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STAFF REPORT FOR THE 2018 ARTICLE IV CONSULTATION—DEBT SUSTAINABILITY ANALYSIS

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Risk of external debt distress:	Moderate
Augmented by significant risks stemming from domestic public and/or private external debt?	No

The debt sustainability analysis (DSA) shows some improvement relative to the previous review mainly due to better-than-expected outcomes in year 2017 and the revised profile of PPP operations.[1] *Staff still assess the risk of debt distress as moderate.*

[1] See *Annex II* of Honduras: Fifth and Sixth Reviews Under the Stand-By Arrangement-Press Release; Staff Report; and Statement by the Executive Director for Honduras (IMF Country Report No. 17/331).

BACKGROUND

1. **Honduras' public debt increased slightly in 2017**. After satisfactory completion of the IMF-supported program (December 2017), gross public debt stood at 40¾ percent of GDP in 2017, an increase of about ¼ percentage *point of GDP relative to 2016*.[2] In 2017, the NFPS posted a deficit of ¾ percent of GDP, and the sovereign placed international bonds for US$700 million at a historically low rate of 6¼ percent.

2. **External debt increased in 2017**. The increase in 2 percentage points of GDP (from 35½ percent of GDP in 2016 to 37½ percent of GDP in 2017) reflected the above-mentioned bond placement. The procedures from the placement were used to pay liabilities from the public electricity company ENEE. Consequently, the actual change in the stock of total external debt is larger than the implicit variation derived from identified debt-creating flows in the LIC-DSA template, thus causing a large residual in 2017. Total external debt figures are consistent with the standard BOP coverage including public banks and the monetary authority.

3. **Public debt is mostly with foreign creditors.** The share of public debt that is external rose from 72 percent in 2016 to about 77 percent in 2017 due mainly to the above-mentioned external bond issuance. The main external lenders to Honduras are the Inter-American Development Bank (IADB), the Central American Bank for Economic Integration (BCIE), and the World Bank. Debt to these institutions carries long maturities but only the IADB continues to provide loans on concessional terms (i.e., with a grant element of at least 35 percent). Domestic public debt is mainly with commercial banks, has a shorter—though rising—maturity (about 3 years), and carries a higher real interest rate. In March-2018, the authorities placed their first 15-year Lempira-denominated bond in the local market at a fixed interest rate of 11 percent.

UNDERLYING ASSUMPTIONS

4. **Economic growth.** The baseline scenario assumes that growth will decelerate to 3¾ percent in 2018, owing to less favorable conditions abroad and uncertainty affecting private consumption and investment. Private consumption and public investment will be the main drivers of growth. Over the medium term, it is expected that growth will converge towards potential (3¾ percent), a similar outlook as envisaged in the previous DSA

5. **Fiscal policy.** As in the previous DSA and consistent with the fiscal responsibility law (FRL) we expect the fiscal outlook continued to be anchored by the FRL, which sets a NFPS deficit ceiling of 1 percent of GDP from 2019 onwards and a limit of about 3 percent in the real increase for current spending. Additionally, the DSA is aligned with the authorities' priority to control the increase in public debt stated in their revised macroeconomic framework. In the baseline scenario,

[2] The NFPS public debt stock presented in this annex includes outstanding liabilities from the security trust fund (around ¼ percent of GDP). Additionally, the authorities adopted the IPSAS-32 standard for reporting PPP operations in the fiscal accounts; therefore, the net stock of liabilities stemming from PPPs is included as public debt stock (estimated at 1½ percent of GDP at end-2017).

the primary balance becomes consistently positive backed by fiscal reforms undertaken in 2013-2017. As part of these reforms, the gatekeeper role of the minister of finance has been strengthened with the requirement of a formal assessment on the size of fiscal liabilities (including contingencies) by the newly created contingency unit for all PPP operations. Thus far this new unit has resulted in a better prioritization of PPP projects. The baseline projection assumes that starting in 2021, the net flows from PPPs would be negative.

6. **Fiscal institutions.** Consolidating the role of the FRL as the cornerstone of macroeconomic policies continues to be the main challenge for the next years. On this front, the experience in Latin America with the adoption of a FRL is mixed. In some countries, a FRL failed to institutionalize fiscal prudence while in others it served to catalyze fiscal reforms and became the backbone of sound policy making. The implementation of the FRL in Honduras requires developing institutions, strengthening commitment, and fostering transparency and accountability across all levels of government. This process is off to a good start but it needs to be entrenched as a binding medium-term target.

7. **Public sector financing.** It is assumed that public financing will be contracted mainly from external sources. Financing conditions are expected to change toward less concessional terms compared to recent years, including with multilateral institutions and in line with Honduras increasing ability to tap international markets. Authorities have been targeting increased Lempiras-denominated debt issuance, with a longer maturity profile. Domestically, authorities target a minimum of 80 percent of the public debt portfolio be issued at fixed rates.

8. **External sector.** On the back of large remittances inflows, favorable terms of trade, and a recovery in coffee production, the current account deficit declined to 1¾ percent of GDP in 2017, its lowest level since 2001. The current account deficit is projected to hover around 4 percent over the medium term, and stabilize at around 3½ percent of GDP over the longer term. Slower growth in remittances, coupled with less favorable terms of trade, explain the move toward higher deficits, which is in line with fundamentals and desired policy settings (see Annex I). As in the previous DSA, the current account deficit continues to be financed primarily by foreign direct investment and, to a lesser extent, public sector borrowing, with small private sector flows. This outcome allows for international reserves to remain around 5 months of non-*maquila* imports throughout the projection period.

EXTERNAL DEBT SUSTAINABILITY ANALYSIS

9. **Public and public guaranteed (PPG) of external debt is expected to start decreasing in the medium term** (Annex II. Table 1). PPG external debt is projected to peak at about 33 percent of GDP in 2022, from about 31 percent of GDP in 2017. The share of PPG external debt in total public debt rises slowly to about 82 percent by 2022. The increase takes place as total debt decreases substantially due to fiscal consolidation. Private external debt is projected to be around 4 percent of GDP through the period.

Selected Macroeconomic Indicators, Current vs. Previous DSA

	2016	2017	2018	2019	Long term 1/
Real GDP growth (percent)					
Current DSA	3.8	4.8	3.7	3.7	3.8
Previous DSA	3.6	4.0	3.6	3.8	3.8
GDP deflator growth (percent)					
Current DSA	3.5	4.2	4.2	4.3	4.0
Previous DSA	3.7	5.9	3.8	4.0	4.4
Primary balance (% of GDP)					
Current DSA	-0.7	-0.4	0.2	0.5	0.7
Previous DSA	-0.3	-0.1	-0.2	0.4	0.5
Current account balance (% of GDP)					
Current DSA	-2.7	-1.7	-3.8	-3.9	-3.5
Previous DSA	-3.8	-4.1	-4.3	-4.0	-3.7
Net FDI (% of GDP)					
Current DSA	4.5	4.2	4.4	4.2	4.3
Previous DSA	4.5	5.7	6.1	6.0	6.4

Source: IMF staff estimates.

