IMF Country Report No. 19/377

HONDURAS

December 2019

FIRST REVIEWS UNDER THE STAND-BY ARRANGEMENT AND THE ARRANGEMENT UNDER THE STANDBY CREDIT FACILITY, AND REQUEST FOR MODIFICATION OF PERFORMANCE CRITERIA

In the context of the First Reviews Under the Stand-By Arrangement and the Arrangement Under the Standby Credit Facility, and Request for Modification of Performance Criteria, the following documents have been released and included in this package:

- **A Press Release** including a statement by the Chair of the Executive Board.
- The **Staff Report** prepared by a staff team of the IMF for the Executive Board's consideration on December 18, 2019, following discussions that ended on November 8, 2019 with the officials of Honduras on economic developments and policies underpinning the IMF Stand-By Arrangement and the Standby Credit Facility. Based on information available at the time of these discussions, the staff report was completed on December 2, 2019.
- A **Statement by the Executive Director** for Honduras.

The documents listed below have been or will be separately released:

Letter of Intent sent to the IMF by the authorities of Honduras*
Memorandum of Economic and Financial Policies by the authorities of Honduras*
Technical Memorandum of Understanding*
*Also included in Staff Report

The IMF's transparency policy allows for the deletion of market-sensitive information and premature disclosure of the authorities' policy intentions in published staff reports and other documents.

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December 18, 2019

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IMF Completes First Reviews Under SBA and SCF Arrangements with Honduras

On December 18, 2019, the Executive Board of the International Monetary Fund (IMF) completed first reviews of Honduras' performance under an economic program supported by a two-year Stand-By Arrangement (SBA) and a two-year arrangement under the Standby Credit Facility (SCF). This program was approved on July 15th, 2019 in the amount of about US$ 309.2 million (SDR 224.8 million), the equivalent of 90 percent of Honduras quota in the IMF (see Press Release 19/285).

The completion of the reviews enables the authorities to access resources in the total amount of about US$144.7 million (SDR 105 million). The authorities have expressed their intention to continue to treat the arrangements as precautionary.

Following the Executive Board's discussion on Honduras, Mr. Mitsuhiro Furusawa, Deputy Managing Director and Acting Chair, made the following statement:

"Despite headwinds to growth and a challenging external environment, the Honduran authorities remain fully committed to the economic program supported by the IMF. They have maintained prudent macroeconomic policies—the fiscal position is in line with the Fiscal Responsibility Law, inflation is within the central bank's target band, and the current account deficit has narrowed despite adverse terms of trade—and have taken initial steps on structural reforms to promote sustained, inclusive growth.

"The authorities have made progress on electricity sector reforms, improving the institutional framework by strengthening the regulatory agency, creating an independent system operator, and issuing regulations that will facilitate an open, transparent, and competitive electricity market. They have also taken important steps to improve operations and governance in the public electricity company, and to implement the plan to reduce electricity losses, notably by creating a task force to address the issue.

"Important measures to strengthen the governance and anti-corruption frameworks have been incorporated into the program, adding to the ongoing efforts to strengthen the institutional framework in the central bank and in public finances, and to improve the business environment. The measures focus on reforms in the framework to manage public-private partnerships, the registry of beneficial ownership, the public officials' asset declaration system, and public procurement.

"The authorities will protect the revenue mobilization efforts made over the past years in order to reduce the infrastructure gap and increase social spending. These efforts will be critical to reduce poverty and inequality, while maintaining a prudent fiscal position that secures debt sustainability over the medium term.

"These policies and reforms should help improve the medium-term outlook, paving the way to gradually boost productivity, growth and employment, and ultimately foster inclusive growth."

INTERNATIONAL MONETARY FUND

HONDURAS

December 19, 2019

FIRST REVIEWS UNDER THE STAND-BY ARRANGEMENT AND THE ARRANGEMENT UNDER THE STANDBY CREDIT FACILITY, AND REQUEST FOR MODIFICATION OF PERFORMANCE CRITERIA

EXECUTIVE SUMMARY

Program objective. An SBA and an SCF arrangements with total access of SDR 224.8 million (90 percent of quota) were approved on July 15, 2019. The Fund-supported program aims at maintaining macroeconomic stability and supporting growth through reforms to foster revenue mobilization, secure sustainability in the electricity sector, and improve governance and the business climate. The authorities plan to continue treating the SBA and SCF arrangements as precautionary.

Economic and political context. Growth has slowed down more than expected due to a challenging external environment and a series of shocks to economic activity—notably, a severe drought. Some social tensions over political reforms and sectoral demands arose over the summer, but recent agreements on electoral management bodies have lessened them. It remains critical to secure the implementation of economic reforms, notably on revenue mobilization and the electricity sector.

Program implementation. Despite a challenging external environment, the authorities remain fully committed to the program, and performance has been strong. All end-September fiscal and monetary quantitative performance criteria—including continuous PCs— were met. The indicative targets on tax revenues, priority social spending, and ENEE's operational ratio have been met as well, while the IT on the wage bill was missed due to a staff's technical error in calculating seasonal factors, but remains on track for end-December. The structural benchmark associated with information on trust funds was met. The one on creating the new customs administration and appointing its management was not met, but it was completed in November. Discussions focused on measures to keep the program on track despite challenging economic developments, and the incorporation of new elements in the program associated with governance reforms and the strengthening of the anti-corruption framework.

Approved By
Patricia Alonso-Gamo (WHD) and Ana Corbacho (SPR)

Discussions took place in Tegucigalpa and San Pedro Sula during October 28-November 8, 2019. The staff team comprised E. Vesperoni (head), J. Kapsoli, C. Lonkeng Ngouana (all WHD), F. Arizala (SPR), and C. Alonso (FAD). J. Puig, Resident Representative, assisted the mission. M. Tábora (OED) participated in the discussions. C. Koh (WHD) provided research assistance and H. Canelas (WHD) document management.

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CONTEXT

1. **Honduras embarked on a program to foster inclusive growth through fiscal, monetary, and governance reforms.** The program aims at maintaining macroeconomic stability and implementing reforms to increase the quality of fiscal policy and the business environment—by sustaining revenue mobilization, securing financial sustainability of the public electricity company (ENEE), and enhancing transparency and governance. On the political front, while some social tensions over political reforms and sectoral demands on the health and education sectors arose during the spring and early summer, recent agreements on electoral reforms appear to have lessened them.

2. **Despite a challenging external environment, the authorities remain committed to the program.** The slowdown in the global economy—which is affecting Honduras through lower demand for exports and terms of trade—has had an impact on economic activity, which is decelerating more than envisaged at the onset of the program. Despite this, all end-September performance criteria were met, and the structural and institutional reform agenda is making progress. The authorities are committed to maintaining prudent macroeconomic policies and implementing reforms in the electricity sector. They are also implementing a roadmap to improve governance—including through a new central bank charter, improvements in the budget process, and reforms to foster transparency and advance the fight against corruption.

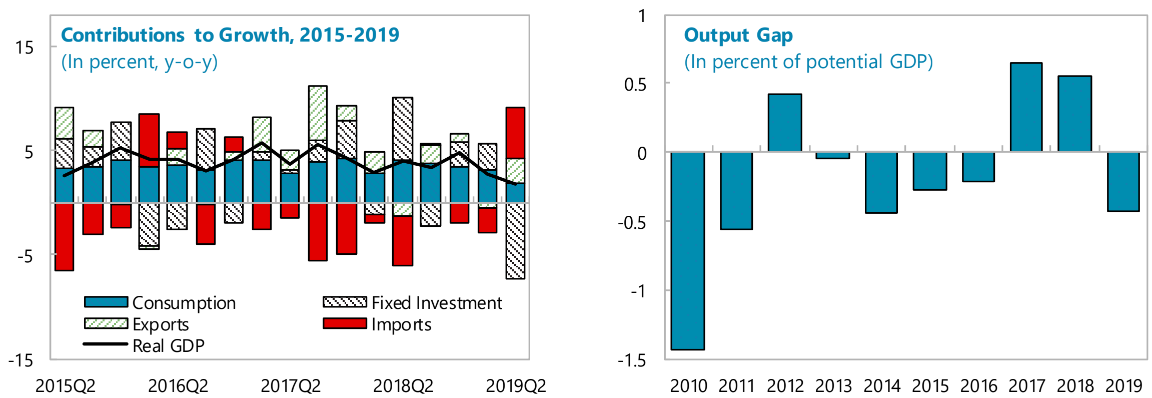
RECENT DEVELOPMENTS, OUTLOOK AND RISKS

3. **The Honduran economy continues to grow but is experiencing headwinds**. These are associated with recent global and domestic developments: (i) the global economy is decelerating in 2019, with an impact on Honduras's main trading partners demand, especially in the agricultural sector; (ii) the country experienced a severe drought, which is putting a toll on the agricultural, livestock, and energy sectors;[1] and (iii) the intensification of social tensions over the summer disrupted economic activity in the second quarter of 2019.

4. **In light of this, economic activity decelerated more than envisaged in the program.** Real GDP slowed to 2¾ percent (y-o-y) during the first half of the year—compared to 3¾ percent in the first half of 2018—opening a mild negative output gap. The slowdown has been reflected in lower gross fixed capital formation, in both private and public investment. Exports fell slightly in real terms; and imports growth decelerated amid less buoyant economic activity, particularly in capital goods. Nonetheless, high frequency indicators during the third quarter—such as the coincident indicator of economic activity (IMAE)—suggests that the deceleration has likely bottomed during the second quarter.

[1] Last September, the government declared a state of emergency amid large harvest losses and water rationing in the capital city.

5. Inflation remains subdued, but inflation expectations continue to hover around the upper limit of the target band. After peaking in May due to one-off factors—increase in food and energy prices—headline inflation has been on a downward path. Weak demand and a relatively stable exchange rate brought 12-month headline and core inflation down to around 4 percent last October—at the center of the BCH's target band (3-5 percent). Inflation expectations also showed a downward trend over the last months; but remain close to the upper limit of the band.



Sources: Central Bank of Honduras and IMF staff calculations.

6. In this context, the monetary policy stance remained unchanged. The BCH has kept the policy rate on hold—after an initial hike early in the year—aiming at keeping inflation expectations anchored through the signaling channel. The crawling peg regime continues to anchor monetary policy in the transition towards inflation targeting. As of end-October, the Lempira has depreciated by 2¾ percent (y-o-y) against the U.S. dollar. Gross reserves reached US$5.3 billion as of September 2019—105 percent of the ARA metric. Surrender requirements were further reduced by 10 percent, allowing banks to sell 40 percent of their FX flows in the interbank market.

7. The current account balance points to a better-than-anticipated external position. The current account posted a surplus of 0.1 percent of GDP during the first semester of 2019, compared to a deficit of ¼ percent of GDP in 2018. The trade balance deteriorated *vis-à-vis* 2018, as a decline in exports—mainly in coffee and bananas—amid lower international prices more than offset the contraction in imports associated with sluggish economic activity. The larger trade deficit was offset by an increase in remittances. The current account surplus and positive flows from the financial and capital accounts prompted an accumulation of gross international reserves of US$253 million—compared to US$96 million in 2018. While reinvested earnings by foreign companies have increased, FDI is showing a decline in 2019, mostly explained by two one-off operations—a loan from a manufacturing firm to its European parent (financed by the purchase of a sugar company by a resident); and a large purchase of financial assets abroad by another manufacturing firm.[2]

8. **Despite a revenue shortfall, the authorities have maintained a prudent fiscal policy**. Against the backdrop of weaker economic activity, the nonfinancial public sector (NFPS) outturn during the first semester showed lower tax revenue, partially compensated by higher revenues from the public electricity company (ENEE) following tariff adjustments in late 2018 and early 2019, before the inception of the IMF-supported program. The authorities restrained public investment while protecting social spending to contain the pressure on the fiscal balance. In August, in line with the framework budget law, the Treasury pre-intervened ENEE to audit its accounts and define the amount of budget support needed by the company—the Treasury had committed its support conditional on rationalization of ENEE's non-critical expenses.[3] The pre-intervention has identified about ¼ percent of GDP in savings, which helped avoid arrears with energy providers. A comprehensive intervention of ENEE will be pursued by end-2019 (see ¶20).

Honduras: Operations of Nonfinancial Public Sector
(In Percent of GDP)

	2018	2019
	January - June	
Total revenue	**15.8**	**15.5**
o/w Taxes	9.7	8.9
o/w Sales of good and service	2.5	2.9
Expenditure	**15.0**	**14.7**
o/w Wage bill	5.6	5.4
o/w Interest bill	1.1	1.2
o/w Investment	1.9	1.5
Overall Balance	**0.7**	**0.7**

Sources: Ministry of Finance and IMF staff calculations.

9. **The authorities have announced measures—mainly on expenditure reallocation—to support growth**. The authorities remain committed to upholding the Fiscal Responsibility Law (FRL) deficit ceiling—one percent of GDP—while counteracting the impact of lower tax collection on investment by restraining current spending in the central administration by about ½ percent of GDP. In this context—and given the large delay in implementation of several large-scale public investment projects (mainly PPPs)—the authorities are reallocating expenditure to support growth in the short-term. As these large projects are in an early stage of execution—many of them have not finalized the prefeasibility assessments—the fiscal space will be used in small infrastructure projects that can be carried out promptly and have high social and economic returns. Implementation will focus on irrigation projects, house improvements under the *Vida Mejor* framework, and maintenance and repair of communal roads.

[2] In the context of the national accounts rebasing project—scheduled to be completed by December 2021—there was a revision of historical FDI information—and its associated primary income—for 2017 and 2018, based on an enhanced coverage of the foreign investment survey and a cross-check of transfer pricing information with the tax authority database. There were other factors having a temporary impact on FDI flows as well. As seen in other emerging economies, FDI flows declined in 2018 in response to tax policy changes in the US that created incentives for repatriation of previously retained profits. The slowdown in growth since 2017 and the political and social tensions this summer have also likely had an impact on FDI flows in the last couple of years; but these flows should recover over the medium term.

[3] The framework budget allows a limited intervention by the Treasury in a set of public institutions—including ENEE. It is focused only on expenditure execution and control.

10. The banking system remains solid and credit growth is slowing. NPLs are low, provision coverage is high, liquidity is ample, and the capital adequacy ratio (CAR) is at 13½ percent, above the regulatory minimum. Credit growth remains strong but is edging down. In particular, FX credit has leveled-off after the surge in the first half of 2018—which at the peak showed year-on-year growth rates close to 22 percent. FX credit is now moving in tandem with local currency credit, with year-on-year growth rates at 11 percent as of end-August.

11. Growth is expected to pick up next year, but the recovery over the medium term would be more gradual than initially envisaged in the program. Real GDP growth has been revised down to slightly below 3 percent in 2019. It is expected to recover in 2020 against the backdrop of a more favorable external environment and a better business climate after the recent agreements on political reforms, but convergence towards its potential over the medium term would take place more gradually. Inflation would stabilize at the center of the BCH's target band; and the fiscal position would be anchored by the FRL. The current account deficit is projected to converge to 4 percent of GDP, as the economy recovers, and remittances return to historical levels—amid lower uncertainty from migration policies and an expected slowdown in the U.S. Gross international reserves are expected to stabilize at about five months of imports.

Text Table 1. Honduras: Program Scenario

(Selected Indicators, Percent of GDP Unless Otherwise Specified)

	Actual		Projections					
	2017	2018	2019	2020	2021	2022	2023	2024
Real								
GDP growth	4.8	3.7	2.8	3.2	3.4	3.5	3.7	3.8
Inflation (average, percent change)	3.9	4.3	4.4	4.0	4.0	4.0	4.0	4.0
Fiscal								
Tax revenue	18.3	18.5	17.7	18.1	18.5	18.6	18.7	18.7
Primary balance	0.1	0.0	0.1	0.1	0.7	0.8	1.0	1.0
Overall balance	-0.8	-0.9	-1.0	-1.0	-1.0	-1.0	-0.9	-0.9
Gross debt	40.2	42.3	43.4	43.2	42.7	42.1	41.5	40.9
Balance of payments								
Current account balance	-0.2	-5.3	-3.3	-3.8	-3.8	-3.9	-4.1	-4.1
Foreign direct investment	4.3	3.7	3.3	3.9	4.2	4.5	4.9	4.9
Terms of trade (percent)	-2.2	-6.6	-0.3	1.8	1.7	0.6	-0.1	-0.4
Monetary								
Gross international reserves (mill. U.S.)	5,088	5,147	5,401	5,591	5,841	6,161	6,501	6,861
Percent of ARA metric	114	110	111	105	103	103	101	102
Net international reserves (mill. U.S.) 1/	4,786	4,853	5,107	5,297	5,547	5,867	6,207	6,567
Credit to the private sector (percent change)	9.4	14.2	9.9	9.6	9.3	9.1	8.9	8.7

Sources: Central Bank of Honduras, Ministry of Finance, and IMF staff estimates and projections.

1/ NIR corresponds to reserves assets minus obligations with the IMF.

12. Risks to the outlook are in line with those described at the onset of the program.

- *External risks.* Rising protectionism and weaker-than-expected global growth would hamper Honduras' growth prospects—weaker external demand would also weigh on exports and the current account. Lower US growth would take a toll on employment for Honduran migrants, affecting the flow of remittances (see Figure 2), which is critical for private consumption.

- *Domestic risks.* The complex political landscape could further affect growth and employment. This could curb appetite for reforms embedded in the program. Domestic risks could increase as 2021—an election year—approaches.

PROGRAM IMPLEMENTATION

13. All quantitative performance criteria (QPC) and indicative targets (IT) for end-September 2019 were met, except for one (Text Table 2).

- **Fiscal Quantitative Targets**. QPCs—on NFPS and ENEE deficits, as well as lending minus repayments from public pension funds—were met.

- **Monetary targets.** Both QPCs on NIR and net domestic assets of the central bank were met with margins.

- **Debt and arrears**. ENEE has not accumulated arrears to electricity generators since the inception of the program. The continuous PC on non-accumulation of external arrears has been met.

- **Indicative targets**. All indicative targets but one—the ceiling on the central government wage bill—have been met. The wage bill target was missed due to a staff's technical error in calculating seasonal patterns—in part due to the payment in the second quarter of a nonrecurrent component of the wage bill that was expected to be paid in the last quarter of the year.[4] The authorities remain committed and on-track to meet the end-year target.

14. The structural benchmark on publication of trust funds spending was met; and the one on the creation of the new custom agency was completed with a delay. The authorities have included a budgetary annex describing the activities—and associated transfers—of trust funds. They also enacted in a timely manner the decree creating the new custom agency and establishing the procedure for hiring the managerial team by end-September, but the appointment of management was only completed in November.

[4] This nonrecurrent component mainly comprises labor debts associated with hiring in previous exercises.

Text Table 2. Honduras: Program Implementation 1/

(Cumulative flows; millions of Lempiras, unless specified)

	End-September		
	Target	Outturn	Status
Fiscal Targets			
Quantitaive Performance Criteria			
Floor on net lending of the nonfinancial public sector	-3,898	3,304	Met
Floor on net lending of ENEE	-4,312	-3,695	Met
Ceiling on the accumulation of domestic arrears by ENEE 1/	0	0	Met
Ceiling on the accumulation of new external arrears (in million US$)	0	0	Met
Ceiling on lending minus repayments from public pension funds	600	569	Met
Indicative Targets			
Floor on the central government tax revenues	66,502	80,348	Met
Ceiling on the central government wage bill	28,200	33,334	Not Met
Floor on priority social spending	1,762	3,578	Met
Floor on the operating revenue-to-spending ratio of ENEE	0.99	1.00	Met
Monetary targets			
Floor on the stock of non-borrowed net international reserves of the BCH (in million US$) 1/	3,738	3,968	Met
Ceiling on the stock of net domestic assets of the central bank 1/	-50,679	-61,394	Met

1/ Definitions as specified in the Technical Memorandum of Understanding.

POLICY DISCUSSIONS

15. Discussions focused on measures to keep the program on track despite sluggish growth, electricity sector reforms, and new program initiatives on governance issues. Discussions emphasized measures to: (i) protect the fiscal targets via revenue measures to safeguard public investment and social spending, (ii) address governance issues in ENEE; (iii) consolidate monetary and exchange rate markets reforms; (iv) strengthen financial sector stability; and (v) foster governance and anti-corruption reforms.

16. While maintaining prudent macroeconomic policies, the authorities intend to use the available fiscal space under the FRL to support growth. The authorities have strived to anchor the fiscal position to the FRL despite lower-than-expected tax collection associated with sluggish economic growth—see below—and are implementing expenditures reallocations to protect investment and social benefits within those limits. On the monetary policy side, they have maintained their policy stance data dependent and aiming to anchor inflation expectations—the transmission mechanism of the monetary policy rate operates mainly through the signaling channel. Going forward, given the current cyclical position, there is a case for using all available fiscal space to support growth in the short-term—the program had initially incorporated an overcompliance of the deficit target in the FRL in 2019-21. Hence, a slight increase in the deficit target for 2019-20 is proposed—of 0.1 and 0.2 percent of GDP for 2019 and 2020 respectively. This would allow the authorities to support growth while securing debt sustainability over the medium term.

A. Securing the Fiscal Position while Protecting Social Spending

Progress on Electricity Sector Reforms

17. The first stage in the electricity sector reform focused on strengthening the institutional framework. The authorities aim at defining a clear governance framework that should guarantee that incentives are aligned with medium-term strategic planning and that markets in the electricity sector are open, competitive, and transparent.

18. The authorities have created an independent dispatch center (ODS) and continue to strengthen the regulatory agency (CREE). The mandate of the new dispatch center—a function previously performed by ENEE—involves the design of plans to expand generation based on sound projections for demand for energy, the preparation of procedures for the purchase of energy in spot markets, and the operation of the payment system in the wholesale market. ODS is already working on these plans and regulations, with a view to finalize them by the end of the year. The governance structure in the CREE has been strengthened—including by appointing all commissioners—and tariffs continue to be updated on a quarterly basis based on technical considerations (*continuous structural benchmark*). After the new tariff structure was approved in June, the authorities have been working on the associated regulations.

19. Following due process, generation contracts that have not come into effect will be reassessed in light of ODS's medium-term strategic planning. These projects had been negotiated by ENEE over the last years, but the increase in supply they will bring about may not be in line with the expected evolution of electricity demand in Honduras—as defined by ODS's medium-term expansion plans—or may not be fully compliant. This process will pave the way to procurement of energy following the electricity framework law.

20. The authorities are improving ENEE's governance and making progress on the unbundling of the company:

- *Management.* A new management team was appointed in ENEE, and the Treasury has established a pre-intervention team to audit its operations. The authorities intend to implement a full intervention of the company by end-2019 to secure a swift implementation of reforms.
- *Audit.* The process to hire international firms to conduct audits of ENEE's financial accounts and its processes will be finalized by early 2020. An inter-institutional commission will value the company's assets and liabilities—which is critical for its unbundling.
- *Unbundling.* As mandated by the electricity framework law, the authorities are making progress to unbundle ENEE into three independent companies that will operate in generation, transmission, and distribution. The separation of the company—which is planned

to be defined by mid-2020—will enhance the functioning of the electricity market and attract investment.

- *Financial and generation issues.* By early 2020, the authorities plan to reach refinancing agreements with ENEE's creditors, including by cancelling the trust funds managing the company's cash flow—which will improve governance. Additionally, in strict adherence to the legal framework, they will seek a more efficient electricity market through agreements with existing private generation companies.

- *Electricity losses.* A new task force was launched to reduce non-technical losses by conducting targeted field assessments of irregular connections, tampered or damaged meters, and unmetered consumers. The authorities are also securing the financing to upgrade the transmission grid. Following due process, the contract with *Empresa Energía Honduras* (EEH)—the operator of the distribution system—will be reassessed (see below).

