b>6,318</b>	<b>10,658</b>	<b>-12,006</b>
Foreign	31,412	10,332	14,224	4,583	5,666	7,968	10,427	6,501	3,635	16,811	4,050
Currency and deposits	0	0	0	0	0	0	0	0	0	0	0
Loans	31,317	10,299	14,274	4,548	5,590	7,919	10,462	6,601	3,792	16,978	4,125
Other accounts payable	0	0	0	0	0	0	0	0	0	0	0
Exceptional financing 1/	246	195	100	215	276	249	176	149	120	125	125
Other external	-151	-163	-151	-180	-201	-201	-211	-249	-277	-291	-200
Domestic	2,675	8,215	3,850	493	6,624	-5,791	-4,744	6,137	5,210	-3,501	-13,426
Currency and deposits	0	0	0	0	0	0	0	0	0	0	0
Loans	4,443	7,465	2,930	2,697	3,936	-1,631	-1,473	1,348	353	-8,994	-18,919
Other accounts payable	-1,768	455	0	-3,621	-500	-7,959	-7,555	0	0	0	0
PPPs/other	0	295	921	1,417	3,188	3,798	4,284	4,788	4,857	5,494	5,494
Adjustment for HIPC debt relief 2/	-1,567	-1,728	-2,109	-1,815	-2,189	-2,189	-2,298	-2,303	-2,526	-2,652	-2,630
<b>Memorandum items:</b>											
Net lending minus net interest payments	-26,176	-14,285	-4,546	520	1,335	-852	-306	1,870	3,691	3,630	2,441
Gross total debt	151,203	167,338	189,840	184,537	200,546	201,451	222,375	243,574	264,790	288,382	299,649
Nominal GDP (in billions of Lempiras)	377	410	441	451	471	481	515	557	604	655	711

Sources: Honduran authorities, Fund staff estimates and projections.

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

2/ Offsets the HIPC/MDRI debt relief accounted as grants.

**Table 8b. Honduras: Statement of Operations of the Nonfinancial Public Sector**  
(In percent of GDP)

	Actual		2015		2016		Projected				
	2013	2014	Prog.	Prel	Prog.	Proj.	2017	2018	2019	2020	2021
<b>Revenue</b>	<b>30.5</b>	<b>31.4</b>	<b>31.4</b>	<b>31.6</b>	<b>31.6</b>	<b>31.0</b>	<b>31.2</b>	<b>31.1</b>	<b>31.4</b>	<b>32.0</b>	<b>32.0</b>
Taxes	15.6	17.3	17.2	18.2	18.1	17.9	18.0	18.1	18.3	18.3	18.4
Taxes on income	5.2	5.3	5.3	5.6	5.8	5.5	5.5	5.6	5.7	5.8	5.9
Taxes on property	0.1	0.1	0.1	0.1	0.1	0.1	0.1	0.1	0.1	0.1	0.1
Taxes on goods and services	8.8	10.2	10.2	10.7	10.5	10.8	10.8	10.8	10.8	10.8	10.8
Taxes on foreign trade	0.7	0.7	0.7	0.8	0.7	0.7	0.7	0.7	0.7	0.7	0.7
Other taxes	0.8	1.0	1.0	1.0	1.0	1.0	0.9	1.0	1.0	1.0	1.0
Social contributions	3.3	3.0	3.1	3.0	3.1	3.0	3.0	3.1	3.1	3.2	3.2
Grants	0.8	0.8	0.8	0.9	0.7	0.7	0.7	0.6	0.6	0.6	0.6
Other revenue	10.8	10.3	10.3	9.5	9.6	9.4	9.5	9.3	9.4	9.9	9.8
Sales of goods and services	6.7	6.5	6.5	5.9	5.7	5.7	5.9	5.6	5.7	6.2	6.2
Interest earnings	1.5	1.7	1.7	1.3	1.5	1.4	1.4	1.4	1.4	1.4	1.4
Capital revenue	0.4	0.2	0.2	0.1	0.1	0.1	0.1	0.1	0.1	0.1	0.1
Nontax revenue	2.2	1.9	1.9	2.2	2.3	2.1	2.1	2.1	2.1	2.1	2.1
<b>Expenditure</b>	<b>37.9</b>	<b>35.3</b>	<b>33.6</b>	<b>32.6</b>	<b>33.1</b>	<b>32.2</b>	<b>32.7</b>	<b>32.3</b>	<b>32.4</b>	<b>32.9</b>	<b>33.0</b>
<b>Expense</b>	<b>32.9</b>	<b>31.5</b>	<b>30.4</b>	<b>28.7</b>	<b>29.1</b>	<b>27.6</b>	<b>27.9</b>	<b>27.4</b>	<b>27.5</b>	<b>27.9</b>	<b>27.8</b>
Compensation of employees	14.2	12.8	12.2	11.9	11.9	11.5	11.6	11.8	11.8	11.8	11.8
Purchases of goods and services	10.6	9.5	8.8	8.3	7.8	7.7	7.8	7.6	7.7	8.2	8.3
Interest	2.1	2.1	2.9	2.4	3.2	2.5	2.9	3.0	3.1	3.0	2.8
Domestic	1.5	1.2	1.9	1.4	2.1	1.5	2.0	2.0	2.1	2.0	1.8
Foreign	0.5	0.9	1.0	0.9	1.1	1.0	0.9	1.0	1.0	1.0	1.0
Subsidies	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Social benefits	3.4	3.6	3.4	3.3	3.3	2.9	2.8	2.8	2.8	2.8	2.8
Other expense	2.6	3.5	3.1	2.9	2.8	2.9	2.8	2.2	2.1	2.1	2.1
Current	1.3	1.3	1.2	1.2	0.9	1.0	1.0	1.0	0.9	0.8	0.8
Capital	1.3	2.2	2.0	1.7	1.9	1.9	1.8	1.2	1.2	1.3	1.3
<b>Net acquisition of nonfinancial assets</b>	<b>5.0</b>	<b>3.8</b>	<b>3.1</b>	<b>3.9</b>	<b>3.9</b>	<b>4.6</b>	<b>4.8</b>	<b>4.9</b>	<b>4.9</b>	<b>5.0</b>	<b>5.2</b>
<b>Gross Operating Balance</b>	<b>-2.4</b>	<b>-0.1</b>	<b>1.0</b>	<b>2.9</b>	<b>2.4</b>	<b>3.4</b>	<b>3.3</b>	<b>3.7</b>	<b>3.9</b>	<b>4.1</b>	<b>4.2</b>
<b>Net lending/borrowing</b>	<b>-7.5</b>	<b>-3.9</b>	<b>-2.2</b>	<b>-1.0</b>	<b>-1.5</b>	<b>-1.2</b>	<b>-1.5</b>	<b>-1.2</b>	<b>-1.0</b>	<b>-1.0</b>	<b>-1.0</b>
<b>Net financial transactions</b>	<b>-7.5</b>	<b>-3.9</b>	<b>-2.2</b>	<b>-1.0</b>	<b>-1.5</b>	<b>-1.2</b>	<b>-1.5</b>	<b>-1.2</b>	<b>-1.0</b>	<b>-1.0</b>	<b>-1.0</b>
<b>Net acquisition of financial assets</b>	<b>1.2</b>	<b>0.2</b>	<b>-1.5</b>	<b>-0.2</b>	<b>0.7</b>	<b>-1.2</b>	<b>-0.9</b>	<b>0.7</b>	<b>0.0</b>	<b>0.7</b>	<b>-2.7</b>
Foreign	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Currency and deposits	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Loans	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Other accounts receivable	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Domestic	1.2	0.2	-1.5	-0.2	0.7	-1.2	-0.9	0.7	0.0	0.7	-2.7
Currency and deposits	1.5	0.3	-1.5	-0.4	0.6	-1.6	-1.1	0.5	-0.1	0.6	-2.7
Debt securities	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Loans	-0.4	-0.1	0.0	0.1	0.1	0.4	0.2	0.1	0.1	0.1	0.1
Other accounts receivable	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
<b>Net incurrence of liabilities</b>	<b>8.6</b>	<b>4.1</b>	<b>0.6</b>	<b>0.7</b>	<b>2.1</b>	<b>0.0</b>	<b>0.7</b>	<b>1.9</b>	<b>1.0</b>	<b>1.6</b>	<b>-1.7</b>
Foreign	8.3	2.5	3.5	1.0	1.2	1.7	2.0	1.2	0.6	2.6	0.6
Currency and deposits	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Loans	8.3	2.5	3.5	1.0	1.2	1.6	2.0	1.2	0.6	2.6	0.6
Other accounts payable	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Exceptional financing 1/	0.1	0.0	0.1	0.0	0.1	0.1	0.0	0.0	0.0	0.0	0.0
Other external	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Domestic	0.7	2.0	-2.4	0.1	1.4	-1.2	-0.9	1.1	0.9	-0.5	-1.9
Currency and deposits	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Loans	1.2	1.8	0.2	0.6	0.8	-0.3	-0.3	0.2	0.1	-1.4	-2.7
Other accounts payable	-0.5	0.1	-2.9	-0.8	-0.1	-1.7	-1.5	0.0	0.0	0.0	0.0
PPPs/other	0.0	0.1	0.2	0.3	0.7	0.8	0.8	0.9	0.8	0.8	0.8
Adjustment for HIPC debt relief 2/	-0.4	-0.4	-0.5	-0.4	-0.5	-0.5	-0.4	-0.4	-0.4	-0.4	-0.4
<b>Memorandum items:</b>											
Net lending minus net interest payments	-7.0	-3.5	-1.0	0.1	0.3	-0.2	-0.1	0.3	0.6	0.6	0.3
Gross total debt	40.2	40.9	43.5	40.9	42.7	41.9	43.2	43.7	43.8	44.0	42.2
Nominal GDP (in billions of Lempiras)	376.5	409.6	440.5	451.3	470.8	481.3	514.7	557.1	604.2	655.4	710.9

Sources: Honduran authorities, Fund staff estimates and projections.

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

2/ Offsets the HIPC/MDRI debt relief accounted as grants.



**Table 9. Honduras: Summary Accounts of Central Bank and Financial System**  
(In millions of Lempiras, end-December)

	2013	2014	Prel. 2015	2016	2017	Proj. 2018	2019	2020	2021
<b>I. Central Bank</b>									
<b>Net International Reserves 1/</b>	<b>62,945</b>	<b>75,648</b>	<b>85,495</b>	<b>95,984</b>	<b>107,292</b>	<b>120,346</b>	<b>134,883</b>	<b>151,240</b>	<b>171,305</b>
(In millions of US\$)	3,056	3,516	3,821	4,072	4,336	4,631	4,944	5,279	5,750
Net International Reserves (in millions of US\$) 2/	2,211	2,475	2,783	3,005	3,250	3,525	3,815	4,127	4,563
<b>Net Domestic Assets</b>	<b>-39,344</b>	<b>-49,253</b>	<b>-56,043</b>	<b>-63,282</b>	<b>-71,332</b>	<b>-80,755</b>	<b>-91,331</b>	<b>-103,340</b>	<b>-118,491</b>
Credit to the public sector (net)	7,237	6,101	3,368	5,933	12,716	12,716	12,716	12,716	12,716
Other depository institutions (net)	-49,112	-58,135	-63,211	-70,649	-83,649	-87,748	-91,564	-95,605	-103,321
Other financial institutions	6,917	6,700	8,026	9,265	10,826	10,681	8,748	6,814	4,881
Nonfinancial private sector	-212	-202	-858	-858	-858	-870	-905	-940	-975
Medium and long-term net foreign assets	2,181	155	1,038	1,629	2,261	883	929	516	536
Other items net	-6,356	-3,872	-4,406	-8,602	-12,629	-16,417	-21,254	-26,841	-32,329
<b>Currency issue</b>	<b>23,600</b>	<b>26,395</b>	<b>29,452</b>	<b>32,702</b>	<b>35,960</b>	<b>39,591</b>	<b>43,552</b>	<b>47,900</b>	<b>52,814</b>
<b>II. Other Depository Institutions</b>									
<b>Net Foreign Assets</b>	<b>-10,277</b>	<b>-11,845</b>	<b>-15,905</b>	<b>-15,743</b>	<b>-16,306</b>	<b>-22,817</b>	<b>-29,320</b>	<b>-21,081</b>	<b>-29,469</b>
(In millions of US\$)	-497	-549	-709	-668	-659	-878	-1,075	-736	-989
Foreign assets (million Lempiras)	10,120	12,123	10,568	12,494	13,887	9,862	6,127	17,368	12,237
Foreign assets (in million of US\$)	490	562	471	530	561	380	225	606	411
<b>Net Domestic Assets</b>	<b>190,820</b>	<b>215,905</b>	<b>236,851</b>	<b>258,905</b>	<b>282,238</b>	<b>314,248</b>	<b>349,722</b>	<b>373,387</b>	<b>417,357</b>
Credit to the monetary authorities (net)	55,650	65,380	71,087	79,535	93,556	98,785	103,720	108,979	117,882
Credit to other financial institutions (net)	-26,045	-28,165	-30,372	-32,510	-34,882	-37,894	-41,249	-44,888	-48,836
Credit to the combined public sector (net)	1,089	2,526	1,181	-1,649	-7,372	-8,937	-8,041	-20,860	-20,550
Central government	-8,618	-9,968	-12,307	-13,249	-15,155	-15,676	-15,378	-19,647	-19,543
Other nonfinancial public sector	5,640	8,469	9,460	7,601	5,689	5,167	5,466	1,184	1,288
Local governments	4,067	4,025	4,028	4,000	2,094	1,572	1,871	-2,398	-2,295
Credit to the private sector	204,443	226,349	249,894	276,985	307,812	341,987	380,129	422,180	468,680
Local currency	145,428	159,179	178,301	200,473	225,942	254,536	286,825	322,886	363,258
Foreign currency	59,015	67,170	71,593	76,513	81,870	87,451	93,304	99,294	105,422
Other items net	-44,316	-50,185	-49,048	-63,456	-76,876	-79,693	-84,837	-92,024	-99,819
<b>Liabilities</b>	<b>180,544</b>	<b>204,060</b>	<b>220,946</b>	<b>243,163</b>	<b>265,932</b>	<b>291,432</b>	<b>320,402</b>	<b>352,306</b>	<b>387,887</b>
Of which: Deposits in domestic currency	127,211	140,062	157,010	173,632	191,376	211,338	234,119	259,382	287,728
Of which: Deposits in foreign currency	52,224	62,989	62,609	67,550	72,437	77,801	83,795	90,226	97,233
<b>III. Financial System</b>									
<b>Net Foreign Assets</b>	<b>51,347</b>	<b>60,412</b>	<b>66,933</b>	<b>77,584</b>	<b>88,329</b>	<b>94,872</b>	<b>102,906</b>	<b>127,502</b>	<b>139,179</b>
(In millions of US\$)	2,484	2,798	2,982	3,292	3,569	3,651	3,772	4,451	4,671
<b>Net Domestic Assets</b>	<b>145,958</b>	<b>163,018</b>	<b>176,006</b>	<b>187,419</b>	<b>201,541</b>	<b>222,824</b>	<b>246,409</b>	<b>256,636</b>	<b>284,038</b>
Credit to the nonfinancial combined public sector	8,326	8,627	4,549	4,284	5,344	3,779	4,675	-8,144	-7,834
Credit to the private sector	204,443	226,349	249,894	276,985	307,812	341,987	380,129	422,180	468,680
Local currency	145,428	159,179	178,301	200,473	225,942	254,536	286,825	322,886	363,258
Foreign currency	59,015	67,170	71,593	76,513	81,870	87,451	93,304	99,294	105,422
Other assets net	-7,369	-6,890	-5,646	-25,245	-26,350	-31,887	-38,500	-46,198	-53,166
Other items net 3/	-59,441	-65,068	-72,791	-68,606	-85,265	-91,055	-99,895	-111,202	-123,642
<b>Broad Money (M4)</b>	<b>197,305</b>	<b>223,429</b>	<b>242,939</b>	<b>265,003</b>	<b>289,870</b>	<b>317,697</b>	<b>349,315</b>	<b>384,137</b>	<b>423,217</b>
(Rate of growth 12 months)									
Currency issue	6.6	11.8	11.6	11.0	10.0	10.1	10.0	10.0	10.3
Currency in circulation	3.9	12.2	12.7	10.4	9.4	9.6	10.0	10.0	10.8
Broad money	8.4	13.2	8.7	9.1	9.4	9.6	10.0	10.0	10.2
Broad money (constant exchange rate)	7.5	12.0	7.6	7.7	8.1	8.3	8.7	8.7	9.2
Credit to the private sector	11.2	10.7	10.4	10.8	11.1	11.1	11.2	11.1	11.0
Credit to the private sector (constant exchange)	10.2	9.4	9.2	9.3	9.7	9.7	9.9	9.8	10.1
M1	4.5	13.5	14.7	2.5	9.7	9.9	10.2	10.2	10.7

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 10. Honduras: Balance of Payments

	2013	2014	Prel. 2015	Projections					
				2016	2017	2018	2019	2020	2021
(In millions of U.S. dollars; unless otherwise indicated)									
<b>Current account</b>	<b>-1,763</b>	<b>-1,444</b>	<b>-1,291</b>	<b>-1,241</b>	<b>-1,211</b>	<b>-1,258</b>	<b>-1,249</b>	<b>-1,220</b>	<b>-1,199</b>
Trade Account	-3,147	-2,998	-3,056	-3,151	-3,255	-3,408	-3,543	-3,639	-3,741
Exports f.o.b.	5,246	5,511	5,526	5,693	6,081	6,404	6,724	7,005	7,322
Maquila Net (exports-imports)	1,330	1,418	1,572	1,609	1,682	1,763	1,848	1,932	2,034
Coffee	750	839	986	907	995	1,116	1,218	1,269	1,328
Others	3,166	3,254	2,968	3,177	3,404	3,526	3,658	3,804	3,959
Imports f.o.b.	-8,393	-8,508	-8,583	-8,843	-9,336	-9,812	-10,266	-10,644	-11,062
Petroleum products	-2,061	-1,903	-1,234	-1,111	-1,366	-1,468	-1,552	-1,651	-1,745
Others	-6,332	-6,605	-7,349	-7,732	-7,970	-8,344	-8,714	-8,993	-9,318
Services (net)	-668	-698	-690	-688	-673	-716	-742	-767	-796
Of which: tourism receipts	608	630	650	684	716	757	801	828	859
Income (net)	-1,353	-1,322	-1,380	-1,473	-1,571	-1,624	-1,680	-1,731	-1,792
Of which: payments on direct investments	-1,208	-1,129	-1,183	-1,234	-1,317	-1,357	-1,402	-1,448	-1,504
Of which: public sector interest payments	-92	-166	-181	-194	-208	-221	-231	-236	-240
Transfers (net)	3,395	3,572	3,835	4,070	4,287	4,489	4,715	4,917	5,129
Of which: Remittances	3,083	3,353	3,650	3,891	4,105	4,301	4,501	4,696	4,899
Others	312	219	185	179	183	188	214	221	230
<b>Capital and Financial account</b>	<b>2,628</b>	<b>1,796</b>	<b>1,541</b>	<b>1,464</b>	<b>1,456</b>	<b>1,534</b>	<b>1,539</b>	<b>1,532</b>	<b>1,635</b>
Direct investment (net)	992	1,120	1,113	1,195	1,293	1,321	1,385	1,452	1,549
Other private capital flows (net)	17	73	-66	-213	-410	-191	-138	-860	-306
Public sector borrowing (net)	1,487	458	174	331	419	246	128	101	135
Disbursements	1,600	599	351	489	605	455	376	380	932
Of which:									
Multilateral	514	453	203	296	384	234	236	495	546
Eurobonds	1,000	0	0	0	0	0	0	0	0
Amortization	-70	-95	-145	-145	-172	-195	-233	-273	-791
Errors and omissions 1/	-332	-87	43	0	0	0	0	0	0
<b>Overall balance</b>	<b>533</b>	<b>265</b>	<b>293</b>	<b>222</b>	<b>245</b>	<b>276</b>	<b>289</b>	<b>312</b>	<b>436</b>
<b>Net international reserves (- increase)</b>	<b>-546</b>	<b>-264</b>	<b>-307</b>	<b>-222</b>	<b>-245</b>	<b>-276</b>	<b>-289</b>	<b>-312</b>	<b>-436</b>
(In percent of GDP, unless otherwise indicated)									
<b>Current account</b>	<b>-9.5</b>	<b>-7.4</b>	<b>-6.3</b>	<b>-5.9</b>	<b>-5.7</b>	<b>-5.7</b>	<b>-5.5</b>	<b>-5.2</b>	<b>-4.9</b>
Trade Account	-17.0	-15.4	-14.9	-15.1	-15.3	-15.5	-15.6	-15.5	-15.4
Exports f.o.b.	28.4	28.2	27.0	27.2	28.5	29.2	29.6	29.9	30.1
Maquila Net (exports-imports)	7.2	7.3	7.7	7.7	7.9	8.0	8.1	8.2	8.4
Coffee	4.1	4.3	4.8	4.3	4.7	5.1	5.4	5.4	5.5
Others	17.1	16.7	14.5	15.2	16.0	16.1	16.1	16.2	16.3
Imports f.o.b.	-45.4	-43.6	-42.0	-42.3	-43.8	-44.7	-45.3	-45.4	-45.5
Petroleum products	-11.1	-9.8	-6.0	-5.3	-6.4	-6.7	-6.8	-7.0	-7.2
Others	-34.2	-33.9	-35.9	-37.0	-37.4	-38.0	-38.4	-38.4	-38.3
Services (net)	-3.6	-3.6	-3.4	-3.3	-3.2	-3.3	-3.3	-3.3	-3.3
Of which: tourism receipts	3.3	3.2	3.2	3.3	3.4	3.4	3.5	3.5	3.5
Income (net)	-7.3	-6.8	-6.7	-7.0	-7.4	-7.4	-7.4	-7.4	-7.4
Of which: payments on direct investments	-6.5	-5.8	-5.8	-5.9	-6.2	-6.2	-6.2	-6.2	-6.2
Of which: public sector interest payments	-0.5	-0.9	-0.9	-0.9	-1.0	-1.0	-1.0	-1.0	-1.0
Transfers (net)	18.4	18.3	18.8	19.5	20.1	20.4	20.8	21.0	21.1
Of which: Remittances	16.7	17.2	17.8	18.6	19.3	19.6	19.8	20.0	20.1
<b>Capital and Financial account</b>	<b>14.2</b>	<b>9.2</b>	<b>7.5</b>	<b>7.0</b>	<b>6.8</b>	<b>7.0</b>	<b>6.8</b>	<b>6.5</b>	<b>6.7</b>
Direct investment (net)	5.4	5.7	5.4	5.7	6.1	6.0	6.1	6.2	6.4
Other private capital flows (net)	0.1	0.4	-0.3	-1.0	-1.9	-0.9	-0.6	-3.7	-1.3
Public sector borrowing (net)	8.0	2.3	0.9	1.6	2.0	1.1	0.6	0.4	0.6
Disbursements	8.6	3.1	1.7	2.3	2.8	2.1	1.7	1.6	3.8
Of which:									
Multilateral	2.8	2.3	1.0	1.4	1.8	1.1	1.0	2.1	2.2
Eurobonds	5.4	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Official budget support									
Amortization	-0.4	-0.5	-0.7	-0.7	-0.8	-0.9	-1.0	-1.2	-3.2
Errors and omissions 1/	-1.8	-0.4	0.2	0.0	0.0	0.0	0.0	0.0	0.0
<b>Overall balance</b>	<b>2.9</b>	<b>1.4</b>	<b>1.4</b>	<b>1.1</b>	<b>1.1</b>	<b>1.3</b>	<b>1.3</b>	<b>1.3</b>	<b>1.8</b>
<b>Net international reserves (- increase)</b>	<b>-2.9</b>	<b>-1.4</b>	<b>-1.5</b>	<b>-1.1</b>	<b>-1.1</b>	<b>-1.3</b>	<b>-1.3</b>	<b>-1.3</b>	<b>-1.8</b>
<b>Residual gap</b>	<b>0.0</b>	<b>0.0</b>	<b>0.0</b>	<b>0.0</b>	<b>0.0</b>	<b>0.0</b>	<b>0.0</b>	<b>0.0</b>	<b>0.0</b>
<b>Memorandum items:</b>									
Non oil current account (in percent of GDP)	1.6	2.4	-0.3	-0.6	0.7	1.0	1.3	1.8	2.2
Terms of trade (percent change)	-2.5	4.3	6.2	-1.2	-0.2	0.4	0.6	0.2	0.0
Exports of goods (percent change)	-6.6	3.4	-0.4	2.0	6.1	5.0	4.8	4.3	4.4
Of Which: volume growth (percent change)	-2.4	2.0	2.6	5.7	4.4	3.6	3.7	3.5	4.0
Imports of goods (percent change)	-3.7	1.1	0.2	2.3	5.3	4.9	4.6	3.8	3.9
Of Which: volume growth (percent change)	-1.8	3.9	9.7	4.7	3.4	3.9	4.1	3.3	3.8
Gross reserves (end of period, millions of U.S. dollars)	3,255	3,698	3,992	4,385	4,648	4,944	5,256	5,591	6,062
In months of next year imports (excluding maquila)	3.9	4.3	4.5	4.7	4.7	4.8	4.9	5.1	5.2
Total external debt to GDP ratio (in percent)	35.9	36.8	36.5	37.4	38.9	39.0	38.5	40.1	39.4
External public debt to GDP ratio (in percent)	28.1	28.5	29.0	30.0	31.5	31.7	31.3	32.9	32.3
Nominal GDP (millions of U.S. dollars)	18,499	19,511	20,450	20,921	21,305	21,961	22,687	23,437	24,330

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

1/ 2016 reflects information through June 2016.

**Table 11. Honduras: External Financing Needs and Sources**

	2013	2014	Prel. 2015	Proj.					
				2016	2017	2018	2019	2020	2021
Current account deficit	1,763	1,444	1,291	1,197	1,210	1,224	1,257	1,221	1,201
Debt amortizations	342	319	362	355	376	393	425	459	971
Public debt amortization	70	95	145	145	172	195	233	273	791
Private debt amortization	272	223	217	210	204	198	192	186	180
<b>Subtotal (requirements)</b>	<b>2,105</b>	<b>1,763</b>	<b>1,653</b>	<b>1,552</b>	<b>1,585</b>	<b>1,616</b>	<b>1,682</b>	<b>1,680</b>	<b>2,172</b>
Capital account flows (net)	133	145	141	149	152	157	162	167	174
Foreign direct investment (net)	992	1,120	1,113	1,195	1,289	1,296	1,340	1,385	1,429
Public sector borrowing (project related)	600	414	351	464	505	455	376	380	932
Eurobond	1,000	0	0	0	0	0	0	0	0
Other capital flows (net) 1/	-74	348	178	-59	-216	-16	93	59	73
Change in reserves (+ decrease)	-546	-264	-307	-222	-245	-276	-289	-312	-436
<b>Subtotal (sources)</b>	<b>2,105</b>	<b>1,763</b>	<b>1,476</b>	<b>1,527</b>	<b>1,485</b>	<b>1,616</b>	<b>1,682</b>	<b>1,680</b>	<b>2,172</b>
<b>Financing gap</b>	<b>0</b>	<b>0</b>	<b>177</b>	<b>25</b>	<b>100</b>	<b>0</b>	<b>0</b>	<b>0</b>	<b>0</b>
World Bank	...	...	50	25	0	0	0	0	0
IADB	...	...	100	0	100	0	0	0	0
IMF	...	...	0	0	0	0	0	0	0
EU	...	...	27	0	0	0	0	0	0

Sources: Central Bank of Honduras and Fund staff estimates and projections.  
1/ Includes errors and omissions.