1/ Defined as the last 15 years of the projection period. For the current DSA, the long term covers the period 2024-38, whereas for the previous DSA it covered 2023-37.

10. **External debt ratios remain within indicative thresholds in all scenarios.**[3] The ratios for the PV of PPG external debt and PPG debt service remain below their indicative thresholds in all scenarios throughout the projection period. PV of external PPG remains initially stable and starts to decline in 2023.

11. **In the baseline scenario, debt indicators remain within indicative thresholds under the probability approach**. All ratios remain within indicative thresholds under the baseline scenario (Figure 2). Under the most extreme shock (one-time 30 percent depreciation), the ratio for the PV of debt-to-GDP plus remittances ratio breaches the threshold in 2020 and only returns to levels below the threshold in the late 2026. The ratio of debt service to revenue is breached only in 2020 under the most extreme shock (a one-time 30 percent depreciation), reflecting the bullet payments of the 2013 bond issuance.

12. **External debt indicators appear resilient to a customized scenario combining negative real, fiscal and financing shocks.** The customized scenario aims at capturing possible downside risks and key vulnerabilities in Honduras. It includes negative shocks to GDP growth, which could arise from weaker external conditions; tighter external financing conditions that could be associated with negative developments in international financial markets; and a weaker fiscal position from possible slippages in the implementation of the fiscal responsibility law. In this scenario, the PV of PPG external debt-to-GDP plus remittances ratio rises initially up to 24 percent and starts to decline

[3] Honduras has large remittances inflows — about 18 percent of GDP on average in 2015-2017. Therefore, the indicative external DSA thresholds reported are remittances-adjusted as per the DSA template.

in 2023. The ratio of debt service-to-exports plus remittances and debt service to revenue also remain below their indicative thresholds throughout the projection.

Baseline vs. Customized Scenario 1/

	2018	2019	2020	Long term 2/
Real GDP growth (percent)				
Baseline	3.7	3.7	3.7	3.8
Customized	2.6	2.5	2.8	3.5
Average interest rate on new external debt				
Baseline	3.4	3.4	3.4	3.4
Customized	4.4	4.4	4.4	4.4
Fiscal balance				
Baseline	-0.8	-0.8	-0.7	-0.7
Customized	-2.8	-2.5	-2.2	-1.9

Source: IMF staff estimates.

1/ In the customized scenario, (i) real GDP growth is 2.5 percent in 2018 and 2.8 in 2019, and rises on average 0.25 percentage points per year to reach 3.5 percent in 2022, staying at this level for the remainder of the DSA period; (ii) financing conditions from external capital markets deteriorate permanently, raising the average interest rate on new external debt by 100 basis points; and (iii) the overall deficit increases by 2 percent of GDP in 2018 compared to the baseline and then fades out partially at a constant rate of 15 percent during the DSA period.

2/ Defined as the last 15 years of the projection period. For the current DSA, 2024-38.

PUBLIC DEBT SUSTAINABILITY ANALYSIS

13. Public debt ratios are expected to peak in 2021 and then start to decline subsequently (Table 3). Public debt is projected to peak at about 41½ percent of GDP in 2021 (up from 40¾ percent of GDP in 2017) and start falling slowly as fiscal consolidation proceeds and interest payments decline reaching 30 percent of GDP by 2028. In present value terms, the debt-to-GDP ratio is expected to peak at around 36¼ percent of GDP in 2021 and fall to about 25 percent of GDP by the late 2020s. Public debt dynamics remain somewhat vulnerable to both policy-related and exogenous shocks, especially to those related to economic growth and fiscal policy (Annex II. Table 4). However, under no scenario the PV of debt-to-GDP ratio breaches its benchmark.

14. The exposure to contingent liabilities is limited. Several measures recently taken by the authorities limit the exposure of public debt to fiscal risks. For instance, by doubling the contribution rate for the social security institute (IHSS), the authorities' have improved the IHSS actuarial position; the PPP framework law was amended to limit the provision of government guarantees for PPP operations; and by upgrading PPPs accounting rules to international standards the impact of PPP's operations is included into the regular spending or financing recording. The 2017 bond issuance was used to clear most of ENEE's liabilities, leaving an estimated of 1¼ percent of GDP under dispute (classified as either pending or contingent).

CONCLUSION

15. Despite marked improvements on public and external debt indicators the risk of external debt distress remains moderate. Stronger than expected fiscal consolidation, and a reduced current account deficit strengthen the resilience of Honduras external position. The FRL passed in 2016, and its fulfillment, is the foundation for continued structural fiscal reforms over the coming years. Against this backdrop, further revenue mobilization efforts and actions to ensure the sustainability of state-owned enterprises will be essential to guarantee fiscal sustainability. On the monetary front, the reform of the monetary policy framework has shown some progress but much more work is needed.

Table 1. Honduras: External Debt Sustainability Framework, Baseline Scenario, 2015-38 1/

(In percent of GDP, unless otherwise indicated)

