**FOR AGENDA**

EBS/82/179

CONFIDENTIAL

October 7, 1982

To: Members of the Executive Board

From: The Acting Secretary

Subject: Honduras - Request for Stand-By Arrangement

Attached for consideration by the Executive Directors is a request from Honduras for a stand-by arrangement equivalent to SDR 76.5 million. A draft decision appears on page 16.

This subject, together with the staff report for the 1982 Article IV consultation with Honduras (SM/82/151, 7/28/82), will be brought to the agenda for discussion on a date to be announced.

Att: (1)

CONFIDENTIAL

INTERNATIONAL MONETARY FUND

HONDURAS

Request for Stand-By Arrangement

Prepared by the Western Hemisphere Department 1/

(In consultation with the Exchange and Trade Relations Department, the Fiscal Affairs Department, the Legal Department, and the Treasurer's Department)

Approved by Carlos E. Sanson and Manuel Guitian

October 5, 1982

## I. Introduction

In the attached letter dated October 5, 1982, the President of the Central Bank and the Minister of Finance of Honduras request a stand-by arrangement for the period through December 1983 in an amount equivalent to SDR 76.5 million (150 per cent of Honduras' quota) from ordinary (about SDR 31.9 million) and enlarged access resources (SDR 44.6 million). This request is expected to be considered simultaneously with a request for a purchase under the compensatory financing facility of SDR 23.1 million, or 45.3 per cent of Honduras' quota, that would bring outstanding purchases by Honduras under that facility to 91 per cent of Honduras' quota.

Purchases under the requested stand-by arrangement would not exceed the equivalent of SDR 15.3 million until February 15, 1983; the equivalent of SDR 30.6 million until May 15, 1983; the equivalent of SDR 45.9 million until August 15, 1983; and the equivalent of SDR 61.2 million until December 15, 1983. A waiver of the limitations in Article V, Section 3(b)(iii) of the Articles of Agreement is being proposed. The Fund's holdings of lempiras as of September 30, 1982 stood at 209.2 per cent of Honduras' quota of SDR 51 million; 45.7 per cent of these holdings represent a purchase under the compensatory financing facility; 25 per cent within the first credit tranche; and 38.5 per cent under the extended facility. Full utilization of the requested stand-by arrangement and the requested purchase under the compensatory financing facility would raise the Fund's holdings of lempiras to 404.5 per cent of quota (Table 1).

1/ A staff team consisting of Mr. Elson (Head), Mr. Cardemil (both WHD), Ms. Swiderski (EP-ETR), and Ms. Rowles (Secretary-WHD) visited Tegucigalpa during the period August 4-25, 1982 to hold the discussions which provided the basis for this paper. The mission was assisted by Mr. Jafri, the Fund's resident representative in Honduras.

Table 1. Honduras: Projection of the IMF Position

| | Outstanding 10/31/82 | 1982 Nov.-Dec. | 1983 Jan.-March | April-June | July-Sept. | Oct.-Dec. | Outstanding 12/31/83 |
|---|---|---|---|---|---|---|---|
| | | | (In millions of SDRs) | | | | |
| Purchases 1/ | 55.7 | 38.4 | 15.3 | 15.3 | 15.3 | 15.3 | 155.3 |
| Credit tranches | 12.8 | 15.3 | 15.3 | 15.3 | 15.3 | 15.3 | 89.3 |
| Extended fund facility | 19.6 | -- | -- | -- | -- | -- | 19.6 |
| Compensatory financing facility | 23.3 | 23.1 | -- | -- | -- | -- | 46.4 |
| Repurchases | | -- | -- | -- | -- | -- | |
| Fund's total holdings of lempiras (end of period) | 106.7 | 145.1 | 160.4 | 175.7 | 191.0 | 206.3 | 206.3 |
| Excluding compensatory financing facility | 83.4 | 98.7 | 114.0 | 129.3 | 144.6 | 159.9 | 159.9 |
| | | | (In per cent of quota) | | | | |
| Fund's total holdings of lempiras (end of period) | 209.2 | 284.5 | 314.5 | 344.5 | 374.5 | 404.5 | 404.5 |
| Excluding compensatory financing facility | 163.5 | 193.5 | 223.5 | 253.5 | 283.5 | 313.5 | 313.5 |

Source: Fund staff projections.

1/ Purchases subject to repurchases.

Honduras had an extended arrangement from the Fund which expired in June 1982. Performance under this arrangement was reviewed in detail in the staff report for the 1982 Article IV consultation (SM/82/151). Performance during the final 12-month period of the arrangement was disappointing because of significant departures from program objectives in the monetary and fiscal areas. As a result, purchasing rights under the arrangement were interrupted after August 1981.

This report will focus primarily on the Honduran Government's economic program for 1982-83 which is described in the attached letter of intent. The discussion of the Government's economic program is followed by a staff appraisal and proposed decision (Section III) and five special appendices covering Fund relations with Honduras (Appendix I), financial relations with the World Bank Group (Appendix II), principal assumptions and main elements of the financial program (Appendix III), selected economic and financial indicators (Appendix IV), and a chart of exchange rate indices (Appendix V). A brief statistical appendix is included, as well as the proposed stand-by arrangement (Attachment I) and the letter of intent (Attachment II).

## II. The Economic Program for 1982-83

Since late 1979 the economic and financial position of Honduras has deteriorated because of a combination of external and internal factors. Political developments in the Central American region have eroded private sector confidence with adverse effects on investment, trade, and domestic financial savings. At the same time, the external terms of trade deteriorated sharply as a result of the second oil price shock and declines in Honduras' major commodity export prices. The negative impact of these external forces on the Honduran economy was compounded by expansionary fiscal and monetary policies. During 1980 and 1981 the overall deficit of the public sector rose to an average of close to 9 per cent of GDP, compared with an average of 6 per cent in the previous three years. This deterioration, which reflected primarily a weakening in tax administration and a rapid growth in current expenditures at the central government level, was mainly financed by increased borrowing from the Central Bank. In addition, the net domestic assets of the Central Bank expanded rapidly because of heavy credit demands on the part of the official financial institutions, reflecting an increase in nonrecoverable loans, and legal reserve deficiencies of various commercial banks.

Against this background, a new Administration took office in early January 1982 and developed a stabilization program designed to move the Honduran economy substantially toward fiscal and balance of payments equilibrium in 1983. The main objective of the program is to reverse the fiscal deterioration of the previous two years by strengthening public savings through a combination of revenue and expenditure measures. Over the two-year period, 1982-83, it is projected that public sector savings will rise by 3-1/2 percentage points of GDP which will facilitate a sharp reduction in the domestic financing requirements of the public sector, a decline in the overall fiscal deficit, and some recovery in investment spending (Table 2). The targeted deficit for 1983 is around 7 per cent of GDP, compared with about 9 per cent in 1981, and is considered to be sustainable as it will be financed mainly with long-term external loans on concessional terms.

The fiscal adjustment will facilitate the achievement of approximate overall balance of payments equilibrium in 1983 after three years of substantial deficits. The balance of payments adjustment process is to be reflected in a reduction in the current account deficit, attendant upon an export recovery and a further compression in private sector demand for goods and services, and an increase in net capital inflows stemming from larger disbursements of development aid, special assistance under the U.S. Caribbean Basin Initiative, and commercial debt relief.

In order to achieve the fiscal and balance of payments objectives outlined above, the following performance criteria have been established for the duration of the stand-by arrangement: (a) ceilings on the net domestic assets of the Central Bank; (b) ceilings on net domestic bank financing of the nonfinancial public sector; (c) limits on net external borrowing of the public sector with maturities of less than ten years subject to testing at the end of June 1983 and December 1983; and (d) targets for the reduction of payments arrears applicable at the end of December 1982 and October 1983. Nonquantitative performance criteria relate to the payments and trade system.

1. Fiscal policy

The main aim of the Government's fiscal policy is to reduce the overall public sector deficit and the requirements for domestic bank financing while at the same time the public investment effort is increased. During 1982, a number of tax measures have been introduced. In addition to actions affecting income and sales taxes in the 1982 budget, which were described in SM/82/151, the authorities introduced in July 1982 a tax package which included the establishment of new selective consumption duties (mainly for vehicles), a temporary import surcharge of 20 per cent (which lapses at the end of 1982), increases in the excise tax on soft drinks and certain alcoholic beverages, and increases in the tax on air tickets and airport departures. At the same time, the authorities introduced important changes in tax administration, including a new regulation of the sales tax and a substantial increase in penalties for tax evasion or delays in tax payments.1/ The revenue measures and administrative improvements just described are expected to yield an additional L 66 million during the remainder of 1982, equivalent to 1 per cent of GDP.

1/ These changes were based on the recommendations of a member of the Fund's fiscal panel.

Table 2. Honduras: Macroeconomic Flows 1/

(As a per cent of GDP)

| | 1979 | 1980 | 1981 | Projected 1982 | Projected 1983 |
|---|---|---|---|---|---|
| **I. Balance of Payments** | | | | | |
| Balance of payments current account | -8.8 | -12.7 | -11.2 | -11.3 | -9.7 |
| Goods, nonfactor services, and transfers | -3.3 | -6.6 | -5.5 | -4.9 | -3.2 |
| Of which: trade account | (-4.4) | (-7.6) | (-7.1) | (-6.5) | (-4.9) |
| Factor payments | -5.5 | -6.2 | -5.7 | -6.5 | -6.5 |
| Capital account | 10.0 | 10.1 | 6.9 | 8.0 | 9.4 |
| Nonfinancial private sector | 2.5 | 3.3 | 1.4 | 0.3 | 0.9 |
| Nonfinancial public sector | 4.6 | 5.8 | 5.8 | 5.2 | 6.1 |
| Financial intermediaries | 2.9 | 1.0 | -0.3 | 0.9 | 1.0 |
| Debt relief | -- | -- | -- | 1.5 | 1.4 |
| Overall balance | 1.2 | -2.6 | -4.3 | -3.3 | -0.3 |
| **II. Public Sector Operations** | | | | | |
| Public sector current account surplus | 5.8 | 3.0 | 1.7 | 3.2 | 5.1 |
| General government current account | 4.1 | 1.5 | 0.4 | 1.8 | 3.7 |
| Revenue | (17.9) | (18.5) | (17.8) | (18.4) | (19.6) |
| Expenditure | (-13.8) | (-17.0) | (-17.3) | (-16.6) | (-15.9) |
| State enterprises' operating surplus | 1.7 | 1.4 | 1.3 | 1.3 | 1.4 |
| Capital expenditure and net lending | -11.1 | -12.3 | -10.3 | -11.5 | -12.1 |
| Fixed investment | -9.9 | -10.1 | -8.1 | -8.5 | -9.0 |
| Other capital expenditure | -1.2 | -2.2 | -2.2 | -3.0 | -3.1 |
| Overall deficit | -5.2 | -9.2 | -8.6 | -8.3 | -7.0 |
| External financing | 4.6 | 5.8 | 5.8 | 5.7 2/ | 6.4 2/ |
| Internal financing | 0.6 | 3.4 | 2.8 | 2.6 | 0.6 |
| **III. Savings and Investment** | | | | | |
| Gross domestic investment | 26.3 | 27.9 | 24.5 | 22.6 | 23.1 |
| Fixed capital formation | 24.3 | 25.6 | 22.9 | 23.4 | 24.0 |
| Public sector | (9.9) | (10.1) | (8.1) | (8.5) | (9.0) |
| Private sector | (14.4) | (15.5) | (14.8) | (14.9) | (15.0) |
| Inventory change | 2.0 | 2.3 | 1.6 | -0.8 | -0.9 |
| Investment=savings | 26.4 | 27.9 | 24.5 | 22.6 | 23.1 |
| External savings | 4.2 | 7.4 | 6.6 | 5.9 | 4.3 |
| Domestic savings | 22.2 | 20.5 | 17.9 | 16.7 | 18.8 |
| Public sector | (5.8) | (3.0) | (1.7) | (3.2) | (5.1) |
| Private sector | (16.4) | (17.5) | (16.2) | (13.5) | (13.7) |

Sources: Statistical Appendix Tables 6 through 10.

