HONDURAS

1. General trends

The Honduran economy's growth rate diminished in 2001 owing to a combination of adverse natural phenomena, a slump in international coffee prices and the global economic slowdown. As a result of the lower-than-expected growth rate of 2.6%, per capita GDP shrank for the third time since 1994 and the open unemployment rate increased.

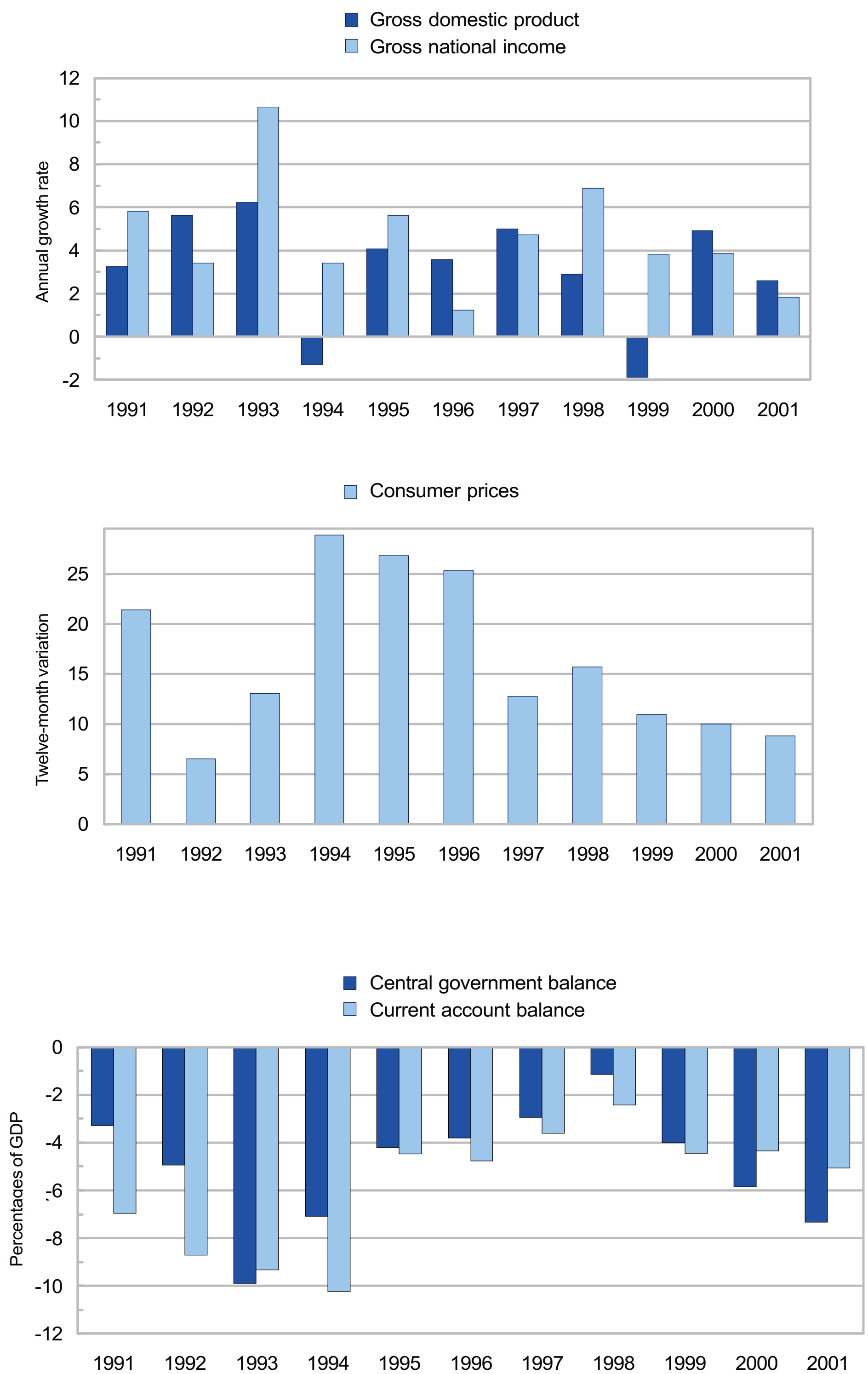
ECONOMIC ACTIVITY in the agricultural, mining, construction and utilities (electricity, gas and water) sectors suffered a contraction in 2001 that was partially offset by the strong expansion observed in public administration. The leading industrial activities maintained their buoyant growth rates of recent years, as the maquila industry once again turned in an outstanding performance, despite the decline in import demand from the United States.