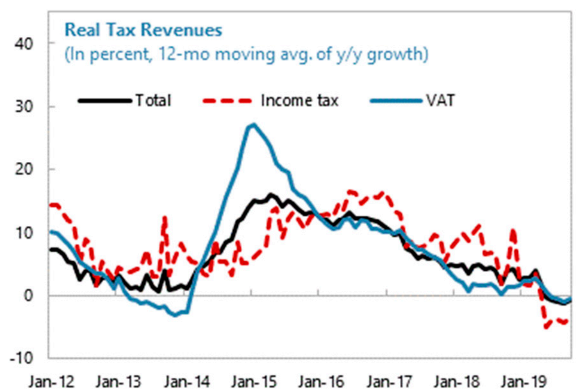
21. The authorities and the staff concurred that continued steadfast implementation of reforms plans is of the essence. The authorities have acknowledged that negotiations with EEH will take longer than expected. Cancelling the contract would involve costs to the Treasury in the form of payments to the company—which are not yet clearly defined—while revisiting the contract requires careful assessment of responsibilities both in terms of management of distribution operations and losses reduction. The authorities argued that these issues call for proceeding cautiously. While this delay is likely to compromise the prospects for reducing losses in 2019 as planned, the authorities have streamlined ENEE's spending to still meet the deficit target in the program and they are confident that the new task force will yield results in terms of losses reduction next year. They remain committed to eliminate the trust funds in ENEE to improve the company's governance, strengthen the payment system in the electricity market, and pave the way to discussions with existing generation companies. These reforms will improve the financial position of ENEE as envisaged in the program, opening up fiscal space for investment and social spending.

Safeguarding the Fiscal Space

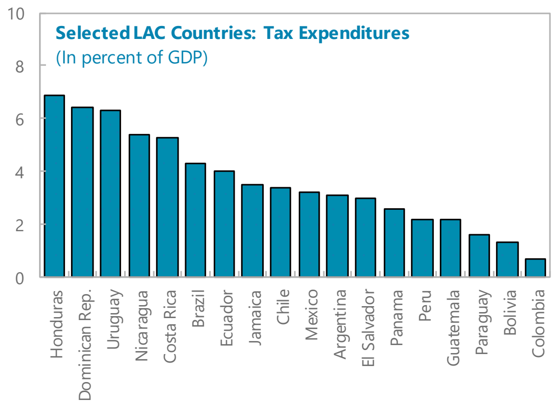
22. Sluggish growth and faster-than-expected tax revenue losses from previous tax measures point to a shortfall in collection this year. Tax revenue projections based on outturns for January-October point to a shortfall of 3.7 billion Lempiras by end-2019—about 3 percent of total collection—mostly explained by underperformance in sales taxes, particularly on VAT on imports. The tax shortfall is partly due to sluggish economic activity, which has dented reported profit rates and imports growth—especially those that do not benefit from tax exemptions (Annex 1). A frontloaded impact of the minimum income tax phase-out also played a role—although this would concomitantly reduce the negative impact of the reform in 2020.[5] The authorities have pointed to the need to streamline tax expenditure to reduce distortions in the

[5] The phase out of the minimum corporate income tax is scheduled in three stages during the 2018-2020 period. Some of the revenue losses expected in 2020 materialized in 2019 via anticipated payments.

tax system and broaden the tax base. Hence, they are finalizing the bill to be sent to Congress to reduce tax exemptions by end-December (*structural benchmark*). They are also finalizing reforms proposals to the tax code that would strengthen tax administration—by allowing electronic notification to tax delinquents and by transferring verification procedures for tax exemptions from the Treasury to the Tax Administration Office (*structural benchmarks*). In this context, the authorities believe that strengthening cooperation between the Treasury, the Tax Administration Office, and the Customs Office is critical.



Sources: Honduras Ministry of Finance and IMF staff calculations.



Sources: CIAT and IMF staff calculations.

23. The authorities are committed to keep the revenue mobilization momentum, although the recovery in revenues is expected to be more gradual. The recent cyclical developments point to an opening of the output gap and a more gradual recovery in economic activity than the one envisaged at the inception of the program, which is having an impact on revenue performance. In light of these trends, it is proposed that the path embedded in the indicative target on tax revenues is modified; though keeping the level in tax collection envisaged at the inception of the program for 2021. While this could imply a more gradual recovery in public investment, social spending can still be protected; and the authorities are working on compensatory expenditure measures focusing on current spending—particularly public consumption—to protect investment as well.

24. The 2020 budget is prudent and protects social spending, and the authorities remain committed to continue enhancing governance and public financial management (PFM). The 2020 draft budget is consistent with fiscal targets in the program, including the protection of social spending. The authorities continue to work on governance and expenditure quality issues:

- *Social spending and climate change.* The budget expands the coverage of the cash transfer-program *Vida Mejor*, strengthens gender programs (including the flagship *Ciudad Mujer*), and plans to tap into the Green Climate Fund to promote climate-resilient forest restoration for the first time.

- *Governance and expenditure quality*. The 2020 budget includes annexes on spending through trust funds (*structural benchmark*) and fiscal risks—in line with recommendations from the Fiscal Transparency Evaluation. The authorities continue to work on the plan to execute trust funds' social and infrastructure spending under the PFM framework in the 2021 budget; and on improvements of the fiscal risks annex for the next budget bundle (including expanding its coverage). The Unit of Works and Processes is working on a transition to performance-based budgeting; aiming at becoming an expenditure quality unit to strengthen efficiency of public services.

- *Fiscal transparency*. The authorities are upgrading their statistical standard towards the GFSM 2014. They are publishing timely information on the Treasury web page; and a revision of the FRL by-law—in order to align it with the new standard—is under preparation.

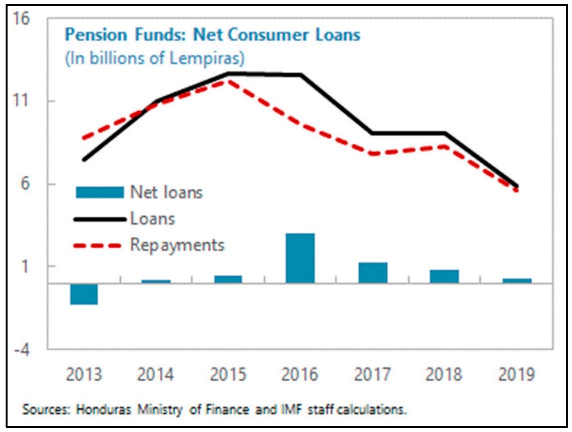
B. Upgrading the Monetary Policy Regime

25. The authorities have made progress in the transition towards inflation targeting. Following recent progress on monetary and FX operations—such as the reduction of FX surrender requirements, better liquidity management, and electronic interbank operations—and guided by recommendations from recent Fund technical assistance, the BCH is working to strengthen the monetary policy framework and develop the FX market, including a further reduction in the FX surrender requirement. A revision of the of monetary QPCs is proposed, due to a higher accumulation of NIR associated with the better-than-expected external position.

26. In line with its objective to modernize the monetary policy framework, the central bank is preparing a draft of its new charter with technical assistance from Fund staff. The draft law enshrines price stability as the central bank's primary objective and limits the scope for direct credit to the public sector—including development banks. The draft law also introduces important changes in areas such as operational independence, transparency, accountability, and governance. In particular, the draft law redesigns the governance structure of the BCH, making it consistent with the international best practice by separating the executive management and oversight functions. The authorities expect to submit the draft law to Congress by end-2019 (*structural benchmark*).

C. Preventing Financial Vulnerabilities

27. A healthy deceleration in pension funds' provision of consumer loans to affiliates is taking place, and the authorities remain committed to assess improvements to the investment policy framework. While lending flows to affiliates show a decreasing trend—and are in line with program targets—their stock still represents 30–35 percent of some pension funds overall investment portfolio. Pension funds find those loans attractive due to the full recourse on pension contributions in case of default, while affiliates benefit from relatively low interest rates. The authorities agreed that strengthening internal risk management practices and transparency in pension funds' investment is critical to safeguard financial sustainability.



28. The authorities intend to broaden financing options for the private sector and investment alternatives for institutional investors. The development of domestic capital markets will also strengthen the interest rate channel of monetary transmission, supporting the transition to inflation targeting. Hence, a new structural benchmark on the submission to Congress of a new securities market law—which was prepared with technical support from Fund staff and has the potential to help expand financing instruments for corporations, including through securitization—is proposed (*March 2020*).

29. The authorities are strengthening supervisory practices in the financial system. In line with Basel III and the Fund's Financial Sector Stability Review (FSSR), they are phasing in an additional capital charge of 2.5 percent on banks through December 2022 and strengthening CNBS capacity in stress testing and risk-based supervision.

30. The supervisory commission intervening BANADESA has received an extension of its deadline but remains committed to report to Congress before end-2019. The CNBS has prolonged the intervention of BANADESA—for the second time—until February 2020. Despite this, the authorities remain committed to submit to Congress the intervention findings before end-2019. They explained that the extension of the deadline aims at retaining control of management in BANADESA while the proposed solution is discussed in Congress. The commission has reportedly stated that the solution will respect depositors' rights without injection of public funds; and it would be coupled with plans to maintain financial inclusion of farmers.

31. Loans provided under the new financial assistance law require close monitoring. The scheme is market-based and aims at reducing the debt burden of heavily-indebted consumers by consolidating multiple loans into a single instrument. Financial institutions will deduct installments from the payroll of participating formal workers, which would lead to lower interest rates on the new loans.[6] The law also facilitates the packing of consumer and mortgage loans, allowing the use of real estate as collateral. It also allows pension funds to increase their position on consumer loans by using investment trusts.[7] The scheme requires a complex

[6] The labor reserve could also be used as collateral for the consolidated loans. The labor reserve is 4 percent of wages paid by employers to be disbursed to employees once the labor relation concludes.

[7] In the Honduran legal framework, the financial risk of an investment trust is carried out by the trustor.

administration to track the relationships among the various parties involved and therefore should be implemented gradually. It also calls for close monitoring of regulatory limits for pension funds' investment, in light of additional exposure to consumers' credit risk.

D. Improving Governance

32. The authorities have been working on a roadmap to foster governance reforms. They are convinced that these reforms can foster inclusive growth through better management of public resources, further anti-corruption efforts, and an enhanced business climate. Improvements in governance can help on three macro-critical issues: (i) the strengthening of the institutional framework to support effective policy making; (ii) the need to address social demands for more effective and transparent public service provision, and (iii) the reduction of red tape. Hence, to complement their ongoing efforts—which includes public finance management, revenue administration, the central bank, the public electricity company, and the reduction of red tape—the authorities have been working together with Fund staff to identify cross-cutting governance issues for further reforms.

33. The authorities see scope to strengthen fiscal governance by preventing the misappropriation of public resources and limiting fiscal risks. They see the need to strengthen their procurement process and to reform the framework to manage Public-Private Partnerships (PPP), through the following measures:

- The creation—with support from the IDB—of a new PPP unit in the Treasury. The regulations for this unit—which will work in tandem with the Treasury's contingency unit—will ensure that it assesses the convenience of procuring projects as PPPs rather than as public investment and conducts technical feasibility and cost-benefit studies at all stages of the project cycle.
- A gradual implementation of an enhanced public purchases and contracting platform—*Honducompras 2*—ensuring its full integration with the Treasury IFMIS (SIAFI) for the central government entities, aiming at preventing misappropriation of public resources and securing budgetary savings.[8]
- Submission to Congress of reforms to the public procurement law to modernize the process and strengthen compliance.

34. They also see scope to enhance governance by strengthening the AML/CFT and anti-corruption framework. The Court of Accounts has decided to issue by-laws to reform the public officials' asset declaration system. This will enhance accountability by revising the criteria to determine reporting officials based on hierarchy and risk, and by digitalizing the submissions. The staff welcomed these initial steps on reforming the asset declaration system; and recommended further progress to update the categories of information requested and the

[8] *Honducompras 2* is a web-based platform that disseminates information and manages procurement operations for all entities oversaw by the public procurement law.

definition of politically exposed persons, and to enhance transparency in the dissemination of this information. The authorities also intend to submit to Congress legislation requiring the amendment to the Code of Commerce to only allow registered shares and the creation of a centralized registry of beneficial ownership that will ensure timely identification of owners of all types of legal persons, including by requiring legal entities to submit updates and establishing dissuasive actions to secure compliance. As noted in the last GAFILAT report, both measures could reinforce both the prevention of and the fight against corruption—notably by building critical information that can be cross-checked.

35. The authorities believe that incorporating these initiatives into the program is critical to respond to social demands and improve their macroeconomic policy framework. Hence, they have proposed five new structural benchmarks: (i) amendments of the by-laws to the organic law of the Court of Accounts to reform the asset declaration system of public officials (*end-September 2020*); (ii) issuance of regulations for the Treasury's PPP unit (*end-June 2020*); (iii) improvements in procurement through the implementation of *Honducompras 2* in the main institutions within the central administration (*end-September 2020*); (iv) reforms to the public procurement law (*end-September 2020*); and (v) the submission of legislative proposals to create a centralized registry of beneficial ownership (*end-September 2020*).

PROGRAM MODALITIES

36. Work is underway to complete the structural benchmarks for end-December:

- *Fiscal*. The Treasury is finalizing the bill to streamline tax exemptions and is working on reforms to the tax code that will introduce electronic notification and transfer control of tax exemptions to SAR. The authorities are also coordinating with a World Bank technical advisor to draft the legal instrument creating a centralized wage bargaining mechanism.
- *Monetary and financial*. Supported by recent Fund TA, the authorities are drafting a new central bank charter (¶26). Supported by Fund TA, the central bank is working on a plan to phase out remaining FX surrender requirements. Finally, the intervention commission is finalizing recommendations to be submitted to Congress to address BANADESA's financial situation.
- *Institutional*. The implementation of the electronic signature is ongoing—a private IT provider has been selected and it is currently incorporating the required technology into an electronic platform for public entities. The plan to complete this process is being finalized by end-2019.

37. The program remains fully financed and Honduras' capacity to repay remains adequate. Financing assumptions and the indicators of Fund credit remain in line with those at program approval (Table 11). The authorities intend to continue treating the program as precautionary**.**

38. The authorities request modifications of the performance criteria on net lending of NFPS, NIR, and NDA. Downward revisions of the NFPS targets for December-2019, June-2020, and December-2020 are proposed to reflect the use of the small fiscal space allowed by the FRL to support growth. NIR and NDA targets for December-2019, June-2020, and December-2020 are more ambitious, reflecting the better-than-expected external position.

39. Safeguards assessment. An updated safeguards assessment of the central bank was completed in September. The assessment found that it has successfully concluded the 2014-2018 recapitalization process and strengthened its financial position. Plans to amend the Central Bank Law are underway—including to strengthen its independence and its governance framework by establishing independent oversight. Staff also recommended the enhancement of transparency through the adoption of International Financial Reporting Standards (IFRS) beginning with the 2021 financial statements.

STAFF APPRAISAL

40. Program performance has been strong thus far. Despite the ongoing economic slowdown, the authorities have made a significant effort to comply with the program's quantitative targets. One end-September IT was missed but remains on track to comply with the end-December target. One SB envisaged for end-September was completed, and while the other SB was not met, required actions were completed in November. All QPCs, continuous PCs, and ITs for end-December remain on track and the authorities have done substantial progress to implement policy measures scheduled for end-2019.

41. Despite the slowdown in economic activity, the authorities remain committed to prudent macroeconomic policies. The economy is experiencing large adverse shocks, but the authorities continue to anchor policies through the FRL by containing the impact of sluggish growth on revenues through restraint in current spending, in order to minimize the impact on public investment and protect social spending. They are also committed to maintain revenue mobilization efforts through streamlining of tax expenditures and to enhance governance by better accounting of trust funds operations. Monetary policy continues to be geared towards maintaining price stability and an adequate level of international reserves to buffer external shocks. Efforts to modernize the monetary policy framework–including steps towards a more flexible exchange rate regime–are being pursued as planned.

42. These policies should help maintain the medium-term outlook broadly consistent with the one envisaged at the time of the program approval. Due to recent shocks, the Honduran economy would underperform in 2019, but it is expected to recover gradually–albeit at a slower pace than previously envisaged. The FRL offers a moderate space to support growth against a challenging external environment—the authorities had overperformed the FRL targets during 2016-18, in an environment of faster growth. Reforms under the program—including those oriented to strengthen governance and the business climate—will pave the way for inclusive growth.

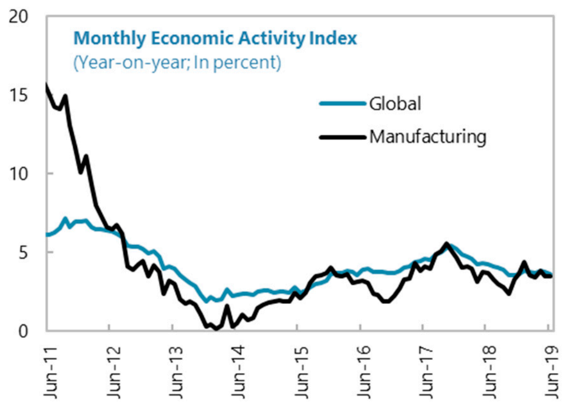
43. The authorities have made progress in reforming the electricity sector, but further efforts are needed. Staff welcomes steps taken to improve the institutional framework in the electricity sector, in particular the ongoing work on the regulations associated with the new tariff scheme, the creation of an independent dispatch center, the strengthening of the regulatory body, the efforts to improve operations and governance in ENEE, and the creation of the electricity losses reduction task force. Further efforts are needed for continued improvements in ENEE's governance, including reaching agreements with various stakeholders, and the implementation of the plan to reduce electricity losses. A stronger financial position in ENEE will create space in the budget for much-needed social and infrastructure spending.

44. The authorities have also set up a roadmap with significant measures to improve governance and step up the fight against corruption. This is adding to ongoing efforts to strengthen the institutional framework in the central bank, the Treasury, and public companies. Staff welcomes reforms to create a registry of beneficial ownership, the decision to upgrade the asset declaration system, the measures to strengthen the quality of PPP projects, and the strengthening of public procurement.

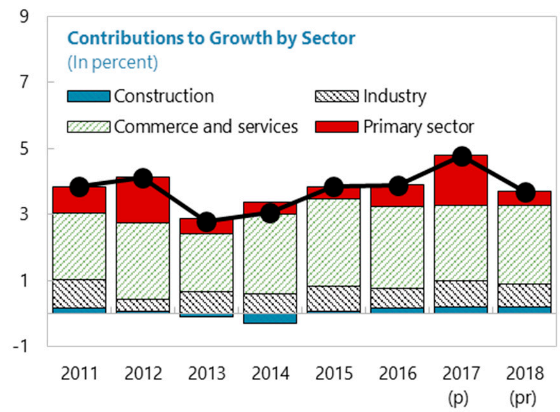
45. Staff supports the completion of the first reviews under the SBA and the SCF arrangements. As performance under both Fund-supported programs remains on track, staff supports the authorities' requests for modifications of the performance criteria on the NFPS net lending, NIR, and NDA as well.

Figure 1. Honduras: Real Sector Developments

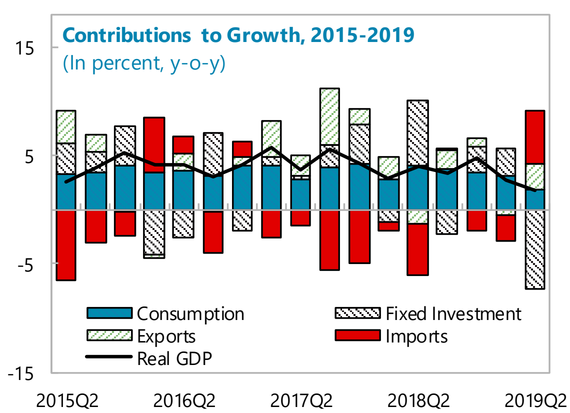
Economic activity has softened…



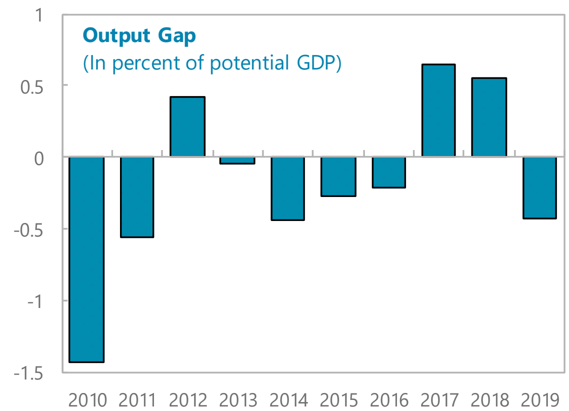
… driven by adverse shocks in the primary sector…



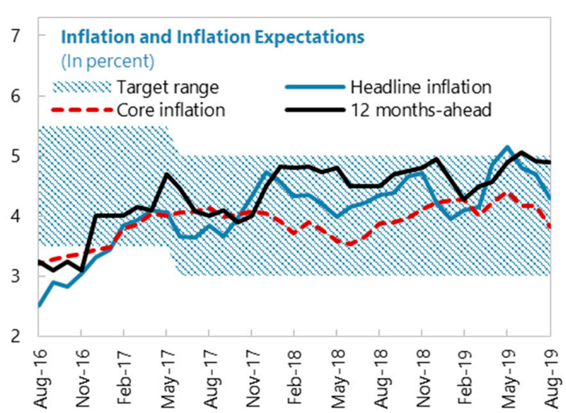
… and low investment and exports.



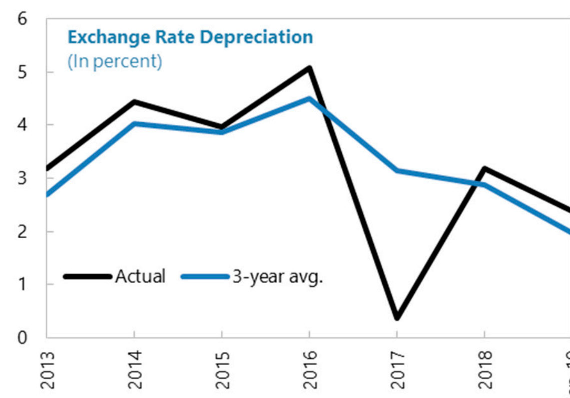
In 2019, the output gap has turned slightly negative…



… contributing to keep inflation subdued…

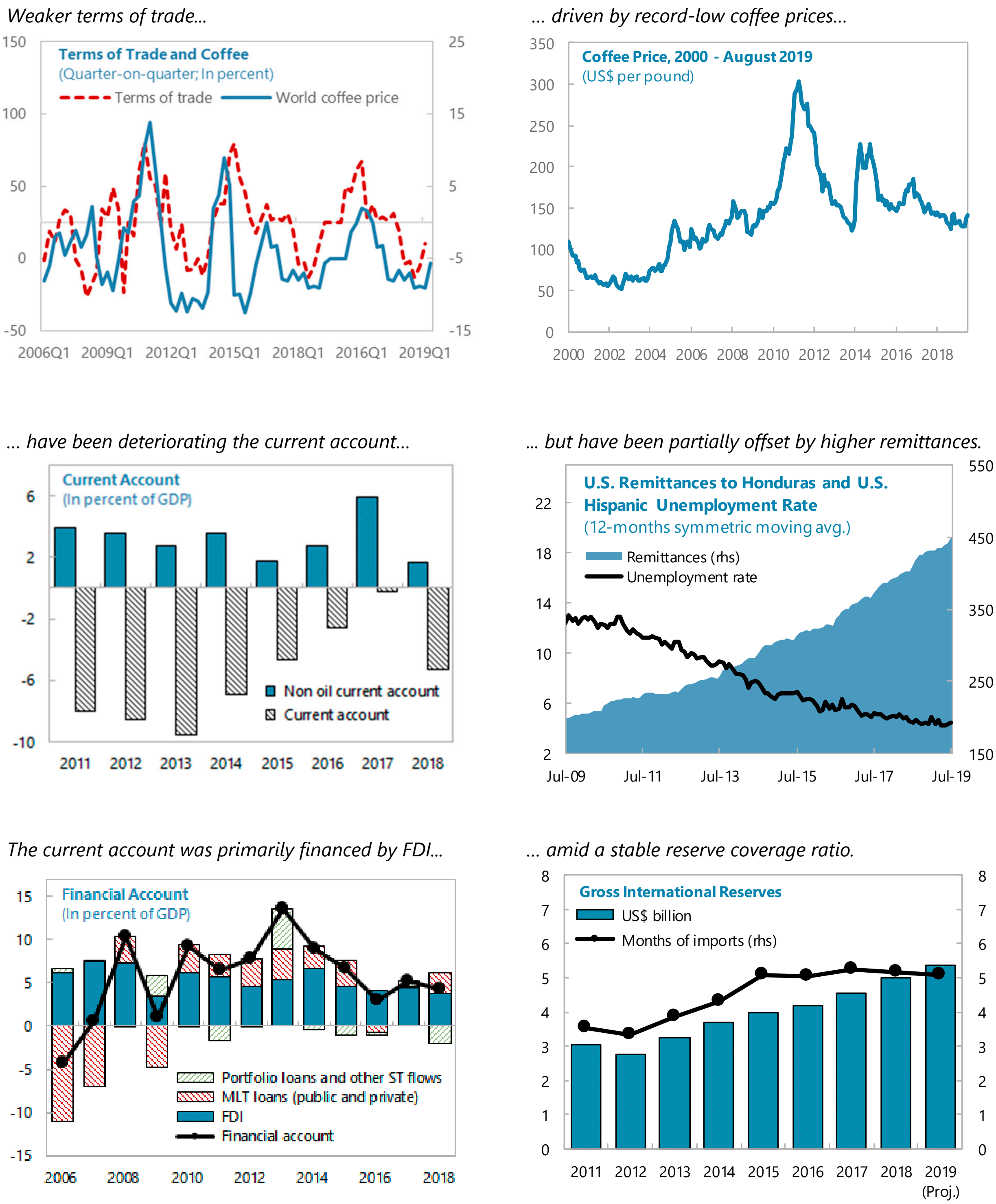


… despite a moderate depreciation of the Lempira.



