



Executive Board Minutes 20/65-1

June 1, 2020–10:00 a.m.

Honduras - Second Reviews Under the Stand-By Arrangement and Arrangement Under the Standby Credit Facility, Requests for Augmentation and Rephasing of Access, and Modification of Performance Criteria

Documents: EBS/20/102 and Sup. 1

Staff: Vesperoni, WHD; Corbacho, SPR

Length: 1 hour, 3 minutes

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CEDA OGADA
Secretary

TABLE OF CONTENTS¹

The Acting Chair’s Summing Up	3
Executive Board Decision	4
Executive Board Attendance	7
Discussion Record	9
Annex	25
○ Gray Statements	
○ Staff’s Responses to Executive Director’s Technical Questions	
○ Constituency Codes	

¹ Minutes are the official record of a formal Board meeting in which the Board may adopt decisions and reach understandings related to the business of the Fund. Staff background documents issued before the meeting are the principal basis for the meeting. Preliminary “gray” or “buff” statements by Executive Directors and staff’s responses to Directors’ technical questions are circulated prior to the meeting. Adopted decisions and/or summings up—the Chair’s “sense of the meeting” or policy conclusions/recommendations—are issued after the meeting. The minutes include all these elements, as well as the discussion record (a verbatim transcript of the discussion lightly edited for clarity). Minutes are made public consistent with the IMF’s Transparency Policy and Open Archives Policy.

THE ACTING CHAIR'S SUMMING UP

Executive Directors welcomed Honduras's track record of sound macroeconomic policies and the progress in implementing reforms. They acknowledged that despite a challenging economic environment, the authorities have strived to maintain macroeconomic stability and protect social spending and investment. Directors noted that the COVID-19 pandemic and external spillovers are having a significant impact on the Honduran economy and welcomed the authorities' strong policy response to mitigate the impact.

Directors supported the use of the flexibility under the Fiscal Responsibility Law to temporarily increase the deficit and accommodate higher healthcare and critical social spending. They noted that measures are temporary and targeted to support affected groups and mitigate structural vulnerabilities, and that they do not jeopardize debt sustainability over the medium term. Directors encouraged the authorities to resume revenue mobilization efforts once the crisis subsides.

Directors noted that monetary policy remains geared toward maintaining price stability and an adequate level of international reserves. They commended ongoing efforts to strengthen the monetary policy framework and support the transition to a more flexible exchange rate.

Directors welcomed the steps taken to improve the institutional framework in the electricity sector and emphasized that further efforts are needed. They noted that important measures have been incorporated into the program, aimed at improving governance and facilitating the unbundling process of the national electricity company (ENEE), while tariffs continue to reflect the cost of electricity provision. Directors encouraged the authorities to sustain their reform efforts to create space for infrastructure and social spending.

Directors welcomed ongoing efforts to improve governance, including strengthening public procurement and the institutional framework in the central bank and the Treasury. They encouraged the authorities to persevere on reforms to enhance the Public Private Partnership, AML/CFT, and anti-corruption frameworks, and to guarantee transparency and accountability, including on pandemic-related emergency spending.

EXECUTIVE BOARD DECISION

The Executive Board took the following decisions:

Honduras - Second Review Under the Stand-By Arrangement, Request for Augmentation and Rephrasing of Access, and Modification of Performance Criteria

1. Honduras has consulted with the Fund in accordance with paragraph 3(c) of the Stand-By Arrangement for Honduras (EBS/19/62, the “Stand-By Arrangement”) in order to review program implementation.
2. The letter dated May 21, 2020 from the President of the Central Bank of Honduras and the Secretary of the Treasury (the “May 2020 letter”), together with its attached Memorandum of Economic and Financial Policies (the “May 2020 MEFP”) and Technical Memorandum of Understanding (the “May 2020 TMU”), shall be attached to the Stand-By Arrangement and the letter dated June 20, 2019, together with attachments, shall be read as supplemented and modified by the May 2020 letter and its attachments.
3. Accordingly, the Stand-By Arrangement shall be amended as follows:
 - (a) In paragraph 1 of the Stand-By Arrangement, “SDR 149.880 million” shall be replaced with “SDR 258.127 million”.
 - (b) Paragraph 2(a) of the Stand-By Arrangement shall be amended to read as follows:

“Purchases under this Stand-By Arrangement shall not, without the consent of the Fund, exceed the equivalent of SDR 62.450 million until December 1, 2019, the equivalent of SDR 79.936 million until April 1, 2020, the equivalent of SDR 180.689 million until November 1, 2020, the equivalent of SDR 223.155 million until March 1, 2021, and the equivalent of SDR 240.641 million until June 20, 2021.”
 - (c) In paragraph 3(a)(iii) of the Stand-By Arrangement, the word “floor” shall be replaced by the word “ceiling”.
 - (d) The floor for the June 30, 2020 and December 31, 2020 performance criterion on the net borrowing of the nonfinancial public sector of Honduras; the floor for the December 31, 2020 performance criterion on the net borrowing by ENEE; the ceiling for the June 30, 2020 and December 31, 2020 performance criterion on the lending minus repayments from public pension funds; the ceiling for the June 30, 2020 performance criterion on the accumulation of domestic arrears by ENEE; the floor for the June 30, 2020 and December 31, 2020 performance criterion on the stock of non-borrowed

net international reserves of the Central Bank of Honduras; the ceiling on the June 30, 2020 and December 31, 2020 performance criterion on the stock of net domestic assets of the Central Bank of Honduras, referred to in paragraphs 3(a)(i)-(vi) of the Stand-By Arrangement respectively, shall be as specified in Table AI.2 to the May 2020 MEFP and as further specified in the May 2020 TMU.

(e) The continuous performance criterion set forth in paragraph 3(b)(i) of the Stand-By Arrangement shall be as specified in Table AI.2 to the May 2020 MEFP and as further specified in the May 2020 TMU.

(f) Paragraph 3(c) of the Stand-By Arrangement shall be amended to read as follows:

“(c) On or after November 30, 2019, March 31, 2020, October 31, 2020, February 28, 2021 and June 19, 2021, respectively, until the reviews contemplated in paragraph 40 of the May 2020 MEFP are completed.”

4. The Fund decides that the second review contemplated in paragraph 3(c) of the Stand-By Arrangement is completed and that Honduras may make purchases in accordance with the terms of the Stand-By Arrangement.

5. This Decision shall become effective only upon the adoption of Decision No. 16819 by the Executive Board. (EBS/20/102, 05/26/20)

Decision No. 16818-(20/65), adopted
June 1, 2020

Honduras - Second Review Under the Arrangement Under the Standby Credit Facility, Request for Augmentation and Rephasing of Access, and Modification of Performance Criteria

1. Honduras has consulted with the Fund in accordance with paragraph 3(c) of the arrangement for Honduras under the Standby Credit Facility (EBS/19/62, the “SCF Arrangement”) in order to review program implementation.

2. The letter dated May 21, 2020 from the President of the Central Bank of Honduras and the Secretary of the Treasury (the “May 2020 letter”), together with its attached Memorandum of Economic and Financial Policies (the “May 2020 MEFP”) and Technical Memorandum of Understanding (the “May 2020 TMU”), shall be attached to the SCF Arrangement and the letter dated June 20, 2019, together with its attachments, shall be read as supplemented and modified by the May 2020 letter and its attachments.

3. Accordingly, the SCF Arrangement shall be amended as follows:

- (a) In paragraph 1 of the SCF Arrangement, “SDR 74.790 million” shall be replaced with “SDR 129.063 million”.
 - (b) In paragraph 2(c) of the SCF Arrangement, “SDR 12.490 million” shall be replaced with “SDR 69.111 million”.
 - (c) In paragraph 2(d) of the SCF Arrangement, “SDR 12.490 million” shall be replaced with “SDR 19.984 million” and “October 1, 2020” shall be replaced with “November 1, 2020”.
 - (d) In paragraph 2(e) of the SCF Arrangement, “SDR 12.490 million” shall be replaced with “SDR 7.494 million”.
 - (e) In paragraph 3(a)(iii) of the SCF Arrangement, the word “floor” shall be replaced with “ceiling”.
 - (f) The reference in paragraph 3(a) of the SCF Arrangement to “Table AI.2 to the November 2019 MEFP and as further specified in the November 2020 TMU” shall be replaced with a reference to “Table AI.2 to the May 2020 MEFP and as further specified in the May 2020 TMU”.
 - (g) In paragraphs 3(b) and 5 of the SCF Arrangement, “September 30, 2020” shall be replaced by “October 31, 2020”.
 - (h) The reference in paragraph 4(a) of the SCF Arrangement to “Table AI.2 to the November 2019 MEFP and as further specified in the November 2019 TMU” shall be replaced with a reference to “Table AI.2 to the May 2020 MEFP and as further specified in the May 2020 TMU”.
4. The Fund decides that the second review contemplated in paragraph 3(c) of the SCF Arrangement is completed and that Honduras may request the third disbursement specified in paragraph 2(c) of the SCF Arrangement.
(EBS/20/102, 05/26/20)

Decision No. 16819-(20/65), adopted
June 1, 2020

Honduras - Multiple Currency Practices Subject to Approval Under Article VIII, Section 3

1. Honduras maintains two multiple currency practices subject to Fund approval under Article VIII, Section 3. These arise (i) from the lack of a mechanism to prevent spreads in excess of 2 percent between the official exchange rate (TCR) of the day and the exchange rates at which foreign exchange is sold at the foreign exchange

auction on that day; and (ii) from the use of previous days' official exchange rates (TCR) in certain FX transactions, which rates may differ by more than two percent from the TCR in force and the interbank market rate on a given day.

2. In the circumstances of Honduras, the Fund grants approval for the retention of the multiple currency practices until May 31, 2021 or the conclusion of the next Article IV consultation with Honduras, whichever is earlier. (EBS/20/102, 05/26/20)

Decision No. 16820-(20/65), adopted
June 1, 2020

EXECUTIVE BOARD ATTENDANCE²

M. Furusawa, Acting Chair

Executive Directors

A. Buisse (FF)

S. Bhalla (IN)

M. Poso (NO)

M. Mouminah (SA)

P. Inderbinen (SZ)

Alternate Executive Directors

O. Odonye (AE)

A. Andrianarivelo (AF)

B. Lischinsky (AG)

N. Heo (AP)

B. Saraiva (BR)

Y. Liu (CC), Temporary

M. Tabora (CE), Temporary

A. McKiernan (CO)

C. Just (EC)

K. Merk (GR)

A. Ribeiro Mateus (IT), Temporary

K. Chikada (JA)

M. El Qorchi (MD)

P. Al-Riffai (MI), Temporary

H. Etkes (NE), Temporary

L. Palei (RU)

K. Tan (ST)

D. Ronicle (UK)

R. Farber (US), Temporary

C. McDonald, Acting Secretary
 H. Malothra, Summing Up Officer
 B. Zhao, Board Operations Officer
 L. Nagy-Baker, Verbatim Reporting Officer

Also Present

Fiscal Affairs Department: C. Alonso. Finance Department: A. Majewski, M. Spinella. Legal Department: J. Swanepoel. Office of Executive Directors: T. Cham, R. Edwards. Strategy, Policy, and Review Department: A. Corbacho, K. Lee. World Bank Group: P. Rodriguez. Western Hemisphere Department: P. Alonso-Gamo, J. Bersch, J. Kapsoli Salinas, C. Koh, J. Puig Forne, E. Vesperoni.

² For countries in each constituency, please see the Constituency Codes in the annex.

Executive Director: H. Beblawi (MI), R. Kaya (EC), L. Levonian (CO), A. Mahasandana (ST), M. Raghani (AF), L. Villar (CE). Alternate Executive Director: R. Alkhareif (SA), A. Guerra (CE), Y. Indraratna (IN), P. Moreno (CE), P. Rozan (FF), F. Sylla (AF). Senior Advisors to Executive Directors: M. Choueiri (MI), A. Ekelund (NO), P. Harvan (EC), T. Nguema-Affane (AF), J. Weil (CO). Advisors to Executive Directors: M. Albert (FF), A. Arevalo Arroyo (CE), S. Belhaj (MD), E. Boukpassi (AF), E. Cartagena Guardado (CE), T. Chrimes (UK), M. Coronel (BR), J. Corvalan (AG), A. Grohovsky (US), A. Nainda (AE), A. Park (AP), F. Rawah (SA), D. Shestakov (RU), M. Shimada (JA), S. Yoe (ST), T. Herold (GR).

DISCUSSION RECORD³

The Acting Chair (Mr. Furusawa):

The COVID-19 pandemic and external spillovers are expected to hit Honduras hard. However, the authorities remain strongly committed to the Fund-supported program. The augmentation of access should help the authorities cover the external financing needs to mitigate the impact of the pandemic. In the gray statements, Directors have welcomed the authorities' strong policy response, including using the flexibility under the Fiscal Responsibility Law to temporarily increase the deficit and accommodate higher healthcare and social spending. In addition, Directors endorsed the current monetary policy stance and called for continued efforts to strengthen the policy framework to support a more flexible exchange rate. The authorities should also continue to improve the institutional framework in the electricity sector. Further steps are needed to improve governance, including strengthening public procurement, AML/CFT frameworks, and central bank institutional framework.

Mr. Tabora Munoz:

We issued a detailed gray statement. Let me start with some important comments. On behalf of the Honduran authorities, we would like to thank Mr. Vesperoni and his team for the hard work and proactive engagement during these unexpected times. We also thank our colleagues at the Board and management for their continued support and prompt response to our authorities' request. The relationship with the IMF has been strengthened and cooperation intensified significantly at this difficult time; the authorities recognize the Fund as a trusted advisor. The non-financial additionality of their relationship has been and continues to be significantly appreciated.

Despite the challenges posed by the COVID-19 pandemic, and as stated in the Letter of Intent (LOI), the Honduran authorities remain strongly committed to the program, which remains on track, as well as to continue implementing prudent macroeconomic policies and deep structural reforms. As an example, the authorities have preferred at this time to request a rephrasing in augmentation of combined access under the current arrangement up to 387 million, 155 percent of quota. Instead of using emergency facilities, this is for the swift policy response to the humanitarian, healthcare, socioeconomic emergency to help mitigate the pandemic's impact on the Honduras' people and economy. The authorities maintain this commitment to the reform agenda and continue striving to protect social spending and investment; strengthen governance; restructure the electricity sector; and modernize the monetary and exchange rate frameworks. They also remain strongly committed to the revenue mobilization agenda that will increase the

³ Edited for clarity.

space to foster growth and reduce poverty over the medium term. The authorities broadly share the staff appraisal.

Let me make some comments about the impact of COVID-19 in Honduras. As of May 31, according to the report, there are 5,200 COVID-19 cases, 212 deaths, and more than 500 recovery. A country-wide quarantine is still in place, including physical distancing and sanitation protocols. Testing and monitoring coronavirus cases continues to be a major challenge, but health authorities are gradually increasing capacity. The lockdown is generating significant disruptions in the economy, impacting negatively the national production. The government is currently devising a mechanism for a gradual reopening of economic activity. However, containment and mitigation measures to save lives are expected to remain in place at least until mid-August. A gradual recovery in economic activity is envisaged for the second half of the year, but significant downside risks remain. A protracted outbreak with a prolonged impact on global growth and financial conditions will have severe health and social consequences, and it will also delay the recovery and affect the fiscal stance.

