Honduras

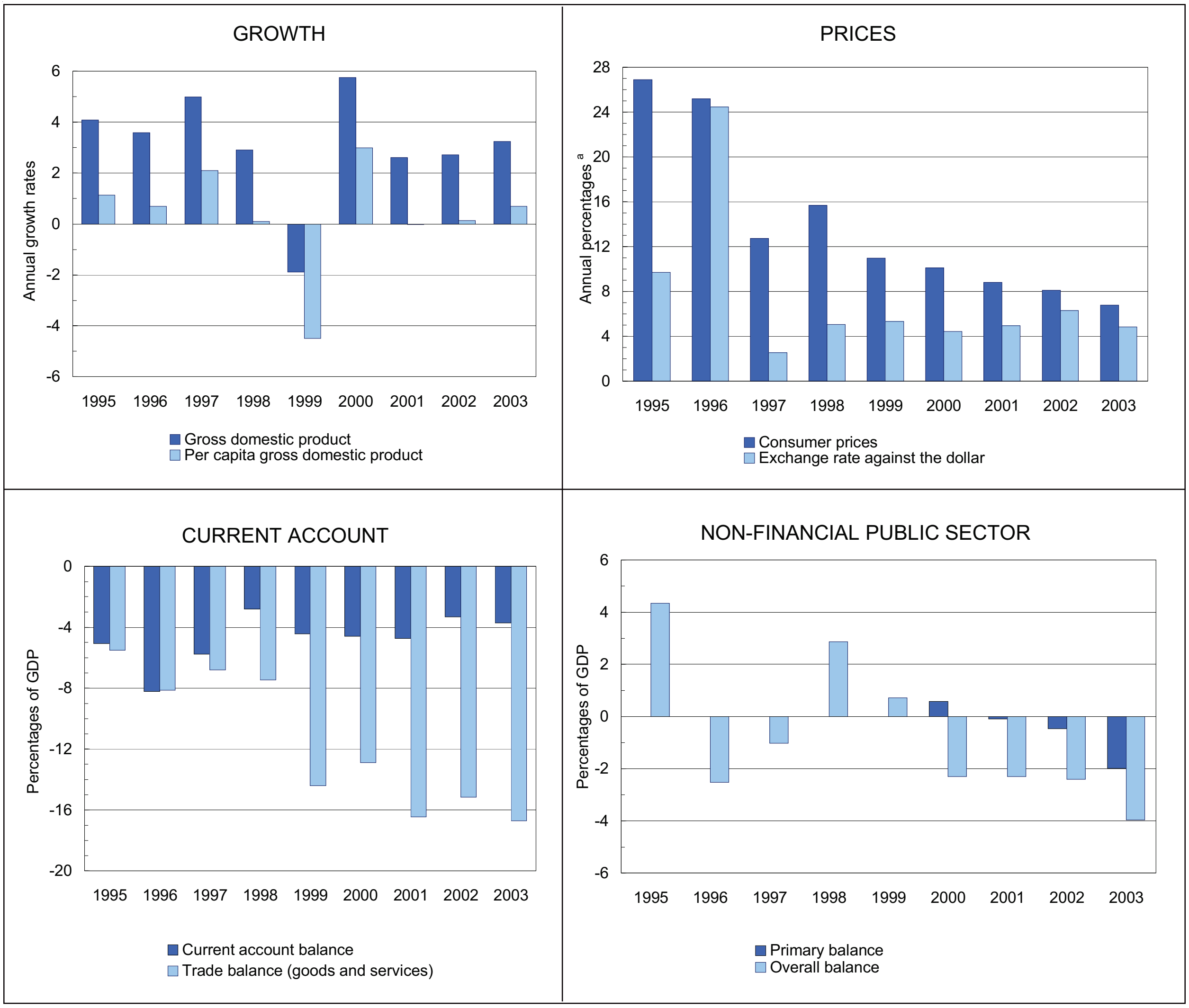
1. General trends

Economic activity in Honduras recovered slightly (3.2%) in 2003 after a biennium of growth rates that barely kept pace with the increase in population. There was a significant upturn in investment, which became the most buoyant component of aggregate demand, outperforming the growth in consumption. The macroeconomic climate became more positive as inflation continued to fall (6.8%) and the exchange rate remained stable. The current account deficit and the central government's fiscal deficit deteriorated slightly, as did labour market conditions.