Sources: Central Bank of Honduras and IMF staff estimates and projections.

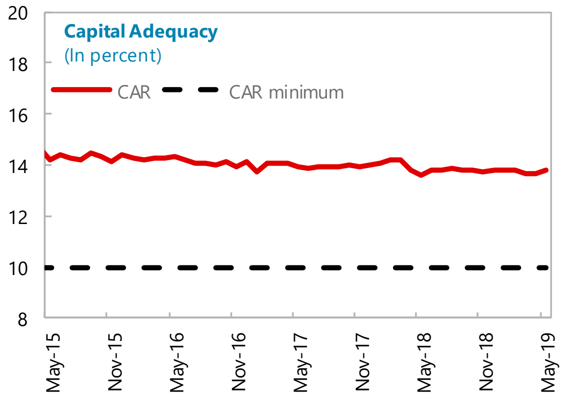
Figure 2. Honduras: External Sector Developments



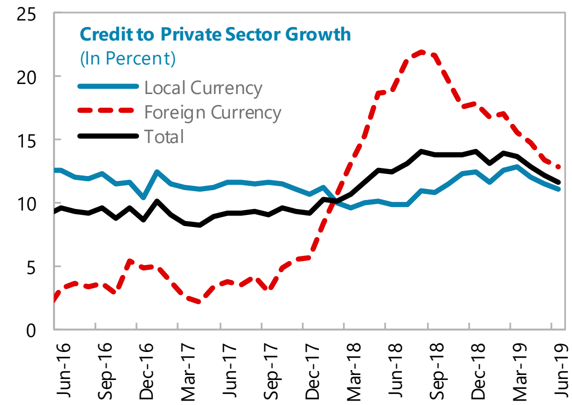
Sources: Central Bank of Honduras, Bloomberg, Haver Analytics, and IMF staff estimates and projections.

Figure 3. Honduras: Financial Sector Developments

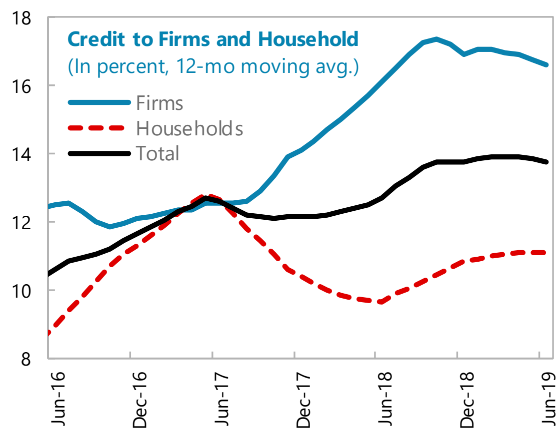
The capital adequacy ratio remains well above the regulatory minimum.



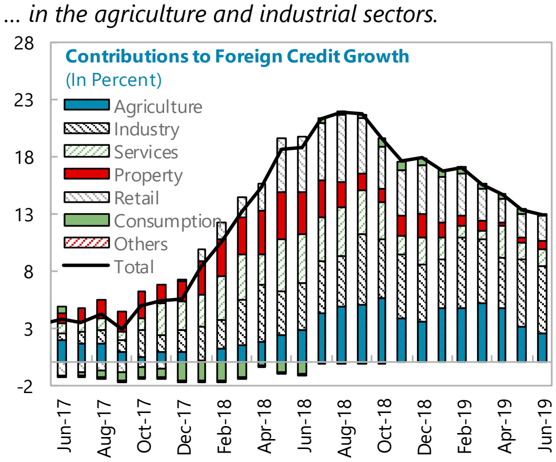
Credit growth still high but falling.



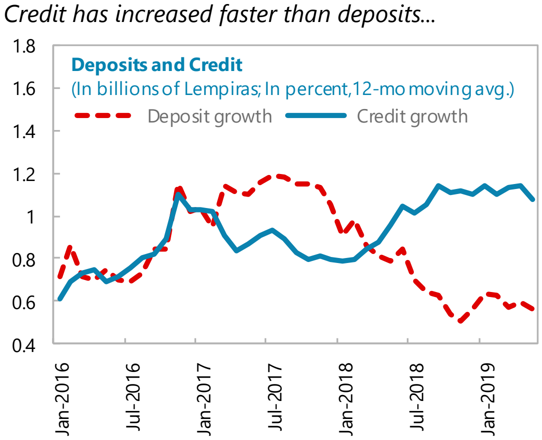
FX credit is mainly channeled to firms…



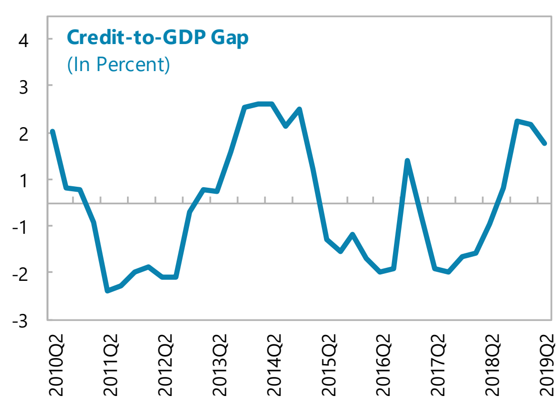
… in the agriculture and industrial sectors.



Credit has increased faster than deposits…



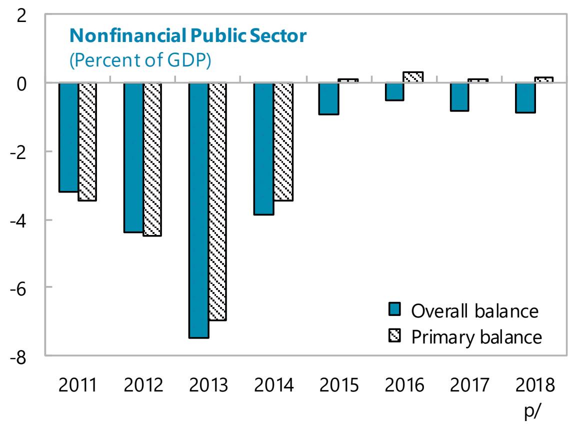
… and the credit gap has turned positive.



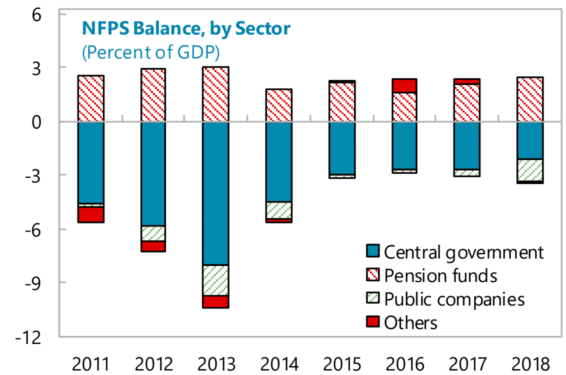
Sources: Central Bank of Honduras and IMF staff estimates and projections.

Figure 4. Honduras: Public Finances

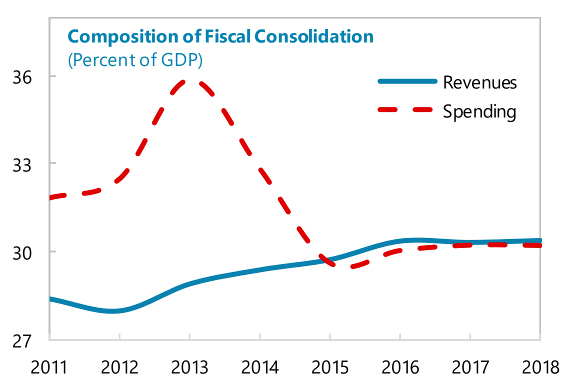
The NFPS deficit remained below the FRL ceiling...



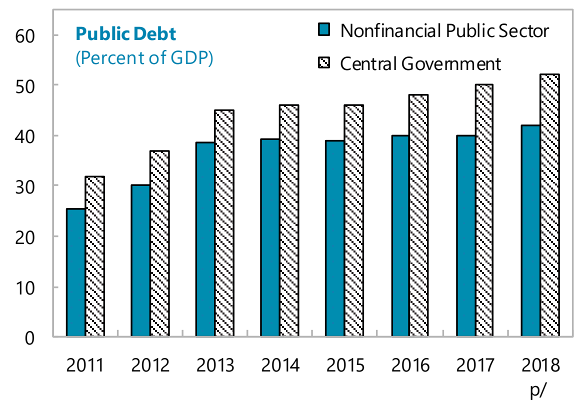
... despite a large increase in the deficit of ENEE...



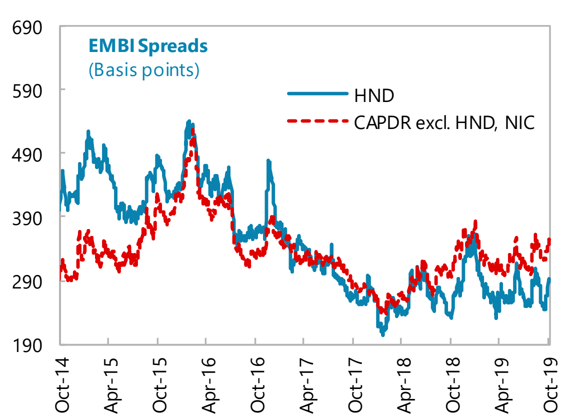
... mainly through an effort to contain spending.



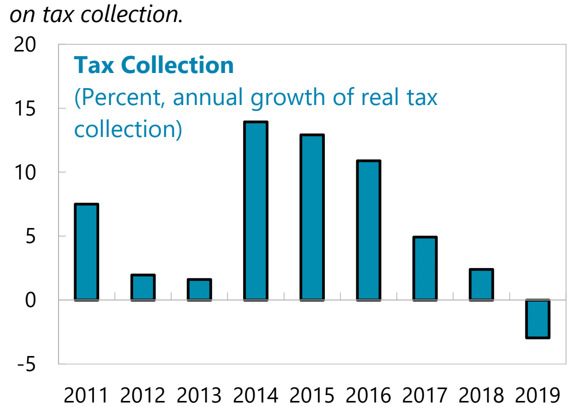
Fiscal prudence has kept public debt at bay...



... which has resulted in lower financial costs.



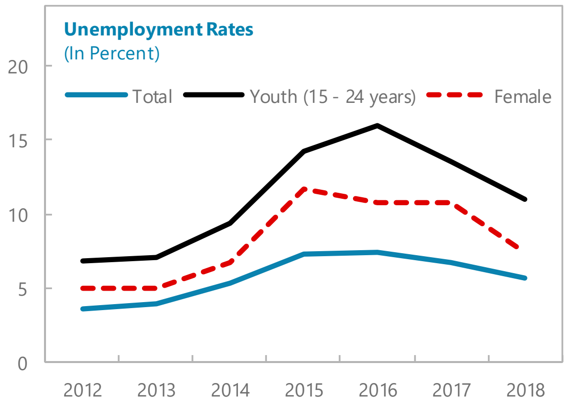
In 2019 policy actions and tepid growth have put a toll on tax collection.



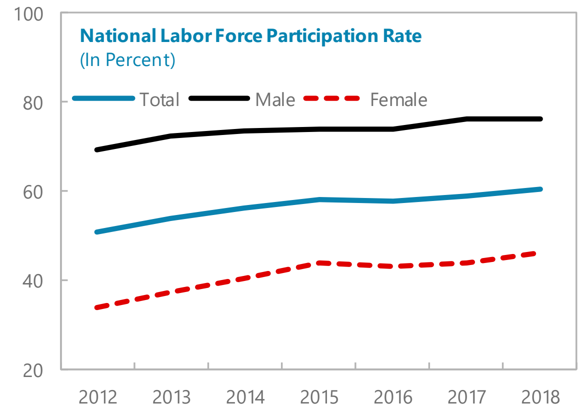
Sources: Ministry of Finance and IMF staff estimates and projections.

Figure 5. Honduras: Labor Market Developments

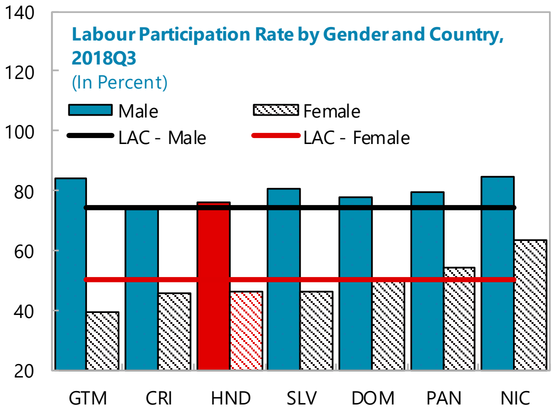
Unemployment rates have declined.



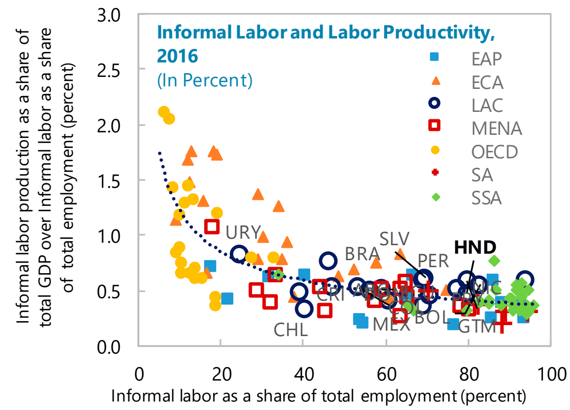
Labor force participation rates have been rising steadily; and the gender gap has fallen.



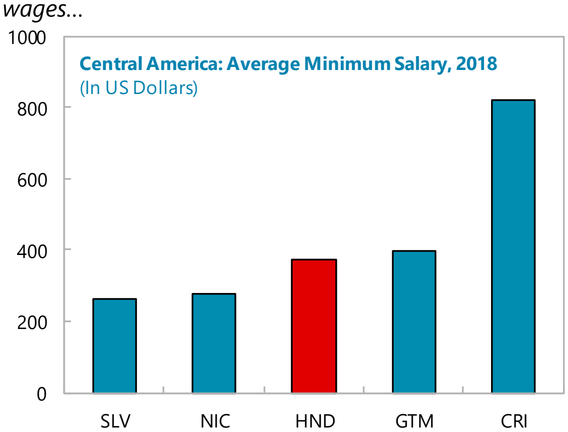
However, female labor participation remains one of the lowest in the region and stays below the LAC average.



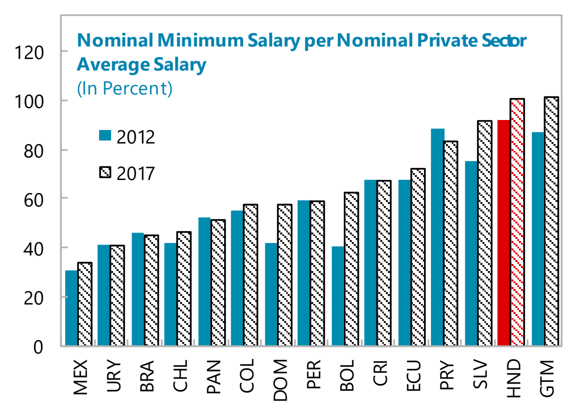
Informality is one the largest in LAC, dragging on productivity and competitiveness.



It is in part explained by relatively high minimum wages…



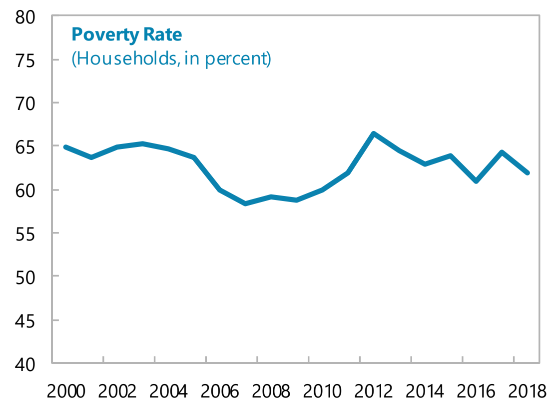
… that are not in line with labor market conditions.



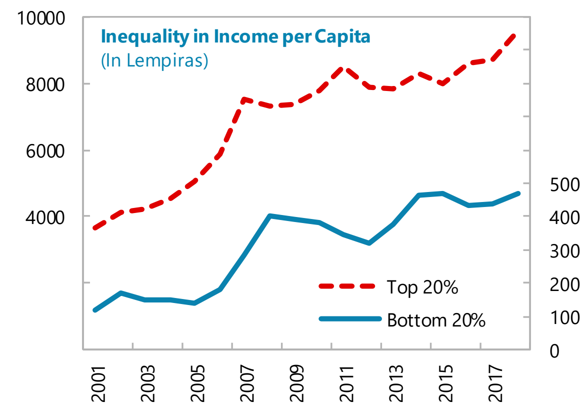
Sources: Honduras' National Institute of Statistics (INE), Ministry of Labor, International Labour Organization; Panorama Laboral América Latina y el Caribe (2018), Informality: Why Is It So Widespread and How Can It Be Reduced?, Loayza (2018), and IMF staff calculations.

Figure 6. Honduras: Social Conditions

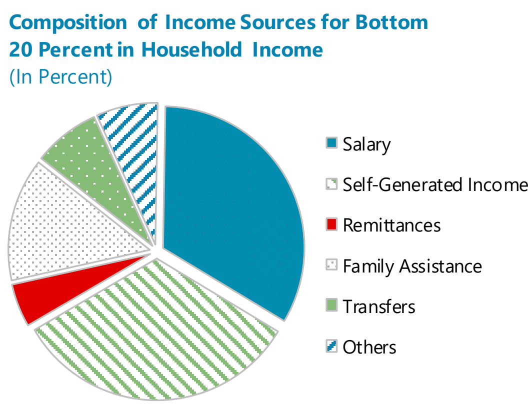
The income measure of poverty has been stable at about 60 percent of households for more than 20 years…



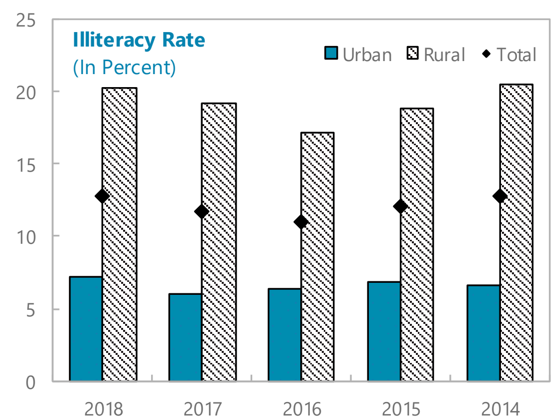
… and income inequality has increased.



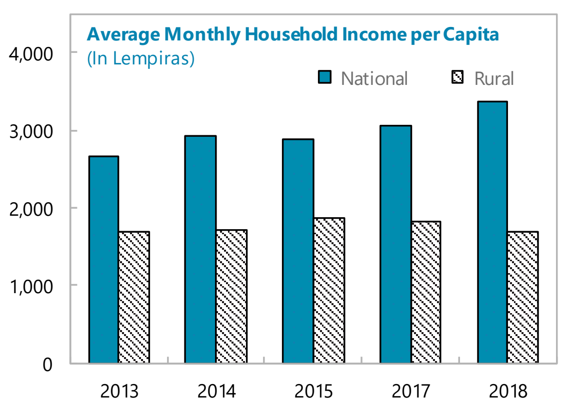
Transfers are an important component of poor households' income.



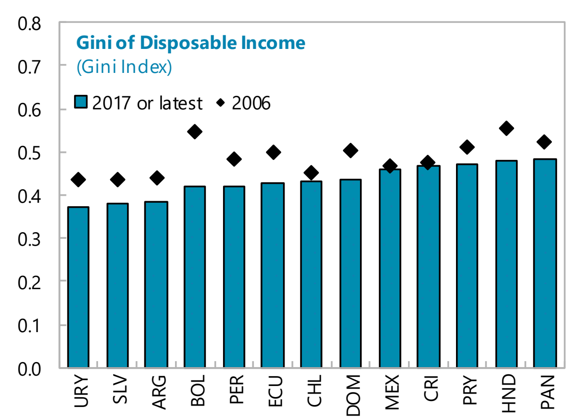
Illiteracy rates are high, particularly in rural areas.



Rural incomes continue to be largely below urban income…



… and the Gini index remains high.



Sources: Honduras' National Institute of Statistics (INE), OECD Income Distribution database, and IMF staff calculations.

Table 1. Honduras: Selected Economic Indicators

I. Social Indicators

Population (2017)	9.3 million	Life expectancy at birth in years (2015)	73
Per capita income in U.S. dollars (PPP, 2017)	4,986	Adult literacy (percent of ages 15 and above, 2014)	89
Rank in UNDP Development Index (2018)	133 of 189	Percent of pop. below poverty line (2018)	61.9
Unemployment rate (2017)	4.3	Gini index (2018)	53
Underemployment rate (2016)	73.8	Oil imports (2018)	U.S. $1.7 billion
Net FDI (as percent of GDP, 2018)	4.8	Main exports: coffee, bananas, palm oil, and maquila.	