As you mentioned, the authorities envisage a loosening in the fiscal stance to create fiscal space for critical spending to mitigate the impact of the pandemic. The measures are targeted to support affected groups and mitigate the structural vulnerabilities. Efforts are concentrated on shoring up the fragile health system, including by reallocating spending toward the health sector to deliver food and health supplies to the needy families, the elderly, and people with disabilities, thus protecting a large segment of the population facing a humanitarian crisis amid the lockdown.

The authorities have also taken measures to guarantee the transparency and accountability of the emergency spending during the pandemic. They are already categorizing and tracking all pandemic-related expenditure in the budget to facilitate monitoring and publication of this spending, including through oversight by civil society in a dedicated workspace. The authorities will also expediently publish post-crisis reports of pandemic related spending.

The Court of Accounts is conducting concurrent audits of all COVID-19 related spending to speed up procurement in addition to the usual ex post audits, which will be published. The Congress authorized the temporary activation of the escape clause of the Fiscal Responsibility Law (FRL) on the grounds of emergency, but Debt Sustainability Analysis (DSA) indicates that Honduras remains at large risk of debt distress, both for public external debt and overall debt. In the context of the COVID-19 pandemic response, our authorities remain committed to continuous adherence to the Fiscal Responsibility Law to prevent jeopardizing debt sustainability and are strongly committed to swiftly return to the deficit limit of 1 percent of GDP from 2022 onwards. The authorities are also implementing monetary and financial sector measures to provide liquidity and soften the impact of the COVID-19 pandemic while preserving financial stability.

For the future of the program, with regard to the structural reforms, during the last six years, the authorities have significantly advanced in strengthening the macroeconomic and governance framework, restoring macroeconomic stability. In the same vein, the authorities remain firmly committed to macroeconomic stability and the reform agenda. They intend to build on previous achievements to strengthen the policy and institutional framework.

The authorities acknowledge that a greater progress in the structural reform of the electricity sector is necessary to consolidate the reform agenda included in the program. In this regard, they remain fully committed to the plan included in the IMF program and welcome the new structural benchmarks. The Central Bank of Honduras reaffirms its commitment with the modernization and further enhancement of the monetary policy framework and supports the transition to a more flexible exchange rate. The National Commission of Banks and Insurance (CNBS) will remain vigilant while continuing measures to further strengthen the regulatory framework and supervisory practices.

The Honduran government is fully committed to strengthen domestic institutions to foster the fight against corruption and to continue taking any and other possible measures appropriate to preserve the objectives of this program.

The staff representative from the Western Hemisphere Department (Mr. Vesperoni):

Staff is grateful for Directors' grays, and their continued support for policies and reforms in the program. The pandemic is having a major impact in Honduras. After a difficult year in 2019 in which the economy experienced the impact of climate change, the pandemic will prompt a recession this year.

Even in this environment, the authorities remain committed to the program. While targets are being adjusted to respond to the emergency, the contour of policies strikes the right balance between this response, fiscal sustainability, and program objectives, including sustained efforts on governance and new elements on electricity sector reforms.

Let me take a few minutes to address questions raised in Director's gray statements, from which we have identified four themes: the fiscal framework and financing issues, including Debt Service Suspension Initiative (DSSI); electricity sector reforms; governance issues; and, four, program issues.

I will start with the financing issues. Directors wondered about the prospects for financing under a more adverse scenario given refinancing needs later in 2020, as well as the authorities' participation in the DSSI.

Let me start by emphasizing the authorities' strong commitment to fiscal sustainability. While the flexibility in the Fiscal Responsibility Law is

being used, they have also defined a clear path to return to its ceilings. The Congress authorization asks the authorities more than what is required by the law, establishing not only convergence but also specific targets for deficits and current spending during the transition. We believe that this is important to discuss financing prospects.

As for refinancing issues, let me clarify that to ensure solid financing assurances, the program does not incorporate market financing this year. The Fund is helping catalyze other financing, as explained in the technical answers. Some financing is explicitly tied to the program, while decisions by other development partners look at the program as an anchor for policies and reforms.

Going forward, there is uncertainty about the full impact of the pandemic. The authorities continue to discuss further potential financing with development partners, and they remain committed to assessing further budget reallocations if needed. They also continue to explore financing opportunities in global markets, notably to refinance ENEE's debt. Despite current uncertainty, the authorities believe that their commitment to fiscal prudence will allow them to access markets at some point, but again, it is not assumed in the program.

Finally, regarding the DSSI, the authorities noted that Honduras' debt to official creditors as well as its debt service, is small this year. Hence, the authorities are assessing the impact they believe this initiative may have on the perceptions of Honduran risk. As stated before, the authorities have strived to give strong signals about fiscal sustainability in managing the emergency, and they need more time to decide.

Let me now turn to electricity sector reforms. Directors wondered about challenges from the pandemic, the reassessment of generation contracts, and the reasons behind the new arrears to generators.

The pandemic is indeed creating challenges in an already complex reform. The new challenges are arising in two areas mainly due to the dramatic social situation in the context of the lockdown. First, the emergency has interrupted the growing momentum of the campaign against electricity theft, critical to reduce non-technical losses. And second, it has created a short-term liquidity shortfall in ENEE, given partial deferral in payments of electricity bills.

Despite these challenges, the authorities continue to manage tariffs based on technical grounds while strengthening the institutional framework. After completion of the staff report, the Congress approved a decree to secure budgetary independence for the regulator, the agency updating tariffs. Medium-term plans on generation and transmission needs have been completed and work on regulations for the new tariff scheme continues.

We see the ongoing reassessment of non-operating generation contracts as important. It involves complex legal issues, but it is necessary for two reasons. First, some of those contracts were negotiated without sound medium-term generation plans. And second, this will pave the way for contracting energy in an open, competitive and transparent market.

Arrears with generators are related to the liquidity issues mentioned before. These difficulties should be temporary, as there were no exemptions to payments of bills, but deferrals. While unavoidable in the short run, there is the commitment from the authorities to clear them in the second half of the year, as reflected in the December PC. We also believe that the elimination of the trust fund managing the cash flow of the company's new structural benchmarks should be instrumental to avoid this problem in the future, as it will pave the way for a better payment system in the sector.

Let me now turn to the governance issues. After discussions with the Organization of American States over the MACCIH mandate, the authorities decided to refocus their efforts on the strengthening of domestic institutions creating the new anti-corruption unit, as explained in the technical answers, to foster transparency and the fight against corruption. The elements in the program are in line with this objective.

Reforms cover virtually all major aspects of last year's governance diagnostics, such as central bank governance, public finance management, public procurement, an area in which some reforms were brought forward, governance in tax collection, governance in public companies, the elimination of red tape, and the anti-money laundering and anti-corruption frameworks.

These reforms are critical to increase efficiency in the delivery of public goods, prevent the misuse of public resources, enhance accountability, and foster the fight against corruption.

Finally, let me close with program issues. Directors wondered how staff, given current uncertainties, intend to maintain ambitious targets.

Staff believes that the program remains as ambitious as it was when conceived, and true to its objectives. Given current uncertainty, staff was cautious in setting June targets, but end-year targets strike the right balance between the response to the pandemic and the macroeconomic objectives of the program. As for reform objectives, we believe that the authorities' commitment is remarkable, including by proposing new benchmarks in the current context.

Mr. Merk:

We have issued a gray statement, so I will be brief.

The authorities' unwavering commitment to the program, as Mr. Tabora Munoz underlined, represents an important anchor for

macroeconomic stability, bolstering market confidence, and enhancing prospects for external financing. Once the immediate emergency abates, a quick return to prudent budget will be paramount to safeguard debt sustainability. To this end, determined steps to strengthen revenues and cut back on nonpriority current spending in combination with further reforms in public financial management (PFM), tax administration, and the energy sector are of the essence, and we welcome the authorities' commitment in this regard. Strengthened governance, transparency and accountability and continuing the fight against corruption remain essential to facilitate vigorous private sector-led growth. With a view to remaining challenges in these areas, we would welcome a rigorous and comprehensive assessment of emergency spending in the next staff report.

Mr. Just:

We would like to make a few more points. First, we also see the rephrasing augmentation of the program preferable to approving or going for RFI/RCF. This signals the commitment by the authorities to the program target and to the challenging structural part of the program.

Second, as we have emphasized in several other recent meetings, economic outcomes may turn out to be worse. Echoing Mr. Merk, we recommend that the authorities, supported by staff, prepare adequate contingency measures to ensure debt sustainability. The possible refinancing risks of the Eurobond hedges this year drives home this point.

Third, we had previously pointed to a need for a strong focus on climate change in the case of Honduras, which on the one hand threatens coffee production and subsistence agriculture, and on the other hand, increases the propensity of natural disasters and weather-related events. Ms. Levonian and others have mentioned focusing on greening the recovery, and we also think it appropriate.

Fourth, the authorities have passed several new laws and regulations or are in the process of doing so. Many of them are critical to enhance governance, and make tax administration more efficient and effective. We would appreciate staff's comments on possible implementation risks and smaller payoffs in view of the forthcoming elections.

Mr. Lischinsky:

We issued a gray statement supporting the completion of the second review under the Stand-By Arrangement and the Standby Credit Facility arrangement, as well as the request for augmentation of access under the rephrasing. These funds will help in the fight against COVID-19. We would like to share two brief comments for emphasis.

First, Honduras' efforts to modernize the fiscal, financial, and monetary frameworks are commendable. The perseverance and consistency in

policy implementation are showing positive results on almost all socioeconomic variables and shall be vigorously supported by the Fund. We are aware that the construction of quality institutions takes time, but the payoff to society is much higher than its cost.

Second, we encourage the authorities to continue to move towards a more flexible exchange rate regime with support from MCM technical assistance and enhance their efforts to improve the AML/CFT framework going forward.

Ms. Indraratna:

We have issued a detailed gray statement; however, we would like to make some remarks for emphasis.

We note that Honduras has made steady progress under the Fund-financed SBA and SCF arrangements. The program remains on track as performance has been strong. We support the completion of the second review under these arrangements, and the authorities' request for the augmentation and rephrasing of access with modification to the performance criteria, as adjustments are needed to allow an adequate policy response to the COVID-19 pandemic.

The policies pursued under these programs have contributed to macroeconomic stability and debt sustainability. We are encouraged by the commitment of the authorities to uphold the Fiscal Responsibility Law, as it provides an anchor for a sound fiscal position. However, we encourage the authorities to continue with the reforms in the electricity sector. We welcome the recent progress made on the monetary policy framework and the advances in monetary and foreign exchange operations, in particular the relaxation of the foreign exchange surrender requirement.

Governance reforms remain critical to achieving sustainable inclusive growth. We commend the authorities for the efforts taken to strengthen the institutional framework of the central bank, the treasury, and public companies. Moreover, improvements to the public procurement process, reforms to the PPP framework, and changes to the public officials' asset declaration system will help in improving the business climate and fostering inclusive growth.

We welcome measures taken to guarantee the transparency and accountability of emergency spending.

Ms. Mateus:

We have issued a joint gray statement and support the completion of the second review and the requests for augmentation and rephrasing of access under the SBA and SCF.

I would only like to add one point here today. We would like to caution against policy advice that fuels procyclical behavior. The authorities' measures on the financial sector rightly allow suspending principal and interest payments by sectors affected by the pandemic. This is a commonly implemented payment moratoria that can lead to target and time-bound loan restructuring. We agree with the authorities that the new classification for loans subject to temporary debt service relief and reprofiling is more adequate than an immediate reclassification of those loans as NPLs. Indeed, debt service relief does not automatically imply that borrowers will stop fulfilling their responsibilities, and, of course, requiring automatic additional provisioning would add to banks' cost at this current juncture.

Mr. Heo:

We issued a joint gray statement with Mr. Tan and broadly agree with staff's assessment. We support the completion of the second review under the SBA and SCF and the authorities' request for rephrasing and augmentation of combined access. Hence, my remarks will be brief.

We note that this augmentation will help the authorities cover some of the unfulfilled increase in financing needs created by the pandemic. We also note that the augmented access would not significantly affect the level of external debt, and Honduras remains at a low risk of debt distress and has a strong capacity to repay the Fund. We welcome the authorities' use of the escape clause under the Financial Responsibility Law to accommodate the higher health and priority social spending. Given the high poverty rates and inequality, we would like to highlight the important role of social spending at this juncture with the programs conditionality, which will help the authorities to implement well-targeted social spending to the most vulnerable, as well as to the people in the informal sector, as well articulated this morning by Mr. Tabora Munoz.

Finally, we welcome the measures taken by the authorities with regard to transparency and accountability on the emergency spending during pandemic, especially through oversight by civil society organizations, which I think would be a good model for others to follow. Tackling governance issues further in subsequent reviews would also ensure the newly financed resources be properly directed to those most in need and to the private market-led development, as also stressed by Mr. Merk this morning.

Mr. Inderbinen:

We issued a gray statement with Mr. Chikada and Mr. Shimada supporting the review and the augmentation of access. We also support the fiscal loosening and welcome the steps to ensure transparency and accountability of emergency spending during the crisis. At the same time, we also note and welcome the intention of the authorities to revert to the targets under the Fiscal Responsibility Law by 2022, as confirmed by Mr. Tabora Munoz in his opening remarks earlier, and also very much welcome the

intentions to affect further fiscal structural reforms on the revenue side in particular.

Like others, we call for further reform in the energy sector, and we welcome the additional benchmarks that have been included under the program, including as elaborated by staff, on the termination of the trust fund, and would stress the importance of timely implementation of these reforms. We also note the ambition to transition to an inflation targeting regime and the commitment to introduce more exchange rate flexibility going forward.

On the monetary and exchange area, we have a question on the multiple currency practices (MCPs) that staff has elaborated on and the link of these to potential deviations between market and official rates. We thank staff for the confirmation that these are, indeed, based on the finding of potentiality. I would like to recall that in the initial discussion that the Board had on the reform of the MCPs, an endorsement by the Board that these MCPs related to potentiality would be no longer continued under the new policy once the discussion has run its course and the new policy is adopted and the new guidelines that staff has circulated. We do see that staff continues to expend quite a lot of energy on these MCPs, including in other countries as well. Just as a general remark, we would think this underlines the importance of concluding this MCP review. We think it was due by February 2020 initially and it will obviously take a little longer under the circumstances, but we do think this underlines the importance of concluding this review as soon as we can.

Mr. Tan:

There are a few rough spots in the global environment today, and like others, Honduras has not been spared from the woes of the ongoing pandemic. That said, in supporting to augment the SBA and SCF arrangements in our joint gray with Mr. Heo, we find it encouraging to be reminded of the country's track record of sound macroeconomic management and strong reform implementation.

It was equally uplifting to learn that the Fund engagement has strengthened and cooperation with the authorities has intensified at this critical juncture and that the authorities highly value the support from the Fund beyond its financial assistance, as highlighted by Mr. Tabora Munoz in his opening remarks. This explains why the staff report and buff statement in the current picture were very helpful. We would like to thank staff and Mr. Villar. We would like to reflect briefly on some of the clarifications by staff today.

First, it is useful to learn more on the DSSI configuration and the financing options for Honduras, as it deals with the pandemic-related challenges. On the DSSI, the briefing last week was timely in informing our Board discussion. This is a healthy debate to have with the authorities given the uncertainties, and we hope the ongoing engagement will persist and bear fruit in time to come.

