International Monetary Fund

Honduras and the IMF

Press Release:
IMF Executive Board Completes First Review of Honduras' Economic Program
April 27, 2011

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Honduras: Letter of Intent, Memorandum of Economic and Financial Policies, and Technical Memorandum of Understanding

April 12, 2011

I. LETTER OF INTENT

Tegucigalpa, April 12, 2011

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

Dear Mr. Strauss-Kahn,

1. During 2010, the Honduran economy started to recover from the external and domestic crises that hit the country in 2009. Real GDP grew 2.8 percent, mainly driven by a rebound of domestic demand. The overall fiscal deficit was reduced significantly to 2.9 percent of GDP (compared to 3.7 percent envisaged in the program) and the overall balance of payments posted a surplus, resulting in an increase in international reserves of about US$600 million. The outlook for 2011 is positive, and economic growth is projected to be 3.5 percent, although external conditions remain a significant risk.

2. In 2010, the government started to implement key reforms aimed at reducing macroeconomic imbalances and strengthening the finances of the public sector. In line with the economic program stated in our letter of September 2010, we have taken measures aimed at improving tax administration and reducing current expenditure. In particular, the administrative capacity of the Large Taxpayer Unit of the Tax Collection Agency is being rebuilt, and the Ministry of Finance now has firm control over the public sector wage bill. This allowed us to expand our anti-poverty programs and increase public investment. We are also moving ahead with important reforms in the financial sector and the public pension funds regime.

3. In line with our commitments under the program, we have implemented the agreed policies and all the quantitative performance criteria for December 2010 have been fully met. Furthermore, our commitments on structural benchmarks up to March 2011 have been observed or had advanced significantly by the date of this first review. In support of our economic program, we request completion of the first review of the 18-month arrangement with the Fund approved on October 2, 2010.

4. The attached Memorandum of Economic and Financial Policies (MEFP) updates the government's economic program and policy framework for 2011-12. It also proposes a set of quantitative performance criteria and structural benchmarks for June, September, and December 2011. Our intention is to continue treating the arrangement as precautionary. We believe that the policies set forth in the letter of September 10, 2010 and contained in the attached MEFP are adequate to achieve the objectives of our program, but we are committed to take any further measures that may be needed for this purpose. We maintain our commitment of consulting with the Fund on the adoption of these measures as needed, and in advance of

revisions to the policies contained in the MEFP, in accordance with IMF policies on such consultations.

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

6. The government requests waivers of applicability for the relevant end-March 2011 performance criteria other than net international reserves and net domestic assets of the central bank in view of the fact that the Board discussion of the first program review will be held in April 2011. Full information to assess performance under the criteria other than net international reserves and net domestic assets of the central bank will not be available by the Board date, but we are confident that all the criteria will be observed. Subsequent reviews under the SCF/SBA are expected to be held on a quarterly basis based on relevant performance criteria.

7. Program implementation will continue to be monitored through quarterly reviews, with the second one to be completed on or after May 15, 2011. The quantitative performance criteria and structural benchmarks under the program are set out in Tables 1, 2, and 3 of the attached MEFP. Consistent with the commitment to keep the public informed, the government will publish the program documents and will report periodically on progress under the program.

Sincerely yours,

________________/s/_________________	_________________/s/________________
Maria Elena Mondragon de Villar	William Chong Wong
President, Central Bank of Honduras	Minister of Finance

Attachments

II. Memorandum of Economic and Financial Policies

I. Recent Developments and Performance under the Program

1. The economy of Honduras is gradually recovering from the recession caused by the global economic crisis and the domestic political impasse of 2009. Following a 2.1 percent decline in 2009, real GDP grew by 2.8 percent in 2010, above program projections (2.4 percent), driven by a surge in domestic demand. Last December, headline inflation reached 6.5 percent, (year-on-year) close to the upper limit of the programmed range of 5.5-6 percent (+/-one percentage point), mostly due to the impact of higher food, fuel, and energy prices, and weather-related domestic supply shocks. However, core inflation, which excludes energy and food prices, declined to 4 percent in 2010.

2. In the Honduran external sector, the current account deficit widened but was more than offset by capital inflows. According to preliminary data, imports rebounded more strongly than exports; however, the current account deficit (6.2 percent of GDP) was as programmed, financed by large private capital inflows, especially at end-2010. This boosted the gross international reserves to a historic record of US$2,931 million (equivalent to four months of non-maquila imports).