Higher external demand boosted economic activity through an improvement in the maquila sector and increases in foreign direct investment and remittances. Negotiations on the United States-Central American Free Trade Agreement (CAFTA), which were completed in December, had positive effects on investor expectations. At the domestic level, negotiations with the International Monetary Fund (IMF) and the requirements for reaching an agreement with that institution formed the basis for the definition of macroeconomic policy. It was with this in mind that two fiscal reforms were adopted and monetary policy was temporarily tightened. The programme agreed upon with IMF in February 2004 has four main elements: a medium-term macroeconomic framework, an ambitious fiscal adjustment, a far-reaching reform of the financial system and improvements in governance and transparency.

In 2004 the recovery of the world economy should help to raise Honduras's growth rate by half a percentage point over its 2003 level. Domestic conditions will depend on the continued implementation of the poverty reduction strategy and the IMF agreement. Honduras will receive international support in the form of grants and will attempt to meet the conditions for reaching, in 2005, the completion point under the Heavily Indebted Poor Countries Initiative, which would make it eligible for external debt relief. In the first half of 2004 Honduras was added to the list of countries due to receive resources from the United States Millennium Challenge Account, and benefited from the Paris Club's decision to cancel US$ 147 million of its debt servicing liabilities.

Figure 1
HONDURAS: MAIN ECONOMIC INDICATORS



Source: Economic Commission for Latin America and the Caribbean (ECLAC), on the basis of official figures.
[a] December-December variation.

2. Economic policy

The economic programme for 2004 is based primarily on the IMF agreement, which projects inflation of between 6.5% and 7% and a central government fiscal deficit of 3.4% of GDP. Other targets include exchange-rate stability and the strengthening of the financial system.

In 2004 macroeconomic policy has behaved much as it did in 2003: as progress is made in terms of fiscal adjustment, monetary policy is eased to inject more liquidity into the economy. This pattern, which was temporarily suspended in the second half of 2003 as a result of speculative attacks on the lempira and a lack of progress in fiscal adjustment, was reinstated in the first half of 2004.

However, there are risk factors. For instance, the rise in oil prices reversed the decline in inflation in the first half of the year. If this trend continues, the central bank will have to adopt a tighter monetary policy, which would cause the recovery to lose momentum. Furthermore, the expiration, on 30 June, of price controls on some 40 products in the basket of staple goods adopted by the Congress in December 2003 has the potential to adversely affect inflation and macroeconomic management. Lastly, a sudden rise in international interest rates could aggravate the situation by raising the cost of external debt servicing and reducing foreign direct investment.

(a) Fiscal policy

Two fiscal reforms were undertaken in 2003 with a view to reducing the deficit to 3.5% of GDP, although the desired outcome did not materialize. The central government deficit widened to 5.9% of GDP owing to non-recurrent expenditure under the Financial Strengthening of Agricultural Producers Act, whose full cost (1% of GDP) was imputed to the 2003 fiscal year even though the relevant payments are to be made over 10 years. Excluding the effect of this measure, the deficit remained at the same level as in 2002. Meeting the 2004 deficit target of 3.4% of GDP will require a fiscal adjustment of one and a half points of GDP. The authorities expect to achieve this through a combination of higher income (thanks to the three fiscal reforms adopted in 2002 and 2003) and lower expenditure, especially on wages.

Current income grew by 4.7% in real terms in 2003, as tax revenues increased (by 5.8%) owing to the measures implemented under the tax reforms. Receipts from direct taxes were up by 7% and those from indirect taxes, by 4.7%. Taxes on production, consumption and sales rose by 45.3%, whereas taxes on services, specific activities and foreign trade were down considerably. Non-tax revenues dipped by 2.6%, slightly less than external grants (5.3%).