1/ The actual data for 1979-81 are slightly different from those shown in Table 2 of SM/82/151 because of some revisions to the balance of payments data for 1980 and 1981 and revisions to the national accounts since 1978.

2/ Includes debt relief of the nonfinancial public sector.

Despite these measures, total public sector revenues are projected to rise by only 11 per cent in 1982 because of the depressed condition of the domestic economy and the decline in foreign trade (Table 3). However, significant efforts have been made to hold the line on current expenditures throughout the public sector and these are now estimated to grow by only 3 per cent in 1982. During 1982, no wage increases have been granted for government workers, excess personnel have been reduced, and vacancies have remained unfilled. Accordingly, public savings are projected to nearly double in 1982, or to rise by 1-1/2 per cent of GDP. Despite this improvement, net lending of the Central Government to entities outside the nonfinancial public sector (mainly CONADI) which cannot meet their debt service payments on foreign commercial indebtedness has increased sharply this year with the result that the overall deficit of the public sector as a ratio to GDP is expected to be only marginally lower than last year. Most of the public sector financing in 1982 is expected to be covered by disbursements of long-term development loans; however, a significant portion of the deficit (around 2-1/2 per cent of GDP) will need to be financed from domestic sources.

The Government's fiscal program for 1983 will continue to be based on a policy of expenditure restraint. Consistent with this approach, the central government budget for 1983, which was submitted to Congress in mid-September, established an overall ceiling on government expenditures financed with local resources of only L 1,180 million, compared with L 1,128 million in the 1982 budget. In order to monitor the growth in these expenditures, the Government has established quarterly limits consistent with the 1983 budget.1/ Based on these limits, it is the intention of the authorities to restrain the growth in current expenditures on a cash basis to only 6 per cent in 1983. Should these limits be exceeded, the authorities are committed to consult with the Fund staff on further actions which may be necessary to achieve the fiscal program objectives.

The 1983 budget also includes provision for a significant reform of the customs tariff which the authorities intend to present to Congress in October 1982 with a view to bringing it into effect before the end of the year. This tariff reform involves the conversion of the existing Central American nomenclature (NAUCA) to that based on the Customs Co-operation Council (Brussels), the substitution of ad valorem for specific duties, the elimination of existing surcharges, including the temporary one established in July 1982, and an increase in the overall tariff rate.2/ The revised tariff is projected to yield additional revenues during 1983 of L 120 million, or 2 per cent of projected GDP. The full year's effect of the other measures introduced in July 1982 (excluding the temporary import surcharge) is expected to amount to L 20 million.

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1/ These limits which are shown in Table 1 of the attached letter of intent exclude amortization payments and investment expenditures financed with foreign development loans.

2/ Other changes in customs administration are also being made by means of a reform of the Customs Law.

Table 3. Honduras: Summary Operations of the Public Sector

| | Actual | | | Program | |
|---|---|---|---|---|---|
| | 1979 | 1980 | 1981 | 1982 1/ | 1983 |
| (In millions of lempiras) | | | | | |
| Revenues 2/ | 858 | 997 | 1,035 | 1,149 | 1,351 |
| Central Government | 617 | 739 | 729 | 813 | 962 |
| Of which: tax revenues | (574) | (697) | (695) | (786) | (939) |
| Rest of public sector | 241 | 258 | 306 | 336 | 389 |
| Expenditures 2/ | 1,087 | 1,457 | 1,499 | 1,633 | 1,801 |
| Current expenditures | 603 | 845 | 935 | 961 | 1,019 |
| Central Government | (455) | (658) | (720) | (729) | (768) |
| Rest of public sector | (148) | (187) | (215) | (232) | (251) |
| Capital expenditures | 446 | 537 | 452 | 512 | 630 |
| Central Government | (215) | (213) | (126) | (139) | (194) |
| Rest of public sector | (231) | (324) | (326) | (373) | (436) |
| Net lending | 38 | 75 | 112 | 160 | 152 |
| Central Government | (13) | (12) | (62) | (103) | (90) |
| Rest of public sector | (25) | (63) | (50) | (57) | (62) |
| Savings 2/ | 252 | 143 | 94 | 183 | 327 |
| Central Government | 162 | 76 | 9 | 84 | 194 |
| Rest of public sector | 90 | 67 | 85 | 99 | 133 |
| Overall deficit | -229 | -460 | -464 | -484 | -450 |
| Central Government | -180 | -389 | -404 | -440 | -390 |
| Rest of public sector | -49 | -71 | -60 | -44 | -60 |
| External financing | 201 | 288 | 315 | 331 | 413 |
| Domestic financing | 28 | 172 | 149 | 153 | 37 |
| Banking system | (43) | (165) | (130) | (150) | (50) |
| Other | (-15) | (7) | (19) | (3) | (-13) |
| (In per cent of GDP) | | | | | |
| Revenues | 19.6 | 20.0 | 19.2 | 19.8 | 21.1 |
| Of which: central government tax revenues | 13.1 | 14.0 | 12.9 | 13.5 | 14.6 |
| Expenditures | 24.8 | 29.3 | 27.8 | 28.2 | 28.1 |
| Current expenditures | 13.8 | 17.0 | 17.4 | 16.6 | 15.9 |
| Capital and net lending | 11.1 | 12.3 | 10.5 | 11.6 | 12.2 |
| Savings | 5.8 | 3.0 | 1.7 | 3.2 | 5.1 |
| Overall deficit | 5.2 | 9.2 | 8.6 | 8.3 | 7.0 |
| External financing | 4.6 | 5.8 | 5.8 | 5.7 | 6.4 |
| Domestic financing | 0.6 | 3.4 | 2.8 | 2.6 | 0.6 |
| Memorandum item | | | | | |
| Overall deficit adjusted for net lending to cover interest payments of entities outside public sector | 5.2 | 9.2 | 8.3 | 7.3 | 6.2 |

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

1/ The projections for 1982 are somewhat different from those presented in Table 4 of SM/82/151 because of revisions made in the light of more recent information.

2/ The breakdown between Central Government and the rest of the public sector is defined as net of intersectoral transfers.

The authorities will continue to take steps to strengthen the position of the decentralized entities and public enterprises. For the first time the budgets of all public sector entities, after being reviewed by the Superintendency of Decentralized Institutions in the Ministry of Finance, will be approved by the President and Congress later this year after the passage of the 1983 Budget Law. These budgets incorporate a number of tariff adjustments which were initiated already this year. In the case of the National Port Authority (ENP), a program of tariff adjustments was initiated in June 1982, which will be revised in November 1982, in order to yield an increase in ENP's operating revenues of about 40 per cent in 1983. Similarly, the National Electricity Authority (ENEE) initiated on September 1, 1982 a sequence of monthly adjustments in its tariffs which will last through December 1983, in order to raise its current revenues by close to 30 per cent next year.1/ In the case of the National Water and Sewerage Authority (SANAA), an average tariff adjustment of 50 per cent has been proposed which is expected to come into effect at the beginning of 1983.

Although current expenditure of the public sector is to be restrained to grow by no more than 6 per cent in 1983, investment expenditure is targeted to grow by 23 per cent next year, compared with 13 per cent in 1982. This increase takes into account an intensification of the construction of the large hydroelectric scheme at El Cajon and further expansion of the port complex at Puerto Castilla after major delays in 1981 and 1982. Other major investment projects include road construction and the development of new agricultural zones. These projects will be financed mainly with long-term development loans already in the pipeline of Honduras. Net lending outside the public sector will also remain high next year, in part, because of a continuation of government credit operations via the National Industrial Development Fund (FONDEI) to support lending activities of the domestic banking system and, in part, because of further assistance to the same entities as in 1982 to cover interest payments on foreign commercial debt, though on a more reduced scale.

In view of these revenue and expenditure trends, the overall deficit of the public sector is projected to decline from an estimated 8-1/2 per cent of GDP in 1982 to 7 per cent in 1983. The planned use by the nonfinancial public sector of external borrowing would reduce internal financing requirements from around 2-1/2 per cent of GDP in 1982 to 1/2 per cent of GDP in 1983. Domestic bank financing of the public sector would be reduced from L 150 million in 1982 to L 50 million in 1983, which is consistent with the limits presented in Table 2 attached to the letter of intent. Those limits are phased quarterly and take into account seasonal factors. As in the EFF arrangement concluded in June 1982, domestic bank financing of the public sector is defined to include net credit from the Central Bank and holdings of government securities by the rest of the banking system. In Honduras, the rest

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1/ The tariff adjustments of ENP and ENEE have been endorsed by the World Bank's technical staff.

of the banking system extends credit to the Central Government mainly through the purchase of securities which the Central Bank accepts for purposes of the legal reserve requirements. The only major item excluded from the ceiling is public sector deposits with the rest of the banking system. Such deposits mainly represent working balances of public sector entities and the funds of agencies such as the Social Security Institute which do not fluctuate widely.

## 2. Monetary policy

The Government's monetary program for 1982-83 is designed to bring about a significant deceleration in total credit expansion of the banking system from an annual rate of around 20 per cent prevailing during 1982 to one of 9 per cent by the end of 1983. Most of this deceleration in the rate of credit expansion is to be brought about by the fiscal program described above and the reduction in domestic credit demands implicit in it. The fiscal improvement would allow for a marked reduction in the growth of the Central Bank's net domestic assets which would also be facilitated by improvements in the operations of the official financial institutions and a reduction in net credit expansion to the rest of the banking system.

In the financial program for 1982-83, the Government will continue its policy of interest rate flexibility to encourage the retention of domestic savings in the local financial system and to discourage their placement abroad. As reported in SM/82/151, the authorities simplified the structure of lending rates in May 1982 by unifying the ceiling on all new bank loans at 19 per cent. Similarly, the rediscount rate of the Central Bank was raised to 15 per cent for all operations, except the financing of basic grains production which remains at 10 per cent. Henceforth, the authorities will review these rates on a quarterly basis in the light of foreign and domestic market conditions to determine whether any further adjustment would be appropriate.

As part of its policy to foster the growth of a domestic market for government debt, the authorities are increasing their sales of government bonds outside the banking system in 1982. To encourage the placement of these securities, the authorities have established new issues of government debt with maturities ranging from six months to eighteen months, and yields ranging from 11 per cent to 13 per cent.

As reported in SM/82/151, efforts have also been made to strengthen the performance of the rest of the banking system. In the case of the state-owned Agricultural Development Bank (BANADESA), its capital base has been recently increased and its internal management strengthened in order to achieve a larger recovery of its loan portfolio. In the case of CONADI, work has been proceeding throughout 1982 on a major restructuring of this institution. In October 1982, the authorities intend to announce a formal reorganization of the institution which takes into account the recommendations of World Bank staff. Furthermore, the monetary authorities are strengthening their bank supervision activities, with technical assistance from the Fund, and have expressed their intention in the attached letter to raise the fines and penalties for legal reserve deficiencies.