Table 12. Honduras: Medium-Term Macroeconomic Framework

	2014	Prel. 2015	Proj.					
			2016	2017	2018	2019	2020	2021
<b>Growth and prices (in percent)</b>								
Real GDP growth	3.1	3.6	3.6	3.7	3.8	3.8	3.8	3.8
GDP deflator	5.5	6.3	3.0	3.1	4.3	4.5	4.5	4.5
CPI inflation (eop)	5.8	2.4	4.0	4.5	4.5	4.5	4.5	4.5
<b>Investment and saving</b>								
<b>Gross domestic investment</b>	<b>22.1</b>	<b>25.2</b>	<b>26.4</b>	<b>26.8</b>	<b>27.7</b>	<b>28.5</b>	<b>29.2</b>	<b>29.7</b>
Private sector	19.2	19.7	20.1	20.3	21.6	22.5	22.9	24.0
Public sector	2.8	5.5	6.3	6.5	6.1	6.0	6.2	5.7
<b>Gross national savings</b>	<b>14.6</b>	<b>18.8</b>	<b>20.5</b>	<b>21.1</b>	<b>21.9</b>	<b>23.0</b>	<b>23.9</b>	<b>24.8</b>
Private sector	14.0	15.7	16.6	17.2	18.2	19.1	19.7	20.1
Public sector	0.6	3.2	3.9	3.9	3.8	3.9	4.2	4.6
<b>Balance of payments</b>								
External current account	-7.4	-6.3	-5.9	-5.7	-5.7	-5.5	-5.2	-4.9
Non oil current account	2.4	-0.3	-0.6	0.7	1.0	1.3	1.8	2.2
Gross international reserves (millions of dollars)	3,698	3,992	4,385	4,648	4,944	5,256	5,591	6,062
Terms of Trade (annual percent change)	4.2	6.5	-1.2	-0.2	0.4	0.6	0.2	0.0
<b>External debt</b>	<b>36.9</b>	<b>36.5</b>	<b>37.4</b>	<b>38.9</b>	<b>39.0</b>	<b>38.5</b>	<b>40.1</b>	<b>39.4</b>
<b>Nonfinancial public sector</b>								
Revenue	31.4	31.6	31.0	31.2	31.1	31.4	32.0	32.0
Of which: Non-interest revenue and grants	29.8	30.4	29.6	29.7	29.7	29.9	30.5	30.6
Expenditure	35.3	32.6	32.2	32.7	32.3	32.4	32.9	33.0
Of which: Noninterest expenditure	33.3	30.2	29.8	29.8	29.3	29.3	30.0	30.2
<b>Primary balance</b>	<b>-3.5</b>	<b>0.1</b>	<b>-0.2</b>	<b>-0.1</b>	<b>0.3</b>	<b>0.6</b>	<b>0.6</b>	<b>0.3</b>
<b>Overall balance</b>	<b>-3.9</b>	<b>-1.0</b>	<b>-1.2</b>	<b>-1.5</b>	<b>-1.2</b>	<b>-1.0</b>	<b>-1.0</b>	<b>-1.0</b>
<b>Central government</b>								
Revenue	18.5	19.5	19.1	19.2	19.2	19.4	19.4	19.5
Expenditure	23.1	22.6	22.3	22.7	22.7	22.6	22.6	22.6
Of which: Non-interest expenditure	20.6	19.9	19.6	19.7	19.6	19.3	19.4	19.7
<b>Primary balance</b>	<b>-2.1</b>	<b>-0.4</b>	<b>-0.5</b>	<b>-0.5</b>	<b>-0.3</b>	<b>0.0</b>	<b>0.0</b>	<b>-0.2</b>
<b>Overall balance</b>	<b>-4.6</b>	<b>-3.0</b>	<b>-3.1</b>	<b>-3.5</b>	<b>-3.5</b>	<b>-3.3</b>	<b>-3.2</b>	<b>-3.1</b>
<b>Nonfinancial public sector debt</b>								
Total	<b>40.9</b>	<b>40.9</b>	<b>41.9</b>	<b>43.2</b>	<b>43.7</b>	<b>43.8</b>	<b>44.0</b>	<b>42.2</b>
Domestic debt	11.5	11.4	11.1	10.9	11.2	11.7	10.3	9.2
External debt	29.3	29.5	30.7	32.3	32.5	32.1	33.7	32.9
<b>Monetary</b>								
Broad money (percentage change)	13.2	8.7	9.1	9.4	9.6	10.0	10.0	10.2
Private sector credit (percentage change)	10.7	10.4	10.8	11.1	11.1	11.2	11.1	11.0
Bank assets	96.1	97.0	99.2	102.6	106.0	109.3	112.7	116.1
Private credit	55.3	55.4	57.5	59.8	61.4	62.9	64.4	65.9
Non-performing loans to total loans (ratio)	3.3	3.0	3.6	3.5	3.3	3.2	3.1	2.9
Capital adequacy (percent)	14.6	14.0	...	...	...	...	...	...
Lending rate (eop, in percent)	15.9	14.0	12.3	13.7	13.4	12.8	12.5	12.3
Deposit rate (eop, in percent)	10.4	8.8	7.6	9.3	9.2	8.8	8.6	8.5
<b>Memo items:</b>								
Nominal GDP (in billions of lempiras)	410	451	481	515	557	604	655	711

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

**Table 13. Honduras: External Vulnerability Indicators**

	2013	2014	Prel. 2015	2016	2017	Proj. 2018	2019	2020	2021
Exports of goods and services, annual percent change	-6.3	3.9	-0.2	2.4	5.6	5.0	4.8	4.3	4.3
Imports of goods and services, annual percent change	-3.0	1.7	0.3	2.4	4.6	5.0	4.5	3.9	3.9
Terms of trade (deterioration -)	-2.5	4.3	6.2	-1.2	-0.2	0.4	0.6	0.2	0.0
Real effective exchange rate (eop, depreciation -)	0.4	3.6	...	...	...	...	...	...	...
Current account balance (percent of GDP)	-9.5	-7.4	-6.3	-1241.5	-1211.3	-1258.1	-1249.5	-1219.9	-1199.1
Capital and financial account (percent of GDP)	14.2	9.2	7.5	7.0	6.8	7.0	6.8	6.5	6.7
External public debt (percent of GDP)	28.1	28.5	29.0	30.0	31.5	31.7	31.3	32.9	32.3
Gross official reserves									
in millions of U.S. dollars	3,255	3,698	3,992	4,383	4,646.2	4,941.2	5,253.3	5,588.7	6179.3
in percent of short-term external debt	1,022	1,041	1,187	1,284	1,341.1	1,404.8	1,470.5	1,523.4	1632.0
Net international reserves									
in millions of U.S. dollars	2,211	2,475	2,783	3,005	3,249.7	3,525.5	3,814.5	4,126.6	4562.7
in percent of short-term external debt	694	697	828	881	938.0	1,002.3	1,067.8	1,124.9	1205.0

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

Table 14. Honduras: Structure and Performance of the Banking Sector

	2009	2010	2011	2012	2013	2014	2015	Prel. 2016M7
<b>Total assets (in millions of Lempiras) 1/</b>	<b>220,277</b>	<b>236,665</b>	<b>270,981</b>	<b>302,662</b>	<b>341,614</b>	<b>393,763</b>	<b>432,178</b>	<b>449,652</b>
(In percent of GDP)	80	79	81	84	91	96	97	97.9
<b>Number of banks</b>	<b>17</b>	<b>17</b>	<b>17</b>	<b>17</b>	<b>17</b>	<b>17</b>	<b>15</b>	<b>15</b>
Domestic	8	8	7	7	7	8	6	6
Foreign	9	9	10	10	10	9	9	9
<b>Bank concentration</b>								
Number of banks accounting for at least								
25 percent of total assets	2	2	2	2	2	2	2	2
75 percent of total assets	6	6	6	6	6	6	5	5
<b>Capital adequacy</b>								
Regulatory capital to risk-weighted assets	14.3	14.9	14.9	14.7	14.5	14.6	14.0	13.7
Capital (net worth) to assets	9.3	9.2	9.1	9.3	9.1	9.2	8.7	8.6
<b>Asset quality and composition</b>								
Nonperforming loans( NPLs) to total loans 2/	4.7	3.7	2.9	3.3	3.4	3.3	3.0	3.6
NPLs net of provisions to capital 2/	4.2	-4.4	-6.5	-4.6	-5.2	-5.2	-5.1	-0.9
Restructured loans to regulatory capital	9.0	19.8	26.6	24.7	25.3	22.3	27.9	26.4
Non earning assets net of provisions								
to regulatory capital	47.2	47.9	46.9	45.0	44.1	51.2	54.6	52.5
Provisions to total loans	4.1	4.3	3.9	4.0	4.2	4.1	3.8	3.7
Provisions to NPLs 2/	86.2	118.9	135.0	121.8	123.7	125.5	126.1	103.9
Sectoral distribution of loans to total loans:								
Commerce	11.6	12.7	13.0	14.4	14.3	14.3	13.6	13.7
Construction and real estate	33.5	34.2	32.9	30.8	28.9	27.1	24.6	24.2
Agriculture and related sectors	5.1	4.7	4.9	4.4	4.7	5.0	5.9	7.3
Industry	15.4	13.6	12.3	11.7	11.9	11.1	11.1	10.6
Consumption	15.7	16.5	18.3	20.5	21.9	21.0	21.3	21.7
Other	18.7	18.3	18.6	18.2	18.0	21.3	23.5	22.3
<b>Profitability</b>								
Return on assets (ROA)	1.2	1.3	1.3	1.5	1.4	1.4	1.4	1.3
Return on equity (ROE)	12.6	12.5	13.2	15.9	14.5	13.4	14.6	13.5
Interest margin to total income	48.1	48.2	48.9	52.1	47.5	52.1	52.8	52.9
Personnel expenses to administrative expenses	39.6	39.6	39.6	39.4	41.8	41.7	42.0	42.4
<b>Liquidity</b>								
Liquid assets to total assets	21.1	24.4	24.3	21.4	25.0	25.2	24.6	24.3
Liquid assets to total short-term liabilities	52.2	58.2	58.8	56.2	69.7	70.8	69.5	67.2
<b>Dollarization</b>								
Deposits in foreign currency in percent of total	30.0	29.5	29.1	30.6	30.6	32.0	29.8	30.1
Credit in foreign currency in percent of total	25.1	28.3	30.1	31.2	33.5	34.7	33.2	31.7

Source: National Commission of Banking and Insurance.

1/ Includes contingent assets.

2/ As of 2012 NPLs include delinquency of restructured loans.

Table 15. Honduras: Millennium Development Goals

	1990	1995	2000	2005	2010	2011	2012	2013	2014	2015
<b>Goal 1: Eradicate extreme poverty and hunger</b>										
Employment to population ratio, 15+, total (%)	56.7	58.9	63.4	58.7	59.2	59.6	60.0	60.2	60.4	..
Employment to population ratio, ages 15-24, total (%)	48.3	50.8	54.1	47.1	44.5	45.0	45.6	45.8	45.8	..
Poverty gap at \$1.25 a day (PPP) (%)	20.8	11.1	8.1	13.9	4.8	7.9	9.3	7.7	..	..
Malnutrition prevalence, weight for age (% of children under 5)	15.8	16.1	12.5	8.6	..	..	7.1	..	..	..
Prevalence of undernourishment (% of population)	23.0	20.5	19.0	16.7	14.9	14.6	13.7	12.8	12.3	12.2
<b>Goal 2: Achieve universal primary education</b>										
Primary completion rate, total (% of relevant age group)	64.1	69.9	..	81.5	97.2	100.7	100.7	94.5	90.7	..
School enrollment, primary (% net)	88.2	..	88.5	90.8	96.1	97.5	97.3	93.8	94.0	..
<b>Goal 3: Promote gender equality and empower women</b>										
Proportion of seats held by women in national parliaments (%)	10.2	..	9.4	23.4	18.0	19.5	19.5	19.5	25.8	25.8
Ratio of girls to boys in primary and secondary education (%)	1.0	..	..	1.1	1.1	1.1	1.1	1.1	1.0	..
<b>Goal 4: Reduce child mortality</b>										
Immunization, measles (% of children ages 12-23 months)	90.0	89.0	98.0	96.0	98.0	95.0	93.0	89.0	88.0	..
Mortality rate, infant (per 1,000 live births)	45.1	36.9	30.5	25.0	20.7	19.9	19.2	18.6	18.0	17.4
Mortality rate, under-5 (per 1,000 live births)	58.2	46.4	37.4	30.0	24.4	23.5	22.6	21.8	21.1	20.4
<b>Goal 5: Improve maternal health</b>										
Births attended by skilled health staff (% of total)	46.9	54.9	55.7	66.9	..	..	82.9	..	..	..
Contraceptive prevalence (% of women ages 15-49)	46.7	49.2	61.6	65.1	..	..	73.2	..	..	..
Maternal mortality ratio (modeled estimate, per 100,000 live births)	272.0	166.0	133.0	150.0	155.0	149.0	141.0	135.0	132.0	129.0
<b>Goal 6: Combat HIV/AIDS, malaria, and other diseases</b>										
Incidence of tuberculosis (per 100,000 people)	114.0	114.0	114.0	73.0	47.0	52.0	48.0	46.0	43.0	..
Prevalence of HIV, total (% of population ages 15-49)	1.0	1.5	1.2	0.8	0.5	0.5	0.5	0.4	0.4	..
Tuberculosis case detection rate (% of all forms)	65.0	78.0	90.0	66.0	82.0	82.0	82.0	82.0	82.0	..
<b>Goal 7: Ensure environment sustainability</b>										
CO2 emissions (metric tons per capita)	0.5	0.7	0.8	1.1	1.1	1.1	..	..	..	..
Forest area (% of land area)	72.7	64.9	57.1	51.8	46.4	45.3	44.3	43.2	..	41.0
Improved sanitation facilities (% of population with access)	48.2	55.9	63.3	70.5	77.4	78.7	80.0	81.3	82.6	82.6
Improved water source (% of population with access)	73.1	77.0	80.8	84.5	88.0	88.7	89.3	90.0	90.6	91.2
Terrestrial protected areas (% of total land area)	13.5	..	21.5	..	..	..	..	..	21.6	..
<b>Goal 8: Develop a global partnership for development</b>										
Internet users (per 100 people)	0.0	0.0	1.2	6.5	11.1	15.9	18.1	17.8	19.1	..
Mobile cellular subscriptions (per 100 people)	0.0	0.0	2.5	18.6	124.7	103.7	92.9	95.9	93.5	..

Source: Millennium Development Goals, World Bank.

**Table 16. Disbursements, Purchases, and Timing of Reviews under the SCF/SBA Arrangements**

Date of Availability	Conditions	Amount (millions of SDRs)			Percent of quota 1/		
		Total	SCF	SBA 2/	Total	SCF	SBA
December 3, 2014	Board approval of the arrangements	6.475	6.475	---	2.59	2.59	---
April 15, 2015	Observance of end-December 2014 performance criteria and continuous performance criteria and completion of first review	3.238	3.238	---	1.30	1.30	---
October 15, 2015	Observance of end-June 2015 performance criteria and continuous performance criteria and completion of second review	3.238	3.238	---	1.30	1.30	---
April 15, 2016	Observance of end-December 2015 performance criteria and continuous performance criteria and completion of third review.	19.425	19.425	---	7.78	7.78	---
October 26, 2016	Observance of end-June 2016 performance criteria and continuous performance criteria and completion of fourth review (SCF) and third and fourth reviews (SBA)	89.500	19.425	70.075 3/	35.83	7.78	28.05
April 15, 2017	Observance of end-December 2016 performance criteria and continuous performance criteria and completion of fifth review	3.8125		3.8125	1.53		1.53
October 15, 2017	Observance of end-June 2017 performance criteria and continuous performance criteria and completion of sixth review	3.8125		3.8125	1.53		1.53
	Total	129.500	51.80	77.700	51.84	20.74	31.11

Honduras' quota is currently SDR 249.8 million. Prior to the effectiveness of Honduras's quota increase, its quota was SDR 129.5 million.

See Press Release No. 16/25 on January 27 (<http://www.imf.org/external/np/sec/pr/2016/pr1625a.htm>) for more information

<http://www.imf.org/external/np/sec/pr/2016/pr1625a.htm>

1/ Refers to current quota

2/ Revisions to this column reflect the rephasing necessary to take into account the increase in Honduras's First Credit Tranche as a result of its quota increase under the Fourteenth General Review of Quota. For clarity, historical information is not shown.

3/ Of this amount of SDR 70.075 million, an amount of SDR 62.45 million, equivalent to Honduras's First Credit Tranche was available from when Honduras's quota increase under the Fourteenth General Review of Quotas became effective and is not subject to phasing or performance clauses. The remaining amount of SDR 7.625 million is to be made available upon completion of the combined third and fourth reviews.



**Table 17. Honduras: Indicators of Fund Credit**  
(As of August 31, 2016; in units indicated)

	2013	2014	2015	Projections				2020
				2016	2017	2018	2019	
<b>Existing Fund credit</b>								
Stock, in millions of SDRs 1/	8.1	4.1	1.0	0.0	0.0	0.0	0.0	0.0
Obligations, in millions of SDRs	4.1	4.1	3.1	1.0	0.0	0.0	0.0	0.0
<b>SCF</b>								
Stock, in millions of SDRs 1/	0.0	0.0	0.0	51.8	51.8	51.8	51.8	46.0
Disbursements, in millions of SDRs	0.0	0.0	0.0	51.8	0.0	0.0	0.0	0.0
Obligations, in millions of SDRs 2/	0.0	0.0	0.0	0.0	0.1	0.1	0.3	6.0
Principal, in millions of SDRs	0.0	0.0	0.0	0.0	0.0	0.0	0.0	5.8
Interest and charges, in millions of SDRs	0.0	0.0	0.0	0.0	0.1	0.1	0.3	0.3
<b>SBA</b>								
Stock, in millions of SDRs 1/	0.0	0.0	0.0	70.1	77.7	77.7	77.7	41.7
Disbursements, in millions of SDRs	0.0	0.0	0.0	70.1	7.6	0.0	0.0	0.0
Obligations, in millions of SDRs 3/	0.0	0.0	0.0	0.4	0.8	0.9	0.9	36.8
Principal, in millions of SDRs	0.0	0.0	0.0	0.0	0.0	0.0	0.0	36.1
Interest and charges, in millions of SDRs	0.0	0.0	0.0	0.4	0.8	0.9	0.9	0.7
<b>Stock of existing and prospective Fund credit 1/</b>								
In millions of SDRs	8.1	4.1	1.0	121.9	129.5	129.5	129.5	87.7
In percent of quota	3.3	1.6	0.4	48.8	51.8	51.8	51.8	35.1
In percent of exports of goods and services	0.1	0.1	0.0	1.8	1.8	1.8	1.7	1.1
In percent of external debt	0.2	0.1	0.0	2.2	2.2	2.1	2.1	1.3
In percent of gross reserves	0.4	0.2	0.0	3.9	3.9	3.7	3.5	2.2
<b>Obligations to the Fund from existing arrangements and prospective Fund arrangements</b>								
In millions of SDRs	4.1	4.1	3.1	1.4	1.0	1.0	1.1	42.8
In percent of quota	1.6	1.6	1.2	0.6	0.4	0.4	0.4	17.1
In percent of exports of goods and services	0.1	0.1	0.0	0.0	0.0	0.0	0.0	0.5
In percent of external debt	0.1	0.1	0.1	0.0	0.0	0.0	0.0	0.6
In percent of gross reserves	0.2	0.2	0.1	0.0	0.0	0.0	0.0	1.1

1/ End of period.  
2/ Expected SCF repayment schedule, assuming full drawings and interest at zero percent through end 2016, 0.25 percent through end 2018 and 0.50 percent thereafter. The Honduran authorities have the intention to treat the arrangement as precautionary.  
3/ Expected repayment schedule SBA, assuming full drawings and a rate of charge of 1.05 percent. The Honduran authorities have expressed their intention to treat the arrangement as precautionary, since balance of payment pressures have not materialized.

## Annex I. Debt Sustainability Analysis

<b>Risk of external debt distress:</b>	Moderate
<b>Augmented by significant risks stemming from domestic public and/or private external debt?</b>	No

*The debt sustainability analysis (DSA) shows improved prospects relative to the previous review.<sup>1</sup> The main factors for this assessment are the stronger fiscal consolidation—containing structural fiscal measures and the adoption of a fiscal anchor through a fiscal responsibility law—and improved external conditions. External and public debt are expected to remain within indicative thresholds in most scenarios, and public domestic and private external debt are relatively low and sustainable. However, the need for further structural reforms on the monetary and fiscal policies support staff's assessment to keep the risk of external debt distress as moderate.<sup>2, 3</sup>*

### A. Background

**1. As part of the migration of the fiscal accounts towards the GFS-2001 standard, the government's institutional coverage underpinning the DSA is the non-financial public sector (NFPS).** The NFPS is a comprehensive measure of the government's impact on the economy. It comprises the general government (central government and local governments) plus non-financial public companies. The NFPS coverage also provides consistency to the debt benchmarking exercise as the reference parameters were calculated based on the IMF Fiscal Affairs Department's *Historical Public Debt Database* which uses the general government gross debt as main indicator.<sup>4</sup> The SPNF gross debt also goes far beyond the recommended public debt coverage.<sup>5</sup>

**2. Honduras' NFPS debt increased slightly in 2015.** After strong implementation of the fiscal consolidation program, the gross public debt stood at 40½ percent of GDP in 2015, a decrease of ½ percent of GDP *vis-à-vis* 2014. The continuous improvement of the fiscal position has been the main driver of this result. In 2015, the fiscal accounts posted a record-low deficit of 1 percent of GDP. The public debt stock presented in this document includes also an estimation of the stock of domestic arrears (2 percent of GDP). Additionally, as the authorities have adopted the IPSAS-32 standard for

<sup>1</sup> See *Annex I* of the [Second Reviews under the Stand-By Arrangement and the Arrangement under the Standby Credit Facility-Press Release; and Staff Report](#) (IMF Country Report No. 16/4).

<sup>2</sup> The DSA has been jointly prepared with the World Bank, and cleared by Masato Miyazaki (IMF) and John Panzer (IDA).

<sup>3</sup> Honduras three-year average CPIA score is 3.41 and its policy performance category is medium.

<sup>4</sup> See Abbas and others (2010) for details on the public debt database.

<sup>5</sup> Dippelsman, Dziobek, and Gutiérrez Mangas (2012) recommended the use of the general government gross debt with full instrument coverage as the main headline indicator for public debt.

reporting PPP operations in the fiscal accounts, the net stock of liabilities stemming from PPPs is also included into the gross public debt stock (½ percent of GDP).<sup>6</sup>

**3. Public debt is mostly with foreign creditors.** About 70 percent of total public debt is external but the share of domestic debt has risen in recent years. The main external lenders to Honduras are the Inter-American Development Bank (IADB), the Central American Bank for Economic Integration, and the World Bank. Debt to these institutions carries long maturities but only the IADB continues to provide loans on concessional terms (i.e., with a grant element of at least 35 percent). Domestic public debt is mainly to commercial banks, has a shorter—though rising—maturity (about 3 years), and carries a higher real interest rate (Tables A1 and A2). In 2015 the authorities re-profiled around US\$400 million in domestic debt. As a result of the operation, the half-life of domestic debt has increased from 3.3 to 4.3 years.

## B. Underlying Assumptions

**4. Economic growth.** The baseline scenario assumes that growth in Honduras will rise to 3.7 percent in 2017 and stabilize at about 3.8 percent in the long-run—broadly in line with its current estimated potential. This reflects a slight improvement from the previous DSA for 2016 and 2017, where growth was expected to reach 3.5 and 3.7 percent, respectively. Private consumption is expected to remain the main driver of domestic demand growth driven by higher confidence and improved security environment. The increase in private investment is expected to benefit from reduced uncertainty due to adoption of the fiscal responsibility law, and also by a fiscal impulse through complementary infrastructure spending. Other factors that will support growth include more supportive monetary policy, continuing improvement in the terms of trade as well as the steady recovery in the U.S. The latter is expected to boost Honduran economy both through higher remittances and external demand.

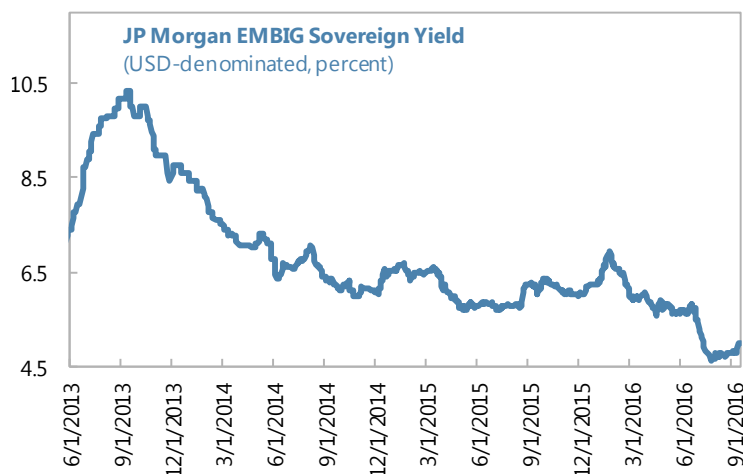
**5. Fiscal policy.** A critical change relative to the previous DSA is that the fiscal projections are now aligned to the recently-enacted fiscal responsibility law (FRL), which puts the medium-term fiscal position on a firmer footing. The law sets a fiscal anchor by establishing a ceiling of 1 percent of GDP for the public deficit over the medium-term. Our baseline scenario factors in a cumulative fiscal adjustment (measured using the primary balance) of about 7 percent of GDP during 2014–17, with the primary balance becoming consistently positive starting in 2017. The fiscal consolidation included a combination of higher tax revenues (about 2½ percent of GDP) and lower expenditures (about 4½ percent of GDP). On the revenue side, the main elements were an increase in tax rates and the adoption of anti-evasion measures geared to strengthen revenue administration; on the spending side, the elements were the rightsizing in public employment and reshaping the role of the state in strategic sectors such as energy and telecommunications. The fiscal deficit is projected to be in line with the law's parameters for the next years.

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<sup>6</sup> See International Financial Reporting Standards (2013) for details on the IPSAS-32 accounting standard. The amount of arrears estimated is based on the current stock of unpaid claims. The authorities are currently implementing an audit with the assistance of an international audit firm to identify valid claims.

**6. Fiscal institutions.** Implementing the FRL is the critical challenge for the next years. On this front, the experience in Latin America with the adoption of a FRL is mixed.

In some countries, a FRL failed to institutionalize fiscal prudence and in others they served to catalyze fiscal reforms and became the backbone of sound policy making. The implementation of the FRL in Honduras will require developing institutions, strengthening commitment, and fostering transparency and accountability across all levels of government. These processes would need time to mature and therefore should be seen as medium term targets.



**7. Public sector financing.** Financing of the public sector is assumed to come mainly from external sources with a gradual increase in domestic sources. It is, however, assumed that the financing mix changes toward less concessional sources compared to recent years (Table A2), including within multilateral institutions. Due to lower financing needs, no placement of external bonds is included in the current DSA although the authorities could take advantage of market opportunities to do debt management operations. Other financing needs are met through official, mostly multilateral, financing.

**8. External sector.** The external current account deficit is projected to decline from 6.3 percent in 2015 to about 5 percent by 2021, and stabilize at about 4½ percent of GDP over the longer term. The external position is expected to improve over the medium to long-term owing to supportive macroeconomic policies and better terms of trade. The improvement in the current account reflects favorable external conditions (including lower oil prices<sup>7</sup> and robust worker remittances), and a stronger macroeconomic policy mix (fiscal consolidation based on reaching the targets stated in the FRL). As in the previous DSA, the current account deficit continues to be financed through foreign direct investment and, to a lesser extent, public sector borrowing, with very small private sector flows. This allows international reserves to increase to about 4.9 months of non-*maquila* imports by 2018 and about 5.5 months of non-*maquila* imports over the medium term.