These developments took place in a climate of mixed macroeconomic indicators and against the background of the political process that culminated in the general elections of 25 November. Annual inflation (8.8%) was lower than in 2000 and just under the target set in the monetary programme. The average real level of interest rates was similar to that of the previous year and the real exchange rate again appreciated somewhat, though its nominal depreciation grew steeper at the end of the year.

Because of adverse external conditions, the current deficit of the balance of payments reached the equivalent of 5.2% of GDP, almost one percentage point higher than its 2000 level. The central government's income was lower than expected, as revenues from indirect taxation rose only slightly while outlays increased substantially. Consequently, the imbalance in the public finances widened significantly, finishing the year at 7.3% of GDP.

The economy's overall performance in 2002 will depend heavily on developments in the international market, the recurrence of natural phenomena such as El Niño and the negotiation of the economic programme between the new government and the International Monetary Fund (IMF). It is estimated that, in 2002, both GDP growth and inflation will post rates similar to those of the previous year (of 2.5% to 3% in the case of GDP and 8% in the case of inflation).

Figure 1
HONDURAS: MAIN ECONOMIC INDICATORS



Source: ECLAC, on the basis of official figures.

2. Macroeconomic policy

The main objectives of macroeconomic policy were to maintain stability and control inflation while consolidating the economic recovery that had begun the previous year. Progress towards these aims was hampered, however, by the erosion of external demand and the circumstances of an election year. Given the higher-than-budgeted fiscal expansion, the task of maintaining stability fell to monetary policy, which became more restrictive.

(a) Fiscal policy

The central government's total revenues grew by 4% in real terms, which was a positive result compared to the 3% contraction the year before. Total expenditure, however, rose by 10%, causing a widening of the fiscal deficit.

There were no substantive changes in tax policy with regard to the guidelines established under the 1998 reform. The new Income Tax Act –which includes some significant changes to the syste of write-offs and the exemption threshold for individuals, and eliminates the 15% tax on capital repatriation– was approved by Congress, but its entry into force was continually postponed owing to objections from various quarters.

The minimum tax revenue target of 17.2% of GDP, which had been set jointly with IMF, proved impossible to meet, despite a 9% real increase in direct tax collection. The good performance of income tax, receipts of which were almost 13% higher in real terms than in 2000, reflected the expiration of the tax remissions that the government had granted to businesses affected by hurricane Mitch at the end of 1998; as from 2001, these firms resumed the normal payment of their tax obligations. Receipts from the extraordinary capital gains tax were also noteworthy, exceeding by 465 million lempiras (15%) the amount projected in the budgetary programme. The same could not be said of the sales tax (the central government's main source of tax revenue), receipts of which fell by 5% in 2001 compared to the previous year's level owing to the listlessness of economic activity.

While the central government's total income rose from 18.0% to 18.2% of GDP, total expenditure swelled to 25.5% of GDP, as against 24% in 2000. Of this total, 6% was allocated for domestic and external debt repayments, 29% for investment and 65% for current outlays. This last component exerted strong pressure on public expenditure, owing mainly to the size of the wage bill, which accounts for over half of the central government's current outlays. Statutory wages, which apply to medical and paramedical personnel and teaching staff, showed a nominal increase of 19.5% in 2001, almost 10 percentage points higher than the rate of inflation. This item of expenditure exceeded by 8.7% the upper limit established in the annual economic programme, reaching 10% of GDP (compared to 9% in 2000).