In view of the weak recovery forecast for domestic economic activity and foreign trade during the period of the requested stand-by arrangement, banking system liabilities to the private sector are projected to grow at relatively low rates during 1982 and 1983, accelerating from about 6 per cent in the year ending December 1982 to 7-1/2 per cent in the year ending December 1983. These growth rates imply a slight increase in the velocity of money and quasi-money during the period of the requested stand-by arrangement. The loanable resources of the banking system are expected to be supplemented by a significant increase in medium- and long-term foreign liabilities arising from the use of credits under the Mexican-Venezuelan regional oil facility and credits under the U.S. Government's Caribbean Basin Initiative.1/ During the year ending June 1983, the net increase in these resources is projected at US$60 million. The domestic and foreign resources that are projected to accrue to the banking system will allow an expansion in credit to the private sector at a rate of about 10 per cent in the years ending December 1982 and December 1983.

As in the EFF arrangement which expired in June 1982, the net domestic assets of the Central Bank subject to ceiling are defined as the difference between its currency issue and its net international reserves.2/ The ceilings on the net domestic assets of the Central Bank referred to in paragraph 9 and Table 3 of the attached letter of intent are consistent with the estimated growth in banking system loanable resources as well as with the bank financing of the public sector deficit, the projected credit expansion to the private sector, and the target for net official international reserves (Table 4). These ceilings have been established on a quarterly basis and take into consideration the seasonality of credit demands.

### 3. External sector policies

The Honduran Government's financial program for 1982-83 seeks to bring about a substantial improvement in the overall balance of payments during the period of the contemplated stand-by arrangement. The current account deficit is estimated to decline from nearly 11-1/2 per cent of GDP in 1982 to less than 10 per cent of GDP in 1983. This improvement reflects, on the one hand, a recovery in exports and, on the other hand, a further compression in private sector imports associated with fiscal and monetary restraint. Nevertheless, total imports are projected to increase in 1983 mainly because of an acceleration in public investment

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1/ These funds will be channeled through the Central Bank, in the latter case, mainly to support an increase in credit expansion to the private sector.

2/ The latter includes as a foreign reserve liability any counterpart deposits arising from payments arrears.

spending which has a high import content. Net capital inflows are projected to increase during the period of the stand-by arrangement, in part, because of larger disbursements of development assistance in connection with the public investment program and the Mexican-Venezuelan regional oil facility and, in part, because of extraordinary assistance provided under the U.S. Government's Caribbean Basin Initiative and commercial debt relief. On the basis of these inflows, the current account deficit projected for 1983 would appear to be compatible with approximate overall balance of payments equilibrium. The overall balance is defined to include changes in external debt and commercial payments arrears (Table 5).1/

Table 4. Honduras: Summary Accounts of Central Bank Operations

(12-month flows in millions of lempiras)

| | Actual | | | Program | | |
|---|---|---|---|---|---|---|
| | 1980 | 1981 | 1982 | 1982 | 1983 | |
| | December | | June | Dec.1/ | June | Dec. |
| Net foreign assets | -129 | -213 | -316 | -194 | -19 | -20 |
| Net domestic assets | 136 | 239 | 315 | 194 | 32 | 40 |
| Net credit to public sector | 151 | 151 | 158 | 150 | 76 | 50 |
| Central Government 2/ | (142) | (156) | (164) | (150) | (74) | (50) |
| Rest of public sector | (9) | (-5) | (-6) | (--) | (2) | (--) |
| Net credit to banks 2/ | 67 | 46 | 88 | 65 | 53 | 30 |
| Medium- and long-term foreign liabilities | -54 | -14 | 36 | -47 | -119 | -59 |
| Unclassified assets | -28 | 56 | 33 | 26 | 22 | 19 |
| Currency issue | 7 | 26 | -1 | -- | 13 | 20 |

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

1/ The projections for December 1982 are slightly different from those shown in Table 5 of SM/82/151 because of revisions made in the light of more recent information.
2/ Government bonds held by the rest of the banking system are included in the Central Bank's net credit to the Central Government and in net claims by banks on the Central Bank.

1/ As explained in SM/82/151 and SM/82/156 the external debt arrears shown for 1981 represent defaults of the private sector, as distinct from commercial payment arrears which have occurred during 1982 because of delays on the part of the Central Bank in approving foreign exchange requests.

Table 5. Honduras: Summary Balance of Payments 1/

(In millions of U.S. dollars)

| | 1979 | Rev. 1980 | Rev. 1981 | Proj. 1982 | Proj. 1983 |
|---|---|---|---|---|---|
| Current account | -192 | -317 | -303 | -329 | -312 |
| Trade balance | -95 | -189 | -192 | -188 | -157 |
| Exports, f.o.b. | (756) | (850) | (784) | (710) | (781) |
| Imports, c.i.f. | (-852) | (-1,040) | (-975) | (-898) | (-938) |
| Net factor payments | -120 | -154 | -153 | -188 | -210 |
| Other services and transfers | 24 | 26 | 42 | 47 | 55 |
| Capital account | 213 | 247 | 181 | 232 | 302 |
| Nonfinancial private sector | 55 | 84 | 37 | 10 | 30 |
| Nonfinancial public sector | 100 | 144 | 157 | 152 | 195 |
| Financial intermediaries | 58 | 19 | -13 | 27 | 34 |
| Debt relief | -- | -- | -- | 44 | 44 |
| SDR allocation | 5 | 5 | 5 | -- | -- |
| Overall balance | 26 | -65 | -117 | -97 | -10 |
| Change in net official international reserves (increase -) | -26 | 65 | 107 | 87 | 20 |
| Defaults | -- | -- | 10 | -10 | -- |
| Rescheduling | -- | -- | -- | 10 | -- |
| Arrears | -- | -- | -- | 10 | -10 |

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

1/ The data for 1980 and 1981 have been adjusted slightly from those shown in Table 3 of SM/82/151 because of revisions provided by the Central Bank of Honduras, whereas the projections for 1982 have been revised from those shown earlier by the Fund staff in the light of more recent information.

The extraordinary balance of payments assistance projected for the period of the requested stand-by arrangement includes US$35 million to be disbursed during the last quarter of 1982 and US$25 million to be disbursed during the first half of 1983 under the U.S. Government's Caribbean Basin Initiative. The foreign exchange component of this assistance is not earmarked for specific development projects, whereas the domestic currency counterpart will be used to finance private sector credit expansion for productive activities. In the case of commercial debt relief, the Honduran authorities have been negotiating with a steering committee of foreign banks a rescheduling of the foreign commercial debt of a number of public entities and private enterprises with public sector guarantee. The most important of these is CONADI, but also included is the Honduran Banana Corporation (COHBANA), the Honduran Coffee Institute (IHCAFE), the National Port Authority (ENP), the municipalities of Tegucigalpa and San Pedro Sula, and the Honduran Cement Company (HONDUCEM). The outstanding balance of foreign commercial debt of these entities for which rescheduling is being sought amounts to about US$200 million and it is estimated that repayments of principal amounting to about US$54 million in 1982 and US$44 million in 1983 will be involved. Of these amounts about US$10 million would represent rescheduling of external debt arrears outstanding at the end of 1981, whereas the remainder would represent rescheduling of payments of principal falling due in 1982 and 1983 (debt relief).1/ It is anticipated that a formal agreement between the banks and the Honduran Government will be finalized during November 1982.

During the period of the stand-by arrangement, the Government intends to utilize mainly credits on concessional terms to the extent available, and to limit the net use of foreign credit on commercial terms in order to maintain the present relatively favorable structure of its external debt and to moderate the increases in debt servicing. The net use of foreign commercial credits by the public sector (including public financial institutions and private sector with official guarantee, but excluding reserve liabilities of the Central Bank, disbursements under the Mexican-Venezuelan oil facility and the amounts mentioned above in respect of rescheduling) is programed not to exceed US$75 million in the period of the stand-by arrangement ending June 1983 and US$100 million in the period of the stand-by arrangement ending December 1983. These limits are performance criteria in the program, as described in paragraph 11 of the letter of intent.2/ The total amount of foreign financing contemplated in the program (including purchases from the Fund under the proposed stand-by arrangement) will increase the outstanding public and publicly guaranteed external debt from US$1.4 billion at the end of 1981 to US$1.7 billion by the end of 1982 and to US$2.0 billion by the end of 1983. Service payments on this debt would rise from the equivalent of 17 per cent of exports of goods and services in 1981 to 21 per cent in 1983 (after anticipated debt relief).

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1/ Some arrears on foreign interest payments due in 1982 have been incurred in recent months, but these are expected to be eliminated prior to a final rescheduling agreement with the banks.

2/ The ceiling on commercial borrowing is expressed in terms of net utilization as this information is more readily available than data on debt contracts which are customarily used in other Fund arrangements to monitor ceilings on foreign commercial borrowing. Efforts are being made to develop more timely information for external debt commitments. Although maturities of less than one year are included in the definition of commercial borrowing, the definition does not include normal trade credits which are channeled through the private domestic banking system.

Honduras has traditionally maintained an exchange and trade system free of restrictions on payments and transfers for current international transactions. Since late 1980, regulations on the operations of the banks as exchange control agents of the Central Bank have been tightened with a view toward restraining capital outflows. Furthermore, in September 1981, registration requirements were extended to all exports and surrender requirements were extended to all exchange receipts. These regulations do not involve restrictions on payments and transfers for current international transactions. However, since late 1981, the Central Bank has been applying a priority scheme to the authorization of exchange requests which has given rise to payments arrears estimated at around US$30 million as of end July 1982.1/ During October 1982, the Central Bank intends to institute a 100 per cent local counterpart deposit against these arrears.2/ As stated in paragraph 13 of the letter of intent, it is the Government's intention to reduce the outstanding balance of arrears by at least US$20 million by the end of 1982 and to eliminate them altogether before the end of October 1983. This intention is a performance criterion under the proposed arrangement. In reducing payment arrears, the Government will apply the same priority scheme as it applied to the approval of exchange requests, following a strict chronological order within each priority item.

In order to alleviate the problem of a buildup in arrears, the authorities as of May 1982 began to apply the priority list for exchange requests to the stage of import permits, which previously had been approved on an automatic basis. As stated in the letter of intent, this import restraint is a temporary measure which the authorities only intend to use during the current period of acute foreign exchange shortage. The system will be the subject of a review with the Fund staff prior to June 1983 geared to its elimination before the expiration of the stand-by arrangement.

In framing their adjustment program, the Honduran authorities plan to maintain the existing parity for the Honduran lempira (L 2 per U.S. dollar). This decision appears appropriate on the basis of the prospects for an improvement in the balance of payments position of Honduras implicit in the adjustment program described above and on the tendency demonstrated over the medium term for Honduras to maintain a rough equivalence between increases in domestic costs and average price rises in its major trading partners. As shown in the chart on effective exchange rate indices presented in Appendix V, the trade-weighted effective exchange rate, adjusted for relative prices, has appreciated in 1981 and 1982 by about 15-1/2 per cent, mainly because of the strength of the U.S. dollar, but this movement followed a period of about eight years in which the Honduran lempira depreciated in real effective terms by 22 per cent.

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1/ This priority scheme is described in Appendix III of SM/82/156.
2/ Any exchange risk involved in these deposits is to be borne by the Central Bank and no interest will be paid on these deposits. In the staff's judgment, no multiple currency practice is involved in the arrangement established by Honduras.