Second, we appreciate staff's elaboration on how to help Honduras respond to the current crisis without losing sight of the longer-term program objectives. We thank Mr. Ronicle for raising a pertinent question that applies to many other countries as the pandemic cost rises. This deserves continuing attention from us to think about how to help countries to better balance different pressing priorities and chart the clear path between immediate crisis management and medium-term policy reforms. The discussion today in the context of Honduras is a good start, and staff should remain engaged with the authorities on this challenge through ongoing programs and with the necessary TA support. More broadly, we will call on other country teams to make the same conscious effort and give greater emphasis to this issue in policy advice to other countries as well.

This brings me to our final point: staff has laid out the scale of the longstanding challenge of reforming the electricity sector, especially in the midst of a pandemic. Nevertheless, the importance of maintaining the reform momentum does not escape us, not least with a significant amount of new financing in the coming years being conditional on these reforms. We take comfort that staff and the authorities are well aligned on the need for more significant progress. We stress the importance of working together to ensure close monitoring and avoid further arrears for the public electricity company in the future.

Mr. Alkhareif:

We have issued a gray statement in which we supported the proposed decision. We are encouraged by the strong program performance and the authorities' commitment to the program objectives.

We agree on the appropriateness of using fiscal policy more flexibly to help the authorities in their response to the COVID-19 shock. We welcome their efforts to reduce poverty and protect the most vulnerable segments of the population, including in the informal sector, since informality is one of the largest in Latin America. Here, I support the point raised by Mr. Heo on the importance of enhancing social protection. It is reassuring to note that Honduras is assessed to be at low risk of debt distress, and its capacity to repay the Fund is adequate. Like Mr. Inderbinen, we welcome the authorities' commitment to transparency and accountability of emergency spending.

Over the medium term and when the crisis is over, we encourage the authorities to step up their efforts in enhancing domestic revenue mobilization and improving public financial management framework to help create additional fiscal space needed for critical social spending. We also encourage the authorities to advance their governance reforms and strengthen the anti-money laundering and CFT framework. And finally, we encourage the authorities to step up their efforts in enhancing the anti-corruption framework.

Mr. Saraiva:

First, I would like to commend the authorities for all the measures that have been taken to contain the outbreak of COVID-19 in Honduras and support the economy. We issued a gray and I have two issues to add at this point.

First, regards the evolution of tax revenue. I see that tax revenue this year will be something around 2.5 percent of GDP. It is natural given the strong impact of the crisis on economic activity. My concern here is: if we look at the projections, until 2025, tax revenue is not projected to reach the pre-crisis level for 2020. For 2020, it was projected to reach 18.1, and by 2025 staff is projecting 17.8. I understand that there are many challenges related to the recovery process as well, but I believe that given the importance of the priority expenditures, especially in the social sector in the country, I would like to hear from staff what could be done to improve the performance in recovering the tax revenue. There was a question that staff answered about the tax administration measures that have been taken, but they will impact tax revenue marginally, therefore, I would appreciate if staff could elaborate a little bit on this. I do understand that part of the priority expenditures could be financed by redirection from nonpriority expenditures, but given the level of tax revenue this year, I think it would be important to have a stronger performance on this in the future.

Another issue regards the program as a whole. It is highly commendable that the authorities are committed to pursue the targets under the program. It is an important reform agenda that they have, but I believe that staff should be mindful that implementing the reform agenda may become extremely challenging under the circumstances of this crisis. We do not know how it is going to evolve. There is an expectation now that the recovery will be a quick one next year, but it depends on how things are going to evolve in the region and globally. Therefore, it requires a lot of flexibility at this point, including for the possibility of natural disasters in the upcoming rainy season, which would not be a surprise, given what has happened in the past years in the country.

It is very important that the country, as others in the Central American region have the support of the Fund to pursue their policies to fight the impact of the COVID-19.

Mr. Palei:

We have issued a detailed gray statement in which we expressed our view that we support the collaboration between the authorities and staff and continuation of the program. In my remarks, I would like to say a few words on a couple of additional points.

First of all, I would like to thank staff for providing us a detailed list of various social programs that constitute social safety net in the country. We

know that the Honduran economy is informal to a large extent, and we would like staff to elaborate on this issue of informality and how the authorities are planning to reach out to the informal sector and provide some economic and social support to the people who are not part of the formal economy.

The second comment is related to the establishment of the new anti-corruption unit. It was created at the regular structure of the public prosecutor's office. The new unit works closely with the old one, OAS-backed anti-corruption mission, and is using the best practices of the old unit. The reestablishment of the unit as a part of the state institutions is, indeed, a welcome step, and it requires, some taking stock of what had been achieved under the previous system. What are the successes of the previous mission? We would like to know whether they have led to any tangible progress on governance. We ask that because recently the Fund became much more active in this area, and the Fund is advising the authorities of various countries on how to create these units. At the same time, we know that the track record of such entities is not clear, and its effectiveness is frequently questioned by various experts. It would be very important for us to understand whether the authorities, the population, the experts, saw the role of the mission as sufficiently constructive and sufficiently effective, and why did the authorities change the institutional setup in this particular area. We would appreciate additional comments by staff on this issue.

The staff representative from the Western Hemisphere Department (Mr. Vesperoni):

I will make a couple of brief comments on some of the points raised by Directors.

First of all, there was a question regarding the authorities plans in the case this shock gets worse, and we do not know yet the full impact of the pandemic on the economy, not only on Honduras but on the global economy as well. Let me say that if the emergency were to worsen significantly, the authorities still can focus on reducing nonpriority spending to some extent, particularly by reducing transfers of earmarked revenues, which will prompt adjustment in spending if needed.

In terms of contingency planning, let me emphasize that the authorities continue to have conversations with development partners to look for additional financing if needed. As I said before, they are still exploring opportunities for new financing in the market as well. It is a combination of looking proactively for more financing if needed, and managing the budget in an effective way to allow fiscal space to attend to the pandemic, in terms of social and health spending going forward.

There was a comment on tax revenue: what can be done? Yes, there is much uncertainty in this environment, and tax revenue is going to suffer this year because of the pandemic. On projections over the medium-term, we will keep discussing these issues with the authorities. As we said, the authorities

are still committed to continue their agenda on revenue mobilization going forward. The pandemic has created a difficult environment at this moment, but we believe that the strategy in the program is the right one.

First, keep working on tax administration. Honduras has made over the last three or four years tremendous progress in terms of tax administration; this cannot be lost and the authorities should continue to build on it. It is not going to have an impact on tax collection in the short term, but it is going to benefit the country in the medium term, and they are aware of what can be done going forward. In fact, in terms of tax administration, TA missions in April or May have continued with the tax administration office in a systematic way. They are taking this agenda very seriously and are working on it consistently.

In terms of tax policy, we believe that the agenda is still the same as the one included in the program. The focus going forward should still be on tax exemption. Tax exemptions are not an issue only in Honduras, it is a rather regional issue. Most of the countries in the region have these issues. Tax exemptions are large. Therefore, we believe that the strategy set up in the program, even if it is facing short-term challenges because of the pandemic, is the right one. Focusing on tax exemptions can broaden the tax base. In terms of tax rates, Honduras is comparable to emerging economies and to the countries in the region. Therefore, looking at tax rates is not a good idea in our view. Looking at how you can broaden the tax base, is still the right path.

There were a couple of comments on how to include people in the informal sector in the social response to the pandemic. The authorities' strategy has been quite broad. On top of the spending on the health sector, there were several social programs that are pointed not only to workers in the formal sector, but also to poor families in general. The authorities are also implementing a program to reach out to informal workers. This program will involve resources for about 1,500 million lempiras, which is about 0.2 percent of GDP.

The strategy is overarching: the authorities have committed to preserve spending related to the pandemic and social programs, trying to reach out, as much as possible, to poor families, to informal sector workers and to formal sector workers. The program is also committed to this objective; commitments of the authorities in the latter are very important. In fact, a careful read of how the targets in the program have been modified in 2020 allows to note that the indicative target on social spending has not been modified despite all the emergency spending. There is a 25 percent increase in the program target, which represents a 15 percent against the outcome, because the outcome last year has overperformed the program. The program shows the authorities' commitment to protecting social spending and to reach out to poor population and population in the informal sectors. In trying to do this, the social programs have also played an important role in responding to the pandemic for two reasons.

First, information on vulnerable population was instrumental to inform the targeting of social spending in the context of the emergency, including to reach out to informal workers. Second, it is important to offer support to vulnerable populations during the pandemic.

There were a few comments on the governance issues. The staff has always recognized the important goal that MACCIH had and its mandate on anti-corruption efforts in Honduras. The decision not to renew the mandate of MACCIH was taken by the government and their partners together, after thorough discussions. The government had the view that developing domestic institutions was critical in its efforts against corruption, and to this end, they have created the anti-corruption unit. The staff continues to look forward to coordinating and cooperating with the authorities on these issues.

I think, we have offered several details on the technical answers. The staff basically welcomes the establishment of the new anti-corruption unit (UFERCO). This was created under the regular structure of the public prosecutor's office. UFERCO keeps the same mandate, management, and personnel as UFECIC, which was the anti-corruption unit that was working closely with MACCIH.

UFERCO's stated mandate is to prosecute high-profile cases of corruption of public officials, including those started within the period of cooperation with MACCIH. The response directed to the Attorney General, who was appointed to a second term in June 2018 with strong support from the international community for its achievements in the fight against organized crime and corruption in the country in the past.

As for the elements of the program, we believe that the program fosters governance reforms. At this point, it covers all major aspects of the diagnostic that we did last year. It includes central bank governance, public finance management, public procurement, a lot of public procurement elements in the program, which are important reforms. The new public procurement law was sent to the Congress well in advance of the deadline incorporated into the program because the authorities are adamant about advancing on these reforms quickly. We also believe that the implementation of Honducompras, which is the system to manage public procurement issues is going to be implemented as quickly as possible, possibly within this year. They are making great progress.

On the governance agenda, they also include governance reforms in tax collection, governance in public companies, and the elimination of trust funds. There are several measures on anti-corruption and anti-money laundering.

Finally, we take note of the comments on the importance of going forward on the transparency and the monitoring of the spending associated with the emergency. Directors have pointed to it. Staff is aware of it. We will continue our conversations and monitoring, in the context of the program,

with the authorities. We believe the authorities have put several measures in place. They have added not only the use of ex post audits of the Court of Accounts as a general rule, but they are also doing concurrent audits taking place in real time. They have also introduced several web pages in which people can check, in real time, the spending associated with the pandemic. They have invited several civil society organizations to check, monitor and follow any spending under the pandemic. We are aware of it, and we take note of Directors' comments. We believe that the authorities are taking a lot of measures to strengthen transparency and monitoring in spending associated with the pandemic

Mr. Tabora Munoz:

I thank our colleagues at the Board for their support. I will convey their concerns to my authorities, and as I mentioned in my initial remarks, we will continue to remain strongly committed to the program and to strengthening the relationship with the IMF.

ANNEX

- Gray Statements
- Staff's Responses to Executive Director's Technical Questions
- Constituency Codes

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May 27, 2020

**Statement by Mr. Villar and Mr. Tabora Munoz on Honduras
Executive Board Meeting 20/65
June 1, 2020**

On behalf of our Honduran authorities, we would like to thank Mr. Vesperoni and his team for their hard work and proactive engagement during these unexpected times. We also thank the Board and Management for their continued support and prompt response to the authorities' request. Authorities decided to draw on the available resources following the successful completion of the first review under the Stand-By Arrangement (SBA) and the Stand-by Credit Facility (SCF), which had been treated as precautionary. They are also requesting rephrasing and augmentation of combined access under the arrangements up to SDR 387.2 million (155.0 percent of quota) to support the swift policy response to the humanitarian, healthcare, and socio-economic emergency to help mitigate the pandemic impact on the Honduran people and economy. Authorities are also considering whether to request debt service suspension from official bilateral creditors, as envisaged in the Debt Service Suspension Initiative, supported by the G-20 and the Paris Club.

Since launching fundamental reforms in 2014, the economic cabinet has made significant progress in implementing structural reforms, strengthening institutions, and improving market and investor confidence. The primary objective of the reforms has been restoring and preserving macroeconomic stability, lifting living standards for Hondurans while transitioning to a modern and market-based economy, which in turn allows to rebuild the social fabric. The relationship with the IMF has been strengthened—cooperation has intensified significantly at this difficult time—and the authorities truly recognize the Fund as a trusted advisor. The non-financial additionality of the relationship has been and continue being significantly valuable.

Despite the challenges posed by the COVID-19 pandemic, and as stated in the Letter of Intent (LOI), the authorities remain firmly committed to the program, which remains on track, as well as to continue implementing prudent macroeconomic policies and deep

structural reforms. Notwithstanding the headwinds to growth in 2019—including due to a severe drought associated with climate change—all quantitative performance criteria (PC), continuous PC and all but one Indicative Targets (IT) for the second review—end-December 2019—were met. The authorities made substantial progress on reforms, completing several structural benchmarks and continue advancing on others.

Authorities continue striving to: (i) protect social spending and investment from the impact of the slowdown on public revenues and strengthen governance; (ii) restructure the electricity sector; and (iii) modernize the monetary and exchange rate frameworks. They also remain strongly committed to the revenue mobilization agenda that will increase space to foster growth and reduce poverty over the medium term. Authorities broadly share the staff's appraisal.

Impact of COVID-19

The first COVID-19 case in Honduras was reported on March 10, 2020. The authorities have implemented a lockdown and strong mitigation measures, closing the borders with neighbor countries and imposing a national curfew on March 16, thus cancelling public and group gatherings, closing school and universities, suspending all international commercial flights, quarantining everyone entering the country, and applying tight restrictions on circulation. As of May 26, there are 4,401 COVID-19 cases, 188 deaths and 493 recovered reported. Considering the fragility of the health system and in line with WHO guidelines, a country-wide quarantine is still in place, including physical distancing and sanitation protocols. Testing and monitoring virus cases continue to be a major challenge, but health authorities are gradually increasing capacity. The transformation of some hospitals and health centers and the construction of new quarantine facilities throughout the country to assist the population are also in progress.

Implementing the lockdown at an early stage of the virus spread has been a prudent, wise decision but it has taken a heavy toll on economic activity, especially for the small and medium enterprises and the informal sector. The pandemic has the potential to reverse significant advances attained over the last years which would curb the country's efforts to foster inclusive growth and reduce poverty. Growth is projected to slow down to -3.3 percent in 2020, after 2.7 percent in 2019 (-6.0 percent of GDP in total). The economic contraction will be the deepest in the last 50 years, strongly impacting industries that are highly dependent on foreign trade. The economy is expected to be hit by negative external shocks through weaker export demand, as economic conditions deteriorate in the main trade

partners, lower remittances mainly due to the record high unemployment levels in the U.S., and a sharp decline in tourism revenues. The lockdown is also generating significant disruptions in the supply and distribution chains, impacting negatively the national production. The government is currently working on devising a mechanism to gradually reopening economic activity. However, containment and mitigation measures to save lives are expected to remain in place at least until June. A gradual recovery in economic activity is envisaged for the second half of the year, with a stronger rebound—above long-term potential of 4.0 percent—in 2021, but significant downside risks remain. A protracted outbreak, with a prolonged impact on global growth and financial conditions, would have severe health and social consequences, and it would also delay the recovery and affect the fiscal stance.