3. Fiscal consolidation is generally proceeding as envisaged, despite higher infrastructure spending related to damage from tropical storms in 2010. The control mechanisms we have put in place have helped keep current spending within the budgetary limits. However, despite tax administration improvements, revenues were below target because even though the April 2010 tax reform (Decree 17-2010) yielded the anticipated results, the strengthening of the tax administration has taken more time than foreseen. In this context, the central government deficit was 0.3 percent of GDP higher than projected. However, performance in the rest of the public sector was better than envisaged, more than offsetting the central government deficit. The estimated deficit of the combined public sector was 2.9 percent of GDP, compared with the programmed 3.7 percent of GDP.

4. All end-December 2010 quantitative performance criteria were met by wide margins. Also, our structural reform commitments through March 2011 were either already implemented by the time of the program review (Tables 1 and 2) or had advanced considerably toward completion:

- The Banking and Securities Commission (CNBS) issued new rules on loan classification, reserve coverage, and liquidity risks in October 2010. In January 2011, the CNBS approved new standards for appraisers. In December 2010, the Early Warning Committee, which meets on a quarterly basis, was reactivated. Also, the Chamber of Commerce and Industry of Tegucigalpa established a register of movable collateral in January 2011, as a first step toward implementation of the "secured transactions" law.

- The contract with an international firm to audit public sector arrears to the private sector was signed in December 2010, and the draft of the final report was presented in March 2011. On the basis of the audit results, a plan will be formulated to regularize all legitimate arrears. We have made progress in settling central government domestic arrears. By end-2010, most of the intra-public sector arrears had been paid.

- In February 2011, the CNBS completed drafts of the laws and regulations to reform the public pension funds (INPREMA, INJUPEMP, and INPREUNAH), modifying the parameters of contributions and benefits with the aim of strengthening the actuarial position of these funds, and the respective boards of directors have duly discussed the drafts. Also, in December 2010, the CNBS revised the regulations for the investment of public pension funds, to diversify the financial instruments for investment, with proper limits to ensure their liquidity, profitability, and security.

- Control over the education sector payroll was effectively transferred to the Ministry of Finance last December and has been fully incorporated into the integrated financial management system (SIAFI). Furthermore, as of January 2011, any modification to the budgeted central government payroll requires prior approval of the Ministry of Finance.

- Efforts are under way to improve human resource management and administrative capacity at the tax collection agency (DEI). In March 2011, the job and pay description manual for the hiring and evaluation of qualified personnel in the Large Taxpayers Unit (LTU) was approved.

- The financial position of the electricity company (ENEE) improved considerably last year, reflecting the increase in electricity tariffs and due to more hydroelectric power was available than anticipated. In March 2011, the arrears to private suppliers were settled. Until January 2011, electricity tariffs were adjusted in line with fuel costs, as envisaged. In February 2011, electricity tariffs for the public sector were increased by 3.63 percent.

- At end-2010, the number of households covered by the conditional cash transfer program (*Bono 10 mil*) reached 161,368. The original target of 150,000 households was thus surpassed.

II. Macroeconomic Policies for 2011-12

5. The macroeconomic outlook for 2011-12 remains broadly as envisaged under the program. A gradual economic recovery is under way, and real GDP growth is projected at 3.5 percent for 2011 and 4 percent for 2012. Year-on-year inflation is expected to rise to 8 percent in December 2011, due to a higher-than-expected increase in oil, energy, and food prices, but a decline in inflation is expected in 2012. The external current account deficit in 2011 is projected to increase to 7.2 percent of GDP, mainly because of the increase in fuel and imported food prices. However, given the still weak state of economic recovery and the control of core inflation, the overall policy stance will be maintained. Furthermore, the accumulation of the net international reserves in 2011 will be broadly as originally programmed, while the stock will possibly exceed the original targets. Fiscal consolidation

will continue, while the monetary policy stance will be adjusted if there is evidence of second-round effects of the commodity price increases or if external sector objectives are threatened. A less favorable external environment would constitute a factor of considerable risk in the process of economic recovery.