Total real expenditure grew by 8.6%, led by a rise in current expenditure (12.1%). Unlike the pattern of previous years, in which increases were driven by hikes in payroll expenditure, the 2003 increase was due to higher interest payments (63%). This, in turn, reflected the government's decision to pay off some of its debt arrears. Payroll expenditure was up by only 1.1%, while capital expenditure fell by 1.7%, although this decline was much smaller than the one posted in 2002 (17.8%).

The overall balance of the consolidated public sector (including the central bank) showed a deficit equivalent to 4% of GDP. This was smaller than the central government's deficit, thanks to the positive balance achieved by public enterprises. The four largest State-owned firms had an operating balance equivalent to 2.6% of GDP.

(b) Monetary and exchange-rate policy

Liquidity was controlled through open-market operations with monetary absorption certificates in local currency and in dollars. Net monetary absorption by these means reached 519 million lempiras. Starting in July 2003 the central bank raised interest rates on both instruments, causing the interbank rate to rebound from a low of just over 7% in May to slightly over 9% at the end of the year. The central bank also pursued its policy of diversifying monetary instruments. Given the increased availability of government securities, they were increasingly used in repo operations. The central bank's decision to reduce mandatory investment requirements in local currency also had a positive effect on total liquidity.

The monetary base grew by 1.8% in real terms, which was much less than the 11.2% increase in the money supply (M1) due to a 14.1% rise in current account deposits. Liquidity in local currency (M2) expanded by 6.4% and broad money (M3), by 6.9%, with both increases slightly outpacing the ones registered in 2002. More optimistic expectations and the economic recovery were reflected in an 11.7% jump in credit activity (which was 4.6 percentage points above the 2002 expansion). This was the first increase in credit activity after five years of downturns.

An important change, instituted in the second quarter of 2004, is that the State no longer guarantees 100% of the financial system's deposits, but only up to 5.18 million lempiras. From October 2004 onward the State will insure only the equivalent of the first US$ 10,000 (180,000 lempiras). Another change is a 25% increase in the minimum capital requirement for financial institutions as from August 2004. Financial institutions will have two years to comply with this rule, which increases the minimum capital for commercial banks from 150 million to 200 million lempiras.

The central bank sought to build confidence and maintain stability in the foreign-exchange market through public auctions of foreign currency. With the uncertainty that emerged in mid-year, speculation against the lempira hampered this effort. However, the tightening of monetary policy was sufficient to calm the market. The exchange rate was 17.75 lempiras to the dollar in December, which represented a depreciation of 4.9% in nominal terms and a slight loss of value in real terms.

(c) Trade policy

The United States-Central American Free Trade Agreement (CAFTA) permanently consolidates the