## III. Staff Appraisal and Proposed Decision

Honduras' economic and financial performance during the last two years deteriorated significantly because of a combination of internal and external factors. The adverse impact of regional economic and political developments, together with unfavorable shifts in the terms of trade and expansionary monetary and fiscal policies, have combined to produce a rapidly declining rate of economic growth and large overall deficits in the balance of payments.

Since early this year, a new Administration in Honduras has been taking actions to reverse the financial deterioration of previous years and to strengthen the external position of the Honduran economy. These actions, together with a modest recovery in exports and special assistance from bilateral creditors and foreign commercial banks, hold out the prospect of a substantial reduction in the overall balance of payments deficit next year.

The centerpiece of the Government's adjustment effort is a strengthening of public sector finances based on an improvement in public sector savings equivalent to 3-1/2 percentage points of GDP in 1982-83. About 2 percentage points of this effort is to be brought about by an improvement in revenue performance, whereas the remainder reflects a policy of expenditure restraint. On the revenue side, a number of tax measures were introduced in January and July 1982, and these will be supplemented by a comprehensive customs tariff reform which is to be put into place before the end of this year. Significant improvements have also been introduced in tax administration affecting income, sales, and customs taxes. Tariff adjustments have also been made in several state enterprises to improve their financial performance. On the expenditure side, the Government has established an austerity program with respect to current expenditures and this policy appears to have yielded already significant results in 1982. In view of the slippages in revenue performance in the past, the staff believes that the authorities must be alert to any departures from the fiscal program in order to adjust expenditures to possible shortfalls in revenue yields.

The overall deficit of the public sector will decrease slightly in terms of GDP in 1982 despite the assumption by the Central Government of interest payments on foreign commercial debt which cannot be met by certain institutions, especially CONADI. In view of this problem, the Government of Honduras has undertaken a fundamental reform of CONADI, with technical assistance from the World Bank, to improve the financial position of this institution and the enterprises in which it holds a financial interest. The likely continuing burden of these interest payments on the central government budget for the foreseeable future makes the pursuit of a prudent fiscal policy all the more important in the present situation of Honduras.

In its adjustment program, the Honduran authorities are committed to a substantial reduction in domestic bank financing of the public sector which is to be facilitated by the tax and expenditure measures just described and an increase in the sale of government bonds in the domestic nonbank market. In view of this latter commitment, the staff welcomes the intention of the authorities to maintain a flexible posture in respect of the ceiling on domestic interest rates and to establish market-related yields for government bonds.

On the external side, the program is designed to re-establish an exchange system free of restrictions on payments and transfers for current international transactions and a trade system free of restrictions for balance of payments reasons. Specifically, during the period of the stand-by arrangement, the authorities intend to eliminate payments arrears and to phase out the import restrictions established earlier this year. This objective together with the Government's intention to maintain the existing parity for the Honduran lempira underscores the critical importance of restrictive demand management policies and a tight control over domestic costs.

The staff is of the opinion that the policies which the Honduran authorities have submitted to the Fund with a request for a stand-by arrangement constitute a substantial effort to return the economy to a sound financial and economic path, and that they are, therefore, worthy of Fund support. Accordingly, the following draft decision is proposed for adoption by the Executive Board:

1. The Government of Honduras has requested a stand-by arrangement for a period extending from November __, 1982 to December 31, 1983, for an amount equivalent to SDR 76.5 million.

2. The Fund approves the stand-by arrangement attached to EBS/82/179.

3. The Fund waives the limitation in Article V, Section 3(b)(iii).

## Fund Relations with Honduras
(As of September 30, 1982)

| | | | |
|---|---|---|---|
| Status: | Article VIII | | |
| Quota: | SDR 51 million | | |
| Fund holdings of Honduran lempiras: | | Millions of SDRs | Per Cent of Quota |
| | Total | 106.7 | 209.2 |
| | Of which: | | |
| | Credit tranches | (12.8) | (25.0) |
| | EFF | (19.6) | (38.5) |
| | CFF | (23.3) | (45.7) |
| | | Millions of SDRs | Per Cent of Allocation |
| SDR Department: | Net cumulative allocation | 19.1 | 100.0 |
| | Holdings | 1.1 | 5.7 |
| Trust Fund (second period): | Disbursed | SDR 14.1 million | |
| Gold distribution: | 21,396 fine ounces | | |
| Direct distribution of profits from gold sales: | US$4.0 million | | |
| Exchange rate: | US$0.50 per lempira | | |
| Last Article IV consultation: | May 1980, discussed by the Executive Board on August 4, 1980 (EBM/80/118). | | |
| Resident representative and technical assistance: | In December 1981, a Fund staff member was assigned as resident representative in Honduras for a period of one year. In early April 1982, an expert from the Fund's fiscal panel completed a two-month assignment as advisor on tax policy and administration, and, in September, another expert from the Fund's fiscal panel completed a two-week assignment as an advisor on customs tariff reform. Also in September, a CBD expert in bank supervision was assigned to the Central Bank for a period of one year. | | |

## Honduras: Financial Relations with the World Bank Group

(In millions of U.S. dollars)

### A. IBRD/IDA/IFC Operations (as of July 31, 1982)

| | Disbursed | Undisbursed |
|---|---|---|
| IBRD/IDA loans | | |
| Agriculture | 30.6 | 17.7 |
| Education | 8.1 | 2.9 |
| Industry | 10.3 | 34.7 |
| Ports | 29.0 | 1.6 |
| Power | 139.5 | 91.3 |
| Regional development | 5.3 | 5.2 |
| Transport | 93.8 | 31.0 |
| Tourism | 4.3 | 15.2 |
| Petroleum exploration | -- | 3.0 |
| Total | 320.9 | 202.6 |
| Of which: repaid | 43.4 | |
| outstanding | 277.5 | |
| IFC investments | 7.0 | -- |

### B. IBRD/IDA Loan Disbursements

| | | | | Projected | |
|---|---|---|---|---|---|
| | 1979 | 1980 | 1981 | 1982 | 1983 |
| Net disbursements | 28.7 | 37.8 | 36.7 | 40.5 | 38.3 |
| Gross Disbursements | 32.1 | 42.1 | 42.4 | 46.9 | 46.1 |
| Amortization | 3.4 | 4.3 | 5.7 | 6.4 | 7.8 |

Source: IBRD.

## Honduras: Principal Assumptions and Main Elements of the Financial Program, 1982-83

### 1. Principal assumptions of the program 1/

| | 1982 | 1983 |
|---|---|---|
| a) **Gross domestic product** | | |
| Real growth rate | -1-1/2 | 1 |
| Nominal growth rate | 7-1/2 | 10-1/2 |
| GDP deflator growth rate | 9-1/2 | 9-1/2 |
| b) **Trade and official capital inflows** | | |
| Export value growth rate | -9-1/2 | 10 |
| Of which: coffee | (-5) | (5) |
| bananas | (10) | (6) |
| Import value growth rate | -8 | 4-1/2 |
| Terms of trade rate of change | -2 | -2 |
| Export unit value | (3-1/2) | (3) |
| Import unit value | (5) | (5-1/2) |
| Net disbursement of medium- and long-term foreign official capital (millions of US$) | 220 | 268 |
| Of which: nonfinancial public sector | (152) | (195) |
| Central Bank | (24) | (30) |
| debt relief | (44) | (44) |
| c) **Monetary variables** | | |
| Growth rate in bank liabilities to the private sector | 6 | 7-1/2 |
| Of which: money and quasi-money | (6) | (7-1/2) |
| Rate of increase in velocity (money and quasi-money) | 1-1/2 | 3 |
| Increase in Central Bank's net domestic assets (millions of lempiras) | 194 | 40 |
| Of which: net credit to public sector | (150) | (50) |
| Increase in banking system domestic credit (millions of lempiras) | 382 | 235 |
| d) **Fiscal variables** | | |
| Growth in public sector revenues | 11 | 17-1/2 |
| Growth in public sector expenditures | 9 | 10 |
| Of which: current | (3) | (6) |
| capital and net lending | (19) | (16) |

1/ All numbers are in per cent, unless otherwise specified.

2. Main elements of the financial program

a. Fiscal policy

(1) Main targets

The main aim of the fiscal program is to increase public sector savings and reduce to a minimum the domestic financing of the overall deficit. Public sector savings are programed to increase from the equivalent of 1.7 per cent of GDP in 1981 to 5.1 per cent in 1983 and the domestic financing of the public sector deficit is programed to be reduced from the equivalent of 2.8 per cent to 0.6 per cent of GDP over the same time period. Consistent with these targets, the overall deficit of the public sector will be reduced from the equivalent of 8.6 per cent of GDP in 1981 to 7.0 per cent in 1983. The external financing of the public sector deficit is associated with the public investment plan and is obtained through medium- and long-term loans, mostly on concessionary terms.

(2) Fiscal measures

New revenue measures were incorporated in the 1982 budget of the Central Government, which included an increase in the sales tax rate from 3 per cent to 5 per cent, the introduction of income tax surcharges of 10 per cent and 15 per cent for the upper brackets of the corporate and personal income tax schedules, and the elimination of certain income tax exemptions. In July 1982, the National Congress approved legislation which established, among other things, selective consumption duties and a temporary import surcharge, and raised the penalties for underpayment or delays in the payment of income and sales taxes. In October 1982, the Government will submit to Congress legislation for a comprehensive customs tariff reform, which involves a shift from a specific to an ad valorem basis and the conversion to the Brussels nomenclature. This reform also involves an increase in the average duty of the tariff to allow for the elimination of existing surcharges. On the expenditure side, the Government has limited the growth of current expenditures in 1982 to only about 2 per cent, and intends to limit such growth to no more than 6 per cent during 1983.

The Government has also taken steps to improve the performance of the rest of the public sector by adopting significant tariff adjustments and cost-cutting measures in various public enterprises and decentralized agencies. The authorities have also taken measures to strengthen the oversight functions of the Superintendency of Decentralized Agencies in order to ensure efficiency throughout the public sector.

b. Monetary policy

A credit program for 1983 has been established consistent with a growth of 7-1/2 per cent in banking system liabilities to the private sector and approximate overall balance of payments equilibrium. Net credit of the banking system to the public sector is programed to be significantly reduced (to 1/3 the flow projected for 1982) to allow a credit expansion to the private sector roughly in line with the projected growth in nominal GDP.

The authorities have instituted a flexible interest rate policy whereby the Central Bank rediscount rate and the banks' maximum lending rate will be reviewed quarterly in line with interest rates abroad and conditions in the domestic financial market. Also, in order to develop more fully the domestic financial market, the authorities intend to increase the sale of government bonds in the domestic nonbank market at competitive interest rates during the remainder of 1982 and in 1983.

c. Price and wage policies

The scope of price controls has been reduced in 1982 in order to allow most prices in the economy to be established by the interplay of demand and supply forces. Wages in the private and public enterprise sectors are determined by collective bargaining arrangements. Wage adjustments in the Central Government will be tightly controlled in 1983 in order to set a standard for private sector wage negotiations.

d. External policies

The financial program assumes the maintenance of the existing parity of the Honduran lempira and is designed to allow for the elimination of existing exchange restrictions and trade restrictions for balance of payments reasons. Specifically, payments arrears are programed to be eliminated before October 1983 and import restrictions are intended to be lifted before the expiration of the stand-by arrangement. In the latter case, a special consultation between the Honduran authorities and the Fund staff is called for before June 1983 to examine the possibilities for the elimination of existing import restrictions.