II. Economic Indicators

	Actual				Projections					
	2015	2016	2017	2018	2019	2020	2021	2022	2023	2024
Real Sector (percentage changes in contributions to growth)										
Real GDP	**3.8**	**3.9**	**4.8**	**3.7**	**2.8**	**3.2**	**3.4**	**3.5**	**3.7**	**3.8**
Domestic demand	7.7	2.3	5.5	4.8	2.1	4.6	3.9	4.0	4.0	4.1
Consumption	3.2	3.5	3.8	3.5	3.4	3.5	3.5	3.4	3.3	3.4
Private	2.9	3.0	3.5	3.2	3.2	3.1	2.9	2.9	3.0	3.0
Public	0.3	0.6	0.3	0.3	0.1	0.4	0.6	0.5	0.4	0.5
Investment	2.5	-1.6	1.8	1.1	-1.3	1.4	0.7	0.6	0.9	1.1
Private	2.8	-2.2	0.8	1.1	-1.0	1.0	0.4	0.4	0.6	0.9
Public	-0.2	0.6	1.0	0.0	-0.3	0.4	0.3	0.2	0.2	0.2
Net exports	-3.9	1.6	-0.7	-1.0	0.6	-1.3	-0.5	-0.5	-0.4	-0.4
Exports	1.7	0.5	2.9	0.8	-0.1	2.2	2.3	2.5	2.6	2.7
Imports	5.6	-1.1	3.6	1.8	-0.7	3.5	2.8	3.0	3.0	3.1
Prices (annual percentage change)										
GDP deflator	6.9	3.7	4.4	1.8	3.2	4.3	4.2	4.1	4.0	4.0
Consumer prices (eop)	2.4	3.3	4.7	4.2	4.1	4.0	4.0	4.0	4.0	4.0
Consumer prices (average)	3.2	2.7	3.9	4.3	4.4	4.0	4.0	4.0	4.0	4.0
Saving and Investment (percent of GDP)										
Gross domestic investment	**26.4**	**23.4**	**24.3**	**25.7**	**24.3**	**25.1**	**25.8**	**26.3**	**27.0**	**27.5**
Private sector	22.6	20.2	19.9	21.3	20.4	20.9	21.3	21.8	22.4	22.8
Public sector	3.8	3.2	4.4	4.4	3.9	4.2	4.4	4.5	4.6	4.7
Gross national savings	**21.7**	**20.8**	**24.1**	**20.4**	**21.0**	**21.3**	**22.0**	**22.5**	**22.9**	**23.4**
Private sector	19.0	18.2	20.4	16.9	18.1	18.0	18.4	18.9	19.1	19.5
Public sector	2.8	2.6	3.5	3.3	2.8	3.1	3.4	3.4	3.7	3.7
Nonfinancial public sector (percent of GDP)										
Primary balance	0.1	0.3	0.1	0.0	0.1	0.1	0.7	0.8	1.0	1.0
Overall balance	-0.9	-0.5	-0.8	-0.9	-1.0	-1.0	-1.0	-1.0	-0.9	-0.9
Gross debt	39.2	40.1	40.2	42.3	43.4	43.2	42.7	42.1	41.5	40.9
Balance of payments										
External current account balance (percent of GDP)	-4.7	-2.6	-0.2	-5.3	-3.3	-3.8	-3.8	-3.9	-4.1	-4.1
Exports, f.o.b. (annual percentage change)	2.9	-2.5	9.7	-2.5	-1.7	7.1	5.6	6.0	4.1	5.4
Imports, f.o.b. (annual percentage change)	1.7	-5.7	7.7	7.9	-0.1	9.0	4.0	5.4	5.3	5.1
Worker's Remittances (percent of GDP)	17.4	17.7	18.6	19.8	21.4	20.8	20.2	19.7	19.3	18.9
Net International Reserves (millions of dollars) 1/	3,822	3,888	4,786	4,853	5,107	5,297	5,547	5,867	6,207	6,567
GIR (In months of imports) 2/	5.1	5.0	5.3	5.3	5.1	5.1	5.1	5.1	5.1	5.1
M1 to Net International Reserves (ratio)	1.6	1.6	1.7	1.7	1.7	1.6	1.6	1.6	1.6	1.6
Terms of Trade (annual percent change)	11.3	5.4	-2.2	-6.6	-0.3	1.8	1.7	0.6	-0.1	-0.4
Real effective exchange rate (eop, depreciation -)	1.8	-2.0	-0.9	1.2	...	...	...	...	...	...
Money and Financial										
Broad money (percentage change)	9.0	15.6	12.8	8.1	8.7	10.0	10.0	10.0	10.1	10.2
Private sector credit (percentage change)	10.0	12.9	9.4	14.2	9.9	9.6	9.3	9.1	8.9	8.7
Bank Assets (percent of GDP)	97.0	97.8	97.8	105.8	109.7	111.7	113.3	114.8	115.9	116.8
Private Credit (percent of GDP)	54.0	56.6	56.6	61.1	63.4	64.6	65.5	66.4	67.0	67.6
Non-Performing Loans to total loans (ratio)	3.0	2.9	2.8	2.6	...	...	...	...	...	...
Capital Adequacy (percent)	14.0	13.8	13.7	13.4	...	...	...	...	...	...

Sources: Central Bank of Honduras, Ministry of Finance, and IMF staff estimates and projections.
1/ NIR (BCH) corresponds to reserves assets minus obligations with the IMF.
2/ Based on following year's imports of goods and services, excluding maquila.

Table 2. Honduras: Statement of Operations of the Central Government

(In percent of GDP)

	Actual			2019		Projection				
	2016	2017	2018	Program	Revised	2020	2021	2022	2023	2024
Revenue	**20.0**	**20.3**	**20.3**	**20.2**	**19.5**	**19.8**	**20.2**	**20.4**	**20.4**	**20.4**
Taxes	18.3	18.3	18.5	18.1	17.7	18.1	18.5	18.6	18.7	18.7
Taxes on income	6.0	6.2	6.3	5.9	5.7	5.6	6.0	6.1	6.2	6.2
Taxes on property	0.1	0.1	0.1	0.1	0.1	0.1	0.1	0.1	0.1	0.1
Taxes on goods and services	11.0	10.8	10.8	10.9	10.7	11.2	11.2	11.2	11.2	11.2
Taxes on foreign trade	0.8	0.8	0.8	0.8	0.7	0.7	0.8	0.8	0.8	0.8
Other taxes	0.5	0.5	0.5	0.5	0.5	0.4	0.4	0.4	0.4	0.4
Social contributions	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Grants	0.8	0.6	0.7	0.7	0.7	0.6	0.6	0.6	0.6	0.6
Other revenue	0.9	1.4	1.1	1.4	1.1	1.2	1.1	1.2	1.2	1.2
Expenditure	**22.8**	**23.0**	**22.4**	**22.6**	**22.1**	**22.7**	**23.2**	**23.3**	**23.4**	**23.5**
Expense	**20.8**	**20.2**	**20.0**	**20.5**	**20.1**	**20.1**	**20.5**	**20.3**	**20.2**	**20.0**
Compensation of employees	8.0	8.5	8.3	8.2	8.2	8.2	8.2	8.2	8.2	8.2
Purchases of goods and services 1/	2.8	2.7	2.2	2.2	2.4	2.3	2.5	2.3	2.3	2.3
Interest	2.6	2.7	3.0	3.3	3.0	3.1	3.3	3.2	3.0	2.9
Domestic	1.7	1.7	1.9	2.1	1.9	2.0	2.2	2.1	2.1	2.0
Foreign	0.9	1.0	1.1	1.2	1.1	1.1	1.1	1.1	1.0	0.9
Subsidies	0.0	0.0	0.2	0.3	0.1	0.2	0.1	0.1	0.0	0.0
Grants	3.7	2.6	2.5	2.4	2.4	2.3	2.3	2.3	2.3	2.3
Current	2.4	1.5	1.6	1.5	1.5	1.5	1.5	1.5	1.5	1.5
Capital	1.3	1.0	0.9	0.9	0.9	0.8	0.8	0.8	0.8	0.8
Social benefits	1.6	1.9	1.6	2.0	1.9	2.1	2.2	2.3	2.4	2.4
Other expense	2.0	1.8	2.2	2.2	2.1	1.9	1.9	1.9	1.9	1.9
Current	0.3	0.2	0.2	0.2	0.2	0.2	0.2	0.2	0.2	0.2
Capital	1.7	1.6	2.0	2.0	1.9	1.7	1.7	1.7	1.7	1.7
Net acquisition of nonfinancial assets	**2.0**	**2.8**	**2.4**	**2.0**	**2.0**	**2.6**	**2.7**	**3.0**	**3.2**	**3.5**
Gross Operating Balance	**-0.8**	**0.1**	**0.3**	**-0.4**	**-0.6**	**-0.3**	**-0.3**	**0.0**	**0.3**	**0.4**
Net lending (+)/borrowing (-)	**-2.7**	**-2.7**	**-2.1**	**-2.4**	**-2.6**	**-2.8**	**-3.0**	**-3.0**	**-3.0**	**-3.1**
Net financial transactions	**-2.7**	**-2.7**	**-2.1**	**-2.4**	**-2.6**	**-2.8**	**-3.0**	**-3.0**	**-3.0**	**-3.1**
Net acquisition of financial assets	**-0.3**	**2.6**	**1.1**	**1.3**	**0.8**	**0.9**	**0.0**	**0.0**	**0.0**	**0.0**
Foreign	0.0	0.0	0.0	1.8	0.0	0.0	0.0	0.0	0.0	0.0
Currency and deposits	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Loans	0.0	0.0	0.0	1.8	0.0	0.0	0.0	0.0	0.0	0.0
Other accounts receivable	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Domestic	-0.3	2.6	1.1	-0.6	0.8	0.9	0.0	0.0	0.0	0.0
Currency and deposits	-0.3	2.6	1.1	-0.6	0.5	-0.5	0.0	0.0	0.0	0.0
Debt securities	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Loans	0.0	0.0	0.0	0.0	0.3	1.3	0.0	0.0	0.0	0.0
Other accounts receivable	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Net incurrence of liabilities	**2.5**	**5.3**	**3.3**	**3.7**	**3.4**	**3.7**	**3.1**	**3.0**	**2.9**	**3.1**
Foreign	0.7	3.6	0.9	2.5	1.6	2.3	1.0	0.8	0.9	0.1
Currency and deposits	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Loans	0.7	3.7	0.9	2.5	1.6	2.3	1.0	0.8	0.9	0.1
Disbursment	1.5	4.8	1.9	5.6	2.7	5.3	2.0	1.8	3.6	1.0
Amorizations	-0.8	-1.1	-1.0	-3.1	-1.1	-2.9	-1.0	-1.0	-2.7	-0.9
Other accounts payable	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Exceptional financing 2/	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Other external	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Domestic	1.7	1.6	2.4	1.2	1.8	1.4	2.1	2.2	2.0	3.0
Currency and deposits	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Loans	3.0	1.2	2.1	1.0	2.0	1.3	1.9	2.4	2.2	3.2
Other accounts payable	-1.3	0.3	0.1	-0.1	-0.1	0.0	0.0	0.0	0.0	0.0
PPPs/other	0.4	0.5	0.6	0.7	0.3	0.5	0.5	0.2	0.1	0.1
Adjustment for HIPC debt relief 3/	-0.4	-0.4	-0.4	-0.4	-0.4	-0.4	-0.4	-0.3	-0.3	-0.3
Memorandum items:										
Net lending minus interest payments	-0.1	0.0	0.9	0.9	0.4	0.3	0.2	0.3	0.1	-0.2
Nominal GDP (in billions of Lempiras)	495.9	542.6	572.9	610.9	607.3	654.0	704.3	759.2	818.4	883.0

Sources: Honduran authorities, IMF staff estimates and projections.

1/ As recommended by the GFSM-2014, since 2019 debt service commissions are reported as goods and services (previously included in the interest bill).

2/ Includes debt forgiveness, accumulation, rescheduling, payment and/or forgiveness of arrears.

3/ Offsets the HIPC/MDRI debt relief accounted as grants.

Table 3. Honduras: Statement of Operations of the Nonfinancial Public Sector

(In percent of GDP)

	Actual			2019		Projections				
	2016	2017	2018	Program	Revised	2020	2021	2022	2023	2024
Revenue	**32.3**	**31.9**	**31.5**	**32.6**	**31.7**	**31.9**	**32.3**	**32.1**	**32.2**	**32.2**
Taxes	19.4	18.7	18.9	18.6	18.2	18.5	19.0	19.0	19.1	19.2
Taxes on income	6.0	6.2	6.3	5.9	5.7	5.6	6.0	6.1	6.2	6.2
Taxes on property	0.1	0.1	0.1	0.1	0.1	0.1	0.1	0.1	0.1	0.1
Taxes on goods and services	11.0	10.8	10.8	10.9	10.7	11.2	11.2	11.2	11.2	11.2
Taxes on foreign trade	0.8	0.8	0.8	0.8	0.7	0.7	0.8	0.8	0.8	0.8
Other taxes	1.5	0.9	0.9	0.9	0.9	0.9	0.9	0.8	0.9	0.9
Social contributions	3.1	3.3	3.4	3.6	3.6	3.6	3.6	3.6	3.6	3.6
Grants	0.8	0.6	0.7	0.7	0.7	0.6	0.7	0.7	0.6	0.6
Other revenue	9.0	9.3	8.5	9.8	9.3	9.2	9.0	8.8	8.8	8.7
Expenditure	**32.8**	**32.7**	**32.4**	**33.5**	**32.7**	**32.9**	**33.3**	**33.1**	**33.0**	**33.1**
Expense	**29.6**	**28.2**	**28.1**	**29.5**	**28.8**	**28.7**	**28.8**	**28.6**	**28.4**	**28.4**
Compensation of employees	11.3	11.2	11.3	11.2	11.2	11.4	11.1	11.1	11.1	11.1
Purchases of goods and services	8.1	8.3	8.2	8.3	8.5	8.2	8.1	8.0	7.8	7.8
Interest	2.7	2.4	2.4	3.2	2.6	2.6	3.0	3.0	3.1	3.0
Domestic	1.8	1.4	1.3	1.9	1.4	1.5	1.9	1.9	2.0	2.1
Foreign	1.0	1.0	1.2	1.3	1.2	1.1	1.1	1.1	1.0	0.9
Subsidies	0.0	0.0	0.1	0.1	0.1	0.0	0.0	0.0	0.0	0.0
Social benefits	3.6	4.1	3.7	4.3	4.2	4.4	4.6	4.6	4.6	4.6
Other expense	3.8	2.2	2.3	2.5	2.3	2.2	2.0	1.9	1.9	1.9
Current	1.1	0.3	0.3	0.3	0.2	0.2	0.2	0.2	0.2	0.2
Capital	2.7	1.8	2.0	2.2	2.1	1.9	1.9	1.7	1.7	1.7
Net acquisition of nonfinancial assets	**3.2**	**4.4**	**4.4**	**4.0**	**3.9**	**4.2**	**4.4**	**4.5**	**4.6**	**4.7**
Gross Operating Balance	**2.7**	**3.6**	**3.4**	**3.1**	**2.9**	**3.2**	**3.5**	**3.5**	**3.7**	**3.8**
Net lending (+)/borrowing (-)	**-0.5**	**-0.8**	**-0.9**	**-0.9**	**-1.0**	**-1.0**	**-1.0**	**-1.0**	**-0.9**	**-0.9**
Net financial transactions	**-0.5**	**-0.8**	**-0.9**	**-0.9**	**-1.0**	**-1.0**	**-1.0**	**-1.0**	**-0.9**	**-0.9**
Net acquisition of financial assets	**-0.4**	**0.4**	**1.9**	**0.5**	**1.0**	**0.4**	**0.1**	**0.1**	**0.1**	**0.1**
Foreign	0.0	0.0	0.1	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Currency and deposits	0.0	0.0	0.1	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Loans	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Other accounts receivable	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Domestic	-0.4	0.4	1.8	0.5	1.0	0.4	0.1	0.1	0.1	0.1
Currency and deposits	-1.0	0.2	1.6	0.4	0.8	0.3	0.0	0.0	0.0	0.0
Debt securities	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Loans	0.6	0.2	0.1	0.1	0.1	0.1	0.1	0.1	0.1	0.1
Other accounts receivable	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Net incurrence of liabilities	**0.2**	**1.2**	**2.8**	**1.5**	**2.0**	**1.4**	**1.1**	**1.1**	**0.9**	**1.0**
Foreign	1.0	3.8	1.1	2.6	1.8	2.3	1.0	0.8	0.9	0.1
Currency and deposits	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Loans	1.0	3.8	1.1	2.6	1.8	2.3	1.0	0.8	0.9	0.1
Other accounts payable	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Exceptional financing 1/	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Other external	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Domestic	-0.5	-2.2	2.1	-0.7	0.6	-0.5	0.4	0.7	0.3	1.2
Currency and deposits	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Loans	0.9	-0.7	1.5	-0.9	0.6	-0.9	0.4	0.5	-0.2	1.1
Other accounts payable	-1.4	-1.6	0.3	-0.5	-0.3	-0.2	-0.1	-0.2	0.0	0.0
PPPs/other	0.1	0.2	0.3	0.7	0.3	0.6	0.1	0.3	0.5	0.0
Adjustment for HIPC debt relief 2/	-0.4	-0.4	-0.4	-0.4	-0.4	-0.4	-0.4	-0.3	-0.3	-0.3
Memorandum items:										
Net lending minus net interest payments	0.3	0.1	0.0	0.6	0.1	0.1	0.7	0.8	1.0	1.0
Gross total debt	40.1	40.2	42.3	42.1	43.4	43.2	42.7	42.1	41.5	40.9
Nominal GDP (in billions of Lempiras)	495.9	542.6	572.9	610.9	607.3	654.0	704.3	759.2	818.4	883.0

Sources: Honduran authorities, IMF staff estimates and projections.

1/ Includes debt forgiveness, accumulation, rescheduling, payment and/or forgiveness of arrears.

2/ Offsets the HIPC/MDRI debt relief accounted as grants.

Table 4. Honduras: Summary Accounts of the Financial System

(In millions of Lempiras; end-December)

	Actual			Projections					
	2016	2017	2018	2019	2020	2021	2022	2023	2024
				I. Central Bank					
Net International Reserves 1/	**91,370**	**112,883**	**118,120**	**128,623**	**136,321**	**146,199**	**158,613**	**172,194**	**187,006**
(In millions of US$)	3,888	4,786	4,853	5,107	5,297	5,547	5,867	6,207	6,567
Net Domestic Assets	**-60,010**	**-75,317**	**-78,827**	**-85,520**	**-89,707**	**-95,644**	**-103,511**	**-112,139**	**-121,505**
Credit to the public sector (net)	9,645	7,472	-397	-2,895	-835	1,443	3,285	4,238	4,650
Other depository institutions (net)	-74,216	-84,589	-75,207	-82,021	-88,233	-94,922	-102,207	-110,058	-118,613
Other financial institutions	10,277	8,302	6,637	6,256	5,737	5,178	4,568	3,911	3,194
Nonfinancial private sector	-213	-228	-217	-215	-279	-363	-472	-613	-797
Medium and long-term net foreign assets	1,876	1,915	2,149	2,979	3,559	4,172	4,820	5,501	6,216
Other items net	-7,361	-7,923	-11,792	-9,625	-9,655	-11,153	-13,505	-15,117	-16,155
Currency issued	**31,359**	**37,567**	**39,292**	**43,102**	**46,614**	**50,555**	**55,102**	**60,055**	**65,500**
				II. Other Depository Institutions					
Net Foreign Assets	**-14,740**	**-16,341**	**-24,603**	**-23,686**	**-23,825**	**-23,711**	**-23,297**	**-22,488**	**-21,204**
(In millions of US$)	-627	-693	-1,011	-940	-926	-900	-862	-811	-745
Foreign assets (in million of US$)	500	543	453	557	641	736	845	970	1,113
Net Domestic Assets	**268,907**	**300,962**	**329,368**	**356,064**	**381,378**	**408,367**	**437,478**	**468,483**	**501,865**
Credit to the monetary authority (net)	83,876	98,107	93,143	100,761	107,860	115,509	123,835	132,815	142,593
Credit to other financial institutions (net)	-32,280	-31,756	-33,716	-42,379	-56,897	-78,190	-101,436	-125,988	-149,820
Credit to the nonfinancial public sector (net)	-1,998	-6,125	-1,803	-501	919	7,523	14,868	22,374	28,042
Central government	-15,565	-18,282	-18,379	-17,562	-14,503	-10,224	-5,382	-430	1,983
Other nonfinancial public sector	9,250	6,368	9,764	10,930	9,904	12,781	15,781	18,781	21,781
Local governments	4,317	5,789	6,812	6,131	5,518	4,966	4,470	4,023	3,620
Credit to the private sector	280,453	306,885	350,345	385,187	422,268	461,540	503,767	548,657	596,519
Local currency	205,788	228,136	257,031	283,434	312,644	343,466	377,566	414,295	453,936
Foreign currency	74,664	78,749	93,314	101,753	109,625	118,074	126,201	134,362	142,583
Other items net	-61,143	-66,149	-78,601	-87,005	-92,773	-98,015	-103,557	-109,375	-115,469
Liabilities	**254,348**	**284,278**	**304,765**	**332,378**	**357,552**	**384,655**	**414,180**	**445,995**	**480,661**
Of which: Deposits in domestic currency	176,593	205,926	222,633	244,633	265,128	287,341	309,396	333,162	359,057
Of which: Deposits in foreign currency	72,425	78,352	82,132	89,573	96,357	103,661	111,618	120,192	129,534
				III. Financial System					
Net Foreign Assets	**78,182**	**98,580**	**95,863**	**107,557**	**112,496**	**122,487**	**135,315**	**149,706**	**165,802**
(In millions of US$)	3,326	4,179	3,939	4,167	4,371	4,647	5,005	5,397	5,823
Net Domestic Assets	**203,241**	**219,384**	**247,833**	**265,872**	**298,414**	**329,570**	**362,131**	**397,744**	**437,566**
Credit to the nonfinancial public sector	7,974	1,167	-2,116	-3,360	84	8,966	18,153	26,611	32,692
Credit to the private sector	280,453	306,885	350,345	385,187	422,268	461,540	503,767	548,657	596,519
Local currency	205,788	228,136	257,031	283,434	312,644	343,466	377,566	414,295	453,936
Foreign currency	74,664	78,749	93,314	101,753	109,625	118,074	126,201	134,362	142,583
Other items net 2/	-80,998	-69,417	-86,893	-97,278	-104,357	-111,257	-118,799	-126,913	-135,617
Broad Money (M4)	**281,747**	**317,841**	**343,498**	**373,231**	**410,712**	**451,860**	**497,249**	**547,253**	**603,171**
				(Rate of growth 12 months)					
Currency issued	6.5	19.8	4.6	9.7	8.1	8.5	9.0	9.0	9.1
Currency in circulation	11.4	18.7	3.4	10.1	8.1	8.5	9.2	9.2	9.3
Broad money	15.6	12.8	8.1	8.7	10.0	10.0	10.0	10.1	10.2
Broad money (constant exchange rate)	11.7	12.6	8.4	8.9	7.6	7.6	7.2	7.2	7.2
Credit to the private sector	12.9	9.4	14.2	9.9	9.6	9.3	9.1	8.9	8.7
o/w foreign currency	6.6	5.5	18.5	9.0	7.7	7.7	6.9	6.5	6.1
Credit to the private sector (constant exchange rate)	11.4	9.3	13.0	9.2	9.0	8.6	8.5	8.2	8.1
M1	11.0	14.8	5.7	9.8	8.2	8.4	8.3	8.3	8.4

Sources: Central Bank of Honduras and IMF staff estimates and projections.

1/ NIR (BCH) corresponds to reserves assets minus obligations with the IMF. Includes allocation of SDR 104.8 million in August, 2009.

2/ Includes the revaluation account reflecting changes in the value of assets due to exchange rate fluctuations.