<sup>7</sup> The Second Reviews projected an APSP of US\$50.36 per barrel for 2016. Oil price assumptions are based on the July WEO, which projects an APSP of \$42.96 per barrel for 2016.

**Table 1. Selected Macroeconomic Indicators, Current vs. Previous DSA**

	2015	2016	2017	Long term 1/
<b>Real GDP growth (percent)</b>				
Current DSA	3.6	3.6	3.7	3.8
Previous DSA	3.5	3.5	3.7	4.0
<b>GDP deflator growth (percent)</b>				
Current DSA	6.3	3.0	3.1	4.5
Previous DSA	3.6	3.6	3.9	4.0
<b>Primary balance (% of GDP)</b>				
Current DSA	0.1	-0.2	-0.1	-0.1
Previous DSA	-1.2	-0.4	-0.3	0.2
<b>Current account balance (% of GDP)</b>				
Current DSA	-6.3	-5.9	-5.7	-4.6
Previous DSA	-6.0	-5.8	-5.8	-5.4
<b>Net FDI (% of GDP)</b>				
Current DSA	5.4	5.7	6.1	6.4
Previous DSA	5.7	5.8	5.8	5.7

1/ Defined as the last 15 years of the projection period. For the current DSA, the long term covers the period 2022-36, whereas for the previous DSA it covered 2021-35.

## C. External DSA

**9. External debt is expected to start decreasing around 2020** (Table A2). External debt ratios are projected to peak at about 40 percent of GDP in 2019-20, from about 37 percent of GDP in 2015. The share of external debt in total public debt rises slowly to about 85 percent by the mid-2020s. The increase takes place as total debt decreases substantially due to fiscal consolidation. Private external debt is less than 10 percent of GDP and is expected to shrink with the ongoing de-dollarization of the economy.

**10. External debt ratios remain within indicative thresholds in most scenarios.**<sup>8</sup> The ratios for the PV of public debt and public debt service remain below their indicative thresholds in the baseline scenario throughout the projection period (Table A4). Compared to the previous DSA, the threshold for the ratio of debt service to revenue does not exceed the indicative threshold in any year,<sup>9</sup> an improvement with respect to the previous DSA. The improvement largely reflects improved

<sup>8</sup> Honduras has large remittances inflows—about 18 percent of GDP. Therefore, the indicative external DSA thresholds reported are remittances-adjusted as per the DSA template.

<sup>9</sup> The standardized most extreme shock scenario that simulates a 30 percent depreciation of the currency may overstate risks in a country like Honduras with a longstanding stable U.S. dollar exchange rate whose external debt is denominated primarily in U.S. dollars.

initial conditions due to the 2015 fiscal results, and the binding commitments included in the fiscal responsibility law. As in the previous DSA, the spikes in debt service ratios reflect the amortization of a global bond with a balloon payment. The ratio of debt service to exports and remittances remain well below its threshold under all scenarios. External public debt rises initially but remains below the indicative threshold and starts to decline earlier than in the previous DSA due to stronger fiscal consolidation and more favorable external conditions.

**11. Debt service ratios remain broadly within indicative thresholds using the probability approach.** While the ratio of external debt service to revenue discussed above remains within the indicative 20 percent threshold, it falls within the 10 percent band that defines borderline cases.<sup>10</sup> As a result, Figure A3 reports the results from the probability approach. The ratio of debt service to revenue shows one breach, of 20bps, in a single year in the most extreme scenario of a 30-percent depreciation. Under the most extreme scenario (a negative shock to export value), however, the present value of debt to GDP goes above the threshold for about 8 years. Going forward, some of the policy reforms that the authorities have embarked upon would increase the overall flexibility and dynamism of the economy to cushion such shocks. In particular, the ongoing scaling up of public sector investment in high-priority infrastructure would increase overall economy-wide productivity growth and lead to the development of other sectors, thus helping to make the economy more diversified and resilient to export shocks, such as the one described in the scenario.

**12. External debt indicators appear resilient to a customized scenario combining negative real, fiscal and financing shocks.** The customized scenario aims at capturing possible downside risks and key vulnerabilities in Honduras. It includes negative shocks to GDP growth, which could arise from weaker external conditions; tighter external financing conditions that could be associated with negative developments in international financial markets such as Fed tapering and turmoil in emerging markets; a weaker fiscal position from possible slippages in the implementation of the fiscal responsibility law.<sup>11</sup> In this scenario, external public debt rises initially but remains below the indicative threshold and starts to decline in the early 2020s. The ratio of debt service to exports and remittances, and to revenue also remain below their indicative thresholds.

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<sup>10</sup> The indicator reaches 19.4 percent in one year, with the band around the 20 percent indicative threshold in this case being defined as ratios of between 19 and 21 (see paragraph 80 of the [Staff Guidance Note on the Application of the Joint Bank-Fund Debt Sustainability Frameworks for Low-Income Countries](#)).

<sup>11</sup> Specifically, in the customized scenario (i) real GDP growth is 2.6 percent in 2016 and 2.5 in 2017, and rises on average 0.25 percentage points per year to reach 3.5 percent in 2021, staying at this level for the remainder of the DSA period; (ii) financing conditions from external capital markets deteriorate permanently, raising the average interest rate on new external debt by 100 basis points; and (iii) the overall deficit of the CPS increases by 2 percent of GDP in 2017 compared to the baseline and then fades out partially at a constant rate of 15 percent during the DSA period.

**Table 2. Baseline vs. Customized Scenario 1/**

	2016	2017	2018	Long term 2/
<b>Real GDP growth (percent)</b>				
Baseline	3.6	3.6	3.7	3.8
Customized	2.6	2.5	2.8	3.5
<b>Average interest rate on new external debt</b>				
Baseline	3.9	3.9	3.9	3.9
Customized	5.0	5.0	5.0	5.0
<b>Fiscal balance</b>				
Baseline	-1.0	-1.4	-1.1	-0.7
Customized	-1.0	-3.4	-2.8	-1.1

1/ In the customized scenario, (i) real GDP growth is 2.6 percent in 2016 and 2.5 in 2017, and rises on average 0.25 percentage points per year to reach 3.5 percent in 2021, staying at this level for the remainder of the DSA period; (ii) financing conditions from external capital markets deteriorate permanently, raising the average interest rate on new external debt by 100 basis points; and (iii) the overall deficit of the CPS increases by 2 percent of GDP in 2017 compared to the baseline and then fades out partially at a constant rate of 15 percent during the DSA period.

## D. Public DSA

**13. Public debt ratios are expected to peak in 2020 and then start to decline subsequently** (Table A3). Public debt is projected to peak at about 44 percent of GDP in 2020 (up from 40.9 percent of GDP in 2015) and start falling slowly as fiscal consolidation proceeds and interest payments decline reaching 35 percent of GDP by 2027. In present value terms, the public-debt ratio is expected to peak at 38 percent of GDP in 2019 and fall to about 30 percent of GDP in the late 2020s. The public debt dynamics remains somewhat vulnerable to both policy-related and exogenous shocks, especially to those related to economic growth and fiscal policy (Table A3). Only the scenario based on historical variables breaches the PV of debt-to-GDP ratio. This is because Honduras ran large fiscal deficits before the recent consolidation program. Currently, the authorities have shown their commitment to fiscal prudence with a reduction of 7 points of GDP in the fiscal deficit in 2 years and their intention to pursue within this line has been clearly stated in the issuance of the fiscal responsibility law. Because of this, we do not see the scenario based on historical behavior of fiscal variables as representative of the future evolution of the Honduran debt dynamics.

**14. The exposure to contingent liabilities seems to be limited.** Several measures recently taken by the authorities limit the exposure of public debt to contingent liabilities. For instance, by doubling the contribution rate for the social security institute, the authorities' have improved its actuarial position; they amended the PPP framework law to limit the provision of government guarantees for PPP operations; and by upgrading to international standards the PPPs accounting (see section A), they have made transparent the potential fiscal impact of PPP's operations. There

could, however, be a contingent obligation for ENEE if the interpretation of financial penalties for differing payments to energy providers, currently under litigation, materializes. That said, this liability would be small. During 2009–15, the nominal amount under dispute is about 0.6 percent of GDP, plus indemnification costs that are to be decided by the courts. As part of the implementation of a medium-term fiscal framework, the authorities are developing a comprehensive framework to analyze and determine potential fiscal risks.

## E. Conclusion

**15. Despite marked improvements on public and external debt indicators, supported by a strong program of reforms, the risk of external debt distress remains as moderate.** The improvement in debt indicators reflects stronger macroeconomic policies underpinned by structural reforms, which would translate into lower fiscal deficits over the medium-term. Together with stronger economic growth, relative to the previous DSA, debt indicators have improved significantly. The FRL is a great achievement and sets the roadmap for a series of structural fiscal reforms over the coming years. On the monetary front, the upgrading the monetary policy framework will be key to enhance the economy's resilience to external shocks. Proper implementation of fiscal and monetary reforms is critical to incline the risk assessment towards a low distress rating.



**Table A1. Honduras: External Debt Sustainability Framework, Baseline Scenario, 2013-2036 1/**  
(In percent of GDP, unless otherwise indicated)

	Actual			Historical Average	Standard Deviation	Projections						2016-2021 Average		2022-2036 Average	
	2013	2014	2015			2016	2017	2018	2019	2020	2021	2026	2036		
<b>External debt (nominal) 1/</b>	<b>36.4</b>	<b>37.6</b>	<b>37.0</b>			<b>38.2</b>	<b>39.7</b>	<b>39.8</b>	<b>39.3</b>	<b>40.9</b>	<b>40.0</b>			<b>33.4</b>	<b>21.6</b>
<i>of which: public and publicly guaranteed (PPG)</i>	28.5	29.3	29.5			30.7	32.3	32.5	32.1	33.7	32.9			26.5	14.9
Change in external debt	11.6	1.3	-0.6			1.2	1.5	0.1	-0.5	1.6	-0.8			-1.5	-0.9
Identified net debt-creating flows	4.2	-0.2	-0.9			-1.1	-1.7	-1.7	-2.0	-2.4	-2.9			-2.9	-2.8
<b>Non-interest current account deficit</b>	<b>8.9</b>	<b>6.8</b>	<b>5.2</b>	<b>6.9</b>	<b>3.5</b>	<b>4.6</b>	<b>4.4</b>	<b>4.4</b>	<b>4.2</b>	<b>3.9</b>	<b>3.7</b>			<b>3.6</b>	<b>3.7</b>
Deficit in balance of goods and services	20.7	19.0	18.3			18.3	18.4	18.8	18.9	18.8	18.6			18.6	18.6
Exports	47.8	47.1	44.7			44.8	46.4	47.3	47.9	48.4	48.6			48.6	48.6
Imports	68.5	66.1	63.0			63.1	64.8	66.0	66.8	67.2	67.3			67.3	67.3
Net current transfers (negative = inflow)	-18.4	-18.4	-18.8	-19.4	1.8	-19.5	-20.1	-20.4	-20.8	-21.0	-21.1			-21.1	-21.1
<i>of which: official</i>	-0.8	-0.5	-0.4			-0.8	-0.8	-0.8	-0.9	-0.9	-0.9			-0.9	-0.9
Other current account flows (negative = net inflow)	6.6	6.2	5.6			5.8	6.1	6.1	6.1	6.1	6.2			6.0	6.1
<b>Net FDI (negative = inflow)</b>	<b>-5.4</b>	<b>-5.8</b>	<b>-5.4</b>	<b>-5.8</b>	<b>1.2</b>	<b>-5.7</b>	<b>-6.1</b>	<b>-6.0</b>	<b>-6.1</b>	<b>-6.2</b>	<b>-6.4</b>			<b>-6.4</b>	<b>-6.4</b>
<b>Endogenous debt dynamics 2/</b>	<b>0.8</b>	<b>-1.3</b>	<b>-0.7</b>			<b>0.0</b>	<b>0.0</b>	<b>-0.1</b>	<b>-0.1</b>	<b>-0.1</b>	<b>-0.3</b>			<b>-0.1</b>	<b>-0.1</b>
Contribution from nominal interest rate	0.7	0.6	1.1			1.3	1.3	1.4	1.4	1.4	1.2			1.1	0.7
Contribution from real GDP growth	-0.7	-1.1	-1.3			-1.3	-1.4	-1.5	-1.5	-1.4	-1.5			-1.3	-0.8
Contribution from price and exchange rate changes	0.7	-0.8	-0.5			...	...	...	...	...	...			...	...
<b>Residual (3-4) 3/</b>	<b>7.3</b>	<b>1.5</b>	<b>0.3</b>			<b>2.2</b>	<b>3.2</b>	<b>1.9</b>	<b>1.5</b>	<b>4.0</b>	<b>2.1</b>			<b>1.4</b>	<b>1.9</b>
<i>of which: exceptional financing</i>	-0.1	0.0	0.0			0.0	0.0	0.0	0.0	0.0	0.0			0.0	0.0
PV of external debt 4/	...	...	30.8			31.6	32.3	32.9	32.6	30.0	32.5			27.7	18.1
In percent of exports	...	...	68.8			70.7	69.6	69.6	68.1	62.0	66.8			57.0	37.3
<b>PV of PPG external debt</b>	<b>...</b>	<b>...</b>	<b>23.3</b>			<b>24.2</b>	<b>24.9</b>	<b>25.6</b>	<b>25.5</b>	<b>22.9</b>	<b>25.4</b>			<b>20.8</b>	<b>11.5</b>
In percent of exports	...	...	52.1			54.1	53.6	54.1	53.1	47.3	52.3			42.8	23.6
In percent of government revenues	...	...	75.8			79.8	81.6	83.9	82.8	73.0	81.0			66.3	36.2
<b>Debt service-to-exports ratio (in percent)</b>	<b>16.9</b>	<b>17.0</b>	<b>22.3</b>			<b>17.2</b>	<b>16.9</b>	<b>16.5</b>	<b>16.3</b>	<b>20.4</b>	<b>15.8</b>			<b>15.0</b>	<b>13.2</b>
<b>PPG debt service-to-exports ratio (in percent)</b>	<b>1.6</b>	<b>2.0</b>	<b>3.7</b>			<b>4.1</b>	<b>4.2</b>	<b>4.3</b>	<b>4.4</b>	<b>8.9</b>	<b>4.4</b>			<b>4.1</b>	<b>2.7</b>
<b>PPG debt service-to-revenue ratio (in percent)</b>	<b>2.6</b>	<b>3.0</b>	<b>5.4</b>			<b>6.0</b>	<b>6.4</b>	<b>6.7</b>	<b>6.9</b>	<b>13.7</b>	<b>6.8</b>			<b>6.4</b>	<b>4.2</b>
Total gross financing need (Billions of U.S. dollars)	2.4	2.1	2.3			1.7	1.6	1.7	1.7	2.1	1.6			1.9	2.9
Non-interest current account deficit that stabilizes debt ratio	-2.7	5.6	5.8			3.5	2.9	4.2	4.7	2.3	4.6			5.1	4.6
<b>Key macroeconomic assumptions</b>															
Real GDP growth (in percent)	2.8	3.1	3.6	3.6	2.4	3.6	3.7	3.8	3.8	3.8	3.8			3.8	3.8
GDP deflator in US dollar terms (change in percent)	-2.9	2.3	1.5	4.1	3.7	-1.3	-1.8	-0.7	-0.5	-0.5	0.0			-0.8	2.0
Effective interest rate (percent) 5/	2.9	1.7	3.2	2.4	0.5	3.6	3.6	3.6	3.6	3.6	3.1			3.5	3.3
Growth of exports of G&S (US dollar terms, in percent)	-6.3	3.9	-0.2	5.5	13.1	2.4	5.6	5.0	4.8	4.3	4.3			4.4	5.8
Growth of imports of G&S (US dollar terms, in percent)	-3.0	1.7	0.3	6.8	15.8	2.4	4.6	5.0	4.5	3.9	3.9			4.1	5.8
Grant element of new public sector borrowing (in percent)	...	...	...	...	...	20.9	17.1	18.2	20.3	13.4	2.3			15.3	16.9
Government revenues (excluding grants, in percent of GDP)	29.7	30.6	30.7			30.3	30.5	30.5	30.7	31.4	31.4			31.4	31.7
Aid flows (in Billions of US dollars) 7/	0.4	0.3	0.3			0.3	0.3	0.2	0.2	0.2	0.2			0.3	0.4
<i>of which: Grants</i>	0.1	0.2	0.2			0.1	0.1	0.1	0.1	0.1	0.1			0.2	0.3
<i>of which: Concessional loans</i>	0.2	0.2	0.1			0.1	0.1	0.0	0.0	0.1	0.1			0.1	0.0
Grant-equivalent financing (in percent of GDP) 8/	...	...	...			1.2	1.1	1.1	1.0	0.8	0.7			0.9	0.8
Grant-equivalent financing (in percent of external financing) 8/	...	...	...			38.8	36.0	33.5	39.5	37.1	13.7			36.6	50.7
<i>Memorandum items:</i>															
Nominal GDP (Billions of US dollars)	18.4	19.4	20.5			20.9	21.3	22.0	22.7	23.4	24.3			31.6	55.7
Nominal dollar GDP growth	-0.2	5.5	5.1			2.3	1.8	3.1	3.3	3.3	3.8			2.9	5.8
PV of PPG external debt (in Billions of US dollars)	...	...	4.7			4.9	5.2	5.5	5.6	5.2	6.1			6.5	6.3
(Pvt-Pvt-1)/GDPt-1 (in percent)	...	...	...			1.3	1.1	1.4	0.7	-1.8	3.5			1.1	0.6
Gross workers' remittances (Billions of US dollars)	3.1	3.4	3.6			3.9	4.1	4.3	4.5	4.7	4.9			6.4	11.2
PV of PPG external debt (in percent of GDP + remittances)	...	...	19.8			20.4	20.9	21.4	21.3	19.1	21.2			17.3	9.5
PV of PPG external debt (in percent of exports + remittances)	...	...	37.2			38.2	37.9	38.3	37.6	33.5	37.0			30.3	16.7
Debt service of PPG external debt (in percent of exports + remittances)	...	...	2.7			2.9	3.0	3.0	3.1	6.3	3.1			2.9	1.9

Sources: Country authorities; and staff estimates and projections.

1/ Includes both public and private sector external debt.

2/ Derived as  $[r - g - p(1+g)] / (1+g+p+g)$  times previous period debt ratio, with  $r$  = nominal interest rate;  $g$  = real GDP growth rate, and  $p$  = 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 A2. Honduras: Sensitivity Analysis for Key Indicators of Public and Publicly Guaranteed External Debt, 2016-2036**

(In percent)

	Projections							2026	2036
	2016	2017	2018	2019	2020	2021			
<b>PV of debt-to-GDP+remittances ratio</b>									
<b>Baseline</b>	21	22	22	22	22	22	<b>18</b>	10	
<b>A. Alternative Scenarios</b>									
A1. Key variables at their historical averages in 2016-2036 1/	21	22	24	25	26	28	<b>34</b>	38	
A2. New public sector loans on less favorable terms in 2016-2036 2	21	21	23	23	23	24	<b>22</b>	17	
A3. Customized 7/	20	22	24	25	27	28	30	27	
<b>B. Bound Tests</b>									
B1. Real GDP growth at historical average minus one standard deviation in 2017-2018	21	21	22	22	22	22	<b>18</b>	10	
B2. Export value growth at historical average minus one standard deviation in 2017-2018 3/	21	25	33	33	33	33	<b>28</b>	14	
B3. US dollar GDP deflator at historical average minus one standard deviation in 2017-2018	21	21	21	21	20	21	<b>17</b>	9	
B4. Net non-debt creating flows at historical average minus one standard deviation in 2017-2018 4/	21	24	28	27	27	27	<b>23</b>	12	
B5. Combination of B1-B4 using one-half standard deviation shocks	21	24	29	28	28	28	<b>24</b>	12	
B6. One-time 30 percent nominal depreciation relative to the baseline in 2017 5/	21	28	29	29	28	28	<b>23</b>	13	
<b>PV of debt-to-exports+remittances ratio</b>									
<b>Baseline</b>	39	39	40	39	38	38	<b>31</b>	17	
<b>A. Alternative Scenarios</b>									
A1. Key variables at their historical averages in 2016-2036 1/	39	41	43	45	47	50	<b>62</b>	71	
A2. New public sector loans on less favorable terms in 2016-2036 2	39	39	41	41	40	42	<b>39</b>	29	
A3. Customized 7/	46	48	51	53	55	58	62	56	
<b>B. Bound Tests</b>									
B1. Real GDP growth at historical average minus one standard deviation in 2017-2018	39	38	39	38	37	37	<b>30</b>	16	
B2. Export value growth at historical average minus one standard deviation in 2017-2018 3/	39	49	69	68	67	68	<b>58</b>	28	
B3. US dollar GDP deflator at historical average minus one standard deviation in 2017-2018	39	38	39	38	37	37	<b>30</b>	16	
B4. Net non-debt creating flows at historical average minus one standard deviation in 2017-2018 4/	39	45	51	49	48	48	<b>40</b>	20	
B5. Combination of B1-B4 using one-half standard deviation shocks	39	47	59	57	56	56	<b>48</b>	23	
B6. One-time 30 percent nominal depreciation relative to the baseline in 2017 5/	39	38	39	38	37	37	<b>30</b>	16	
<b>PV of debt-to-revenue ratio</b>									
<b>Baseline</b>	82	84	87	86	83	83	<b>68</b>	37	
<b>A. Alternative Scenarios</b>									
A1. Key variables at their historical averages in 2016-2036 1/	82	87	92	94	97	104	<b>123</b>	134	
A2. New public sector loans on less favorable terms in 2016-2036 2	82	84	89	89	88	92	<b>86</b>	63	
A3. Customized 7/	80	72	79	83	85	90	97	85	
<b>B. Bound Tests</b>									
B1. Real GDP growth at historical average minus one standard deviation in 2017-2018	82	84	88	87	84	85	<b>69</b>	37	
B2. Export value growth at historical average minus one standard deviation in 2017-2018 3/	82	98	129	128	125	126	<b>109</b>	51	
B3. US dollar GDP deflator at historical average minus one standard deviation in 2017-2018	82	80	81	80	77	78	<b>64</b>	34	
B4. Net non-debt creating flows at historical average minus one standard deviation in 2017-2018 4/	82	93	108	107	104	105	<b>88</b>	44	
B5. Combination of B1-B4 using one-half standard deviation shocks	82	92	110	109	106	107	<b>91</b>	44	
B6. One-time 30 percent nominal depreciation relative to the baseline in 2017 5/	82	118	122	120	116	117	<b>95</b>	51	

**Table A2. Honduras: Sensitivity Analysis for Key Indicators of Public and Publicly Guaranteed External Debt, 2016-2036 (concluded)**

(In percent)

**Debt service-to-exports+remittances ratio**

<b>Baseline</b>	2	3	3	3	3	6	<b>4</b>	2
<b>A. Alternative Scenarios</b>								
A1. Key variables at their historical averages in 2016-2036 1/	2	3	3	3	3	6	<b>5</b>	5
A2. New public sector loans on less favorable terms in 2016-2036 2	2	3	3	3	3	6	<b>4</b>	3
A3. Customized 7/	3	3	4	4	4	8	6	5
<b>B. Bound Tests</b>								
B1. Real GDP growth at historical average minus one standard deviation in 2017-2018	2	3	3	3	3	6	<b>4</b>	2
B2. Export value growth at historical average minus one standard deviation in 2017-2018 3/	2	3	4	5	5	9	<b>6</b>	4
B3. US dollar GDP deflator at historical average minus one standard deviation in 2017-2018	2	3	3	3	3	6	<b>4</b>	2
B4. Net non-debt creating flows at historical average minus one standard deviation in 2017-2018 4/	2	3	3	4	4	7	<b>5</b>	3
B5. Combination of B1-B4 using one-half standard deviation shocks	2	3	4	4	4	8	<b>6</b>	3
B6. One-time 30 percent nominal depreciation relative to the baseline in 2017 5/	2	3	3	3	3	6	<b>4</b>	2

**Debt service-to-revenue ratio**

<b>Baseline</b>	5	6	7	7	7	14	<b>9</b>	4
<b>A. Alternative Scenarios</b>								
A1. Key variables at their historical averages in 2016-2036 1/	5	6	6	6	7	12	<b>10</b>	10
A2. New public sector loans on less favorable terms in 2016-2036 2	5	6	6	7	7	13	<b>9</b>	7
A3. Customized 7/	5	6	7	7	8	15	12	10
<b>B. Bound Tests</b>								
B1. Real GDP growth at historical average minus one standard deviation in 2017-2018	5	6	7	7	7	15	<b>10</b>	4
B2. Export value growth at historical average minus one standard deviation in 2017-2018 3/	5	6	7	9	9	16	<b>12</b>	7
B3. US dollar GDP deflator at historical average minus one standard deviation in 2017-2018	5	6	6	7	7	13	<b>9</b>	4
B4. Net non-debt creating flows at historical average minus one standard deviation in 2017-2018 4/	5	6	7	8	8	15	<b>11</b>	6
B5. Combination of B1-B4 using one-half standard deviation shocks	5	6	7	8	8	15	<b>11</b>	6
B6. One-time 30 percent nominal depreciation relative to the baseline in 2017 5/	5	9	9	10	10	20	<b>13</b>	6
<i>Memorandum item:</i>								
Grant element assumed on residual financing (i.e., financing required above baseline) 6/	11	11	11	11	11	11	<b>11</b>	11

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 that an offsetting adjustment in import levels).

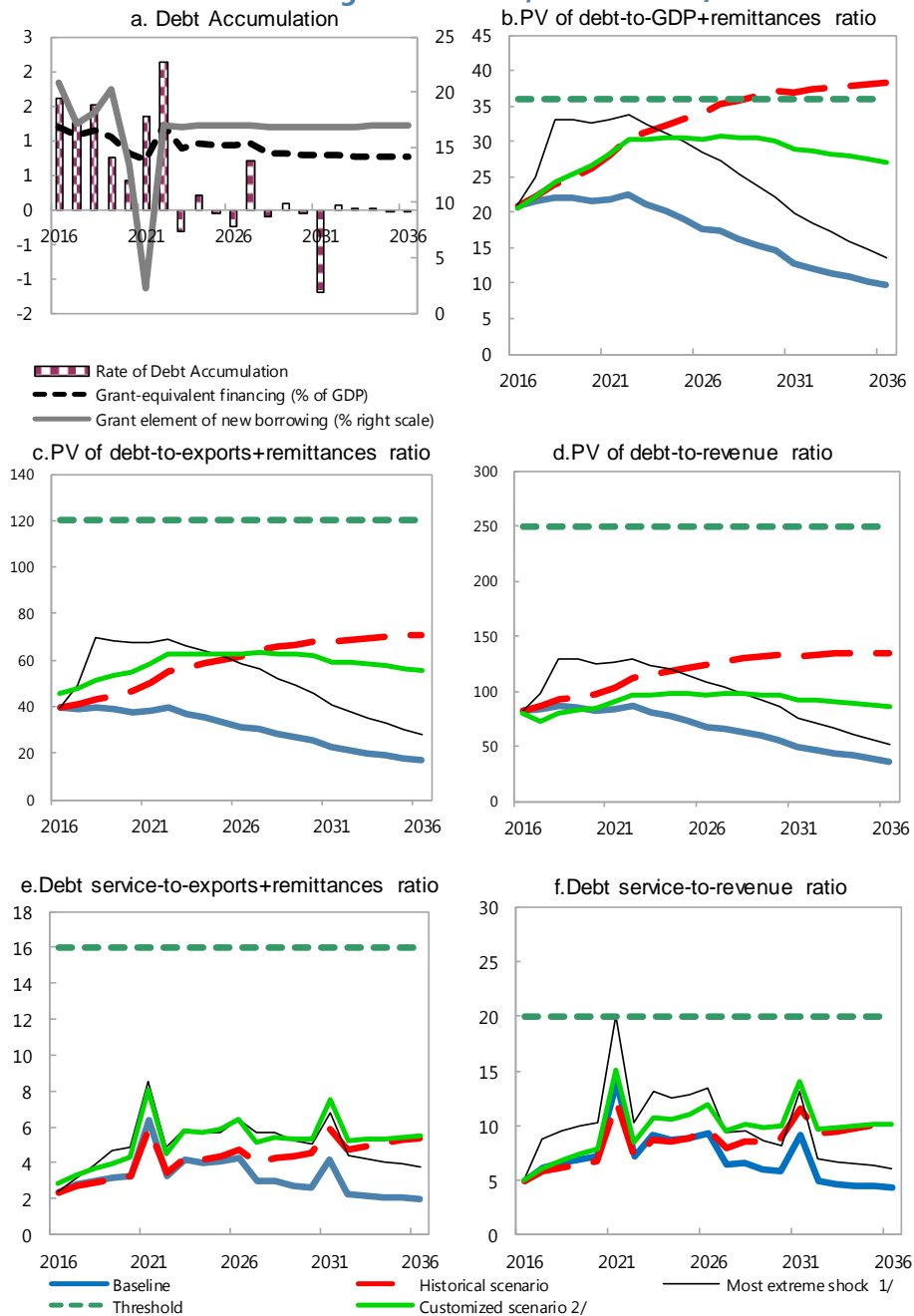
4/ Includes official and private transfers and FDI.

