

Honduras

1. General trends

The Honduran economy contracted by 1.9% in 2009, owing to both the adverse effects of the international financial crisis and the political crisis in the country. Manufacturing output declined and activity in the agricultural and construction sectors slowed. Inflation was 3%, the lowest rate since 1987. The fiscal deficit increased from 2.5% of GDP in 2008 to 6.2% at the end of 2009.

The economic slowdown in Honduras in 2008 worsened in the first quarter of 2009 owing to a sharp drop in external demand and a decline in domestic demand as foreign-exchange inflows from remittances fell. This was magnified by the adverse effects of the domestic political crisis caused by the expulsion from office of President Zelaya in late June 2009, which heightened political and economic uncertainty.

The political crisis severely damaged relations with the international community and led to the withdrawal of financial support by the International Monetary Fund (IMF) and multilateral banks, causing both public and private investment to decline yet further and domestic consumption to fall.

However, since presidential elections were held on 29 November 2009 and President Porfirio Lobo Sosa took office at the beginning of 2010, relations between Honduras and the international community and multilateral financial bodies have gradually been re-established.

By May 2010, relations with IMF, the World Bank, the Inter-American Development Bank (IDB) and the Central American Bank for Economic Integration (CABEI) had been restored. In May, Honduras was a signatory to the

free trade agreement with the European Union. Honduras has also entered into negotiations with the United States with a view to extending the temporary protected status (TPS) of Honduran migrants for the ninth time. Against the backdrop of a recovering international economy, the country's trade within and beyond the region is projected to improve and investment and consumption are expected to pick up as family remittance flows and foreign trade are re-established. The economy is accordingly forecast to grow by about 2.5% in 2010, while inflation could be close to the target set by the Central Bank of Honduras (6%, with a margin of 1% either side).

In view of the increase in the public-sector deficit at the end of 2009, the National Congress passed an act for the enhancement of revenues, social equity and rationalization of public expenditure, by virtue of which the deficit is supposed to fall to 4.4% of GDP by the end of 2010. This could negatively impact economic recovery efforts, although the adverse effects may be counteracted by the possible signing in the third quarter of 2010 of an agreement with the IMF enabling the World Bank and IDB to grant additional loans worth approximately US\$ 300 million.

2. Economic policy

(a) Fiscal policy

Fiscal policy remained expansionary in 2009, the result being a fiscal deficit of 6.2% of GDP, compared with 2.5% at the end of 2008. Spending increased to 63,669.1 million lempiras (23.5% of GDP), an 8.5% rise in nominal terms from the level of December 2008. A policy of public-sector wage increases continued to be applied, unsustainable though this was in the face of falling tax revenues. There was a large drop in public investment (26.2%), in contrast with the 16.3% growth seen in 2008. The rise in spending was financed mainly from central bank lending. This was expected to be short-term, but the maturity had to be extended to 10 years because of the political crisis, the continuing decline in fiscal revenues and the suspension of external financing.

As a result of the crisis, tax pressure fell by more than 3 billion lempiras to 39.035 billion lempiras (14.5% of GDP). As a result, according to official central bank figures, the fiscal deficit, including floating debt, stood at 16.662 billion lempiras at the end of 2009 (6.2% of GDP). Since international credit was no longer available, the deficit was financed primarily with domestic credit, causing total domestic debt (including the debt owed to the Central Bank of Honduras) to rise to 21.017 billion lempiras (7.7% of GDP).

The total deficit of the non-financial public sector rose to 11.734 billion lempiras (4.3% of GDP) as receipts from sales of goods and services fell, mainly owing to a drop in revenues at the National Electric Power Company (ENEE) and a rise in current expenditures, particularly wages.

The Act for the enhancement of revenues, social equity and rationalization of public expenditure was recently passed with a view to correcting the fiscal imbalance in 2010. The Act introduces significant reforms to the Honduran tax system, including some income tax changes; for example, it provides for the temporary solidarity contribution to be raised to 10.0% and then reduced annually until it is phased out completely in the 2015 tax year. It also reintroduces the dividend tax at a flat rate of 10.0%. The reforms likewise include changes to the sales tax and the introduction of a selective vehicle import tax of between 10% and 60%. Lastly, the Act provides for measures to rationalize

public expenditure and improve tax collection. With the new legislation the authorities hope to reduce the central government deficit to 4.4% of GDP by the end of 2010.