External debt control procedures are to be tightened and the authorities expect to finalize a selective rescheduling of certain foreign commercial debt before the end of 1982.

Honduras: Selected Economic and Financial Indicators

| | EFF Actual 1979 | EFF Actual 1980 | EFF Prel. 1981 | SBA Program 1982 | SBA Program 1983 |
|---|---|---|---|---|---|
| (Annual per cent changes, unless otherwise specified) | | | | | |
| **National income and prices** | | | | | |
| GDP at constant prices | 6.2 | 2.9 | 0.2 | -1.5 | 1.0 |
| GDP deflator | 8.1 | 10.5 | 8.1 | 9.3 | 9.5 |
| Consumer prices (annual average) | 12.1 | 18.1 | 9.4 | 9.5 | 10.0 |
| **External sector (on the basis of U.S. dollars)** | | | | | |
| Exports, f.o.b. | 20.5 | 12.2 | -7.8 | -9.4 | 10.0 |
| Imports, c.i.f. | 19.8 | 22.7 | -6.2 | -8.0 | 4.5 |
| Non-oil imports, c.i.f. | 16.4 | 17.5 | -6.5 | -9.9 | 5.3 |
| Export volume | 19.5 | -6.1 | 4.3 | -12.3 | 6.7 |
| Import volume | -0.7 | 4.5 | -11.7 | -12.6 | -0.8 |
| Terms of trade (deterioration -) | -16.4 | 1.8 | -16.7 | -1.9 | -2.0 |
| **Nominal effective exchange rate (depreciation -)** | -0.6 | 0.9 | 7.5 | ... | ... |
| **Real effective exchange rate (depreciation -)** | -- | 1.3 | 6.3 | ... | ... |
| **Government budget** | | | | | |
| Revenue and grants | 16.4 | 19.9 | -2.4 | 12.3 | 17.8 |
| Total expenditure | 6.7 | 41.2 | -0.3 | 11.1 | 7.7 |
| **Money and credit** | | | | | |
| Domestic credit | | | | | |
| Public sector | 25.4 | 77.6 | 34.4 | 29.5 | 7.6 |
| Private sector | 13.2 | 7.8 | 8.5 | 9.9 | 10.1 |
| Money and quasi-money (M2) | 11.5 | 6.6 | 9.5 | 6.0 | 7.5 |
| Velocity (GDP relative to M2) | 3.4 | 3.6 | 3.6 | 3.7 | 3.8 |
| Interest rate (annual rate, one-year savings deposit) | 8.5 | 9.5 | 11.0 | 12.0 | 12.0 |
| (In per cent of GDP) | | | | | |
| Overall public sector deficit | 5.1 | 9.2 | 8.6 | 8.3 | 7.0 |
| Central government savings | 2.1 | 0.1 | -1.5 | -0.2 | 1.4 |
| Central government budget deficit | 4.1 | 7.8 | 7.5 | 7.6 | 6.1 |
| Domestic financing | (0.9) | (2.8) | (3.3) | (3.3) | (1.4) |
| Foreign financing | (3.2) | (5.0) | (4.2) | (4.3) | (4.7) |
| Gross domestic investment | 26.4 | 27.9 | 24.5 | 22.6 | 23.1 |
| Gross domestic savings | 22.2 | 20.5 | 17.9 | 16.7 | 18.8 |
| Current account deficit | 8.8 | 12.7 | 11.2 | 11.3 | 9.7 |
| **External debt 1/** | | | | | |
| Inclusive of use of Fund credit | 39.0 | 44.9 | 50.1 | 55.3 | 57.9 |
| (In per cent of exports of goods and services) | | | | | |
| Debt service | 11.7 | 12.7 | 15.3 | 22.2 2/ | 23.8 2/ |
| Interest payments 3/ | 5.2 | 6.7 | 9.0 | 12.1 | 13.0 |
| (In millions of U.S. dollars) | | | | | |
| Overall balance of payments | 25.8 | -64.6 | -116.5 | -97.0 | -10.0 |
| Gross official reserves (months of imports) | 2.5 | 2.0 | 1.6 | 1.5 | 1.6 |
| Payments arrears | -- | -- | -- | 10.0 | -- |

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

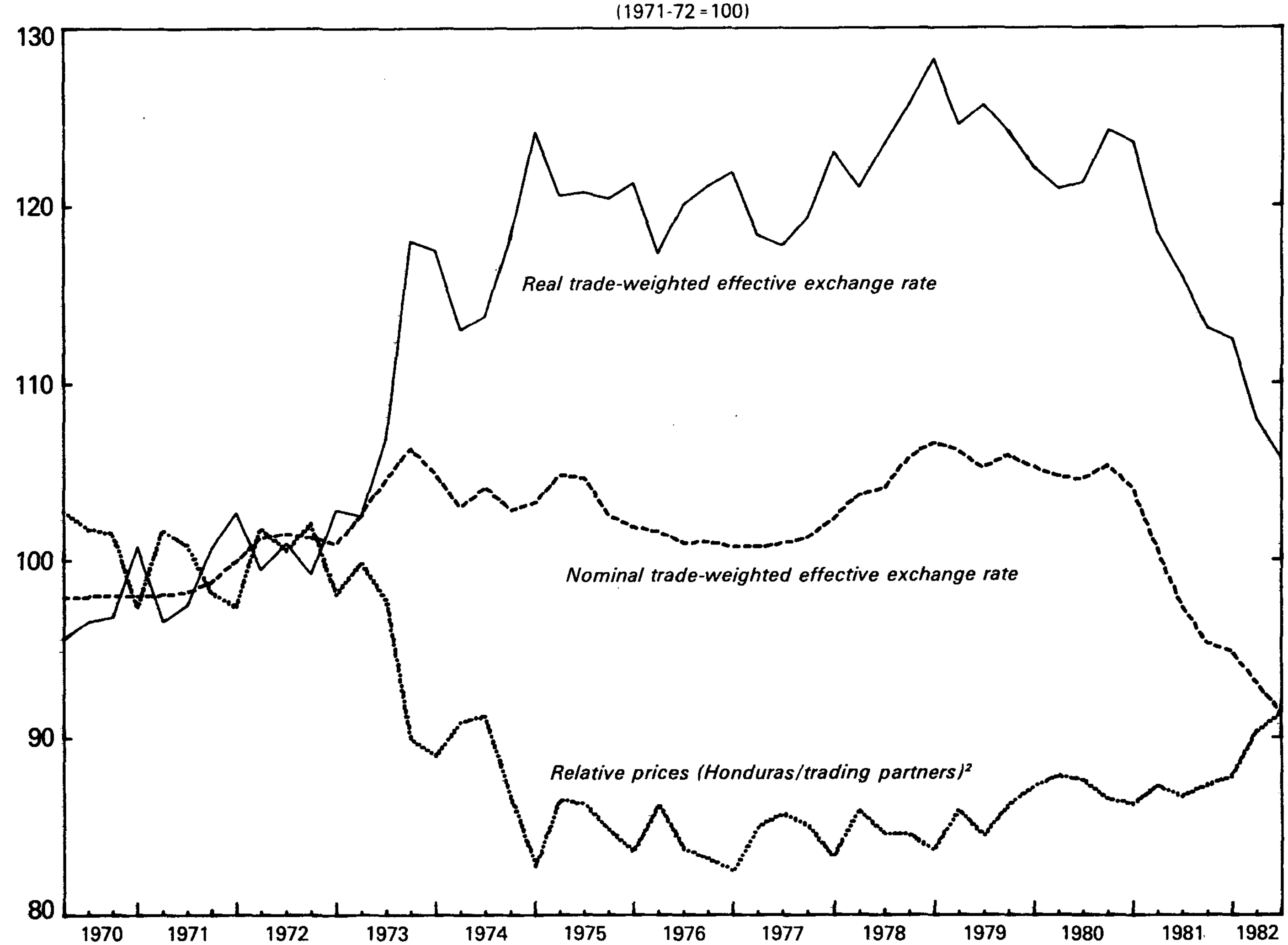
1/ Public and officially guaranteed external debt with original maturity of one year and over.
2/ Before anticipated debt relief.
3/ Excludes interest payments on short-term external debt and Fund credit.

CHART

HONDURAS

## EFFECTIVE EXCHANGE RATE INDICES, 1970-82[1]

(1971-72 = 100)




Sources: IMF, *International Financial Statistics;* and Fund staff estimates.

[1] In Honduran lempiras per unit of foreign exchange. The weights were based on the average distribution of export and import trade in 1978-80. Over 90 per cent of trade with partner countries is covered by these weights.

[2] Relative price levels were measured by wholesale price indices, and where not available, consumer price indices.

Table 6. Honduras: National Accounts

| | Revised 1/ | | | Projected | |
|---|---|---|---|---|---|
| | 1979 | 1980 | 1981 | 1982 | 1983 |
| | (In millions of lempiras) | | | | |
| GDP at market prices | 4,378 | 4,976 | 5,389 | 5,801 | 6,418 |
| Consumption | 3,407 | 3,958 | 4,421 | 4,833 | 5,212 |
| General government | 603 | 845 | 935 | 961 | 1,019 |
| Central Government | (456) | (658) | (720) | (729) | (768) |
| Rest of general government | (147) | (187) | (215) | (232) | (251) |
| Private sector | 2,804 | 3,113 | 3,486 | 3,872 | 4,193 |
| Gross domestic investment | 1,155 | 1,388 | 1,322 | 1,309 | 1,480 |
| Fixed capital formation | 1,066 | 1,274 | 1,234 | 1,355 | 1,539 |
| Public sector | (432) | (505) | (438) | (493) | (578) |
| Private | (634) | (769) | (796) | (862) | (961) |
| Inventory changes | 89 | 114 | 88 | -46 | -59 |
| Gross domestic expenditure | 4,562 | 5,346 | 5,743 | 6,142 | 6,692 |
| Exports of goods and non-factor services | 1,679 | 1,886 | 1,771 | 1,609 | 1,756 |
| Imports of goods and non-factor services | -1,863 | -2,256 | -2,125 | -1,950 | -2,030 |
| Net factor payments | -241 | -307 | -306 | -377 | -420 |
| Factor receipts | 39 | 49 | 36 | 37 | 37 |
| Factor payments | -280 | -356 | -342 | -414 | -457 |
| Savings | 1,155 | 1,388 | 1,322 | 1,309 | 1,480 |
| External savings | 184 | 370 | 354 | 341 | 274 |
| Domestic savings | 971 | 1,018 | 968 | 968 | 1,206 |
| Public sector | (252) | (148) | (94) | (183) | (327) |
| Private sector | (719) | (870) | (874) | (785) | (879) |
| | (Annual percentage changes) | | | | |
| Memorandum items | | | | | |
| Real GDP | 6.2 | 2.9 | 0.2 | -1.5 | 1.0 |
| GDP deflator | 8.1 | 10.5 | 8.1 | 9.3 | 9.5 |
| Nominal GDP | 14.8 | 13.7 | 8.3 | 7.7 | 10.6 |

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

1/ These accounts have been revised and therefore differ in some respects from those shown in Table 14 of SM/82/156.