Table 5. Honduras: Balance of Payments

	Actual			Projections					
	2016	2017	2018	2019	2020	2021	2022	2023	2024
	(In millions of U.S. dollars; unless otherwise indicated)								
Current account	**-567**	**-44**	**-1,263**	**-808**	**-988**	**-1,027**	**-1,105**	**-1,234**	**-1,297**
Trade Account	-2,599	-2,686	-3,536	-3,631	-4,068	-4,129	-4,315	-4,625	-4,836
Exports f.o.b.	5,576	6,117	5,961	5,860	6,274	6,624	7,023	7,309	7,705
Maquila (net)	1,635	1,550	1,555	1,811	1,826	1,887	1,978	2,087	2,218
Coffee	913	1,317	1,115	841	882	964	1,014	1,074	1,129
Others	3,028	3,250	3,291	3,208	3,566	3,772	4,030	4,148	4,358
Imports f.o.b.	-8,175	-8,803	-9,497	-9,491	-10,341	-10,752	-11,337	-11,933	-12,541
Petroleum products	-1,171	-1,403	-1,661	-1,686	-1,726	-1,715	-1,746	-1,796	-1,857
Others	-7,004	-7,400	-7,836	-7,805	-8,615	-9,038	-9,592	-10,138	-10,683
Services (net)	-463	-589	-807	-823	-824	-831	-890	-935	-985
Of which: tourism receipts	693	715	736	758	797	839	882	927	974
Income (net)	-1,508	-1,262	-1,855	-1,821	-1,737	-1,840	-1,814	-1,787	-1,807
Of which: payments on direct investments	-1,278	-1,018	-1,653	-1,589	-1,480	-1,558	-1,533	-1,610	-1,693
Of which: public sector interest payments	-182	-212	-237	-280	-279	-307	-309	-303	-288
Transfers (net)	4,003	4,493	4,934	5,467	5,641	5,774	5,914	6,112	6,331
Of which: Remittances	3,847	4,305	4,760	5,236	5,330	5,458	5,601	5,756	5,925
Others	155	188	174	231	311	316	313	356	406
Capital and Financial account	**787**	**1,390**	**1,170**	**1,062**	**1,178**	**1,277**	**1,425**	**1,574**	**1,657**
Financial account	**657**	**1,210**	**1,002**	**886**	**993**	**1,082**	**1,220**	**1,359**	**1,431**
Direct investment (net)	900	1,003	890	806	999	1,131	1,273	1,455	1,530
Other private capital flows (net)	-395	-634	-152	-354	-605	-322	-280	-373	-132
General government (net)	152	841	264	434	599	272	227	277	34
Capital account	**130**	**181**	**168**	**176**	**185**	**195**	**205**	**215**	**226**
Errors and omissions	-170	-462	139	0	0	0	0	0	0
Overall balance	**50**	**884**	**46**	**254**	**190**	**250**	**320**	**340**	**360**
Change in central bank reserves (- increase)	**-66**	**-884**	**-50**	**-254**	**-190**	**-250**	**-320**	**-340**	**-360**
Exceptional financing	**16**	**-1**	**4**	**0**	**0**	**0**	**0**	**0**	**0**
	(In percent of GDP; unless otherwise indicated)								
Current account	**-2.6**	**-0.2**	**-5.3**	**-3.3**	**-3.8**	**-3.8**	**-3.9**	**-4.1**	**-4.1**
Trade Account	-12.0	-11.6	-14.7	-14.9	-15.8	-15.3	-15.2	-15.5	-15.4
Exports f.o.b.	25.7	26.5	24.9	24.0	24.4	24.5	24.7	24.5	24.5
Maquila net (exports-imports)	7.5	6.7	6.5	7.4	7.1	7.0	7.0	7.0	7.1
Coffee	4.2	5.7	4.6	3.4	3.4	3.6	3.6	3.6	3.6
Others	14.0	14.1	13.7	13.1	13.9	14.0	14.2	13.9	13.9
Imports f.o.b.	-37.7	-38.1	-39.6	-38.8	-40.3	-39.8	-39.9	-39.9	-39.9
Petroleum products	-5.4	-6.1	-6.9	-6.9	-6.7	-6.3	-6.1	-6.0	-5.9
Others	-32.3	-32.0	-32.7	-31.9	-33.5	-33.4	-33.7	-33.9	-34.0
Services (net)	-2.1	-2.5	-3.4	-3.4	-3.2	-3.1	-3.1	-3.1	-3.1
Of which: tourism receipts	3.2	3.1	3.1	3.1	3.1	3.1	3.1	3.1	3.1
Income (net)	-6.9	-5.5	-7.7	-7.4	-6.8	-6.8	-6.4	-6.0	-5.8
Of which: payments on direct investments	-5.9	-4.4	-6.9	-6.5	-5.8	-5.8	-5.4	-5.4	-5.4
Of which: public sector interest payments	-0.8	-0.9	-1.0	-1.1	-1.1	-1.1	-1.1	-1.0	-0.9
Transfers (net)	18.4	19.4	20.6	22.4	22.0	21.4	20.8	20.5	20.2
Of which: Remittances	17.7	18.6	19.8	21.4	20.8	20.2	19.7	19.3	18.9
Capital and Financial account	**3.6**	**6.0**	**4.9**	**4.3**	**4.6**	**4.7**	**5.0**	**5.3**	**5.3**
Financial account	**3.0**	**5.2**	**4.2**	**3.6**	**3.9**	**4.0**	**4.3**	**4.5**	**4.6**
Direct investment (net)	4.1	4.3	3.7	3.3	3.9	4.2	4.5	4.9	4.9
Other private capital flows (net)	-1.8	-2.7	-0.6	-1.4	-2.4	-1.2	-1.0	-1.2	-0.4
Public sector borrowing (net)	0.7	3.6	1.1	1.8	2.3	1.0	0.8	0.9	0.1
Capital account	**0.6**	**0.8**	**0.7**	**0.7**	**0.7**	**0.7**	**0.7**	**0.7**	**0.7**
Errors and omissions	-0.8	-2.0	0.6	0.0	0.0	0.0	0.0	0.0	0.0
Overall balance	**0.2**	**3.8**	**0.2**	**1.0**	**0.7**	**0.9**	**1.1**	**1.1**	**1.1**
Change in central bank reserves (- increase)	**-0.3**	**-3.8**	**-0.2**	**-1.0**	**-0.7**	**-0.9**	**-1.1**	**-1.1**	**-1.1**
Exceptional financing	**0.1**	**0.0**	**0.0**	**0.0**	**0.0**	**0.0**	**0.0**	**0.0**	**0.0**
Memorandum items:									
Terms of trade (percent change)	5.4	-2.2	-6.6	-0.3	1.8	1.7	0.6	-0.1	-0.4
Exports of goods (percent change)	-2.5	9.7	-2.5	-1.7	7.1	5.6	6.0	4.1	5.4
Imports of goods (percent change)	-5.7	7.7	7.9	-0.1	9.0	4.0	5.4	5.3	5.1
Gross reserves (end of period, millions of U.S. dollars)	4,488	5,088	5,147	5,401	5,591	5,841	6,161	6,501	6,861
In months of next year imports	4.1	4.3	4.3	4.2	4.2	4.2	4.2	4.2	4.2
In months of next year imports (excluding maquila)	5.0	5.3	5.3	5.1	5.1	5.1	5.1	5.1	5.1
Total external debt to GDP ratio (in percent)	35.5	37.3	38.6	38.8	39.5	38.9	38.1	37.5	36.1
Nominal GDP (millions of U.S. dollars)	21,698	23,123	23,987	24,445	25,686	27,042	28,440	29,883	31,414

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

Table 6. Honduras: External Financing Needs and Sources

(In millions of U.S. dollars)

	Actual			Projections					
	2016	2017	2018	2019	2020	2021	2022	2023	2024
Current account deficit	567	44	1,263	808	988	1,027	1,105	1,234	1,297
Debt amortizations (public and private)	1,242	1,951	1,797	1,630	1,943	1,489	1,471	1,942	1,398
Subtotal (requirements)	**1,809**	**1,994**	**3,060**	**2,438**	**2,931**	**2,515**	**2,576**	**3,176**	**2,696**
Capital account flows (net)	130	181	168	176	185	195	205	215	226
Foreign direct investment (net)	900	1,003	890	806	999	1,131	1,273	1,455	1,530
Public sector borrowing	325	431	504	700	464	548	516	573	325
Bonds (public)	0	700	0	0	890	0	0	500	0
Other capital flows	520	564	1,547	1,011	583	891	902	773	975
Change in reserves (+ decrease)	-66	-884	-50	-254	-190	-250	-320	-340	-360
Subtotal (sources)	**1,809**	**1,994**	**3,060**	**2,438**	**2,931**	**2,515**	**2,576**	**3,176**	**2,696**
Financing gap	**0**	**0**	**0**	**0**	**0**	**0**	**0**	**0**	**0**

Sources: Central Bank of Honduras and IMF staff estimates and projections.

Table 7. Honduras: External Vulnerability Indicators

	Actual			Projections					
	2016	2017	2018	2019	2020	2021	2022	2023	2024
Exports of goods and services, annual percent change	-2.2	8.0	0.3	-1.6	6.2	5.4	5.1	4.1	5.1
Imports of goods and services, annual percent change	-4.2	7.7	8.3	-0.4	7.3	4.1	5.1	5.0	5.0
Terms of trade (deterioration -)	5.4	-2.2	-6.6	-0.3	1.8	1.7	0.6	-0.1	-0.4
Real effective exchage rate (eop, depreciation -)	-2.2	-0.7	1.1	...	...	...	...	...	...
Current account balance (percent of GDP)	-2.6	-0.2	-5.3	-3.3	-3.8	-3.8	-3.9	-4.1	-4.1
Capital and financial account (percent of GDP)	3.6	6.0	4.9	4.3	4.6	4.7	5.0	5.3	5.3
External public debt (percent of GDP)	28.4	30.5	31.0	31.9	32.6	32.1	31.3	30.7	29.4
Gross official reserves									
in millions of U.S. dollars	4,488	5,088	5,147	5,401	5,591	5,841	6,161	6,501	6,861
in percent of short-term external debt	962	1,057	737	1,476	1,454	1,443	1,447	1,453	1,459
Net international reserves 1/									
in millions of U.S. dollars	3,888	4,786	4,853	5,107	5,297	5,547	5,867	6,207	6,567
in percent of short-term external debt	834	994	694	1,396	1,378	1,371	1,378	1,388	1,397

Sources: Central Bank of Honduras and IMF staff estimates and projections.
1/ NIR (BCH) corresponds to reserves assets minus obligations with the IMF.

Table 8. Honduras: Medium-term Macroeconomic Framework

(In percent of GDP. unless otherwise specified)

	Actual					Projections					
	2014	2015	2016	2017	2018	2019	2020	2021	2022	2023	2024
Growth and prices (in percent)											
Real GDP growth	3.1	3.8	3.9	4.8	3.7	2.8	3.2	3.4	3.5	3.7	3.8
GDP deflator	6.8	6.9	3.7	4.4	1.8	3.2	4.3	4.2	4.1	4.0	4.0
CPI inflation (eop)	5.8	2.4	3.3	4.7	4.2	4.1	4.0	4.0	4.0	4.0	4.0
Investment and saving											
Gross domestic investment	**23.0**	**26.4**	**23.4**	**24.3**	**25.7**	**24.3**	**25.1**	**25.8**	**26.3**	**27.0**	**27.5**
Private sector	19.2	22.6	20.2	19.9	21.3	20.4	20.9	21.3	21.8	22.4	22.8
Public sector	3.8	3.8	3.2	4.4	4.4	3.9	4.2	4.4	4.5	4.6	4.7
Gross national savings	**16.0**	**21.7**	**20.8**	**24.1**	**20.4**	**21.0**	**21.3**	**22.0**	**22.5**	**22.9**	**23.4**
Private sector	16.4	19.0	18.2	20.6	17.1	18.2	18.2	18.6	19.0	19.2	19.7
Public sector	-0.3	2.8	2.6	3.5	3.3	2.8	3.1	3.4	3.4	3.7	3.7
Balance of payments											
External current account	-6.9	-4.7	-2.6	-0.2	-5.3	-3.3	-3.8	-3.8	-3.9	-4.1	-4.1
Non oil current account	3.6	1.8	2.8	5.9	1.7	3.6	2.9	2.5	2.3	1.9	1.8
Gross international reserves (millions of dollar	3,698	4,187	4,488	5,088	5,147	5,401	5,591	5,841	6,161	6,501	6,861
Terms of Trade (annual percent change)	5.5	11.3	5.4	-2.2	-6.6	-0.3	1.8	1.7	0.6	-0.1	-0.4
External debt	**37.3**	**36.2**	**35.5**	**37.3**	**38.6**	**38.8**	**39.5**	**38.9**	**38.1**	**37.5**	**36.1**
Nonfinancial public sector											
Revenue	31.0	31.0	32.3	31.9	31.5	31.7	31.9	32.3	32.1	32.2	32.2
Expenditure	34.9	31.9	32.8	32.7	32.4	32.7	32.9	33.3	33.1	33.0	33.1
Primary balance	**-3.4**	**0.1**	**0.3**	**0.1**	**0.0**	**0.1**	**0.1**	**0.7**	**0.8**	**1.0**	**1.0**
Overall balance	**-3.9**	**-0.9**	**-0.5**	**-0.8**	**-0.9**	**-1.0**	**-1.0**	**-1.0**	**-1.0**	**-0.9**	**-0.9**
Central government											
Revenue	18.3	19.2	20.0	20.3	20.3	19.5	19.8	20.2	20.4	20.4	20.4
Expenditure	22.9	22.1	22.8	23.0	22.4	22.1	22.7	23.2	23.3	23.4	23.5
Primary balance	**-2.1**	**-0.4**	**-0.1**	**-0.1**	**0.6**	**0.2**	**0.1**	**0.1**	**0.1**	**-0.1**	**-0.3**
Overall balance	**-4.5**	**-3.0**	**-2.7**	**-2.7**	**-2.1**	**-2.6**	**-2.8**	**-3.0**	**-3.0**	**-3.0**	**-3.1**
Nonfinancial public sector debt											
Total	**39.5**	**39.2**	**40.1**	**40.2**	**42.3**	**43.4**	**43.2**	**42.7**	**42.1**	**41.5**	**40.9**
Domestic debt	11.2	11.0	11.7	9.6	11.2	11.5	10.5	10.6	10.8	10.8	11.5
External debt	28.3	28.2	28.4	30.5	31.0	31.9	32.6	32.1	31.3	30.7	29.4
Monetary and financial											
Broad money (percentage change)	13.3	9.0	15.6	12.8	8.1	8.7	10.0	10.0	10.0	10.1	10.2
Private sector credit (percentage change)	10.8	10.0	12.9	9.4	14.2	9.9	9.6	9.3	9.1	8.9	8.7
Bank assets	96.1	97.0	97.8	97.8	105.8	109.7	111.7	113.3	114.8	115.9	116.8
Private credit	54.5	54.0	56.6	56.6	61.1	63.4	64.6	65.5	66.4	67.0	67.6
Non-performing loans to total loans (ratio)	3.3	3.0	2.8	2.3	2.4	...	...	...	...	...	...
Capital adequacy (percent)	14.6	14.0	13.8	13.7	13.4	...	...	...	...	...	...
Memorandum items:											
Nominal GDP (in billions of lempiras)	415	460	496	543	573	607	654	704	759	818	883

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

Table 9. Honduras: Structure and Performance of the Banking Sector 1/

(In percent, unless otherwise indicated)

	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019M8
Total assets (in millions of Lempiras) 2/	**236,665**	**270,981**	**302,662**	**341,614**	**393,763**	**432,178**	**473,722**	**521,869**	**579,373**	**608,780**
(In percent of GDP)	79	81	84	91	95	94	96	96	101	100
Number of banks	**17**	**17**	**17**	**17**	**17**	**15**	**15**	**15**	**15**	**15**
Domestic	8	7	7	7	8	6	6	6	6	6
Foreign	9	10	10	10	9	9	9	9	9	9
Bank concentration										
Number of banks accounting for at least										
25 percent of total assets	2	2	2	2	2	2	2	2	2	2
75 percent of total assets	6	6	6	6	6	5	5	5	5	5
Capital adequacy										
Regulatory capital to risk weighted assets (RWA)	14.9	14.9	14.7	14.5	14.6	14.0	13.8	13.7	13.4	13.6
Capital (net worth) to assets	9.2	9.1	9.3	9.1	9.2	8.7	8.7	8.7	8.7	8.7
Asset quality and composition										
Nonperforming loans(NPLs) to total loans 3/	3.7	2.9	3.3	3.4	3.3	3.0	2.9	2.3	2.1	2.6
NPLs net of provisions to capital	-4.4	-6.5	-4.6	-5.2	-5.2	-5.1	-3.4	-5.8	-5.8	-3.3
Restructured loans to regulatory capital	19.8	26.6	24.7	25.3	22.3	27.9	23.7	25.0	25.0	27.1
Non earning assets net of provisions										
to regulatory capital	47.9	46.9	45.0	44.1	51.2	54.6	48.4	41.6	42.4	40.7
Provisions to total loans	4.3	3.9	4.0	4.2	4.1	3.8	3.4	3.2	3.0	3.1
Provisions to NPLs 2/	118.9	135.0	121.8	123.7	125.5	126.1	117.4	138.0	140.2	118.9
Sectoral distribution of loans to total loans:										
Commerce	12.7	13.0	14.4	14.3	14.3	13.6	13.0	14.9	15.2	14.6
Construction and real estate	34.2	32.9	30.8	28.9	27.1	24.6	23.6	23.3	23.0	23.0
Agriculture and related sectors	0.0	0.0	4.4	4.7	5.0	5.9	7.2	7.4	7.5	7.6
Industry	13.6	12.3	11.7	11.9	11.1	11.1	10.4	10.3	10.8	10.6
Consumption	16.5	18.3	20.5	21.9	21.0	21.3	23.1	20.9	21.1	21.0
Other	0.0	0.0	18.2	18.0	21.3	23.5	22.5	23.0	21.9	22.6
Profitability										
Return on assets (ROA)	1.3	1.3	1.5	1.4	1.4	1.4	1.3	1.2	1.2	1.2
Return on equity (ROE)	12.5	13.2	15.9	14.5	13.4	14.6	14.6	12.0	12.0	12.6
Interest margin to total income	48.2	48.9	52.1	47.5	52.1	52.8	52.9	51.1	49.6	48.5
Personnel expenses to administrative expenses	39.6	39.6	39.4	41.8	41.7	42.0	41.8	45.5	45.1	44.6
Liquidity										
Liquid assets to total assets	24.4	24.3	21.4	25.0	25.2	24.6	24.3	26.3	22.2	21.9
Liquid assets to total short-term liabilities	58.2	58.8	56.2	69.7	70.8	69.5	66.3	71.5	61.7	61.9
Dollarization										
Deposits in foreign currency in percent of total	29.5	29.1	30.6	30.6	32.0	29.8	30.2	29.9	28.9	28.4
Credit in foreign currency in percent of total	28.3	30.1	31.2	33.5	34.7	33.2	32.1	31.2	31.8	30.9

Source: National Commission of Banking and Insurance.

1/ The information covers only private banks.

2/ Includes contingent assets.

3/ As of 2012 NPLs include delinquency of restructured loans.

Table 10. Honduras: Disbursements, Purchases, and Timing of Reviews Under the SBA/SCF Arrangements, 2019-21

		Amount (millions of SDRs)			Percent of quota		
Date of Availability	Conditions	Total	SCF	SBA	Total	SCF	SBA
July 15, 2019	Approval of the arrangement	74.940	12.490	62.450	30.00	5.00	25.00
December 1, 2019	Observance of end-September 2019 performance criteria and continuous performance criteria and completion of first reviews	29.976	12.490	17.486	12.00	5.00	7.00
April 1, 2020	Observance of end-December 2019 performance criteria and continuous performance criteria and completion of second reviews	29.976	12.490	17.486	12.00	5.00	7.00
October 1, 2020	Observance of end-June 2020 performance criteria and continuous performance criteria and completion of third reviews	29.976	12.490	17.486	12.00	5.00	7.00
March 1, 2021	Observance of end-December 2020 performance criteria and continuous performance criteria and completion of fourth reviews	29.976	12.490	17.486	12.00	5.00	7.00
June 20, 2021	Observance of end-March 2021 performance criteria and continuous performance criteria and completion of fifth reviews	29.976	12.490	17.486	12.00	5.00	7.00
	Total	224.820	74.940	149.880	90.00	30.00	60.00

* Honduras' quota is SDR 249.8 million.

Table 11. Honduras: Indicators of Fund Credit, 2019-28 [1/]

(As of September 30, 2019; in units indicated)

	Projections									
	2019	2020	2021	2022	2023	2024	2025	2026	2027	2028
Existing Fund credit										
Stock, in millions of SDRs 2/	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Obligations, in millions of SDRs	0.2	0.6	0.6	0.6	0.6	0.6	0.6	0.6	0.6	0.6
Proposed SCF										
Stock, in millions of SDRs 2/	25.0	50.0	74.9	74.9	72.2	62.5	45.8	29.2	12.5	2.8
Disbursements, in millions of SDRs	25.0	25.0	25.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Obligations, in millions of SDRs 3/	0.0	0.0	0.0	0.0	2.8	9.7	16.7	16.7	16.7	9.7
Principal, in millions of SDRs	0.0	0.0	0.0	0.0	2.8	9.7	16.7	16.7	16.7	9.7
Interest and charges, in millions of SDRs	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Proposed SBA										
Stock, in millions of SDRs 2/	79.9	114.9	149.9	149.9	105.5	37.2	6.6	0.0	0.0	0.0
Disbursements, in millions of SDRs	79.9	35.0	35.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Obligations, in millions of SDRs 4/	0.4	2.2	3.1	3.3	47.4	70.5	31.6	7.2	0.6	0.6
Principal, in millions of SDRs	0.0	0.0	0.0	0.0	44.3	68.4	30.6	6.6	0.0	0.0
Interest and charges, in millions of SDRs	0.4	2.2	3.1	3.3	3.0	2.1	1.0	0.6	0.6	0.6
Stock of existing and prospective Fund credit 2/										
In millions of SDRs	104.9	164.9	224.8	224.8	177.7	99.6	52.4	29.2	12.5	2.8
In percent of quota	42.0	66.0	90.0	90.0	71.1	39.9	21.0	11.7	5.0	1.1
In percent of exports of goods and services	1.4	2.1	2.8	2.7	2.0	1.1	0.5	0.3	0.1	0.0
In percent of external debt	1.6	2.4	3.1	3.1	2.4	1.3	0.7	0.4	0.2	0.0
In percent of gross reserves	2.7	4.1	5.4	5.2	3.9	2.1	1.2	0.7	0.3	0.1
Obligations to the Fund from existing arrangements and prospective Fund arrangements										
In millions of SDRs	0.6	2.8	3.7	3.8	50.7	80.8	48.9	24.4	17.8	10.8
In percent of quota	0.2	1.1	1.5	1.5	20.3	32.3	19.6	9.8	7.1	4.3
In percent of exports of goods and services	0.0	0.0	0.0	0.0	0.6	0.9	0.5	0.2	0.2	0.1
In percent of external debt	0.0	0.0	0.1	0.1	0.7	1.1	0.6	0.3	0.2	0.1
In percent of gross reserves	0.0	0.1	0.1	0.1	1.1	1.7	1.2	0.6	0.4	0.2

1/ This table of capacity to pay indicators is prepared based on an adverse scenario in which more modest terms of trade growth—a ½ percent increase compared to 2 percent in the baseline—would lead to lower growth, a higher current account deficit, and slighlty higher public debt (the authorities would still comply with the FRL, but they would not overperform). The higher external deficit would open a financing gap of about 90 percent of quota.

2/ End of period.