	Actual			Historical 6/	Standard 6/	Projections													
				Average	Deviation							2018-2023							2024-2038
	2015	2016	2017			2018	2019	2020	2021	2022	2023	Average	2024	2025	2026	2027	2028	2038	Average
External debt (nominal) 1/	**36.1**	**35.5**	**37.6**			**36.8**	**36.8**	**36.8**	**37.1**	**37.1**	**34.9**		**32.8**	**30.9**	**29.3**	**27.9**	**25.7**	**17.3**	
of which: public and publicly guaranteed (PPG)	28.8	29.0	31.2			31.5	32.4	32.5	32.8	32.9	30.7		28.6	26.8	25.2	23.8	21.6	13.4	
Change in external debt	-1.0	-0.6	2.1			-0.8	0.0	0.1	0.2	0.1	-2.3		-2.1	-1.8	-1.6	-1.4	-2.3	0.3	
Identified net debt-creating flows	-2.0	-2.5	-4.8			-1.7	-1.6	-1.6	-1.7	-1.8	-1.8		-1.9	-1.9	-1.9	-1.9	-1.9	-2.0	
Non-interest current account deficit	**3.6**	**1.4**	**0.4**	**5.8**	**4.2**	**2.5**	**2.6**	**2.7**	**2.7**	**2.7**	**2.7**		**2.7**	**2.7**	**2.7**	**2.7**	**2.7**	**2.7**	2.7
Deficit in balance of goods and services	16.2	14.2	14.1			15.6	15.8	15.9	16.0	16.2	16.3		16.3	16.3	16.3	16.3	16.3	16.3	
Exports	45.0	42.5	43.5			42.6	42.9	43.5	43.6	43.8	43.8		43.8	43.8	43.8	43.8	43.8	43.8	
Imports	61.2	56.8	57.6			58.2	58.7	59.4	59.6	60.0	60.1		60.1	60.1	60.1	60.1	60.1	60.1	
Net current transfers (negative = inflow)	-18.3	-18.5	-19.6	-18.7	1.1	-19.2	-19.3	-19.3	-19.4	-19.6	-19.7		-19.7	-19.6	-19.6	-19.6	-19.6	-19.6	-19.6
of which: official	-0.4	-0.2	-0.8			-0.7	-0.7	-0.7	-0.7	-0.7	-0.7		-0.7	-0.7	-0.7	-0.7	-0.7	-0.7	
Other current account flows (negative = net inflow)	5.7	5.7	5.8			6.1	6.1	6.1	6.1	6.1	6.1		6.1	6.1	6.1	6.1	6.1	6.1	
Net FDI (negative = inflow)	**-4.5**	**-4.2**	**-4.4**	**-5.2**	**1.2**	**-4.2**	**-4.2**	**-4.2**	**-4.3**	**-4.3**	**-4.3**		**-4.3**	**-4.4**	**-4.4**	**-4.4**	**-4.5**	**-4.6**	-4.5
Endogenous debt dynamics 2/	**-1.1**	**0.2**	**-0.7**			**-0.1**	**0.0**	**0.0**	**-0.1**	**-0.2**	**-0.2**		**-0.2**	**-0.2**	**-0.2**	**-0.2**	**-0.2**	**-0.1**	
Contribution from nominal interest rate	1.1	1.3	1.3			1.3	1.3	1.3	1.2	1.2	1.1		1.1	1.0	1.0	0.9	0.8	0.5	
Contribution from real GDP growth	-1.3	-1.3	-1.6			-1.3	-1.3	-1.3	-1.3	-1.4	-1.4		-1.3	-1.2	-1.1	-1.1	-1.0	-0.6	
Contribution from price and exchange rate changes	-0.8	0.2	-0.5			...	...	...	...	...	...		...	...	...	...	...	...	
Residual (3-4) 3/	**1.0**	**1.9**	**6.9**			**0.9**	**1.6**	**1.7**	**1.9**	**1.9**	**-0.4**		**-0.2**	**0.0**	**0.3**	**0.4**	**-0.3**	**2.3**	
of which: exceptional financing	-0.1	-0.1	0.0			0.0	0.0	0.0	0.0	0.0	0.0		0.0	0.0	0.0	0.0	0.0	0.0	
PV of external debt 4/	...	...	31.7			31.1	31.4	31.2	31.8	32.0	30.1		28.4	26.8	25.6	24.1	22.3	13.8	
In percent of exports	...	...	72.9			73.2	73.3	71.7	73.0	73.0	68.8		64.9	61.3	58.4	55.1	50.9	31.4	
PV of PPG external debt	**...**	**...**	**25.4**			**25.9**	**27.0**	**26.9**	**27.6**	**27.7**	**25.9**		**24.2**	**22.7**	**21.5**	**20.0**	**18.2**	**9.9**	
In percent of exports	**...**	**...**	**58.3**			**60.8**	**63.1**	**61.8**	**63.2**	**63.3**	**59.2**		**55.4**	**51.9**	**49.0**	**45.8**	**41.7**	**22.6**	
In percent of government revenues	**...**	**...**	**80.8**			**84.1**	**89.3**	**88.8**	**91.1**	**92.1**	**85.8**		**80.2**	**75.1**	**71.0**	**66.3**	**60.3**	**32.8**	
Debt service-to-exports ratio (in percent)	**20.5**	**30.7**	**15.7**			**16.2**	**14.5**	**17.3**	**12.3**	**13.6**	**13.3**		**13.1**	**13.4**	**11.3**	**16.1**	**11.1**	**9.7**	
PPG debt service-to-exports ratio (in percent)	**3.5**	**4.1**	**4.5**			**4.8**	**4.9**	**9.5**	**4.6**	**6.0**	**5.9**		**5.7**	**6.1**	**4.1**	**9.0**	**4.0**	**3.0**	
PPG debt service-to-revenue ratio (in percent)	**5.3**	**5.5**	**6.2**			**6.7**	**6.9**	**13.6**	**6.6**	**8.8**	**8.5**		**8.3**	**8.9**	**5.9**	**13.0**	**5.8**	**4.3**	
Total gross financing need (Billions of U.S. dollars)	2.1	2.6	0.9			1.6	1.4	1.8	1.2	1.4	1.5		1.5	1.6	1.4	2.2	1.5	2.0	
Non-interest current account deficit that stabilizes debt ratio	4.5	2.0	-1.7			3.3	2.6	2.6	2.5	2.6	5.0		4.8	4.5	4.3	4.2	5.0	2.5	
Key macroeconomic assumptions																			
Real GDP growth (in percent)	3.8	3.8	4.8	3.2	2.0	3.7	3.7	3.7	3.7	3.8	3.8	3.8	3.8	3.8	3.8	3.8	3.8	3.8	3.8
GDP deflator in US dollar terms (change in percent)	2.3	-0.6	1.3	3.3	3.8	1.2	-0.7	-0.8	-0.3	0.2	0.7	0.1	1.2	1.5	1.5	1.5	1.5	1.5	1.4
Effective interest rate (percent) 5/	3.2	3.7	4.0	2.7	0.8	3.5	3.6	3.7	3.3	3.4	3.2	3.4	3.2	3.2	3.3	3.2	3.1	3.3	3.3
Growth of exports of G&S (US dollar terms, in percent)	1.2	-2.4	8.5	5.1	13.2	2.7	3.7	4.5	3.6	4.6	4.6	3.9	5.1	5.4	5.4	5.4	5.4	5.4	5.4
Growth of imports of G&S (US dollar terms, in percent)	0.8	-4.2	7.6	4.0	15.3	6.1	3.8	4.2	3.8	4.7	4.8	4.5	5.1	5.4	5.4	5.4	5.4	5.4	5.4
Grant element of new public sector borrowing (in percent)	...	...	...	...	...	16.5	15.0	14.9	15.3	14.3	15.6	15.3	17.7	17.7	17.7	15.2	17.7	17.1	17.5
Government revenues (excluding grants, in percent of GDP)	30.1	31.6	31.4			30.8	30.3	30.3	30.3	30.1	30.2		30.2	30.2	30.2	30.2	30.2	30.2	30.2
Aid flows (in Billions of US dollars) 7/	0.3	0.3	0.3			0.2	0.2	0.2	0.2	0.2	0.2		0.2	0.2	0.2	0.3	0.2	0.4	
of which: Grants	0.2	0.2	0.1			0.2	0.2	0.2	0.2	0.2	0.2		0.2	0.2	0.2	0.2	0.2	0.4	
of which: Concessional loans	0.1	0.1	0.1			0.0	0.1	0.1	0.1	0.0	0.0		0.0	0.0	0.0	0.0	0.0	0.0	
Grant-equivalent financing (in percent of GDP) 8/	...	...	...			1.0	1.1	1.2	1.1	1.1	0.8		0.8	0.9	0.8	1.1	0.6	0.7	0.8
Grant-equivalent financing (in percent of external financing) 8/	...	...	...			34.2	29.2	26.5	30.6	28.4	50.4		47.6	41.9	54.8	29.8	94.0	83.4	53.2
Memorandum items:																			
Nominal GDP (Billions of US dollars)	21.0	21.6	23.0			24.1	24.8	25.5	26.4	27.5	28.8		30.2	31.8	33.6	35.4	37.3	62.8	
Nominal dollar GDP growth	6.2	3.2	6.2			4.9	2.9	2.9	3.4	4.1	4.6	3.8	5.1	5.4	5.4	5.4	5.4	5.4	5.4
PV of PPG external debt (in Billions of US dollars)			5.8			6.1	6.6	6.7	7.1	7.5	7.3		7.2	7.1	7.1	7.0	6.7	6.2	
(PVt-PVt-1)/GDPt-1 (in percent)						1.2	1.9	0.6	1.7	1.4	-0.5	1.0	-0.4	-0.3	-0.1	-0.3	-0.8	-0.7	-0.2
Gross workers' remittances (Billions of US dollars)	3.7	3.8	4.3			4.5	4.6	4.8	5.0	5.2	5.5		5.7	6.0	6.4	6.7	7.1	11.9	
PV of PPG external debt (in percent of GDP + remittances)	...	...	21.4			21.8	22.8	22.6	23.2	23.3	21.8		20.4	19.1	18.0	16.8	15.3	8.3	
PV of PPG external debt (in percent of exports + remittances)	...	...	40.8			42.3	44.0	43.2	44.2	44.2	41.3		38.6	36.2	34.2	31.9	29.1	15.8	
Debt service of PPG external debt (in percent of exports + remittances)	...	...	3.1			3.4	3.4	6.6	3.2	4.2	4.1		4.0	4.3	2.8	6.3	2.8	2.1	