Table 7. Honduras: Public Sector Operations

| | Actual | | | Program | |
|---|---|---|---|---|---|
| | 1979 | 1980 | 1981 | 1982 | 1983 |
| (In millions of lempiras) | | | | | |
| Revenues | 858 | 997 | 1,035 | 1,149 | 1,351 |
| Tax revenues | 605 | 724 | 728 | 821 | 979 |
| Nontax revenues | 250 | 269 | 301 | 323 | 367 |
| Central Government | (43) | (42) | (34) | (27) | (23) |
| Rest of general government | (134) | (160) | (197) | (220) | (255) |
| Public enterprises | (73) | (67) | (70) | (76) | (89) |
| Other revenue | 3 | 4 | 6 | 5 | 5 |
| Total expenditures and net lending | 1,087 | 1,457 | 1,499 | 1,633 | 1,801 |
| Current expenditures | 603 | 845 | 935 | 961 | 1,019 |
| Capital expenditures and net lending | 484 | 612 | 564 | 672 | 782 |
| Capital | (446) | (537) | (452) | (512) | (630) |
| Net lending | (38) | (75) | (112) | (160) | (152) |
| Of which: for interest payments on external debt | /--/ | /--/ | /14/ | /63/ | /49/ |
| Savings | 252 | 148 | 94 | 183 | 327 |
| Overall deficit | -229 | -460 | -464 | -484 | -450 |
| External financing (net) | 201 | 288 | 315 | 331 | 413 |
| Domestic financing (net) | 28 | 172 | 149 | 153 | 37 |
| Banking system | (43) | (165) | (130) | (150) | (50) |
| Bonds and other | (-15) | (7) | (19) | (3) | (-13) |
| (Annual rates of change) | | | | | |
| Revenues | 18.3 | 16.2 | 3.8 | 11.0 | 17.6 |
| Of which: tax revenues | 14.8 | 19.7 | 0.6 | 12.8 | 19.2 |
| Total expenditures and net lending | 12.8 | 34.0 | 2.9 | 8.9 | 10.3 |
| Current expenditures | 11.9 | 40.1 | 10.7 | 2.8 | 6.0 |
| Capital expenditures and net lending | 13.9 | 26.4 | -7.8 | 19.1 | 16.4 |
| Of which: capital expenditures | (10.1) | (20.4) | (-15.8) | (13.3) | (23.0) |

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

Table 8. Honduras: Central Government Operations

| | Actual | | | Program | |
|---|---|---|---|---|---|
| | 1979 | 1980 | 1981 | 1982 | 1983 |
| (In millions of lempiras) | | | | | |
| Revenues | 633 | 759 | 741 | 832 | 980 |
| Tax revenues | 574 | 697 | 695 | 786 | 939 |
| Of which: 1982 measures | (--) | (--) | (--) | (66)1/ | (20)2/ |
| 1983 measures | (--) | (--) | (--) | (--) | (120) |
| Nontax revenues | 43 | 42 | 34 | 27 | 23 |
| Transfers | 16 | 20 | 12 | 19 | 18 |
| Total expenditures and net lending | 813 | 1,148 | 1,145 | 1,272 | 1,370 |
| Current expenditures | 527 | 734 | 808 | 825 | 873 |
| Transfers to rest of public sector | (72) | (76) | (88) | (96) | (105) |
| Other | (455) | (658) | (720) | (729) | (768) |
| Capital expenditures and net lending | 286 | 414 | 337 | 447 | 497 |
| Capital | (260) | (277) | (189) | (242) | (312) |
| Net lending | (26) | (137) | (148) | (205) | (185) |
| Of which: for interest payments on external debt | /--/ | /--/ | /14/ | /83/ | /55/ |
| Savings | 90 | 5 | -79 | -12 | 89 |
| Overall deficit | -180 | -389 | -404 | -440 | -390 |
| External financing (net) | 142 | 251 | 226 | 250 | 300 |
| Domestic financing (net) | 38 | 138 | 178 | 190 | 90 |
| Banking system | (19) | (141) | (156) | (150) | (50) |
| Bonds and other | (19) | (-3) | (22) | (40) | (40) |
| (Annual rates of change) | | | | | |
| Revenues | 16.4 | 19.9 | -2.4 | 12.2 | 17.8 |
| Of which: tax revenues | 14.1 | 21.4 | -0.3 | 13.1 | 19.5 |
| Total expenditures and net lending | 6.6 | 41.2 | -0.3 | 11.1 | 7.7 |
| Current expenditures | 11.7 | 39.3 | 10.1 | 2.1 | 5.8 |
| Capital expenditures and net lending | -1.7 | 44.8 | -18.6 | 32.6 | 11.2 |
| Of which: capital expenditures | (-1.5) | (6.5) | (-31.8) | (28.0) | (28.9) |

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

1/ Measures adopted in July 1982 including temporary import surcharge.
2/ Excluding temporary import surcharge.

Table 9. Honduras: Summary Accounts of the Banking System

(Stocks in millions of lempiras)

| | Actual | | | | Program | |
|---|---|---|---|---|---|---|
| | 1980 | 1981 | | 1982 | 1982 | 1983 |
| | Dec. | June | Dec. | June | December | |
| Net foreign assets | 126 | 163 | -18 | -209 | -251 | -293 |
| Central Bank | 234 | 185 | 21 | -131 | -173 | -193 |
| Rest of banking system | -108 | -22 | -39 | -78 | -78 | -100 |
| Domestic assets | 1,903 | 1,973 | 2,239 | 2,437 | 2,621 | 2,856 |
| Net credit to the public sector | 378 | 439 | 508 | 578 | 658 | 708 |
| Central Bank 1/ | (421) | (496) | (572) | (654) | (722) | (772) |
| Rest of banking system | (-43) | (-57) | (-64) | (-76) | (-64) | (-64) |
| Credit to the private sector | 1,465 | 1,431 | 1,590 | 1,671 | 1,747 | 1,924 |
| Central government trust fund operations with the rest of the banking system 2/ | -57 | -60 | -79 | -121 | -174 | -258 |
| Medium- and long-term foreign liabilities | 481 | 545 | 533 | 519 | 578 | 637 |
| Central Bank | 297 | 332 | 311 | 296 | 358 | 417 |
| Rest of banking system | 185 | 324 | 222 | 223 | 220 | 220 |
| Liabilities to private sector | 1,548 | 1,591 | 1,688 | 1,709 | 1,792 | 1,926 |
| Money and quasi-money | 1,363 | 1,404 | 1,492 | 1,509 | 1,582 | 1,700 |
| Money | (605) | (590) | (632) | (596) | (638) | (665) |
| Quasi-money | (759) | (814) | (860) | (913) | (944) | (1,035) |
| Private capital and surplus | 185 | 187 | 197 | 200 | 210 | 226 |

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

1/ Government bonds held by the rest of the banking system are included in the Central Bank's net credit to the public sector and in net claims by banks on the Central Bank.

2/ Also includes central government lending to CONADI for external debt service payments.

Table 10. Honduras: Balance of Payments

(In millions of U.S. dollars)

| | 1978 | 1979 | Revised 1980 | Revised 1981 | Est. 1982 |
|---|---|---|---|---|---|
| Current account | -155.9 | -192.0 | -316.8 | -302.7 | -329.1 |
| Goods and services | -173.2 | -212.5 | -338.3 | -330.2 | -359.1 |
| Merchandise trade | -83.9 | -95.5 | -189.2 | -191.6 | -187.5 |
| Exports, f.o.b. | (627.6) | (756.5) | (850.3) | (783.8) | (710.0) |
| Imports, c.i.f. | (-711.5) | (-852.0) | (-1,039.5) | (-975.4) | (-897.5) |
| Travel | -6.4 | -7.8 | -6.5 | 3.8 | 4.2 |
| Factor payments | -85.6 | -120.4 | -153.5 | -153.3 | -188.4 |
| Direct investment income | (-47.2) | (-68.1) | (-77.7) | (-43.7) | (-47.5) |
| Interests and dividends | (-38.4) | (-52.3) | (-75.8) | (-109.6) | (-140.9) |
| Other services | 2.7 | 11.2 | 11.0 | 11.0 | 12.7 |
| Unrequited transfers | 17.3 | 20.5 | 21.5 | 27.5 | 30.0 |
| Capital account | 174.8 | 212.9 | 247.2 | 181.2 | 232.1 |
| Nonfinancial private sector | 57.6 | 54.9 | 84.4 | 36.7 | 10.0 |
| Direct investment | 8.2 | 28.2 | 5.8 | -3.6 | -2.5 |
| Medium- and long-term loans | 37.3 | 31.5 | 104.5 | 12.5 | 12.5 |
| Short-term capital and net errors and omissions | 12.1 | -4.8 | -25.9 | 27.8 | -- |
| Nonfinancial public sector | 104.7 | 100.4 | 144.1 | 157.4 | 152.0 |
| Central Government | 80.0 | 71.2 | 125.5 | 113.0 | 125.0 |
| Rest of general government | 2.2 | -0.2 | -0.2 | -0.2 | -- |
| State enterprises | 21.9 | 34.9 | 20.0 | 42.2 | 27.0 |
| Short-term loans | 0.6 | -5.5 | -1.2 | 2.4 | -- |
| Financial intermediaries | 11.3 | 62.1 | 16.1 | -9.9 | 26.6 |
| Central Bank | 14.7 | 32.9 | 26.9 | 6.7 | 23.5 |
| Other official banks | 14.0 | 14.9 | 6.8 | 2.8 | -15.4 |
| Private banks and savings institutions | -15.6 | 15.1 | -19.7 | -22.6 | 18.5 |
| Rest of financial system | -1.8 | -0.8 | 2.1 | 3.2 | -- |
| Transactions with nonmonetary international agencies | 1.2 | -4.5 | 2.6 | -3.0 | -- |
| Debt relief | -- | -- | -- | -- | 43.5 |
| Allocation of SDRs | -- | 4.9 | 5.0 | 5.0 | -- |
| Overall balance | 18.9 | 25.8 | -64.6 | -116.5 | -97.0 |
| Change in net international reserves of the Central Bank (increase -) | -18.9 | -25.8 | 64.6 | 106.5 | 87.0 |
| External debt defaults | -- | -- | -- | 10.0 | -10.0 |
| Rescheduling | -- | -- | -- | -- | 10.0 |
| Payments arrears | -- | -- | -- | -- | 10.0 |

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

Table 11. Honduras: External Public Debt 1/

| | | | | Projections | | | |
|---|---|---|---|---|---|---|---|
| | 1979 | 1980 | 1981 | 1982 | 1983 | 1984 | 1985 |
| | | | (In millions of U.S. dollars) | | | | |
| Total outstanding public debt at year-end | 912.0 | 1,178.0 | 1,428.0 | 1,735.0 | 2,034.0 | 2,301.0 | 2,575.0 |
| Medium- and long-term debt | 855.0 | 1,103.0 | 1,310.0 | 1,533.0 | 1,792.0 | 2,072.0 | 2,372.0 |
| Short-term debt 2/ | 57.0 | 75.0 | 118.0 | 202.0 | 242.0 | 229.0 | 203.0 |
| Debt service payments | 105.5 | 128.9 | 151.7 | 174.1 | 189.0 | 226.3 | 308.9 |
| Interest | 49.5 | 70.2 | 97.1 | 117.0 | 136.0 | 155.0 | 17[illegible] |
| Amortization 3/ | 56.0 | 58.7 | 48.4 | 82.8 | 96.8 | 115.3 | 134.9 |
| Defaults 3/ | — | — | 6.2 | — | — | — | — |
| Debt relief 3/ | — | — | — | 25.7 | 43.8 | 44.0 | — |
| | | | (In per cent) | | | | |
| Total public debt/GDP | 41.7 | 47.3 | 53.0 | 59.8 | 63.4 | 65.2 | 66.3 |
| Of which: medium- and long-term | (39.1) | (44.3) | (48.6) | (52.9) | (55.8) | (58.7) | (61.1) |
| Debt service payments/GDP | 4.8 | 5.2 | 5.6 | 6.0 | 5.9 | 6.4 | 7.9 |
| Of which: interest payments | (2.3) | (2.8) | (3.6) | (4.0) | (4.2) | (4.4) | (4.5) |
| Debt service payments/exports of goods and services | 12.3 | 13.3 | 16.8 | 21.2 | 21.1 | 22.6 | 27.5 |
| Of which: interest payments | (5.8) | (7.3) | (10.8) | (14.2) | (15.2) | (15.5) | (15.5) |
| Interest payments/total public debt (at midyear)4/ | 6.0 | 6.8 | 7.6 | 7.6 | 7.4 | 7.2 | |

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

1/ Public and officially guaranteed external debt.
2/ Includes liabilities to IMF (except disbursements under the Trust Fund).
3/ Excludes short-term external debt.
4/ Midyear external debt estimated by the arithmetic mean of the outstanding amounts at the end of the current and previous years.