Fiscal Policy

6. Our fiscal policy will continue to aim at reducing the public sector deficit to 2 percent of GDP in the medium term, consistent with a debt-to-GDP ratio of less than 30 percent, and on improving the quality of public expenditure. In line with these objectives, the 2011 public sector budget targets a deficit of 3.1 percent of GDP. This target is consistent with a central government deficit equivalent to 3.5 percent of GDP. Furthermore, the 2012 budget we plan to submit to Congress by September 2011 will target an overall deficit of the central government at about 2.5 percent of GDP, consistent with a consolidated public sector deficit of 2 percent of GDP.

7. During 2010, we managed to reduce the public sector fiscal deficit, control current expenditure, and settle the domestic payment arrears. Nevertheless, important challenges lie ahead. In particular, during 2011 it will be essential to broaden the tax revenue base, establish firm control over employment and the wage bill in the public sector, and improving domestic debt management to ease the liquidity pressures facing the government.

8. On the revenue side, we plan to fully implement the tax measures approved in 2010 and strengthen the DEI. In particular, we will continue strengthening the LTU, implement electronic tax filing, and prohibit firms with tax arrears from obtaining government contracts. In addition, we are advancing preparations for a census of taxpayers, expected to begin in September 2011. The operations of the LTU will improve once it is focused on a number of taxpayers accounting for 80 percent of total tax revenue. We will continue to implement the tax reform of April 2010 and the controls to verify its proper enforcement. In addition, by December 2011 we will complete a comprehensive review of tax exemptions and create a franchising and tax exemption unit in the Ministry of Finance by July 2011, which should help enforce tax compliance. We expect to send to Congress, in April 2011, the final version of the preliminary draft law against tax evasion. These measures are intended to increase the tax revenue of the central government to 15.4 percent of GDP (from 14.8 percent of GDP in 2010).

9. We will continue to exercise firm control over public sector current spending and give priority to high-impact capital investment projects and well-targeted social spending, in part to mitigate the effects of the food and fuel price increases on the most vulnerable segments of the population. To this effect, it will be essential to maintain government expenditure strictly within the ceilings established in the 2011 budget. We will also identify low-priority expenditure which could be deferred in the event of insufficient revenue or of

higher spending in priority areas, so as to ensure observance of the 2011 targets for the overall deficit of the consolidated public sector. These measures, combined with the positive impact of the ongoing reforms of public sector enterprises and public pension funds, will help us meet the fiscal deficit targets, strengthen the financial position of the public sector, and improve the composition of expenditure.

10. One of the key elements of our expenditure policy for 2011 is control of the wage bill. In line with our commitment to tighten payroll control, regarding existing positions, the process of employment verification in the education sector was completed in March 2011, and in the health sector completion is envisaged for December 2011. As a follow up, the Government Audit Office (TSC) will implement remedial measures based on the census and the audit of teaching positions by end-March 2012. At the same time, the Ministry of Finance, the Ministry of Planning and External Cooperation, and the Ministry of Education will take action to screen the payroll, seeking to eliminate all the redundant and irregular positions identified in SIAFI and the educational human resources integrated management system (SIARHD). It is envisaged that this process will be completed by October 2011, and the TSC will be kept informed for all pertinent purposes. A centralized unit was created in the Ministry of Finance last year for payroll control, which incorporated into the SIAFI the payroll management modules of the Ministry of Education, and by October 2011 it is planned to incorporate into the SIAFI payments by bank transfer to day laborers.

11. Our budget financing strategy aims at reducing reliance on domestic resources and not using central bank credit to the public sector. For that purpose, our 2011 financial plan includes external budget financing of US$170 million. In addition, last September we contracted a nonconcessional loan with the Central American Bank for Economic Integration (CABEI) for US$280 million, which remains within the limit on the contracting of nonconcessional external debt (US$350 million). We will not incur external arrears at any time during the program period.

12. Our budget plan provides that if tax revenue were to be higher than projected, we will use up to 50 percent of the excess revenue to repay domestic debt and allocate the remainder to social investment projects. Also, should external budget support loans exceed the amount projected in the program for 2011, the floor of the NIR target will be raised (the ceiling on the central bank's net domestic assets will be lowered) by the excess amount (TMU, paragraph 14).