Sources: Country authorities; and staff estimates and projections.

1/ Includes both public and private sector external debt.

2/ Derived as [r - g - ρ(1+g)]/(1+g+ρ+gρ) times previous period debt ratio, with r = nominal interest rate; g = real GDP growth rate, and ρ = growth rate of GDP deflator in U.S. dollar terms.

3/ Includes exceptional financing (i.e., changes in arrears and debt relief); changes in gross foreign assets; and valuation adjustments. For projections also includes contribution from price and exchange rate changes.

4/ Assumes that PV of private sector debt is equivalent to its face value.

5/ Current-year interest payments divided by previous period debt stock.

6/ Historical averages and standard deviations are generally derived over the past 10 years, subject to data availability.

7/ Defined as grants, concessional loans, and debt relief.

8/ Grant-equivalent financing includes grants provided directly to the government and through new borrowing (difference between the face value and the PV of new debt).

Table 2. Honduras: Sensitivity Analysis for Key Indicators of Public and Publicly Guaranteed External Debt, 2018–38

(In percent)

		Projections						
	2018	2019	2020	2021	2022	2023	2028	2038
PV of debt-to-GDP+remittances ratio								
Baseline	22	23	23	23	23	22	**15**	8
A. Alternative Scenarios								
A1. Key variables at their historical averages in 2018-2038 1/	22	24	24	26	27	26	**26**	27
A2. New public sector loans on less favorable terms in 2017-2037 2/	22	23	23	24	25	24	**19**	13
A3. Customized 7/	21	23	24	25	26	25	**17**	4
B. Bound Tests								
B1. Real GDP growth at historical average minus one standard deviation in 2019-2020	22	23	23	24	24	22	**16**	8
B2. Export value growth at historical average minus one standard deviation in 2019-2020 3/	22	25	32	32	33	31	**23**	11
B3. US dollar GDP deflator at historical average minus one standard deviation in 2019-2020	22	22	22	22	23	21	**15**	8
B4. Net non-debt creating flows at historical average minus one standard deviation in 2019-2020 4/	22	24	25	25	26	24	**17**	9
B5. Combination of B1-B4 using one-half standard deviation shocks	22	24	26	27	27	25	**18**	9
B6. One-time 30 percent nominal depreciation relative to the baseline in 2019 5/	22	30	30	30	31	29	**20**	11
PV of debt-to-exports+remittances ratio								
Baseline	42	44	43	44	44	41	**29**	16
A. Alternative Scenarios								
A1. Key variables at their historical averages in 2018-2038 1/	42	46	47	50	52	51	**50**	54
A2. New public sector loans on less favorable terms in 2017-2037 2/	42	44	45	47	48	45	**35**	25
A3. Customized 7/	50	54	55	57	59	56	39	10
B. Bound Tests								
B1. Real GDP growth at historical average minus one standard deviation in 2019-2020	42	43	42	43	43	41	**28**	15
B2. Export value growth at historical average minus one standard deviation in 2019-2020 3/	42	53	71	72	72	69	**51**	24
B3. US dollar GDP deflator at historical average minus one standard deviation in 2019-2020	42	43	42	43	43	41	**28**	15
B4. Net non-debt creating flows at historical average minus one standard deviation in 2019-2020 4/	42	47	49	48	49	46	**33**	17
B5. Combination of B1-B4 using one-half standard deviation shocks	42	48	55	56	56	53	**38**	19
B6. One-time 30 percent nominal depreciation relative to the baseline in 2019 5/	42	43	42	43	43	41	**28**	15
PV of debt-to-revenue ratio								
Baseline	84	89	89	91	92	86	**60**	33
A. Alternative Scenarios								
A1. Key variables at their historical averages in 2018-2038 1/	84	92	94	99	103	101	**97**	100
A2. New public sector loans on less favorable terms in 2017-2037 2/	84	89	92	96	99	94	**74**	53
A3. Customized 7/	82	77	79	83	85	81	57	14
B. Bound Tests								
B1. Real GDP growth at historical average minus one standard deviation in 2019-2020	84	89	91	93	95	88	**62**	34
B2. Export value growth at historical average minus one standard deviation in 2019-2020 3/	84	100	124	127	129	122	**91**	43
B3. US dollar GDP deflator at historical average minus one standard deviation in 2019-2020	84	87	85	88	89	83	**58**	32
B4. Net non-debt creating flows at historical average minus one standard deviation in 2019-2020 4/	84	92	97	100	101	95	**68**	35
B5. Combination of B1-B4 using one-half standard deviation shocks	84	92	101	104	105	99	**72**	36
B6. One-time 30 percent nominal depreciation relative to the baseline in 2019 5/	84	125	124	128	129	121	**85**	46

Table 2. Honduras: Sensitivity Analysis for Key Indicators of Public and Publicly Guaranteed External Debt, 2018–38 (concluded)

(In percent)

