Honduras: Letter of Intent, Memorandum of Economic and Financial Policies, and Technical Memorandum of Understanding

September 10, 2010

The Authorities' Letter of Intent

Tegucigalpa, September 10, 2010

Mr. Dominique Strauss-Kahn
Managing Director
International Monetary Fund
Washington, D.C. 20431

Dear Mr. Strauss-Kahn,

1. During 2009, the Honduran economy was severely affected by the global slowdown and a domestic political crisis. Real GDP declined by almost 2 percent and unemployment rose significantly. In addition, the fiscal position deteriorated markedly and international reserves declined by about US$360 million, to the lowest level since 2006. Although external conditions have begun to improve in 2010, economic growth is still weak and the recovery faces risks.

2. To establish the conditions for robust and sustainable growth in the medium term, the Government has started to implement key reforms, and has developed an economic program for 2010–11 aimed at reducing macroeconomic imbalances and strengthening the finances of the public sector. We expect that strong implementation of this program will help bolster investor confidence and strengthen the support of the international community. In support of this program, we are requesting 18-month arrangements with the Fund, in the total amount of SDR129.5 million, equivalent to 100 percent of Honduras' quota at the Fund (with a blend of resources from the Stand-By and Standby Credit Facilities, of SDR 64.75 million each). We intend to treat the arrangement as precautionary.

3. The main objective of this program is to restore macroeconomic stability, strengthen public finances, help establish the conditions for sustainable economic growth and increase resources for investment. In the attached Memorandum of Economic and Financial Policies (MEFP), we outline the economic program and set out the policies of the Government for 2010–11. These policies reflect the Government's commitment to fiscal consolidation, improvements in revenue mobilization and tax administration, combined with improvements in the composition of public sector expenditure, strict control of the public sector wage bill, that enable an increase in anti-poverty programs and public investment. The government believes that the policies contained in the MEFP are adequate to achieve the objectives of its program, and it is committed to take any further measures that may be needed for this purpose. We will consult with the Fund on the adoption of these measures as needed, and in advance of revisions to the policies contained in the MEFP, in accordance with IMF policies on such consultation.

4. During the program, the Government will not introduce or intensify any exchange rate restrictions, multiple currency practice, and import restrictions for balance of payments purposes, and will continue to comply with all obligations of Article VIII of the IMF's Articles of Agreement.

5. Program implementation will be monitored through five quarterly reviews, with the first one to be completed on or after February 15, 2011. The quantitative performance criteria and structural benchmarks under the program are set out in Tables 1 and 2 of the attached MEFP. Consistent with the commitment to keep the public informed, the Government will publish the program documents and will report periodically on progress under the program.

Sincerely yours,

/s/ /s/

Maria Elena Mondragón de Villar
President, Central Bank of Honduras

William Chong Wong
Minister of Finance

Attachments

Memorandum of Economic and Financial Policies for 2010–11

I. Background and Program Objectives

1. During 2009, the economy of Honduras was severely affected by the global slowdown and a domestic political crisis. Real GDP declined by 1.9 percent, resulting in a significant loss of employment. The impact of these developments, combined with domestic macroeconomic policies in place, resulted in a deterioration in the external position, as net capital inflows (FDI and official assistance) contracted by more than the external current account deficit, and gross international reserves fell by 15 percent to US$2.3 billion (3½ months of imports).

2. The government of President Porfirio Lobo, which took office in January 2010, inherited a weak economic situation and large fiscal imbalances. In 2009, the overall deficit of the public sector rose sharply to 4.6 percent of GDP (from 1.7 percent in the previous year), reflecting a large widening in the deficit of the central government (from 2.4 percent of GDP in 2008 to 6.2 percent last year). A strong increase in government spending (mostly public sector wages) and weaker tax revenue were the main contributors to the higher deficit, which was financed with a combination of short-term domestic debt, central bank credit, and domestic arrears. The financial position of public sector enterprises and pension funds also worsened.

3. Since taking office, the new government has taken several measures to restore macroeconomic stability and strengthen the public finances. Last April, Congress approved a comprehensive tax reform that is expected to yield revenues by up to 2½ percent of GDP (on an annual basis). In June, we initiated a process of employment verification in the education and health sectors (which account for the bulk of the government wage bill), eliminated subsidies to all users with electricity consumption above 150 kWh per month, and improved the targeting of the energy subsidy to the poor, and public enterprises adjusted their tariffs to better reflect operating costs. These measures will contribute to reduce fiscal disequilibrium.