13. The government has recently adopted a new a debt management strategy to extend the maturity profile of public domestic debt and lower its cost. In the first operation of this kind, completed in January 2011, existing bonds (1.2 percent of GDP) were swapped on a voluntary basis for 3-7 year instruments carrying 9-12.25 percent coupon rates. In addition, the Guidelines for Public Sector Borrowing for 2011-14, aimed at building public debt

management capacity and to link government borrowing plans to a multiyear fiscal framework, were updated in April 2011.

Monetary and Exchange Rate Policies

14. The government is committed to seeking price stability while keeping core inflation under control and maintaining an adequate level of international reserves. The monetary program for 2011 takes into account the impact of rising oil, energy, and food prices. Accordingly, in 2011 we will seek to keep annual inflation in the range of 8 percent (+/- one percentage point), whereas the accumulation of net international reserves is projected at US$227 million. However, if inflation continues to accelerate and external reserves target becomes at risk, we will tighten monetary policy, as appropriate. We commit to maintain the policy of not extending central bank credit to the nonfinancial public sector or to public banks. We will assess the appropriateness of interest rate levels throughout the program period and will adjust the policy rate (TPM) as necessary to achieve the inflation target and protect the external position. The monetary program will be kept consistent with a prudent expansion of credit to the private sector.

15. The central bank will reform the operational framework for conducting monetary and exchange rate policy. The central bank will take measures to foster the development of an active interbank market and secondary markets for central bank and government paper, refine monetary instruments, and enhance policy signaling. The reform program we have devised includes: (i) adopting a system of daily liquidity forecasting and management; (ii) improving repo operations for liquidity management, (iii) ensuring that the TPM functions as a tool for signaling the monetary policy stance; and (iv) strengthening the structural auctions of central bank paper to allow for price discovery by market participants. We are committed to maintaining an exchange policy that is consistent with the objective of safeguarding competitiveness and strengthening the external position.

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

III. STRUCTURAL REFORMS

17. Successful modernization of the Honduran economy requires the sustained implementation of structural reforms in the public and financial sectors. During 2011, the government's reform efforts will center on the following areas:

- **Strengthening the operating balances of key public enterprises**. The tariff adjustment is a key factor in the financial sustainability of the ENEE. Accordingly, we are committed to adjusting the tariffs as required by law. HONDUTEL has concluded an alliance with a U.S. company to improve its services. In December 2011, the ENEE and HONDUTEL will present comprehensive plans to restore their financial viability and enhance their operational efficiency.

- **Strengthening the financial position of public pension funds**. In March 2011, we submitted for review and approval the INPREUNAH Regulations to the institution's Board of Directors. In the case of the INJUPEMP and INPREMA, we anticipate that the draft laws will be submitted to the National Congress later this year.

- **Improving the management and fortifying the financial position of the Honduran Social Security Institute (IHSS).** The Ministries of Finance, Labor and Social Security, and the CNBS, with technical assistance from the Inter-American Development Bank (IDB) will prepare an administrative, technical, and financial assessment of the IHSS, including actuarial studies and a thorough assessment of the situation of the Disease and Maternity System.

- **Reform of the civil service law**. With the assistance of the IDB, we have prepared the Terms of Reference for hiring an expert to review the current regulations and procedures for the selection and recruitment of employees at all levels of public administration. Based on the expert's report, a plan to amend the Civil Service Law will be presented to Congress by December 2011.

- **Financial sector policies**. The government is committed to continue improving the regulatory framework and supervisory practices in the financial system and to strengthen the financial safety net. In line with our commitments in the program, much progress has been made in the process of establishing adequate regulations for bonded warehouses, credit bureau, and extraordinary assets. Also, the process has been initiated to revise regulations to promote transparency, disclosure, and the protection of users of financial services. We will strengthen the risk-based supervision framework for savings and loans associations and, for that purpose; we plan to issue new regulations by February 2012. The restructuring of *Banco de los Trabajadores* is well advanced, and the only outstanding task is that of establishing the trust that will be responsible for collecting doubtful assets. At BANADESA, the CNBS is conducting a study to assess the actual position of the bank, to be completed in December 2011, for the purpose of preparing an institutional strengthening and financial plan.