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.

7/ In the customized scenario, (i) real GDP growth is 2.6 percent in 2016 and 2.5 in 2017, and rises on average 0.25 percentage points per year to reach 3.5 percent in 2021, staying at this level for the remainder of the DSA period; (ii) financing conditions from external capital markets deteriorate permanently, raising the average interest rate on new external debt by 100 basis points; and (iii) the overall deficit of the CPS increases by 2 percent of GDP in 2015 compared to the baseline and then fades out partially at a constant rate of 15 percent during the DSA period.

**Figure A1. Honduras: Indicators of Public and Publicly Guaranteed External Debt Including Remittances, 2016-2036 1/**

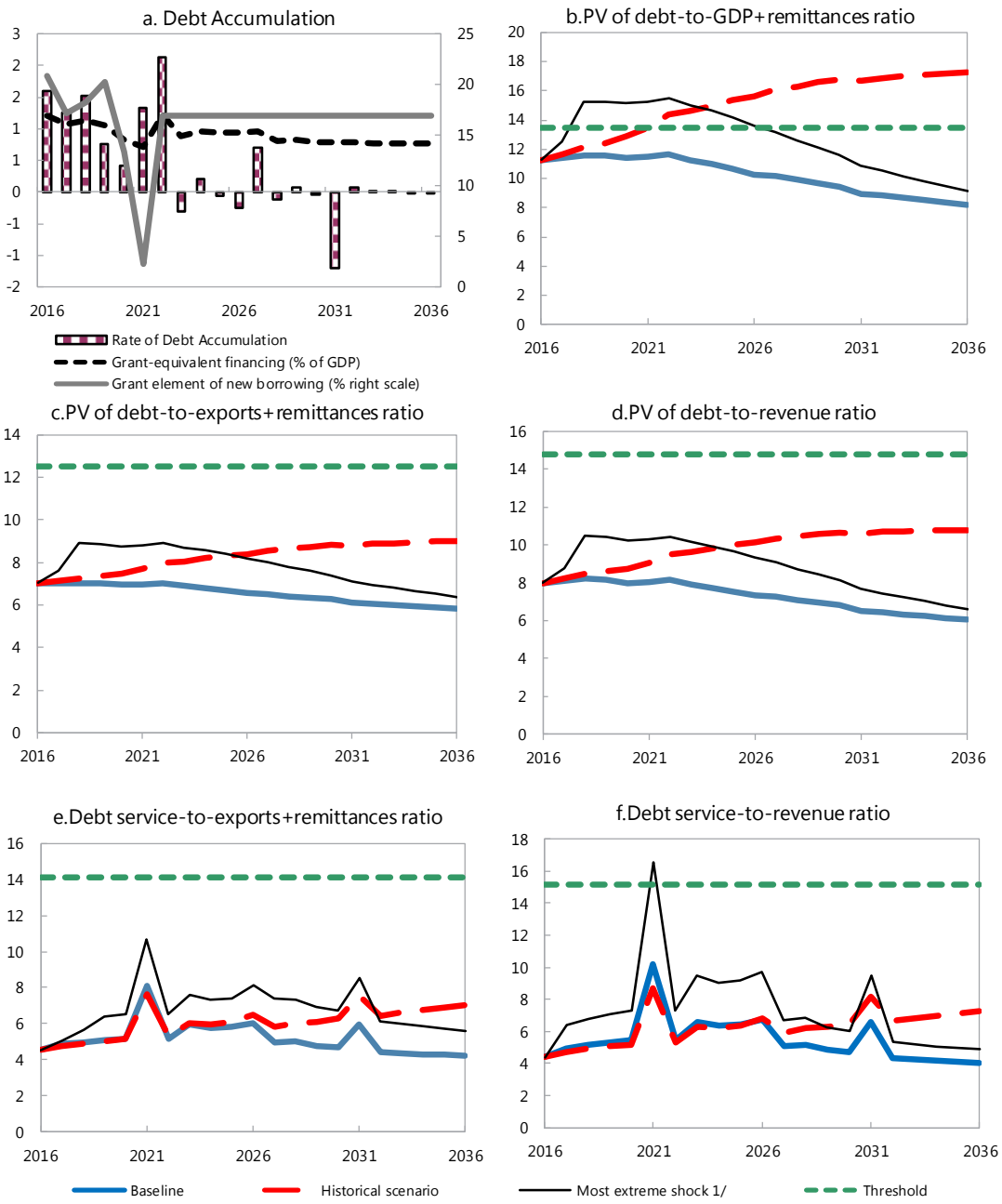


Sources: Country authorities; and staff estimates and projections.

1/ The most extreme stress test is the test that yields the highest ratio on or before 2026. In figure b. it corresponds to 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 One-time depreciation shock

2/ In the customized scenario, (i) real GDP growth is 2.6 percent in 2016 and 2.5 in 2017, and rises on average 0.25 percentage points per year to reach 3.5 percent in 2021, staying at this level for the remainder of the DSA period; (ii) financing conditions from external capital markets deteriorate permanently, raising the average interest rate on new external debt by 100 basis points; and (iii) the overall deficit of the CPS increases by 2 percent of GDP in 2015 compared to the baseline and then fades out partially at a constant rate of 15 percent during the DSA period.

**Figure A2. Honduras: Probability of Debt Distress of Public and Publicly Guaranteed External Debt under Alternative Scenarios, Including Remittances, 2016-2036 1/**



Sources: Country authorities; and staff estimates and projections.

1/ The most extreme stress test is the test that yields the highest ratio on or before 2026. In figure b, it corresponds to 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 One-time depreciation shock

**Table A3. Honduras: Public Sector Debt Sustainability Framework, Baseline Scenario, 2013-2036**  
(In percent of GDP, unless otherwise indicated)

	Actual			Average <sup>5/</sup>	Standard Deviation <sup>5/</sup>	Estimate					Projections				2022-36 Average
	2013	2014	2015			2016	2017	2018	2019	2020	2021	2016-21 Average	2026	2036	
<b>Public sector debt 1/</b>	40.2	40.9	40.9			41.9	43.2	43.7	43.8	44.0	42.2		36.4	27.9	
<i>of which: foreign-currency denominated</i>	27.7	28.8	29.3			30.7	32.3	32.5	32.1	33.7	32.9		26.5	14.9	
Change in public sector debt	11.9	0.7	0.0			1.0	1.4	0.5	0.1	0.2	-1.9		-1.2	-0.5	
Identified debt-creating flows	9.1	3.5	-0.2			1.5	1.7	0.9	0.6	0.5	0.3		0.3	1.0	
Primary deficit 2/	6.9	3.5	-0.1	3.4	1.9	0.2	-0.1	-0.4	-0.7	-0.6	-0.5	-0.4	0.1	0.2	
Revenue and grants	28.9	29.8	30.4			29.6	29.7	29.7	29.9	30.5	30.6		30.6	30.9	
<i>of which: grants</i>	0.8	0.8	0.9			0.7	0.7	0.6	0.6	0.6	0.6		0.6	0.6	
Primary (noninterest) expenditure	35.9	33.3	30.3			29.8	29.7	29.3	29.2	29.9	30.1		30.7	31.0	
Automatic debt dynamics	1.3	-0.5	-0.3			1.3	1.8	1.3	1.3	1.1	0.8		0.2	0.8	
Contribution from interest rate/growth differential	0.7	-0.7	0.0			0.4	0.8	0.4	0.4	0.3	0.2		0.2	0.8	
<i>of which: contribution from average real interest rate</i>	1.5	0.5	1.4			1.8	2.3	2.0	2.0	1.9	1.9		1.5	1.8	
<i>of which: contribution from real GDP growth</i>	-0.8	-1.2	-1.4			-1.4	-1.5	-1.6	-1.6	-1.6	-1.6		-1.4	-1.0	
Contribution from real exchange rate depreciation	0.6	0.2	-0.3			0.9	1.0	0.9	0.8	0.8	0.5		...	...	
Other identified debt-creating flows	0.8	0.5	0.2			0.0	0.0	0.0	0.0	0.0	0.0		0.0	0.0	
Privatization receipts (negative)	0.8	0.5	0.2			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)	0.0	0.0	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	2.8	-2.8	0.2			-0.5	-0.4	-0.3	-0.5	-0.3	-2.1		-1.5	-1.5	
<b>Other Sustainability Indicators</b>															
<b>PV of public sector debt</b>			35.0			36.0	36.6	37.6	38.0	36.2	35.3		31.2	24.6	
<i>of which: foreign-currency denominated</i>	...	...	23.4			24.9	25.7	26.4	26.3	25.9	26.1		21.3	11.6	
<i>of which: external</i>	...	...	23.6			24.9	25.7	26.4	26.3	25.9	26.1		21.3	11.6	
PV of contingent liabilities (not included in public sector debt)	...	...	...			...	...	...	...	...	...		...	...	
Gross financing need 3/	6.8	4.4	4.7			3.6	4.5	3.6	6.7	6.4	9.5		8.9	10.2	
PV of public sector debt-to-revenue and grants ratio (in percent)	...	...	115.3			121.6	123.2	126.8	127.1	118.4	115.7		102.0	79.8	
PV of public sector debt-to-revenue ratio (in percent)	...	...	118.9			124.6	126.0	129.6	129.8	120.8	118.0		104.0	81.4	
<i>of which: external 4/</i>	...	...	80.2			86.1	88.4	91.0	89.8	86.5	87.2		71.0	38.3	
Debt service-to-revenue and grants ratio (in percent) 5/	8.0	8.2	19.2			15.6	19.2	17.7	28.0	26.6	35.9		32.1	35.5	
Debt service-to-revenue ratio (in percent) 6/	8.2	8.4	19.7			15.9	19.6	18.0	28.6	27.2	36.6		32.7	36.2	
Primary deficit that stabilizes the debt-to-GDP ratio	-5.0	2.8	-0.1			-0.8	-1.4	-0.9	-0.8	-0.8	1.3		1.3	0.7	
<b>Key macroeconomic and fiscal assumptions</b>															
Real GDP growth (in percent)	2.8	3.1	3.6	3.6	2.4	3.6	3.7	3.8	3.8	3.8	3.8		3.8	3.8	
Average nominal interest rate on forex debt (in percent)	2.2	1.7	3.6	2.1	0.6	3.4	3.6	3.6	3.6	3.6	3.6		3.5	3.2	
Average real interest rate on domestic debt (in percent)	14.2	4.5	6.3	5.2	4.3	10.4	15.5	14.6	14.9	13.1	13.7		13.7	13.4	
Real exchange rate depreciation (in percent, + indicates depreciation)	3.4	0.6	-1.2	-2.0	3.4	3.0	...	...	...	...	...		...	...	
Inflation rate (GDP deflator, in percent)	1.4	5.5	6.3	5.7	2.1	3.0	3.1	4.3	4.5	4.5	4.5		4.0	4.5	
Growth of real primary spending (deflated by GDP deflator, in percent)	13.3	-4.5	-5.6	0.4	5.0	1.9	3.2	2.4	3.7	6.1	4.4		3.6	3.8	
Grant element of new external borrowing (in percent)	...	...	...	...	...	20.9	17.1	18.2	20.3	13.4	2.3		15.3	16.9	

Sources: Country authorities; and staff estimates and projections.

1/ Gross debt of the Combined Public Sector

2/ As defined in the fiscal accounts

3/ 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.

4/ Revenues excluding grants.

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

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

Table A4. Honduras: Sensitivity Analysis for Key Indicators of Public Debt 2016-2036

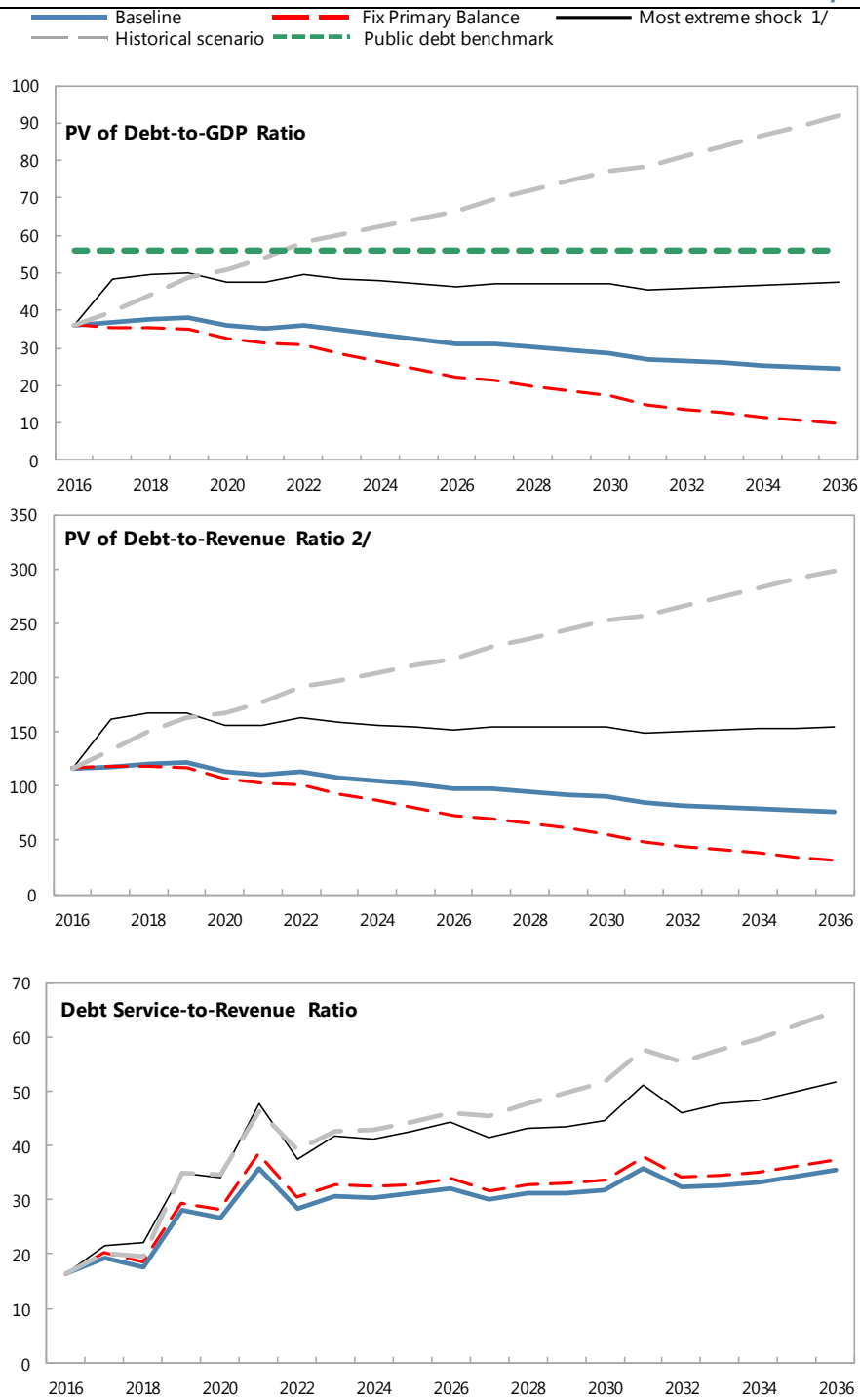
	Projections							
	2016	2017	2018	2019	2020	2021	2026	2036
<b>PV of Debt-to-GDP Ratio</b>								
<b>Baseline</b>	36	37	38	38	36	35	31	25
<b>A. Alternative scenarios</b>								
A1. Real GDP growth and primary balance are at historical averages	36	40	44	49	51	54	67	92
A2. Primary balance is unchanged from 2016	36	35	36	36	33	32	25	14
A3. Permanently lower GDP growth 1/	35	36	37	39	36	38	43	67
<b>B. Bound tests</b>								
B1. Real GDP growth is at historical average minus one standard deviations in 2017-2018	36	37	41	43	40	43	48	60
B2. Primary balance is at historical average minus one standard deviations in 2017-2018	36	41	48	48	47	46	43	42
B3. Combination of B1-B2 using one half standard deviation shocks	36	41	47	48	47	48	49	53
B4. One-time 30 percent real depreciation in 2017	36	48	49	50	48	48	46	48
B5. 10 percent of GDP increase in other debt-creating flows in 2017	36	46	47	47	46	45	42	41
<b>PV of Debt-to-Revenue Ratio 2/</b>								
<b>Baseline</b>	116	117	121	121	92	110	97	76
<b>A. Alternative scenarios</b>								
A1. Real GDP growth and primary balance are at historical averages	116	131	150	163	138	210	218	298
A2. Primary balance is unchanged from 2016	116	119	120	119	110	106	80	45
A3. Permanently lower GDP growth 1/	116	124	129	132	126	127	142	216
<b>B. Bound tests</b>								
B1. Real GDP growth is at historical average minus one standard deviations in 2017-2018	116	128	140	145	141	144	158	193
B2. Primary balance is at historical average minus one standard deviations in 2017-2018	116	139	161	161	153	151	142	135
B3. Combination of B1-B2 using one half standard deviation shocks	116	138	159	162	155	156	159	172
B4. One-time 30 percent real depreciation in 2017	116	162	167	168	156	156	151	154
B5. 10 percent of GDP increase in other debt-creating flows in 2017	116	153	158	158	149	147	139	132
<b>Debt Service-to-Revenue Ratio 2/</b>								
<b>Baseline</b>	16	19	18	28	27	36	32	35
<b>A. Alternative scenarios</b>								
A1. Real GDP growth and primary balance are at historical averages	16	20	19	35	34	46	46	65
A2. Primary balance is unchanged from 2016	16	20	19	30	29	39	34	39
A3. Permanently lower GDP growth 1/	16	20	19	32	31	41	41	58
<b>B. Bound tests</b>								
B1. Real GDP growth is at historical average minus one standard deviations in 2017-2018	16	21	20	33	33	44	42	55
B2. Primary balance is at historical average minus one standard deviations in 2017-2018	16	20	20	37	36	43	39	48
B3. Combination of B1-B2 using one half standard deviation shocks	16	21	20	37	36	44	41	52
B4. One-time 30 percent real depreciation in 2017	16	22	22	35	34	48	44	52
B5. 10 percent of GDP increase in other debt-creating flows in 2017	16	20	21	40	31	43	39	48

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.

**Figure A3. Honduras: Indicators of Public Debt Under Alternative Scenarios, 2016-2036 1/**



Sources: Country authorities; and staff estimates and projections.  
 1/ The most extreme stress test is the test that yields the highest ratio on or before 2026.  
 2/ Revenues are defined inclusive of grants.



## Annex II. External Assessment

### Overall Assessment

**1. Staff's assessment is that the external position is moderately weaker than the level consistent with medium-term fundamentals and desired policies.** The assessment is based the strength of the real effective exchange rate (REER), and strong non-oil import growth. This partly reflects the strength of the U.S. dollar, and recent depreciations in some trading partners due to terms of trade shifts. Going forward, the full pass-through to inflation of some partner's nominal depreciations may partially reverse the recent appreciation, and planned steady fiscal consolidation will help improve competitiveness. The impact of these policies would be enhanced by continued wage moderation and reforms that address weaknesses in the business environment.

### Exchange Rate, Current Account, and Investment Position

	Actual CA/Y	Underlying CA/Y	CA/Y norm	CA/Y gap (Actual or Underlying - Norm)	REER gap
CA model	-6.3		-6.7	0.3	-1.1
REER model					7.1
ES approach		-5.1	-3.1	-2.0	7.0

Source: IMF Staff calculations based on External Balance Assessment methodology.

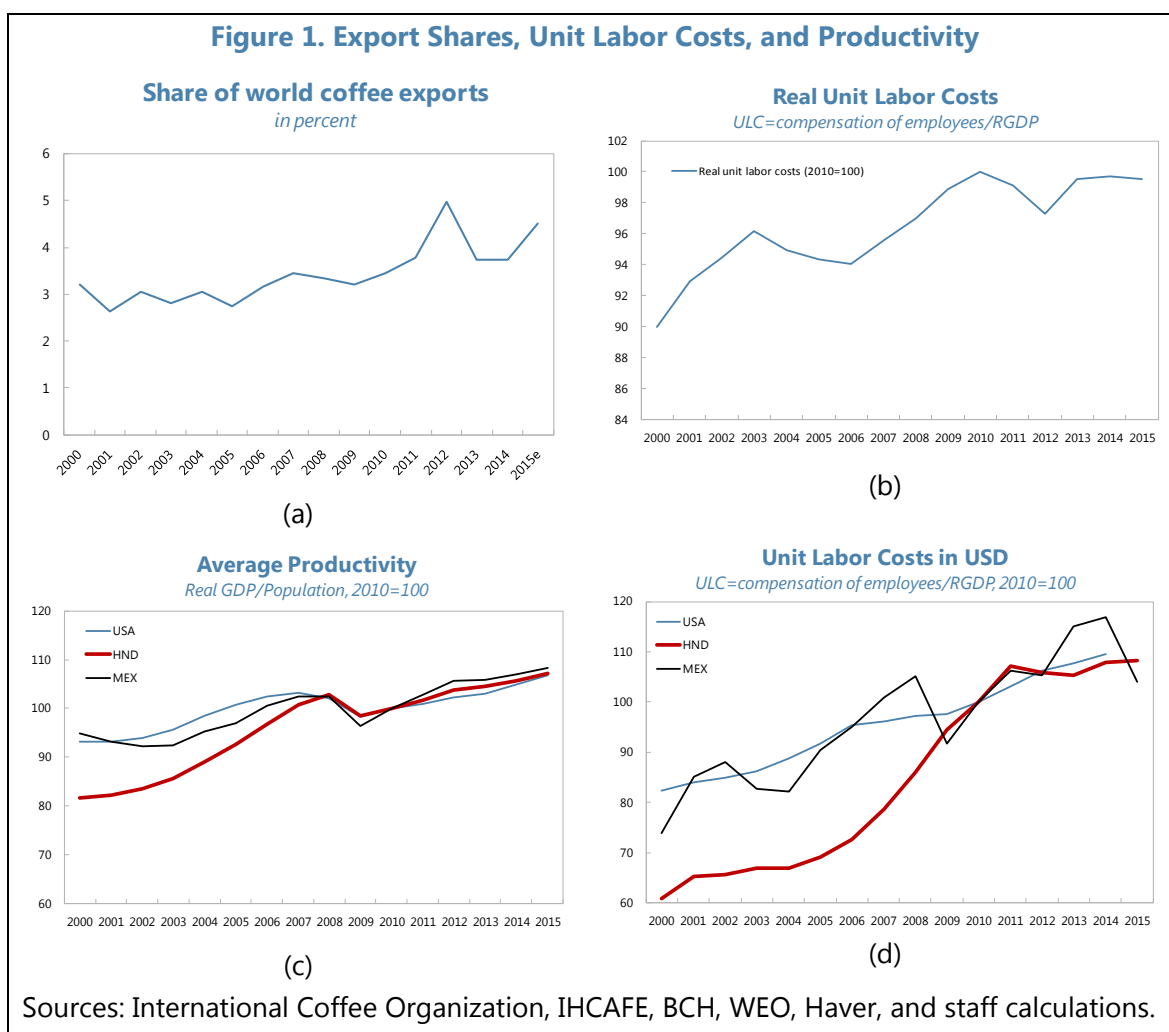
**1. The REER appears to be moderately overvalued.** The current account deficit required to stabilize the net International Investment Position (IIP) is of 3.1 percent, about 2 percentage points of GDP lower than current medium-term projections. The implied necessary correction in the REER would be of about 7 percent. Backward-looking approaches that fit observed current account and REER movements to fundamentals offer similar results. The CA regression finds virtually no overvaluation. However, this is partly thanks to over-performance in the 2015 fiscal targets.<sup>1</sup> The REER regression predicts a REER about 7 percent lower (i.e. more depreciated), considering Honduras terms of trade, trade openness, and other fundamentals. It is important to mention, however, that there is no policy gap; results are driven by non-policy fundamentals.<sup>2</sup>

**2. Depreciations in trading partners due to oil-related terms of trade shifts prompted a REER appreciation in 2015.** Honduras REER appreciated by 3.3 percent in 2015, partly driving the bottom line assessment. Going forward, the full pass-through to inflation of the nominal depreciations experienced by regional trading partners may partly reverse the recent REER appreciation. Available 2015 export data show that Honduras share in world coffee exports (the country's main export, accounting for 25 percent of general goods exports) remains strong (see Figure 1(a)). While oil related imports fell by 3.7 percent of GDP in 2015 (from nearly 10 percent of GDP in 2014 to about 6 percent

<sup>1</sup> In 2015, the consolidated public sector deficit was of 1.4 percent of GDP, outperforming the 2.7 percent estimated under the program. Without this over-performance, the CA gap would have been of -0.5 percent. Closing such gap would require a REER depreciation of 1.7 percent.

<sup>2</sup> The prediction is driven by two main factors. First, Honduras relatively high degree of trade openness, which is expected to keep domestic prices in check and thus implies a lower REER. Second, based on the country's existing distance to the productivity frontier (U.S., Japan and Germany), the model predicts a more depreciated REER through Balassa-Samuelson.

of GDP in 2015), non-oil non-maquila imports increased by 2.4 percentage points of GDP over the same period.



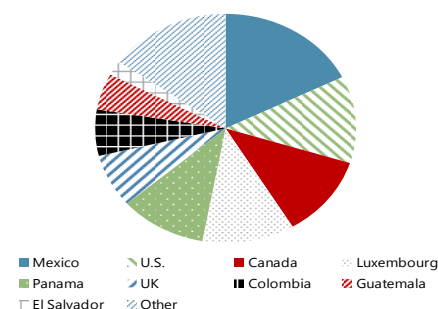
**3. Real wages have on average grown in line with productivity.** Over 2013-2015, real wages have grown in line with average productivity (with productivity measured as the ratio of real GDP to employment) (Figure 1(b)). Average labor productivity grew very fast in the early 2000s, and has grown in line with main trading partners since 2008 (Figure 1(c)). In particular, when measured in USD, unit labor costs grew slower in Honduras than in main trading partners during 2010–2014 (Figure 1(d)). In 2015 the terms of trade shift due to lower oil prices prompted depreciations in oil exporters, driving down USD labor costs in some of Honduras trading partners.