(b) Monetary and exchange-rate policies

The central bank maintained an expansionary monetary policy during the first half of 2009 in order to stimulate lending to the private sector, which had dropped because of the international financial crisis. Among the main measures adopted were the establishment of differential reserve requirements, with a 0% requirement for banks providing housing loans, and reduction of the monetary policy rate by 5.5 percentage points to 3.5% by the end of the semester. Seven-day open market operations were suspended and the interest rate on central bank bills with 4- to 12-month maturities was cut to 2.0% at the end of July 2009. These measures were intended to encourage lending to businesses. Among the countercyclical policies adopted was the approval in early 2009 of the BANHPROVI trust fund underwritten by the Honduran Bank for Production and Housing (BANHPROVI) and the central bank to spur lending to the private sector. This policy was unsuccessful because of the absence of a complementary industrial policy and technical support programmes for micro and small enterprises. What is more, no programmes were created to support domestic demand. While domestic political uncertainty dampened demand for consumer credit, the steep drop in external demand had the same effect on business borrowing.

One of the main measures taken by the central bank in 2010 was its review of the financial conditions of the BANHPROVI trust fund with a view to stimulating lending to the sectors that can generate the most value added in the economy in the shortest time, namely housing, production and microcredit.

The fall in demand for credit (as a result of lower demand in the production sector and higher real interest rates), the lack of other investment assets (because of the suspension of seven-day open market operations) and the cut in the interest rate applied to auctions of central bank instruments forced the treasurers of banking institutions to change their strategy for

attracting deposits and cut the deposit rate by 3.71%, the result being an 8.65 percentage point increase in the interest-rate spread.

There was a change in the distribution of lending, with 49.5% going to enterprises and 50.5% to households.

The monetary authorities are expecting an increase of about 6% in the outstanding private-sector credit balance in 2010 on account of the upturn in demand and reduced risk aversion on the part of banking institutions as the country's political and economic situation stabilizes.

To keep inflation down, the exchange rate was held steady at 18.8951 lempiras per United States dollar. In a climate of uncertainty, this exchange-rate rigidity led to an increase in the velocity of money that resulted in lower demand for local currency. In combination with an expansionary monetary policy, this exacerbated a loss of reserves that had amounted to US\$ 343.7 million by the end of 2009. Net international reserves stood at US\$ 2,116.3 million, covering approximately three months of imports. The monetary authorities set themselves the target of increasing reserves by US\$ 62 million in 2010 (0.6 months of imports).

Inflation remained relatively low (3.0%) as a result of the drop in domestic demand and the absorption of liquidity caused by the loss of reserves. The exchange

rate appreciated by 0.9% in real terms over the course of 2009 compared with December 2008.

In May 2009 the central bank revised its monetary policy for the second semester with a view to stabilizing the economy, resuming open market operations and setting a unified reserve requirement of 6.0%. In keeping with the decisions taken, the deposit rate increased by 1.24% during the second semester, and although the lending rate continued to rise, it did so by only 1.19%. The goal of monetary policy for 2010 is to keep inflation down to 6%, with a 1% margin in either direction. Since prices had risen 2.7% by May, the expectation is that the central bank's inflation target will be met.

(c) Trade policy

Trade policy was affected by the political situation, with Brussels suspending negotiations on the free trade agreement with Europe because of the events that led to the departure from office of President Zelaya. However, the country did sign the agreement in May 2010 once presidential elections had been held and President Lobo had taken office. In 2010, efforts are focused on harnessing the benefits of the Dominican Republic-Central America-United States Free Trade Agreement (CAFTA-DR) and seeking early ratification of the agreement with the European Union.

3. The main variables

(a) Economic activity

Real GDP contracted by 1.9% in 2009, owing to the effects of the international financial crisis and the political events of mid-2009, which had negative repercussions for investment, exports and consumption.

Supply-side developments were dominated by a 7.1% drop in manufacturing, which continues to represent a large proportion of GDP (19.7%). The manufacturing sector was affected by the slowdown in the maquila industry because of the crisis in the United States economy and a decrease in financial intermediation as a result of the significant slowdown in lending to the private sector, which grew by 2.9% in

2009 as compared to 11.6% in 2008 and 32.7% in 2007. There was a sharp contraction in construction (9.8%), commerce (9.5%) and agriculture (1.7%) because of the fall in international coffee, African palm and banana prices, which discouraged harvesting and production activities.