- **Social investment**. Poverty reduction is one of the strategic objectives of the government. With this purpose, the 2011 budget allocates 1.5 percent of GDP to all social investment programs. In addition, the government will continue improving the targeting of subsidies to allocate savings to ease the impact of the rise in food and fuel prices on the most vulnerable segments of the population. With the assistance of multilateral banks and in accordance with the established procedures, the government is fully committed to a gradual expansion of the coverage of the conditional cash transfer program (*Bono 10 mil*) to include 300,000 households by end-2011, to the monitoring and strict control of proper program implementation, and to expand the provision and access to health and education services to the program's beneficiaries.

IV. Other Program Issues

18. **Safeguards Assessment**. An IMF mission visited Honduras last December to update the safeguards assessment of the Central Bank of Honduras. The central bank is committed to fully implement the recommendations resulting from that assessment.

19. **Program Monitoring**. The program will continue to be monitored through regular quarterly reviews, quantitative performance criteria, and structural benchmarks. The second program review will be completed on or after May 15, 2011; the third one, on or after August 15, 2011; the fourth one, on or after November 15, 2011; and the final one, on or after February 15, 2012. The quantitative performance criteria proposed for June, September, and December 2011 are shown in Table 3. The structural benchmarks are shown in Table 2. The date for the submission of the law reforming public pension funds will be changed from the original December 2010 date to March 2011 for INPREUNAH (presentation of statute to that institution's Board of Directors), and for INJUPEMP and INPREMA, the draft laws will be submitted to the National Congress later in 2011. We propose to add a new benchmark on improving the management of the IHSS and strengthening its financial position. The definitions and reporting procedures are specified in the attached Technical Memorandum of Understanding.

Table 1. Honduras - Performance Criteria 2010 1/

(Cumulative flows; millions of Lempiras, unless specified)

	Prog.	Prel.	Margin
	End-December 2010		
QUANTITATIVE PERFORMANCE CRITERIA			
Fiscal targets 2/			
Deficit of the combined public sector (ceiling)	7,487	5,060	-2,427
Net domestic financing of the combined public sector (ceiling)	-250	-711	-461
Monetary targets			
Stock of net international reserves (floor, in millions of US$)	1,557	2,082	525
Stock of net domestic assets of the central bank (ceiling)	-11,080	-19,408	-8,328
Public debt targets 2/			
Contracting or guaranteeing of non-concessional external debt (continuous ceiling, in million of US$)	350	280	-70
New arrears of ENEE with the private sector (continuous ceiling)	0	0	
External payment arrears of the combined public sector (continuous ceiling)	0	0	
INDICATIVE TARGETS 2/			
Central government current primary expenditure (ceiling)	28,773	28,342	-431
Social investment related spending (floor)	1,197	3,153	1,956
Wage bill of the central government (ceiling)	17,335	17,008	-327
Memo Items 2/			
Central government tax revenues 3/	24,146	23,264	-882
Budget support external loans (in million of US$)	190	157	-33

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

2/ Cumulative starting on July 1, 2010.

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

Table 2. Honduras: Structural Benchmarks

	Date	Status
A. Fiscal		
Present to Congress a 2011 Budget consistent with a combined public sector deficit of 3.1 percent of GDP.	Prior action	**Done**
Improve human resources management and administrative capacity of the DEI; strengthen a Large Taxpayer Unit with adequate staff; and develop a job and pay description manual.	March 2011	**In progress**
Transfer the control over Education payroll to the Ministry of Finance.	March 2011	**Done** Control transferred in December 2010.
Sign a contract to audit public sector arrears with the private sector.	January 2011	**Done** Contract signed in December 2010.
Adjust electricity tariffs in line with fuel costs (continuous starting 2011).	Continuous 2011	**Not met** Implementation suspended during February and March 2011.
Present a law reform proposal that allows changing the bases of defined benefits, to reduce the actuarial deficit of INPREMA, INJUPEMP and INPREUNAH	December 2010	**Not observed, new dates proposed** (see below). The INPREUNAH reform to statutes was presented to its Board of Directors in March 2011.
Present a law reform proposal for INJUPEMP to Congress	April 2011	**New date proposed**
Present a law reform proposal for INPREMA to Congress	2011	**New date proposed**
Contract an administrative, technical and financial assessment of the Honduran Institute of Social Security (IHSS).	September 2011	**New structural benchmark**
B. Financial Sector		
Issue norms for loan classifications, reserve coverage and approve regulations for measuring and monitoring liquidity risks in line with international best practices.	December 2010	**Done** The Banking and Securities Commission issued these regulations in October 2010.
C. Monetary		
Prepare a plan to recapitalize the central bank.	December 2011	**In progress**