4. Consistent with the goals stated in the *Visión de País 2010-2038* and the strategic elements of the *Plan de Nación 2010-2022*, our economic policy's main objectives will be to restore macroeconomic stability, strengthen public finances, help establish the conditions for sustained economic growth, and increase resources for investment. In line with these objectives, our economic program aims at bolstering confidence in the government's policies, strengthening the fiscal position of the central government and key public sector entities, raising the level and efficiency of social spending, and boosting our international reserves. We expect that prompt adoption and steadfast implementation of this program will help mobilize official external financing to support its objectives.

5. We believe that a large and sustainable reduction in fiscal deficits and improvement in the composition of public expenditure are critical to the success of our economic program. To this end, the program targets a reduction in the deficit of the central government of almost 3 percent of GDP during 2010–11 (from 6.2 percent of GDP in 2009). During this period, the overall fiscal deficit of the consolidated public sector would be lowered by1.6 percent of GDP; higher investment by public sector enterprises would be the main reason for the smaller decline in the consolidated public sector deficit. The projected reduction in the fiscal deficit will be driven by higher tax revenues resulting from the implementation of the April 2010 reform, improved tax administration and collection, and, importantly, strict control of current spending. Monetary and exchange rate policies will be consistent with our inflation and external objectives. The program also envisages structural reforms which are critical to its success, mostly in public finances and the financial sector.

II. Macroeconomic Policies for 2010–11

6. Our program envisages a gradual economic recovery, with real GDP growth in the range of 2½-3½ percent during 2010–11. Inflation is expected to rise, largely reflecting higher prices of imported goods (mostly petroleum), but will be kept below 6 percent throughout the program period. The deficit in the external current account is projected to rise to 6–17 percent of GDP (from 3.2 percent in 2009) owing to higher prices of imported commodities (mostly oil) and strong import demand for public and private investment. A strong pickup in foreign direct investment and in official external financing is expected to be more than sufficient to cover the current account deficit and, as a result, gross international reserves are expected to increase gradually throughout the program period.

A. Fiscal Policy

7. Our fiscal policy aims at improving the quality of public expenditure, reducing the overall deficit of the public sector to 2 percent in the medium term, and keeping the debt-to-GDP ratio at below 30 percent. In line with these objectives, the overall deficit of the consolidated public sector for end-2010 will be lowered to 3.7 percent of GDP (0.9 percent less than in 2009), on account of higher tax revenue and expenditure restraint. The 2011 budget that we plan to submit to Congress by mid-September 2010 (prior action) will target an overall fiscal deficit of the central government of 3.4 percent of GDP, consistent with the overall deficit of the consolidated public sector of 3.1 percent of GDP. The budget will accommodate higher spending in priority areas, mostly poverty reduction and public investment. To achieve this objective we plan to fully implement the tax measures approved last April, and exercise strict control of public sector current spending, especially of the wage bill. In addition, we plan to adopt measures to strengthen the operating balance of public sector enterprises. The key elements of our program for 2010–11 include:

- ***Improvements in tax policy and administration***. In support of the tax reform, we plan to further strengthen the institutional framework for tax collections. In particular, we will: (i) submit to the National Congress the necessary reforms, including to the tax code, to enforce tax compliance; (ii) maintain unchanged the rules, regulations, resolutions and technical directives related to the proper implementation of the reform to the zero tax rate, taxes on income and sales, and excise taxes contained in Decree 17-2010; iii) review the tax exemptions established in various laws in order to ensure their proper application and strengthen their respective controls by the Ministry of Finance and the tax collection agency (DEI) by June 2011; (iv) continue the institutional upgrading of the DEI, strengthening its capacity to control, analyze, and collect revenue; and (v) improving management of human resources in the areas of training programs and internal wage policy, to facilitate the implementation of the civil service career path and incentives plan. At the same time, we will improve the administrative capacity of the DEI, we will strengthen the large taxpayers unit with equipment and qualified personnel, and we will develop a manual of job description and salaries (March 2011).

- ***Control of expenditure on goods and services***. For 2011, we will maintain the ceiling established in the 2010 budget on central government expenditure on goods and services. In addition, we will start using reverse auctions and online purchases to reduce costs and increase availability of medicine, fuels, and other goods in the public sector.

- ***Control of the wage bill***. Our policies will aim at reining in the growth of the wage bill of the central government, which is projected to decline to 10.3 percent of GDP in 2011 (from 11.1 percent of GDP in 2010). Payroll control will be tightened by: (i) completing, by end-September 2010, the process of employment verification in the education and health sectors (by the Ministry of Finance and with the support of Ministry of Planning and External Cooperation), based on the information available from the 2009 census and the employment audit carried out by the Government Audit Office (TSC), and the findings of the joint Government/Teachers commission envisaged in the August 28, 2010 agreement, and detailed employment records provided by the respective ministries; (ii) eliminating all redundant and irregular positions identified by the TSC; (iii) setting-up a centralized unit for payroll monitoring at the Ministry of Finance by end- 2010; (iv) linking payroll management modules for the education and health ministries to the integrated system of financial management (SIAFI) by October 2010 and fully incorporating it into SIAFI by March 2011; (v) requiring prior approval by the Ministry of Finance for any modification of the budgeted payroll of the central government; and (vi) integrating payments to day laborers into SIAFI and the financial system.