Table 1
HONDURAS: MAIN ECONOMIC INDICATORS

	1995	1996	1997	1998	1999	2000	2001	2002	2003 [a]
	Annual growth rates [b]								
Gross domestic product	4.1	3.6	5.0	2.9	-1.9	5.7	2.6	2.7	3.2
Per capita gross domestic product	1.1	0.7	2.1	0.1	-4.5	3.0	0.0	0.1	0.7
Gross domestic product, by sector									
Agriculture, livestock, hunting, forestry and fishing	8.8	2.5	4.2	-1.9	-8.5	11.7	-0.5	4.9	1.9
Mining	15.7	7.3	4.9	3.7	5.4	1.7	-0.8	4.2	3.2
Manufacturing	5.5	4.6	6.1	3.4	2.6	5.5	5.2	3.8	3.7
Electricity, gas and water	14.6	15.4	7.6	4.9	2.1	10.6	-1.8	5.6	7.9
Construction	-6.4	-11.4	-3.0	5.3	10.5	1.5	-5.2	-14.2	13.8
Wholesale and retail commerce, restaurants and hotels	5.6	4.5	3.5	3.1	0.7	3.7	3.0	2.9	3.1
Transport, storage and communications	7.7	4.4	4.4	2.7	1.7	5.0	5.3	3.5	3.7
Financial institutions, insurance, real estate and business services	6.3	4.3	7.8	7.2	0.8	2.6	3.4	2.8	2.7
Community, social and personal services	-1.6	0.7	5.3	3.3	-0.9	10.5	11.0	6.9	1.4
Gross domestic product, by type of expenditure									
Consumption	1.2	5.4	2.5	5.7	0.4	7.9	5.4	4.5	3.0
General government	-2.8	5.3	-1.0	15.4	9.8	15.7	12.1	0.5	0.8
Private	1.7	5.5	2.9	4.5	-0.9	6.8	4.3	5.2	3.4
Gross domestic investment	-14.3	6.2	15.8	10.3	6.5	-7.6	-7.7	-5.9	8.5
Exports (goods and services)	13.6	8.1	1.3	1.6	-11.2	7.3	3.2	4.9	5.2
Imports (goods and services)	4.0	2.4	-1.4	7.5	4.3	3.8	4.0	2.5	9.0
	Percentages of GDP								
Investment and saving [c]									
Gross domestic investment	31.6	31.1	32.2	30.9	34.7	30.7	29.6	25.6	27.4
National saving	27.1	26.4	28.6	28.5	30.2	26.6	25.0	21.9	23.3
External saving	4.5	4.8	3.6	2.4	4.4	4.1	4.6	3.7	4.1
	Millions of dollars								
Balance of payments									
Current account balance	-201	-335	-272	-148	-241	-276	-302	-219	-258
Merchandise trade balance	-141	-287	-294	-323	-753	-658	-833	-836	-987
Exports, f.o.b.	1 377	1 638	1 857	2 048	1 756	2 012	1 935	1 974	2 078
Imports, f.o.b.	1 519	1 926	2 150	2 371	2 510	2 670	2 768	2 809	3 065
Services trade balance	-76	-45	-26	-70	-28	-119	-221	-162	-173
Income balance	-226	-231	-212	-204	-155	-147	-178	-190	-190
Net current transfers	243	227	260	449	696	648	929	969	1 092
Capital and financial balance [d]	160	257	454	-8	53	119	302	282	27
Net foreign direct investment	50	91	122	99	237	282	193	176	198
Financial capital [e]	110	166	333	-107	-185	-163	...	...	...
Overall balance	-41	-79	182	-155	-188	-157	0	64	-231
Variation in reserve assets [f]	-90	13	-308	-230	-442	-32	-147	-214	88
Other financing [g]	132	66	126	385	630	189	148	151	143
Other external-sector indicators									
Real effective exchange rate (index: 2000=100) [h]	124.0	126.8	119.4	109.4	104.7	100.0	96.9	96.1	98.3
Terms of trade for goods (index: 1997=100)	86.7	80.4	100.0	102.3	95.5	90.0	88.1	85.4	81.7
Net resource transfer (% of GDP)	1.6	2.3	7.8	3.3	9.7	2.7	4.2	3.7	-0.3
Total gross external debt (millions of dollars)	4 243	4 121	4 073	4 369	4 691	4 711	4 757	4 922	5 122
Total gross external debt (% of GDP)	107.1	101.0	86.4	83.0	86.5	78.2	74.3	74.8	73.8
Net profits and interest (% of exports) [i]	-14.1	-13.1	-10.6	-8.6	-7.3	-6.1	-7.3	-7.6	-7.1

Table 1 (concluded)