Public expenditure on investment increased by 10% in real terms, or slightly more than originally planned. Much of this amount was allocated according to the priorities set under the poverty reduction strategy and the strategy for rebuilding the urban and rural infrastructure destroyed by hurricane Mitch.

As a result of these trends, the central government accumulated a fiscal deficit higher than the budgeted level of 5.5% of GDP. The final amount, equivalent to 7.3% of GDP, exceeded the previous year's level by 1.3 percentage points. In accordance with borrowing policy guidelines, the deficit in the public finances was financed almost entirely with external resources in the form of concessional loans. The government contracted 26 new loans for US$ 402.7 million under the enhanced Heavily Indebted Poor Countries (HIPC) Debt Initiative and was granted about US$ 25 million in debt relief.

The government also issued current bonds in the amount of 355.4 million lempiras to supply the additional financing needed for the fiscal year. Although this amount is relatively small (representing 5% of the year's requirements), this measure signals a shift away from the public authorities' policy, in recent years, of avoiding the issuance of domestic debt to finance the central government's deficit.

(b) Monetary policy

Open-market operations were the principal monetary policy tool. Accordingly, the Central Bank issued securities for a total net amount of 3.9 billion lempiras. In the second half of the year, it introduced dollar-denominated monetary absorption certificates with exchange risk coverage for a total amount of US$ 94.4 million, equivalent to almost 40% of the total net value of securities issued during the year.

Broad money (M3) showed a year-on-year increase of 12.4%, which was lower than the rate observed in

Table 1
HONDURAS: MAIN ECONOMIC INDICATORS

	1993	1994	1995	1996	1997	1998	1999	2000	2001[a]
	Annual growth rates [b]								
Growth and investment									
Gross domestic product	6.2	-1.3	4.1	3.6	5.0	2.9	-1.9	4.9	2.6
Per capita gross domestic product	3.1	-4.1	1.1	0.7	2.1	0.1	-4.5	2.2	-0.1
Gross domestic product, by sector									
Goods	4.0	-2.6	6.3	2.0	4.3	0.6	-2.8	7.1	0.9
Agriculture	-0.6	0.9	8.8	2.5	4.2	-1.9	-8.5	9.5	-0.1
Mining	3.6	-3.5	15.7	7.3	4.9	3.7	5.4	1.7	-3.3
Manufacturing	6.3	-1.8	5.5	4.6	6.1	3.4	2.6	5.5	5.2
Construction	21.1	-18.0	-6.4	-11.4	-3.0	5.3	10.5	1.5	-7.1
Basic services	4.4	-3.9	9.2	7.0	5.2	3.3	1.8	6.5	2.4
Electricity, gas and water	7.7	-7.1	14.6	15.4	7.6	4.9	2.1	10.6	-2.3
Transport, storage and communications	3.4	-2.9	7.7	4.4	4.4	2.7	1.7	5.0	4.2
Other services	9.7	-0.5	3.4	3.2	5.8	4.8	0.3	5.0	5.5
Commerce, restaurants and hotels	8.1	0.0	5.6	4.5	3.5	3.1	0.7	3.7	3.4
Financial establishments, insurance, real estate and business services	8.2	5.5	6.3	4.3	7.8	7.2	0.8	2.7	3.1
Consumption	2.5	-0.2	1.2	5.4	2.5	5.7	0.2	6.1	5.9
General government	-9.4	-5.1	-2.8	5.3	-1.0	15.4	9.8	8.0	18.7
Private	4.4	0.5	1.7	5.5	2.9	4.5	-1.1	5.8	4.0
Gross domestic investment	29.2	7.3	3.0	-6.3	8.4	1.9	8.6	-0.2	-5.9
Exports of goods and services	-1.1	-10.1	13.6	8.1	1.3	1.6	-11.2	6.5	3.8
Imports of goods and services	7.1	1.1	4.0	2.4	-1.4	7.5	4.3	3.8	3.6
	Percentages of GDP [c]								
Gross national income	93.2	98.2	100.0	97.7	97.5	100.9	106.3	105.3	104.5
Gross domestic investment	29.0	31.8	31.6	28.5	29.5	29.1	32.1	30.5	28.8
National saving	19.2	21.9	27.2	24.3	26.3	26.8	28.2	26.8	24.2
External saving	9.8	9.8	4.3	4.3	3.2	2.3	3.9	3.7	4.6
	Percentages								
Employment and wages									
Labour force participation rate [d]	50.2	49.2	49.5	52.2	53.1	52.9	55.7	...	...
Open unemployment rate [e]	3.8	2.8	3.7	4.5	3.6	3.5	3.5	...	4.2
Real minimum wage (index: 1995=100)	123.0	105.8	100.0	96.0	102.0	105.4	105.8	114.7	121.3
	Growth rates								
Prices (December-December)									
Consumer prices	13.0	28.9	26.8	25.3	12.8	15.7	10.9	10.1	8.8
Wholesale prices	14.0	35.1	21.2	26.6	6.6	11.9	10.3	7.5	6.7
External sector									
Terms of trade (index: 1995=100) [c]	90.3	92.1	100.0	92.8	115.4	118.0	110.2	103.8	103.1
Nominal exchange rate (lempiras per dollar)	6.47	8.41	9.47	11.71	13.00	13.39	14.21	14.86	15.48
Real effective exchange rate for imports (index: 1995=100)	102.3	112.6	100.0	102.3	96.4	88.1	85.3	82.5	80.5
	Millions of dollars								
Balance of payments									
Current account	-327	-352	-177	-194	-170	-128	-241	-258	-326
Trade balance (goods and services)	-320	-345	-178	-212	-269	-407	-814	-853	-1,051
Exports	1,211	1,370	1,735	1,915	2,183	2,449	2,239	2,464	2,447
Imports	1,530	1,714	1,913	2,128	2,452	2,856	3,053	3,318	3,498
Capital and financial accounts [f]	135	331	216	297	358	269	457	191	342
Overall balance	-192	-20	39	103	188	141	216	-66	16
Variation in reserve assets (- indicates an increase)	105	-17	-136	-174	-296	-230	-474	-119	-147