Stand-By Arrangement - Honduras

Attached hereto is a letter, dated October 5, 1982, from the Minister of Finance and Public Credit and the President of the Central Bank of Honduras requesting a stand-by arrangement and setting forth the objectives and policies that the Government of Honduras intends to pursue. To support these objectives and policies, the International Monetary Fund grants this stand-by arrangement in accordance with the following provisions:

1. For the period from                1982 to December 31, 1983, Honduras will have the right to make purchases from the Fund in an amount equivalent to SDR 76.5 million, subject to paragraphs 2, 3, 4, and 5 below, without further review by the Fund.

2. (a) Purchases under this stand-by arrangement shall not, without the consent of the Fund, exceed the equivalent of SDR 15,300,000 until February 15, 1983, the equivalent of SDR 30,600,000 until May 15, 1983, the equivalent of SDR 45,900,000 until August 15, 1983, and the equivalent of SDR 61,200,000 until December 15, 1983.

(b) None of the limits in (a) above shall apply to a purchase under this stand-by arrangement that would not increase the Fund's holdings of Honduras' currency in the credit tranches beyond 25 per cent of quota, or increase the Fund's holdings of that currency resulting from purchases of borrowed resources beyond 12.5 per cent of quota.

3. Purchases under this stand-by arrangement shall be made from borrowed resources until purchases under this arrangement reach the equivalent of SDR 6,372,645, then each purchase shall be made from ordinary and borrowed resources in the ratio of 2 to 1 until purchases under this arrangement reach the equivalent of SDR 6,379,711 and then each purchase shall be made from ordinary and borrowed resources in the ratio of 1 to 1.2, provided that any modification by the Fund of the proportions of ordinary and borrowed resources shall apply to amounts that may be purchased after the date of modification.

4. Honduras will not make purchases under this stand-by arrangement that would increase the Fund's holdings of Honduras' currency in the credit tranches beyond 25 per cent of quota or increase the Fund's holdings of that currency resulting from purchases of borrowed resources beyond 12.5 per cent of quota:

(a) during any period in which

(i) the limit on the net domestic assets of the Central Bank of Honduras set forth in Table 3 annexed to the attached letter; or

(ii) the limit on the banking system's net outstanding credit to the nonfinancial public sector set forth in Table 2 annexed to the attached letter;

(iii) the limit on net external commercial borrowing set forth in paragraph 11 of the attached letter

is not observed; or

(b) during any period in which the intentions regarding the elimination of external payments arrears described in paragraph 13 of the attached letter are not observed; or

(c) during the entire period of the stand-by arrangement, if Honduras:

(i) imposes or intensifies restrictions on payments and transfers on current international transactions; or

(ii) introduces multiple currency practices; or

(iii) concludes bilateral payments agreements which are inconsistent with Article VIII; or

(iv) imposes or intensifies import restrictions for balance of payments reasons.

When Honduras is prevented from purchasing under this stand-by arrangement because of this paragraph 4, purchases will be resumed only after consultation has taken place between the Fund and Honduras and understandings have been reached regarding the circumstances in which such purchases can be resumed.

5. Honduras' right to engage in the transactions covered by this stand-by arrangement can be suspended only with respect to requests received by the Fund after (a) a formal ineligibility, or (b) a decision of the Executive Board to suspend transactions, either generally or in order to consider a proposal, made by an Executive Director or the Managing Director, formally to suppress or to limit the eligibility of Honduras. When notice of a decision of formal ineligibility or of a decision to consider a proposal is given pursuant to this paragraph 5, purchases under this arrangement will be resumed only after consultation has taken place between the Fund and Honduras and understandings have been reached regarding the circumstances in which such purchases can be resumed.

6. Purchases under this stand-by arrangement shall be made in the currencies of other members selected in accordance with the policies and procedures of the Fund, and may be made in SDRs if, on the request of Honduras, the Fund agrees to provide them at the time of the purchase.

7. The value date of a purchase under this stand-by arrangement involving borrowed resources will be normally either the 15th day or the last day of the month, or the next business day if the selected day is not a business day. Honduras will consult the Fund on the timing of purchases involving borrowed resources.

8. Honduras shall pay a charge for this stand-by arrangement in accordance with the decisions of the Fund.

9. (a) Honduras shall repurchase the outstanding amount of its currency that results from a purchase under this stand-by arrangement in accordance with the provisions of the Articles of Agreement and decisions of the Fund, including those relating to repurchase as Honduras' balance of payments and reserve position improves.

(b) Any reductions in Honduras' currency held by the Fund shall reduce the amounts subject to repurchase under (a) above in accordance with the principles applied by the Fund for this purpose at the time of the reduction.

(c) The value date of a repurchase in respect of a purchase financed with borrowed resources under this stand-by arrangement will be normally either the 6th day or the 22nd day of the month, or the next business day if the selected day is not a business day, provided that repurchase will be completed not later than seven years from the date of purchase.

10. During the period of the stand-by arrangement Honduras shall remain in close consultation with the Fund. These consultations may include correspondence and visits of officials of the Fund to Honduras or of representatives of Honduras to the Fund. Honduras shall provide the Fund, through reports at intervals or dates requested by the Fund, with such information as the Fund requests in connection with the progress of Honduras in achieving the objectives and policies set forth in the attached letter.

11. In accordance with paragraph 15 of the attached letter, Honduras will consult the Fund on the adoption of any measures that may be appropriate at the initiative of the Government or whenever the Managing Director requests consultation because any of the criteria in paragraph 4 above have not been observed or because he considers that consultation on the program is desirable. In addition, after the period of the arrangement and while Honduras has outstanding purchases in the upper credit tranches, the Government will consult with the Fund from time to time, at the initiative of the Government or at the request of the Managing Director, concerning Honduras' balance of payments policies.

Tegucigalpa, Honduras
October 5, 1982

Mr. Jacques de Larosiere
Managing Director
International Monetary Fund
700 19th Street, N.W.
Washington, D.C. 20431

Dear Mr. de Larosiere:

1. During the last two years, Honduras' economic and financial situation has deteriorated sharply because of a combination of internal and external factors. As a result of an erosion in confidence associated with the regional political crisis, private investment has been depressed, whereas exports earnings have declined due to a deterioration in the terms of trade and a weakening in regional demand. Consequently, the rate of real economic growth decelerated markedly from an average of 7-1/2 per cent in the period 1976-79 to 2-1/2 per cent in 1980 and to less than 1/2 per cent in 1981. At the same time, the balance of payments has come under pressure partly because of the problems of exports, high interest rates abroad, and the terms of trade, and partly because of the curtailment of foreign lines of credit in response to the deterioration in regional political and economic conditions. The result has been that net international reserves of the Central Bank declined by US$65 million in 1980 and by US$107 million in 1981.

2. The weakening of the productive base of the economy and an erosion of confidence have created problems for the conduct of monetary and fiscal policies and, consequently, for Honduras' performance last year in connection with the EFF program for the third year which was approved by the Fund in June 1981. The overall deficit of the public sector amounted to 8-1/2 per cent of GDP in 1981, compared with a program target of around 7-1/2 per cent, mainly because of a substantial shortfall in central government revenues which reflected both the downturn in the domestic economy and foreign trade and a deterioration in tax administration. Current expenditure grew about in line with program projections, but total outlays of the public sector grew by only 3-1/2 per cent in 1981, because of a sharp decline in investment expenditures arising from administrative bottlenecks and the lack of domestic counterpart funds. As a result of these trends, public sector savings fell well short of what was programed and, consequently, the banking system was forced to finance a much larger than programed share of the public sector deficit.

3. The adverse effect of the weak public finances on the credit program of the Central Bank was compounded last year by a deterioration in the performance of the domestic financial system. Legal reserve deficiencies of the banks increased, in part, because of a liquidity squeeze brought about by the curtailment of normal foreign capital

inflows mentioned earlier. In addition, several financial institutions used more Central Bank credit than anticipated because of a marked deterioration in their financial position resulting from an increase in nonrecoverable loans. Also, the Industrial Development Corporation (CONADI) was unable to meet fully its external debt service commitments last year. All in all, the deviations in the fiscal performance and larger than projected credit demands by the rest of the banking system, combined with a shortfall in disbursements of medium- and long-term foreign borrowing by the Central Bank, resulted in an expansion of its domestic assets by more than twice the amount programed for 1981.

4. The Constitutional Government which came into office in January 1982 has committed itself to redress the financial imbalances created over the last two years and to strengthen the public finances in such a way as to facilitate a recovery in the public investment effort without detrimental effects on the balance of payments. Accordingly, the Government of Honduras has been implementing an adjustment program during 1982 which is designed to bring about a substantial improvement in the overall fiscal and balance of payments performance. Because of the continuing decline in domestic economic activity and foreign trade in 1982, the authorities do not expect significant results from this adjustment program until next year. In support of its stabilization effort, the Honduran Government requests the use of Fund resources under a stand-by arrangement extending through the end of 1983 in an amount equivalent to SDR 76.5 million. The main aim of the program is to bring about an increase in public savings during 1982-83 of 3-1/2 percentage points of GDP which will allow for a substantial reduction in net domestic bank financing of the public sector in 1983. The Government considers the targeted level of the fiscal deficit for 1983 to be sustainable as it will be financed mainly with long-term external credits, mostly on concessional terms.

5. During 1982 the Government has raised new revenues, reduced the growth in its current expenditures, and increased its bond sales in the domestic nonbank market with a view to ensuring that the Central Government's recourse to net Central Bank credit is limited to L 150 million in 1982 and to L 50 million in 1983. New revenue measures were incorporated in the 1982 budget which included an increase in the sales tax rate from 3 per cent to 5 per cent, the introduction of income tax surcharges of 10 per cent and 15 per cent for the upper brackets of the corporate and personal income tax schedules, and the elimination of certain income tax exemptions. In addition, in July 1982, the National Congress approved legislation which established selective consumption duties and a temporary import surcharge, and raised substantially the penalties for underpayment or delays in the payment of income and sales taxes. Also, in August 1982, the Government implemented an administrative reform of the sales tax. As a result of these measures, central government revenues are projected to grow this year by 12 per cent, or by nearly 1 per cent of GDP. On the expenditure side, the Government has limited the growth of current expenditures this year to only about 2 per cent, or less than half the rate of increase recorded last year.

