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September 30, 2010

**Statement by Mr. Stein and Ms. Holler on Honduras
(Preliminary)
Executive Board Meeting 10/97
October 1, 2010**

We thank the staff for a concise report and Mr. Guzmán and Mr. Gramajo-Marroquin for their helpful Buff statement. Honduras went through a difficult time and experienced a deep recession, with an economy burdened by the global economic downturn and, additionally, political uncertainty. Sensible economic reforms which were implemented during the first half of the last decade have been abandoned or even reversed more recently, as candidly discussed in the recent Article IV report, and, therefore the authorities' readiness for economic reforms is welcome. **Against this background, we can consent to the proposed decisions.** However, we would like to highlight the following issues and concerns.

We would have preferred a non-financial Fund arrangement to support the authorities' policy agenda and to intensify the cooperation with the Fund. Additionally, this would have provided the authorities with more time to show their commitment to the economic reform agenda and to build a satisfactory track-record of policy implementation, especially after the last Fund programs went off-track. We therefore strongly encourage the authorities to make every effort to make good use of the opportunity presented by the program, including the rebuilding of confidence. In this regard, the April tax reforms, adjustment of public sector tariffs and the central bank's discontinuation of providing credit to the public sector bank are encouraging first steps. We also welcome the commitment to social spending, demonstrated by including a floor on social expenditures in the program.

Implementing fiscal measures is a cornerstone of this program, especially in light of the substantial debt relief. It will be important to keep current expenditure in check, in particular the public sector wage bill. *We ask staff to keep the Board informed about developments concerning the negotiations of minimum wages in Honduras.* We take note of staff comments that the ambitious fiscal consolidation is subject to several risks. Therefore, having contingency measures in place will contribute to the ability to effectively respond to negative shocks and to the credibility of the program. Thus, we welcome that the authorities

are working on a contingency plan and stand ready to take additional measures, as pointed out by Mr. Guzmán and Mr. Gramajo-Marroquin.

We acknowledge that the move towards greater exchange rate flexibility needs to be prepared carefully. However, greater exchange rate flexibility remains an important step towards strengthening external stability. Returning to a crawling band regime would help to correct the current overvaluation and would provide more policy space to respond to external shocks. Meanwhile, monetary policy needs to be appropriately tight to limit inflationary pressures.