Initial estimates envisage fiscal revenues could deteriorate by about 2.5 percent of GDP in the short term—of which 0.5 percent of GDP are deferred taxes expected to be collected in 2020, so that net impact is 1.9 percent of GDP—due to the economic recession and temporary measures to mitigate the impact of the pandemic. Most of the decline may be in tax collection (2.4 percent of GDP lower than expected under the program) which is expected to drop to 15.6 percent of GDP. Additional crisis-related spending needs are estimated at 2.1 percent of GDP in 2020, including emergency healthcare expenditures (0.9 percent of GDP), and additional social spending (1.2 percent of GDP) that includes: temporary unemployment benefits to formal workers, delivery of food supplies to poor families, and cash transfers to informal workers. Authorities have identified about 1.0 percent of GDP in nonpriority current spending that will be reduced through budget reallocations, leaving the net increase in expenditure at about 1.0 percent of GDP. The consolidated Non-Financial Public Sector fiscal deficit will then expand from the 1.0 percent of GDP limit as mandated by the Fiscal Responsibility Law (FRL) to 4.0 percent of GDP in 2020 and 3.0 percent of GDP in 2021. Congress authorized the temporary activation of the FRL escape clause on the grounds of emergency (Art. 4, item 1), and they are strongly committed to swiftly return to the deficit limit of 1.0 percent of GDP from 2022 onwards.

Inflation up to April 2020 is at 3.3 percent, within the Central Bank's band, and it is expected to stabilize at 4.0 percent—the Central Bank's target—while the current account deficit is envisaged to widen from -1.4 percent of GDP in 2019 to -2.1 percent of GDP in 2020 due to the fall in remittances in 2020 which are projected to decrease by about 14.0 percent in nominal terms, and a collapse in tourism and textile manufacturing which will be only partially offset by lower oil prices and imports reduction.

The sudden stop of private capital flows, together with higher financing needs in the public sector, have opened a BOP financing need of about US\$1.1 billion in 2020. This gap is planned to be financed by drawing on the augmented SBA and SCF arrangements—Fund disbursements will be used for budget support—and additional financing from multilateral development banks (MDB) for US\$582 million. These will allow the authorities to reduce the use of international reserves and preserve the adequacy ratio. At May 25, the net international reserves were about US\$6.3 billion, and the reserve adequacy ratio is greater than 7 months of next-year imports. The exchange rate has depreciated modestly in the context of the crawling peg regime and authorities do not expect it to be under pressure due to the pandemic.

The Debt Sustainability Analysis (DSA) indicates that Honduras remains at low risk of debt distress both for public external debt and overall debt. In the context of the COVID-19 pandemic response, authorities remain committed to the continuous adherence to the Fiscal Responsibility Law (FRL) to prevent jeopardizing debt sustainability. EMBI spreads increased from 252 basis points at the beginning of the year to 741 basis points on April 28. We agree with the staff that this increase reflects a general trend of massive capital outflows from emerging economies that have taken place over the last few months, rather than a Honduras-specific financial constraint. Indeed, after completing the IMF's technical review and the ratification of the sovereign credit rating, the EMBI Spreads drop to 466 basis points on May 21.

Policy Response

The authorities envisage a loosening in the fiscal stance by 3.0 percent of GDP in 2020 to create fiscal space for critical spending to mitigate the impact of the pandemic. Measures are targeted to support affected groups and mitigate structural vulnerabilities. Efforts are concentrated on shoring up the fragile health system, including by reallocating spending towards the health sector, and the creation of the program “Honduras Solidaria” to deliver food and health supplies to needy families, the elderly and people with disabilities thus protecting a large segment of the population facing a humanitarian crisis amid the lockdown, as well as temporary cash transfers to informal workers. New resources will be allocated for containment measures, the expansion of social protection safety net to protect the more vulnerable, and support to small and medium enterprises, including temporary unemployment benefits to formal workers.

Congress passed legislation granting tax exemptions on medical supplies and free economic zones—equivalent to 0.1 percent of GDP—and the administration have conceded tax deferrals reducing advance payments for corporate income tax to provide cash flow relief to businesses (0.5 percent of GDP).

The authorities are also implementing monetary and financial sector measures to provide liquidity and soften the impact of the COVID-19 pandemic, while preserving financial stability. In line with Fund advice, swift crisis response measures have focused on monetary easing, including by lowering the policy rate and injecting liquidity; allowing temporary (120 days) debt service relief for affected sectors; a new credit guarantee scheme to foster credit while maintaining financial stability with the support of the Central American Bank for Economic Integration (CABEI); and well-targeted support to critical sectors (agriculture, tourism and housing) from the public development bank (BANHPROVI).

The authorities are closely monitoring the impact of the pandemic on the financial sector, while bank liquidity, Non-Performing Loans (NPL), profitability and capital adequacy are currently adequate. They are firmly committed to ensure that any losses will be recognized against available buffers and new capital will be required if adequacy falls below regulatory standards. The Central Bank is also modernizing procedures to guarantee swift activation of its emergency lending facility when needed. Authorities have introduced a debt service relief initiative, allowing the suspension of principal and interest payments for three months for the affected sectors, using the flexibility provided by current regulatory and supervisory framework. Afterwards, targeted and timebound loan restructurings according to repayment capacity can be made available, while credit classifications remain frozen until the process is completed by October 2020.

The authorities have taken measures to guarantee the transparency and accountability of the emergency spending during the pandemic. They are already categorizing and tracking all pandemic related expenditure in the budget to facilitate monitoring and publication of this spending—including through oversight by civil society—in a dedicated web page. The authorities will also expeditiously publish post-crisis reports of pandemic-related spending as policy responses to the crisis continue to be implemented. The Court of Accounts is conducting concurrent audits of all COVID-19 related spending to speed up procurement, in addition to usual ex-post audits, which will be published.

Ongoing structural reforms

During the last six years, the authorities have attained significant advance in strengthening the macroeconomic and governance framework, restoring macroeconomic stability, including but not limited to fiscal consolidation, while protecting fiscal space to attend to the more vulnerable, achieving approval of the Fiscal Responsibility Law (FRL), modernization of the Monetary Policy Framework, and enhancing of the AML/FCT framework.

In that vein, Authorities remain firmly committed to macroeconomic stability and the reform agenda. They intend to build on previous achievements to strengthen the policy and institutional frameworks. They also continue fully committed to the revenue mobilization agenda that will increase fiscal space to foster growth and reduce poverty over the medium term. Moreover, they will continue their proven record of compliance with the FRL and debt sustainability, including with the implementation of a centralized wage bargaining mechanism to guide decisions on nominal wage increases. Authorities will enhance the level of engagement with the private sector and with Congress for the approval of submitted legislation introducing electronic notification from the tax administration office (SAR) on procedures to taxpayers and return to SAR the control and verification procedures for tax exemptions. They will also continue to strengthen capacity of the new customs administration and gradually broaden the tax base through the streamlining of exemptions.

The authorities recognize that more significant progress in the structural reform of the electricity sector is necessary to consolidate the reform agenda encompassed in the program and in that regard, they continue firmly committed with the plan included in the IMF program. They will pursue the strengthening of the governance structure in the regulatory body (CREE) and system operator (ODS). Authorities are also fully committed to the proper implementation of the General Law of the Electricity Industry (LGIE), aiming at creating an open, transparent, efficient and competitive electricity market, as well as taking the necessary steps to tackle long-standing challenges in the state-owned enterprise (ENEE), in particular the oversupply and high generation costs, a misalignment between tariffs and costs, high electricity losses, and persistent operational inefficiencies.

The Central Bank of Honduras (BCH) reaffirms its commitment with the modernization and further enhancement of the monetary policy framework and supports the transition to a more flexible exchange rate, including the adjustment of FX intervention rules in preparation for the elimination of surrender requirements, the regulations to support development of an FX derivative market, the use of treasury securities for monetary policy, and the development of an electronic platform to support a secondary securities market. A

securities market law has been submitted to Congress; it should help strengthen the interest rate transmission channel, and the new central bank law that will increase the central bank's autonomy, transparency and accountability by, inter alia, stating price stability as the overriding policy mandate of the BCH, establishing a sound central bank's governance structure with a proper allocation of oversight, daily management, and policy formulation responsibilities among its decision-making bodies.

The National Commission of Banks and Insurance (CNBS) will remain vigilant to potential needs for temporary relaxation of existing macroprudential buffers, while continue maintaining measures to further strengthen the regulatory framework and supervisory practices. They are also fully committed to continue expanding the supervision coverage of Designated Nonfinancial Businesses and Professions (DNFBP); and enhancing identification of shareholders and beneficial owners as well as access to this information to prevent misuse of legal entities. They will submit to Congress a proposal to create a unified and centralized registry collecting beneficial ownership information that will ensure timely identification of owners and all types of legal persons, including by requiring legal entities to submit updates and establishing dissuasive actions to secure compliance.

The Honduran Government is fully committed to strengthen domestic institutions to foster the fight against corruption. Following thorough discussions with the Organization of American States, the attorney general office created a new anti-corruption unit (Unidad Fiscal Especial contra la Impunidad y la Corrupción (UFERCO), based on the structure of the former MACCIH prosecutor office. The Ministry of Finance (SEFIN) also continues enhancing fiscal governance to prevent corrupt practices. A new public procurement law has been submitted to Congress, aimed at modernizing the process and strengthening compliance, including with the enhanced public purchases and contracting platform, "Hondocompras 2", that will fully integrate the procurement process with the Treasury IFMIS (SIAFI) for central government entities covering 90 percent of the procurement budget. A reform to the organic law of the Court of Accounts introduced last year addressed shortcomings in the current internal audit system. The Court of Accounts will issue by-laws to reform the public officials' asset declaration system in line with good international practices.

Finally, the authorities reaffirm their commitment to continue taking any other possible measure that is appropriate to preserve the objectives of the program.

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GRAY/20/2165

May 29, 2020

**Statement by Mr. Odonye, Mr. Cham, and Ms. Nainda on Honduras
(Preliminary)
Executive Board Meeting 20/65
June 1, 2020**

We thank staff for a comprehensive report and Mr. Villar and Mr. Tabora for their insightful Buff statement.

Honduras has been impacted by the COVID-19 pandemic and associated spillovers, which tilted the economy to a recession in 2020. The large additional financing need occasioned by the deterioration in external financing conditions warrants immediate response. Against this background, we support the completion of the second review under the SBA and SCF arrangements and the authorities' request for augmentation and rephrasing of access. We note the solid program performance and strong capacity to repay the Fund. The authorities are optimistic that augmentation of the access would close external financing needs and subsequently, guaranteed the transparency and accountability of the emergency spending through the publication of the post-crisis audit reports.

We commend the authorities for timely articulation of policy response to contain the impact of the virus and the commitment to uphold the objectives of the program. On this note, we expect a rapid implementation of the policy response through flexible use of the FRL, including a temporary increase in the NFPS deficit. Program performance at end-2019 has been remarkable, reflecting the authorities' strong commitment to macroeconomic stability, fiscal responsibility, and social spending and investment despite the tight revenue conditions. Going forward, we urge that the authorities sustain their commitment to the program and redouble the implementation as emphasized in Mr. Villar and Mr. Tabora's statement. Once the crisis subsides, more prudent macroeconomic policies and deep structural reforms would be pertinent. We also concur with staff on preventing a reduction in tax revenue and controlling non-priority current spending. *Nevertheless, could staff estimate the near-term gains in revenue envelope to the authorities from engaging the private sector in collaboration with the legislature?*

We note that monetary policy remained focus on price stability and adequate international reserves to absorb external shocks. Given the difficult financial conditions, we support the temporary monetary injection aimed at strengthening liquidity and restoring financial

stability. At the same time, the Central Bank of Honduras' (CBH) needs clear communication of its stance and the conditions in the markets under which to discontinue the softening measures in future. Further efforts to strengthen monetary and financial policy framework and support the transition towards a more flexible exchange rate would be crucial. Though Honduras remains at low risk of debt distress both for public external debt and overall debt, we see merit in shoring debt sustainability and encourage the authorities to leverage the debt service suspension from official bilateral creditors offered under the G-20 and the Paris Club Debt Service Suspension Initiative.

Finally, advancing structural reforms remains critical to promote investment and enhance sustainable and inclusive growth. The authorities need to redouble their efforts to improve governance and strengthen the fight against corruption. Others include the institutional frameworks of the central bank, the Treasury and SOEs, which need more enhancements. We look forward to the implementation of envisioned public procurement and PPP frameworks, and measures to enhance transparency and accountability of emergency spending. Given the vulnerability to climate change, we encourage more effort to restore the country's forest and invest in climate-resilient infrastructure. To this end, we view as critical to secure access to grants and concessional green funds to address climate related change.

With these, we wish the Honduran authorities' success in their endeavors.

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GRAY/20/2169

May 29, 2020

**Statement by Mr. Just and Mr. Harvan on Honduras
(Preliminary)
Executive Board Meeting 20/65
June 1, 2020**

We thank staff for the report, and Messrs. Villar and Tabora Munoz for their informative Buff statement. We welcome the Honduran authorities' continued commitment to the program and reform efforts. In light of the satisfactory program performance, **we support the completion of the second review under the SBA and SCF as well as the rephasing and augmentation of access** to SDR 387.2 million (155 percent of quota), SDR 129.1 million under the SCF and SDR 258.1 million under the SBA in view of the changing risk landscape and need for increasing domestic emergency spending.

We agree with the temporary relaxation of the Fiscal Responsibility Law in 2020 and 2021 to support the health system and social policies but stress the need for maintaining the quality of **fiscal stimulus and preventing an extended fall in revenues**. We note the lack of revenue mobilization, and in particular the delays in streamlining tax exemptions, as well as putting in place a centralized wage bargaining mechanism. We positively note the new structural benchmarks aimed at improving the governance and financial situation of the electricity sector and encourage frontloading the adjustment to avoid delays in the run-up to the 2021 elections.

The **monetary and financial sector** measures are appropriate to soften the impact of the COVID-19 pandemic as inflation remains close to the target. Following the expiration of the temporary debt service relief, close monitoring of NPLs and capital buffers is needed. To ensure transparency and a level playing field, we support staff's call for clear rules for provisioning and potential migration to NPLs of restructured loans. *Staff's comments on whether current supervisory action is in line with best practice would be appreciated.* We positively note the steps to close the BANADESA agricultural bank. *Can staff comment on the progress on the investment policy framework of public pension funds.* We welcome the progress on the monetary policy framework and the transition to a more flexible exchange rate with the support from Fund technical assistance.

In light of Honduras' challenges in fighting corruption and sustained improvements in governance, we call for strong **governance safeguards**. We welcome the reforms of public procurement and the PPP framework and encourage staff to go beyond changes in the

legislative framework. *We positively note the plans to create a beneficial ownership register and would welcome staff's comments on the envisaged timeline to publish the list of beneficial owners. We note that the authorities are considering participation in the G20 debt service suspension initiative and would welcome staff's comments on the likely liquidity support Honduras would accrue, whether Honduras already meets the public debt disclosure requirements of the DSSI and the likelihood of having an appropriate monitoring framework in place.*

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GRAY/20/2174

May 29, 2020

**Joint Statement by Mr. Heo, Mr. Tan, Ms. Park, and Ms. Yoe on Honduras
(Preliminary)
Executive Board Meeting 20/65
June 1, 2020**

We thank staff for the report, and Mr. Villar and Mr. Tabora Munoz for their informative Buff statement.

We support the completion of the second reviews under the SBA and SCF as program performance remains strong. Despite the revenue shortfall, it is commendable that the authorities have maintained the fiscal stance within program targets while protecting investment and social spending through strict control of nonpriority current spending. We also welcome the significant reform progress made and recognize that some of the structural benchmarks have been delayed due to the pandemic. That said, we are encouraged by the authorities' strong commitment to the program, and trust that program implementation will remain on track despite the challenges created by the pandemic. The Fund can also help to facilitate program implementation by providing continued TA support including in areas such as governance, tax administration, monetary policy framework where the authorities have requested for TA.