- ***Improved public investment management***. We will develop by March 2011 a plan to strengthen the management of investment projects at the institutional and project execution levels, through the simplification of the mechanisms and processes for the procurement, implementation, and monitoring of public investment.

- ***Strengthening of the operating balance of key public enterprises***. We plan the following measures to strengthen the operating balance of public enterprises: (i) raise electricity tariffs by 3 percent by end-September 2010 and thereafter adjust electricity tariffs periodically in line with fuel costs as stipulated in the law; (ii) regularize overdue payments of other public sector entities (December 2010) to the electricity company (ENEE) so as to enable the repayment of ENEE's overdue obligations to the private sector by March 2011; and (iii) prepare by March 2011 comprehensive plans to restore the financial viability and enhance the operational efficiency of the public enterprises.

- ***Strengthening the financial position of public pension funds***. The pension funds together with the Banking and Securities Commission (CNBS) have developed an action plan for reforming the law that would reduce the actuarial deficit of the pension system (INPREMA, INJUPEMP, INPREUNAH) by changing the bases of defined benefits. We will present a draft law based on this action plan to the National Congress by December 2010. We are also reviewing and reforming regulations to allow pension funds to diversify their investment instruments within the limits that guarantee their liquidity, profitability and safety (December 2010).

- ***Audit of government arrears to private sector suppliers***. By January 2011, a contract will be signed with a reputable international audit company to undertake an audit of accumulated domestic arrears to the private sector. Based on this audit, we will develop a plan to only clear arrears generated from contracts that adhered to existing regulations and procedures.

- ***Reform of the civil service law***. By December 2011, the government, with the support of the Inter-American Development Bank (IADB), will review the legislation that regulates recruitment and selection processes, and recruitment procedures for all existing regimes in the public administration. This diagnosis will be the basis of a plan to reform the Civil Service Law, which will be later presented to Congress for its discussion and approval.

- ***Budget financing***. Our strategy will encompass a lower reliance on domestic financing and refraining from using central bank financing to the budget. In line with this objective, we have requested budget support from the World Bank and the IADB totaling US$220 million for 2010–11. In addition, the Central American Bank for

Economic Integration (CABEI) approved a non-concessional loan of US$280 million, which remains within the limit on the contracting of nonconcessional debt (US$350 million). We will not incur external arrears at any time during the program period.

- ***Use of higher-than-projected revenue and external disbursements of budget support***. Our fiscal projections for 2010–11 are based on conservative assumptions for output and revenue growth. If tax revenues were to be higher than projected, we will use up to 50 percent of the excess revenue to repay domestic debt, and allocate the rest to counterpart financing of social investment projects (TMU, paragraph 7, Table B). Also, if external disbursements for budget support exceed the amount projected, we will save the total amount of the excess in the net international reserves of the central bank, which will also reduce the ceiling on net domestic assets.

- ***Improved public debt management***. With the objective of strengthening the capacity to manage to public debt and link government borrowing plans to a sound, multiyear fiscal framework, we will update the Guidelines for Public Sector Borrowing (*Propuesta de Lineamientos de Política de Endeudamiento Público*) *2011–2014* in the following areas: (i) establish a borrowing ceiling for the central government, based on the debt sustainability analysis prepared by the public credit department of the Ministry of Finance; (ii) properly record and administer domestic arrears and contingencies resulting from public-private partnerships (PPPs) and other contracts; (iii) strengthen the fiscal risks unit of the Ministry of Finance to improve debt profile; and (iv) establish by February 2011 specific norms for controlling and managing the outstanding debt of local governments.

B. Monetary and Exchange Rate Policies

8. Our monetary policy will aim at keeping inflation at single digits and maintaining an adequate level of international reserves. Accordingly, we will seek to keep annual inflation in the range of 5½–6 percent in 2010–11 (plus/minus one percentage point). The central bank's monetary program for the program period is consistent with a prudent expansion of bank credit to the private sector to support the growth objectives of the government. We will control the growth of net domestic credit through active placements of central bank bills, and will not extend new credit to the public banks and to the central government. We will monitor monetary conditions and assess the appropriateness of interest rate levels throughout the program period, and will adjust our policy rate (TPM) as necessary to achieve our inflation target and protect the external position. In addition, the program envisages that net international reserves will increase by US$50 million in 2010 and by US$220 million in 2011, and establishes a ceiling for the net domestic assets of the central bank.