	1995	1996	1997	1998	1999	2000	2001	2002	2003 [a]
				Average annual rates					
Employment									
Labour force participation rate [j]	49.5	52.2	53.1	52.9	55.7	…	52.5	51.7	50.0
Open unemployment rate [k]	3.7	4.5	3.6	3.5	3.5	…	4.1	3.9	5.3
Visible underemployment rate [k]	1.5	2.4	3.0	2.1	2.7	…	4.4	3.9	6.4
				Annual percentages					
Prices									
Variation in consumer prices (December-December)	26.9	25.2	12.7	15.7	11.0	10.1	8.8	8.1	6.8
Variation in nominal exchange rate (December-December)	9.7	24.5	2.5	5.1	5.3	4.4	5.0	6.3	4.8
Variation in the real minimum wage	-5.5	-4.0	6.3	1.9	-3.0	3.1	17.8	-11.2	8.6
Nominal deposit rate [l]	…	…	21.3	19.0	19.4	15.9	14.5	13.7	11.5
Nominal lending rate [m]	…	…	32.1	30.4	30.2	26.8	23.8	22.7	20.8
				Percentages of GDP					
Non-financial public sector									
Current income	30.2	29.5	29.4	31.8	32.1	29.7	31.9	32.0	33.0
Current expenditure	23.3	22.8	22.8	22.9	22.6	24.4	27.1	28.6	29.8
Current balance	7.0	6.7	6.5	8.9	9.5	5.3	4.8	3.4	3.1
Net capital expenditure	11.4	9.2	7.6	6.3	8.9	6.6	6.1	6.0	7.3
Primary balance	0.0	0.0	0.0	0.0	0.0	0.6	-0.1	-0.5	-2.0
Overall balance	4.3	-2.5	-1.0	2.9	0.7	-2.3	-2.3	-2.4	-4.0
Public debt	87.0	82.2	80.3	72.7	77.2	68.8	68.7	70.9	70.3
Domestic	…	…	…	…	…	…	3.7	4.0	3.8
External	87.0	82.2	80.3	72.7	77.2	68.8	65.1	67.0	66.5
Interest payments (% of current income)	…	…	…	…	…	9.7	6.9	6.1	6.0
Money and credit [n]									
Domestic credit [o]	24.5	23.3	24.1	31.0	33.1	33.4	35.3	35.6	36.4
To the public sector	1.7	0.9	-0.1	-2.3	-4.8	-4.6	-3.5	-3.0	-2.3
To the private sector	22.7	22.3	24.1	33.4	37.9	38.0	38.9	38.7	38.6
Liquidity (M3)	29.2	29.0	35.0	40.8	43.3	45.3	46.7	48.6	49.4
Money stock and local-currency deposits (M2)	25.1	22.7	27.2	32.2	33.2	34.7	34.7	34.6	34.8
Foreign-currency deposits	4.1	6.3	7.8	8.6	10.1	10.6	12.0	14.0	14.6

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 1978 prices. [c] Based on figures in local currency at current prices. [d] Includes errors and omissions. [e] Refers to the capital and financial balance (including errors and omissions), minus net foreign direct investment. [f] A minus sign (-) denotes an increase in reserves. [g] Includes the use of IMF credit and loans and exceptional financing. [h] Annual average, weighted by the value of merchandise exports and imports. [i] Refers to net investment income as a percentage of exports of goods and services as shown on the balance of payments. [j] Economically active population as a percentage of the working-age population; nationwide total. [k] Unemployed and underemployed population as a percentage of the economically active population, nationwide total. [l] Weighted average rate on time deposits. [m] Weighted average rate on loans. [n] The monetary figures are annual averages. [o] Refers to net credit extended to the public and private sectors by commercial banks and other financial and banking institutions.

benefits which the United States had previously granted unilaterally under the Caribbean Basin Initiative. In terms of market access, Honduras agreed to grant duty-free entry to 75% of its imports from the United States and will receive the same treatment for 91% of its exports. In addition, Honduras obtained a degree of protection for its socially sensitive sectors, in the form of transition periods of 5 to 20 years to allow these sectors to adapt gradually to keener competition.

Early in 2003 Nicaragua temporarily suspended its 35% tariff surcharge on imports from Honduras, which it had begun to apply after Honduras concluded a maritime border treaty with Colombia. Moreover, progress was made towards the formation of a Central American customs union, especially in terms of harmonizing tariff items. In May 2004 border posts between Guatemala, El Salvador, Honduras and Nicaragua were removed.