	Projections							
	2018	2019	2020	2021	2022	2023	2028	2038
Debt service-to-exports+remittances ratio								
Baseline	3	3	7	3	4	4	**3**	2
A. Alternative Scenarios								
A1. Key variables at their historical averages in 2018-2038 1/	3	3	6	3	4	4	**4**	5
A2. New public sector loans on less favorable terms in 2017-2037 2/	3	3	6	3	4	4	**4**	3
A3. Customized 7/	4	4	8	4	5	5	4	2
B. Bound Tests								
B1. Real GDP growth at historical average minus one standard deviation in 2019-2020	3	3	7	3	4	4	**3**	2
B2. Export value growth at historical average minus one standard deviation in 2019-2020 3/	3	4	8	5	6	6	**5**	4
B3. US dollar GDP deflator at historical average minus one standard deviation in 2019-2020	3	3	7	3	4	4	**3**	2
B4. Net non-debt creating flows at historical average minus one standard deviation in 2019-2020 4/	3	4	7	3	4	4	**3**	2
B5. Combination of B1-B4 using one-half standard deviation shocks	3	4	7	4	5	5	**4**	3
B6. One-time 30 percent nominal depreciation relative to the baseline in 2019 5/	3	3	7	3	4	4	**3**	2
Debt service-to-revenue ratio								
Baseline	7	7	14	7	9	8	**6**	4
A. Alternative Scenarios								
A1. Key variables at their historical averages in 2018-2038 1/	7	7	13	6	8	8	**7**	9
A2. New public sector loans on less favorable terms in 2017-2037 2/	7	7	13	7	9	9	**7**	6
A3. Customized 7/	7	7	14	7	9	9	7	4
B. Bound Tests								
B1. Real GDP growth at historical average minus one standard deviation in 2019-2020	7	7	14	7	9	9	**6**	4
B2. Export value growth at historical average minus one standard deviation in 2019-2020 3/	7	7	14	8	10	10	**9**	6
B3. US dollar GDP deflator at historical average minus one standard deviation in 2019-2020	7	7	13	7	9	8	**6**	4
B4. Net non-debt creating flows at historical average minus one standard deviation in 2019-2020 4/	7	7	14	7	9	9	**7**	5
B5. Combination of B1-B4 using one-half standard deviation shocks	7	7	14	7	9	9	**7**	5
B6. One-time 30 percent nominal depreciation relative to the baseline in 2019 5/	7	10	20	9	13	12	**8**	6
Memorandum item:								
Grant element assumed on residual financing (i.e., financing required above baseline) 6/	15	15	15	15	15	15	**15**	15

Sources: Country authorities; and staff estimates and projections.

1/ Variables include real GDP growth, growth of GDP deflator (in U.S. dollar terms), non-interest current account in percent of GDP, and non-debt creating flows.

2/ Assumes that the interest rate on new borrowing is by 2 percentage points higher than in the baseline., while grace and maturity periods are the same as in the baseline.

3/ Exports values are assumed to remain permanently at the lower level, but the current account as a share of GDP is assumed to return to its baseline level after the shock (implicitly assuming an offsetting adjustment in import levels).

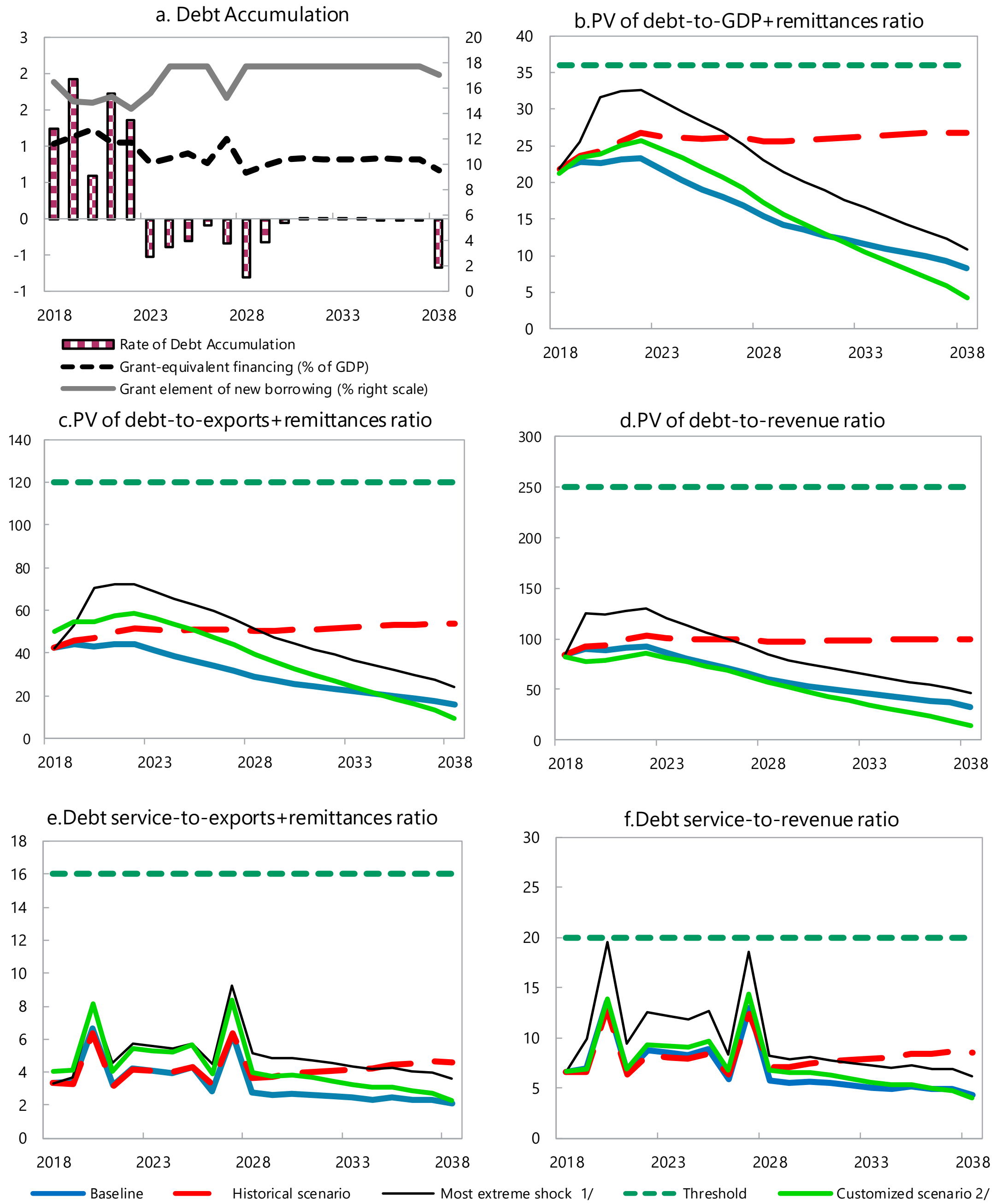
4/ Includes official and private transfers and FDI.

5/ Depreciation is defined as percentage decline in dollar/local currency rate, such that it never exceeds 100 percent.