3/ On May 24, 2019 the IMF Executive Board approved a modified interest rate setting mechanism which effectively sets interest rates to zero on ECF and SCF through June 2021 and possibly longer. The Board also decided to extend zero interest rate on ESF till end June 2021 while interest rate on RCF was set to zero in July 2015. Based on these decisions and current projections of SDR rate, the following interest rates are assumed beyond June 2021: 0/0/0/0 percent per annum for the ECF, SCF, RCF and ESF, respectively. The Executive Board will review the interest rates on concessional lending by end-June 2021 and every two years thereafter.

4/ Expected repayment schedule SBA, assuming full drawings and a rate of charge of 1.789 percent as of November 14, 2019. The Honduran authorities have expressed their intention to treat the arrangement as precautionary, since balance of payment pressures have not materialized.

Table 12. Honduras: Sustainable Development Goals

	2012	2013	2014	2015	2016	2017	2018
Goal 1. End poverty in all its forms everywhere							
Proportion of population below international poverty line (%)	19.6	17.3	15.9	16.2	16.0	..	..
Proportion of population living below the national poverty line (%)	66.5	64.5	62.8	63.8	60.9	..	..
Goal 2. End hunger, achieve food security and improved nutrition and promote sustainable agriculture							
Prevalence of undernourishment (% of population)	15.3	15.4	15.6	15.5	15.3	..	..
Goal 3. Ensure healthy lives and promote well-being for all at all ages							
Mortality rate, infant (per 1,000 live births)	18.6	18.0	17.3	16.7	16.2	15.6	..
Mortality rate, under 5 (per 1,000 live births)	21.9	21.0	20.3	19.6	18.9	18.2	..
Maternal mortality ratio (per 100,000 live births)	141.0	135.0	132.0	129.0	..	..	..
Prevalence of HIV, total (% of population ages 15-49)	0.4	0.4	0.4	0.4	0.4	0.3	..
Goal 4. Ensure inclusive and equitable quality education and promote lifelong learning opportunities for all							
Minimum proficiency in mathematics, secondary (%)	..	58.2	92.0	85.0	92.0	..	..
Minimum proficiency in reading, secondary (%)	..	70.4	93.0	80.0	93.0	..	..
Gender parity index for achievement in mathematics, secondary	..	1.0	..	..	..	..	..
Gender parity index for achievement in reading, secondary	..	1.1	..	..	..	..	..
Rural to urban parity index for achievement in mathematics, secondary	..	0.8	..	..	..	..	..
Rural to urban parity index for achievement in reading, secondary	..	0.9	..	..	..	..	..
Goal 5. Achieve gender equality and empower all women and girls							
Proportion of seats held by women in national parliaments (%)	19.5	19.5	25.8	25.8	25.8	25.8	21.1
Proportion of women in managerial positions (%)	59.5	61.3	59.9	49.1	47.0	48.4	..
Goal 6. Ensure availability and sustainable management of water and sanitation for all							
Proportion of population with basic handwashing facilities on premises, rural (%)	80.3	80.3	80.3	80.3	..	..	..
Proportion of population with basic handwashing facilities on premises, urban (%)	87.2	87.2	87.2	87.2	..	..	..
Goal 7. Ensure access to affordable, reliable, sustainable and modern energy for all							
Proportion of population with primary reliance on clean fuels and technology (%)	..	..	..	51.0	52.0	54.0	..
Renewable energy share in total energy consumption (%)	54.3	53.4	54.1	53.5	55.2	..	..
Goal 8. Promote sustained, inclusive and sustainable economic growth, full and productive employment and decent work for all							
Annual growth rate of real GDP per capita (%)	2.2	1.0	1.3	2.1	2.0	3.1	..
Proportion of informal employment in non-agriculture employment (%)	75.2	75.3	73.3	74.2	73.8	..	..
Proportion of youth not in education, employment or training (%)	28.7	26.8	28.7	27.0	27.8	27.7	..
Goal 9. Build resilient infrastructure, promote inclusive and sustainable industrialization and foster innovation							
Manufacturing value added as a proportion of GDP (%)	16.3	16.4	16.3	16.3	16.2	16.2	16.2
Researchers (in full-time equivalent) per million inhabitants (per 1,000,000 population)	..	..	..	23.0	..	..	..
Proportion of medium and high-tech industry value added in total value added (%)	7.2	7.2	7.2	7.2	7.2	..	..
Goal 10. Reduce inequality within and among countries							
Growth rate of household expenditure or income per capita (%)	..	..	..	-4.2	..	..	..
Remittance costs as a proportion of the amount remitted (%)	..	..	..	4.3	..	4.2	..
Goal 11. Make cities and human settlements inclusive, safe, resilient and sustainable							
Annual mean levels of fine particulate matter in cities, total population (micrograms per cubic meter)	..	..	..	..	20.1	..	..
Goal 14. Conserve and sustainably use the oceans, seas and marine resources for sustainable development							
Average proportion of Marine Key Biodiversity Areas (KBAs) covered by protected areas (%)	1.5	48.9	48.9	48.9	48.9	48.9	48.9
Goal 16. Promote peaceful and inclusive societies for sustainable development, provide access to justice for all and build effective, accountable and inclusive institutions at all levels							
Number of victims of intentional homicide per 100,000 population	84.3	..	66.9	..	56.5	..	..
Bribery incidence (% of firms experiencing at least one bribe payment request)	..	..	..	..	8.7	..	..

Source: UN SDG Indicators Global Database.

Note: Goals 12, 13 and 17 are not listed due to data limitations.

Annex I. Drivers of the Revenue Underperformance in 2019

Tax revenue is expected to underperform in 2019. The shortage can be attributed to a faster-than-anticipated impact of the 2018 reform to the minimum corporate income tax and weaker economic conditions—mostly through lower imports and lower reported corporate profit rates.

1. Tax revenue in 2019 is expected to be lower than previously projected. The projection based on data as of October 2019 yields an estimate of tax revenue of L107 billion for the full year, L3.7 billion below target (or 3 percent of total tax revenues). Sixty percent of the shortage is explained by underperformance in value added tax (VAT) and other indirect taxes, whereas the rest can be attributed to weaknesses in direct taxes.

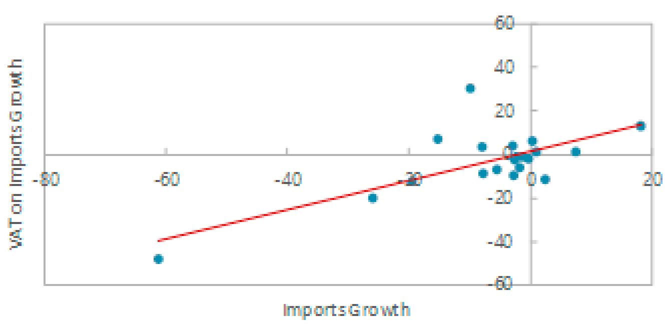
Tax Revenue in 2019
(in billions of Lempiras)

	Indicative Target	Expected	Shortage
Direct Taxes	37	35	-1.5
Value Added Tax	45	43	-1.6
Fuel Tax	14	14	0.2
Custom Duties	5	5	0.0
Others	11	10	-0.6
Total	**111**	**107**	**-3.7**

Source: IMF staff estimates.

2. Underperformance in value added tax is mainly explained by lower imports. Driven by the stronger-than-expected slowdown in economic activity, imports have dropped substantially. In the first eight months of 2019, imports —excluding energy —dropped by 4.8 percent in dollar terms with respect to the same period of 2018, reflecting a deterioration across the board on consumption, intermediate, and capital goods, albeit with different intensities—nominal imports in domestic currency fell by 2 percent during this period.[1] While a recovery is expected during the last quarter, the projected growth rate for non-energy imports for the full year has been revised downwards to 2.9 percent from 10.4 percent at the time of the 2019 Article IV Staff Report. Hence, VAT collected by the customs administration is expected to be L1.5 billion below of the 2019 target. Similarly, another L0.1 billion of tax shortage can be attributed to other indirect taxes on imports and custom duties.

Imports and VAT on Imports by Product
(Percent, Jan-Ago 2019 vs. Jan-Aug 2018)



[1] Fuels are not taxed with VAT in Honduras. Maquila imports are also excluded from the import behavior discussed in this annex because of their special tax treatment.

Impact of Lower Imports on Value Added Tax in 2019

	(in percent)	
	Growth Rate of Imports (excl. Energy) in Lempiras	
(1)	IMF Staff Forecast in 2019 Article IV Staff Report	10.4%
(2)	New IMF Staff Forecast	2.9%
(3) = (2) - (1)	Difference	-7.5%
	(in billions of Lempiras)	
(4)	Value Added Tax Collected by Customs in 2018	20.5
(5) = (3) x (4)	**Impact on Value Added Tax Collected by Customs**	**-1.5**

Source: IMF staff estimates.

3. In addition, changes in expenditure composition due to the economic slowdown further reduced tax collections on imports. Households disproportionately reduced expenditures on luxury goods, which benefit less from VAT exemptions in Honduras, leading to sharper reductions in VAT collections.[2] The fall in investment led to sharp declines in imports of capital goods, for which VAT exemptions are also less prevalent. For example, while food imports in dollars declined by 1.9 percent in the first eight months of the year, the reduction was over four times larger for imports of vehicles. The impact of the sharper decline of imports of goods that are not tax exempt is estimated at 0.3 billion for the full year.

4. The expected VAT shortage for 2019 also reflects slight delays in a policy measure. The 2019 Article IV projection included the elimination of the VAT refund for purchases with credit and debit cards in the second half of the year. The measure has not been passed yet, but it has been submitted to Congress and is expected to be implemented in 2020. The delay in implementation has cost L0.3 billion in 2019.

5. The security fee collection also declined beyond what was envisioned in initial projections. The security fee comprises a set of taxes earmarked for fighting organized crime. Its main component is a financial transactions tax but also includes a tax on mining exports. Weaker economic conditions led to lower-than-anticipated growth in the financial transactions' component. Additionally, a Supreme Court ruling has deemed the mining export as unconstitutional. As a result, collections are expected to be L0.2 lower.

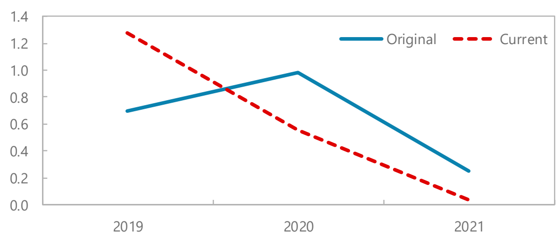
6. The shortage in direct taxes is explained by a faster-than-anticipated impact of the minimum corporate income phase out and weaker economic conditions. The minimum corporate income tax was reformed in 2018, lowering rates and increasing thresholds in three steps finalizing in 2020. The reform was expected to cost L0.7 billion in 2019 but amounted

[2] In Honduras, a basic basket of goods is exempted from VAT.

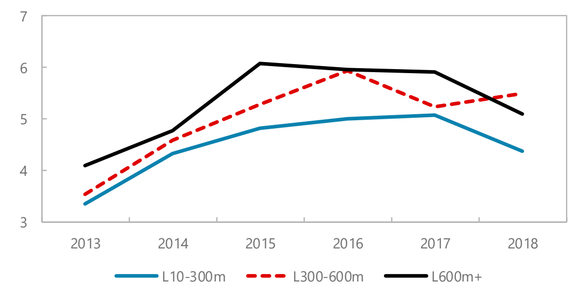
instead to L1.3 billion. The overall estimated impact of the reform has not changed significantly, but its timing has become more frontloaded as revenue losses projected for 2020 materialized already in 2019 owing to the effect of direct payments. Lower reported profit rates for fiscal year 2018 also contributed to weaker-than-expected direct taxes collections, both for firms affected and unaffected by the reform, as economic conditions worsened lowering actual profit rates and likely deteriorating tax compliance. The decline in profit rates could have contributed L0.7 billion to the tax shortage in 2019.

Expected Tax Revenue Loss of Reform to Minimum Corporate Income Tax

(in billions of Lempiras)



Average Profit Rate by Level of Firm Sales



Source: Country authorities and IMF staff estimates.

7. The table below summarizes the main drivers of revenue underperformance. Most of the revenue underperformance can then be explained by faster-than-anticipated impact of the minimum corporate income tax reform and by the economic slowdown, which has led to lower imports and lower reported corporate profit rates.

Drivers of Revenue Underperformance in 2019

(in billions of Lempiras)	
Direct Taxes	
Faster-than-anticipated impact of the reform to the minimum corporate income tax	0.6
Lower reported profit rate	0.7
Indirect Taxes	
Slowdown in imports	2.0
Delay in eliminating VAT refund for purchases with credit/debit card	0.3
Underperformance of tasa de seguridad	0.2
Tax Revenue Shortage	3.7

Source: IMF staff estimates.

Appendix I. Letter of Intent

November 27, 2019

Ms. Kristalina Georgieva
Managing Director
International Monetary Fund
Washington, DC 20431

Dear Ms. Georgieva,

1. **Honduras has made great strides reducing macroeconomic imbalances and strengthening its policy framework over the last years, but challenges remain.** The government implemented a front-loaded fiscal consolidation through significant revenue mobilization and expenditure control, and institutionalized fiscal prudence by enacting a Fiscal Responsibility Law in 2016. We also took steps towards modernizing our monetary policy framework and adopted measures to increase resilience in the financial system. While these efforts have spurred growth and fostered sound macroeconomic management, challenges remain to reduce risks and vulnerabilities. Poverty is still high and the financial situation of the public electricity company (ENEE) is constraining needed infrastructure and social spending. We also believe that achieving sustainable inclusive growth requires reforms to improve governance.

2. **The main objective of our economic program is to maintain macroeconomic stability, while enacting reforms to foster inclusive growth.** The main elements of the program remain as described in our Letter of Intent of June 20, 2019: (i) securing the fiscal position by putting ENEE on a sustainable path through deep reforms while maintaining policy space for investment and social spending; (ii) strengthening monetary policy and financial institutions to buffer shocks and maintaining stability; and (iii) reforms to improve the business environment and governance, including by stepping up efforts in the fight against corruption.

3. **Despite challenging conditions affecting economic growth recently, we remain committed to the program.** The slowdown in the global economy, persistently weak terms of trade, a severe drought, and political tensions over the summer had a negative impact on growth, straining public finances. Despite these developments, we remain committed to our fiscal and monetary policy frameworks; and all quantitative performance criteria were met for the first review period ending September 2019. We have also taken steps to strengthen governance and restructure the electricity sector, in line with the structural benchmarks set in the program. The SBA will continue to be treated as precautionary, that is, as an insurance policy against external shocks beyond our control.

4. **In line with our stated intent to strengthen institutions, we are incorporating new reforms to improve governance and strengthen the anti-corruption framework.** Our program already included decisive actions to improve the institutional framework in the electricity sector,

public financial management, the monetary policy framework, business climate, and the AML/CFT framework. To complement these initial plans, we have been working with Fund staff to define a road map that strengthens the anti-corruption framework and public finance management, including the mitigation of risks. We believe that this comprehensive approach will help preventing corruption, protect public resources, rebuild confidence in public institutions and generate increased societal support for our reform program.

5. We believe that the policies set forth in the attached Memorandum of Economic and Financial Policies (Attachment I) are adequate to achieve the objectives of our program. The attached memorandum updates the one submitted on June 20, 2019, notably describing progress in electricity sector reforms and new initiatives to enhance governance. We will take any further measures that may become appropriate for this purpose. We will consult with the Fund on the adoption of these measures, and before any revision to the policies contained in memorandum, in accordance with the Fund's policies on such consultation. We will continue to provide Fund staff with all relevant information needed, as outlined in the Technical Memorandum of Understanding (Attachment II).

6. Consistent with the commitment to keep the public informed, we authorize the IMF to publish this Letter of Intent, its attachments and the related staff report, as well as all future program documents.

Sincerely yours,

/s/	/s/
Wilfredo Cerrato Rodriguez	Rocío Tábora Morales
President, Central Bank of Honduras	Secretary of the Treasury

Attachments (2)

Attachment I. Memorandum of Economic and Financial Policies

Background and Program Objectives

1. **Over the last years, Honduras has made great strides reducing macroeconomic imbalances and strengthening its policy framework.** At the onset of the Fund-supported economic program in 2014, Honduras was facing numerous macroeconomic challenges; with slowing economic activity, a challenging external environment and political uncertainty. Fiscal policy in previous years had led to a rapid increase in public debt, the current account deficit had increased, and reserve coverage was limited. Against this backdrop, the government took decisive actions on all fronts. It implemented a front-loaded fiscal consolidation through significant revenue mobilization and expenditure control, reducing the fiscal deficit by almost 7 percent of GDP in three years. Moreover, the government institutionalized fiscal prudence by enacting a Fiscal Responsibility Law (FRL) in 2016, which has been overperformed during the last three years. The government also took steps towards modernizing its monetary policy framework—aiming at facilitating a transition towards inflation targeting—and adopted measures to make the financial system more resilient. This program managed to secure macroeconomic stability and to increase confidence, as manifested by the steady improvement in international sovereign ratings.

2. **While government efforts have spurred growth and established the foundation for sound macroeconomic management, challenges remain to reduce vulnerabilities and risks.** Honduras continues to be one of the poorest countries in the region, with more than 60 percent of households living below the poverty line. In this context, while our commitment with fiscal prudence—enshrined in the FRL—is instrumental to ensure debt sustainability, there is a need to increase social and infrastructure spending to improve social conditions for the Hondurans. To buffer potential external shocks associated with volatile terms of trade and global financial conditions, Honduras also needs to continue strengthening its monetary policy framework. Finally, we believe that an overarching challenge to achieve sustainable inclusive growth is associated with the need to improve governance, which calls for wide-ranging institutional reforms.

3. **The main objective of our economic program is to maintain macroeconomic stability, while enacting economic and institutional reforms to foster inclusive growth.** We remain firmly committed to macroeconomic stability; and intend to build on previous achievements to strengthen the policy and institutional framework. Adherence to the FRL will be coupled with reforms aiming at creating space to reduce the infrastructure gap and increase social spending. We intend to preserve previous revenue mobilization efforts, implement the electricity sector framework law, and put the financial situation of the public electricity company (ENEE) on a sustainable path. The program will continue strengthening monetary policy and financial institutions; and building money and foreign exchange markets to transition towards inflation targeting. Finally, we are fully committed to strengthening governance, including by stepping up efforts in its fight against corruption. These governance reforms will tackle areas that pertain to the macroeconomic policy framework, as well as the rule of law, fundamental to improve the business environment and foster inclusive growth.

Recent Economic Developments and Outlook

4. **While the macroeconomic environment is stable, economic activity has decelerated due to a number of external and domestic headwinds.** The Honduran economy is experiencing adverse shocks: (i) a deceleration in the global economy; (ii) a severe drought, which is affecting the agricultural, livestock, and energy sectors; and (iii) the intensification of social tensions during the summer. Against this background, growth is projected at slightly below 3 percent in 2019, with a gradual recovery starting in 2020. Consumer price inflation and inflation expectations are converging to the center of the central bank´s 4±1 percent target band. Against a backdrop of more sluggish activity and still buoyant remittances, the current account deficit is expected to narrow; and remain financed mainly by foreign direct investment flows. In this context, the international reserves coverage has hovered around 5.2 months of non-maquila imports of goods and services. Private sector credit has slowed in 2019, and the banking system remains sound, liquid and well capitalized—bank capital is above regulatory requirements and NPLs are at low levels. Fiscal policy continues to be anchored by the FRL; and monetary policy remains data dependent.

5. **Policies under the program will uphold macroeconomic performance.** Our policies aim at maintaining the hard-won gains achieved over the past years by maintaining our revenue mobilization efforts, promptly reforming the electricity sector and implementing a wide range of institutional reforms to promote sustained inclusive growth and raise the living standards of all Hondurans. Fiscal measures and reforms will allow us to open space for infrastructure and social spending, while adhering to the FRL. The central bank will continue to steer inflation toward the midpoint of the target band through data-dependent policy actions. We will continue to accumulate reserves to cushion our economy against external shocks and treat the SBA as precautionary.

Fiscal Policy

6. **Continued fiscal prudence will put public debt on a sustainable path.** We have strived to overperform the FRL since its inception in 2016, notably through the electoral cycle in 2017 and despite the significant challenges raised by ENEE's financial situation in 2018. As this has played a critical role in signaling fiscal prudence and paving the way to put public debt on a sustainable path, the government's fiscal policy will continue to be guided by the FRL in coming years. This will be instrumental to maintaining confidence and keeping Honduras's risk premium low, reducing financing costs for the economy. To protect tax revenue, we will abstain from introducing measures with the potential to lower tax collections—either in the short- or the medium-term.

7. **At the same time, efforts to maintain revenue mobilization and reforms in the electricity sector will increase fiscal space for much-needed investment and social spending.** Measures and reforms—aiming at streamlining tax exemptions and strengthening revenue administration—over the course of the program will preserve the hard-won tax revenues achieved through reforms adopted in the last program. At the same time, bold measures in the electricity sector will put ENEE's financial situation on a sustainable path—including by implementing the

electricity sector law approved in 2014, strengthening the regulatory body, addressing governance issues both in the electricity sector and in ENEE, reducing electricity losses and energy purchase costs, keeping tariffs in line with costs, and refinancing ENEE's financial obligations to replace high-cost debt. These reforms will create fiscal space to increase investment and social spending. The FRL targets in terms of current spending and measures to control the wage bill will steer the evolution of other spending.

A. Revenue

8. We aim at preserving the revenue gains achieved over the last years. Some changes introduced in the tax code in 2017—including, inter alia, the increase in gross income exempted of the corporate minimum income tax—have resulted in a permanent reduction in tax revenue. Considering this, we are implementing a number of tax policy and administrative measures to protect the gains from recent revenue mobilization efforts:

- **Tax base.** At almost 7 percent of GDP, tax expenditures are large. Such level threats the underlying principles of our economic program by curbing much-needed resources to expand social and infrastructure spending. Revenue mobilization efforts can be maintained without recourse to changes in statutory tax rates. In this context, we are gradually broadening the tax base by streamlining exemptions, while protecting the poor (*structural benchmark, December 2019*).

- **Control of tax exemptions.** In line with international best practices, we are proposing legislative changes to return to the tax administration office (SAR) the control and verification procedures for the management of tax exemptions (*structural benchmark, December 2019*).

- **Strengthening tax administration.** Several amnesties have been implemented in recent years, which yielded some short-term resources at the price of weakening medium-term tax enforcement. In light of this, we will not issue new tax amnesties, widen the scope for rescheduling of tax liabilities, or grant tax relief in any form.

- **Customs.** We have terminated the operations of COPRISAO by enacting the decree that creates the new customs administration, and its new managerial team was appointed last November (*structural benchmark, September 2019*).

- **Modernization of tax procedures.** We are on track for introducing electronic notification of SAR procedures to taxpayers (*structural benchmark, December 2019*). We will also develop a plan to upgrade our obsolete system based on exempted purchase orders—which is cumbersome, bureaucratic, and costly—with a modern system of timely tax refunds.

- **Information sharing.** SAR, the ministry of finance, and the customs administration have signed an agreement to share information on a timely basis; and we are working on its implementation.

B. Spending

9. Rightsizing expenditure will continue to guide our policy of fiscal prudence. We have been implementing measures to contain current spending growth, as mandated by the FRL. This containment is needed to expand social and infrastructure spending. Specifically, our spending plan includes the following:

- **Wage bill.** In the short term, we are working to implement a centralized wage bargaining mechanism to guide decisions on nominal wage increases, in line with the FRL (*structural benchmark, December 2019*). Over the medium-term, we plan to upgrade the general directorate of civil service to a public administration authority in charge of reforms to right-size the number of labor frameworks existing in the public sector and establish a modern civil service career aligned with merit and performance.

- **Goods and services.** We will control spending in goods and services by streamlining unnecessary travels, consultant services, and temporary contracts.

- **Public investment.** We are implementing a plan to speed up high-impact spending. This plan will prioritize small investment projects—with large social returns—that can be implemented rapidly.