Table 2
HONDURAS: MAIN QUARTERLY INDICATORS

	2002				2003[a]				2004[a]	
	I	II	III	IV	I	II	III	IV	I	II
Merchandise exports, f.o.b. (millions of dollars)	311	367	328	315	367	346	222	313	408	...
Merchandise imports, c.i.f. (millions of dollars)	685	748	739	809	758	781	837	900	915	...
International reserves (millions of dollars)	1 437	1 538	1 463	1 524	1 450	1 454	1 395	1 430	1 501	1 625
Real effective exchange rate (index: 2000=100) [b]	95.4	96.2	96.3	96.7	97.2	98.4	98.3	99.4	100.3	99.8
Consumer prices (12-month percentage variation)	7.7	7.6	7.2	8.1	8.7	7.2	7.3	6.8	6.7	...
Average nominal exchange rate (lempiras per dollar)	16.07	16.31	16.55	16.80	17.03	17.22	17.41	17.64	17.86	18.06
Nominal interest rates (annualized percentages)										
Deposit rate [c]	14.4	14.3	13.6	12.8	12.2	11.5	11.2	11.1	11.3	11.2
Lending rate [d]	23.1	23.0	22.6	22.1	21.5	20.9	20.5	20.2	20.1	20.2
Interbank interest rate	...	11.7	9.5	8.6	7.3	7.3	8.0	8.7	8.3	7.6
Domestic credit (variation from same quarter of preceding year) [e]	13.4	7.0	7.1	7.7	10.4	14.7	15.9	18.4	18.4	...
Non-performing loans as a percentage of total loans[f]	5.7	7.0	6.8	5.3	4.8	5.0	3.9	3.8	3.5	...

Source: Economic Commission for Latin America and the Caribbean (ECLAC), on the basis of official figures.
[a] Preliminary figures. [b] Quarterly average, weighted by the value of merchandise exports and imports. [c] Weighted average rate on time deposits. [d] Weighted average rate on loans. [e] Refers to net credit extended to the public and private sectors by commercial banks and other financial and banking institutions. [f] Refers to total credit extended by the banking system.

3. The main variables

(a) Economic activity

In 2003 GDP increased by 3.2%, or 0.7% in per capita terms. In 2004 GDP is likely to expand by between 3.5% and 4% as a result of better external and domestic conditions.

Growth in overall demand rose from 2.7% in 2002 to 4.6% in 2003, driven mainly by investment and exports. Domestic demand more than doubled its expansion of the preceding year, as its growth accelerated from 2.1% to 4.5%. Gross domestic investment, which had contracted in the previous three years, climbed by 8.5% to become the driving force of the Honduran economy, along with goods and services exports (5.2%). Growth in consumption, on the other hand, was less buoyant than in previous years (3%); the general government component was up by 0.8% and the private component, by 3.4%. In 2004 the authorities plan to implement a programme of public investment in road infrastructure, low-cost housing and the expansion of the telephone network, and private-sector entities have announced investments in maquila activity, electricity generation, telecommunications, tourism and agriculture. Investment is therefore expected to re-emerge as an important engine of economic growth.

The agricultural sector grew by 1.9%, falling short of its 2002 expansion (4.9%). Agricultural output dipped by 0.7% owing to downturns in the production of coffee (7.9%) and sugar cane (4.9%). Crops for domestic consumption performed well, as did livestock and poultry production. Manufacturing expanded at a rate similar to the one posted in 2002 (3.7%). The performance of most manufacturing subsectors was positive but mediocre, with growth rates of between 1%

and 3%. The sole exception was the textile and clothing industry (10.1%), which was boosted by an upturn in external demand. Construction made a remarkable recovery (13.8%) after two straight years of decline.

Two other sectors that achieved solid growth were electricity, gas and water (7.9%) and transport, storage and communications (3.7%). Commerce, restaurants and hotels and financial institutions also continued to post positive rates in line with the economy's average performance. Public administration and defence, on the other hand, were down by 2% after having shown strong growth in previous years.

(b) Prices, wages and employment

The variation in the consumer price index (CPI) was 6.8%, which was the lowest rate in 11 years and 1.3 percentage points lower than the 2002 rate. Once again, food prices and merchandise import prices helped to slow the pace of inflation, rising by 5% and 2.9%, respectively. Conversely, the rise in the international price of petroleum and petroleum products contributed to the increase in transport costs (8%). Increases in the cost of alcoholic beverages, tobacco, housing, water, electricity and gas outpaced the average increase in the CPI, as did the hike in education costs. By May 2004 inflation had already reached 4.3%, over half the rate predicted for the year as a whole.