Table 1 (concluded)

	1993	1994	1995	1996	1997	1998	1999	2000	2001[a]
					Percentages				
External debt									
Gross debt (as a percentage of GDP)	109.8	117.7	107.1	101.0	86.4	83.7	87.2	79.6	74.6
Net interest (as a percentage of exports) [g]	14.5	14.2	11.5	9.8	7.0	5.7	5.4	3.3	2.3
					Percentages of GDP				
Central government									
Current income	16.9	16.0	18.2	16.6	16.9	18.8	19.3	18.0	18.2
Current expenditure	18.4	16.6	15.6	16.0	16.4	15.9	15.8	16.6	17.7
Saving	-1.5	-0.6	2.6	0.6	0.5	2.9	3.5	1.3	0.5
Capital expenditure (net)	8.8	7.2	7.7	5.1	4.1	4.7	7.8	7.2	7.8
Financial balance	-9.9	-7.1	-4.2	-3.8	-2.9	-1.1	-4.0	-5.9	-7.3
Non-financial public sector balance	...	...	-3.7	-2.9	-0.6	0.6	0.8	-2.1	...
					Growth rates				
Money and credit									
Net international reserves	-62.9	79.1	252.5	133.0	122.4	34.5	52.8	8.7	9.9
Net domestic credit	25.8	28.6	9.4	34.5	19.0	5.7	-5.7	28.4	15.3
To public sector	16.4	14.5	-93.2	...	...	...	...	...	...
To private sector	14.9	24.7	21.1	49.2	49.9	33.0	18.4	12.3	11.7
Money (M1)	13.0	37.0	18.3	27.1	33.8	12.7	21.8	4.7	5.1
Local currency savings and time deposits	5.3	10.1	22.1	33.3	68.7	26.8	25.6	22.6	8.8
M2	8.8	25.1	19.8	38.5	43.3	16.8	21.2	16.6	7.9
					Annual rates				
Real interest rate (annualized, %)									
Deposit rate	0.9	-7.9	-13.6	-5.7	0.9	4.5	6.9	4.5	4.4
Lending rate	10.3	2.8	-2.0	4.9	9.9	15.0	16.6	14.3	13.0
Equivalent interest rate in foreign currency [h]	11.1	11.2	11.0	16.1	22.5	18.5	19.3	15.9	14.4