## HONDURAS

### 4. The external position is mainly financed by FDI.

About 57 percent of IIP liabilities correspond to FDI; the rest is mostly debt. Net IIP liabilities have reached 70 percent of GDP in 2015 (up from 65 percent in 2014), and an adjustment would be required in order to stabilize this ratio going forward (see discussion above). However, a large share of (well-diversified) FDI financing makes the country's external position relatively more resilient to negative external shocks.

FDI inflows by source country  
Average 2013-2015



### 5. Improving competitiveness will require addressing weaknesses in the business environment.

Honduras rank in the WEF Global Competitiveness Index improved over the last two years (from 111th out of 148 countries to 88th out of 140 countries) but remains low. The largest improvements were in terms of goods markets efficiency (from 91th to 68th), financial market development (from 59th to 38th), and innovation (from 74th to 55th).<sup>3</sup> While there has been progress in terms of institutions (from 105th to 88th), the ranking remains very low. Most significant weaknesses include labor market efficiency, infrastructure, health and primary education, and higher education and training. In the latest (2015) World Bank Doing Business Indicators, Honduras ranks 110th out of 189 countries (18th out of 32 LAC countries). Main weaknesses include the difficulty of starting a business, getting electricity, paying taxes, enforcing contracts, and resolving insolvency. Increased security problems in recent years are also having a negative impact on competitiveness, with crime and theft cited as the most problematic factor for doing business according to the last Global Competitiveness Report.

## Reserves Adequacy

6. Reserves appear to be adequate assuming there is little exchange rate flexibility, and ample if the exchange rate regime was deemed to be floating. Two different Fund methodologies suggest that the level of international reserves is adequate for a fixed exchange rate regime, and ample if there is exchange rate flexibility.

7. The assessment methodology designed for emerging market countries compares reserves to potential net outflows during a stress scenario. The framework compares reserves to potential net outflows during a balance of payments crisis. These outflows include: *reduced export earnings* (10 percent reduction if exchange rate is fixed, 5 if floating); *deposit flight* (10 percent of broad money if exchange rate is fixed, 5 if floating); *rollover risk* (30 percent of short-term external debt (regardless of exchange rate regime), and 20 percent of other external liabilities if exchange rate is fixed, 15 if floating). The indicative range for adequate reserves is between 100 and 140 percent coverage of these potential net outflows. For Honduras, coverage is at near 100 percent if there is no flexibility in the exchange rate (Figure 2(a)), and 133 percent if floating (Figure 2(b)).

<sup>3</sup> Leading gains were on effectiveness of antimonopoly policy, prevalence of trade barriers and business impact of FDI rules (for goods markets efficiency), regulation of security exchanges and legal rights index (for financial market development), and government procurement of advance technological products and availability of scientists and engineers (for innovation).

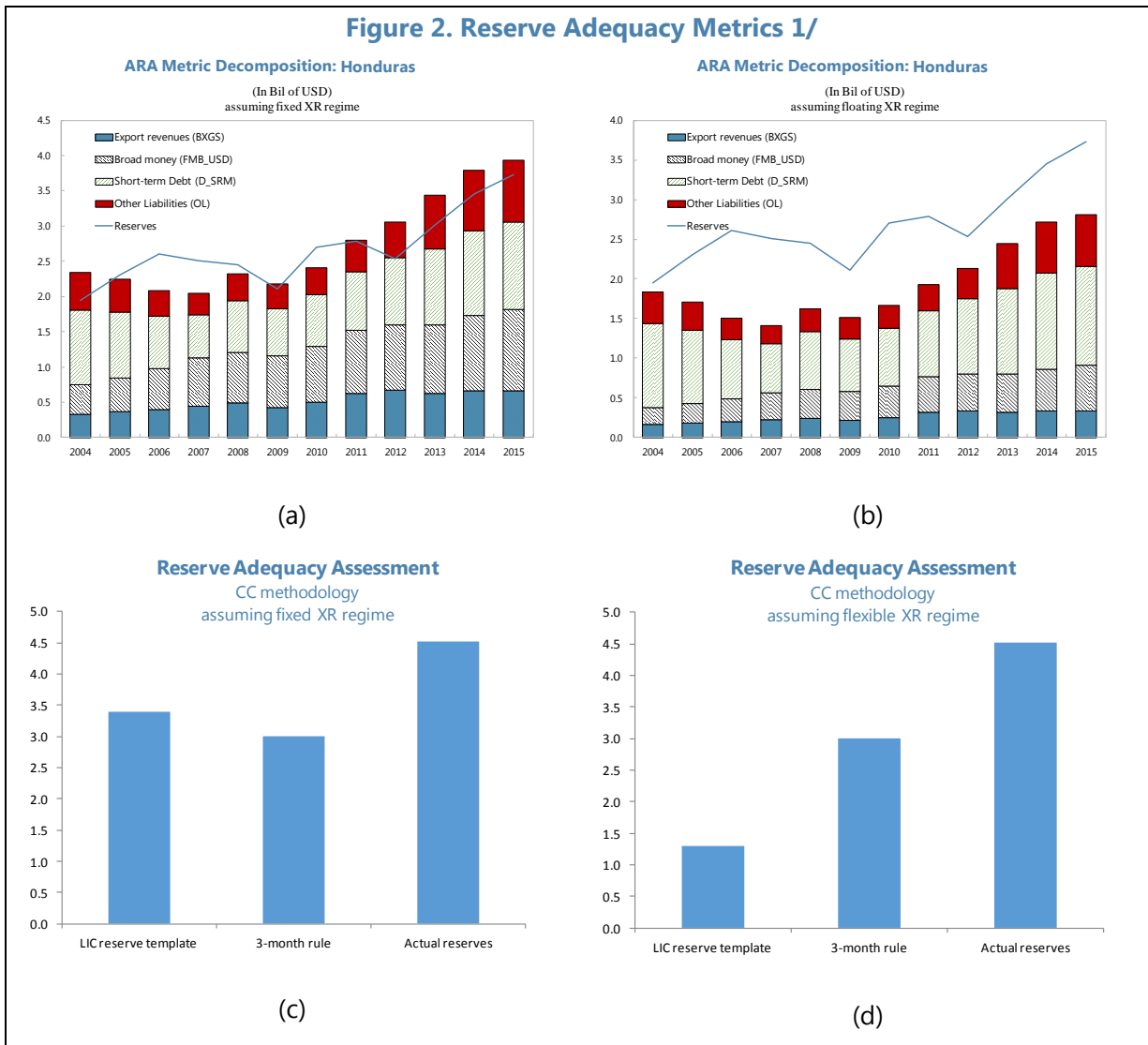
**8. An approach designed for credit-constrained economies/LICs evaluates tradeoffs from holding reserves.** The assessment methodology weighs the marginal benefit of holding reserves, in terms of output gains from reducing likelihood and severity of crises, against the opportunity cost of holding reserves. The marginal benefit is estimated based on data for 49 countries.<sup>4</sup> The cost of holding reserves is assumed to be equal to the marginal productivity of capital in LICs (6.2 percent).<sup>5</sup> This methodology suggests that, if the XR regime is assumed to be fixed, the appropriate level of reserves is 3.4 months of imports, below the observed level of 4.5 (Figure 2(c)). However, with flexible XR regime the adequate level of reserves drops to about 1.3 month of imports (Figure 2(c)).

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<sup>4</sup> See Section IV in [International Monetary Fund](#), “Assessing Reserve Adequacy – Supplementary Information,” February 14, 2011.

<sup>5</sup> Arguably, for LICs that have accessed bond markets the cost could be lower, at around the rate of bond issuance (see pp. 45-7 in [International Monetary Fund](#), “Assessing Reserve Adequacy – Further Considerations,” IMF Policy Paper, November 2013).

Figure 2. Reserve Adequacy Metrics 1/



Source: Fund staff calculations.

1/ In panels (c) and (d), ratios are to monthly imports of goods and services, excluding maquila imports.

Annex III. Risk Assessment Matrix<sup>1</sup>

Source of Risks	Up/ Downside	Overall Level of Concern (Scale—high, medium, or low)		
		Relative Likelihood <sup>2</sup>	Impact if Realized	Policy Responses
<b>1. Slower growth in advanced and/or emerging economies.</b>	↓	<p><b>Low/Medium/High</b></p> <p>Sharper-than-expected global slowdown in the short-term, triggered by significant China slowdown (Low in the short-term, Medium thereafter), or turning credit cycle in EMs (Medium).</p> <p>To the extent that structurally weaker growth in advanced (High) and emerging economies negatively impacts the U.S., it could reduce growth in Honduras (Medium).</p>	<p><b>Medium/High</b></p> <p>Protracted period of weaker-than-expected growth in the U.S. would lower export demand and remittances, significantly weighing on activity and tax revenues (High).</p>	<p>Ease monetary policy, but ensure inflation expectations remain anchored.</p> <p>Increase nominal exchange rate flexibility.</p>
<b>2. Tighter or more volatile global financial conditions.</b>	↓	<p><b>Medium/High</b></p> <p>Surges in global financial market volatility—triggered by geopolitical tensions, revised market expectations on USMP exit/emerging market fundamentals (Medium), or Brexit (High)—could reduce capital flows to Honduras, lead to an increase in cost of government financing, as well as potentially an increase in cost of funding for the private sector</p> <p>Surge in U.S dollar prompted by improving U.S. economic prospects versus the rest of the world (High).</p>	<p><b>High/Medium</b></p> <p>A decline in capital flows to emerging markets could disrupt foreign credit lines and reduce banking sector liquidity (Medium).</p> <p>An appreciation of the Lempira in line with the dollar is likely to adversely impact the cost competitiveness of the export sector vis-à-vis the rest of the world (Medium)."</p>	<p>Strengthen bank capital buffers to cover macro-financial risks, and gradually move towards Basel III standards.</p> <p>Monetary tightening increased exchange rate flexibility, fiscal consolidation.</p> <p>Ease monetary policy if financial distress weakens demand and drives inflation below target.</p>
<b>3. Dislocation in capital and labor flows.</b>	↓	<p><b>Medium/High</b></p> <p>Reduced financial services by global/regional banks, including loss of correspondent banking relationships (High).</p> <p>Security dislocations in the Middle East may create upside risks for oil prices, along with lower tourist arrivals (High).</p>	<p><b>Medium</b></p> <p>Likely to restrict private remittances inflows.</p> <p>Higher oil prices could result in wider external current deficit, higher inflation, lower real income and growth.</p>	<p>Strengthening AML/CTF supervision of the banking sector and effectively implementing fit and proper requirements for beneficial ownership and control of financial institutions.</p> <p>Increase exchange rate flexibility.</p> <p>Monetary policy should be tightened to contain second round effects of higher oil prices.</p>
<b>4. Persistently lower energy prices.</b>	↑	<p><b>High</b></p> <p>Triggered by supply factors reversing only gradually.</p>	<p><b>Low</b></p> <p>For Honduras, persistently low global oil prices are likely to be accompanied by lower prices for coffee and bananas, thereby offsetting the gains from lower energy prices. Therefore, from an overall perspective, it is likely to yield slower growth.</p>	<p>Build fiscal and monetary buffers.</p>
<b>5. Higher spending pressures associated to upcoming elections.</b>	↓	<p><b>Medium</b></p> <p>Inadequate application of the FRL.</p>	<p><b>High</b></p> <p>This could result in substantial loss in policy credibility and translate into lower investment/growth and high unemployment.</p>	<p>Monetary tightening and increased exchange rate flexibility."</p>
<b>6. Continued institutional strengthening and improved governance.</b>	↑	<p><b>Medium</b></p> <p>The recent adoption of the fiscal responsibility law, coupled with ongoing reform of key state institutions, along with the steadfast fight against corruption has given hope that improved governance is taking root in Honduras</p>	<p><b>High</b></p> <p>Investment, productivity and potential growth would be positively impacted.</p>	<p>Increased exchange rate flexibility.</p>

<sup>1</sup> The Risk Assessment Matrix (RAM) shows events that could materially alter the baseline path discussed in this report (which is the scenario most likely to materialize in the view of the staff). The relative likelihood of risks listed is the staff's subjective assessment of the risks surrounding this baseline.

<sup>2</sup> In case the baseline does not materialize.

## Annex IV. The Trans-Pacific Partnership and Honduras

### The Trans-Pacific Partnership (TPP), a major trade deal between 12 Pacific Rim nations, includes major trade partners and competitors of Honduras.

The TPP was signed in February 2016, and is currently pending domestic ratification by its members. The agreement covers frontier issues such as services, investment, government procurement, intellectual property, environmental standards and competition policy, and would entail substantial reductions in tariff and non-tariff barriers among its members. Together, TPP members account for about half of Honduras non-maquila exports, and over three-fourths of maquila exports. Importantly, while the TPP includes large exporters of textiles and coffee, the challenges to Honduran exporters are likely to come in the textiles sector.<sup>1</sup>

Top 10 Textile Exporters to the U.S.		
Rank	Country	Share in U.S. textile imports 1/
1	China	37.6
2	Viet Nam	8.6
3	India	6.5
4	Mexico	4.7
5	Indonesia	4.7
6	Bangladesh	4.6
7	Pakistan	2.8
8	Honduras	2.4
9	Cambodia	2.3
10	Italy	1.8

Source: UN Comtrade.  
1/ Average 2013-2015, in percent.

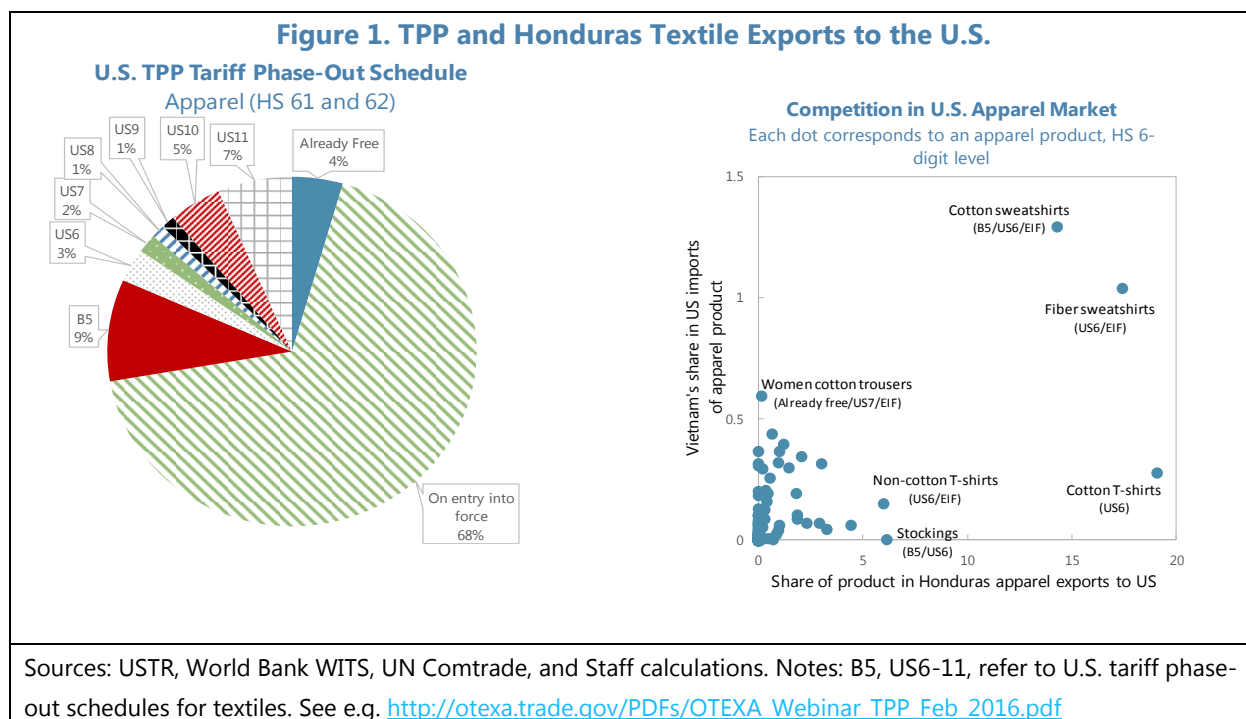
### The TPP can potentially challenge the textiles sector, but Honduras still has some advantages.

Substantial tariff reductions in textiles would come into effect immediately once the TPP is ratified. This would represent an erosion of preferences vis-à-vis partners with which Honduras has a regional trade agreement, most notably the U.S.—the main destination for maquila exports.<sup>2</sup> Honduras faces intense competition from Vietnam, especially in synthetic textiles and in several of its other main apparel exports to the U.S. (Figure 1). That said, Honduras still possess several advantages that could lessen the impact of TPP (Henn et al., 2016).<sup>3</sup> These include; (i) its geographic proximity to the U.S. market, which provides a key competitive advantage to Honduras, considering lower-inventory operations under increasingly prevalent e-commerce sales in the textile market; (ii) the tariff phase-out periods, which for some of Honduras main exports extend up to 10 years after TPP's entry into force; and (iii) TPP's rules of origin, which after an initial transition period will require all TPP producers to source all inputs from TPP countries to apply for preferences, and so for some TPP firms there is likely to be an adjustment period, during which Honduras could maintain its competitive position.

<sup>1</sup> The impact on the agricultural sector is expected to be small, as the U.S. (the only TPP member buying significant amounts of Honduran coffee) already has zero tariffs for virtually all coffee products and all countries.

<sup>2</sup> About 77 percent of maquila products were exported to the U.S. in 2015, and 82 percent of all maquila exports were textile products. The trade agreement with the U.S. is in the context of the CAFTA-DR agreement, in effect since 2006. Regional trade agreements are also in force with other three TPP members (Chile (2008), Mexico (2013), and Canada (2014)).

<sup>3</sup> Henn, C., S. Ahmed, M. Appendino, D. Cerdeiro and M. Saleh (2016), "A Conceptual Framework to Assess the Trans-Pacific Partnership," International Monetary Fund, mimeo.



**The Honduran authorities have expressed their interest in joining the TPP.** TPP provisions could drive large productivity gains for its developing members as they catch up with the productivity frontier through knowledge spillovers associated with FDI. For Honduras, it could also provide the opportunity to expand trade on the extensive margin, diversifying both the product base and the export markets. For instance, Japan’s agricultural import tariffs will be substantially reduced under TPP (12-percent tariffs on roasted coffee will be eliminated upon entry into force), pointing to a potential source of gains from joining the agreement and developing new products and new markets.<sup>4</sup> Note that while the integration of textile value chains with the U.S. could reduce adjustment costs, there could potentially be some challenges in terms of the capacity to implement and enforce some of the provisions of the agreement.

<sup>4</sup> Honduras total coffee exports to Japan are currently small, amounting to less than \$1mn in 2015.



## Appendix I. Letter of Intent

October 13, 2016

Ms. Christine Lagarde  
Managing Director  
International Monetary Fund  
Washington, DC 20431

Dear Ms. Lagarde,

After 2½ years in office our government is succeeding in improving domestic security, stabilizing the economy, institutionalizing fiscal prudence with the approval of the Fiscal Responsibility Law (FRL), and paving the way to combat corruption. These ambitious policies are creating the foundations for sustainable and inclusive growth.

Economic performance in 2015 was better than expected. Real output grew at 3.6 percent while improved macroeconomic stability plus lower domestic gasoline prices helped to reduce headline inflation to 2.4 percent (eop), much below the inflation target of 4.75 percent. The central government and the combined public sector deficit targets were met by ample margins—deficits reached 3.1 percent (target 3.8 percent) and 1.5 percent (target 2.7 percent) of GDP, respectively. NIR increased by US\$307 million as private capital inflows exceeded program projections owing to improved investor confidence. That said, the NDA target for end-December 2015 was missed by a small margin, owing to faster than projected growth in currency issue.

Notwithstanding the economic activity acceleration in 2015, we are aware that continued efforts are required to keep macroeconomic stability, enhance credibility and transparency of public policies, and advance the conditions for sustainable and inclusive economic growth.

We remain fully committed to the guidelines set out in the November 2014, April and November 2015 Memoranda of Economic and Financial Policies (MEFP). The attached MEFP discusses the key elements of our economic program for 2016–17.

The economic outlook for the remainder of 2016 is positive. Real output growth is projected to grow by 3.6 percent in 2016, supported by the gradual implementation of the law of social protection that seeks to reduce poverty and income inequality, additional infrastructure investment and a supportive monetary policy stance. After the significant fiscal over-performance of 2015 and in line with the existing program and the FRL approved last April, the fiscal situation is expected to marginally ease to accommodate higher infrastructure spending. Social spending will remain constant as share of GDP increasing the quality of total public spending and maximizing its impact on inclusive growth and poverty reduction. Consistent with expanding real sector activity, credit to the private sector would grow by 10 percent in line with a sustainable pace of financial deepening. While output is expected to remain marginally below potential, inflation is projected to pick up following the increase in energy

costs, but remain in line with the inflation objectives. Following the reduction of 25 bp in the policy rates adopted last June, monetary policy is expected to maintain inflation under control and the currency to be consistent with the objective of strengthening the external position. NIR are projected to rise to 4.7 months of imports.

The policies set forth in the attached supplement to the MEFP aim to bolster the fiscal and external position, and move forward with structural reforms to boost competitiveness and inclusive growth. In particular, the MEFP for 2016–17 seeks to (i) effectively implement the FRL, (ii) establish a new tax administration agency to consolidate the progress so far achieved on tax collection, (iii) advance with the gradual implementation of the law of social protection in a fiscally sustainable manner, (iv) continue with the electricity sector reform and accelerate efforts to reduce non-technical losses, (v) modernize the operational monetary policy framework by enacting reforms to the law on the Central Bank of Honduras in line with Fund recommendations to start the transition process towards inflation targeting and a more flexible foreign exchange rate regime, and (vi) protect financial stability by enhancing the financial resolution framework and strengthening macroprudential regulations on household indebtedness.

We remain confident that the policies set forth in the attached supplement are adequate for a successful implementation of the program. Nonetheless, the government stands ready to take additional measures that may be required. The government will consult with the Fund on the adoption of such measures, and in advance of revisions to the policies contained in the MEFP and the attached supplement of the MEFP in accordance with Fund's policies on such consultations. The government will also continue to provide relevant information to monitor performance and reviews of the program on a timely basis. Given the minor deviation from the end-December 2015 NDA performance criteria, the corrective measures taken to address the deviation from the net-lending by public pension funds program target for end-June 2016, and the actions taken to clear the temporary increase in domestic arrears from the National Electricity Company (ENEE) (continuous performance criteria), we request a waiver of these nonobservances. We also request modification of the end-December 2016, PCs on NDA and the present value of net external debt contracted, and the completion of the third and fourth reviews. We additionally request a rephrasing of the SBA to take into account the increase in Honduras's first credit tranche as a result of the increase in Honduras's quota under the Fourteenth General Review of Quotas.

We authorize the IMF to publish this Letter of Intent, its attachments and the related staff report.

Sincerely yours,

/s/

Wilfredo Cerrato

Chief Economic Cabinet and Finance Minister

Attachments

- I. Memorandum of Economic and Financial Policies
- II. Technical Memorandum of Understanding

/s/

Manuel de Jesús Bautista Flores

President of the Central Bank

## Attachment I. Memorandum of Economic and Financial Policies for 2016–17

### 1. **Honduras has made steady progress in its efforts to bolster macroeconomic stability.**

Since taking office in January 2014, President Hernández's administration embarked on a sound homegrown economic program, supported later by the December approval of a Stand-By Arrangement (SBA) and an arrangement under the Standby Credit Facility (SCF). Strong program implementation resulted in over performance on fiscal targets owing to higher revenue, strict spending controls, and sustained progress on reforming the electricity sector. Despite the fiscal consolidation, social and security spending have increased to reduce poverty and income inequality and improve the domestic security situation. Structural reforms have been broadly on track (Tables 1 and 2).

### 2. **We remain fully committed to the objectives set forth in the November 2014**

**Memorandum of Economic and Financial Policies (MEFP).** These measures underpinning these objectives will be complemented with the policies described in this MEFP to ensure the program's goals remain within reach. The MEFP for 2016–17 seeks to (i) effectively implement the FRL, (ii) establish a new tax administration agency to consolidate the progress so far achieved on tax collection, (iii) advance with the gradual implementation of the law of social protection in a fiscally sustainable manner, (iv) continue with implementation of the electricity sector reform and accelerate efforts to reduce non-technical losses, (v) modernize the operational monetary framework by starting the transition process towards adopting inflation targeting and a more flexible foreign exchange rate regime, and (vi) protect financial stability by enhancing the financial resolution framework and strengthening macroprudential regulations on household indebtedness.

### **Macroeconomic Developments, Program Implementation and Outlook**

**3. **Economic recovery consolidated in 2015.**** Real GDP growth accelerated for a second consecutive year to 3.6 percent (3.1 percent in 2014 and 2.8 percent in 2013) driven by a boost in investment and the recovery in private consumption—which responded positively to a reduction in gasoline prices and strong remittances inflows. Sound macroeconomic policies and lower domestic gasoline prices helped to reduce headline inflation, which at the end of 2015 was at 2.4 percent, below the inflation target of 4.75 percent. The central government and the combined public sector deficit targets were met by ample margins—deficits reached 3.1 percent (target 3.8 percent) and 1.4 percent (target 2.7 percent) of GDP, respectively. This over-performance reflected vigorous revenue collection—mainly of value added and income taxes—as well as expenditure control, including outlays on wages and salaries. Private sector balance sheets strengthened and the financial system remained sound while credit dollarization fell 1½ percentage point to 33.2 percent, in response to tighter regulations on foreign exchange exposure. The external current account deficit widened to 6.3 percent of GDP, higher than the 6.0 percent of GDP foreseen in the program, because of weaker global prices of exports. That said, NIR increased by US\$307 million as private capital inflows exceeded program projections supported by improved investor confidence reflected in the Honduras international bond spreads over U.S. treasuries.

**4. In 2016, output growth is expected to remain steady, amid low inflation, steady credit growth and an increase in net international reserves.** Real output growth is projected to grow by 3.6 percent in 2016, supported by increased public sector infrastructure investment and a supportive monetary policy stance. After the significant fiscal over-performance of 2015, and in line with the existing program and the FRL, the fiscal situation is expected to marginally ease to accommodate planned investment in infrastructure. Consistent with expanding real sector activity, credit to the private sector would grow by 10 percent in line with a sustainable pace of financial deepening. While output is expected to remain marginally below potential, inflation is projected to pick up following the increase in energy costs, but remain low and in line with the inflation target. Following the reduction of 25 bp in the policy rates adopted last June, monetary policy will adjust as necessary to maintain inflation under control and the currency to continue to be consistent with the objective of strengthening the external position. Notwithstanding an expected marginal narrowing of the external current account deficit to 5.8 percent of GDP, due to better terms of trade, net international reserves are projected to rise to 4.7 percent of imports, consistent with achieving the end-June and end-December targets.

**5. Fiscal performance has been consistent with most program targets during the first semester of 2016.** The central government had a deficit of 0.2 percent GDP supported by vigorous tax collection and expenditure control including in wages and salaries. The nonfinancial public sector posted a surplus of 1.5 percent of GDP as pension contributions rose and the electricity company ENEE improved its operational balance following the rationalization of redundancies implemented thus far.

**6. The fiscal outlook for 2016 remains positive.** With vigorous tax revenues growth (15 percent annual growth cumulative through July) and spending under control, we assess that most of the December 2016 fiscal targets are achievable. The ENEE deficit is expected to decline slightly to 0.2 percent of GDP (from 0.3 percent of GDP in 2015) as the operational margin continues to improve.