9. Our exchange rate policy will be transparent, predictable, and consistent with the objective of safeguarding competitiveness and strengthening the external position. The central bank will take measures to foster the development of an active interbank market and secondary markets for central bank and government paper, refine monetary instruments, and enhance policy signaling. The central bank will undertake a comprehensive reform of its operational framework for conducting monetary policy. The reform will include: (i) moving toward a system of liquidity forecasting and liquidity management on a daily basis; (ii) improving market-based repo operations for liquidity management, (iii) increasing the signaling content of the policy rate (TPM); (iv) revamping the system of primary auctions of central bank paper to allow for price discovery by market participants, and (v) simplifying the current system of reserve requirements. We are requesting assistance from the IMF to strengthen the central bank's institutional capacity for designing and implementing these reforms, and for developing a timetable for their adoption.

10. To enhance the central bank's ability to pursue effective monetary policy, we will develop a plan for its recapitalization and institutional strengthening by December 2011. We will request technical assistance from the IMF for this purpose.

C. Financial Sector Policies

11. Building on the progress achieved in recent years, we are fully committed to further improve our regulatory framework and supervisory practices in the financial system, and to strengthen the financial safety net, as recommended in the update to the Financial Sector Assessment Program (FSAP). In particular, we plan to: (i) issue new norms for loan classifications and reserve coverage in line with international best practices, by December 2010; (ii) approve regulations for measuring and monitoring liquidity risks in line with international best practices; (iii) strengthen the capacity for risk-based supervision, (iv) re-activate the Early Warning Committee; (v) strengthen the risk-based supervision framework for saving and loans cooperatives, (vi) review bank resolution procedures to ensure that they follow the best practices, and (vi) strengthen the deposit guarantee fund (FOSEDE) and the Capitalization Fund. We are also committed to improve access to financial services. To this effect, we expect that the Chamber of Commerce and Industry of Tegucigalpa will be able to implement, by January 2011, the "secured transactions" Law and to have in place a public registry of movable collateral. Furthermore, the CNBS will modify regulations for appraisers, extraordinary assets, bonded warehouses, and credit bureau (February 2011). We will also design and adhere to new norms to increase transparency, information disclosure, and protection to users of financial services (September 2011).

D. Poverty Reduction Policy

12. ***Targeting social spending to the poor.*** With the assistance of the multilateral banks and donors, the government plans to consolidate its anti-poverty expenditure in a conditional

cash transfer program (*Bono 10 mil*). This program aims at covering a large share of the families living in extreme poverty and providing cash benefits conditional on periodic monitoring of child growth and use of health and education services. In particular, we plan to: (i) increase the coverage of the conditional transfer program by 150,000 additional families by end-2011; (ii) strengthen the monitoring and control mechanisms of the *Bono 10 mil*; and (iii) expand the provision and access to health and education services to the program's beneficiaries. The government has committed resources equivalent to 1.6 percent of GDP to all social investment programs in 2011.

E. Reforms to Improve the Investment Climate

13. We are committed to improving the business climate in Honduras in order to increase foreign and domestic investment, in particular in infrastructure. To facilitate this, Congress approved a draft law for public-private partnerships (PPP) and is considering a draft law on investment protection and promotion. We also plan to improve the regulatory framework for creditors' rights and insolvency proceedings. To improve the safety of transactions and facilitate commercial and administrative operations, we will make legal the use of electronic signatures.

III. Safeguards Assessment

14. We recognize the importance of completing an updated safeguards assessment of the Central Bank of Honduras before the first review of the program. To facilitate this, we have authorized the central bank's external auditors to provide IMF staff with all necessary information and to hold discussions directly with IMF staff. The central bank will work with IMF staff to ensure the smooth completion of the updated safeguards assessment before the first review. The central bank intends to fully implement the recommendations resulting from that assessment.

IV. Program Monitoring

15. The program with the IMF will cover the period October 2010–March 2012 and will be monitored on a quarterly basis, by quantitative performance criteria and indicative targets, and structural benchmarks. The first program review will be completed on or after February 15, 2011, the second one on or after May 15, 2011, and the third one on or after August 15, 2011. The quantitative performance criteria and indicative targets for December 2010 and March 2011 are set out in the attached table, and those for the period April 2011–March 2012 will be established in the first review of the program. Structural benchmarks are set out in Table 2. The definitions and reporting procedures are further specified in the accompanying Technical Memorandum of Understanding.