C. Financing

10. Our program continues to be fully financed. From multilateral development banks, we envisage total disbursements of about US$1.3 billion during 2019-21. For the same period, we expect disbursements for about US$0.1 billion from bilateral loans, US$0.3 billion from commercial loans, and US$0.9 billion from market operations. We anticipate that, in the context of strong program implementation, financing conditions for Honduras will continue to improve. Thus, we will consider further operations in global markets to take advantage of opportunities for reprofiling operations, aiming at replacing high-interest, short-maturity domestic debt with cheaper and longer-maturity external debt. With the program fully financed, we are confident that we will not need to withdraw resources from the IMF.

11. Domestic arrears. ENEE had accumulated domestic arrears to private generators before program inception. As of June 2019, these arrears were estimated at about 1½ percent of GDP. We are conducting a full review of these arrears, with a view of clearing them gradually. No new arrears to generators have been incurred by ENEE.

D. Fiscal Governance and Transparency

12. The quality of fiscal policy relies on sound governance and transparency of public spending. We are committed to enhancing the quality of public expenditure, so that policies supported by our sustained revenue mobilization efforts succeed in delivering the public services demanded by the population. Transparency and strong governance are key factors to achieve these aims. In line with this, we are implementing the recommendations of the Fiscal Transparency Evaluation (FTE) recently conducted by the Fund. We are also committed to developing a plan to enhance fiscal governance, supported by technical assistance from the Fund.

13. The incorporation of expenditure channeled through trust funds into the budget is important to ensure transparency and accountability. To align our expenditure policies with the budget unity principle, we will take steps to transfer well-established programs to the budget. As a first step, we have included an annex on spending by trust funds in the 2020 budget (*structural benchmark, September 2019*). We will present a plan to execute spending currently funneled through social and infrastructure trust funds under full Public Financial Management regulations starting with the 2021 budget (*structural benchmark, March 2020*). We have also introduced a mandatory assessment from the ministry of finance as a pre-condition for contracting debt by trust funds.

14. We will take additional measures included in FTE recommendations. We are committed to enhancing the comprehensiveness of fiscal reports and strengthening the assessment of fiscal risks—particularly those stemming from trust funds and financial and non-financial public companies—through the publication of an annual Fiscal Risk Statement. This will include proposed contingent policies for risks with high probability of materialization. Moreover, we will work to strengthen the Unit of Norms and Processes in the Budget Office, aiming at creating an expenditure quality unit. The unit will be tasked with identifying the main sectors where performance budgeting pilots can be applied, as well as with developing the relevant indicators and their corresponding baselines—focus will be placed on improving the quality of expenditure in the sectors that are critical for the social wellbeing and long-term development.

E. Electricity Sector: Governance and Sustainability

15. The structural overhaul of the electricity market constitutes a cornerstone in our economic program. We are taking important steps to implement the approved electricity framework law, which aims at rehabilitating and upgrading the sector's infrastructure and mobilizing investment resources. We have created the system operator (ODS) in charge of managing the power grid to ensure the reliable delivery of electricity. The mandate of the ODS—a function previously performed by ENEE—involves the design of plans to expand generation and transmission based on sound projections of energy demand, the preparation of procedures for purchase of energy in spot markets, and the operation of the payment system in the wholesale market. The ODS is already working on these plans and regulations, with a view to finalize them by the end of the year, which will allow open, competitive, and transparent auctions for new energy purchases.

16. We have approved a new tariff scheme; and the regulatory body (CREE) is working on the regulatory framework needed to implement it. The new tariff scheme—prepared with assistance from the World Bank—defines the framework to reflect generation, distribution, transmission, and other costs to provide electricity services. The governance structure in the CREE has been strengthened—including by appointing all commissioners—and tariffs continue to be updated on a quarterly basis based on technical considerations (*continuous structural benchmark*).

Following the approval of the new tariff structure, the CREE has begun working on the associated regulations, aiming at finalizing them by end-2019.

17. Following due process, generation contracts that have not come into effect will be reassessed in light of ODS's medium-term strategic planning. These projects had been negotiated by ENEE over the last years, but the increase in supply they will bring about may not be in line with the expected evolution of electricity demand in Honduras—as defined by ODS's medium-term expansion plans—or may not be fully compliant. This process will pave the way to procurement of energy following the electricity framework law.

18. We are taking steps to tackle long-standing challenges in ENEE. At the onset of the program, the company's financial situation was critical—its deficit reached 1 percent of GDP in 2018, owing to lack of strategic planning that gave place to oversupply and high generation costs, a misalignment between tariffs and costs, high electricity losses, governance issues, and persistent operational inefficiencies. Over time, these weaknesses have resulted in a large accumulation of debt—close to 11 percent of GDP—and the loss of the company's financial autonomy. In line with the plan outlined in July 2019, reforms are focused on the following issues:

- *Management.* A new management team was appointed in ENEE last July, and the Ministry of Finance has established a pre-intervention team to audit its operations—this facilitates the transfer of the budgetary support needed to prevent new arrears during the transition period. Based on a high-level commitment, we will submit a legislative decree to Congress to intervene ENEE. This will strengthen supervision of ENEE's operations and governance, securing a swift implementation of reforms in ENEE.

- *Audits.* With support from the Inter-American Development Bank, the Ministry of Finance is finalizing the process to hire international firms to conduct audits of ENEE's financial accounts and its processes. We will establish an inter-institutional commission to value the company's assets and liabilities—which is critical for its unbundling.

- *Unbundling of the company.* As mandated by the electricity framework law, with technical support from the Inter-American Development Bank, we are making progress in the unbundling of ENEE into three independent companies that will operate in generation, transmission, and distribution. The separation of the company will enhance the functioning of the electricity market and attract investment.

- *Financial and generation issues.* We plan to reach refinancing agreements with ENEE's creditors to reduce financing costs, including by cancelling the trust funds managing the company's cash flow; which will improve governance as well. Additionally, in strict adherence to our legal framework, we will seek a more efficient electricity market through agreements with existing private generation companies.

- *Electricity losses.* The current level of losses is testimonial of operational inefficiency. We are working towards implementing our strategy to reduce electricity losses in transmission and distribution. To this end, we: (i) have launched a new law enforcement task force to reduce non-technical losses associated with large consumers by conducting more targeted field assessments looking for irregular connections, tampered or damaged meters, and unmetered consumers; and (ii) are securing the financing to upgrade the transmission grid. Following due process, we are also working to reassess the contract with *Empresa Energía Honduras* (EEH), the operator of the distribution system.

19. Our comprehensive energy sector reform plan includes appropriate support for the poor. It aims at clearly stating its long-term objectives—in consultation with key stakeholders—and maintaining communication with the public. Moreover, specific programs to protect the poor have been put in place, including by maintaining the electricity subsidy for those consuming less than 75kwh per month and by introducing transitory budgetary transfers for low-consumption households after the tariff adjustment in April.

Monetary Policy

20. The central bank (BCH) will continue to control inflation and maintain an adequate level of international reserves. The BCH will seek to keep headline inflation within the 4±1 percent target band. The program includes ceilings on the expansion of net domestic assets and floors on the accumulation of non-borrowed net international reserves of the central bank as performance criteria. To ensure that the growth in private sector credit is in line with the program objectives, the BCH will keep credit developments under close review and will use its monetary policy instruments as needed. We will not provide additional financing to BANHPROVI beyond that envisaged under the trust fund approved in 2013.

21. We will continue to improve the operational framework for conducting monetary policy, aiming at the implementation of full-fledged inflation targeting in coming years. A critical element to meet this end is the new central bank charter, which we aim to submit to Congress in December 2019 (structural benchmark), supported by continued technical assistance from the Fund to strengthen the central bank's capacity building required to implement these reforms. The charter will safeguard operational autonomy and will increase transparency and accountability of the institution by, *inter alia*, stating price stability as the policy mandate of the BCH, improving transparency by introducing the International Financial Reporting Standards, securing a sound central bank's governance structure, and clarify operational, oversight, and policy decision responsibilities.

22. Continuous cooperation between the central bank and the ministry of finance will be of the essence to enhance the operational framework for monetary policy. In the past, coordination has resulted in a successful recapitalization of the central bank. Going forward, we believe that coordination has the potential to further increase efficiency in money markets by reducing market fragmentation between central bank and Treasury instruments. In line with this, we will assess, drawing from technical assistance from the Fund, the benefits of signing an agreement between the central bank and the ministry of finance to give the former unrestricted access to a pool of government securities to implement monetary policy—as it is successfully done in other countries—with the proceeds of these placements to be deposited in a sterilized account at the central bank.

23. We will move gradually towards a flexible exchange rate regime. Over the medium term, this will allow the Honduran economy to adjust to terms-of-trade and other external shocks. As of November 2019, we have reduced the FX surrender requirement by 40 percentage points. We are preparing a plan for the gradual removal of the remainder 60 percent (*structural benchmark, December 2019*).

24. As part of our transition to inflation-targeting, we are working to improve pricing and economic activity statistics that are critical to assess the monetary stance. We will complete by December 2020 the National Household Income and Expenditure Survey (NHIES), with the aim of publishing a new consumer price index (CPI) by January 2022. We are also working on a project to rebase the national accounts series to 2016. We are committed to publishing the new national accounts series by December 2021.

Financial Policies

25. We are fully committed to further improving the regulatory framework and supervisory practices in the financial system. In line with the FSSR recommendations and the Basel III standard, we are phasing in an additional capital charge of 2.5 percent on banks through December 2022—the first increase of ¾ percent occurred in December 2018. We are also strengthening the CNBS capacity in risk-based supervision—with assistance from the Fund and the Toronto Center—and furthering our stress testing capacities. Going forward, we plan to: (i) phase in the liquidity coverage ratio and capital conservation buffer requirements as currently scheduled; (ii) introduce regulations for market risks; and (iii) develop new methodologies to assess operational risks. The CNBS will also complete implementation of the bank resolution framework by creating guidelines for banks to prepare their recovery plans and develop manuals for bank resolution mechanisms with support from OTA. We will remain vigilant to the evolution of credit growth as well—especially in foreign currency, with a view of considering tightening the macro-prudential framework.

26. Improving access to credit of small- and medium-size agricultural producers is a key element in our economic program. Given the situation of financial insolvency of the public agricultural development bank (BANADESA), we will continue the process envisaged in the financial sector law and send Congress a proposal to address its financial situation (structural benchmark, December 2019).

27. We will continue to assess improvements to the investment policy framework of public pension funds. Pension funds' investment policy frameworks should aim at aligning the maturity of their assets and liabilities. Therefore, we will gradually move the structure of their investment portfolio towards international best practices. We will also assess whether lending policies place the incentives to secure the right amount of accumulated rights—net of outstanding loans—at the time of retirement.

28. Modernizing our legal framework is critical to broaden financing options for the private sector and investment alternatives for institutional investors. We will submit to Congress a new securities market law to support the development of domestic capital markets (*structural benchmark, March 2020*). The development of domestic capital markets will also strengthen the interest rate channel of monetary transmission, supporting the transition to inflation targeting.

Social Policies

29. Reducing the unacceptable high poverty rate is critical for the success of our reform agenda. Therefore, it is critical to put measures in place to combat poverty and favor social mobility—by focusing on women and early-age children.

30. Priority social spending. We have defined a set of social programs to be monitored during periodic reviews (indicative target), which is testimonial to our commitment to further expand the social safety net. The priority social spending will be channeled mainly through well-targeted cash transfers or other similar programs, including support for returning migrants. We will expand our flagship cash-transfer program "*Bono Vida Mejor*", aiming at covering population in extreme poverty by end-2021.

31. Electricity subsidy. As suggested above, we will continue providing the subsidy for households consuming up to 75KW per month and provide additional temporary subsidies to buffer the impact of higher energy price on households.

32. Gender equality. Raising female labor participation is critical to boost potential growth. We will tailor our subsidized lending programs to small and self-employed producers to ensure adequate gender distribution that contributes to a gradual closing of the gender gap in the labor market. Some of our key programs in this area—*Primera Infancia, Ciudad Mujer, and Empoderamiento Económico de la Mujer*—will be included as priority social spending.

Business Environment, Governance, and Anti-Corruption Efforts

33. Fostering the conditions for private sector activity is critical to our economic program. Steps have been taken for further administrative simplification; and a one-step window is being implemented for international trade. We will submit to Congress legislation requiring public regulatory agencies to streamline and publicize requirements for obtaining permits, to reduce discretion and accelerate approvals (*structural benchmark, March 2020*). We will also develop a plan to implement the electronic signature to simplify public administration procedures (*structural benchmark, December 2019*).

34. We have been working with Fund staff to define a roadmap to improve the legal framework and its implementation. These plans—which we will implement in consultation with Fund staff—will anchor our efforts to enhance fiscal governance and prevent corrupt practices:

- *Procurement*. We will: (i) conclude the implementation of our enhanced public purchases and contracting platform—the first two modules of *Honducompras 2,* which include the suppliers registry, the annual purchasing and contracting plans, and the procurement process—ensuring its full integration with the Treasury IFMIS (SIAFI) for central government entities covering 90 percent of the procurement budget (*new structural benchmark, September 2020*); and (ii) submit to Congress a new public procurement law to modernize the process and strengthen compliance (*new structural benchmark, September 2020)*.

- *Fiscal Risks*. The framework for Public-Private Partnerships (PPP) will be improved through the creation—with support from the Inter-American Development Bank—of a new PPP unit in the Treasury. This unit will work in tandem with the Treasury's contingency unit to (i) assesses the convenience of procuring projects as PPPs rather than as traditional public investments; and (ii) conduct technical feasibility and cost-benefit studies at all stages of the project cycle (*new structural benchmark, June 2020*).

- *Strengthening the Anti-corruption Framework*. A reform to the organic law of the Court of Accounts will address shortcomings in the current internal audit system, including lack of concurrent audits and independence of internal auditors from audited entities by granting the Court of Accounts exclusive responsibility over their nomination and removal. The Court of Accounts will issue by-laws to reform the public officials' asset declaration system in line with good international practices (*new structural benchmark, September 2020*). These by-laws will enhance accountability by revising the criteria to determine reporting officials—based on hierarchy and risk criteria, such as salary and access to public funds—, and migrating the system to electronic submission of declarations.

35. AML/CFT. We will continue to expand supervision coverage of Designated Non-Financial Businesses and Professions (DNFBPs); and enhance the identification of shareholders and beneficial owners of all types of legal persons as well as the access to this information for AML/CFT purposes. To this end, in consultation with Fund staff, we will submit to Congress legislation requiring the amendment of the Code of Commerce to allow only registered shares, and the creation of a unified and centralized registry collecting beneficial ownership information that will ensure timely identification of owners of all types of legal persons, including by requiring legal entities to submit updates and establishing dissuasive actions to secure compliance (*new structural benchmark, September 2020*).

Safeguards Assessment and Program Monitoring

36. The institutional reforms identified in the Fund safeguards assessments of the BCH are underway. The assessment noted the successful recapitalization of our central bank during 2014–18. We are preparing submission to Congress of the new central bank charter that will strengthen its independence and its governance framework, including by establishing independent oversight—in line with the recommendations of the Safeguards Assessment (*structural benchmark, end-December 2019*). We will also introduce the International Financial Reporting Standards to enhance transparency.

37. Program monitoring. The waiver for multiple currency practices (MCPs) approved at program inception is still valid; we have not introduced any new rule on the FX market that would lead to a spread of more than 2 percent between the official exchange rates and the exchange rates resulting from the BCH's FX auction. The program will continue to be subject to semi-annual reviews, and will be monitored through performance criteria, indicative targets, and structural benchmarks, as set out in tables 1 and 2. To facilitate program monitoring, we are committed to provide detailed information as specified in the technical memorandum of understanding (TMU). Relevant definitions and reporting procedures are further specified in the accompanying TMU.

38. Program Monitoring Committee (PMC). The PMC—comprising the chief of the economic cabinet, the president of the central bank, the minister of finance, the director of SAR, the president of the CNBS, the chief economist of the central bank, and the director of macro-fiscal policy at the ministry of finance—will continue to meet at least once a month to review implementation of the Fund-supported program and consistency of all relevant policy initiatives with the program's objectives. The Fund resident representative will attend the meetings as an observer. The central bank will prepare minutes of the meetings and send them to the Fund resident representative no later than five business days after each meeting.

Table AI.1. Honduras: Structural Benchmarks 2019-20		
Measure	**Test Date**	**Status**
Ensure that CREE implement periodic tariff adjustments aligned with the evolution of energy generation costs.	Continuous	Met
Include an annex on spending by trust funds in the 2020 budget proposal to be submitted to congress.	September 2019	Met
Enact the decree that creates the new customs administration and appoint its managerial team.	September 2019	Not met
Introduce legislation to transfer all verification procedures for the management of tax exemptions from SEFIN to SAR.	December 2019	…
Amend Article 89 of the Tax Code, allowing for electronic notification of SAR procedures to taxpayers.	December 2019	…
Streamline tax exemptions, including those that are not in line with commitments under the benefit and/or lack proof of economic impact.	December 2019	…
Submit to Congress the new draft BCH charter, in line with the recommendations of Fund staff (see paragraph 21 of the MEFP).	December 2019	…
Present a plan to phase out FX surrender requirements.	December 2019	…
Establish a centralized wage bargaining mechanism, in line with the FRL.	December 2019	…
Submit to Congress of a proposal to address the financial situation in BANADESA.	December 2019	…
Prepare a plan to implement electronic signature.	December 2019	…
Submit to Congress draft legislation requiring regulatory agencies to streamline and publicize requirements for obtaining permits (*Ley de Simplificación Administrativa*).	March 2020	…
Present a plan to execute social and infrastructure spending currently funneled by trust funds to be managed within full PFM regulations for the 2021 budget.	March 2020	…
Submit to Congress a new securities market law.	March 2020	…
Issue regulations ensuring that the Treasury's PPP unit: (i) assesses the convenience of procuring projects as PPPs rather than as traditional public investments; and (ii) secures that technical and cost-benefit analysis is implemented at each stage of the project cycle.	June 2020	…
Issue regulations to the framework law of the *Tribunal Superior de Cuentas* to reform the public officials' asset declaration system in line with international good practices, reducing and prioritizing the number of reporting officials based on hierarchy and risk, and digitalizing the submissions of declarations—in consultation with Fund staff.	September 2020	…
Ensure that the procurement portal *Honducompras 2* is integrated with the Treasury's IFMIS (paragraph 34 of MEFP).	September 2020	…
Submit to Congress a new procurement law.	September 2020	…
Submit legislation to ensure timely access to accurate beneficial ownership information on all types of legal persons in Honduras—including by requiring legal entities to submit updates, ensuring the centralization of beneficial ownership information, and establishing actions to secure compliance (paragraph 35 of the MEFP).	September 2020	…

Table AI.2. Honduras: Performance Criteria [1/]

(Cumulative flows; millions of Lempiras, unless specified)

	2019					2020			
	End-Sep.			End-Dec.		End-Jun.		End-Dec.	
	Prog.	Actual	Status	Prog.	Rev. Prog.	Prog.	Rev. Prog.	Prog.	Rev. Prog.
QUANTITATIVE PERFORMANCE CRITERIA									
Fiscal targets 2/									
Net lending/borrowing of the nonfinancial public sector (-= borrowing, floor)	-3,898	3,304	Met	-5,569	-6,100	-3,105	-4,100	-5,175	-6,800
Net lending/borrowing of ENEE (-= borrowing, floor) /3	-4,312	-3,695	Met	-6,160	-6,160	-3,264	-3,264	-5,440	-5,440
Lending minus repayments from public pension funds (ceiling)	600	569	Met	800	800	525	525	700	700
Public debt targets									
Accumulation of domestic arrears by ENEE (ceiling) 4/	0	0	Met	0	0	0	0	0	0
Accumulation of new external arrears (ceiling, in million US$) 5/	0	0	Met	0	0	0	0	0	0
Monetary targets									
Stock of non-borrowed net international reserves of the Central Bank (floor, in million US$)	3,738	3,968	Met	3,858	3,972	3,898	4,029	4,026	4,161
Stock of net domestic assets of the central bank (ceiling) 6/	-50,679	-61,394	Met	-52,300	-53,931	-51,574	-53,574	-52,996	-55,051
QUANTITATIVE INDICATIVE TARGETS 2/									
Tax revenue of the central government (floor)	66,502	80,348	Met	110,837	107,180	72,725	59,020	121,208	118,040
Wage bill of the central government (ceiling) 7/	28,200	33,334	Not Met	47,000	47,000	30,300	30,300	50,500	50,500
Priority Social spending (floor)	1,762	3,578	Met	5,873	5,873	2,193	2,193	7,309	7,309
Operating revenue-to-spending ratio of ENEE (floor)	0.99	1.00	Met	1.02	1.02	1.02	1.02	1.04	1.04

1/ Definitions as specified in the Technical Memorandum of Understanding.
2/ Cumulative starting in January of the correspondent year.
3/ Excluding subsidies from the central government.
4/ Relative to the stock defined in the Technical Memorandum of Understanding.
5/ Continuous PC.
6/ Using the program exchange rate of L24.4316 = 1US$.
7/ Corresponds to the budgetary central governement (*Administración Central*) in the authorities' sectorization.

Appendix to the MEFP: Main Policies and Structural Reform Program

A. Public Finances

Tax Policy

1. Do not issue additional tax amnesties, regularizations and exemptions, including by abstaining from extending existing regularizations.

2. Publish a list of tax exemptions and eliminate those that: (i) are not in line with the commitments of the approved benefit; and (ii) have no proof of economic impact (Article 20.3 of the Tax Code).

Tax and Customs Administration

3. Transfer all operational management of tax exemptions from SEFIN to SAR, including by replacing the system of "purchase orders" with tax refunds for VAT exempted taxpayers.

4. Amend Article 89 of the Tax Code—which requires personal notification to taxpayers—allowing for electronic notification of tax noncompliance by the SAR (structural benchmark).

5. Sign and implement the agreement for the exchange of information between DARA, SAR, and SEFIN.

6. Enact the decree that creates the new customs administration and appoint its executive authority (structural benchmark).

Expenditure Policy

7. Upgrade the General Directory of Civil service to a public administration authority in charge of establishing a pay policy for the whole public sector and reducing the fragmentation of labor regimes.

8. Substitute (all kinds of) wage indexation with a non-automatic and centralized bargaining mechanism for the public-sector, consistent with fiscal affordability within the medium-term fiscal framework.

Public Financial Management: Governance and Expenditure Quality

9. Include an annex on spending by trust funds in the 2020 budget proposal submitted to Congress (structural benchmark).

10. Present a plan to allow trust funds to be managed within the full PFM legal framework—as per Article 26 of the Fiscal Responsibility Law—in the 2021 budget proposal (structural benchmark).

11. Publish an annual Fiscal Risk Statement to quantify and mitigate fiscal risks related to trust funds and financial and non-financial SOEs.

12. Make the Unit of Norms and Processes in the budget office operational as an expenditure quality unit in charge of developing a plan to extend performance budget pilots to areas in the health and education sectors.

Electricity Sector: Governance and Structural Issues

13. Approve a new tariff scheme that secures the recovery of electricity generation and ENEE's operational costs (prior action for approval of the arrangement).

14. Secure budgetary and operational independence in CREE, and the automatic implementation of periodic tariff adjustments that reflect the evolution of energy generation costs (continuous benchmark).

15. Prepare a plan to secure financial sustainability in ENEE, including a debt profile and policies for energy purchase that are consistent with the new electricity tariff scheme (prior action).

16. Present a plan to secure a reduction in electricity losses, starting in 2019, with a floor of 3 percent per year from 2020 onwards (prior action for approval of the arrangement).

17. Conduct an audit of ENEE financial accounts for the 2019 fiscal year.

B. Financial Sector

18. National Banking Commission (CNBS) to issue prudential regulations for the investment of pension funds in line with international best practices, including limits on the share of consumer loans in their portfolios.