6/ Applies to all stress scenarios except for A2 (less favorable financing) in which the terms on all new financing are as specified in footnote 2.

7/ In the customized scenario, (i) real GDP growth is 2.6 percent in 2016 and 2.5 in 2017, and rises on average 0.25 percentage points per year to reach 3.5 percent in 2021, staying at this level for the remainder of the DSA period; (ii) financing conditions from external capital markets deteriorate permanently, raising the average interest rate on new external debt by 100 basis points; and (iii) the overall deficit of the CPS increases by 2 percent of GDP in 2015 compared to the baseline and then fades out partially at a constant rate of 15 percent during the DSA period.

Figure 1. Honduras: Indicators of Public and Publicly Guaranteed External Debt 1/

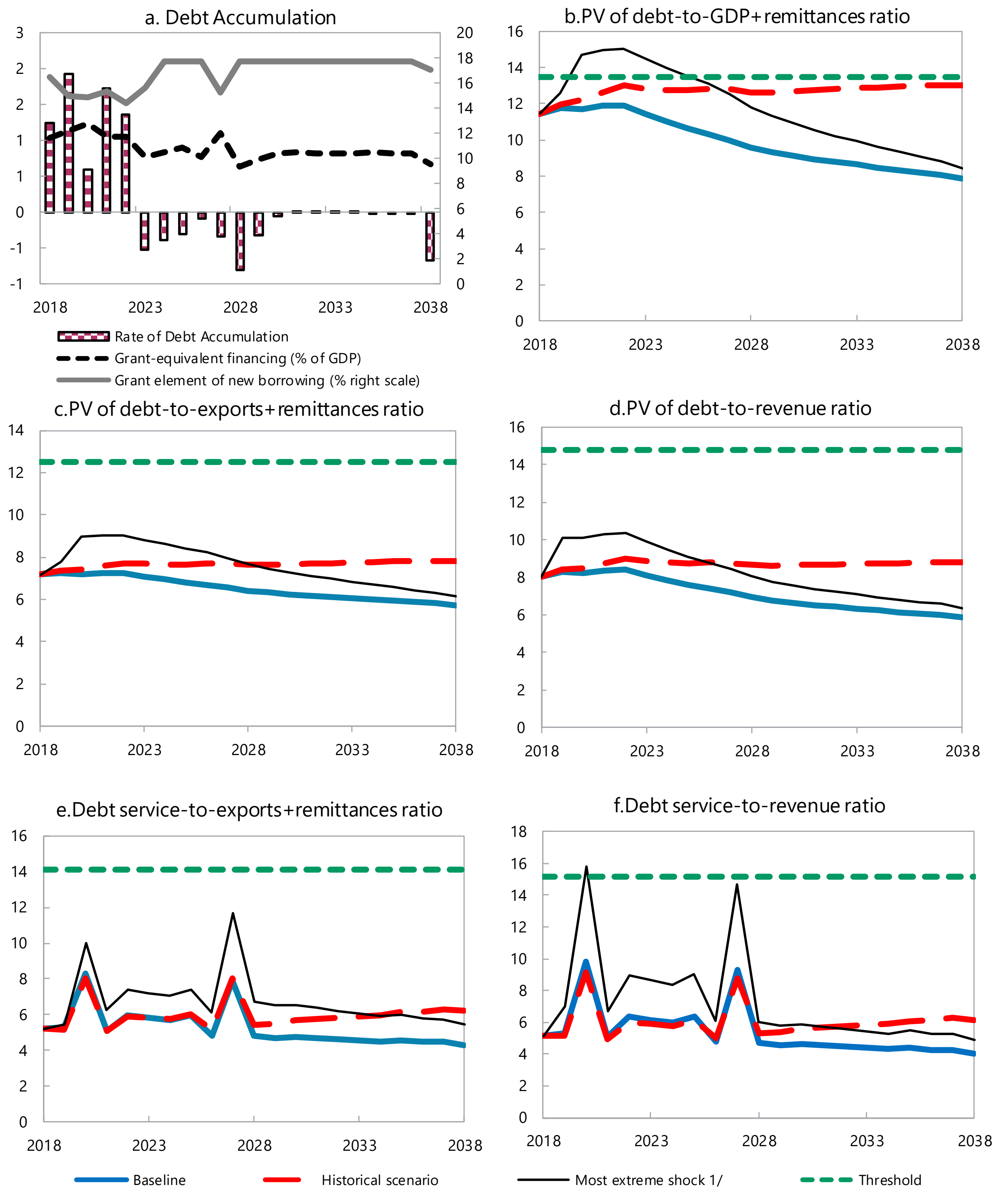


Sources: Country authorities; and staff estimates and projections.

1/ The most extreme stress test is the test that yields the highest ratio on or before 2028. In figure b. it corresponds to a Exports shock; in c. to a Exports shock; in d. to a One-time depreciation shock; in e. to a Exports shock and in figure f. to a One-time depreciation shock

2/ In the customized scenario, (i) real GDP growth is 2.5 percent in 2018 and 2.8 in 2019, and rises on average 0.25 percentage points per year to reach 3.5 percent in 2022, staying at this level for the remainder of the DSA period; (ii) financing conditions from external capital markets deteriorate permanently, raising the average interest rate on new external debt by 100 basis points; and (iii) the overall deficit of the CPS increases by 2 percent of GDP in 2018 compared to the baseline and then fades out partially at a constant rate of 15 percent during the DSA period.

Figure 2. Honduras: Probability of Debt Distress of Public and Publicly Guaranteed External Debt under Alternatives Scenarios, 2018-38 1/



Sources: Country authorities; and staff estimates and projections.

1/ The most extreme stress test is the test that yields the highest ratio on or before 2028. In figure b. it corresponds to a Exports shock; in c. to a Exports shock; in d. to a One-time depreciation shock; in e. to a Exports shock and in figure f. to a One-time depreciation shock

Table 3. Honduras: Public Sector Debt Sustainability Framework, Baseline Scenario, 2015-38

(In percent of GDP, unless otherwise indicated)