Table 1. Honduras - Proposed Performance Criteria 1/

(Cumulative flows; millions of Lempiras, unless specified)

	2010			2011			
	Prel.	Proj.	PC	PC	Indicative Targets		
	end-Jun.	end-Sep.	end-Dec.	end- Mar.	end- Jun.	end- Sep.	end- Dec.
QUANTITATIVE PERFORMANCE CRITERIA							
Fiscal targets 2/							
Deficit of the combined public sector (ceiling)	3,413	4,688	7,487	4,715	4,244	6,055	9,700
Net domestic financing of the combined public sector (ceiling)	2,008	2,214	-250	3,868	689	-23	922
Monetary targets							
Stock of net international reserves (floor, in millions of US$)	1,598	1,462	1,557	1,606	1,751	1,783	1,777
Stock of net domestic assets of the central bank (ceiling)	-14,679	-13,231	-11,080	-12,855	-16,083	-17,004	-13,676
Public debt targets 2/							
Contracting or guaranteeing of non-concessional external debt (continuous ceiling, in million of US$)			350	350	350	350	350
New arrears of ENEE with the private sector (continuous ceiling)		0	0	0	0	0	0
External payment arrears of the combined public sector (continuous ceiling)			0	0	0	0	0
INDICATIVE TARGETS 2/							
Central government current primary expenditure (ceiling)	22,433	14,157	28,773	10,827	23,800	36,555	50,572
Social investment related spending (floor)	1,536	213	1,197	442	954	1,532	3,477
Wage bill of the central government (ceiling)	14,900	8,203	17,335	6,716	15,580	23,054	32,235
Memo Items 2/							
Central government tax revenues 3/	19,908	10,920	24,146	9,298	25,268	37,558	50,322
Budget support external loans (in million of US$)	0	0	190	0	0	40	80

1/ Definitions as specified in the Technical Memorandum of Understanding.
2/ Cummulative starting on July 1 for 2010 and on January 1 for 2011.
3/ Does not constitute a Performance Criterion, Indicative Target or Structural Benchmark.

Table 2. Honduras: Structural Benchmarks

	Date	Rationale
A. Fiscal		
Present to Congress a 2011 Budget consistent with a combined public sector deficit of 3.1 percent of GDP.	Prior action	Anchoring the macroeconomic program
Improve human resources management and administrative capacity of the DEI; strengthen a Large Taxpayer Unit with adequate staff; and develop a job and pay description manual.	March 2011	Critical to strengthen tax revenue collections
Transfer the control over Education payroll to the Ministry of Finance.	March 2011	Critical to control the wage bill
Sign a contract to audit public sector arrears with the private sector.	January 2011	Definitely establish government obligations
Adjust electricity tariffs in line with fuel costs.	Continuous	Improve the financial position of ENEE
Present a law reform proposal that allows changing the bases of defined benefits, to reduce the actuarial deficit of IMPREMA, INJUPEMP and INPREUNAH	December 2010	Strengthen the financial sustainability of pension regimes
B. Financial Sector		
Issue norms for loan classifications, reserve coverage and approve regulations for measuring and monitoring liquidity risks in line with international best practices.	December 2010	Strengthen the stability of the financial system
C. Monetary and External		
Prepare a plan to recapitalize the central bank.	December 2011	Strengthen the financial position and independence of the CBH

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 October 2010–March 2012. It defines the concepts used to assess observance of quantitative performance criteria, structural benchmarks, and indicative targets specified in Tables 1 and 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.

I. Program Assumptions

2. For program monitoring purposes, unless otherwise indicated, U.S. dollar denominated components of the balance sheet of the Central Bank of Honduras will be valued at the exchange rate of L18.8951/US$. Amounts denominated in other currencies will be converted for program purposes into U.S. dollar amounts using the cross-rates as of end-June 2010 published on the IMF website http://www.imf.org.

II. Fiscal Targets

3. **The deficit of the combined public sector (CPS)** will be measured from the financing side (i.e., “below the line”), and will correspond to the net borrowing of the CPS, from both external and domestic sources. The CPS comprises the nonfinancial public sector (NFPS) and the operating result (quasi-fiscal balance) of the central bank. The NFPS covers the central government, local governments and decentralized agencies, the social security institute (IHSS), the pension institutes (INJUPEMP, INPREMA, IPM), and the public enterprises.

4. **The deficit of the central government** also will be measured from the financing side. The central government includes the executive, judicial, and legislative branches, and the so-called decentralized agencies (*desconcentradas*).

5. **The current primary expenditure of the central government** is defined as total current expenditure less interest payments.

6. **The central government wage bill** is defined as all central government wages and salaries, including severance payments, plus employer social security and pension contributions; other remunerations (such as bonus payments) are also included in the definition.