We also support the authorities' request for rephasing and augmentation of combined access to SDR 387.2 million (155 percent of quota) to help cover some of the unforeseen increase in financing needs created by the pandemic. We note that the augmented access would not significantly affect the level of external debt, and Honduras remains at a low risk of debt distress and has strong capacity to repay the Fund. Given the uncertainty and downside risks to the outlook, it is prudent for the authorities to seek additional financing in case the shocks proved larger and longer than envisaged. *Can staff update on whether Honduras' upcoming graduation from PRGT would affect its ability to seek concessional loans from multilaterals?*

We agree that it is necessary to adjust the program, including modifying some of the

performance criteria, to maintain the program objectives while allowing for an adequate policy response to the pandemic. Given the high poverty rates and informality, we welcome the use of the escape clause under the FRL to accommodate the higher health and priority social spending. Additional social spending needs to be well targeted to the most vulnerable including cash transfers to the informal sector as well articulated in the letter of intent. That said, over the medium term, we encourage further strengthening of tax administration as well as continued prioritization to control nonpriority current spending in order to preserve program objectives and to create fiscal space for critical spending. We also welcome further efforts to improve the governance and finances of ENEE by tackling high electricity losses, misaligned tariffs and operating inefficiencies.

We welcome the authorities' efforts to ensure monetary and liquidity conditions remain adequate to cushion the impact of the pandemic, including through maintaining an accommodative monetary stance, improving SME access to credit and relaxing macroprudential buffers while maintaining prudent regulatory and supervisory practices. We note that the financial sector measures to support credit growth should be carefully designed to avoid moral hazard and to ensure sound credit risk management to maintain financial stability. We also encourage further reforms to advance the agenda on governance.

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GRAY/20/2180

May 29, 2020

**Statement by Mr. Merk and Mr. Herold on Honduras
(Preliminary)
Executive Board Meeting 20/65
June 1, 2020**

We thank staff for the well written reports and Mr. Villar and Mr. Tabora Munoz for the insightful Buff statement. We support the completion of the second reviews under the Stand-By Arrangement and the Standby Credit Facility as well as the augmentation and rephasing of access, and the modification of performance criteria.

Like staff, we see the current program as the appropriate tool to support Honduras in these challenging times. Broadly concurring with staff's assessment and economic policy advice, we would like to provide the following comments:

The authorities' unwavering commitment to the program represents an important anchor for macroeconomic stability, also to bolster market confidence and prospects for external financing. Program performance was satisfactory, with all quantitative targets for end-December met and tangible progress on structural reforms realized. Going forward, we call on the authorities to stay their course with prudent macroeconomic policies that safeguard the stability gains achieved over the last years and push ahead with further economic and institutional reforms to strengthen growth forces and facilitate a quick and vigorous economic recovery.

The impact of the COVID-19 pandemic will bring about substantial financing and balance of payments pressures. Under current projections, the Fund would shoulder the brunt of financial support to cover the projected balance of payments need. While Honduras' risk of debt distress remains low and the program appears fully financed over the next two years, this course of action will nevertheless increase risks for the Fund. The heavy reliance on Fund financing also appears somewhat problematic with respect to the catalytic nature of Fund arrangements. Not least against this background, we encourage the authorities to actively seek further multilateral and bilateral financing, on concessional terms wherever

possible. *Could staff give an update on financing prospects in the case of a more profound negative impact of the current crisis?*

We further took note that staff foresees increased refinancing risks for the end of the year. *Could staff elaborate on specific contingency plans to address these risks?*

Once the immediate emergency abates, a quick return to prudent budgets will be paramount to safeguard debt sustainability. To this end, determined steps to strengthen revenues (including by abolishing unequitable tax exemptions) and cut back on non-priority current spending in combination with further reforms in public financial management, tax administration and the energy sector appear of the essence. We welcome the authorities' commitments in this regard.

Given the substantial downside risks to the economic outlook we would recommend to fully prepare adequate fiscal contingency measures to ensure debt sustainability also in case of a more detrimental or protracted impact of the COVID-19 epidemic.

Further action will be necessary to strengthen the monetary policy framework in order to ensure adequate central bank independence and bolster financial stability. Remaining surrender requirements should be gradually eliminated and the authorities should continue to cautiously proceed towards greater exchange rate flexibility.

Strengthening governance, transparency and accountability and continuing the fight against corruption remains essential to facilitate vigorous private sector-led growth. Not least with a view to remaining challenges in these areas, we would welcome a rigorous and comprehensive assessment of emergency spending in the next staff reports.

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GRAY/20/2183

May 29, 2020

**Statement by Mr. Mouminah and Mr. Rawah on Honduras
(Preliminary)
Executive Board Meeting 20/65
June 1, 2020**

We thank staff for the well-focused report and Mr. Villar and Mr. Tabora Munoz for their helpful Buff statement. We are in broad agreement with staff's analysis and policy recommendations and would limit our remarks to a few issues.

1. **We support the authorities' request for the completion of the second reviews under the SBA and SCF as well as augmentation of access and rephasing.** It is encouraging to note that program performance remains strong, reflecting the authorities' commitment to the program objectives. However, the COVID-19 outbreak has hit the Honduran economy hard and is expected to cause a deep recession at a time when the health system is fragile and poverty rate is already high. In view of the temporary shocks, the augmentation of access is appropriate to help close the urgent financing needs and support the authorities' efforts to fight the pandemic, which have been reasonably swift and targeted. Also, we agree with the need to use the flexibility provided under the FRL and allow for a temporary widening of fiscal deficit, which should be gradually reduced once crisis abates. We are comforted to note that Honduras is assessed to be at low risk of debt distress and its capacity to repay the Fund is adequate. The authorities' commitment to transparency and accountability of emergency spending, including by facilitating the monitoring and publication of pandemic-related spending, is welcome. We also welcome concurrent audits by the Court of Accounts.

2. **Over the medium term, we agree that preventing tax revenue reduction and controlling non-priority current spending would be important to help create fiscal space for critical spending.** In this regard, the authorities' commitment to enhance revenue mobilization, including through targeted measures aimed at improving tax administration, is welcome. Also, we underline the importance of continued improvement in PFM and take positive note of the authorities' plan to enact a new wage negotiation mechanism for the civil service with the assistance of the WB and FAD. In addition, we welcome the ongoing efforts

to reform the energy sector and encourage further steps to improve the operations and governance of ENEE.

3. **Finally, we encourage the authorities to advance governance reforms and strengthen the anti-corruption framework.** In this connection, the submission of the new procurement law to Congress and the ongoing efforts to improve PPP framework and strengthen AML/CFT framework are welcome. We also support the initiatives aimed at improving the business climate and look forward to meaningful progress.

With these remarks, we wish the authorities further success.

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GRAY/20/2184

May 29, 2020

**Statement by Mr. Poso and Ms. Ekelund on Honduras
(Preliminary)
Executive Board Meeting 20/65
June 1, 2020**

We thank staff for the well-written and clear papers and Mr. Villar and Mr. Tabora Munoz for their helpful Buff statement. The negative impact on the Honduran economy stemming from the Covid-19 shock and from external spillovers have increased the financing needs, thus we support the authorities' request for rephrasing and augmentation of access to SDR 387.2 million (155 percent of quota) under the SCF and SBA, to be used for budget support.

We concur that there is an immediate need for a well-targeted fiscal loosening to mitigate the impact of the pandemic while maintaining the objective of fiscal prudence remains equally important over the medium term, reinforced by the Fiscal Responsibility Law. It is reassuring that the Honduran economy remains at low risk of debt distress. We note that the authorities are also considering whether to request debt service suspension from official bilateral creditors under the Debt Service Suspension Initiative. *Could staff please elaborate on the perceived trade-offs in these considerations and the reasons for the authorities' hesitancy?*

We welcome the authorities' strong commitment to the program and note that several structural benchmarks are already completed, in many cases with technical support from the IMF. This seems to be a good example when program objectives and technical assistance are mutually reinforcing. We note, for example, that a new central bank law (that benefitted from input from LEG) has been submitted to Congress. *A strong and independent central bank backed by solid legislation is an important anchor for good policies and we would be interested to hear staff elaborate on the key elements of this law, and if there are lessons to be learned for other countries?*

We trust that the authorities will continue with their strong reform agenda, and we especially support the aim to strengthening domestic institutions in order to foster the fight against corruption, including the creation of a new anti-corruption unit. We also welcome the authorities' measures to guarantee the transparency and accountability of emergency spending during this pandemic, for instance by tracking all pandemic-related expenditure in the budget to facilitate the monitoring and publication of this spending. We note that the report states that steps are being taken to align the internal audit function with leading

international practices, but until this work is concluded, *an independent ex-post audit of crisis-related spending could be considered. We would welcome staff's comments.*

With these remarks, we wish the authorities all the best in these challenging times.

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GRAY/20/2185

May 29, 2020

**Statement by Mr. Beblawi and Ms. Al-Riffai on Honduras
(Preliminary)
Executive Board Meeting 20/65
June 1, 2020**

We thank staff for their reports and Messrs. Villar and Tabora Munoz for their informative Buff statement. Honduras' reform efforts, which started in 2014, and strong program performance are restoring and preserving macroeconomic stability, lifting the living standards of the Honduran people, and helping the country's transition to a modern market-based economy. The COVID-19 pandemic threatens the Honduran economy by reducing external demand, tourism receipts and remittances, as well as tightening external financing conditions. In spite of these difficult conditions, the authorities have stated their commitment to the SBA/SCF arrangement, as they work to keep the program on track. The program can help provide financing until external financial conditions normalize. We support the completion of the second reviews under the SBA and SCF arrangements and the proposed decisions. We commend the authorities on their swift and decisive measures to contain and mitigate COVID-19's impact on lives, livelihoods, and economic activity and welcome staff's re-focus of the review to address COVID-19 related challenges, as well as measures to maintain the program's objectives.

The authorities appropriately loosened their fiscal stance to combat the COVID-19 pandemic. Lower fiscal revenue streams and a significantly larger spending envelope on health and social protection are expected to widen the non-financial public sector (NFPS) deficit. We welcome that the authorities protected investment and social spending by rationalizing non-priority current spending. We note that some of these spending rationalizations reflect lower operational costs due to pandemic-related closures of some government activity. *Once the economy re-opens and these pandemic-related closures are reversed, will there be space to cut other non-priority spending to create space for priority spending?* We welcome the authorities' substantial spending measures on mitigating the economic, social, and humanitarian impact of the pandemic, including through targeted support to families, workers, and firms and *wonder if families just above the poverty line would also benefit from these targeted measures.* We take positive note that the authorities intend to strengthen fiscal governance and transparency and intend to return to the 1 percent NFPS deficit ceiling in 2022.

The Central Bank of Honduras' liquidity measures have supported the banking system and solvency and liquidity indicators remain adequate. We commend the authorities' close monitoring of the impact of the crisis on the sector and that they stand ready to intervene should potential liquidity or solvency issues arise. Further strengthening the monetary policy and AML/CFT frameworks is warranted, and we therefore welcome the ongoing technical assistance from the Fund.

The authorities' have made progress in advancing electricity sector reforms aimed at improving the institutional framework, including the efforts to strengthen the regulatory body and improve operations and governance. Whilst we note that the pandemic may challenge the reform momentum in the electricity sector, advancing the sector's reforms remain crucial. We note that the authorities missed the target on public electricity company's operational ratio, since the court ordered the electricity company to rehire the workers previously dismissed. *Can staff shed light on the reasoning behind the court's order and what that means for operational efficiency and worker productivity in the sector?*

We wish the Honduran authorities further success in their reform efforts.

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GRAY/20/2191

May 29, 2020

**Statement by Mr. Ronicle and Mr. Chrimes on Honduras
(Preliminary)
Executive Board Meeting 20/65
June 1, 2020**

We thank staff for the informative report, and Mr. Villar and Mr. Tabora Muñoz for their helpful buff statement. We welcome the authorities' continued commitment to their economic reform program. Given the challenging circumstances, new financing needs have emerged, and we acknowledge that adjustment to the economic program will be necessary. **We broadly share staff's assessment and therefore support the completion of the second reviews under the Stand-By Arrangement and the arrangement under the Standby Credit Facility, the requests for augmentation and rephasing of access, and the modification of the performance criteria.**

COVID-19 and the associated response looks set to have significant negative impacts on the Honduran economy, as elsewhere in the region. Performance against key program objectives was largely positive prior to the pandemic, despite Honduras facing a suite of challenges in 2019, and the authorities had treated the arrangements as precautionary. Financing needs since the arrival of COVID-19 have prompted the authorities to draw down the full amount available following completion of the first review. Seeking augmented and rephased access under the parameters of the existing program, with appropriate adjustments, strikes us as preferable to requesting emergency financing, and should help maintain reform momentum. Staff see the financing gap being fully closed for both 2020 and 2021, thanks in part to multilateral support. *Is all of the \$579m of financing from other IFIs catalyzed by and contingent on the Fund-supported program?*

The Fiscal Responsibility Law escape clause has been invoked to allow for targeted fiscal loosening, which makes sense against a backdrop of tax revenue losses and new pandemic-related spending pressures. Monetary and financial sector measures have also played an important part in softening the impact of the pandemic. We are pleased to see progress on strengthening the monetary policy framework. At the time of the first review, we noted that ideally fiscal policy would be anchored by fiscal rules, with monetary policy playing a greater role in managing demand fluctuations. Ultimately, we continue to believe this should be an important medium-term objective.

We understand the case for deferring some structural measures, but we reinforce staff's messages on the importance of advancing the structural reform agenda, including on strengthening tax administration and improving the governance of the public electricity company.

The authorities' continued commitment to governance and anticorruption progress is significant: this remains a key pillar of the program. This has always mattered for economic development and for the people of Honduras. There is an added layer of reputational risk for the Fund as well, now that the arrangements are being drawn down and used for budget support. Transparency and efficiency in the use of government resources will be important. Public procurement practices should set a strong example. We therefore strongly welcome the measures to categorize, track and publish pandemic-related expenditures. The commitment to concurrent audits of such spending by the Court of Accounts in addition to usual ex-post audits is also positive.

We support the adjustments to the performance criteria, but we also share staff's view that continued progress on the reform agenda remains key. Relaxing some targets is appropriate in the current context, but it will be important not to lose sight of the original objectives of the program. Advancing the reform agenda – while keeping distributional concerns in mind and ensuring an adequate response to the pandemic – remains crucial to delivering sustainable growth over the medium term. At the same time, we note the challenges of specifying precise and credible performance criteria amid such elevated uncertainty. *Could staff elaborate on how they intend to ensure an appropriate balance is maintained ahead of the next review, given conjunctural uncertainties, to ensure that performance criteria and indicative targets remain meaningful, realistic and sufficiently ambitious?*

Finally, we appreciate Mr. Villar and Mr. Tabora Muñoz's observation that deepened engagement with the Fund has delivered significant non-financial additionality. The Fund is uniquely placed to offer economic assessments, policy advice and support to its member countries, not just financing. All three of the Fund's core functions – surveillance, financing support and capacity development – will remain critical for the membership as the current crisis evolves.

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GRAY/20/2193

May 29, 2020

**Statement by Mr. Lischinsky and Mr. Corvalan Mendoza on Honduras
(Preliminary)
Executive Board Meeting 20/65
June 1, 2020**

We thank staff for the report and Mr. Villar and Mr. Tabora Munoz for their informative Buff statement. Despite multiple challenges posed by the COVID-19 pandemic, the authorities were able to deliver a strong program performance.