	Actual					Estimate						Projections							
	2015	2016	2017	Average 5/	Standard Deviation 5/	2018	2019	2020	2021	2022	2023	2024	2025	2026	2027	2018-23 Average	2028	2038	2024-38 Average
Public sector debt 1/	39.6	40.5	40.8			41.3	41.7	41.5	41.5	39.9	38.2	36.5	34.7	33.1	31.5		30.0	18.2	
of which: foreign-currency denominated	28.1	28.6	31.0			31.5	32.4	32.5	32.8	32.9	30.7	28.6	26.8	25.2	23.8		21.6	13.4	
Change in public sector debt	0.7	0.9	0.3			0.5	0.3	-0.1	0.0	-1.6	-1.7	-1.7	-1.7	-1.6	-1.6		-1.6	-1.0	
Identified debt-creating flows	0.6	2.5	-0.3			0.8	0.6	0.5	0.1	-0.1	-0.2	-0.3	-0.3	-0.3	-0.3		-0.3	-0.3	
Primary deficit 2/	0.5	0.7	0.4	3.1	2.2	-0.2	-0.5	-0.7	-0.6	-0.5	-0.6	-0.6	-0.7	-0.7	-0.7	-0.5	-0.7	-0.7	-0.7
Revenue and grants	29.8	30.5	30.5			29.9	29.5	29.5	29.6	29.5	29.7	29.7	29.8	29.8	29.9		29.9	30.4	
of which: grants	0.9	0.8	0.6			0.6	0.6	0.6	0.6	0.6	0.6	0.6	0.6	0.6	0.6		0.6	0.6	
Primary (noninterest) expenditure	30.3	31.2	30.9			29.7	29.0	28.9	29.0	29.0	29.1	29.2	29.1	29.1	29.2		29.2	29.7	
Automatic debt dynamics	-0.5	1.4	-0.9			0.9	1.1	1.2	0.7	0.4	0.4	0.3	0.4	0.5	0.5		0.4	0.5	
Contribution from interest rate/growth differential	-0.1	0.6	-0.3			0.1	0.2	0.2	0.1	0.0	0.1	0.2	0.3	0.3	0.3		0.3	0.4	
of which: contribution from average real interest rate	1.4	2.0	1.5			1.6	1.7	1.7	1.6	1.5	1.5	1.6	1.6	1.6	1.6		1.5	1.1	
of which: contribution from real GDP growth	-1.4	-1.4	-1.9			-1.5	-1.5	-1.5	-1.5	-1.5	-1.5	-1.4	-1.4	-1.3	-1.2		-1.2	-0.7	
Contribution from real exchange rate depreciation	-0.5	0.8	-0.6			0.8	0.9	0.9	0.6	0.5	0.3	0.1	0.1	0.1	0.1		...	...	
Other identified debt-creating flows	0.7	0.4	0.2			0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0		0.0	0.0	
Privatization receipts (negative)	0.7	0.4	0.2			0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0		0.0	0.0	
Recognition of implicit or contingent liabilities	0.0	0.0	0.0			0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0		0.0	0.0	
Debt relief (HIPC and other)	0.0	0.0	0.0			0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0		0.0	0.0	
Other (specify, e.g. bank recapitalization)	0.0	0.0	0.0			0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0		0.0	0.0	
Residual, including asset changes	0.0	-1.6	0.6			-0.2	-0.2	-0.7	-0.1	-1.5	-1.5	-1.5	-1.4	-1.4	-1.3		-1.3	-0.8	
Other Sustainability Indicators																			
PV of public sector debt	...	...	35.0			35.7	36.3	35.9	36.3	34.8	33.5	32.1	30.6	29.3	27.7		26.6	14.7	
of which: foreign-currency denominated	...	...	25.2			25.9	27.0	26.9	27.6	27.7	25.9	24.2	22.7	21.5	20.0		18.2	9.9	
of which: external	...	...	25.4			25.9	27.0	26.9	27.6	27.7	25.9	24.2	22.7	21.5	20.0		18.2	9.9	
PV of contingent liabilities (not included in public sector debt)	...	...	...			...	...	...	...	...	...	...	...	...	...		...	...	
Gross financing need 3/	3.7	3.1	6.9			3.4	3.8	5.9	3.9	4.1	4.2	4.3	4.5	3.6	5.8		3.8	2.5	
PV of public sector debt-to-revenue and grants ratio (in percent)	...	...	114.6			119.3	122.9	121.4	122.7	117.8	112.7	108.1	102.9	98.3	92.8		88.8	48.3	
PV of public sector debt-to-revenue ratio (in percent)	...	...	117.0			121.9	125.7	124.1	125.3	120.2	115.1	110.4	105.1	100.5	94.8		90.7	49.4	
of which: external 4/	...	...	84.9			88.4	93.7	93.0	95.1	95.9	89.2	83.4	77.9	73.6	68.6		62.3	33.3	
Debt service-to-revenue and grants ratio (in percent) 5/	17.2	13.4	25.0			16.1	18.7	25.7	18.8	19.1	19.2	19.6	20.4	17.5	24.2		17.6	12.1	
Debt service-to-revenue ratio (in percent) 6/	17.7	13.7	25.5			16.4	19.1	26.3	19.2	19.5	19.6	20.0	20.9	17.8	24.7		18.0	12.4	
Primary deficit that stabilizes the debt-to-GDP ratio	-0.1	-0.2	0.1			-0.7	-0.9	-0.5	-0.6	1.1	1.1	1.2	1.0	0.9	0.9		0.9	0.3	
Key macroeconomic and fiscal assumptions																			
Real GDP growth (in percent)	3.8	3.8	4.8	3.2	2.0	3.7	3.7	3.7	3.7	3.8	3.8	3.8	3.8	3.8	3.8	3.8	3.8	3.8	3.8
Average nominal interest rate on forex debt (in percent)	3.6	3.4	4.0	2.6	0.8	3.4	3.5	3.6	3.2	3.3	3.1	3.1	3.1	3.2	3.1	3.4	3.0	3.1	3.1
Average real interest rate on domestic debt (in percent)	6.6	12.8	8.1	7.2	4.0	11.8	13.5	14.4	14.1	12.9	17.1	17.1	17.1	17.0	17.0	14.0	16.9	16.5	16.8
Inflation rate (GDP deflator, in percent)	6.9	3.5	4.2	5.4	2.3	4.2	4.3	4.1	4.1	4.0	4.0	4.0	4.0	4.0	4.0	4.1	4.0	4.0	4.0
Growth of real primary spending (deflated by GDP deflator, in percent)	-5.7	6.9	3.9	0.6	3.2	-0.3	1.0	3.4	4.1	3.9	4.4	3.9	3.5	4.0	4.0	2.7	4.0	4.1	4.0
Grant element of new external borrowing (in percent)	...	...	...	...	...	16.5	15.0	14.9	15.3	14.3	15.6	17.7	17.7	17.7	15.2	15.3	17.7	17.1	17.5

