

EBS/82/179
Supplement 1

CONFIDENTIAL

November 8, 1982

To: Members of the Executive Board
From: The Secretary
Subject: Honduras - Stand-By Arrangement

Attached for the records of the Executive Directors is the text of the stand-by arrangement for Honduras agreed at Executive Board Meeting 82/142, November 5, 1982.

Att: (1)

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 November 5, 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 programmed and, consequently, the banking system was forced to finance a much larger than programmed 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 re-discount 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).