Once again, the wholesale price index rose more slowly than the CPI. However, its 4.7% increase in 2003 was higher than the preceding year's upturn, providing further confirmation of the economy's recovery. Inflationary pressure came mostly from industrial prices (6%) and construction materials prices (8%). This pattern of wholesale price increases is expected to continue in 2004.

The minimum wage climbed by 13.8% in 2003, increasing the annual average by 8.6% in real terms. The current administration's policy is to try to limit wage increases, particularly in the public sector. The central government's wage bill expanded by only 2%, indicating that the authorities succeeded in slowing down the pronounced increases of previous years, which had resulted from statutory wage hikes for teachers and for medical and paramedical personnel. The minimum wage increase implemented in April 2004 averaged 7.9%, meaning that real wage growth was negative.

Unemployment indicators continued to worsen in 2003. Nationwide, open unemployment shot up from 3.9% in 2002 to 5.3% in 2003, while open unemployment rose from 8.5% to 11% in Tegucigalpa and from 5.9% to 6.7% in San Pedro Sula. Invisible underemployment also rose (from 25.6% to 29.5%), on account of the economy's limited capacity to generate formal-sector jobs.

(c) The external sector

Export growth revived in 2003, with a significant increase in maquila-sector value added, combined with an impressive upswing in remittances. Export growth reflected an increase in export volume, given that the terms of trade deteriorated for the fifth year running. The balance-of-payments current account deficit widened from 3.4% to 3.8% of GDP, while the financial account posted a negative balance of about US$ 30 million. Since imports are likely to expand more than exports in 2004, the balance-of-payments current account deficit could swell to 6.6% of GDP.

The 5.3% growth in merchandise exports (twice the preceding year's rate) was the result of two opposing trends. On the one hand, almost all types of traditional exports posted declines in export value. The most striking example is that of banana exports (-23%), which continued their downslide of recent years. On the other hand, strong growth was observed among all non-traditional exports except lobster, whose export value fell, essentially because of a lower export volume. The standouts in this group included palm oil (78%), soap and detergent (29%), melons (22%) and shrimps (17%). Maquila exports surged by 15%, approaching the rates they had posted during the boom of the 1990s.

The economic recovery generated an increase in merchandise imports (9.9%). The value of oil and fuel imports grew by about 25% as a result of international price hikes and increased consumption. The rise in construction materials prices also reflected more vigorous activity in this sector and higher international prices. Imports of consumer goods climbed by 5.8%; the fastest growth was in consumer durables imports. Capital goods imports slipped by 3.6% as a result of reduced purchases by the agricultural and transport sectors. Capital goods for industry, however, picked up by a robust 10%.

The services trade deficit widened by US$ 10 million; this meant that the worsening of the trade gap (including both merchandise and non-factor services) was due primarily to a deterioration in the merchandise trade component. The negative balance of trade in goods and services went from US$ 998 million in 2002 to US$ 1.16 billion in 2003. Net current transfers increased by more than US$ 120 million owing to an upsurge in family remittances; inflows under this balance-of-payments item are estimated to have grown by some 20% in 2003, to US$ 860 million (12.4% of GDP).

The financial account exhibited a shortfall of US$ 32 million in 2003, which represents a US$ 265-million slump from the preceding year's surplus. This reflected a net outflow of short-term capital, which went from a positive balance of US$ 116 million in 2002 to a negative balance of US$ 110 million in 2003, largely because of the upturn in imports. Foreign direct investment exceeded its 2002 level by US$ 22 million thanks to maquila-sector investment, and reached a total of US$ 198 million. The financial balance was adversely affected by other long-term capital movements, particularly net bank lending and debt arrears payments by the government and banking sectors. Net international reserves declined to US$ 1.764 billion, falling below their 2002 level by US$ 88 million.