**7. Monetary policy continued to evolve in line with program objectives.** We lowered the policy rate by 25 basis points in June 2016, in the context of low stable inflation and growing international reserves. At the same time the central bank stepped up its efforts to absorb additional liquidity from capital inflows while keeping under control private sector credit growth. In addition, the deceleration of banks' credit in foreign currency contributed to reduce risks in the banking system from unhedged borrowers following the introduction of additional measures to reduce this risk. These actions have exerted downward pressure on lending rates and contributed to favorable monetary and credit conditions.

**8. Progress in the structural benchmarks has been mixed.** Congress approved the FRL in April 2016. Last February, we submitted to congress a draft law of the Social Security Institute (IHSS) that seeks to strengthen its actuarial position and improve its governance. Approval by congress of this law is still pending and we will ensure it is consistent with the fiscal objectives of the program before enacting it. We requested an ambitious TA program on the monetary and foreign exchange policies from the Fund to design a plan for a gradual removal of surrender requirements in line with

the objective of adopting an inflation targeting regime. We rescheduled the audit of public sector arrears owed to private creditors and will formulate a plan to clear them by December 2016 (see below).

## Fiscal Policy

### I. Fiscal Program for 2016

**9. Our 2016 fiscal program seeks to effectively implement the FRL and execute efficiently the high-quality infrastructure projects underway.** The revised program, targets central government and NFPS deficits of 3.4 and 1.5 percent of GDP, respectively for year end. The 2016 fiscal effort, measured by the primary balance of the NFPS, declines by 0.3 percent of GDP owing to the implementation of targeted infrastructure projects. Social spending will remain constant as share of GDP and strive to increase the quality of total public spending, seeking to maximize its impact on inclusive growth and poverty reduction.

### II. Revenue

**10. Tax revenues.** We will continue to mobilize revenues as committed in the program. Tax revenues are expected to remain constant as a percentage of GDP once the one off adjustments in 2015 are netted out. We have submitted to congress a tax code aimed at simplifying tax collection. We will ensure that the new tax code, on a continuous basis, remain consistent with the international best practice. In particular, the new tax code will include instruments to ensure effective monitoring, as well as an appropriate regime of penalties and sanctions for tax fraud. We will also facilitate the dissemination of tax laws by compiling all of the relevant decrees and laws in a single text.

**11. Tax authority reform.** We are implementing an overhaul of the tax authority and have created a new institution, *Servicio de Administración de Rentas* (SAR). To protect the tax base during this transition, we have strengthened the large taxpayer unit and created a new unit to verify invoicing procedures which is now implementing a plan to strengthen tax enforcement. The SAR will function within a unified operational program (POA) by March 2017 (structural benchmark, March 2017). At the same time, customs reforms continue and we have established a detailed mapping of the business process and adopted new operating manuals in *Puerto Cortés* to enhance collection of import duties in gasoline and bulk freight (structural benchmark, June 2016).

### III. Spending

**12. Wage bill.** We reaffirm our commitment to keep the wage bill under control. For 2016 the wage bill of the Central Government is expected to be 8.4 percent of GDP and for the NFPS at 11.8 percent of GDP (targeting a nominal increase in the wage bill of 5 percent). We have made significant advances in several initiatives to control the payroll growth. Currently, all payrolls in the central administration are executed through our integrated financial management information system (SIAFI) which is linked to the public employment management system (SIREP). We finished the vacancies, jobs and skills audit in line ministries with assistance of the World Bank. The audit will be used by the

civil service reform commission to rightsize the central government wage bill. We expect additional savings and productivity gains once the recommendations of the audit are implemented.

**13. Public investment.** Considering the fiscal space created by the faster than anticipated fiscal consolidation and the need to boost employment growth with high-impact spending, we plan to allocate additional resources to increase public investment. The additional investment spending for 2016 amounts to 0.4 percentage points of GDP and will be allocated to fund several infrastructure projects (see TMU, Paragraph 14). These projects are expected to enhance employment and growth and have already been declared as priority projects by the Public Investment Management System (SNIP). If any of these projects are not implemented as scheduled, the associated resources will be saved and our fiscal targets will be adjusted accordingly. To help strengthen investment outcomes, we have requested technical assistance from the Fund on strengthening our public investment management system.

**14. Financing.** We successfully re-profiled about US\$400 million in 2015, extending the half-life of domestic debt from 3.3 to 4.3 years at lower interest rates supported by the ample liquidity in the domestic financial system. We remain open to the possible tapping of the international capital markets to undertake liability management operations to smooth debt service. Our extended investment plan will require about US\$750 million for 2016–17 in external financing which we plan to obtain mainly from multilateral institutions. Given the strong program implementation we expect to obtain this financing at concessional terms.

#### IV. Public Financial Management

**15. Fiscal Responsibility Law (FRL).** The enacting of the FRL has institutionalized the hard-won fiscal consolidation achieved thus far. This law embodies accountability, transparency, and stability principles consistent with international best practices. It contains numerical rules that we expect to be fully enforceable in 2019. These are: a limit on the public sector deficit of 1 percent of GDP and a limit on the growth rate of current spending equal to the average of the real growth rate over the last 10 years plus current headline inflation. The law also includes a transitory clause defining the transition path to achieve such targets, which are fully consistent with our program's fiscal targets. We will elaborate the 2017 budget based on the law's parameters and include the medium-term fiscal framework (MTFF) documentation where the consistency of the draft budget and the FRL rules is explained. We will also disseminate between spending units and other stakeholder the importance of the MTFF as budget and planning control instrument to prevent slippages and initiatives that could undermine it.

**16. Transparency and accountability.** One of the key components of the FRL is the strengthening of transparency and accountability of public spending. To this end the law states that all trust funds will operate through the budget. We plan to fully implement the law ensuring that: (i) all trust funds will be managed under the Treasury Single Account (TSA), (ii) any spending from trust funds should comply with the same spending controls than regular budgetary spending, and (iii) the operations of trust funds are disclosed and properly consolidated into the general government

accounts (structural benchmark March 2017). During the implementation process, we remain committed with the dissemination of a national registry of all trust funds funded by public resources (structural benchmark, June 2016).

**17. Treasury single account.** We will continue strengthening the operational coverage and performance of the TSA with technical assistance from CAPTAC-DR. While implementing these TA recommendations, we will work on a special module that allows the operation of trust funds through the TSA.

**18. Settlement of Arrears.** We are focusing the audit on claims that have proper documentation (verification notes also known as F-01). Once the audit is finalized, we will present a plan to settle all validated claims. The audit of all domestic arrears to private creditors, estimated at 2½ percent of GDP at end-2015 had to be stopped as the firm selected to conduct the audit was blacklisted by the World Bank. A new auditor firm will complete the audit later than envisaged and therefore we request an extension to complete the audit by December 2016 (currently set for end-June 2016). Once the audit is completed, we will discuss with creditors and the Fund the best strategy to clear them.

**19. Implementing a sound PPP framework.** In December 2014 a unit was created in the Ministry of Finance in charge of assessing fiscal risks stemming from PPPs. The unit has now received extensive training and technical support from the IADB and the Millennium Challenge Account. For fiscal reporting, as stated in the law, we will continue preparing fiscal statistics based on the international accounting standard recommended by the International Public Sector Accounting Standards Board (IPSASB). The unit will ensure that PPP projects will not be approved if they compromise the fiscal targets of the program.

**20. Public pension funds net loans to public workers.** In recent years, public pension funds have been increasing their financial resources due to higher contribution rates and a wider tax base. This fact combined with the limited availability of appropriate investment opportunities have increased their appetite to offer loans to their affiliates. To ensure the financial sustainability of the pension funds, however, we have adopted measures to limit the risk of these loans by limiting the increase in lending net of repayments through the duration of the program. For 2017, we will issue a new investment guideline, prepared by CNBS, that will ensure that public pension funds be managed in a prudent and sustainable manner in line with best international practices.



## V. Public Enterprises

### **ENEE**

**21. We will continue to strengthen ENEE's financial position.** As indicated in our April 2015 MEFP, we expect that the financial impact of the rationalization measures to bear fruit over time. In 2015 ENEE's deficit shrank by 1 percent of GDP to 0.3 percent of GDP. We will continue with our policy of zero subsidies to finance the company (continuous structural benchmark). During the first 6 months of 2016, ENEE's domestic arrears temporarily increased, as it transitioned to a new management team. Since then, we have adopted appropriate controls that have reduced these arrears by half, and commit to clearing the remainder by end-December 2016. Going forward, we will take administrative measures aiming to prevent the recurrence of this problem. The 2014 and 2015 financial audits are still pending.

**22. Electricity distribution losses.** The reduction in the electricity losses is the main pending issue in our reform agenda but we are determined to implement an aggressive plan to reduce non-technical electricity losses. Supported by a bidding process we selected in February 2016 a management company for a 7-year period that will help to collect unpaid bills, reduce non-technical losses, maintain and upgrade the distribution network, and streamline costs. Given the delays in the company selection process we commit to reduce non-technical losses by 1 percent in 2016 and up to 17 percent during the next 6 years.

### **Monetary, Exchange Rate, and Financial Sector Policies**

**23. Monetary policy will remain focused on price stability and protecting the external position.** We are aiming to keep inflation within the  $4.5 \pm 1$  percent uncertainty band in 2016–17. Despite an uncertain external environment but supported by the recent upgrade of the sovereign risk rating, we kept unchanged our target of net international reserves (NIR) of US\$3,005 million for end-December 2016 (albeit increasing reserve coverage to 4.7 months of imports, up from 3.8 months in the original program). The net domestic assets ceiling is consistent with a prudent expansion of bank credit to the private sector to support the growth objectives of the program. Having said that, should the achievement of the inflation target be threatened we stand ready to adjust monetary policy as appropriate.

**24. We will continue to move ahead with our plans to improve the operational framework for conducting monetary policy.** The BCH introduced daily liquidity auctions last October. To enhance further the monetary operations we plan to: (i) improve further its liquidity forecasting and management; (ii) develop the interbank market; (iii) increase the signaling content of the monetary policy interest rate (TPM); (iv) improve coordination on liquidity management with the Ministry of Finance supported by the recent formalization of information exchange agreement with the Central Bank and (v) continue the phasing out of the banks' use of government bonds to meet a portion of reserve requirements with the aim to eliminate this practice during the program period. The BCH has not issued any new authorizations to allow government bonds to be held as reserve



requirements. To guide our future reforms efforts, we intend to approve a strategic plan to modernize monetary policy (structural benchmark, end-October 2016). This plan would include announcing inflation targeting as the nominal anchor, a new communication strategy and a road map for the further development of the interbank money and foreign exchange markets. In line with this, we also plan to prepare regulations to create a system of primary dealers in the domestic money market in line with international best practices.

**25. Our exchange rate policy will continue to be consistent with the objective of strengthening the external position.** With the view to gradually move towards inflation targeting and a more flexible exchange rate arrangement, we have requested an extensive technical assistance program on monetary operations from the Fund. As part of this process, starting in January 2017, we plan to reduce by 10 percent obligations of authorized dealers to sell their FX proceeds to the central bank (structural benchmark, Prior Action 5<sup>th</sup> Review). Building upon the TA on surrender requirements last November, starting in October 2016 we will begin issuing regulations to establish a foreign exchange rate market (Structural benchmark end-December 2016). The flexibilization of the FX market will be supported by a code of conduct for market participants, transparent criteria for FX transactions including reporting arrangements for FX dealers, strengthened guidelines for banks FX exposures, enhanced reporting arrangements for authorized dealers and the elimination of the system of commissions.

**26. The modernization of the monetary policy framework includes strengthening institutional arrangements to adopt an inflation-forecast targeting framework.** The modernization of monetary policy will benefit from enhancing financial supervision and financial market infrastructure as guided by financial sector stability reviews and complementary technical assistance. In this regard, we plan to enhance the bank's governance framework by amending the BCH Law (structural benchmark) to align it with international best practices and safeguards assessments recommendations. In addition, by end-2016, we will approve a plan to adopt International Financial Reporting Standards (structural benchmark, end-December 2016) for FY2017. We will request IMF-TA to help the BCH in achieving these objectives.

**27. Recapitalization of the central bank.** In December 2014, we started implementing a multiyear plan to recapitalize the central bank (adopted by congress in May 2014) through non-negotiable bonds bearing a positive real interest rate. As scheduled, the second issuance took place in December 2015 for L3,000 million, with an 8 percent coupon. The recapitalization program comprises three additional annual issuances of L3,000 million at an 8 percent coupon with the next issuance scheduled for December 2016.

**28. We are taking measures to reduce risks in the financial sector.** With technical assistance from LEG and MCM, we aim to strengthen the legal framework for bank resolution with a substantive reform currently before Congress, and upgraded an early warning committee to perform as a Financial Stability Council. These measures complement previous actions to enhance financial stability. In addition, we adopted higher capital requirements for foreign currency borrowing by unhedged agents. Since mid-2015, we have adjusted, for lending to unhedged agents, the risk-

weighted capital asset ratios to 150 percent for mortgage loans where debt-to-collateral ratio exceeds 85 percent and 175 percent for consumer loans (including credit cards). This regulation is currently being implemented. We will continue to monitor household indebtedness and adopt regulations to keep it within prudent margins and establish programs to increase financial literacy. In addition, since 2015, we began issuing guidelines to strengthen pension funds' investment policies and governance according to international best practices. This should safeguard pension fund resources while achieving adequate returns. In September 2016, we continued to implement our plans for improving institutional governance and stream the operations of the development finance agencies with the merger of the agricultural development bank, BANADESA, and the Honduran Bank for Production and Housing.

## Structural Reforms

**29. Electricity sector.** We continue to adopt measures to overhaul the electricity sector. A new electricity sector law was enacted in 2014 to promote a more efficient, open and transparent electricity sector. The law also allows for greater private sector participation in transmission and distribution. Private sector companies already participate in electricity generation thus increasing competition and efficiency. We seek to complete the full implementation of the law in 2017. In June 2016, as first step in this process, the regulatory commission (CREE) established a new tariff scheme based on cost recovery and by end-2016 will issue new regulations to improve the functioning of the electricity market.

**30. Social protection framework law.** With the enactment of the social protection framework law, we expect to increase the coverage of the social safety net and reach universal health coverage over the next years. We commit to work speedily on all complementary regulations and bylaws to ensure it complies with the fiscal targets of the program. Specifically, (i) we will clarify that no form of tax benefit is needed for the implementation of the provisions of the law, (ii) we commit to working with the Fund in designing the changes in the capital market required for the proper operation of the new private pension fund scheme, and (iii) we will seek to improve the governance of the investment funds.

**31. Streamlining tax expenditures.** At 6½ percent of GDP, Honduras has one of the largest stocks of tax expenditures in the region. Some of these have been ineffective to achieve our targets of fostering inclusive growth and reduce poverty. As stated in the LPS we will gradually eliminate them to finance the implementation of the law. We are committed not to renew any tax benefit scheduled to expire during the remainder of the program (continuous benchmark). In the FRL we included provisions to modernize the tax expenditure management system by adopting a platform to administer tax incentives and to improve the control of the benefits granted. We will include an annual estimate of tax expenditures in the budget bundle to be submitted to Congress.

**32. Social Security Institute reform.** Last February, we submitted to congress a draft law of the Social Security Institute (IHSS) that seeks to strengthen its actuarial position and improve its governance. Approval by congress of this law is still pending and we will ensure it is consistency with

the fiscal objectives of the program before enacting it. The social protection framework law has increased the contribution rate from 3.5 to 6.5 percent. Resources from the Private Contributions Scheme (RAP) were used for this and therefore it was neutral to workers and employers. We will take the necessary actions to place the IHSS on a sound financial footing by focusing on maintaining international competitiveness of the contribution rate.

**33. The efficiency of social spending.** With the ambitious path of fiscal consolidation stated in the FRL and limited room on the revenue side, increasing the efficiency (value for money) of health and education spending should be the primary way to increase the delivery of public services. To that end, we have noticed that both sectors have room for efficiency savings. We will conduct a comprehensive study of the different compensation schemes of the education and health wage bills by benchmarking them against other public employees and private sector comparators (structural benchmark, June 2017).

### **Program Monitoring**

**34. Program Monitoring.** The program will be subject to semi-annual reviews, and will be monitored through performance criteria, indicative targets, and structural benchmarks, as set out in Tables 1–3.

**Table 1. Honduras: Performance Criteria**  
(Cumulative flows; millions of Lempiras, unless specified)

	2015								2016				2017		
	End-Jun.			End-Dec.					End-Jun.				End-Jun.		
	Prog.	Adjusted	Actual	Prog.	Rev. Prog.	Adjusted	Prel.	Status	Prog.	Adjusted	Prel.	Status	Prog.	Rev. Prog.	Prog.
<b>QUANTITATIVE PERFORMANCE CRITERIA</b>															
<b>Fiscal targets 2/</b>															
Overall balance of the public sector (ceiling) 3/ 4/	-5,256	-3,345	3,461	-14,283	-11,700	-8,933	-6,399	met	-3,000	-1,824	4042.6	met	-9,600	...	-4,000
Overall balance of the central government (ceiling) 4/	-6,870	-4,959	-707	-17,873	-16,900	-14,133	-13,750	met	-6,500	-5,324	-811	met	-16,300	...	-8,000
Overall balance of ENEE (ceiling)	-1,491	...	-395	-3,353	-1,648	...	-1,397	met	-750	...	-404	met	-1,000	...	-600
Net Lending of the Combined Public Sector (ceiling) 5/	...	...	...	...	680	...	544	met	200	...	2,420	not met	400	1,700	500
<b>Public debt targets 6/</b>															
Contracting and guaranteeing of new non-concessional loans (continuous ceiling, in million US\$)	600	...	80	600	600	...	336	met	...	...	...	...	...	...	...
Present value of new external debt contracted (continuous ceiling, in millions US\$) 7/	...	...	...	...	...	...	...	met	520	520	18	met	520	240	260
Increase in the stock of arrears of ENEE (continuous ceiling) 8/	0	...	0	0	...	...	0	met	0	...	2,327	not met	...	...	0
Accumulation of new external arrears (continuous ceiling, in million US\$)	0	...	0	0	...	...	0	met	0	...	0	met	...	...	0
<b>Monetary targets</b>															
Net international reserves of the Central Bank (floor, in million US\$)	2,390	2,406	2,848	2,411	2,730	2,783	2,800	met	2,859	2,871	2,935	met	3,005	3,005	3,120
Stock of net domestic assets of the central bank (ceiling) 9/	-27,001	-27,345	-38,706	-22,454	-28,625	-29,743	-29,638	not met	-35,342	-35,588	-35,641	met	-31,760	-30,723	-36,751
<b>Indicative targets 2/</b>															
Wage bill of the central government (ceiling)	18,850	...	18,459	39,248	38,456	...	38,441	met	19,100	...	19,096	met	39,800	...	21,075
Social spending (floor)	2,384	...	3,985	7,333	9,000	...	9,898	met	3,000	...	4,934	met	9,600	...	3,500
Operating revenue-to-spending ratio of ENEE (floor)	0.97	...	1.04	0.97	1.03	...	1.06	met	1.00	...	1.07	met	1.05	...	1.05

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

2/ Cumulative starting in January of the correspondent year.

3/ Corresponds to the combined public sector for test dates end-June 2016 and end-December 2016 and the nonfinancial public sector thereafter.

4/ Excluding capital grants resulting from debt cancellation.

5/ Stock of gross lending operations of public pension funds to remain constant as of 09/12/2016.

6/ Cumulative starting in December 2014. Targets on non-concessional debt and external arrears are for the public sector.

7/ This PC will apply continuously from June 30, 2016

8/ As stated in the Technical Memorandum of Understanding paragraph 23.

9/ Using the program exchange rate of L21.1066 = 1US\$.

Table 2. Honduras: Structural Benchmarks

Measure	Rationale	Target Date	Status
1. Adjust average electricity tariffs by 2.5 percent during 2015 to reflect past cost increases; further adjust tariffs to incorporate current changes in costs.	Promote a more efficient, open and transparent electricity sector. Improve financial position of ENEE by aligning its tariffs with underlying costs	Continuous	Met
2. Approval of legislation to strengthen the PPP framework.	Eliminate fiscal risks stemming from PPPs. Improve transparency and accountability of fiscal policy	December 2014	Met
3. Repeal legislation allowing the issuance of government guarantees for debt contracted by private companies involved in PPP projects.	Eliminate fiscal risks stemming from PPPs. Align incentives of private companies with productive activities.	December 2014	Met
4. Conduct a census of public employees, with the aim of identifying and cancelling redundant positions during 2015.	Strengthen the fiscal position by making the public sector more efficient and eliminate fraud	December 2014	Met
5. Take actions sufficient to achieve savings in ENEE's wage bill as indicated in paragraph 11 of the MEFP of the November 2014 MEFP.	Eliminate fiscal risks stemming from ENEE by improving its operational margin	March 2015	Met
6. Submit to congress legislation to reform the Social Security Institute (IHSS) to strengthen its actuarial position and improve its governance.	Strengthen financial position of the IHSS	End-November 2015 <sup>1</sup>	Not Met
7. In consultation with staff, prepare a plan to address the financial difficulties of HONDUTEL.	Restore financial sustainability of the company	March 2015	Met
8. Submit to congress legislation to reform the Social Security Institute (IHSS) to strengthen its actuarial position and improve its governance.	Strengthen financial position of the IHSS	End-December 2015	Met
9. Approval of the law reforming the IHSS consistent with the fiscal objectives of the program	Strengthen financial position of the IHSS	End-December 2016 <sup>2</sup>	
10. Present a program for developing a medium-term fiscal framework with a clear fiscal anchor and fiscal policy targets	Anchor fiscal policy for the medium run in a credible and realistic manner. Ensure fiscal sustainability	June 2015	Met
11. Complete an audit of public sector arrears, with a view to clearing them	Improve the business environment by increasing accountability of the public sector	End-December 2016 <sup>3</sup>	
12. Present to congress a 2016 budget bill consistent with the program targets for central government and CPS deficits	Ensure fiscal sustainability	September 2015	Met
13. Strengthen the Large Taxpayer Unit with adequate staff levels	Improve audit of large taxpayer and ensure stable and fair revenue collection by protecting the tax base	September 2015	Met
14. Present a plan for a gradual removal of foreign exchange surrender requirements	Safeguard competitiveness and strengthen the external position by reducing foreign exchange transaction costs on importers, exporters, banks, and the BCH.	End-December 2015	Met
15. Submit to Congress a law to reform the tax code in line with recommendations of the FAD.	Simplify the tax code and align it with international best practices	End-June 2016	Not Met
16. Establish a new tax administration agency	Introduce best practices in modern tax administration and	End-June 2016	Met

**Table 2. Honduras: Structural Benchmarks (concluded)**

17. Publish a national registry of trust funds, conduct a study and prepare an assessment of their feasibility.	Make fiscal policy more transparent and improve its accountability.	End-June 2016	Not Met
18. Include in the annual budget submission a document explaining the consistency of the proposed budget with the achievement of the medium term Fiscal Responsibility Legislation goals	Ensure consistency of the budget with the FRL. Increase awareness of the FRL.	End-September 2016	
19. Eliminate central government subsidies to ENEE	Eliminate fiscal risk stemming from subsidies. Align incentives of the company away from government support and towards higher efficiency and autonomy.	Continuous	
20. Adopt customs manuals in Puerto Cortes to enhance collection of import duties in gasoline and bulk freight	Enhance collection of import duties.	End-June 2016	Met

<sup>1</sup>. The original date was March 2015.  
<sup>2</sup>. The original date was June 2015.  
<sup>3</sup>. The original date was June 2015.

Table 3. Honduras: Proposed Structural Benchmarks

Proposed Measures	Rationale	Target Date	Status
<b>Prior Action</b>			
Restore the PPP framework law to make it consistent with international best practices.	Eliminate fiscal risks stemming from PPPs. Improve transparency and accountability of fiscal policy.	Prior action 3 <sup>rd</sup> review	Met
<b>Structural benchmarks</b>			
1. BCH's board to approve strategic plan to modernize monetary policy. This must include: the announcing of inflation-forecast targeting as the nominal anchor; a communication strategy; and a road map for the further development of the interbank money and foreign exchange markets.	Improve operational framework for conducting monetary policy	End- October2016	
2. BCH to prepare regulations to create a system of primary dealers in the domestic money market in line with international best practices.	Develop the money market	End- December 2016	
3. BCH to approve a plan to adopt International Financial Reporting Standards (IFRS) for the financial year ending December 31, 2017.	Enhance financial supervision and financial market infrastructure	End- December 2016	
4. BCH to issue supporting regulations/rules for the development of the FX market consistent with recommendation of Fund TA report of November 2015.	Develop the foreign exchange interbank market	End- December 2016	
5. BCH to reduce by 10 percent obligations of authorized dealers (ADs) to sell their FX proceeds to the BCH, this is in line with the recommendations of the November 2015 MCM-TA report on eliminating surrender requirements.	Develop the foreign exchange interbank market	End- December 2016	

**Table 3. Honduras: Proposed Structural Benchmarks (concluded)**

6. Submit to Congress reforms to the BCH's law in line with Fund recommendations to support the transition towards inflation-forecast targeting.	Give the Central Bank a clear mandate to maintain price stability	End March 2017	
7. National Banking Commission (CNBS) to issue prudential regulations for the investments of public pensions funds in line with IMF recommendations	To strengthen pension funds investment policies	End March 2017	
8. Tax Administration Authority to be fully operational.	Protect hard-won gains in tax collection and ensure its stability	End-March 2017	
9. Ensure that the trust funds are managed within the general budget as per Art. 26 of the FRL.	Increase transparency and predictability of government spending	End-March 2017	



## Attachment II. 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 November 2014–November 2017. 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. For the purposes of calculating performances criteria for end-December 2015, all the assumptions indicated in the TMU signed on April 29, 2015 will prevail.

### 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 L. 21.1066/US\$ exchange rate at end-August 2014. Amounts denominated in other currencies will be converted for program purposes into U.S. dollar amounts using the cross-rates as of end-August 2014 published on the IMF website <http://www.imf.org>, including US\$/EUR = 1.3188, JPY/US\$ = 103.71, CHF/US\$ = 0.9145, CAD/US\$ = 1.0858, SDR/US\$ = 0.6586.

### Fiscal Targets

3. Unless otherwise specified, the definitions of all fiscal variables contained in this Technical Memorandum of Understanding are those defined in the IMF's 2001 Manual on Government Finance Statistics.

4. **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, excluding payment of domestic arrears accumulated until December 2013. 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 public pension funds (INJUPEMP, INPREMA, and IPM), all decentralized agencies and funds, and non-financial public enterprises. For the purposes of measuring this PC, any capital grant resulting from debt cancellation as a result of the audit of domestic arrears will not be included as revenue.

5. **The deficit of the central government** will also be measured from the financing side, excluding payment of domestic arrears accumulated until December 2013. For program purposes, the central government corresponds to the concept of central administration used by the authorities and includes the executive, judicial, and legislative branches. For the purposes of measuring this PC, any capital grant resulting from debt cancellation as a result of the audit of domestic arrears will not be included as revenue.

- 6. The current primary expenditure of the central government** is defined as total current expenditure less interest payments.
- 7. The central government wage bill** is defined as all central government wages and salaries, including severance payments, plus employer social security, pension contributions, and other contribution for social benefits; other remunerations (such as bonus payments and in-kind compensations) should be included in the definition.
- 8. Social spending** is measured at the central government level and defined as the programs and projects with social content that are financed with domestic resources, debt relief, grants, and loans (see Table B).
- 9. The overall balance of ENEE** will be measured from the financing side. For program purposes, it will be defined excluding subsidies from the central government. Subsidies are defined as in GFSM 2001 ¶6.60 “Subsidies also include transfers to public corporations and quasi-corporations to compensate for losses they incur on their productive activities as a result of charging prices that are lower than their average costs of production as a matter of deliberate government economic and social policy.”
- 10. The operating margin of ENEE** is defined as the ratio of operating revenue to operating expenditure. Operating revenue will be defined as current revenue excluding interest earnings and subsidies from the central government. Operating expenditure will be defined as total expenditure excluding interest payments and capital spending.
- 11. Net domestic financing of the CPS** will be measured as the operating result of the central bank and the annual change 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 depository institutions, according to the Monetary and Financial Statistics Manual (MFSM) definition.
- 12. Net lending (lending minus repayments).** It is defined as the difference between loans made by non-financial public institutions and repayments received by them.
- 13. 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.