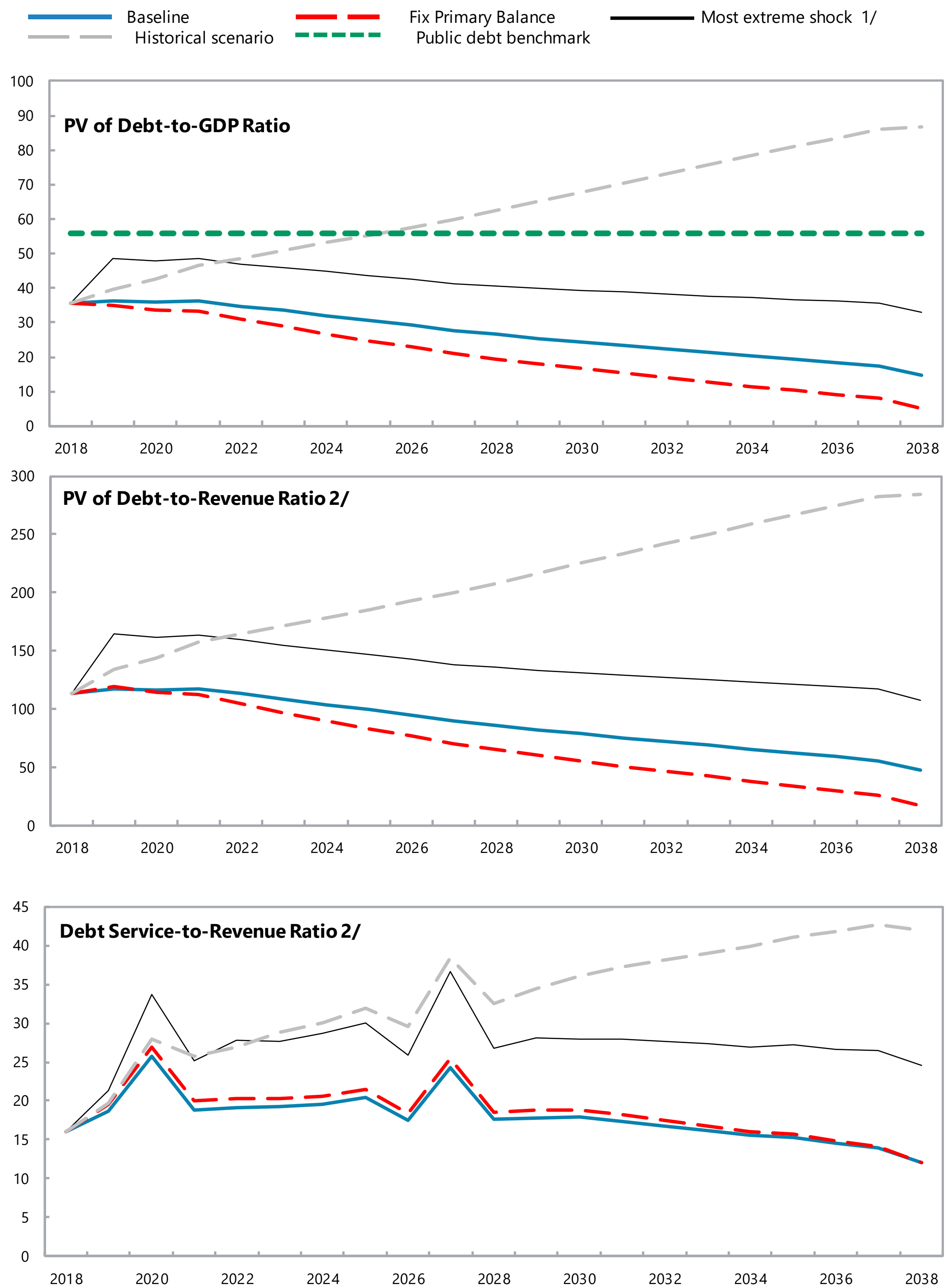
Sources: Country authorities; and staff estimates and projections.
1/ Gross debt of the Combined Public Sector
2/ As defined in the fiscal accounts
3/ Gross financing need is defined as the primary deficit plus debt service plus the stock of short-term debt at the end of the last period.
4/ Revenues excluding grants.
5/ Debt service is defined as the sum of interest and amortization of medium and long-term debt.
6/ Historical averages and standard deviations are generally derived over the past 10 years, subject to data availability.

Table 4. Honduras: Sensitivity Analysis for Key Indicators of Public Debt 2018–38

		Projections						
	2018	2019	2020	2021	2022	2023	2028	2038
PV of Debt-to-GDP Ratio								
Baseline	36	36	36	36	35	33	27	15
A. Alternative scenarios								
A1. Real GDP growth and primary balance are at historical averages	36	39	43	47	49	51	62	87
A2. Primary balance is unchanged from 2018	36	35	34	33	31	29	19	5
A3. Permanently lower GDP growth 1/	36	36	36	37	36	36	36	46
B. Bound tests								
B1. Real GDP growth is at historical average minus one standard deviations in 2019-2020	36	38	39	41	41	41	41	44
B2. Primary balance is at historical average minus one standard deviations in 2019-2020	36	41	46	47	45	44	38	29
B3. Combination of B1-B2 using one half standard deviation shocks	36	41	45	47	46	45	43	40
B4. One-time 30 percent real depreciation in 2019	36	48	48	48	47	46	41	33
B5. 10 percent of GDP increase in other debt-creating flows in 2019	36	45	45	45	43	42	36	27
PV of Debt-to-Revenue Ratio 2/								
Baseline	114	117	116	118	113	108	86	48
A. Alternative scenarios								
A1. Real GDP growth and primary balance are at historical averages	114	134	144	157	164	171	208	285
A2. Primary balance is unchanged from 2018	114	119	114	113	105	97	65	17
A3. Permanently lower GDP growth 1/	114	123	123	126	123	121	119	150
B. Bound tests								
B1. Real GDP growth is at historical average minus one standard deviations in 2019-2020	114	128	133	139	139	138	138	145
B2. Primary balance is at historical average minus one standard deviations in 2019-2020	114	140	157	157	152	147	126	94
B3. Combination of B1-B2 using one half standard deviation shocks	114	138	154	157	155	152	143	133
B4. One-time 30 percent real depreciation in 2019	114	164	162	164	159	155	136	108
B5. 10 percent of GDP increase in other debt-creating flows in 2019	114	152	151	152	147	142	121	90
Debt Service-to-Revenue Ratio 2/								
Baseline	16	19	26	19	19	19	18	12
A. Alternative scenarios								
A1. Real GDP growth and primary balance are at historical averages	16	20	28	26	27	29	33	42
A2. Primary balance is unchanged from 2018	16	20	27	20	20	20	19	12
A3. Permanently lower GDP growth 1/	16	20	27	22	22	23	24	27
B. Bound tests								
B1. Real GDP growth is at historical average minus one standard deviations in 2019-2020	16	20	29	23	24	25	26	26
B2. Primary balance is at historical average minus one standard deviations in 2019-2020	16	20	28	28	28	25	24	21
B3. Combination of B1-B2 using one half standard deviation shocks	16	20	29	27	28	26	26	25
B4. One-time 30 percent real depreciation in 2019	16	21	34	25	28	28	27	25
B5. 10 percent of GDP increase in other debt-creating flows in 2019	16	20	29	31	23	26	24	20

Sources: Country authorities; and staff estimates and projections.
1/ Assumes that real GDP growth is at baseline minus one standard deviation divided by the square root of the length of the projection period.
2/ Revenues are defined inclusive of grants.

Figure 3. Honduras: Indicators of Public Debt under Alternative Scenarios, 2018–38 1/



Sources: Country authorities; and staff estimates and projections.
1/ The most extreme stress test is the test that yields the highest ratio on or before 2028.
2/ Revenues are defined inclusive of grants.