19. Amend the budget framework law to allow liability management operations by SEFIN, including debt buybacks.

20. Submit to Congress a new securities market law (*structural benchmark*).

C. Monetary Sector

Monetary Policy and Governance

21. Abstain from central bank financing to BANHPROVI beyond the level envisaged in the trust fund approved in 2013.

22. Present a plan to address the financial situation in BANADESA (structural benchmark).

23. Submission to Congress of the new central bank law that enshrines price stability as the central bank's primary objective and strengthens institutional, operational, and financial independence in line with Fund technical assistance (structural benchmark).

24. Sign an agreement between the BCH and SEFIN to guarantee the former access to a pool of government securities to conduct monetary policy; and gradually increase the use of these securities to: (i) reduce excess liquidity in the banking system (replacing current BCH paper); and (ii) replace the one-day BCH bills auction with auctions of repo and reverse repos.

25. BCH to adopt the IFRS as the accounting framework to prepare and disseminate its financial statements.

Exchange Rate Policy

26. Establish a calendar to lift surrender requirements to the BCH, simultaneously allowing for increasing interbank foreign exchange transactions (structural benchmark).

27. Present a plan to gradually develop an intervention budget, and a set of intervention rules that should be approved and published by the BCH.

D. Governance: Rule of Law and Corruption

28. Issue regulations ensuring that the Treasury's PPP unit: (i) assesses the convenience of procuring projects as PPPs rather than as traditional public investments; and (ii) secures that technical and cost-benefit analysis is implemented at each stage of the project cycle (*structural benchmark*).

29. Issue regulations to the framework law of the Court of Accounts to reform the public officials' asset declaration system in line with international good practices, reducing and prioritizing the number of reporting officials and digitalizing the submissions of declarations (*structural benchmark*).

30. Ensure that the procurement portal *Honducompras* 2 is fully integrated with the Treasury's IFMIS and submit to Congress a new public procurement law (*structural benchmark*).

31. Submit to Congress legislation to ensure timely access to accurate beneficial ownership information on all types of legal persons in Honduras—including by requiring legal entities to submit updates, ensuring the centralization of beneficial ownership information, and establishing actions to secure compliance (*structural benchmark*).

E. Governance: Market Regulations

32. Implement electronic signature as part of the project to upgrade the National Registry of Persons.

33. Approve new policy of '*simplificación administrativa*' to reduce red tape and enhance governance.

F. Social Policies

34. Assess the efficiency of social spending, and present a sustainable plan to increase its coverage, including to families in extreme poverty.

Attachment II. Technical Memorandum of Understanding

1. **This memorandum sets out technical understandings between the Honduran authorities and the Fund staff for monitoring of the economic program agreed for the period July 2019–June 2021.** It defines the concepts used to assess observance of quantitative performance criteria, structural benchmarks, and indicative targets specified in Tables AII.1 and AII.2 of the Memorandum of Economic and Financial Policies (MEFP). It also specifies the frequency of the data to be provided to the Fund to monitor the developments under the program.

2. **For program monitoring purposes, all foreign currency-related assets, liabilities, and flows will be evaluated at "program exchange rates" as defined below, except for items related to fiscal operations which will be measured at current exchange rates.** The program rates are those that prevailed on March 29, 2019. Accordingly, the exchange rates for the purposes of the program are show in Table AII.1.

Table AII.1. Program Exchange Rates

Lempira to the U.S. dollar	24.43
U.S. dollar to the SDR	0.72
U.S. dollar to the Yen	110.92
U.S. dollar to the Euro	0.89
U.S. dollar to the Canadian dollar	1.34
U.S. dollar to the Bristish Pound	0.76
U.S. dollar to the the Renminbi	6.72

3. **Any variable that is mentioned herein for the purposes of monitoring a PC or IT and that is not explicitly defined, is defined in accordance with the Fund latest statistical manuals.**

A. Quantitative Performance Criteria: Definition of Variables

4. **Definitions:**

a. The central government for the purposes of the program consists of the budgetary central government (*Administración Central*), trust funds, decentralized institutions (*desconcentradas*), and the Social Investment Fund (FHIS).

b. The nonfinancial public sector (NFPS) for the purposes of the program consists of the central administration as defined above, the social security institute (IHSS), all state-owned public pension funds, local governments, other decentralized agencies, and nonfinancial public enterprises.

Cumulative Floor of NFPS' Net Lending

5. Definitions: Net lending of the NFPS is defined as the difference between revenue and expenditure. NFPS' revenue is recorded on a cash basis and includes taxes, social contributions, grants, and other revenue—except for revenue of nonfinancial public enterprises, which will be recorded on an accrual basis. Payments from private users of public-private partnerships (PPPs) facilities will be considered public revenue.

6. NFPS expenditure is recorded on accrual basis and includes expense and net acquisition of nonfinancial assets. Private investment for PPPs is treated as expenditures and measured as part of the NFPS government net lending as they occur.

7. NFPS' net lending will be measured at each test date as the cumulative value starting from the beginning of each calendar year.

8. Monitoring. All fiscal data referred to above and needed for program monitoring purposes will be provided to the Fund with a lag of no more than 45 calendar days after the end of each month.

Cumulative Floor of ENEE's Net Lending

9. Definitions: Net lending of ENEE is defined as the difference between revenue and expenditure. Revenues and spending will be recorded on an accrual basis. For program purposes, it will be defined excluding subsidies from the central government to the company.

10. ENEE's net lending will be measured at each test date as the cumulative value starting from the beginning of each calendar year.

11. Monitoring. All fiscal data referred to above and needed for program monitoring purposes will be provided to the Fund with a lag of no more than 45 calendar days after the end of each month.

Cumulative Floor of Lending minus Repayments from Public Pension Funds

12. Definitions: Lending minus Repayments from Public Pension Funds is defined as loans to their affiliates made by public pension funds net of repayments received by them. Public pension funds included for this calculation are INJUPEMP, INPREMA, IMPREUNAH, and IPM.

13. Lending minus Repayments from Public Pension Funds will be measured at each test date as the cumulative value starting from the beginning of each calendar year.

14. Monitoring. All fiscal data referred to above and needed for program monitoring purposes will be provided to the Fund with a lag of no more than 45 calendar days after the end of each month.

Ceiling on the ENEE's Accumulation of Domestic Arrears

15. Definition: Arrears of ENEE are defined as overdue payments of ENEE. Technical delays stemming from the payment process will not be considered arrears. Technical delays are defined as unpaid claims still under the maximum period allowed for payment stated in the law on state contracts (Decree 74-2001). This decree states a deadline up to 45 days starting from the submission of appropriate documents for payment. This definition does not preclude payment before the deadline if it is agreed by both parties.

16. ENEE's Accumulation of Domestic Arrears is measured as the difference between the increase in the stock of arrears at each test date relative to 9,133 million of Lempiras, the stock of arrears recorded at June 28, 2019.

17. Monitoring. All fiscal data referred to above and needed for program monitoring purposes will be provided to the Fund with a lag of no more than 45 calendar days after the end of each month.

Ceiling on the Non-Accumulation of External Debt Payment Arrears

18. Definition of debt: External debt is determined according to the residency criterion. The term "debt"[1] will be understood to mean a current, i.e., not contingent, liability, created under a contractual arrangement through the provision of value in the form of financial and nonfinancial assets (including currency) or services, and which requires the obligor to make one or more payments in the form of assets (including currency) or services, at some future point(s) in time; these payments will discharge the principal and/or interest liabilities incurred under the contract. Debts can take several forms; the primary ones being defined as follows:

c. Loans, i.e., advances of money to the obligor by the lender made on the basis of an undertaking that the obligor will repay the funds in the future (including deposits, bonds, debentures, commercial loans and buyers' credits) and temporary exchanges of assets that are equivalent to fully collateralized loans under which the obligor is required to repay the funds, and usually pay interest, by repurchasing the collateral from the buyer in the future (such as repurchase agreements and official swap arrangements);

d. Suppliers' credits, i.e., contracts where the supplier allows the obligor to defer payments until sometime after the date on which the goods are delivered or services are provided, and

e. Leases, i.e., arrangements under which the lessee has the right to use the provided property for one or more specified period(s) of time that are usually shorter than the total expected service life of the property, while the lessor retains the title to the property. For the program, the debt is the present value (at the inception of the lease) of all lease

[1] As defined in Guidelines on Public Debt Conditionality in Fund Arrangements, Decision No 15688-(14/107).

payments expected to be made during the period of the agreement excluding those payments that cover the operation, repair, or maintenance of the property.

19. Definition of external arrears: External debt payments arrears for program monitoring purposes are defined as external debt obligations (principal and interest) falling due after June 30, 2019 that have not been paid, considering the grace periods specified in contractual agreements. Under the definition of debt set out above, arrears, penalties, and judicially awarded damages arising from the failure to make payment under a contractual obligation that constitutes debt are debt. Failure to make payment on an obligation that is not considered debt under this definition (e.g., payment on delivery) will not give rise to debt.

20. Coverage: This performance criterion covers the NFPS. This performance criterion does not cover (i) arrears on trade credits, (ii) arrears on debt subject to renegotiation and restructuring; and (iii) arrears resulting from the nonpayment of commercial claims that are the subject of litigation initiated prior to June 28th, 2019.

21. Monitoring: This PC will be monitored on a continuous basis.

Floor on the stock of Non-Borrowed Net International Reserves

22. Definitions: Non-Borrowed Net International Reserves (NIR) of the BCH are equal to the balance of payments concept of NIR defined as the U.S. dollar value of gross international reserves of the BCH minus gross official liabilities as defined below. Non-U.S. dollar denominated foreign assets and liabilities will be converted into U.S. dollar at the program exchange rates.

23. Gross official reserves are defined consistently with the Sixth Edition of the Balance of Payments manual and International Investment position Manual (BMP6) as readily available claims on nonresidents denominated in foreign convertible currencies. They include the (i) monetary claims, (ii) free gold, (iii) holdings of SDRs, (iv) the reserve position in the IMF, and (v) holdings of fixed income instruments. Excluded from reserve assets are any assets that are pledged, collateralized or otherwise encumbered, claims on residents, claims in foreign exchange arising from derivatives in foreign currency *vis-à-vis* domestic currency (such as futures, forwards, swaps and options), precious metals other than gold, assets in nonconvertible currencies and illiquid assets.

24. Gross official liabilities in foreign currencies include (i) all borrowed reserves, including foreign currency swaps, loans, and repo operations with all counterparties (domestic and foreign), regardless of maturity, (ii) other foreign currency liabilities including deposits of financial institutions, (ii) the use of Fund resources for Balance of Payments support extended in the context of the exceptional financing package, (iii) any deliverable forward foreign exchange (FX) liabilities on a net basis—defined as the long position minus the short position payable in foreign currencies. The stock of non-borrowed net international reserves will be measured as each test date.

25. Monitoring: Foreign exchange asset and liability data will be provided to the Fund at monthly frequency, within 2 weeks of the end of each month.

26. Adjustors

- **Adjustor for multilateral loans.** The NIR target will be adjusted upward (downward) by the surplus (shortfall) in program loans and disbursements from the IMF and other multilateral institutions, relative to the baseline projection reported in Table AII.2. Program loan disbursements are defined as external loan disbursements (excluding project financing disbursements) from official creditors that are usable for the financing of the NFPS.

Table AII.2. External Program Disbursements

Cumulative flows	Million of US$
Budget Support Loans	
end-September 2019	0
end-December 2019	315
end-June 2020	0
end-December 2020	27

- **Ceiling on the Stock of the BCH's Net Domestic Assets**

27. Definitions. Net Domestic Assets (NDA) of the BCH are defined as the difference between currency issued and non-borrowed NIR measured at program exchange rates.

28. The ceiling applies to the stock of NDA measured at each test date.

29. Monitoring: Data will be provided to the Fund monthly with a lag of no more than 2 weeks.

30. Adjustor for multilateral loans. The NDA target will be adjusted downward (upward) by the surplus (shortfall) in program loan disbursements from the IMF and other multilateral institutions and grants, relative to the baseline projection reported in Table AII.2. Program loan disbursements are defined as external loan disbursements (excluding project financing disbursements) from official creditors that are usable for the financing of the NFPS.

B. Quantitative Indicative Targets: Definition of Variables

- **Floor in the Central Government's Tax Revenues**

31. Definition: Tax revenue will be measured on a cash basis at the level of the central government. All compulsory and unrequited receivables by the government will be considered taxes as stated in the GFSM 2014.

32. For compliance with this IT the central government will be equivalent to the budgetary central government (*Administración Central*).

33. Monitoring. Monthly data will be provided to the Fund no more than 2 weeks after the end of the month.

- **Ceiling on the Central Government's Wage Bill**

34. Definition: The wage bill is defined as all wages and salaries measured on an accrual basis, including all cash and in-kind wage and salaries and severance payments, plus employers' social benefits.

35. For compliance with this IT the central government will be equivalent to the budgetary central government (*Administración Central*).

36. Monitoring. Quarterly data will be provided to the Fund no more than within 45 days of the end of each month.

Floor on Priority Social Spending

37. Priority social spending is defined as the public interventions with high impact on poverty reduction and long-term influence on beneficiaries. Interventions oriented to increase the participation of women in the labor market are also included. For program purposes, all interventions listed in Table AII.3 will be considered priority social spending.

Table AII.3. Priority Social Spending

Social Safety Net
Better families
School lunch
Teen pregnancy prevention program
Criando con amor
Conditional Cash Transfer
Other "Vida Mejor" interventions
Early childhood
Childcare
Support for people with disabilities
Ciudad Mujer
Strenghtening pre-elementary education
Maternal and Newborn Health Integration
Assistance to endangered woman/children
Opportunities for young mothers
Assistance to people with special abilities
Woman empowerment through credit
Electricity Subsidy for low-income consumers

38. Monitoring. Quarterly data will be provided to the Fund no more than within 45 days of the end of each month.

Floor on ENEE's Operating Revenue-to-Spending Ratio

39. Definition: Operating revenue-to-spending ratio of ENEE is defined as the ratio of operating revenue to operating expenditure. Operating revenue will be defined as current revenue excluding interest earnings and transfer from the central government either for investment or subsidies from the central government. Operating expenditure will be defined as total expenditure excluding interest payments and capital spending.

40. Monitoring. Quarterly data will be provided to the Fund no more than within 45 days of the end of each month.

Statement by Mr. Villar, Executive Director and Mr. Tabora Munoz, Senior Advisor on Honduras December 18, 2019

Our Honduran authorities are deeply grateful to the staff for the constructive engagement and high-quality policy discussions. They broadly share the staff's assessment of the economic outlook and policy priorities for the upcoming years. It is important to highlight that this is the seventh review since 2014 under two IMF-supported programs, something unprecedented for Honduras. This progress reflects the authorities' steadfast commitment to enhance and consolidate their policy and economic framework. During the 2014-2017 Fund-supported program, Honduras secured macroeconomic stability and institutionalized fiscal responsibility. The new program, approved earlier in 2019, further supports the new economic and institutional reforms to address social needs and governance issues, and to boost investors' confidence.

Authorities intend to continue treating this program as precautionary and build on past gains, supported by technical assistance from the Fund and other multilateral institutions.

Economic Outlook

Economic growth has decelerated due to a number of adverse shocks, and it is projected at slightly below 3 percent in 2019 because of persistently weak terms of trade, a severe drought, and political tensions during the summer of 2019. But it is expected to recover above 3 percent in 2020 led by a more favorable external environment, better business climate and a more stable political context. Inflation expectations at the end of November (3.8 percent y-o-y) continued showing a downward trend after peaking in May and remain below the mid-point of the band (3 to 5 percent), helped by a very low exchange rate depreciation (1.3 percent y-o-y). The revised current account deficit for end-2019 is estimated below 3 percent of GDP and the reserve coverage ratio remains stable at around 5.1 months of imports. Overall balance for 2019 is projected at 1.0 percent of GDP, in line with the program fiscal targets.

Program Performance

Despite the challenging environment and recent adverse shocks, authorities remain fully committed to the program, and aim to maintain macroeconomic stability, enhance the business climate, strengthening transparency and governance. In that regard, all end-September fiscal and monetary quantitative performance criteria (PC) have been met, including continuous non-accumulation of external arrears. Authorities remain on track to meet the end-year targets. Structural Benchmarks (SB) are progressing in line with expectations, except one that was completed with a delay.

Fiscal policy

The authorities reiterate that government fiscal policy will continue to be guided by the Fiscal Responsibility Law (FRL). The overall fiscal deficit is in line with the FRL ceiling, despite sluggish growth and faster-than-expected tax revenue losses, which implies a more gradual recovery of public investment while protecting social spending. However, authorities are implementing expenditure relocation, including restraining current spending in central government by about 0.5 percent of GDP to protect investment and the social safety net "Vida Mejor", and to support short-term growth while securing debt sustainability and upholding the FRL deficit ceiling.

Authorities are strongly committed to revenue mobilization efforts, recognizing that the recovery will be more gradual. They are pursuing streamlining of tax expenditure to reduce distortions in the tax system and broaden the tax base. The 2020 budget just approved is consistent with fiscal targets in the program (including social spending) and incorporates a more detailed report of spending through trust funds.

Authorities have continued enhancing the quality of public expenditure and implementing the recommendations of the Fiscal Transparency Evaluation (FTE) by the Fund. In this line, the Ministry of Finance (SEFIN) recently approved the General Directorate of Trust Funds responsible for the structuring, control and monitoring, and for the registry of each trust fund, all aimed at improving fiscal transparency and observing the public financial management regulations. Moreover, authorities are upgrading statistical standards towards GFSM 2014, also aimed to improve fiscal transparency.

Electricity Sector

Authorities reiterate their full commitment to continue addressing the long-standing challenges in the electric sector, particularly in the electricity public company ENEE. Proper implementation of the General Law of the Electrical Industry (LGIE) constitutes a cornerstone in the current economic program. In that regard, authorities continue strengthening the regulatory agency (CREE), after having set up its governance structure, supporting its financial autonomy, and implementing the new tariff mechanism to update tariffs on a quarterly basis, based solely on technical considerations. The CREE with the assistance from the World Bank (WB) and Interamerican Development Bank (IDB) continues working on completing the regulatory framework needed to fully implement the LGIE.

The system operator (ODS), responsible for managing the power grid and all spot market transactions, is already functional. ODS is in the final stage of socializing the indicative expansion plans for generation and transmission, which will help guide future energy purchases, especially the bidding processes planned for early 2020. The Ministry of Energy (MoE) is working on streamlining the Power Purchase Agreements (PPA) that do not comply with the LGIE.

With support from IDB, SEFIN will start early in 2020 the audits of ENEE's financial statements and its processes -to value the assets and liabilities of the company- as a critical task to complete the unbundling of the company. Recovering the company's financial independence from the trust funds that manage its cash flows is fundamental to improve the sector's governance and clear arrears. The authorities expect to cancel the trusts early in 2020, using the resources coming from a new 2020 bond placement. All these actions are oriented to establishing a more open, efficient and transparent electricity market.

Authorities recognize that reducing electricity losses is a cornerstone of the electrical sector reform and to secure financial sustainability of the ENEE. In that regard, a new task force to reduce non-technical losses is being established, as well as measures to secure financing to upgrade the transmission grid and reassessing the contract with the distribution operator *Empresa Energía Honduras* (EEH). Even though a new management team was appointed last July, a comprehensive intervention of ENEE will be pursued in early 2020 to advance the company's structural overhaul.

Monetary Policy

The Central Bank of Honduras (BCH) continues gearing monetary policy towards maintaining price stability and an adequate level of international reserves. BCH also continues the transition towards full-fledged Inflation Targeting (IT), and the work to strengthen the monetary policy framework in order to move gradually to a flexible exchange rate regime. In that regard, BCH's board of directors recently approved further reduction of 20 percent of FX surrender requirements, thus allowing economic agents to sell up to 60 percent of FX inflows to deepen the interbank FX market. Additional technical support from Fund departments will be needed to strengthen BCH capabilities required to develop the new market intervention mechanisms.

BCH authorities, with strong support from the IMF, have completed a draft of the new central bank charter that will be submitted to Congress by end-2019. This new charter is aimed to: (i) clearly define price stability as the primary policy mandate of the BCH; (ii) institute a sound central bank governance structure to clarify operational, oversight and policy decision responsibilities; and (iii) preserve operational autonomy, increase transparency and accountability of the institution.

On November 2019, BCH started the National Household Income Expenditure Survey (NHIES), fundamental tool to improve pricing and economic activity statistics, critical to assess the monetary stance and transition towards full-fledged Inflation Targeting.

Financial Policies

The National Banking and Insurance Commission (CNBS) stays fully committed to the improvement of the regulatory framework and supervisory practices in line with the FSSR recommendations and the Basel III standards, as well as strengthening CNBS capacities in risk-based supervision and stress testing. The CNBS remains attentive to tightening the macro-prudential framework depending on the evolution of credit growth, especially in foreign currency. Non-Performing Loans (NPLs) are low, provision coverage is high, liquidity is plenty, and capital adequacy ratio (CAR) is well above the regulatory minimum. The CNBS continues assessing the investment policy framework of public pension funds, oriented to align the maturity of their assets and liabilities, in line with international best practices.

Consistent with the modernization of the monetary policy framework and aiming towards a full-fledged Inflation Targeting, the CNBS and BCH are drafting the new securities market law to support development of domestic capital markets but also to strengthen the interest rate channel of monetary transmission. The authorities plan to submit the new law to the legislative early in the first quarter of 2020.

Business Environment and Governance

Fostering the conditions for greater private sector activity is critical for the success of the economic program. In that sense, application of the new administrative simplification regulations is ongoing, including developing a plan for the gradual implementation of the electronic signature. Authorities also continue strengthening the fiscal governance to prevent misuse of public resources and limiting fiscal risks. In that regard, the recently-created Public Private Partnership technical unit will work in tandem with the fiscal contingencies unit to improve the PPP framework.

Authorities are reaching full implementation of the enhanced public purchases and contracting platform *Honducompras 2*.0, ensuring full integration with Treasury IFMIS (SIAFI). As part of this process and following OCDE standards, reforms of the public procurement law to strengthen compliance are planned for late 2020. Additionally, an inter-agency group for transparency and anti-corruption, following the 2018 Lima commitment – “Democratic Governance against Corruption”- was created this year. Along these lines and as part of the Fifth Open Government plan, an outline for the Open Parliament Plan is expected by mid-2020.

The authorities also continue their work on fostering the AML/CFT and anti-corruption framework. In that regard, the court of accounts has decided to issue by-laws to reform the public officials' asset declaration system and to revise the criteria to determine which officials should report based on their hierarchy and/or risk profile. Moreover, with the help of the Fund, authorities are working on an amendment of the Code of Commerce to create a unified and centralized registry of beneficial ownership.

Climate Change

Honduras remains one of the most vulnerable countries to climate change in the world, as demonstrated by this year's severe drought that affected dramatically the economic activity and put a toll on the agricultural, cattle and energy sectors. Honduras continues making substantial investments to restore its forests and build climate-resilient infrastructure. The authorities remain committed to create buffers in the national budget for this purpose, but it is critical to secure access to grants and concessional green funds to continue financing adaptation and mitigation measures, and climate change interventions, including water management and food security.

Final Remarks

During the last six years, Honduras has made significant strides in: reducing macroeconomic imbalances, promoting economic stability, strengthening its policy framework and increasing investors' confidence. However, there are still many challenges ahead, so the authorities hope to maintain a continuous and close cooperation with the Fund to successfully complete the program and to solve outstanding problems for the benefit of its population. On behalf of our Honduran authorities, we thank Staff, Management and the Executive Board for the continued support to the country.

Consistent with the commitment to keep the public informed, the authorities consent to the publication of the Letter of Intent, its attachments and the related staff report.