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International Monetary Fund  
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### **IMF Executive Board Approves an Stand-By Arrangement for Honduras**

The Executive Board of the International Monetary Fund (IMF) approved yesterday a 12-month Stand-By Arrangement for Honduras for SDR 38.8 million (about US\$63.5 million) to support the country's economic program for 2008. The authorities intend to treat the arrangement as precautionary. The main objective of the authorities' program is to entrench macroeconomic stability and sustain high growth by consolidating and reorienting the fiscal stance, containing inflation, reinforcing external stability, and addressing weaknesses in the energy sector.

Following the Executive Board discussion, Murilo Portugal, Deputy Managing Director and Acting Chair, said:

“The Honduran economy has posted robust growth and declining poverty in recent years. Nevertheless, given that internal and external economic imbalances have developed, and to support prospects for continued growth and poverty reduction, the authorities' program appropriately strengthens the policy framework to reinforce macroeconomic stability and place the energy sector on a stronger financial footing.

“The authorities' fiscal policy aims at a stable debt/GDP ratio and a reorientation of public spending toward priority investment, while reducing the fiscal deficit. On the revenue side, tax administration is being strengthened and electricity tariffs raised. On the expenditure side, the program envisages strict control of current spending, targeting energy subsidies to protect the poor, and limiting net lending by the public pension funds to protect their financial integrity. A central element of the authorities' program is the stabilization, and subsequent reduction, of the public wage bill as a percentage of GDP.

“Monetary policy is aimed at containing inflation in single-digits, bringing bank credit growth to more sustainable levels, and ensuring the build-up of international reserves to maintain coverage relative to 2007. The authorities have already taken actions to tighten monetary policy, and are committed to further tightening as necessary to reach the program

targets. Prudential policies are designed to strengthen the resilience of the banking system while introducing forward looking risk-based supervision.

“The central bank has started to use exchange rate policy more actively within the current framework to safeguard external competitiveness and help protect the economy against external shocks.

“A centerpiece of the program is to strengthen the energy sector to support growth and safeguard public finances. In this context, electricity tariffs have already been increased. The program envisages the clearance of arrears with electricity suppliers, and the implementation of a new tariff structure that covers operational costs of the electricity company.

“The precautionary Stand-By Arrangement will support the authorities’ economic program and provide a bridge to a new medium-term program that could be supported under the IMF’s Poverty Reduction and Growth Facility (PRGF) later in the year,” Mr. Portugal said.

## ANNEX

### **Recent Economic Developments**

Honduras has had three previous Poverty Reduction and Growth Facility (PRGF) arrangements, the last of which ended in February 2007. The most recent PRGF program focused on fiscal consolidation and structural reforms to strengthen growth prospects and reduce vulnerabilities in the financial sector.

Over the last year, growth remained robust at over 6 percent in 2007 and macroeconomic stability has been maintained; however, internal and external emerging imbalances have developed. Inflation has increased to 9 percent from 5.3 percent in 2006, reflecting rising international food and oil prices. Also, despite an improvement in the terms of trade and good export performance, the external current account deficit almost doubled, to 10 percent of GDP, due to rapid growth in imports. Net international reserves slightly declined in 2007, but that trend has been recently reversed. At the same time, the overall fiscal deficit deteriorated, partly reflecting rising current spending, including wages (due to teacher’s agreements), and the weakening finances of the public companies, particularly the electricity company (ENEE).

### **Program Summary**

The authorities’ economic program for 2008 is designed to sustain continued high growth and contain inflation within a less favorable external environment. A set of fiscal, monetary,

and prudential policy measures aims at addressing the emerging macroeconomic imbalances, and placing the energy sector on a sustainable footing.

**Fiscal consolidation and reorientation.** The overall fiscal deficit will be reduced to 1.5 percent of GDP in 2008 from 2.3 percent in 2007 through a mix of revenue and expenditure measures. On the expenditure side, the government has committed to keep a cautious control on current primary spending of the central government. At the same time, the program allows for a substantial increase in public investment, particularly in infrastructure projects to reduce bottlenecks in the electricity and transportation sectors. The authorities are also improving the targeting of electricity and direct fuel subsidies to the poor.

**Containing inflation and safeguarding external stability.** The monetary program seeks to avoid the second round effects of food and energy prices and wage increases and maintain inflation in a range of 8-10 percent. The program also contains measures to encourage banks to tackle with the rapid growth in credit and bring it down to more sustainable levels. The program also aims to build net international reserves by US\$253 million, to keep a coverage around of 4 months of nonmaquila imports.

**Strengthening the energy sector.** Reforming the electricity sector is fundamental to create the appropriate conditions to attract investment and support growth, besides safeguarding public finances. In cooperation with the World Bank and the Inter-American Development Bank (IADB), the authorities will implement a plan to reduce energy distribution losses and fraud; stimulate and reactivate investment in the sector; improve the finances of ENEE and clear its arrears with electricity generators.