## Fiscal Adjustors

- a. **For tax revenues:** If tax revenues net of legally-mandated transfers to the *Vida Mejor* and security trust funds were to exceed those underpinning the program targets, at least 50 percent of the excess revenue will improve the balance of the government and the remainder could be allocated for social and/or capital spending (Paragraph 8, Table B).
- b. **For investment projects:** If spending (in Lempiras) on the specific public investment projects as specified in Table C is less than the amount specified in such table, the targets for the central government and CPS will be reduced in the difference between the value in the Table and the amount effectively spent (measured on an accrual basis).

## Monetary Targets

**14. 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) the transfer to the central bank of foreign currency deposits held abroad by all public entities, including HONDUTEL, INJUPEMP, and IHSS. 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.

**15. 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.

- **Adjustors.** Starting in 2016, the target floor on NIR will be adjusted downwards or upwards for the shortfall or excess of programmed external public disbursements, except for those disbursements related to debt issuances to restructure, refinance, or prepay existing debts.<sup>1</sup> In case of a shortfall or excess during the program period, the target floor on NIR will be adjusted downwards or upwards by the full amount. External disbursements to the budget (including sovereign bond placements) are expected to be US\$117.10 million to end-June 2016 and total US\$416.60 million in 2016. For 2017, external disbursements to the budget (including sovereign bond placements) are expected to be US\$322.4 million to end-June 2017 and total US\$624.6 million in the year.

<sup>1</sup> In the program, any adjustment to the NIR target will be mirrored by an equal adjustment in the opposite direction to the target ceiling on net domestic assets of the central bank.

## External Targets

**16. External debt.** For program purposes, the definition of debt is the one set forth in point No. 8 of the Guidelines on Public Debt Conditionality in Fund Arrangements (Executive Board's Decision No. 6230-(79/140), as amended by Decision on December 5, 2014 (effective June 30, 2015). 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.

**17. Debt definition.** The definition of debt set forth in No. 8 of the Guidelines on Public Debt Conditionality in Fund Arrangements reads as follows:

(a) For the purpose of these guidelines, 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 lessor retains the title to the property. For the purpose of these guidelines, 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 this paragraph, arrears, penalties, and judicially awarded damages arising from the failure to make payment under a contractual obligation that constitutes debt are 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.

**18. Definition of public debt.** For the purpose of the program, public sector debt is defined as the debt of the NFPS.

**19.** For purpose of the program, the guarantee of a debt arises from any explicit legal obligation of the nonfinancial public sector or any other agency acting on behalf of the nonfinancial public sector 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.

**20. New external debt contracted.<sup>2</sup>** For the purposes of the program and starting end-June 2016 the continuous ceiling on the present value (PV) of new external debt contracted applies to all external debt contracted in each year. PV will be calculated using a unified discount rate of 5 percent and taking into account all different loans agreements, including maturities, grace periods, payment schedules, upfront commissions, and management fees. The PV of debt at the time of its contracting is calculated by discounting the future stream of payments of debt service due on this debt. The PV of every loan with negative grant element will be equal to its face value. 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.

**21. New external debt contracted adjustor.** Recognizing that deviations may come from one large loan or a few number of small/medium loans, program conditionality could accommodate moderate changes to the debt limit set on PV terms and use an adjustor of up to 5 percent of the new borrowing in PV terms (i.e., the envisioned debt limit) only when deviations are prompted by an unexpected change in the financing terms of a loan or loans.

**22. Exclusions.** Excluded from the 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.

**23. Stock of external debt arrears.** For the purpose of the program's 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 NFPS will accumulate no external debt arrears during the program period.

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<sup>2</sup> The Public Debt Limits in IMF-Supported Programs website at <http://www.imf.org/external/np/spr/2015/conc/index.htm> provides information on this issue and The Present Value (PV) Monitoring Tool for calculations.

## Energy Sector

**24. Arrears of ENEE** are defined as overdue payments of ENEE to private and public entities. During the program period, the stock of arrears to the private sector will not be increased relative to 3,867 million of Lempiras (as at December 2013), 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 decree states a deadline up to 45 days starting from the submission of appropriate documents for payment. This does not preclude payments before the deadline if it is agreed by both parties.

## Monitoring and Reporting Requirements

**25. 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 (electronically, to the extent possible) and within 45 days of the end of the previous month (unless otherwise noted) according to the sources detailed in the next paragraph.

**26. 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:

**27. 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.

**28. 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 Balance diario; (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.

**29. The ceilings on the wage bill of the central government** will be monitored monthly on the basis of the Ministry of Finance report: *Sueldos y salarios de la administración central*.

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

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

**32. The overall balance of ENEE** and its non-accumulation of arrears will be monitored monthly on the basis of financial reports provided by the Ministry of Finance.

**33. 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.

**34. The ceilings on the contracting of non-concessional external debt and on the non-accumulation 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.

**35. 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 1. Data to Be Reported to the IMF

Item	Periodicity
<b>I. Fiscal Data</b>	
<b>Net external financing:</b> detailed information on disbursements, amortizations, exceptional financing, zero coupon bond, and accumulation of arrears.	Monthly, within 45 days of the end of each month.
<b>Net domestic financing</b> 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.
<b>Monitoring of net domestic financing to the central government</b> 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.
<b>Monitoring of net domestic financing to the CPS</b> 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.
Overall balance of ENEE and arrears (if any, with detailed explanations)	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.
Report on tax credits (claims submitted, claims paid, claims in dispute)	Monthly, within 45 days of the end of each month.



<b>Table 1. Data to Be Reported to the IMF (concluded)</b>	
Social spending	Quarterly, within 45 days of the end of each
Detailed information on:	
Revenues and expenditures of the central government.	Monthly, within 45 days of the end of each month.
Revenues and expenditures of the NFPS, including the operating balance of public enterprises.	Quarterly, within 45 days of the end of each month.
Revenues and expenditures of ENEE.	Monthly, within 45 days of the end of each month.
Annual estimation of tax expenditures	Annually as part of the budget bundle
<b>II. Monetary Data</b>	
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.
<b>III. External Debt</b>	
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, 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.
<b>IV. Additional Data</b>	
Balance of Payments statistics	Quarterly, within three months of the end of each quarter.

<b>Table 2. Social Programs</b>
Description
<b><i>Bono Diez Mil and Vida Mejor Programs</i></b>
<i>Bono Diez Mil</i> <i>Vida Mejor</i>
<b>Other social investment expenditures and programs</b>
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 Caserios, NGOs Academic excellence scholarships Various scholarships Other scholarships and programs

<b>Table 3. Extended Investment Plan for 2016</b>	
In millions of Lempiras	
<b>Project</b>	<b>Amount</b>
CA-5 section 2A	404
Road infrastructure priority projects	229
Logistic corridor, sections I-A and I-B	229
CA-4 La Entrada-Santa Rosa de Copan	142
CA-4 La Entrada-El Florido	142
Irrigation project: Nacaome valley	115
CA-1: Jicaro Galan - El Amatillo	115
CA-1: Jicaro Galan - Choluteca	115
CA-3: jicaro Galan - Guasaule	115
<b>Total</b>	<b>1,605</b>



# HONDURAS

October 13, 2016

**STAFF REPORT FOR THE 2016 ARTICLE IV CONSULTATION  
AND THIRD AND FOURTH REVIEWS UNDER THE STAND-BY  
ARRANGEMENT AND THE ARRANGEMENT UNDER THE  
STANDBY CREDIT FACILITY—INFORMATIONAL ANNEX**

Prepared By

The Western Hemisphere Department

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## FUND RELATIONS

(As of May 31, 2016)

**Membership Status:** Joined: December 27, 1945

<b>General Resources Account:</b>	<b>SDR Million</b>	<b>% Quota</b>
Quota	249.8	100.00
Fund holdings of currency (Exchange Rate)	211.1	84.51
Reserve Tranche Position	38.7	15.49

<b>SDR Department:</b>	<b>SDR Million</b>	<b>% Allocation</b>
Net cumulative allocation	123.85	100.00
Holdings	53.84	43.48

<b>Outstanding Purchases and Loans:</b>	<b>SDR Million</b>	<b>% Quota</b>
ECF Arrangements	1.02	0.79

### Latest Financial Arrangements:

<b>Type</b>	<b>Date of Arrangement</b>	<b>Expiration Date</b>	<b>Amount Approved (SDR Million)</b>	<b>Amount Drawn (SDR Million)</b>
Stand-By	12/03/2014	12/02/2017	77.70	
SCF	12/03/2014	12/02/2016	51.80	
Stand-By	10/01/2010	3/31/2012	64.75	0.00
SCF	10/01/2010	3/31/2012	64.75	0.00
Stand-By	04/07/2008	03/30/2009	38.85	0.00
ECF <sup>1</sup>	02/27/2004	02/26/2007	71.20	40.68
ECF <sup>1</sup>	03/26/1999	12/31/2002	156.75	108.30

### Projected Payments to Fund

(SDR Million; based on existing use of resources and present holdings of SDRs):

	<b>Forthcoming</b>				
	2016	2017	2018	2019	2020
Principal	0.0	0.0	0.0	0.0	0.0
Charges/Interest	0.02	0.04	0.04	0.04	0.04
<b>Total</b>	<b>0.02</b>	<b>0.04</b>	<b>0.04</b>	<b>0.04</b>	<b>0.04</b>

<sup>1</sup> Formerly PRGF.

**Implementation of Enhanced HIPC Initiative: Enhanced Framework****Commitment of HIPC Assistance**

Decision point date	June 30, 2000 <sup>2</sup>
Assistance committed (NPV terms)	End-1999
Total assistance (US\$ million)	556.00
<i>Of which:</i> IMF assistance (US\$ million)	30.30
Completion point date	April 2005

**Disbursement of IMF Assistance (SDR million)**

Amount disbursed	22.66
Interim assistance	8.80
Completion point balance	13.86
Additional disbursement of interest income	3.70
<b>Total Disbursements</b>	<b>26.36</b>

**Implementation of MDRI Assistance**

Total Debt Relieve (SDR million) <sup>3</sup>	107.46
<i>Of which:</i> MDRI	98.24
HIPC	9.21
Debt Relief by Facility (SDR million)	

Delivery Date	Eligible Debt		
	GRA	PRGF	Total
January 2006	N/A	107.46	107.46

**Implementation of Catastrophe Containment and Relief (CCR):** Not Applicable.

**Exchange Rate Arrangement.** Honduras' de jure exchange rate arrangement is crawling band since July 2011, when the Central Bank of Honduras (BCH) reactivated the crawling band arrangement that had been in operation until mid-2005. The de facto exchange arrangement is a crawling peg. The exchange rate of the lempira is determined by foreign exchange auctions of the BCH. The BCH maintains an operational band requiring all bid prices for the purchase of foreign exchange to be within a range of 7 percent above or below the base price, with such prices subject to the requirement that bids in auctions not exceed 1 percent of the average base price from auctions during the preceding seven business days. The base price is revised weekly according to a procedure

<sup>2</sup> World Bank Board, July 6, 2000.

<sup>3</sup> The Multilateral Debt Relief Initiative (MDRI) provides 100 percent debt relief to eligible member countries that are qualified for the assistance. Grant assistance from the MDRI Trust and HIPC resources provide debt relief to cover the full stock of debt owed to the Fund as of end-2004 that remains outstanding at the time the member qualifies for such debt relief.

established by the BCH board of directors for this purpose, which includes the following variables: (1) the differential between the domestic inflation rate and the estimated inflation rates of Honduras's main trading partners, (2) changes in the exchange rates of these countries' currencies vis-à-vis the U.S. dollar, and (3) the performance of official reserve assets. In this setting, the lempira has followed a slow depreciating trend against the U.S. dollar.

The BCH calculates an official exchange rate (TCR) daily as the weighted average of the accepted bids submitted by participants in BCH's foreign exchange auction. The TCR is then used the next day for (i) sales of foreign exchange by authorized dealers to the BCH, (ii) purchases of foreign exchange by authorized dealers from their clients and (iii) sales and purchases of foreign exchange between public institutions and the BCH.

Honduras has accepted the obligations under Article VIII, Section 2, 3, and 4 of the Articles of Agreement, and currently maintains two multiple currency practices subject to the Fund's approval under Article VIII, Section 3. The two multiple currency practices arise from the absence of a mechanism to prevent the potential deviation of more than two percent at any given time among effective exchange rates for spot exchange transactions: (i) between successful bids within the foreign exchange auction; and (ii) between the official exchange rate (TCR) of the day and the exchange rates at which foreign exchange is sold at the auction on that day.

**Article IV Consultation.** The last Article IV consultation with Honduras was concluded on June 9, 2014.

**An update safeguards assessment of the BCH was concluded in April 2015.** The assessment concluded that the BCH Law continues to pose a significant risk to central bank autonomy and also that the bank's Board and audit committee do not have any independent members, which undermines these bodies' oversight function. The assessment recommended amendments to the BCH Law to protect the bank from political interference, establish its financial autonomy, and strengthen its governance arrangements. In addition, the assessment noted that recurring operating losses since the 1990s have severely weakened the bank's financial position and a recapitalization plan has been initiated, with the BCH expected to achieve positive equity in 2021. The assessment also recommended that the BCH adopt International Financial Reporting Standards.

**FSAP participation and ROSCs.** Fiscal ROSC conducted on February 26–March 2, 2001 (IMF Country Report No. 02/16) and updated (IMF Country Report No. 05/256). Data ROSC data conducted on July 8–24, 2003 (IMF Country Report No. 05/230). FSAP conducted on October 14–19, 2002 and January 20–February 4, 2003. FSAP Update conducted on September 24 to October 9, 2007.

**Technical Assistance.** Honduras has received substantial technical assistance. The table below details assistance provided since November 2012.

<b>Department</b>	<b>Purpose</b>	<b>Time of Delivery</b>
LEG	Legal Framework for Bank Resolution	May 2016
MCM	Central Bank Accounting	Nov 2012
MCM	Bank Supervision & Regulations	Nov 2012
MCM	Bank Supervision and Regulations	Feb 2013
MCM	Monetary and Foreign Exchange Policy	Apr 2013
MCM	Bank Supervision and Regulation	Apr 2013
MCM	Bank Supervision and Regulation	May 2013
MCM	CAPTAC-DR: Building of a Model of Inflation Forecasts	Nov 2013
MCM	Bank Supervision and Regulations	Nov 2013
MCM	CAPTAC-DR: Hedging Derivatives	Dec 2013
MCM	CAPTAC-DR: Building a Model for Structural Liquidity Forecasts	May 2014
MCM	CAPTAC-DR: Treasury Management	Jul 2014
MCM	CAPTAC-DR: Bank Supervision and Regulation	Jul 2014
MCM	CAPTAC-DR: Treasury Management	Oct 2014
MCM	Monetary Operations	Nov 2014
MCM	Bank Supervision and Regulations	Dec 2014
MCM	CAPTAC-DR: Risk Based Supervision Scheme	Dec 2014
MCM	FX Lending Prudential Requirements	Feb 2015
MCM	CAPTAC-DR: Strengthening Monetary Policy Framework	Feb 2015
MCM	Financial Supervision	March 2015
MCM	Strengthening Monetary Policy Operational Framework	May 2015
MCM	CAPTAC-DR: Risk Based Supervision Implementation	May 2015
MCM	CAPTAC-DR: Strengthening and Expanding the Macroeconomic Model	August 2015
MCM	Modernizing The Foreign Exchange System	Sep 2015
MCM	CAPTAC: Training on Macroeconomic Forecast Models	February 2016
MCM	CAPTAC: Forecast Efficiency of the Central Bank's Semi-structural Macroeconomic Model	March 2016
FAD	Public Financial Management	Nov 2012
FAD	MTEF Implementation	Nov 2012
FAD	Budget Execution and Cash Planning	Jan 2013
FAD	Customs Administration	Jan 2013
FAD	Tax Administration	Mar 2013
FAD	Customs Administration	Apr 2013
FAD	Public Financial Management	Aug 2013
FAD	Tax Administration	Aug 2013
FAD	Budget Execution and Arrears Control	Sept 2013
FAD	Managing Fiscal Risks	Sep 2013
FAD	Customs Administration	Nov 2013

<b>Department</b>	<b>Purpose</b>	<b>Time of Delivery</b>
FAD	Tax Administration	Dec 2013
FAD	Financial Programming and Analyzing Fiscal Risks	Feb 2014
FAD	Public Financial Management	Feb 2014
FAD	Strengthening the Medium-term Expenditure Framework	Feb 2014
FAD	Customs Administration	Apr 2014
FAD	Tax Administration	Apr 2014
FAD	Modernization of Revenue Administration	Jul 2014
FAD	Tax Administration	Oct 2014
FAD	Management of fiscal risks	Oct 2014
FAD	Treasury Single Account	Oct 2014
FAD	Accounting Rule for PPP Operations	Dec 2014
FAD	Medium-term expenditure framework	Mar 2015
FAD	Medium-term expenditure framework	July 2015
FAD	Streamlining tax exemptions	March 2016
FAD	Tax administration	May 2016
STA	Balance of Payments	Nov 2012
STA	CAPTAC: Export/Import Price Index and PPI	Feb 2013
STA	Migration to GFSM 2001	Feb 2013
STA	CAPTAC: National Accounts 2008 SNA	Mar 2013
STA	CAPTAC: Balance of Payments Statistics and IIP	May 2013
STA	CAPTAC: National Accounts-Construction Data Sources	Jul 2013
STA	CAPTAC: Balance of Payments	Nov 2013
STA	CAPTAC: Producer Price Index	Dec 2013
STA	CAPTAC: National Accounts-Statistics and Construction Data Sources	Mar 2014
STA	CAPTAC: Coordinated FDI and Portfolio Surveys	Mar 2014
STA	External Debt Statistics	Jun 2014
STA	Balance of Payments and IIP Statistics	Jul 2014
STA	Topics of the Secondary Income Account	Jul 2014
STA	Balance of Payments and IIP	Feb 2015
STA	Topics of the Financial Account	March 2015
STA	CAPTAC: National Accounts-Statistics and Construction Data Sources	May 2015
STA	Balance of Payments and IIP	July 2015
STA	Balance of Payments and IIP	June-July 2016
STA	Enhanced General Data Dissemination System (e-GDDS)	March 2016
STA	National Accounts Statistics Mission	April 2016



## RELATIONS WITH THE INTER-AMERICAN DEVELOPMENT BANK

(As of June 13, 2016)

### RECENT PROJECTS AND OBJECTIVES

**1. On December 2014, the IADB approved its country strategy with Honduras for the period 2015-2018.** It focused on the following areas: (i) fiscal consolidation; (ii) sustainability and competitiveness in the energy sector; (iii) road infrastructure for regional integration; (iv) social inclusion; and (v) sustainable development in the Central District.

**2. As of June 16<sup>th</sup> 2016, the portfolio of approved sovereign-guaranteed loans under execution amounted to USD 689.4 million, with an undisbursed balance of USD 382.5 million.**

**3. The existing sovereign guaranteed portfolio focuses on:** (i) transport 44 percent; (ii) social protection 23%; (iii) energy 9 percent; (iv) modernization of the State 8 percent; and (v) health 7 percent. In the private sector, the IADB has four non-sovereign projects under execution amounted to USD 44 million, which support trade facilitation and energy efficiency.

**4. The pipeline for IADB approvals in 2016 includes four operations in the public sector for USD 170 million distributed as follow:** (i) one operation in the transport sector for USD 75 million for the improvement of road infrastructure (ii) two operations in the social protection sector, aimed at: (a) improving women living conditions, and (b) breaking the intergenerational poverty transmission cycle; and (iii) one operation in climate change for USD 25 million. The pipeline will be approved before the end of the year.

**IADB Sovereign Guaranteed Loan Portfolio in Honduras  
As of June 13th 2016 (In millions of US Dollars)**

Sector	Current Approved	Available Amount
Transport	267.0	169.4
Social protection	109.9	89.9
Modernization of the State	102.0	30.9
Health	80.0	27.2
Energy	45.9	34.2
Municipal management	28.6	1.5
Fiscal	27.0	27.0
Disaster risk prevention	19.0	1.7
Trade	10.0	0.7
<b>Total</b>	<b>689.4</b>	<b>382.5</b>

**IADB Non-sovereign Guaranteed Loan Portfolio in Honduras  
As of June 13th 2016 (In millions of US Dollars)**

<b>Sector</b>	<b>Current Approved</b>	<b>Available Amount</b>
Trade facilitation	35.0	20.0
Energy efficiency	8.9	8.9
<b>Total</b>	<b>43.9</b>	<b>28.9</b>

**IADB Disbursement of Sovereign Guaranteed Loan Portfolio in Honduras  
2010-2016 (In millions of US Dollars)**

<b>Year</b>	<b>Amount</b>
2010	162.8
2011	256.1
2012	206.8
2013	224.3
2014	302.0
2015	216.3
2016*	114.0

(\*) projected

**IADB Annual Net Flows with Sovereign Guarantee in Honduras 2010-2015  
(In millions of US Dollars)**

	<b>2010</b>	<b>2011</b>	<b>2012</b>	<b>2013</b>	<b>2014</b>	<b>2015</b>
Repayments	25.3	24.3	17.1	12.0	12.7	19.5
Disbursement	162.8	256.1	206.8	224.3	302.0	216.3
<b>Net Loan Flow</b>	<b>137.5</b>	<b>231.7</b>	<b>189.7</b>	<b>212.2</b>	<b>289.3</b>	<b>196.8</b>
Subscriptions and Contributions	1.3	0.0	15.9	8.7	9.3	1.7
<b>Net Capital Flow</b>	<b>136.2</b>	<b>231.7</b>	<b>173.8</b>	<b>203.6</b>	<b>280.1</b>	<b>195.1</b>
Interest and Charges	10.2	12.7	16.5	22.1	26.1	32.7
<b>Net Cash Flow</b>	<b>125.9</b>	<b>219.1</b>	<b>157.2</b>	<b>181.5</b>	<b>254.0</b>	<b>162.4</b>

## RELATIONS WITH THE WORLD BANK GROUP

(As of June 15, 2016)

A new Country Partnership Framework (CPF) for 2016-2020 was endorsed by the Board on December 2015 using inputs from the Systematic Country Diagnostic (which was prepared in October 2015). The 2016-2020 CPF seeks to support Honduras in its efforts to foster social inclusion, while bolstering conditions for growth and reducing vulnerabilities to enhance the country's resilience. The new CPF will continue supporting the Honduras' Country Vision for 2038 (adopted in 2010) and the Administration's "Plan para una Vida Mejor." Strengthening institutions and enhancing governance are critical cross-cutting themes that will underpin the strategic pillars.

The combined World Bank Group active portfolio in Honduras (IDA, IFC, MIGA plus trust funds), equals US\$ 1.35 billion. The IDA17 allocation is SDR97.8 million (US\$138 million), of which US\$ 130 million has already been allocated to an additional financing for a Social Protection Program and two Development Policy Credits. At the request of the Government of Honduras, the WBG mobilized resources from the IDA 17 round to help the new administration with its fiscal consolidation program, including a US\$55 million Fiscal Sustainability and Enhanced Social Protection Development Policy Credit approved in December 2014 and a US\$50 million First Fiscal Sustainability and Enhanced Competitiveness DPF approved in December 2015.

The active portfolio is made up of 9 projects, totaling US\$354.28, of which approximately US\$95 million are undisbursed. The portfolio is rather mature, and by end of FY2016 the Bank expects to have 7 operations disbursing. The portfolio was consolidated from 14 to 9 projects with increasingly larger grant or credit amounts. Project disbursements (excluding budget support) increased steadily from US\$62.6 million in FY12, to US\$87.1 million in FY13. Gains in disbursements during the first two years of the previous Country Partnership Strategy period were reversed by the Government's fiscal measures to contain the deficit. As a result, project disbursements dropped to US\$68.1 million in FY14, US\$36.2 million in FY15 and US\$ 28.9 in FY16.

The World Bank's current activities are helping Honduras efforts to achieve fiscal consolidation, improve the investment climate (especially transport/logistics for trade), strengthened education quality and social protection and better disaster risk management. With respect to reducing the fiscal burden of the state-owned Electricity Company (ENEE), progress has been made in laying the policy and institutional groundwork for future improvements and the authorities have taken measures to reduce subsidies and adjust electricity tariffs, although ENEE's losses continue to represent a fiscal burden. Furthermore, the World Bank's activities are contributing to Honduras adopt a balanced and comprehensive approach to reducing violence, combining the traditional focus on control and punishment with a new emphasis on prevention contributing to the achievement of improvements in citizen security and to strengthening evidence-based decision-making at both national and local levels. Targets aimed at improving coverage and management

of Honduras' National Conditional Cash Transfer Social Protection Program (Bono Vida Mejor, formerly Bono 10,000) have been achieved. Ongoing activities are also supporting public sector financial management practices, increased access of small and medium enterprises to agriculture markets, land titling, and improved logistics in transport.

In line with its regional strategy, IFC's investment activities focus on renewable energy generation, strengthening and broadening the financial sector, and supporting competitive agribusiness and commercial sectors. Furthermore, IFC has played a catalytic role in PPP development, improving access to finance for SMEs, streamlining administrative processes for business regulation and regional trade, and facilitation of international trade. IFC investments, for instance, include four large scale renewable energy projects with an aggregate capacity of 210.5MW (accounting for about 15 percent of the country's installed capacity), financing to 7 out of the 16 banks of the local banking system and investments on commercial real estate, services and agribusiness sectors. Current portfolio stands at US\$662.56 million, mostly in financial sector, infrastructure, commercial real estate and agribusiness.). This represents a substantial increase compared to FY11 results of US\$193.4 million and is IFC's second largest portfolio in Central America. Since 2012 IFC financing has contributed to improving access to finance for approximately 18,000 micro, small and medium enterprises (MSMEs) and is supporting key agri-commodities, such as palm oil and sugar reaching 2,500 farmers and contributing to nearly 7,500 direct jobs, out of which 1,600 (21 percent) are women. IFC is currently considering opportunities in commercial property development, construction materials, infrastructure, logistics and health coverage.

MIGA has US\$326.9 million in gross exposure through three projects in the transport and energy sectors. MIGA has provided guarantees of US\$187.9 million for the construction and operation of a toll road which will improve the connectivity between Honduras' second largest city and the coast. In energy, MIGA granted US\$82.4 million in guarantees for a 24MW expansion of the existing 102MW Cerro de Hula wind farm, and an investment of US\$56.7 million in guarantees in three photovoltaic projects supporting 80 MW solar power.

## A. Projects

**The active IDA portfolio is made of 9 projects (8 investment operations plus one US\$50 million budget support operation) totaling US\$354 million in IDA funding, of which approximately US\$95 million is undisbursed.**

**Honduras Rural Competitive Project.** The Project Development Objective (PDO) is to contribute to increased productivity and competitiveness among organized rural small-scale producers through their participation in productive alliances. The closing date of this Project is November 30, 2015, however it is expected to be extended with an additional financing.

**Corredor Seco Food Security Project.** The objective of the Project is to enhance food and nutritional security of vulnerable households in Selected Areas of the Corredor Seco. Project will

increase household availability of quality food and revenues of poor and extremely poor rural residents in 25 municipalities as a basis for improving nutrition and in the long-term for reducing child stunting. Project will also improve nutrition and nutritional practices especially for children and women in selected municipalities. Project is implemented with US\$ 30 million of GAFSP (trust fund) resources.