Source: ECLAC, on the basis of official figures.
[a] Preliminary figures. [b] Based on constant 1978 lempiras. [c] Based on constant 1995 dollars. [d] Percentages of the working-age population, nationwide. [e] Open unemployment rate, nationwide. [f] Includes errors and omissions. [g] Refers to net interest as shown in the balance of payments, divided by exports of goods and services. [h] Interest rate on deposits, deflated by the variation in the average bank exchange rate (selling rate) for banknotes.

2000 (17.1%). Other monetary aggregates rose more slowly than inflation. Narrow money (M1) grew by only 5.1%, and liquidity in local currency (M2), by 7.9%. Contrasting with this general slowdown was the expansion of foreign currency deposits, which racked up their highest annual growth rate of recent years (26.3%).

Credit from the banking system as a whole to the private sector expanded by 11.7% (compared to 12.3% a year earlier), which in real terms represents an increase of 2.7%. The vast majority of these operations were denominated in local currency. New commercial bank loans to private agents were concentrated in loans for the purchase of consumer goods, which showed a very high year-on-year growth rate (71% from December to December), at the expense of loans extended for other activities. Bank lending to the productive and trade sectors stalled or declined in 2001. The slump in lending over the year was especially pronounced in loans for industrial activities and, to a lesser degree, for agriculture.

Starting in the second quarter of the year, nominal lending rates for new loans began to fall, bringing the annual real average down to 13.5%, or two percentage points below the previous year's level. As real deposit rates increased slightly, the financial system's interest rate spreads narrowed from 10.5 percentage points in 2000 to 7.8 points in 2001.

Table 2
HONDURAS: MAIN QUARTERLY INDICATORS

	1999				2000				2001 [a]				2002 [a]
	I	II	III	IV	I	II	III	IV	I	II	III	IV	I
Consumer prices (12-month variation, %)	13.3	10.6	10.7	10.9	10.9	11.9	10.8	10.0	10.3	9.5	10.2	8.8	7.7
International reserves (millions of dollars)	871	1,094	1,087	1,258	1,376	1,331	1,293	1,313	1,303	1,289	1,225	1,416	1,437
Real effective exchange rate [b] (index: 1995=100)	85.5	85.5	85.8	84.5	83.6	82.2	82.5	81.9	81.0	80.5	80.1	80.5	80.8
Real interest rates (annualized, %)													
Deposit rate	4.7	7.4	8.1	7.5	7.0	3.7	3.4	3.9	3.9	4.6	4.5	4.7	-3.9
Lending rate	13.8	17.3	18.0	17.1	17.0	14.0	12.9	13.4	12.8	13.1	12.7	13.0	3.4

Source: ECLAC, on the basis of official figures.
[a] Preliminary figures. [b] Refers to exchange rate for imports.

As the banks' capital ratios improved, Congress adopted two basic laws for the restructuring and development of the financial sector: one on insurance and reinsurance companies and the other on insuring deposits in financial institutions. Moreover, near the middle of the year the authorities permanently revoked the authorization of the Banco Hondureño de Crédito y Servicio to operate as a financial institution.

(c) Foreign-exchange policy

Foreign-exchange policy was the subject of intense debate in 2001, as its use to reduce inflation caused a lag in the real exchange rate of the lempira for the fourth year in a row, undermining the competitiveness of the country's tradable goods. Pressure to replace the current auction system with a free-floating exchange regime subsided when the monetary authorities changed the formula for adjusting the differential between domestic and external inflation with a view to encouraging the lempira exchange rate to move more freely.