7. **Social investment spending** is defined as the programs and projects of social content that are financed with domestic resources, debt relief, grants and loans. (See Table B).

8. **The operating balance of the public enterprises** is defined as the difference between the operating revenue (excluding interest earnings and transfers) and the operating expenditure (excluding interest payments and transfers) of the enterprises.

9. **Net domestic financing of the CPS** will be measured as the operating result of the central bank and the change (relative to end-June 2010) in the stocks of: (1) outstanding indebtedness of the NFPS (direct bank credit plus bank holdings of public sector bonds less deposits) to the domestic financial system (central bank, commercial banks, and other financial institutions); (2) outstanding public sector bonds held outside the financial system; (3) repatriation of deposits held abroad; and (4) outstanding suppliers' credit and floating debt (un-cashed and undelivered checks, and unpaid invoices and orders) of the central government, and unpaid orders of the rest of the NFPS. For the purposes of the program, domestic financial system is defined as comprising all depositary institutions, according to the Monetary and Financial Statistics Manual (MFSM) definitions.

10. **Discrepancies**. The authorities will undertake periodic reconciliations to minimize discrepancies between above-the-line and below-the-line financing data. As needed, such reconciliations must be carried out prior to completion of the program reviews.

11. **Adjustor**. If tax revenues were to exceed those projected under the program for 2010 and 2011 during each year, up to 50 percent of the excess revenue will be used to amortize domestic debt (and thus reduce fiscal deficit and its domestic financing) and the residual will be allocated as counterpart to social investment projects (Paragraph 7, Table B).

III. Monetary Targets

12. **Net International Reserves (NIR) of the central bank (program definition)**. For program purposes, the NIR of the central bank will be measured as gross international reserves that are readily available minus (i) short-term reserve liabilities (including purchases and credits from the Fund), as described in the international reserves table prepared by the central bank according to the MFSM); (ii) foreign assets that are counterpart of foreign currency deposits of financial institutions at the central bank and of any other liability of the central bank with residents that is payable in foreign currency; (iii) any conversion of short-term reserve liabilities; and (iv) the transfer to the central bank of foreign currency deposits held abroad by HONDUTEL, INJUPEMP, and IHSS, which amounted to US$73.4 million at end-June 2010. Readily available reserves also exclude those assets that are pledged or otherwise encumbered, including but not limited to reserve assets used as collateral or guarantee for a third-party external liability. NIR will be valued at program accounting exchange rates.

13. **Net domestic assets (NDA) of the central bank** will be measured as the difference between currency issue and NIR, both measured on the basis of end-of-period data.

14. **Adjustor**. Starting in 2011, the target floor on NIR will be adjusted downwards (the target ceiling on net domestic assets of the central bank will be adjusted upwards) by up to US$50 million by the shortfall of programmed external disbursements to the budget. In case of an excess during the program period, the target floor on NIR will be adjusted upwards (the target ceiling on domestic assets of the central bank will be adjusted downwards) by full such amount. The external disbursements contemplated in the program are to be received from the World Bank, IADB, and Taiwan, province of China, totaling US$270 million.

IV. External Targets

15. **External debt**. For program purposes, the definition of debt is the one set forth in point No. 9 of the Guidelines on Performance Criteria with Respect to External Debt (Executive Board's Decision No. 6230-(79/140), as amended by Decision No 14416-(09/91, effective December 1, 2009). This definition applies also to commitments contracted or guaranteed for which value has not been received, and to private debt for which official guarantees have been extended and which, therefore, constitute a contingent liability of the public sector. Excluded from this definition are normal import-related credits, defined as liabilities that arise from the direct extension, during the normal course of trading, of credit from a supplier to a purchaser—that is, when payment of goods and services is made at a time that differs from the time when ownership of the underlying goods or services changes. Normal import credit arrangements covered by this exclusion are self-liquidating; they contain pre-specified limits on the amounts involved and the times at which payments must be made; they do not involve the issuance of securities. For the purpose of the program, external debt is defined on the basis of residency.

16. **Debt definition**. The definition of debt set forth in No. 9 of the Guidelines on Performance Criteria with Respect to External Debt in Fund Arrangements reads as follows:

(a) For the purpose of this guideline, the term "debt" 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 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 a number of forms, the primary ones being as follows: (i) 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); (ii) suppliers' credits, i.e., contracts where the supplier permits the obligor to defer payments until sometime after the date on which the goods are delivered or services are provided; and (iii) leases, i.e., arrangements under which property is provided which the lessee has the right to use for one or more specified period(s) of time that are usually shorter than the total expected service life of the property, while the lesser retains the title to the property. For the purpose of the guideline, the debt is the present value (at the inception of the lease) of all lease payments expected to be made during the period of the agreement excluding those payments that cover the operation, repair, or maintenance of the property. (b) Under the definition of debt set out in point 9(a) above, arrears, penalties, and judicially awarded damages arising from the failure to make payment under a contractual obligation that constitutes debt give rise to new 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.