As to spending, private consumption shrank by 2.8%, owing mainly to the 11.8% fall in family remittances and higher unemployment in urban areas. This had a significant effect on domestic demand, which declined by 12.4%, being influenced too by a 32.4% contraction in gross fixed capital formation (compared with modest growth of 4.1% in 2008) and substantial destocking. Particularly striking was the decline of private-sector investment (33.4%),

Table 1
HONDURAS: MAIN ECONOMIC INDICATORS

	2001	2002	2003	2004	2005	2006	2007	2008	2009 ^a
Annual growth rates^b									
Gross domestic product	2.7	3.8	4.5	6.2	6.1	6.6	6.3	4.0	-1.9
Per capita gross domestic product	0.6	1.7	2.5	4.1	3.9	4.4	4.2	1.9	-3.8
Gross domestic product, by sector									
Agriculture, livestock, hunting, forestry and fishing	2.1	4.5	2.3	7.2	-2.3	7.6	5.5	0.5	-1.7
Mining	34.5	-5.8	8.5	-5.6	-0.6	-3.5	-13.1	-9.8	-1.3
Manufacturing	3.8	7.8	6.4	4.0	7.0	4.5	5.0	3.0	-7.1
Electricity, gas and water	-14.0	-13.6	-20.6	6.2	52.4	22.6	21.8	1.5	-1.5
Construction	-7.8	-11.5	3.8	1.2	-2.3	9.4	6.6	6.5	-9.8
Wholesale and retail commerce, restaurants and hotels	1.2	3.3	2.1	4.2	5.4	5.5	3.8	3.0	-8.0
Transport, storage and communications	2.9	2.4	11.5	13.5	16.6	11.6	12.7	14.2	6.4
Financial institutions, insurance, real estate and business services	9.7	9.7	8.6	12.4	12.3	15.1	15.4	7.8	0.8
Community, social and personal services	5.4	5.4	4.0	5.8	5.4	6.0	6.6	6.0	7.1
Gross domestic product, by type of expenditure									
Final consumption expenditure	4.8	4.0	4.3	5.0	6.8	7.9	7.2	4.9	-0.7
Government consumption	6.4	3.1	3.7	5.4	10.1	3.9	12.8	5.3	9.5
Private consumption	4.5	4.2	4.4	5.0	6.1	8.7	6.1	4.8	-2.8
Gross capital formation	-3.9	-4.6	4.9	21.9	-1.2	7.2	24.5	7.1	-44.9
Exports (goods and services)	4.0	10.0	8.7	13.2	5.3	1.6	2.5	3.6	-12.6
Imports (goods and services ^c)	3.6	5.9	7.9	16.2	3.6	4.1	10.7	6.0	-26.0
Percentages of GDP									
Investment and saving^c									
Gross capital formation	26.0	24.3	25.3	29.7	27.6	28.3	33.2	35.5	19.6
National saving	19.7	20.7	18.6	22.0	24.6	24.6	24.2	22.6	16.5
External saving	6.3	3.6	6.7	7.6	3.0	3.7	9.0	12.9	3.1
Millions of dollars									
Balance of payments									
Current account balance	-479	-282	-553	-678	-290	-404	-1 116	-1 800	-449
Goods balance	-729	-637	-1 020	-1 293	-1 497	-2 027	-3 104	-4 052	-2 471
Exports, f.o.b.	3 423	3 745	3 754	4 534	5 048	5 277	5 784	6 458	5 090
Imports, f.o.b.	4 152	4 382	4 774	5 827	6 545	7 303	8 888	10 509	7 560
Services trade balance	-207	-190	-162	-204	-229	-291	-288	-310	-143
Income balance	-258	-301	-362	-446	-460	-537	-395	-420	-487
Net current transfers	715	846	991	1 265	1 895	2 450	2 671	2 982	2 652
Capital and financial balance ^d	419	272	358	1 040	477	687	930	1 633	24
Net foreign direct investment	301	269	391	553	599	669	926	901	500
Other capital movements	117	3	-32	487	-122	19	4	732	-475
Overall balance	-60	-10	-194	362	187	283	-186	-167	-424
Variation in reserve assets ^e	-101	-106	97	-510	-346	-282	109	78	354
Other financing	161	115	98	149	159	-1	78	89	71
Other external-sector indicators									
Real effective exchange rate (index: 2000=100) ^f	97.2	97.0	98.5	101.0	100.6	98.1	97.9	95.2	88.3
Terms of trade for goods (index: 2000=100)	94.8	92.0	88.0	87.2	87.2	83.2	81.6	76.6	81.9
Net resource transfer (millions of dollars)	322	86	94	743	177	149	612	1 303	-392
Gross external debt (millions of dollars)	4 757	5 025	5 343	6 023	5 135	3 935	3 190	3 464	3 338
Average annual rates									
Employment									
Labour force participation rate ^g	52.5	51.7	50.0	50.6	50.9	50.7	50.7	51.0	53.1
Open unemployment rate ^h	5.9	6.1	7.6	8.0	6.5	4.9	4.0	4.1	4.9
Visible underemployment rate ⁱ	3.8	4.7	5.9	6.5	6.9	5.4	4.3	3.5	4.2
Annual percentages									
Prices									
Variation in consumer prices (December-December)	8.8	8.1	6.8	9.2	7.7	5.3	8.9	10.8	3.0
Variation in nominal exchange rate (annual average)	4.3	6.3	5.5	5.1	3.4	0.4	0.0	0.0	-0.0