After September, when this decision was taken, the lempira's nominal rate of depreciation accelerated. By this means, the monetary authorities aim to produce a gradual and orderly transition to a more competitive real exchange rate and mitigate the inflationary and redistributive impacts of a possible sudden depreciation of the currency. Thus, Honduras maintained its system of public auctions of foreign exchange, under which nominal year-on-year depreciation reached 5% in December 2001, as the reference exchange rate went from 15.14 to 15.91 lempiras.

(d) Trade policy

The government endorsed the resolutions of the Council of Ministers for Economic Integration concerning the harmonization of tariff policy through the introduction of uniform tariffs. This, in turn, led to the adoption and implementation of the Central American Uniform Customs Code, which applies to commercial transactions between countries in the subregion.

Honduras signed the World Intellectual Property Organization (WIPO) Copyright Treaty and concluded an agreement on the same subject with El Salvador, Guatemala and Nicaragua. In June the trade treaty it had signed with Mexico in 2000 came into force, and in December the treaty negotiated with the Dominican Republic, together with Costa Rica, El Salvador, Guatemala and Nicaragua, was approved. In addition, Honduras opened trade negotiations with Canada and Chile.

3. The main variables

The above-described macroeconomic policy mix, combined with the adverse effects of the world economic slowdown and harsh weather conditions, did not provide a growth-friendly environment for the private sector. The inflation rate, however, was lower than expected.

(a) Economic activity

In its economic programme, the government projected aggregate economic growth of 4.5% in real terms, which was slightly lower than the rate of 4.9% recorded in 2000. In fact, GDP increased by 2.6%, which actually represents a decline in per capita output, given the high rate of population growth.

The most dynamic component of aggregate demand was consumer spending, with real growth of almost 6%. Within this component, the expansion recorded by the public sector was particularly striking. The increase in public spending on final consumption (18.7%) was the biggest in almost a decade, and was four times higher than the expansion recorded by the private sector, which, in any event, was higher than the rate for the economy as a whole.

Gross domestic investment, which had stalled the previous year, took a downturn in 2001 that amounted to 5.9% in constant values. While private investment fell drastically, contracting by close to 10% for the second year running, public investment did not change. Export volume expanded at a pace similar to that of import volume (less than 4%).

Output declined in the agricultural, mining, construction and electricity, gas and water production sectors, while growth rates in the other main sectors of activity showed little variation from the previous year.

The poor performance of the agricultural sector contrasted with its dynamic recovery in 2000 and thwarted expectations that it would regain the levels reached in various areas of production prior to hurricane Mitch. The sector's negative results were largely due to natural phenomena. The drought that plagued Central America from May to July affected more than 60,000 small producers of basic grains in Honduras, causing crop losses of about 120,000 tons. At the end of the year, tropical storm Michelle also caused losses of output.

Honduran agriculture was also hard hit by the collapse of international coffee prices, which was compounded by a slide in coffee production volume of nearly 10%. Owing to the social importance of this crop -it is estimated that 105,000 families depend on it directly-, this situation led to an acute contraction of employment and income in rural and agricultural areas, which, in turn, affected certain consumer goods industries and further undermined the already precarious financial position of many coffee producers.

Manufacturing output grew by 5.2% over the year, thus maintaining the trend it had followed in 2000. Some key activities for the aggregate performance of this sector (food, clothing, chemicals and non-metallic minerals) posted growth rates higher than those of industry as a whole, with average activity levels which, in some cases, were even higher than those of the previous year. Beginning in the third quarter, the growth of industrial production as a whole began to flag, especially in firms producing internationally tradable goods.

The construction industry contracted sharply (-7.1%). Although this decline was evident across the entire sector, its effects were especially pronounced in commercial and industrial construction. This, in turn, acted as a drag on the mining sector (of which quarrying is by far the biggest segment), whose real output fell by 3.3%.

Services slightly outpaced the overall average growth rate of the economy. In the final quarter, employment in tourism-related activities declined with regard to the same period of previous years, reflecting some of the international repercussions of the 11 September attacks.