17. **Definition of public debt**. For the purpose of the program, public sector debt is defined as the debt of the combined public sector excluding the debt of local governments.

18. For purpose of the program, the guarantee of a debt arises from any explicit legal obligation of the central government or any other agency acting on behalf of the central government to service such a debt in the event of nonpayment by the recipient (involving payments in cash or in kind), or from any implicit legal or contractual obligation to finance partially or in full any shortfall incurred by the debtor.

19. **Concessionality** will be calculated using currency-specific discount rates based on the OECD commercial interest reference rates (CIRRs) and taking into account all details of the loan agreement, including maturity, grace period, payment schedule, upfront commission, and management fees. The ten-year average of CIRRs will be used as the discount rate to assess the concessionality of loans of an original maturity of at least 15 years, and a six-month average of CIRRs will be used to assess the concessionality of loans with original maturities of less than 15 years. To both the ten-year and six-month averages, the following margins will be added: 0.75 percent for repayment periods of less than 15 years; 1 percent for 15–19 years; 1.15 percent for 20–30 years; and 1.25 percent for over 30 years. The grant element of loans can be calculated using the concessionality calculator available at the IMF web site http://www.imf.org.[1] For program purposes, a debt is **concessional** if it includes a grant element of at least 35 percent, calculated as follows: the grant element of a debt is the difference between the present value (PV) of debt and its nominal value, expressed as a percentage of the nominal value of the debt. The PV of debt at the time of its contracting is calculated by discounting the future stream of payments of debt service due on this debt. The discount rates used for this purpose are the CIRRs published by the OECD.

[1] Currently available at http://www.imf.org/external/np/pdr/conc/calculator/default.aspx

20. **Borrowing on nonconcessional terms**. For the purposes of the program, this continuous ceiling applies to the contracting or guaranteeing of nonconcessional external debt by the CPS or any other agencies on its behalf.[2] Debt denominated in currencies other than the U.S. dollar shall be converted to the U.S. dollars using program assumptions on bilateral exchange rates. The continuous ceiling applies not only to debt as defined above, but also to commitments contracted or guaranteed for which value has not been received. This ceiling will be adjusted downwards by the amount of programmed disbursements that change into concessional resources.

21. **Excluded** from the non-concessional external debt continuous ceiling are: (i) debts classified as international reserve liabilities of the Central Bank, (ii) debts to restructure, refinance, or prepay existing debts, (iii) use of Fund resources (iv) short-term import financing (with a maturity of less than one year), and (v) central bank instruments placed in the domestic market held by nonresidents.

22. **Stock of external debt arrears**. For the purpose of the program continuous ceiling, external debt service arrears are defined as overdue debt service arising in respect of obligations incurred directly or guaranteed by the public sector, except on debt subject to rescheduling or restructuring, as indicated by the respective creditors. The CPS will accumulate no external debt arrears during the program period.

V. Energy Sector

23. **Arrears of ENEE** are defined as overdue payments (capital and interest) of ENEE to private and public entities. During the program period, no new arrears to the private sector will be accumulated, excluding technical delays stemming from the payment process. Technical delays are defined as the maximum period allowed for the payment of suppliers' and/or contractors' invoices to ENEE without incurring arrears, in line with the law on public contracts (Decree 74-2001). This period extends up to 45 days, starting from the submission of appropriate documents for payment.

VI. Monitoring and Reporting Requirements

24. **The information required to monitor the compliance with quantitative and structural benchmarks** specified in the MEFP will be supplied to the Fund at least monthly (electronically, to the extent possible) and within 45 days of the end of the previous month (unless otherwise noted) according to the following sources:

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[2] This includes short-term external debt (with an original maturity of up to and including one year) and non-concessional medium- and long-term debt with original maturities of more than one year.

25. **The ceilings on the deficit of the central government and of the CPS** will be monitored below-the-line on the basis of the monthly reports *Financiamiento de la Administración Central* and *Financiamiento del Sector Público Combinado*, respectively, prepared by the central bank, which contain:

- **Net external financing** of the central government and the NFPS, respectively, with detailed information on disbursements, amortizations, exceptional financing, zero coupon bonds, and accumulation of arrears. This information will be prepared by the central bank and reconciled with the Ministry of Finance.