Table 1 (concluded)

	2001	2002	2003	2004	2005	2006	2007	2008	2009 ^a
Variation in real minimum wage	2.5	2.1	8.6	0.8	5.8	5.1	2.8	0.2	70.4
Nominal deposit rate ^j	14.5	13.7	11.5	11.1	10.9	9.3	7.8	9.5	10.8
Nominal lending rate ^k	23.8	22.7	20.8	19.9	18.8	17.4	16.6	17.9	19.4
Percentages of GDP									
Central government									
Total revenue ^l	16.7	16.4	16.5	17.2	17.6	18.1	19.1	19.7	17.4
Current revenue	15.2	15.3	15.6	16.4	16.4	16.6	17.5	17.6	15.5
Tax revenue	13.6	13.3	13.7	14.5	14.5	15.2	16.3	16.0	14.4
Total expenditure ^m	21.1	20.3	21.3	19.8	19.8	19.2	22.2	22.2	23.5
Current expenditure	14.7	15.2	16.2	14.8	15.3	16.0	18.0	17.4	19.0
Interest ⁿ	1.0	1.0	1.0	1.1	1.1	1.0	0.7	0.6	0.7
Capital expenditure	5.7	4.2	4.6	5.0	4.5	3.3	4.1	4.8	5.2
Primary balance	-3.4	-2.9	-3.7	-1.5	-1.1	-0.1	-2.4	-1.9	-5.4
Overall balance	-4.4	-3.9	-4.7	-2.6	-2.2	-1.1	-3.1	-2.5	-6.2
Central government debt									
Domestic	53.9	55.5	60.7	59.6	44.7	28.7	17.3	19.9	24.3
External	3.8	3.9	6.3	4.6	3.8	3.3	2.8	4.8	8.5
	50.1	51.6	54.4	55.0	40.9	25.4	14.5	15.1	15.8
Money and credit^o									
Domestic credit ^p	25.3	23.7	26.7	24.0	23.7	27.2	34.1	33.0	34.0
To the public sector	-1.9	-2.3	0.4	-1.0	-0.9	-2.6	-2.1	-1.1	1.5
To the private sector	36.7	36.1	37.7	38.5	39.7	45.2	52.8	52.1	52.6
Others	-9.4	-10.1	-11.4	-13.6	-15.0	-15.4	-16.7	-18.1	-20.1
Liquidity (M3)	44.9	46.5	47.2	49.2	50.8	55.0	56.6	52.6	51.6
Currency outside banks and local-currency deposits (M2)	33.1	34.0	34.5	35.4	37.3	41.3	42.6	38.7	37.8
Foreign-currency deposits	11.7	12.4	12.5	13.6	13.4	13.8	14.0	13.9	13.8

Source: Economic Commission for Latin America and the Caribbean (ECLAC), on the basis of official figures.

^a Preliminary figures.

^b Based on figures in local currency at constant 2000 prices.

^c Based on figures in local currency expressed in dollars at current prices.

^d Includes errors and omissions.

^e A minus sign (-) denotes an increase in reserves.

^f Annual average, weighted by the value of goods exports and imports.

^g Economically active population as a percentage of the working-age population; nationwide total.

^h Percentage of the economically active population; urban total.

ⁱ Percentage of the working population; urban total.

^j Weighted average rate on time deposits.

^k Weighted average rate on loans.

^l Includes grants and recovery of interest.

^m Includes net lending.

ⁿ Central bank data include accrued interest on the public debt.

^o The monetary figures are end-of-year stocks.

^p Includes securities issued for monetary regulation and short- and long-term external loans.

which followed moderate growth in 2008 (2.4%), and of public investment (26.0%), whose growth in 2008 was 16.3%. This reflected the authorities' limited scope for action owing to lower tax revenues, loss of access to international credit and the need to implement the wage increases to which they were committed.

(b) Prices, wages and employment

Despite vigorous monetary and fiscal expansion, year-on-year inflation, as measured by the consumer price index, was just 3.0% in December 2009 (the lowest rate in two decades) because of lower domestic demand

and international food and fuel prices, with subsidies for electricity and some basic foodstuffs also a factor.