We support the completion of the second reviews under the Stand-By Arrangement (SBA) and Standby Credit Facility (SCF) arrangements and support the request for augmentation of access and rephasing. The authorities' commitment to modernize the policy frameworks and to strengthen the quality of their institutions, which are responsible for delivering public goods, are showing positive results. The country is assessed as having a low risk of debt distress.

Fiscal Responsibility Law (FRL) flexibility is warranted. We take positive note of the authorities' decision to accommodate the external shock with a temporary increase in the NFPS deficit, while mandating a gradual return to the deficit ceiling once the pandemic wanes. The FRL is an important mechanism to deal with sluggish economic performance in extreme situations like this and its gradual return to its target levels would warrant needed resources for investments and social expenditures in the medium term. Domestic and foreign investors' confidence importantly depends on the trajectory of the economy and on the proper function of this mechanism.

We welcome the authorities' progress in reforming the electricity sector. In particular, efforts to strengthen the regulatory body and improve operations and governance in ENEE might become relevant for the economy's medium-term expansion. *We would appreciate staff's further elaboration on reassessing generation contracts by the authorities to increase the electricity supply, in line with the expected evolution of electricity demand in the country.*

The good progress made on the monetary front and in the financial sector is encouraging. A new charter for the central bank was submitted to Congress, as well as the

proposal to address the financial situation in BANADESA. These actions are consistent with the need to redesign the financial structure, and to make it consistent with international best practices. We encourage the authorities to pursue the implementation of recommendations of the Fund's Sector Stability Review (FSSR) once the pandemic subsides. The capacity of the financial system to channel funds for investment and consumption would remain critical to accelerate economic growth in the medium term.

With these comments, we wish the people of Honduras every success in these challenging times.

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GRAY/20/2194

May 29, 2020

**Statement by Mr. El Qorchi and Mr. Belhaj on Honduras
(Preliminary)
Executive Board Meeting 20/65
June 1, 2020**

We thank staff for the well-written reports and Mr. Villar and Mr. Tabora Munoz for their helpful Buff statement. Honduras has shown a strong commitment to the Fund-supported program, as evidenced by the overall satisfactory performance at end-December 2019 despite drought. However, Covid-19 fallout will add to the country's already challenging economic situation and result in additional BoP and fiscal needs. **Therefore, we support Honduras' request for augmentation and rephasing of access under the SBA/SCF arrangements, as well as modification of performance criteria** to face the Covid shock, and we offer the following remarks.

On the response to the pandemic, we welcome the targeted measures taken to address the fragile health system and to support vulnerable families, workers and businesses. We encourage the authorities to be diligent in promoting transparency and accountability in the management of emergency expenditures and welcome the association of the civil society in the monitoring process. A temporary loosening of fiscal policy seems inevitable to meet short-term expenditure needs, and we welcome the authorities' commitment to maintaining fiscal prudence over the medium term and returning to the budget ceiling in 2022. To account for the crisis' impact, we also support the proposed changes of performance criteria in ¶38.

We appreciate the macroeconomic and financial stability achieved so far as well as the encouraging progress on reforms achieved with Fund's technical assistance (¶9). We urge the authorities to maintain this momentum and to resume fiscal and monetary reforms as soon as the pandemic is over. The reforms should aim at strengthening the tax administration, improving revenue mobilization, controlling the wage bill, and further liberalizing the foreign exchange market which would accelerate the elimination of the multiple currency practices.

We take positive note of the initiatives taken by the authorities to improve governance and the institutional framework as well as of the progress in the reform of the national electricity company (ENEE) although it was slowed down by the crisis. We call on the authorities to continue on the path of reform once the crisis abates. To enhance public support for reforms and improve the business climate, we encourage the authorities to step up efforts to fight corruption. In this regard, *we would welcome staff's elaboration on the non-renewal of the OAS- backed Mission to Support the Fight against Corruption and Impunity in Honduras and on the scope of the mandate given to the new anti-corruption unit.*

Finally, *we would appreciate staff elaboration on the factors behind the authorities' hesitancy to request debt service suspension from official bilateral creditors under the Debt Service Suspension Initiative.*

With these remarks, we wish the authorities every success.

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GRAY/20/2195

May 29, 2020

**Joint Statement by Mr. Inderbinen, Mr. Chikada, Mr. Danenov, and Mr. Shimada on
Honduras
(Preliminary)
Executive Board Meeting 20/65
June 1, 2020**

We thank staff for the report and Mr. Villar and Mr. Tabora Munoz for their detailed Buff statement. Despite the challenging economic environment in 2019 due to drought, the authorities remained firmly committed to the program and achieved satisfactory performance – all quantitative and continuous PCs and all but one indicative targets for end of December 2019 were met. However, the country is heavily hit by the COVID-19 pandemic, which has caused severer BOP needs than the ones considered at the time of program approval. Against this backdrop and taking into account Honduras’ strong capacity to repay the Fund, **we support the completion of the second review under the SBA/SCF-supported program as well as the request for augmentation of access, and modification of performance criteria to address the financing needs due to the pandemic.**

We support the temporary and well targeted fiscal loosening to mitigate the pandemic impact under the escape clause of the Fiscal Responsibility Law (FRL). Given the fragile health care system and high poverty rate, it is indispensable to reallocate spending towards the health sector, and provide transfers to protect the large share of the population facing a humanitarian crisis amid the lockdown. We also welcome that the authorities taking measures to guarantee the transparency and accountability of emergency spending through publication on a dedicated webpage and ex-post audit by the Court of Accounts.

In the medium term, creating fiscal space is essential for securing critical spending. We welcome the authorities’ intention to revert to the target of the FRL in 2022, and to continue the efforts to improve tax administration and broaden the tax base. We support the authorities’ continued measures to raise social awareness and build consensus for this agenda, which is essential to swiftly proceed with reforms once the pandemic abates. We also

emphasize the need to address the deteriorating financial situation of the public electricity company (ENEE). *While we welcome the progress in the electricity sector reform, could staff elaborate more on how the current crisis could impact the sector and the reform process, considering the fact that many factors, such as poor management of tariffs, several decrees exempting consumers, electricity losses and past higher oil prices, have led to the current severe situation in ENEE?*

We welcome that the authorities are implementing monetary and financial sector measures to soften the impact of the COVID-19 pandemic. In the medium term, it is important to achieve the BCH's plan to shift the monetary policy framework to inflation targeting with a flexible exchange rate regime. In this regard, it is encouraging that the amendments to the central bank law have been submitted to Congress and the authorities are working on improving the FX market, supported by TA from the Fund. In connection to that, we note that the country maintains MCPs, but we are of the view that they would be no longer relevant under the new policy once it is adopted. *Staff comments are welcome.* Regarding the financial sector, we welcome that the authorities submitted to Congress a proposal to close the public agricultural bank (BANADESA).

Fostering inclusive growth through ongoing governance reforms is crucial to restore social stability and enhance the business climate. In this regard, we welcome the progress achieved to date, such as the creation of a new anti-corruption unit and the submission of a new procurement law to Congress. We encourage the authorities to strengthen the reforms agenda, once the current crisis abates.

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GRAY/20/2199

May 29, 2020

**Statement by Mr. Farber, Ms. Pollard, and Mr. Grohovsky on Honduras
(Preliminary)
Executive Board Meeting 20/65
June 1, 2020**

The COVID-19 pandemic has hit the Honduran economy hard, which was already slowing before the crisis began. The authorities have taken quick action to contain the outbreak and support the economy, including through their strong commitment to the fiscal framework and to maintaining social spending given high poverty levels. We welcome their strong performance under the SBA/SCF in challenging circumstances and support their drawing on the program to fill the financing gap, but also urge the authorities not to lose momentum on crucial reforms to their economic framework and governance structures. We generally agree with the staff assessment and support the proposed decisions, including the proposed augmentation of 65 percent of quota, bringing total access under the program to 155 percent of quota. We focus our remaining comments on a few issues.

We welcome the good progress the Honduran authorities have made in meeting the performance criteria and indicative targets under the program. We also welcome the progress on completing structural benchmarks, although we recognize that the current environment has made those efforts more difficult. While the authorities will naturally need to prioritize their crisis response, we strongly encourage them to maintain their focus on reforming the energy sector and improving governance, which have been major sources of problems for the business environment. We are encouraged by the three new proposed structural benchmarks on valuing ENEE assets, terminating the trust fund on electricity distribution, and completing a study on the costs of operating and maintaining the electricity distribution network. These benchmarks and their future implementation send a strong signal of commitment to reform in this sector. We also welcome the strong governance agenda of the program and the various safeguard commitments, particularly given that some of the augmentation will be used for budget support.

One PC where we have concerns, however, is on the relaxation of the zero limit on new ENEE domestic arrears. We welcome the authorities' commitment to clear these arrears by

year-end and encourage the authorities to resolve this issue as soon as possible. Recognizing the problems with arrears at ENEE to date, we wonder if there were not other options for dealing with the issue. *Further information on the cause of the new arrears and staff comments on the options discussed with the authorities to deal with ENEE's liquidity issues would be welcome.*

Additionally, we can support the temporary approval of the two multiple currency practices, although we concur with staff that these should indeed be temporary and we encourage the authorities to continue with FX market liberalization that should ultimately end these measures. We welcome that MCM has been able to provide TA in this space and hope that it can continue despite the challenging operating environment.

Finally, noting that frontier economies have been priced out of sovereign debt markets, we hope that continued strong implementation of IMF-supported reforms will bring forward the date that markets will once again open for Honduras.

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GRAY/20/2200

May 29, 2020

**Joint Statement by Ms. Levonian, Mr. Doornbosch, Mr. Psalidopoulos, Mr. Etkes, Ms. Edwards, and Ms. Mateus on Honduras
(Preliminary)
Executive Board Meeting 20/65
June 1, 2020**

We thank staff for the well-written report and Mr. Villar and Mr. Tabora Munoz for their informative Buff statement. We commend the authorities for very satisfactory program implementation, which creates space for critical spending and for the continued progress on electricity sector reforms. We support the completion of the second review. Considering the COVID-19 pandemic and ensuing economic consequences, we also support the requests for augmentation and rephrasing of access under the SBA and SCF from SDR 225 million to SDR 387 million, as well as the proposed modification of performance criteria. We offer the following comments:

- **We welcome the authorities' measures to contain the spread of the pandemic and to support the vulnerable population.** Containment measures should be continued. While the infection rate in Honduras is still low (0.5 per 1,000 as of late May 2020), the daily increase of infection is high (average increase of 5.6% since mid-April). The external economic shocks include declines in remittances and tourism as well as tighter financial conditions, which might weigh on debt servicing. We encourage the authorities to consider possible labor market policies as unemployment is correlated with the declining remittances. In a context of high poverty and already rising income inequality, we also encourage the authorities to implement other necessary measures to further shielding the population with lower income from the consequences of the pandemic.

- **We support the authorities' easing monetary policy stance, with the lowering of the policy rate and the provision of additional liquidity.** We encourage Banco

Central de Honduras to continue working on the emergency lending facility to allow its swift activation, in case of need. We consider that the credit guarantee scheme and the measures introduced via the financial system can help alleviate liquidity strains and support the economic recovery. Finally, while the implementation of the FSSR recommendations is warranted, we caution the authorities on the timing to impose the continued phase-in of the liquidity coverage ratio and capital conservation buffer requirements. A procyclical phase-in of such requirements should be avoided.

- **Honduras remains vulnerable to natural disasters.** We note that a severe drought caused by climate change impacted the Honduras economy in 2019. Many developing states are coping with a dynamic set of risks, including from climate change, which requires close attention from the international community. *In addition to the distribution of food supplies, what other actions are the authorities taking to address the impact of climate change on food security, particularly in the rural areas most affected by the drought? How can the authorities make the recovery of the economy greener?*

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GRAY/20/2204

May 29, 2020

**Statement by Mr. Bevilaqua, Mr. Saraiva, and Mr. Coronel on Honduras
(Preliminary)
Executive Board Meeting 20/65
June 1, 2020**

We support the completion of Honduras’s second reviews under the Stand-By Arrangement (SBA) and Standby Credit Facility (SCF) as well as the request for augmentation and rephasing of access. We thank staff for the report and Messrs. Villar and Tabora-Muñoz for their comprehensive statement. Program performance remains on track, despite the delays and disruptions caused by the COVID-19 pandemic. The difficult circumstances justify the request for modification and scheduling of several performance criteria (PC) and indicative targets (IT). However, the authorities have made substantial progress on reforms, including on key issues of governance and the electricity sector. The augmentation of access helps to cover the external financing gap and support the authorities’ efforts to strengthen the public health and economic policy responses to the severe consequences of the pandemic.

We commend the authorities for the timely measures to contain the COVID-19 pandemic and cope with its economic fallout. In this regard, we appreciate the detailed account of the government’s policy responses on public health, fiscal, and monetary fronts, provided by Messrs. Villar and Tabora. The authorities have opted for a strict and early lockdown, acting swiftly and decisively to contain the spread of the virus. Moreover, in the case of Honduras and Central America at large, climate-change related natural disasters are risk factors with high probability and high impact, particularly during vulnerable times. Accordingly, the authorities must stand ready to expand the response should the forthcoming season produces droughts or floods, as has been frequently the case during the last decade.

We welcome the authorities’ measures guaranteeing transparency and accountability on managing Fund resources. This fits well with the ongoing reforms aimed at strengthening domestic institutions to foster the fight against corruption and prevent misappropriation of public resources. The authorities have devised a way to track, monitor, and make public, all pandemic related expenditure through the budget. They have also committed to publish post-crisis reports while also engaging with the Courts of Accounts.

The monetary and financial sector measures taken by the authorities have been appropriate and have managed to preserve financial stability. The central bank has focused on monetary easing by lowering the policy rate and injecting liquidity, including temporary debt service relief for the most affected sectors, and a new credit guarantee to foster credit with the support of the Central American Bank for Economic Integration (CABEI). Additionally, Honduras's public development bank is providing targeted support to the agriculture, tourism, and housing sectors. Thus far, the impact of the pandemic on the financial sector has been limited, as bank liquidity, non-performing loans, profitability and capital adequacy have remained adequate.

In closing, we'd like to highlight the commitment demonstrated by the authorities by moving forward with the program and its reform agenda, at this current critical juncture. That said, the authorities and staff should remain attentive to how challenging delivering benchmarks and targets could become under the difficult conditions posed by the pandemic, which may warrant further adjustments in the program. We take note that the authorities have decided to draw on the available resources after the first review of the program and are contemplating a debt service suspension request from official bilateral creditors, as envisaged in the G20 Debt Service Suspension Initiative. We look forward to the next review and wish the authorities success on the remaining period of the program and on coping with the consequences of the COVID-19 pandemic.