In the maquila sector, 36 firms closed their plants in 2001 because of the drop in orders and work contracts as a result of the slowdown in the United States economy. At the same time, however, 32 new plants opened, having previously planned to set up operations in Honduras, thus compensating in general terms for the losses of production, employment and income resulting from the closures. Most of the plants that closed down or started up in 2001 were in the textile and clothing sector. This segment of the country's production system continued to grow briskly, despite the slump in overall demand for imports in the United States. According to the Honduran Maquila Association, maquila plants employed 125,600 workers in 2001, or almost 2,300 more than in 2000.

(b) Prices, wages and employment

Annual inflation, measured by the consumer price index (CPI), was 8.8%, which was lower than the preceding year's rate (10.1%) and was consistent with the provisions of the Central Bank's monetary programme. This favourable result reflected both the appreciation of the real exchange rate and the reduction of international fuel prices. In addition, the variation in food prices was less than that of the CPI, which helped to consolidate the downward trend of inflation over the past three years. The change in the wholesale price index, at 6.7%, was lower than the CPI variation for the second year in a row.

The average minimum wage rose by around 6% in real terms, which was below the 10% increase in statutory wages in the public sector. In contrast, non-statutory civil service wages remained unchanged.

The National Survey, which did not take place in 2000 but was resumed in 2001, showed a worsening of the labour market situation. In San Pedro Sula (the country's economic hub), the open unemployment rate in 2001 was 7.4%, compared to 6.9% in 1999, when the Honduran economy had contracted owing to the effects of hurricane Mitch. This was the city's highest unemployment rate in 14 years. The labour market situation could deteriorate even further in 2002, since economic growth will probably remain weak, international markets are likely to remain more or less stagnant for most of the year and coffee prices have slumped considerably.

(c) The external sector

The current-account deficit expanded by a third in 2001, reaching US$ 330 million. Given the modest growth of the economy, this imbalance increased from 4.4% to 5.2% of GDP.

This outcome was due to a deterioration, for the third straight year, in the terms of trade (-7.8% in 2001), which were strongly affected by the unremitting decline in international coffee prices. In that production segment alone, the value of exports was down by US$ 180 million in comparison to the previous year, accounting for half of the balance-of-payments current-account deficit in 2001. As most traditional exports were likewise affected by the sluggishness of the global economy, the value of these exports fell by nearly 20%.

In contrast, exports from the maquila plants picked up speed, growing at a rate (10%) three points higher than the 2000 rate. In 2001, the maquila industry came to generate almost half of the income recorded in the trade account of the balance of payments.

Despite the slackening of domestic economic activity, merchandise imports continued to rise. In total, their value increased by 5.4% over the year. Among merchandise imports, consumer goods increased by almost the same proportion as the total, capital goods were up by a fourth and raw materials and intermediate goods dipped slightly.

The large trade deficit was partially offset by family remittances, which swelled by one quarter. As a result, net current transfers continued to rise, reaching a level 17% higher than the 2000 amount. Almost three fifths of the value of net transfers, or US$ 510 million, was accounted for by remittances from workers living abroad. In contrast, the factor income balance remained unchanged.

In the financial account balance, foreign direct investment (FDI) inflows ebbed by 25% (from US$ 262 million in 2000 to US$ 195 million in 2001), though their absolute level remained high in relation to the trends that had prevailed in the period prior to hurricane Mitch. The relative decline in FDI in 2001 was due almost entirely to the completion of the process of reconstructing banana plantations, which had required the producer firms to make substantial investment outlays in 1999 and 2000.

Because of increased inflows to the financial account of the balance of payments, the overall balance was positive, in a reversal of the trend observed in 2000. Taken together, commercial and financial transactions in 2001 generated an increase in net international reserves of about US$ 150 million. At the end of the year, this indicator totalled US$ 1.64 billion (almost six months' worth of goods and services imports); two thirds of this amount was held by the Central Bank.

The total external debt balance reached US$ 4,802 billion (equivalent to 75% of GDP, which was 4.5 percentage points lower than the 2000 proportion). By the end of the year, 71% of that amount consisted of debt contracted on concessional terms.