**Honduras Water and Sanitation Sector Modernization Project.** The PDO is to support the Recipient to improve: (a) the sustainability, efficiency, and reliability of Honduras's water supply and sanitation (WSS) services in Eligible Municipalities; (b) the performance of its national WSS sector institutions in the exercise of their respective roles in accordance with the WSS Sector Framework Law; and (c) its capacity to respond promptly and effectively to an Eligible Emergency. The closing date of this Project is December 31, 2016.

**Second Land Administration Project.** The PDO is to provide the population in the Project Area with improved, decentralized land administration services, including better access to and more accurate information on property records and transactions. The closing date of this Project is January 30, 2017.

**Social Protection.** The PDOs of this Project are to: (a) improve the institutional capacity of Recipient's institutions to manage the Conditional Cash Transfer (CCT) Program, by strengthening transparent mechanisms and instruments for targeting Program beneficiaries, monitoring compliance with Program co-responsibilities, and making payments to Program beneficiaries; (b) provide income support to Eligible Beneficiaries; (c) increase the use of preventive health services and school attendance in grades 1 to 6 among Program beneficiaries in rural areas; and (d) improve the Recipient's capacity to respond promptly and effectively to an Eligible Emergency. The closing date of this Project is December 31, 2017.

**Safer Municipalities.** The PDOs of this Project are to support Honduras (i) to improve the capacities of national and local actors in violence prevention, (ii) to ensure urban municipalities are addressing crime and violence risk factors, and (iii) to respond promptly and effectively to an eligible emergency. The closing date of this Project is August 31, 2018.

**Disaster Risk Management.** The PDOs of this Project are to support Honduras to: (a) continue strengthening its capacity for integrated disaster risk management at the municipal and national level; and (b) improve its capacity to respond promptly and effectively to an eligible emergency. The closing date of this Project is April 30, 2019.

**Rural Infrastructure.** The PDOs of the Project are: (a) to improve the access, quality and sustainability of infrastructure services (roads, water, sanitation and electricity) for the rural poor in the Recipient's territory; (b) to develop capacities and an enabling environment within the Recipient for locally-driven infrastructure service provision and planning; and (c) to improve the Recipient's capacity to respond promptly and effectively to an Eligible Emergency. The closing date of this Project is June 30, 2016.

**First Fiscal Sustainability and Enhanced Competitiveness DPF** to support the Government's efforts in (i) strengthening institutional arrangements to support fiscal sustainability; and (ii) enhancing the regulatory framework to promote competitiveness.

### **Recently Closed Projects:**

**Improving Public Sector Performance (closed December 2015).** The PDO is to strengthen the management of public finances and to establish a more efficient, effective and transparent public procurement system through: (i) upgrading the public financial management system; (ii) upgrading the e-procurement platform; (iii) enhancing the internal control systems over personnel expenditures; and (iv) building capacity of the Central Administration.

**Power Sector Efficiency Enhancement Project.** The PDO was to improve ENEE's operational and financial performance, thus contributing to the sustainability of the power sector in Honduras.

**Roads Rehabilitation and Improvement.** The PDO was to improve the quality of road network and of road management in support of the government's growth and competitiveness goals through: (i) Improved governance and enhanced road management capacity in INSEP (former SOPTRAVI) and the Road Fund; (ii) Improvement in selected road corridors; and (iii) Extension in the scope of the maintenance of the unpaved road network; and (iv) improvement of the Recipient capacity to respond promptly and effectively to an eligible emergency

## **B. Non-Lending Activities**

**Economic and Sector Work.** Honduras benefits from a comprehensive series of completed, ongoing and planned analytical and advisory activities to support the CPF pillars. Recently completed economic and sector work includes: a "Honduras Public Expenditure Review: Towards Restoring Fiscal Consolidation" (2013); a poverty and inequality report titled "Centroamérica en el Nuevo Milenio: Seis Historias Diferentes de Pobreza y Desigualdad" (2013) with a chapter on Honduras; a series of Policy and Sectoral Notes titled "Towards Fiscal Stability and Sustainable Development for a Better Life" (2014); a "Honduras Gender Assessment" (2014); a "Debt Management and Performance Assessment" (2014); a "Honduras Current Account Assessment" (2014); a "Honduras Economic Diagnostic for National Action (DNA)" (2015); and a Guidance for enhanced regulatory capacity for improved governance in extractive industries (2016).

## C. Financial Relations

Project	Loan	Original Amount	Percent Disbursed	Approval	Sign	Closing	Undisbursed	Disbursed
		(USD Eq)		Date	Date	Date	Balance	Outstanding Balance
							(USD Eq)	(USD Eq)
<b>Honduras First Fiscal Sustainability and Enhanced Competitiveness DPF</b>	IDA 57500	50,000,000.00	100.00%	15-Dec-15	15-Dec-15	30-Mar-17	0.00	50,000,000.00
<b>Disaster Risk Management Project</b>	IDA 51900	30,000,000.00	34.46%	13-Dec-12	18-Dec-12	30-Apr-19	15,611,633.27	8,208,877.16
<b>HN Safer Municipalities</b>	IDA 51920	15,000,000.00	32.20%	13-Dec-12	18-Dec-12	31-Aug-18	9,355,104.77	4,443,393.23
<b>Improving Public Sector Performance</b>	IDA 50200	18,200,000.00	91.17%	6-Dec-11	7-Dec-11	31-Dec-15	470,884.77	4,860,453.65
<b>Second Land Administration Project</b>	IDA 46410	32,800,000.00	98.05%	30-Jun-11	23-Aug-11	30-Jan-17	562,181.29	28,302,023.71
<b>Social Protection</b>	IDA 56030	25,000,000.00	4.00%	31-Mar-15	19-May-15	31-Dec-17	24,000,000.00	1,000,000.00
<b>Social Protection</b>	IDA 52940	12,300,000.00	58.76%	8-Aug-13	26-Aug-13	31-Dec-17	4,760,869.60	6,784,812.40
<b>Social Protection</b>	IDA 47740	40,000,000.00	98.66%	29-Jun-10	2-Aug-10	31-Dec-17	498,508.86	36,813,756.14
<b>Honduras Rural Competitiveness Project</b>	IDA 44650	30,000,000.00	85.44%	17-Jun-08	17-Sep-08	31-Dec-16	2,870,494.19	16,841,645.81
<b>HN Water and Sanitation Sector Modernization Project</b>	IDA 52700	10,000,000.00	49.24%	19-Jun-13	12-Jul-13	31-Dec-16	4,788,949.24	4,644,717.76
<b>HN Water and Sanitation Sector Modernization Project</b>	IDA 43350	30,000,000.00	100.00%	21-Jun-07	16-Nov-07	31-Dec-16	0.00	27,878,598.00
<b>HN Rural Infrastructure Project</b>	IDA 52890	20,000,000.00	99.83%	19-Jun-13	12-Jul-13	30-Jun-16	20,358.78	11,890,393.46
<b>HN Rural Infrastructure Project</b>	IDA 40990	47,000,000.00	100.00%	7-Jul-05	16-Nov-05	30-Jun-16	0.00	40,550,688.00

Period	Disb. Amt.	Repay Amt.	Net Amt.	Charges	Fees
Jul 2006 - Jun 2007	41,624,795.86	0.00	41,624,795.86	2,424,638.03	596,191.13
Jul 2007 - Jun 2008	62,219,851.37	0.00	62,219,851.37	1,395,496.53	1,810,261.38
Jul 2008 - Jun 2009	49,391,574.72	0.00	49,391,574.72	0.00	3,313,284.34
Jul 2009 - Jun 2010	31,696,088.07	0.00	31,696,088.07	0.00	3,643,503.66
Jul 2010 - Jun 2011	118,584,340.26	1,105,404.96	117,478,935.30	0.00	4,103,991.95
Jul 2011 - Jun 2012	147,730,043.84	2,635,298.73	145,094,745.11	0.00	4,855,712.31
Jul 2012 - Jun 2013	87,062,015.07	3,202,199.84	83,859,815.23	1,186,246.38	5,943,753.48
Jul 2013 - Jun 2014	68,112,870.03	4,390,624.09	63,722,245.94	1,098,579.63	6,554,020.70
Jul 2014 - Jun 2015	91,206,208.19	7,633,158.67	83,573,049.52	1,165,256.68	6,484,201.02
Jul 2015 - Jun 2016	76,539,217.77	21,332,670.75	55,206,547.02	2,166,183.33	6,653,254.21
<b>Total</b>	<b>774,167,005.18</b>	<b>40,299,357.04</b>	<b>733,867,648.14</b>	<b>9,436,400.58</b>	<b>43,958,174.18</b>



## STATISTICAL ISSUES

(As of June 2016)

### I. Assessment of Data Adequacy for Surveillance

**General: Data provided to the Fund are broadly adequate for surveillance and program monitoring purposes.** Data on the banking system, the public finances, trade, and external debt, national accounts and prices broadly satisfy the criteria required for surveillance and program monitoring purposes. However, monitoring will benefit from both better timing of data release and more comprehensive data coverage. Regarding timing, data release dates should be predetermined and published online to increase predictability of economic forecasts. On data coverage, estimates of average wages and unit labor costs will help assess competitiveness and conducting a comprehensive household survey will help evaluate labor market conditions. Some issues that were flagged in the previous Article IV but have not been fully addressed includes the lack of comprehensive data on the financial operations of public enterprises, insufficient coverage of financial institutions, improving estimate of arrears and floating debt of public entities, enhancing reporting of government guarantees and fiscal contingent liabilities, and a valid and reliable methodology to estimate private capital flows. The authorities implemented in June 2016, the Enhanced General Data Dissemination System (e-GDDS), which was endorsed by the IMF's Executive Board in May 2015. This makes Honduras the first IMF member in the Western Hemisphere to implement those recommendations.

**National Accounts:** The Central Bank of Honduras (BCH) compiles the national accounts estimates following the *System of National Accounts 1993 (1993 SNA)*, rev. 4. The base year is 2000. The BCH has published quarterly GDP data that are fully consistent with the new annual series. The BCH annually provides the Honduran Institute of Tourism (ITH) with basic detailed data of the input-output matrix in order to develop the Tourism Satellite Account in the framework of national accounts (expected to be published during the second semester). The BCH is working on updating the base year, including adopting the main recommendations of the 2008 SNA, with support of TA from an independent consultant and CAPTAC-DR.

**Price Statistics:** The BCH prepares and publishes (since April 2000) the consumer price index (CPI), with reference period December 1999 = 100. The selection of products included in the CPI basket and corresponding weights are based on the National Household Income and Expenditure Survey (NHIES) of 1998–1999. A new NHIES for 2016–2017 is expected to begin shortly. The BCH also revised the producer price index by expanding its coverage and updating its base and classification, in the context of the revision of the national accounts; preliminary estimations of this index were made and its release is expected soon. This index includes goods for processing activities (maquila), trade and transport margins, making it difficult to use it in the compilation of national accounts at constant prices.

**Government Finance Statistics:** The Ministry of Finance (SEFIN) compiles and disseminates

<p>government finance statistics (GFS) covering central administration, central government, general government, and nonfinancial public sector. The above-the-line data of these sectors are reported to WHD, along with below-the-line data for central administration and nonfinancial public sector, which are provided by the BCH. Currently, the SEFIN and the BCH are participating in the GFS harmonization project for Central America, Panama, and Dominican Republic. Under this project, country participants will elaborate and publish comparable GFS across countries to permit a comparative analysis of fiscal developments and facilitate the regional policy dialogue. The components of the projects are: (i) compilation and dissemination of GFS sub-annual and annual using the GFSM 2001 framework, and (ii) preparation of a detailed migration plan for gradual adoption of the full GFSM 2001 framework. A mechanism to collect data systematically of arrears and floating debt of public entities, particularly public enterprises are needed.</p>	
<p><b>Monetary and Financial Statistics:</b> Monetary and financial statistics (MFS) are reported on a regular monthly basis to STA using the standardized report forms (SRFs) for the central bank, other depository corporations, and other financial corporations (OFCs). However, pension funds and financial auxiliaries are excluded from the institutional coverage of OFCs. The inclusion of pension funds and cross-sectoral data consistency between MFS and other data sets are the major issues that should be addressed by the authorities.</p>	
<p><b>Financial sector surveillance:</b> The authorities report nine out of 12 core financial soundness indicators and five of the encouraged set.</p>	
<p><b>External sector statistics:</b> Honduras has achieved significant milestones in the context of the CAPTAC-DR's Regional Harmonization Project of External Sector Statistics, which ended in December 2015. The BCH disseminates quarterly Balance of Payments and International Investment Position (IIP) statistics, and monthly the Data Template on International Reserves and Foreign Currency Liquidity. Honduras also participates in the Coordinated Direct Investment Survey (CDIS) and the Coordinated Portfolio Investment Survey (CPIS). Work in progress at the BCH aims at (a) improving the coverage of the surveys on nonfinancial corporations, and, particularly, on direct investment enterprises, (b) improving the coverage of external debt statistics; (c) ensuring consistency between external debt statistics and IIP statistics, and, (d) completing the migration to a BPM6 basis of recording and dissemination of external sector statistics.</p>	
<p><b>II. Data Standards and Quality</b></p>	
<p>The country is an e-GDDS participant. STA conducted an e-GDDS mission in March 2016. The authorities updated their metadata where appropriate. The authorities also introduced a new National Summary Data Page to serve as a one-stop portal for essential macroeconomic data and metadata.</p>	<p>Data ROSC was published on July 29, 2005.</p>

## Appendix I. Table of Common Indicators Required for Surveillance

	Date of latest observation (For all dates in table, please use format dd/mm/yy)	Date received	Frequency of Data <sup>7</sup>	Frequency of Reporting <sup>7</sup>	Frequency of Publication <sup>7</sup>	Memo Items: <sup>8</sup>	
						Data Quality – Methodological soundness <sup>9</sup>	Data Quality – Accuracy and reliability <sup>10</sup>
Exchange Rates	04/10/16	05/10/16	D	D	D		
International Reserve Assets and Reserve Liabilities of the Monetary Authorities <sup>1</sup>	29/09/16	04/10/16	D	W	D		
Reserve/Base Money	29/09/16	04/10/16	D	W	D		
Broad Money	31/07/16	14/09/16	M	M	M		
Central Bank Balance Sheet	29/09/16	04/10/16	D	M	D		
Consolidated Balance Sheet of the Banking System	31/07/16	14/09/16	M	M	M		
Interest Rates <sup>2</sup>	31/09/16	01/10/16	M	M	M		
Consumer Price Index	31/09/16	04/10/16	M	M	M		
Revenue, Expenditure, Balance and Composition of Financing <sup>3</sup> – General Government <sup>4</sup>	30/06/16	30/08/16	Q	Q	Q		
Revenue, Expenditure, Balance and Composition of Financing <sup>3</sup> – Central Government	30/06/16	30/08/16	Q	Q	Q		
Stocks of Central Government and Central Government-Guaranteed Debt <sup>5</sup>	30/06/16	30/08/16	Q	Q	Q		
External Current Account Balance	30/06/16	30/09/16	Q	Q	Q		
Exports and Imports of Goods and Services	31/07/16	15/09/16	M	M	M		
GDP/GNP	30/06/15	21/09/16	Q	Q	Q		
Gross External Debt	30/07/16	15/08/16	M	M	M		
International Investment Position <sup>6</sup>	30/06/15	30/09/16	Q	Q	Q		

<sup>1</sup> Any reserve assets that are pledged or otherwise encumbered should be specified separately. Also, data should comprise short-term liabilities linked to a foreign currency but settled by other means as well as the notional values of financial derivatives to pay and to receive foreign currency, including those linked to a foreign currency but settled by other means.

<sup>2</sup> Both market-based and officially-determined, including discount rates, money market rates, rates on treasury bills, notes and bonds.

<sup>3</sup> Foreign, domestic bank, and domestic nonbank financing.

<sup>4</sup> The general government consists of the central government (budgetary funds, extra budgetary funds, and social security funds) and state and local governments.

<sup>5</sup> Including currency and maturity composition.

<sup>6</sup> Includes external gross financial asset and liability positions vis-à-vis nonresidents.

<sup>7</sup> Daily (D); weekly (W); monthly (M); quarterly (Q); annually (A); irregular (I); and not available (NA).

<sup>8</sup> These columns should only be included for countries for which Data ROSC (or a Substantive Update) has been published.

<sup>9</sup> This reflects the assessment provided in the data ROSC or the Substantive Update (published on ..., and based on the findings of the mission that took place during...) for the dataset corresponding to the variable in each row. The assessment indicates whether international standards concerning concepts and definitions, scope, classification/sectorization, and basis for recording are fully observed (O); largely observed (LO); largely not observed (LNO); not observed (NO); and not available (NA).

<sup>10</sup> Same as footnote 7, except referring to international standards concerning (respectively) source data, assessment of source data, statistical techniques, assessment and validation of intermediate data and statistical outputs, and revision studies.

**Statement by Hurtado, Executive Director for Honduras  
and Ms. Garcia Corzo, Advisor to the Executive Director  
October 26, 2016**

The Honduran authorities thank staff for the candid and productive discussions during 2016 Article IV Consultation and Third and Fourth Reviews Under the Stand-By Arrangement (SBA) and Standby Credit Facility (SCF). They also thank Management and Executive Directors for their continued support.

In 2013, Honduras medium-term economic and development prospects were undermined by fiscal imbalances, weak external position and structural weaknesses. A strong comprehensive fiscal consolidation strategy and an ambitious structural reform plan were needed to preserve fiscal sustainability and pave the way for higher sustainable and inclusive economic growth.

In October 2016, after almost two years of successful program implementation and strong ownership by the government, Honduras has taken significant steps on the right path for achieving its economic and development goals over the medium-term. Fiscal sustainability has been restored, fiscal prudence has been institutionalized with the approval of the Fiscal Responsibility Law, social expenditure has been protected, public investment has increased, the external position has been strengthened, significant advances have been made on structural reforms (including tax administration, state-owned enterprises and the public wage bill) and investment confidence has been bolstered. Furthermore, successful program implementation has been a catalyst for other multilateral and bilateral donors' support as well as for sovereign credit ratings upgrades.

**Recent economic developments**

**Economic activity remains strong.** The quarterly GDP increased 4.5 percent (yoy) during the second quarter of 2016, with all economic sectors reporting a positive performance. The main economic activities contributing to growth were financial intermediation, manufactures, agriculture, communications, energy and commerce. On the expenditure side, growth was supported mainly by exports and private consumption encouraged by lower gasoline prices and strong remittances inflows. The economic outlook for the remainder of the year is positive. Real GDP growth is projected at 3.6 percent in 2016, supported by increased public sector infrastructure investment and a supportive monetary policy stance.

**Lower international commodity prices continue impacting the external accounts.** As of June 2016, total exports have decreased by 5.5 percent (yoy) mainly due to lower exports of coffee (-22.6 percent) as a result of a reduction of about 19 percent in prices and to a lesser extent of exported volumes (-4.5 percent). Total imports reported a contraction of 9.4 percent during the same period, mainly due to lower imports of machinery for energy plants already in operation and to lower fuel prices as imports of fuels decreased about 22 percent. As a

result, the trade deficit improved by 21.8 percent. Remittances inflows increased by about 6 percent during the same period and are expected to remain strong, reaching almost 19 percent of GDP by end-2016. A current account deficit of 5.3 percent of GDP is expected for end-2016 (9.5 percent of GDP at end-2013).

**Inflation and inflation expectations remain contained.** Headline and core inflation continued their downward trend reaching 2.90 percent and 3.29 percent (yoy), respectively, in September, supported by continued low oil prices and a still negative output gap, while inflation expectations set the rate at 2.96 percent by the end of the year, below the lower band of the inflation target range of 4.5 +/- 1 percent set by the Central Bank. Considering that inflationary pressures are contained, the Central Bank has implemented a more supportive monetary policy stance by reducing its monetary policy interest rate in 150 bps from 7.00 percent in December 2014 to 5.50 percent in June 2016. This reduction has already translated to lower interest rates in the banking system as interest rates for loans in local currency have decreased 79 bps from Dec-2015 to July-2016 and 143 bps since Dec-2014. Regarding interest rates for loans in foreign currency, the downward trend shown during the last years has changed in recent months, showing an increase of 11 bps from Dec-15 to July-2016. Meanwhile, total credit to the private sector increased by 10.9 percent as of July (yoy) mainly supported by credit in local currency (13.7 percent increase) which accounts for more than 70 percent of total credit. Credit in foreign currency increased by 4.0 percent as of July, significantly lower than the two-digit growth rates observed in previous years (18.2 percent in Dec-2013), in part due to the tightening of regulations on credit to unhedged borrowers.

**The banking system remains sound and profitable while actions are being taken to further strengthen its supervision and legal frameworks.** The capital adequacy ratio was 13.7 percent as of July, above the 10 percent minimum legally required; the ratio of non-performing loans to total loans was 3.6 percent with more than a 100 percent coverage; the return on equity reached 13.6 percent and liquid assets represented 3.3 percent of deposits. Furthermore, actions are being taken to reduce risks in the financial sector including by strengthening the legal framework for bank resolution; upgrading an early warning committee to perform as a Financial Stability Council; adopting higher capital requirements for foreign-currency borrowing by unhedged agents; issuing new guidelines to strengthen pension funds' investment policies and governance according to international best practices; and strengthening anti-money laundering regulations including the recent resolution issued by the Central Bank to reduce the amount of cash deposits in local and foreign currency on a monthly basis. Also, the Fund is providing TA to strengthen the macro-prudential framework and the results from the recent Financial Sector Stability Review mission will provide key additional elements to further improve the financial system's supervision and legal framework.

**Fiscal discipline has been restored.** The balance of the non-financial public sector was 0.9 percent of GDP by June, supported by strong tax collections (17 percent annual increase) and

expenditure control. However, a deficit of 1.5 percent of GDP is expected at the end of 2016 (well below the 7.2 and 3.9 percent of GDP of 2013 and 2014, respectively), to accommodate higher infrastructure and social spending. As of June, total public debt was 46.3 percent of GDP of which 34 percent was denominated in local currency and 74 percent was at fixed interest rates. Also, less than 5 percent of total debt is due within the next year.

**Fiscal policy is expected to become more prudent, predictable and transparent.** In April, Congress approved the Fiscal Responsibility Law which will lock-in fiscal discipline and increase fiscal policy predictability and transparency by: i) establishing limits to the non-financial public sector deficit, the annual growth rate of nominal current expenditure and new arrears; ii) instituting the adoption and publication of a medium-term fiscal framework whose implementation has to be reported to Congress on an annual basis by the Secretary of Finance; and iii) establishing that all trust funds (former and new) financed with public resources should be managed within the public budget. Regarding control of the payroll, important advances have been made as currently all payrolls in the central administration are executed through the integrated financial management information system which is linked to the public employment management system.

**The government launched a five-year strategic program to foster employment and economic growth.** The program was launched earlier this year and approved by Congress in April. It benefits from a broad support of the private sector and focuses on six key sectors: i) tourism; ii) textile industry; iii) intermediate manufactures; iv) services to support businesses (e.g. call centers); v) housing; and vi) agroindustry. A specific entity was created to coordinate program implementation; its Executive Director will report to a board comprised by members of government and private sector.

### **Strengthening institutions and fostering investment climate**

**The tax authority has undergone complete overhaul** with a new and strengthened tax authority already in place which is in the process of hiring and training new personnel. The new agency will be fully operational early next year. Customs reforms are also ongoing, a detailed mapping of the business process has been established and operating manuals have been issued and implemented in one of the seaports as a pilot to enhance collection of import duties in gasoline and bulk freight.

**Measures to strengthen the financial position of the energy company (ENEE) are ongoing.** Besides the reduction of the wage bill, the creation of an independent regulatory agency for the electricity sector (CREE) and the appointment of its three commissions, all measures taken last year, in 2016 the CREE has put in place a comprehensive tariff scheme that will secure cost recovery. Furthermore, the government is implementing an aggressive plan to reduce non-technical electricity losses, maintain and upgrade the distribution network

and streamline costs. Specific targets for the reduction of non-technical losses have been set for the current and the next six years.

**The operational framework for conducting monetary policy keeps improving.** The Central Bank (BCH) has introduced daily liquidity auctions and is working on further improving its liquidity forecasting and management. Furthermore, the information exchange with the Secretary of Finance, which will improve monetary and fiscal policy coordination, was recently formalized through an agreement between the two institutions. Also, with TA from the Fund, BCH plans to develop the interbank market and increase the signaling content of the monetary policy rate. With support from the Fund, BCH has decided to gradually implement an inflation-forecast targeting framework which will be accompanied by continued progress towards a more flexible exchange rate. In order to reduce excess liquidity and within a medium-term strategy to phase out mandatory investments for financial institutions, in September the Central Bank increased reserve requirements from 7 percent to 12 percent and reduced mandatory investments (mainly in government bonds) from 10 percent to 5 percent.

**Decisive actions are being taken on fighting corruption, strengthening the rule of law and reducing the levels of crime and violence.** Earlier this year, the government and the Organization of American States (OAS) signed an agreement to establish the Mission to Support the Fight Against Corruption and Impunity in Honduras (MACCIH). Its areas of action are based on four components: i) prevention of and combating corruption; ii) reform of the criminal justice system; iii) political and electoral reform; and iv) public security. It is expected that MACCIH will be fully operational shortly and its members will provide active cooperation, technical advice, supervision and oversight of the state institutions responsible for preventing, investigating, and prosecuting corruption. Furthermore, the government has made the reduction of crime and violence one of its top priorities. Progress on this front include an ongoing strong police force reform as well as a comprehensive plan to fight gangs and drug trafficking which is being implemented in close coordination with the governments of neighboring countries (El Salvador and Guatemala). Also, the budget allocated for security purposes is expected to continue increasing in the following year.

**Improving social programs management.** The government is working with the World Bank to strengthen management of the conditional cash transfers program (Bono Vida Mejor) to ensure that it is more effective, cost efficient and transparent. Also, additional resources have been secured for the rest of the year as the government seeks to expand coverage of the extreme poor to reach 300,000 families by 2017. The Secretaries of Labor and Social Security, Education, and Social Inclusion are developing a study to identify ways of formalizing the linkages between existing Active Labor Market Programs and CCT beneficiaries to support the transition from schools to jobs and with microenterprise programs to support entrepreneurial opportunities.

**Investment confidence has improved.** Besides the actions being taken to fight crime, violence and corruption as well as to strengthening the rule of law and preserving macroeconomic and financial stability, the government has been working on promoting doing business easing. The progress made so far on these areas has been recognized by credit rating agencies Moody's and Standard & Poor's by improving Honduras' ratings (Moody's) and setting a positive outlook (both) in May and July, respectively, reflecting the view of continued progress on fiscal policy and reform agenda for the near term. Furthermore, Honduras improved five positions on the ease of doing business 2016 World Bank ranking (110 out of 189); it was also highlighted in the report as the country that improved the most (43 positions) in the area of protecting minority investors in the last years and was noted among the countries with more improvement on strengthening frameworks for secured transactions.

**Regarding program implementation, most performance criteria (PC) and all of the indicative targets for end-December 2015 and end-June 2016 have been met.** The PC on net domestic assets of the Central Bank for end-December 2015 was missed by a minor deviation and corrected by end-June 2016. Also, the authorities have taken the corrective measures to address the deviation from the net-lending by public pension funds program target for end-June 2016 as well as to clear the temporary increase in domestic arrears from the National Electricity Company. Thus, on behalf of our authorities we request a waiver for these nonobservances. We also request the completion of the Third and Fourth Reviews under SBA and SCF arrangements.

The authorities remain confident that the planned policy mix is adequate for a successful implementation of the program. Nonetheless, the government stands ready to take additional measures that may be required to achieve program objectives. The program will continue to be treated as precautionary.