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GRAY/20/2206

May 29, 2020

**Statement by Mr. Palei and Mr. Shestakov on Honduras
(Preliminary)
Executive Board Meeting 20/65
June 1, 2020**

1. We thank staff for the insightful report and Mr. Villar and Mr. Tabora Munoz for their informative Buff statement. The COVID-19 pandemic took a toll on the Honduran economy. Honduras has fragile healthcare system, which aggravates the risks of the virus spread. Moreover, the country was affected by the adverse global spillovers, including lower external demand, reduced tourism arrivals and shrinking remittances. In addition, a severe drought additionally suppresses economic activity. The economic downturn will open significant and urgent fiscal financing gaps and increase balance of payments needs. Given the severity of the global crisis and major spillovers to Honduras, we support the augmentation and rephasing of access from SDR 224.8 million (90 percent of quota) to SDR 387.2 million (155 percent of quota) under the SCF/SBA arrangement. We also concur with the use of resources for budget support. We find it reassuring that, according to staff, the Fund's support will help to catalyze additional financing from multilateral development banks, and disbursements from the IADB, the CABEI, and the World Bank will completely close the BOP financing gap for 2020.
2. We commend the Honduran authorities for the strong performance under the SBA and take positive note on the fact that all end-December 2019 PCs and all but one ITs were met. The authorities made a significant progress on reforms, reorganizing the assistance to the agriculture sector (closing the public agricultural bank BANADESA and creating a new agency) and preparing draft securities market law and a new public procurement law. We also commend the authorities for streamlining the PFM regulations, starting in the 2021 budget, in line with FAD recommendations.
3. The Honduran authorities responded swiftly to mitigate the impact of the pandemic, including closing the border and declaring a national curfew, reallocating spending towards the health sector, and providing transfers to the vulnerable population. The BCH reduced its policy rate by 100 basis points, which is an appropriate accommodation, given that the inflation in 2019 was at the midpoint of the target band amid falling inflation expectations. Rescheduling debt service and subsidized loans to SMEs and the agricultural

sector is also a welcome measure to keep the economy afloat. *How will the support to the agricultural sector be administered, given the high informality rate in Honduras? Has there been any success in the reduction of informality from the authorities' job creation and entrepreneurship funding programs? Also, we would be interested in the coverage of the social safety net, as well as additional safeguards to monitor the quality of additional fiscal expenditures aimed at addressing the COVID-19 effects.*

4. Staff's debt sustainability analysis indicates that Honduras has a low risk of external and overall debt distress. *We would appreciate it if staff could provide additional information on the debt composition and debt service payments to multilateral, bilateral, and commercial creditors in 2020-22. In particular, we are interested in more granular details on the situation with commercial creditors and how the Fund's financing compares with commercial debt repayments.*

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GRAY/20/2210

May 29, 2020

**Statement by Mr. Andrianarivelo and Mr. Nguema-Affane on Honduras
(Preliminary)
Executive Board Meeting 20/65
June 1, 2020**

We thank staff for the set of interesting papers and Mr. Villar and Mr. Tabora Munoz for the helpful Buff statement.

We commend the Honduran authorities for their macroeconomic performance in 2019, with moderate growth, subdued inflation, low risk of debt distress for both public external debt and overall debt, and high level of international reserves. In this context, implementation of the Fund-supported program was satisfactory with all end-December 2019 PCs, continuous PCs, and all but one ITs were met. Progress has been also made on the reform agenda, notably with regard to governance and the electricity sector. The COVID-19 pandemic is severely affecting Honduras mainly through a sharp decline in external demand, remittances and capital flows. This is adding challenges to program implementation in 2020 as the pandemic is expected to cause economic contraction and create large external and fiscal financing needs. We welcome the authorities' swift response to strengthen the health system and mitigate the impact of the pandemic as well as their continued commitment to the objectives of the program in a more challenging environment. Against this background, **we support the authorities' request for the completion of the 2nd review under the SBA/SCF arrangements and their requests for augmentation and rephrasing of access and modification of performance criteria.**

A loosening of the fiscal stance is warranted to accommodate crisis-related measures but should be reversed when the crisis abates. We find appropriate the activation of the escape clause under the Fiscal Responsibility Law (FRL) and the reallocation of resources to support higher health spending and the groups the most affected by the pandemic. We particularly welcome the actions taken to target the most vulnerable population through cash transfers and food supplies. *Could staff elaborate on the existing social protection schemes and their effectiveness?* We commend the authorities for the measures taken to ensure transparency and accountability of the resources allocated to the emergency situation and

welcome their commitment to preserve fiscal and debt sustainability during the pandemic. Once the crisis subsides, a contractionary fiscal policy, through notably a reversal of temporary pandemic-related fiscal measures, should start to return to the FRL fiscal target of 1 percent of GDP. It should focus on mobilizing domestic revenue, which is being adversely affected by the strong mitigation measures. Pursuing the reforms of the tax administration will be essential in this regard.

Monetary and prudential policies have been adequately relaxed to cope with the pandemic, while safeguarding financial stability. The monetary easing as well as the relaxation of prudential and regulatory measures to swiftly provide enough liquidity to the banking system and mitigate the impact of the pandemic on individuals and corporations affected are laudable. The creation of the credit guarantee fund to support economic recovery through foster credit to micro, small and medium enterprises is particularly noteworthy. We welcome the central bank's commitment to pursue the strengthening of the monetary policy framework and the transition to a more flexible exchange rate while advancing the development of the financial sector.

Progress on the structural front should continue. While we note that the pandemic could delay the implementation of structural reforms, we would like to encourage the authorities to sustain the ongoing efforts to strengthen public financial management which will be critical to improve governance and spending efficiency and preserve fiscal sustainability. Likewise, the authorities should press ahead with the reform of the electricity sector to improve the business environment while lessening the burden on public finances. Pursuing the enhancement of anti-corruption and AML/CFT frameworks is also warranted.

With these remarks, we wish the Honduran authorities and people, success in their endeavors during these challenging times.

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GRAY/20/2211

May 29, 2020

**Statement by Mr. Bhalla and Ms. Indraratna on Honduras
(Preliminary)
Executive Board Meeting 20/65
June 1, 2020**

1. We thank staff for the comprehensive set of reports and Mr. Villar and Mr. Tabora Munoz for the useful buff statement. We concur with the staff appraisal and underscore some country specific issues for emphasis only.
2. Honduras is currently under a Fund financed SBA and SCF program, for which the second review is under consideration. However, the COVID-19 pandemic has had a severe impact on the Honduran economy with adverse consequences for growth, which is expected to significantly contract in 2020, and substantial financing needs for the external and fiscal sectors. As the SBA and SCF arrangements are already in place, the authorities have drawn on available Fund resources in March 2020 for budgetary support to deal with the policy response to the crisis. However, additional external and budgetary financing needs arising from the pandemic have necessitated the authorities to request an augmentation and rephasing of access to the SBA and SCF arrangements with modifications to the performance criteria. We note that the program remains on track and performance has been strong as the authorities have successfully met all end-December 2019 PCs, continuous PCs and all but one indicative target. We take positive note of the substantial progress made on reforms with the completion of several structural benchmarks and progress on others. **We commend the authorities for their ownership of the program and the steadfast commitment to the reform agenda and support the completion of the second review under the SBA and SCF arrangements. We also support the authorities' request for the augmentation and rephasing of access to the SBA and SCF arrangements with modifications to the performance criteria as adjustments are needed to allow an adequate policy response to the pandemic.**
3. We commend the authorities for the swift and strong response to the COVID-19 shock. We welcome the focus on the health sector and targeted and temporary transfers to vulnerable segments of the population during the pandemic period. We also welcome steps taken by the Central Bank to ease liquidity conditions and maintain the smooth functioning of markets and note positively the timebound credit relief measures extended by financial institutions.

4. We note that Honduras remains at low risk of debt distress for external as well as total public debt, supported by adherence to the Fiscal Responsibility Law (FRL). We are encouraged that the authorities are committed to upholding the Fiscal Responsibility Law (FRL) as it provides an anchor for a sound fiscal position. We take note of the staff view that despite the huge response to the COVID-19 crisis, the authorities' proven track record of compliance to the FRL will not jeopardize debt sustainability in the medium term. In this regard, we take note of the authorities' commitment in the near term to maintain tax revenues by improving tax administration and protect critical spending by restraining non-priority current expenditures. We note that the authorities have already identified a significant quantum of nonpriority expenditure to partly finance emergency spending of the pandemic. Going forward, we concur with the staff view that reducing tax exemptions to broaden the tax base, rationalizing the wage bill and public finance management reforms are necessary to create fiscal space for much needed investments. Meanwhile, continuing with reforms in the electricity sector is also essential to create more fiscal space for budgetary operations.
5. We welcome the recent progress made by the authorities on the monetary policy framework and the new initiatives taken in this area. We note the advances made in monetary and foreign exchange operations and welcome the relaxation of the foreign exchange surrender requirement, which will deepen the forex market. We welcome the technical assistance from the Fund to further enhance the monetary policy framework and support the transition to a more flexible exchange rate regime.
6. Governance reforms remain critical to achieving sustainable inclusive growth. We commend the authorities for the numerous efforts taken to strengthen governance and fight corruption. We welcome measures taken to strengthen the institutional framework of the central bank, the treasury and public companies. Moreover, improvements to the public procurement process, reforms to the PPP framework and changes to the public officials' asset declaration system will help in improving the business climate and fostering inclusive growth.
7. With these comments, we wish the authorities success in their future endeavours.

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GRAY/20/2216

May 29, 2020

**Statement by Mr. Buisse, Mr. Rozan, and Ms. Albert on Honduras
(Preliminary)
Executive Board Meeting 20/65
June 1, 2020**

We thank staff for their detailed report, as well as Mr. Villar and Mr. Tabora Munoz for their informative buff statement.

We support the request of the authorities for a rephrasing and augmentation of combined access under the SBA and SCF arrangement, as well as the drawing of the available resources. Until now the instruments were treated as precautionary, but the Covid-19 crisis will have a considerable negative impact and warrants some additional financial support to face external financing pressures. Honduras has been committed to the program, and we commend the authorities for the completion of the first review and welcome that all end-December 2019 quantitative performance criteria (PC), continuous PCs and all but one Indicative Targets for the second review have been met. We also welcome the commitment of the authorities to guarantee the transparency and accountability of the emergency spending during the pandemic.

We welcome the measures adopted by the authorities to tackle the crisis to protect the most vulnerable. The use of the FRL escape clause is warranted, and the DSA remains at low risk of debt distress. As 60 percent of households are living under the poverty line, social protection measures are critical. We thus strongly welcome the important focus of the authorities to protect the most vulnerable and limit the increasing of poverty, and in particular those dedicated to the informal workers, as informality is one of the largest in Latin America. We note that the authorities are currently considering whether to request debt suspension from official bilateral creditors, at a time when authorities are running into fiscal constraints related to the crisis. *Could staff elaborate on the authorities' current reasoning, and explain what could be the potential financial impact of the DSSI for the country?* We also note the country should refinance a US\$500 million Eurobond due by late 2020. *Could staff indicate what is the strategy of the authorities for this refinancing operation?*

Finally, we encourage the authorities to pursue their structural reforms. The streamlining of tax exemptions is a top priority and could help provide additional fiscal space. We also encourage the authorities to continue to move towards a more flexible exchange rate regime with support from MCM TA, pursue their efforts to improve the AML/CFT framework and to fight corruption, as well as building resilience against natural

disasters. Finally, we encourage the authorities to address more quickly the challenges in the electricity sector. In this sense, we welcome the new structural benchmarks dedicated to the electricity sector reforms.

Honduras

Responses to Technical Questions Posed by Executive Directors in Advance of
EBM/20/65 — June 1, 2020

Staff's responses to technical and factual questions are below. Broader policy questions in the areas of financing (incl. the G20 debt service suspension initiative), electricity sector reforms, governance issues, and program issues will be addressed in staff's oral intervention at the Board meeting.

Outlook/Risks

1. ***In addition to the distribution of food supplies, what other actions are the authorities taking to address the impact of climate change on food security, particularly in the rural areas most affected by the drought? How can the authorities make the recovery of the economy greener?***
 - Droughts, exacerbated by climate change, affect in particular small farmers who depend on rainfed agriculture surrounding the Dry Corridor area. The recurrence of these droughts has been identified as a key driver of migration.
 - The authorities have introduced an in-kind benefit (bono cafetalero) for coffee producers—coffee is the main export and largest agricultural product—targeting 91,000 coffee producers (87 percent of total). The bono provides 56 metric tons of fertilizer per each producer.
 - For the first time, resources from the UN Green Fund are funding the budget in 2020—tied to targets in reforestation. The authorities also plan to tap the Green Fund for the 2021 budget.

2. ***Could staff elaborate on how they intend to ensure an appropriate balance is maintained ahead of the next review, given conjunctural uncertainties, to ensure that performance criteria and indicative targets remain meaningful, realistic and sufficiently ambitious?***
 - Staff will respond to this question during the Board meeting.

Fiscal Policy

3. ***Nevertheless, could staff estimate the near-term gains in revenue envelope to the authorities from engaging the private sector in collaboration with the legislature?***

- Our projections do not assume any immediate gains from these revenue administration measures because there is substantial uncertainty. Yet, even in the near-term, these measures would be critical to make revenue administration more efficient and agile in Honduras. First, the transfer of management of tax exemptions from SEFIN to SAR could help eliminate abuses in the incentive regimes which could amount to, at least, 0.1 percent of GDP per year. There is uncertainty on the timing of materialization of these gains as some taxpayers could appeal against the removal of tax exemptions, which would be followed by the due process in the corresponding tribunals. Second, the electronic notification per se may not yield revenue gains directly, but it would be an extremely useful tool to speed up processes, improve efficiency, and facilitate the response to taxpayers' needs. For example, the electronic notification would accelerate the timeline of audits. It would also allow the revenue administration agency to quickly notify taxpayers of inconsistencies between their tax declarations and information provided by third parties, a low-cost measure that has been found very effective in other countries (Carrillo et. al 2017; Ortega and Scartascini 2015).
4. ***Once the economy re-opens and these pandemic-related closures are reversed, will there be space to cut other non-priority spending to create space for priority spending?***
- Yes, there would be some space for further cuts in non-priority spending once the economy re-opens. Our projections already incorporate such cuts in order to protect priority spending while adequately responding to the crisis.

Financing and debt

5. **We note that the authorities are also considering whether to request debt service suspension from official bilateral creditors under the Debt Service Suspension Initiative. Could staff please elaborate on the perceived trade-offs in these considerations and the reasons for the authorities' hesitancy?**
- Staff will respond to this question during the Board meeting.
6. **Finally, we would appreciate staff elaboration on the factors behind the authorities' hesitancy to request debt service suspension from official bilateral creditors under the Debt Service Suspension Initiative.**
- Staff will respond to this question during the Board meeting.
7. **Could staff elaborate on the authorities' current reasoning, and explain what could be the potential financial impact of the DSSI for the country?**
- Staff will respond to this question during the Board meeting.

8. *We note that the authorities are considering participation in the G20 debt service suspension initiative and would welcome staff's comments on the likely liquidity support Honduras would accrue, whether Honduras already meets the public debt disclosure requirements of the DSSI and the likelihood of having an appropriate monitoring framework in place.*

- Honduras' debt to official bilateral creditors is small, at 3.5 percent of GDP (end-2019) and the debt service due this year is also relatively small. Current debt coverage is reasonably good, but not yet in line with GFSM2014. The authorities are working with Fund TA on their debt statistics and expect to fully transition to GFSM 2014 by early 2021.
- The authorities have taken measures to strengthen transparency and accountability of emergency spending during the pandemic, including a labeling mechanism to categorize and track all pandemic-related expenditure in the budget. For details, please see response to question 17.
- Staff will further comment on the DSSI during the Board meeting.