Table 3. Honduras - Proposed Performance Criteria for 2011 1/

(Cumulative flows; millions of Lempiras, unless specified)

	PC 2/	Proposed Targets		
	End-Mar.	End- Jun.	End- Sept.	End-Dec.
	2011			
QUANTITATIVE PERFORMANCE CRITERIA				
Fiscal targets 3/				
Deficit of the combined public sector (ceiling)	4,715	4,921	7,070	10,100
Net domestic financing of the combined public sector (ceiling)	3,868	2,204	347	1,645
Monetary targets				
Stock of net international reserves (floor, in millions of US$)	1,606	2,299	2,303	2,309
Stock of net domestic assets of the central bank (ceiling)	-12,855	-25,007	-26,727	-21,404
Public debt targets 3/				
Contracting or guaranteeing of nonconcessional external debt (continuous ceiling, in million of US$)	350	350	350	350
New arrears of ENEE with the private sector (continuous ceiling)	0	0	0	0
External payment arrears of the combined public sector (continuous ceiling)	0	0	0	0
INDICATIVE TARGETS 3/				
Central government current primary expenditure (ceiling)	10,827	24,223	36,402	50,744
Social investment related spending (floor)	442	954	1,532	3,477
Wage bill of the central government (ceiling)	6,716	15,917	22,779	32,235
Memo Items 3/				
Central government tax revenues 4/	9,298	24,573	36,961	49,813
Budget support external loans (in million of US$)	0	25	90	170

1/ Definitions as specified in the Technical Memorandum of Understanding.
2/ Performance criteria established at the time of program approval (IMF Contry Report 10/322).
3/ Cummulative starting on January 1 for 2011.
4/ Does not constitute a Performance Criterion, Indicative Target or Structural Benchmark.

III. Technical Memorandum of Understanding

1. This memorandum sets out technical understandings between the Honduran authorities and the Fund staff for monitoring of the economic program agreed for the period October 2010–March 2012. It defines the concepts used to assess observance of quantitative performance criteria, structural benchmarks, and indicative targets specified in Tables 1 and 2, and 3 of the Memorandum of Economic and Financial Policies (MEFP). It also specifies the frequency of the data to be provided to the Fund to monitor the developments under the program.

I. Program Assumptions

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

II. Fiscal Targets

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

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

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

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

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

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

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

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

11. **Adjustor**. If tax revenues of the central government were to exceed those projected under the program for 2011, up to 50 percent of the excess revenue will be used to amortize domestic debt (and thus, the ceilings on the deficit of the CPS and its net domestic financing would be lowered by the exact amount of the excess revenue used to amortize domestic debt) and the residual will be allocated to increase social investment spending defined in Paragraph 7, Table B (and accordingly, the floor on social investment would be raised by the exact amount of the excess revenue allocated to social investment).

III. Monetary Targets

12. **Net International Reserves (NIR) of the central bank (program definition)**. For program purposes, the NIR of the central bank will be measured as gross international reserves that are readily available minus (i) short-term reserve liabilities (including purchases and credits from the Fund), as described in the international reserves table prepared by the central bank according to the MFSM); (ii) foreign assets that are counterpart of foreign currency deposits of financial institutions at the central bank and of any other liability of the central bank with residents that is payable in foreign currency; (iii) any conversion of short-term reserve liabilities; and (iv) the transfer to the central bank of foreign currency deposits held abroad by HONDUTEL, INJUPEMP, and IHSS, which amounted to US$73.4 million at

[1] The losses of the Central Bank of Honduras will be explicitly excluded from the calculation of credit to the public sector.

end-June 2010. Readily available reserves also exclude those assets that are pledged or otherwise encumbered, including but not limited to reserve assets used as collateral or guarantee for a third-party external liability. NIR will be valued at program accounting exchange rates. In addition, monetary gold included in the gross international reserves will be valued at the constant price as at December 31, 2010 (US$1,411.5 per troy ounce).