In order to achieve this result, the Government has reduced personnel throughout the Central Administration, and has cut to a minimum its outlays for goods and services through the enforcement of strict expenditure control procedures. Despite these measures, the overall deficit of the Central Government will increase in 1982 because of a large increase in net lending to cover interest payments on certain guaranteed debt of the private and public sectors to foreign commercial banks. In the absence of these extraordinary payments, the overall deficit on central government operations would be reduced by 1-1/2 per cent of GDP this year.

6. The Government has also taken steps to improve the performance of the rest of the public sector by reducing the growth in the current expenditures of public sector entities and by revising the rates and prices of public enterprises as needed to increase their operating surpluses, especially in view of the growing financial difficulties being experienced by some of them. In particular, tariffs of the National Electricity Authority (ENEE) have been increased, whereas those of the National Port Enterprise (ENP) will be raised in October 1982, in line with World Bank recommendations. Moreover, in the case of the National Water and Sewerage Company (SANAA), the Honduran Telecommunications Enterprise (HONDUTEL), the Honduran Coffee Institute (IHCAFE), and the Honduran Forestry Development Corporation (COHDEFOR), significant cost-cutting measures have been taken to improve their financial performance in 1982 and 1983. In order to ensure efficiency throughout the Honduran public sector, the Government has strengthened the oversight functions of the Superintendency of Decentralized Agencies in respect of the state enterprises and other decentralized entities. Furthermore, the authorities have taken measures to strengthen control over foreign indebtedness of the public sector and, in accordance with this aim, they intend to revise the existing legislation governing public sector borrowing.

7. During 1982, the authorities have been carrying out significant structural reforms of several public entities whose financial performance deteriorated in recent years. In particular, the lending and investment activities of CONADI were suspended in early 1982, pending the completion of a detailed study of its operations and those of the local enterprises in which it has investments. In October 1982, the authorities will reach a decision, in collaboration with the World Bank, on a major restructuring of CONADI's operations and functions. Also, as of July 1982, the Honduran Banana Corporation (COHBANA) was reorganized on a much reduced scale and its financial operations were shifted to the National Agricultural Development Bank (BANADESA). The authorities intend to strengthen the financial position of BANADESA over the medium term and to this effect they have recently rescheduled BANADESA's debt with the Central Bank and have initiated a program to increase its capitalization.

8. Looking to 1983, the Government intends to adopt additional measures with a view to improving the savings performance of the public sector. In the presentation of its 1983 budget to the National Congress

in September 1982, the Government has announced that it intends to establish a reform of the customs tariff which will involve a shift from a specific to an ad valorem basis as well as a conversion to the Brussels nomenclature. The reform will also involve an increase in the average duty of the tariff to allow for the elimination of existing surcharges and to raise the overall level of customs duties. The authorities will present the customs reform to Congress in October 1982 with a view to bringing it into effect before the end of 1982. As a temporary measure to bridge the time until the new tariff comes into effect, the National Congress established an ad valorem import surcharge of 20 per cent in July 1982. The tariff reform, together with the full year's effects of the other revenue measures introduced in July 1982, is expected to yield additional revenues during 1983 equivalent to around 2 per cent of GDP. Consistent with the Government's fiscal objectives, the growth in current expenditures of the Government will be limited to around 6 per cent next year. In order to ensure this result, the Government has established quarterly limits on its expenditures in local currency, as shown in the attached Table 1, consistent with the annual targets for total expenditure in 1982 and 1983. It is the intention of the authorities not to exceed these limits; but if these limits are exceeded, the authorities will consult with the Fund staff on the means by which local currency expenditures can be brought into line with the programed targets.

9. Despite the Government's efforts to improve the public finances, a further loss of net official international reserves is unavoidable in 1982, given the need to accommodate a moderate growth in credit to the private sector and the weak performance of financial savings anticipated. Monetary policy, therefore, will be aimed at limiting the overall balance of payments deficit to US$97 million in 1982, and at achieving approximate overall balance of payments equilibrium during 1983. As mentioned earlier, the monetary program contemplates an expansion in net credit of the banking system to the public sector of L 150 million in 1982 and of L 50 million in 1983 which is compatible with the programed public sector deficit and the anticipated foreign borrowing by that sector. Consistent with these annual projections in bank credit expansion to the public sector, quarterly ceilings on the net indebtedness of the nonfinancial public sector with the domestic banking system have been established through December 1983, as specified in Table 2. In conformity with the objectives of the monetary program, the net domestic assets of the Central Bank are programed to increase by not more than L 194 million during 1982, and by not more than L 40 million during 1983, and quarterly ceilings for the net domestic assets of the Central Bank have been established through December 1983, as indicated in Table 3. Consistent with these limits, the Central Bank's net credit expansion to the rest of the banking system is targeted to increase by L 30 million during 1983, compared with L 65 million in 1982. These projections are based on the authorities' determination to enforce the legal reserve requirements strictly to eliminate the problem of reserve deficiencies. To this effect, sanctions for reserve deficiencies will be increased, including the application of penalty rates on the use of Central Bank resources to cover such deficiencies.

10. As an essential feature of monetary policy, the authorities have followed a flexible interest rate policy. Since mid-1981, all bank deposit rates have been free to fluctuate and, since November 1981, there has been no limit on interest rates for bank loans financed with foreign funds. Moreover, in May 1982, the authorities simplified the structure of interest rates, unifying the maximum rate on bank loans financed with local resources at 19 per cent and the Central Bank's rediscount rates at 15 per cent. These rates will henceforth be reviewed quarterly in the light of domestic and foreign financial market conditions in order to ensure a positive return in real terms to domestic savers as well as the competitiveness of domestic interest rates vis-a-vis comparable rates in foreign markets. As part of the Government's policy to promote the development of the local financial market, the authorities intend to increase the sale of government bonds in the domestic nonbank market at competitive interest rates during the remainder of 1982 and in 1983.

11. Since late last year, several public entities have been encountering problems in meeting their external debt service obligations because of the burden of high interest rates in foreign financial markets and a tendency on the part of foreign banks to reduce their exposure in the Central American region. The Government is now in the process of negotiating a rescheduling of the foreign commercial debt of several public institutions and of the private sector with government guarantee. As a result of this operation, external debt relief of US$54 million in 1982 and US$44 million in 1983 is expected. Looking to the future, the Government intends to minimize external borrowing at commercial terms by the public sector in order to prevent a deterioration in the term structure of the external debt and to moderate the debt service burden. The authorities also intend to limit severely the granting of guarantees on private sector external, as well as internal, indebtedness. During the period of the stand-by arrangement, the authorities will limit the net use by the public sector, including official financial institutions and private sector with official guarantee, of external credits on commercial terms to no more than US$75 million in the period of the stand-by arrangement ending June 1983, and to no more than US$100 million during the entire period of the stand-by arrangement. Credits on commercial terms are defined as loans with initial maturities of less than ten years, excluding reserve liabilities of the Central Bank, disbursements under the Mexican-Venezuelan oil facility, and the amounts mentioned above in respect to external debt relief.

12. The Government of Honduras believes that domestic wages and prices should essentially reflect the interplay of market forces. Accordingly, the scope of price controls was reduced in March 1982 and is being maintained only for essential consumer goods and medicines. Also, these controls will be administered flexibly to preclude the emergence of distortions. Minimum wage levels are established by the Government, but otherwise the authorities do not intervene in the wage determination process, except as a mediator in collective bargaining procedures. In an effort to set a standard for private sector wage adjustments, the Government will pursue a policy of wage restraint in the public sector.

13. Honduras' exchange system has traditionally been free of restrictions on payments and transfers for current international transactions. In November 1980, Honduras introduced regulations for exchange approval and export surrender designed to restrain capital outflows. These regulations were intensified in September 1981 and May 1982 with the introduction of prior registration requirements for exports and the extension of surrender requirements to all exchange receipts. Furthermore, in September 1981, the authorities established a priority scheme for approval of foreign exchange requests which has given rise to payments arrears on current international transactions, amounting to an estimated US$30 million. Since the end of September 1982, all arrears on current international transactions have been fully backed by a 100 per cent local counterpart deposit in the Central Bank. The Government intends to reduce these arrears by at least US$20 million during the remainder of 1982 or to eliminate them altogether if the outstanding balance is less than US$20 million. Any arrears remaining at the end of 1982 will be eliminated before the end of October 1983. The Government does not intend to introduce any multiple currency practices, or to impose any new restrictions, or intensify existing restrictions on payments and transfers for current international transactions during the period of the stand-by arrangement.

14. In its commercial policy, the Government has traditionally relied on few restrictions, mainly for protectionist purposes. In May 1982, the authorities extended, on a temporary basis, a priority scheme mentioned above to the approval of import permits in order to restrain the demand for nonessential imports. However, it is the intention of the authorities not to deny bona fide import requests; furthermore, the authorities will consult with the Fund staff before June 1983, with a view to eliminating this import restraint before the expiration of the stand-by arrangement. The Government does not intend to impose any new restrictions, or intensify existing restrictions, on imports for balance of payments reasons.

15. The Government of Honduras believes that the policies set forth in this letter are adequate to achieve the objectives of its program, but will take any further measures that may become appropriate for this purpose. The Government will consult with the Fund, on the adoption of any measures that may be appropriate, in accordance with the Fund's policies on such consultation.

Sincerely yours,

Arturo Corleto Moreira
Minister of Finance and
Public Credit

Gonzalo Carias Pineda
President
Central Bank of Honduras

Attachments

Table 1. Honduras: Cumulative Targets for Central Government Expenditure 1/

(In millions of lempiras)

| Period | Target |
|---|---|
| January 1, 1982 - December 31, 1982 | 1,022 |
| January 1, 1982 - March 31, 1983 | 1,249 |
| January 1, 1982 - June 30, 1983 | 1,516 |
| January 1, 1982 - September 30, 1983 | 1,826 |
| January 1, 1982 - December 31, 1983 | 2,092 |

1/ Total expenditures of the Central Government financed from domestic sources.

Table 2. Honduras: Limits on the Debt of the Nonfinancial Public Sector with Domestic Banks 1/

(In millions of lempiras)

| Period | Limits |
|---|---|
| From September 30 to December 31, 1982 | 725 |
| From January 1 to March 31, 1983 | 730 |
| From April 1 to June 30, 1983 | 735 |
| From July 1 to September 30, 1983 | 755 |
| From October 1 to December 31, 1983 | 775 |

1/ The debt of the nonfinancial public sector with domestic banks is defined to include: (a) the net credit from the Central Bank to the nonfinancial public sector, and (b) holdings of government bonds by the rest of the banking system.

Table 3. Honduras: Limits on the Net Domestic Assets of the Central Bank 1/

(In millions of lempiras)

| Period | Limits |
|---|---|
| From September 30 to December 31, 1982 | 510 |
| From January 1 to March 31, 1983 | 505 |
| From April 1 to June 30, 1983 | 490 |
| From July 1 to September 30, 1983 | 505 |
| From October 1 to December 31, 1983 | 550 |

1/ The net domestic assets of the Central Bank are defined as the difference between: (a) currency issue, and (b) net international reserves of the Central Bank (including as a foreign reserve liability any deposits held by the Central Bank as a domestic counterpart against payments arrears).