- **Net domestic financing** of the central government and the NFPS, respectively, with detailed information on: (1) net domestic financing from the central bank and the rest of the financial system to the central government and the NFPS, as contained in the *Panorama Financiero* monthly report; (2) net placement of bonds (including stabilization bonds) by the central government and the NFPS outside the financial system, as reported by the central bank with data from the Public Credit Directorate of the Ministry of Finance; (3) change in foreign currency deposits held abroad by the central government and the NFPS; and (4) change in the outstanding stock of suppliers' credit and floating debt of the central government, as reported by the Treasury, and the rest of the NFPS as reported by the central bank. To monitor the net domestic financing to the CPS, the central bank will provide the Fund with detailed data on a cash basis on the operating revenue and expenditure of the central bank.

26. **The ceilings on the wage bill of the central government** will be monitored monthly on the basis of the Ministry of Finance report: *Información institucional por objeto de gasto - servicios personales y aportes patronales.*

27. To complement the monitoring of fiscal performance, a breakdown of tax revenue by type of tax will also be provided monthly.

28. **Social investment (Table B)** will be monitored quarterly on the basis of financial reports provided by the Ministry of Finance.

29. **The floor on NIR and the ceiling on NDA of the central bank** will be monitored on the basis of information produced by the central bank, in accordance with the new presentation of the MFSM. This information will be provided within two weeks of the end of the previous month.

30. **The ceilings on the contracting of nonconcessional external debt and on the nonaccumulation of external payments arrears** will be monitored with information provided by the Ministry of Finance. The accounting of non-reschedulable external debt-service arrears by creditor (if any), with detailed explanations, will be transmitted by the Ministry of Finance on a monthly basis within four weeks of the end of each month.

Moreover, a loan-by loan accounting of all new loans contracted or guaranteed by the public sector, including detailed information on the amounts, currencies, and terms and conditions, as well as relevant supporting materials, will be transmitted by the central bank on a quarterly basis within four weeks of the end of each quarter.

31. **Implementation of structural measures in the program** will be monitored monthly based on information provided by the central bank, the Ministry of Finance, and the Banking and Securities Commission.

Table A: Data to be Reported to the IMF

Item	Periodicity
I. Fiscal Data	
Net external financing (detailed information on disbursements, amortizations, exceptional financing, zero coupon bond, and accumulation of arrears).	Monthly, within 45 days of the end of each month.
Net domestic financing of the central government and the NFPS detailed information on: (1) net domestic financing from the central bank and the rest of the financial system to the central government and the NFPS, (2) net placement of bonds by the central government and the NFPS outside the financial system, (3) change in foreign currency deposits held abroad by the central government and the NFPS; and (4) change in the outstanding stock of suppliers' credit and floating debt of the central government, as reported by the Treasury, and the rest of the NFPS as reported by the central bank.	Monthly, within 45 days of the end of each month.
Monitoring of net domestic financing to the CPS will require that the central bank provide the Fund with detailed data on a cash basis on the operating revenue and expenditure of the central bank.	Monthly, within 45 days of the end of each month.
Wage bill of the central government.	Monthly, within 45 days of the end of each month.
Breakdown of tax revenue by type of tax.	Monthly, within 45 days of the end of each month.
Social investment.	Quarterly, within three weeks of the end of each quarter.
Detailed information on: Revenues and expenditures of the central government. Revenues and expenditures of the NFPS, including the operating balance of public enterprises.	 Monthly, within 45 days of the end of each month. Quarterly, within 45 days of the end of each quarter.

II. Monetary Data	
Detailed information on the Central Bank balance sheet, including Net International Reserves and Net Domestic Assets.	Monthly, within 2 weeks of the end of each month.
Detailed information on domestic liabilities of the central bank payable in foreign currency, including change in foreign currency deposits of public enterprises in the central bank.	Monthly, within 2 weeks of the end of each month.
III. External Debt	
Loan-by loan accounting of all new loans contracted or guaranteed by the public sector, including detailed information on the amounts, currencies, and terms and conditions, as well as relevant supporting materials.	Quarterly basis within four weeks of the end of each quarter.
The accounting of arrears on external debt-service by creditor (if any), with detailed explanations.	Monthly, within four weeks of the end of each month.
IV. Additional Data	
Balance of Payments statistics.	Quarterly, within 3 months of the end of each quarter.

Table B. Social Investment Expenditure

Description
Bono Diez Mil
Bono Diez Mil
Other social investment expenditures
Honduran Social Investment Fund (FHIS)
Community Education Program (PROHECO)
Family allowances program (PRAF)
Healthy schools program (Free school meals)
Free tuition
Social work scholarships
Transportation education bond
Social aid to persons
Patronatos Aldeas y Caseríos
Academic excellence scholarships
Various scholarships
Other scholarships and programs