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

14. **Adjustor**. Starting in 2011, the target floor on NIR will be adjusted downwards (the target ceiling on net domestic assets of the central bank will be adjusted upwards) by up to US$50 million by the shortfall of programmed budget support external loans. In case of an excess during the program period, the target floor on NIR will be adjusted upwards (the target ceiling on domestic assets of the central bank will be adjusted downwards) by full such amount. The external disbursements contemplated in the program for 2011 are to be received from the World Bank, IADB, and Taiwan, province of China, totaling US$170 million.

IV. External Targets

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

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

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

(b) Under the definition of debt set out in point 9(a) above, arrears, penalties, and judicially awarded damages arising from the failure to make payment under a contractual obligation that constitutes debt give rise to new debt. Failure to make payment on an obligation that is not considered debt under this definition (e.g., payment on delivery) will not give rise to debt.

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

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

19. **Concessionality** will be calculated using currency-specific discount rates based on the OECD commercial interest reference rates (CIRRs) and taking into account all details of the loan agreement, including maturity, grace period, payment schedule, upfront commission, and management fees. The ten-year average of CIRRs will be used as the discount rate to assess the concessionality of loans of an original maturity of at least 15 years, and a six-month average of CIRRs will be used to assess the concessionality of loans with original maturities of less than 15 years. To both the ten-year and six-month averages, the following margins will be added: 0.75 percent for repayment periods of less than 15 years; 1 percent for 15–19 years; 1.15 percent for 20–30 years; and 1.25 percent for over 30 years. The grant element of loans can be calculated using the concessionality calculator available at the IMF

website (http://www.imf.org).[1] For program purposes, a debt is **concessional** if it includes a grant element of at least 35 percent, calculated as follows: the grant element of a debt is the difference between the present value (PV) of debt and its nominal value, expressed as a percentage of the nominal value of the debt. The PV of debt at the time of its contracting is calculated by discounting the future stream of payments of debt service due on this debt. The discount rates used for this purpose are the CIRRs published by the OECD.

20. **Borrowing on nonconcessional terms**. For the purposes of the program, this continuous ceiling applies to the contracting or guaranteeing of nonconcessional external debt by the CPS or any other agencies on its behalf.[2] Debt denominated in currencies other than the U.S. dollar shall be converted to the U.S. dollars using program assumptions on bilateral exchange rates. The continuous ceiling applies not only to debt as defined above, but also to commitments contracted or guaranteed for which value has not been received. This ceiling will be adjusted downwards by the amount of programmed disbursements that change into concessional resources.

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

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

V. Energy Sector

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

[1] http://www.imf.org/external/np/pdr/conc/calculator/default.aspx

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

VI. Monitoring and Reporting Requirements

24. **The information required to monitor the compliance with quantitative and structural benchmarks** specified in the MEFP will be supplied to the Fund at least monthly (electronically, to the extent possible) and within 45 days of the end of the previous month (unless otherwise noted) according to the following sources:

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

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

- **Net domestic financing** of the central government and the NFPS, respectively, with detailed information on: (i) net domestic financing from the central bank and the rest of the financial system to the central government and the NFPS, as contained in the *Panorama Financiero* monthly report; (ii) 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; (iii) change in foreign currency deposits held abroad by the central government and the NFPS; and (iv) change in the outstanding stock of suppliers' credit and floating debt of the central government, as reported by the Treasury, and the rest of the NFPS as reported by the central bank. To monitor the net domestic financing to the CPS, the central bank will provide the Fund with detailed data on a cash basis on the operating revenue and expenditure of the central bank.

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

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

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

29. **The floor on NIR and the ceiling on NDA of the central bank** will be monitored on the basis of information produced by the central bank, in accordance with the new

presentation of the MFSM. This information will be provided within two weeks of the end of the previous month.

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

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

Table A: Data to be Reported to the IMF

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

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

Table B. Social Investment Spending

Description
Bono Diez Mil
Bono Diez Mil
Other social investment expenditures
Honduran Social Investment Fund (FHIS)
Community Education Program (PROHECO)
Family allowances program (PRAF)
Healthy Schools Program (free school meals)
Social work scholarship
Transportation education bond
Social help to individuals
Patronatos, Aldeas y Caseríos
Academic excellence scholarships
Miscellaneous scholarships
Other scholarships and programs