9. *Can staff update on whether Honduras' upcoming graduation from PRGT would affect its ability to seek concessional loans from multilaterals?*

- While different institutions have different rules to grant concessional financing, we do acknowledge the importance of access to the Poverty Reduction and Growth Facility to facilitate disbursements under concessional facilities. As you may have noticed in the staff report, this is playing an important part in the financing of this emergency. The role played by multilateral institutions has proved fundamental in the current environment to aid a good performer like Honduras, which would have not needed this support in the absence of the pandemic—in fact, as you know, the Fund program was treated as precautionary until March.

10. *Could staff give an update on financing prospects in the case of a more profound negative impact of the current crisis?*

- Staff will respond to this question during the Board meeting.

11. *We further took note that staff foresees increased refinancing risks for the end of the year. Could staff elaborate on specific contingency plans to address these risks?*

- Staff will respond to this question during the Board meeting.

12. *Is all of the \$579m of financing from other IFIs catalyzed by and contingent on the Fund-supported program?*

- The Fund is indeed helping catalyze other financing. Some financing is explicitly tied to the program, such as part of the budget support given by the Inter-American Development Bank. Financing from other development partners is not tied explicitly, but the program is regarded as an anchor for policies and reforms. In this connection, a significant amount of new financing—US\$500 million by CABEL in 2020 and 2021, and potentially another US\$250 million in 2022—is conditional on reforms in the electricity sector, which we have been supporting from the onset.

13. We also note the country should refinance a US\$500 million Eurobond due by late 2020. Could staff indicate what is the strategy of the authorities for this refinancing operation?

- Staff will respond to this question during the Board meeting.

14. We would appreciate it if staff could provide additional information on the debt composition and debt service payments to multilateral, bilateral, and commercial creditors in 2020-22. In particular, we are interested in more granular details on the situation with commercial creditors and how the Fund's financing compares with commercial debt repayments.

- In terms of stocks as of end-2019, 64 percent of the nonfinancial public sector external debt was owed to multilaterals, 26 percent to commercial creditors, and the remainder to bilateral creditors. Debt service payments in 2020-22 amount to US\$ 2.5 billion, including US\$ 1.1 billion in debt service to multilaterals, US\$ 0.1 billion to bilateral creditors, and US\$ 1.3 billion to commercial creditors (which includes a US\$ 0.5 billion Eurobond maturing this year).
- Fund financing is projected to amount to US\$ 530 million in 2020-21. Repayments to the Fund will take place after 2022.

Social policies

15. We welcome the authorities' substantial spending measures on mitigating the economic, social, and humanitarian impact of the pandemic, including through targeted support to families, workers, and firms and wonder if families just above the poverty line would also benefit from these targeted measures.

- Yes, non-poor families could also benefit from some of these measures. For example, the temporary unemployment benefits could help non-poor workers suspended due to the COVID-19 crisis.

16. Could staff elaborate on the existing social protection schemes and their effectiveness?

17. How will the support to the agricultural sector be administered, given the high informality rate in Honduras? Has there been any success in the reduction of informality from the authorities' job creation and entrepreneurship funding programs? Also, we would be interested in the coverage of the social safety net, as well as additional safeguards to monitor the quality of additional fiscal expenditures aimed at addressing the COVID-19 effects.

- Support to the agricultural sector is mostly managed by the Agriculture ministry and by the public development bank in the case of *Agrocrédito 8.7* (a subsidized loan program).
- The authorities have been implementing a series of programs aiming at fostering formal job creation, such as:
 - *Con Chamba Vivís Mejor*, which subsidizes 50 percent of wages during 3 months for unemployed workers, benefiting 80,000 people.
 - *Chamba Comunitaria*, a program of temporary work (three months maximum) that benefits 90,000 people.
 - *Chamba Joven*, which subsidizes 50 percent of wages during 5 months for unemployed young workers (18-30 years). It benefits 27,000 people.
- A recent World Bank study (Michel and Walker, 2019) found that these programs are well-designed and effective to foster the development of formal employment. They are, however, small given that informality is widespread in Honduras, affecting the majority of the 4.5 million workers in the labor force.
- The social safety net comprises a large list of social programs, articulated under the umbrella of the “Vida Mejor” program and funded by 3 points of the VAT. The most important programs are:

Program	Beneficiaries	Budget (% GDP)
Bono Vida Mejor	300,000 families	0.5
Vivienda saludable	682,870 families	0.7
Seguridad alimentaria	569,000 elderly and 1.3 million children	0.6
Guías de familia	58,350 people	0.5
Ingresos complementarios	32,000 people	0.3

The Conditional Cash Transfer program “*Bono Vida Mejor*” is the most known and studied program, benefiting about 300,000 families with transfers for about US\$400 (900,000 families currently live in extreme poverty). There is solid evidence that this program has been successful in improving long-term outcomes for participating families (Molina Millán and others, 2019)

- The authorities have taken measures to strengthen transparency and accountability of emergency spending during the pandemic:
 - In addition to its ex-post auditing, the Court of Accounts is conducting concurrent audits of the emergency healthcare and social spending. The Court

of Accounts will also publish ex-post audits of spending related to the pandemic.

- A labeling mechanism is being implemented to categorize and track all pandemic-related expenditure in the budget. This facilitates the monitoring and publishing of this spending—including through oversight by the civil society—which is taking place in real time in a dedicated web page (www.sefin.gov.hk/covid-19). Other webpages set up by the Institute for Access to Public Information and by the public procurement agency provide additional detailed information, including publication of emergency procurement’s contracts, details of product pricing, and historical and international comparisons for these prices.
- The authorities are also committed to:
 - Publishing related procurement contracts, including names of companies awarded.
 - Publishing post-crisis reports of pandemic-related spending as policy responses to the crisis continue to be implemented.

Monetary and Financial Sector

18. Staff’s comments on whether current supervisory action is in line with best practice would be appreciated.

- Given the current state of high uncertainty over the impact of the pandemic on repayment capacity of borrowers, the authorities have taken the approach of closely monitoring loans participating in the 3-month debt service moratoria through a special classification, while not requiring additional provisioning until loans are restructured or released, the latest by October. This is consistent with other temporary measures to support liquidity in the banking system during the height of the pandemic. While not best practice, it seems a reasonable approach given the emergency and the authorities’ supervisory track-record.

19. Can staff comment on the progress on the investment policy framework of public pension funds.

- The last broad-based adjustment to these frameworks reduced the share of the investment portfolio that could be allotted for provision of consumer loans to affiliates was reduced from 50 to 35 percent—a step in the right direction. This share could be increased by 5 percent if NPLs of these loans are below 3 percent of the loan book. As these loans are full-recourse, the 3 percent condition is usually fulfilled.
- In August 2019, a policy framework for the newly-created private pension funds—introduced in 2015 with the social protection framework law—was issued by the Bank Superintendency.

- Further changes to the public pension funds' policy framework continue to be assessed by the authorities. In the meantime, pension fund portfolios are being monitored closely.

20. *A strong and independent central bank backed by solid legislation is an important anchor for good policies and we would be interested to hear staff elaborate on the key elements of this law, and if there are lessons to be learned for other countries?*

- The new central bank charter was elaborated with extensive support from LEG and the main elements are:
 - Establishing price stability as the primary objective and financial stability as the secondary objective. This will facilitate transition to a fully-fledged inflation targeting scheme.
 - Limiting direct and indirect credit to the public sector. This limits the provision of credit to the government and other public entities—particularly the development bank—using SPVs or other financial vehicles, also, preventing the development of quasi-fiscal operations.
 - Strengthening the governance structure through separation of executive management and oversight. The draft BCH Law establishes a Board with a majority of non-executive members—three, charged with oversight over executive management and policy formulation. Executive management will be conducted by the governor and the deputy governor.
 - Improving the process to appoint and dismiss Board members. The draft BCH Law establishes a double veto procedure for appointment and dismissal (President of the Republic appoints/dismisses upon proposal of the Board), which is considered good practice.

21. *In connection to that, we note that the country maintains MCPs, but we are of the view that they would be no longer relevant under the new policy once it is adopted. Staff comments are welcome.*

- Staff notes that the two current MCP findings are based on the potential for spreads in excess of two percent to emerge. While Executive Directors broadly endorsed key elements of the new MCP policy when they considered the paper on Initial Considerations for the MCP Policy Reform, a new MCP policy has not yet been adopted by the Executive Board. Once a new MCP policy is adopted, staff will reassess the measures giving rise to Honduras's MCPs and if these measures no longer constitute MCPs under the new policy, these MCPs will be considered eliminated.

Electricity Sector

22. *We would appreciate staff's further elaboration on reassessing generation contracts by the authorities to increase the electricity supply, in line with the expected evolution of electricity demand in the country.*

- Staff will respond to this question during the Board meeting.

23. *While we welcome the progress in the electricity sector reform, could staff elaborate more on how the current crisis could impact the sector and the reform process, considering the fact that many factors, such as poor management of tariffs, several decrees exempting consumers, electricity losses and past higher oil prices, have led to the current severe situation in ENEE?*

- Staff will respond to this question during the Board meeting.

24. *Recognizing the problems with arrears at ENEE to date, we wonder if there were not other options for dealing with the issue. Further information on the cause of the new arrears and staff comments on the options discussed with the authorities to deal with ENEE's liquidity issues would be welcome.*

- Staff will respond to this question during the Board meeting.

25. *We note that the authorities missed the target on public electricity company's operational ratio, since the court ordered the electricity company to rehire the workers previously dismissed. Can staff shed light on the reasoning behind the court's order and what that means for operational efficiency and worker productivity in the sector?*

- ENEE's labor force was excessively large and layoffs were deemed necessary. The number of employees was reduced from 4,916 in 2013 to 2,099 in 2016. The courts found that some of those dismissals did not follow due process, deeming them unlawful. The courts then ordered ENEE to rehire those workers and pay them all the wages accrued since they were fired, leading to a large increase in the company's wage bill in 2019. However, most of those workers chose not to return to work and applied for retirement immediately, so that the number of workers in the company increased by only 65 during 2019. We expect more court sentences along these lines for 2020, again raising the wage bill for the year but with limited impact on employment. Thus, we do not expect actual worker productivity to deteriorate substantially in ENEE.

Governance and Transparency

26. In this regard, we would welcome staff's elaboration on the non-renewal of the OAS-backed Mission to Support the Fight against Corruption and Impunity in Honduras and on the scope of the mandate given to the new anti-corruption unit.

- Staff welcomes the establishment of the new anti-corruption unit (UFERCO), created under the regular structure of the public prosecutor's office. UFERCO conserves the same mandate, management, and personnel as the UFECIF—the anti-corruption unit that was working closely with the MACCIH. UFERCO's stated mandate is to prosecute high profile cases of corruption of public officials, including regarding lines of investigation initiated by the MACCIH, using the best practices acquired during the period of cooperation with the MACCIH. The unit responds directly to the attorney general, who was reappointed to a second term in June 2018 with strong support from the international community for his achievements in the fight against organized crime and corruption in the country.
- Staff will further comment on this question during the Board meeting.

27. We positively note the plans to create a beneficial ownership register and would welcome staff's comments on the envisaged timeline to publish the list of beneficial owners.

- For the registry of beneficial ownership, the first step is to send the reform to congress (September 2020 SB). The timeline for publication of the list of beneficiaries will depend on the timing of congressional approval, and the time needed to implement the approved changes, mainly conversion of any existing bearer shares into registered ones, and work on the update of the registry in line with new regulations.

28. We note that the report states that steps are being taken to align the internal audit function with leading international practices, but until this work is concluded, an independent ex-post audit of crisis-related spending could be considered. We would welcome staff's comments.

- The reference in paragraph 40 of the staff report to align internal audits function with international leading practices is associated with the Central Bank's internal audits.
- As for crisis-related spending, the Court of Accounts, an independent institution, is already conducting concurrent audits of all crisis-related spending and publishing online the preliminary results. The Court of Accounts will conduct ex post audits, as mandated by law, and it is committed to publish them expeditiously. In addition, the authorities have invited third parties to monitor all crisis-related spending. Civil society organizations, such as ASJ (the local branch of Transparency International),

FONAC, COHEP, COST, and different churches, have indeed participated in overseeing the delivery of food supplies and purchases of medical equipment. ASJ has already published preliminary reports of the procurement of medical supplies for the emergency. Finally, the Ministry of Finance has created a dedicated website to track all crisis-related spending and it is committed to publish post-crisis reports, while the Transparency Institute is publishing crisis-related documentation, including procurement contracts.

CONSTITUENCY CODES

OEDAE

Angola, Botswana, Burundi, Eritrea, Eswatini, Ethiopia, The Gambia, Kenya, Lesotho, Liberia, Malawi, Mozambique, Namibia, Nigeria, Sierra Leone, Somalia, South Africa, South Sudan, Sudan, Tanzania, Uganda, Zambia, and Zimbabwe

OEDAF

Benin, Burkina Faso, Cameroon, Central African Republic, Chad, Comoros, Democratic Republic of Congo, Republic of Congo, Côte d'Ivoire, Djibouti, Equatorial Guinea, Gabon, Guinea, Guinea Bissau, Madagascar, Mali, Mauritania, Mauritius, Niger, Rwanda, São Tomé & Príncipe, Senegal, Togo

OEDAG

Argentina, Bolivia, Chile, Paraguay, Peru, and Uruguay

OEDAP

Australia, Kiribati, Korea, Marshall Islands, Federated States of Micronesia, Mongolia, Nauru, New Zealand, Palau, Papua New Guinea, Samoa, Seychelles, Solomon Islands, Tuvalu, and Vanuatu

OEDBR

Brazil, Cabo Verde, Dominican Republic, Ecuador, Guyana, Haiti, Nicaragua, Panama, Suriname, Timor-Leste, and Trinidad and Tobago

OEDCC

China

OEDCE

Colombia, Costa Rica, El Salvador, Guatemala, Honduras, Mexico, Spain, and República Bolivariana de Venezuela

OEDCO

Antigua and Barbuda, The Bahamas, Barbados, Belize, Canada, Dominica, Grenada, Ireland, Jamaica, St. Kitts and Nevis, St. Lucia, and St. Vincent and the Grenadines

OEDEC

Austria, Belarus, Czech Republic, Hungary, Kosovo, Slovak Republic, Slovenia, and Turkey

OEDFF

France

OEDGR

Germany

OEDIN

Bangladesh, Bhutan, India, and Sri Lanka

OEDIT

Albania, Greece, Italy, Malta, Portugal, and San Marino

OEDJA

Japan

OEDMD

Afghanistan, Algeria, Ghana, Islamic Republic of Iran, Libya, Morocco, Pakistan, and Tunisia

OEDMI

Bahrain, Egypt, Iraq, Jordan, Kuwait, Lebanon, Maldives, Oman, Qatar, United Arab Emirates, and Yemen

OEDNE

Armenia, Belgium, Bosnia and Herzegovina, Bulgaria, Croatia, Cyprus, Georgia, Israel, Luxembourg, Moldova, Montenegro, Netherlands, Republic of North Macedonia, Romania, and Ukraine

OEDNO

Denmark, Estonia, Finland, Iceland, Latvia, Lithuania, Norway, and Sweden

OEDRU

Russian Federation and Syrian Arab Republic

OEDSA

Saudi Arabia

OEDST

Brunei Darussalam, Cambodia, Fiji, Indonesia, Lao People's Democratic Republic, Malaysia, Myanmar, Nepal, Philippines, Singapore, Thailand, Tonga, and Vietnam

OEDSZ

Azerbaijan, Kazakhstan, Kyrgyz Republic, Poland, Serbia, Switzerland, Tajikistan, Turkmenistan, and Uzbekistan

OEDUK

United Kingdom

OEDUS

United States