Among the measures it adopted in December 2008 to offset the effects of the crisis, the government announced an increase in the minimum wage, which was set at 5,500 lempiras per month in urban areas and 4,055 lempiras per month in rural areas. President Lobo has indicated that he will not decree any wage adjustments in 2010. Negotiations between workers and employers were still in progress at the end of May. This factor will certainly influence inflation, which stood at 3.0% at the end of December. The inflation target set by the central bank for 2010 was 6.0%, with a 1% margin.

Table 2
HONDURAS: MAIN QUARTERLY INDICATORS

	2008				2009 ^a				2010 ^a	
	I	II	III	IV	I	II	III	IV	I	II
Goods exports, f.o.b. (millions of dollars) ^b	767	795	620	505	635	648	548	473	747	246 ^c
Goods imports, c.i.f. (millions of dollars)	1 988	2 374	2 430	2 030	1 535	1 574	1 466	1 558	1 728	634 ^c
Gross international reserves (millions of dollars)	2 736	2 780	2 590	2 690	2 784	2 658	2 261	2 174	2 250	2 203 ^d
Real effective exchange rate (index: 2000=100) ^e	98.3	98.0	94.9	89.4	87.4	88.3	88.3	89.0	88.3	87.8 ^d
Consumer prices (12-month percentage variation)	9.2	12.2	13.7	10.8	8.8	5.4	3.1	3.0	4.0	4.4 ^d
Average nominal exchange rate (lempiras per dollar)	18.9	18.9	18.9	18.9	18.9	18.9	18.9	18.9	18.9	18.9
Nominal interest rates (annualized percentages)										
Deposit rate ^f	8.3	8.8	9.6	11.2	12.1	10.7	10.0	10.6	10.7	10.5 ^c
Lending rate ^g	16.6	17.1	18.4	19.7	19.8	19.8	19.2	19.0	19.0	19.0 ^c
Interbank interest rate	8.0	8.4	9.8	10.1	7.2	5.6	6.4	5.9	5.7	5.4 ^d
Domestic credit (variation from same quarter of preceding year)	30.6	29.6	21.6	9.2	4.9	0.6	-2.6	5.6	9.1	8.7 ^c
Non-performing loans as a percentage of total credit	1.7	1.5	1.5	1.7	2.2	2.1	1.8	1.9	1.8	1.8 ^c

Source: Economic Commission for Latin America and the Caribbean (ECLAC), on the basis of official figures.

^a Preliminary figures.

^b Does not include maquila activities.

^c Data to April.

^d Data to May.

^e Quarterly average, weighted by the value of goods exports and imports.

^f Weighted average rate on time deposits.

^g Weighted average rate on loans.

Another important factor in wage negotiations was the rise in open unemployment in urban areas from 3.9% in May 2008 to 4.9% in May 2009. This rise is attributable to the loss of about 40,000 jobs in maquila firms producing textiles and wiring assemblies for the automotive industry and about 20,000 jobs in small enterprises because of reduced access to credit, lower domestic demand and higher costs resulting from the increase in the minimum wage for workers in urban areas at the end of 2008.

(c) The external sector

Goods exports contracted by 21.2% in 2009 to US\$ 5,089.6 million because of reduced volumes, a consequence of the fall-off in external demand, and lower international prices for coffee, African palm and bananas. A decline in maquila contracts for both textiles and wiring assemblies for the automotive industry, which fed through into a 22.0% drop in maquila industry exports, had the largest impact on goods exports. Imports fell by 28.1% to US\$ 7,560.2 million dollars as a result of lower domestic consumption and manufacturing output and a drop in oil revenues as the average price per barrel fell.

However, these trends began to reverse in early 2010. Year-on-year exports in the first quarter were up 13.4%, boosted by the recovery in external sales of coffee (43.5%), bananas (14.6%) and products from the maquila industry (9.4%). Imports rose by 11.8% in the first quarter of 2010 compared with the same period in 2009. This increase was due mainly to higher imports of raw materials (15.5%), fuel (45.4%) and maquila industry inputs (5.9%).

In 2009, over 90% of the trade deficit was financed by remittance inflows from abroad, which were 11.8% down on the 2008 figure but still totalled US\$ 2,475.7 million. The current account deficit dropped from 13.9% of GDP at the end of 2008 to 3.1% at the end of 2009. This is not a positive result, however, since it is due to the downturn in economic activity.

As a result of operations in the external sector, net international reserves had decreased by US\$ 343.7 million to US\$ 2,116.3 million by the end of 2009. By June 2010, net international reserves had increased by US\$ 99.6 million owing to higher exports, foreign-exchange inflows from family remittances and US\$ 40.8 million in donations from the Millennium Challenge Account.