
SUMMARY OF FINANCIAL MARKETS IN HONDURAS: SECONDARY SOURCE SURVEY

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NOTE

This document was prepared by Arthur Young and summarizes existing literature describing the country. Secondary sources were obtained from the International Monetary Fund, the World Bank, the Inter-American Development Bank, the African Development Bank, the Asian Development Bank, the United Nations, and other relevant commercial sources.

HONDURAS

SUMMARY OF FINANCIAL MARKETS SURVEY

A. ENVIRONMENT

1. Stable political climate

Honduras had a military government up until 1982. The first democratically elected President was Roberto Scazo Cordova of the liberal party. In November of 1985, Dr. Jose Azconca Hoyo of the Liberal Party won the National Election. The two administrations have advocated less government intervention both socially and economically.

Due to the strategic location of Honduras, the U.S. current policy has been to promote: i) strong support of Honduras' recent turn to civilian rule to display it as a working democratic government and ii) an increase in military assistance to aid Honduras in countering the expanding leftist Sandinista military force of Nicaragua and to protect against guerilla warfare from neighboring countries such as El Salvador.

2. Unstable economic climate

Honduras, the poorest country in Central America, has serious economic and social problems. The strength of the economy depends on the export market for its raw and processed agricultural commodities of coffee, bananas and, to a lesser extent, lumber. This agrarian market is vulnerable to natural disasters such as the recent drought affecting coffee growers. The economy has slowed down in the 1980's due to soft world markets for Honduran exports, high import costs, shortage of credit and high interest rates.

Honduras' strategy for economic development, based on the import substitution growth model of the Central American Common Market, has not succeeded. The Honduran Central Bank foreign reserves are negative, and the national deficit has risen to 11% of the GDP. It has exhausted its external lines of credit.

The IMF has been assisting the Honduran government with its economic problems. It has worked with Honduras to improve its tax system, develop incentives for increasing exports, and review the proposed incentive and tariff legislation. The IMF has proposed a U.S. \$30 million fund for a Trade Credit Insurance Program to

provide lines of credit for Honduran importers. The World Bank and the IDB have joined IMF to form the Joint Economic Working Group to help Honduras develop a stabilization program for its economy. The group is currently evaluating different combinations of fiscal measures, non-bank deficit financing and flexible foreign exchange regulations.

3. Stable social climate

There are two economic classes typical of those found in other Latin American countries; the minority wealthy upper class which controls local and national politics and the majority of population composed of rural, small farmers. Extremes of wealth and poverty are not as definite as in other Latin American countries, however, due to lack of indigenous mineral wealth in Honduras, and a homogeneous Hispanic heritage.

Hondurans are mostly mestizo - a blend of Spanish, Indian, and black stock. The national language is Spanish and the majority of the population is Catholic.

4. Multilateral donors

- IMF
- IFC
- IDA
- World Bank
- Inter-American Development Bank (IDB)

5. Major bilateral donors

- United States
- Japan
- European Economic Community

6. IMF Stand-by Agreement - None

B. ECONOMY

1. a) GDP growth rate

The economic growth rate of the Honduran economy depends on the ability to develop a strong export market. In 1984, there was a solid, but minimal rise in GDP of 2.8 percent due to a rise in demand of exports and an increase in fixed capital accumulation. Although inevitable inflation and lower coffee output (due to the drought) could mitigate export earnings, GDP should still grow by 3-5 percent due to a compensatory boost from other exports.

b) Honduras' per capita GDP was under \$600 for 1984 due to a high population growth rate of over 3.6%.

c) Inflation rate: inflation measured in terms of CPI advanced at an average rate of 9.2% from 1981 through 1983. The inflation rate then slowed to 4.8% for 1984 as a result of a fixed exchange rate. Authorities, consequently, are reluctant to devalue the lempira.

2. Balance of Payments

In 1984, export growth was strong, reaching \$850 million, an increase of 9.9 percent over 1983. This growth occurred despite a large trade deficit with the Central American Common Market (CACM) countries due to the collapse of other currencies outside Honduras. In addition to these trade imbalances, the GOH's growing external debt adds to the balance of payment deficit. In 1982 approximately two-thirds of the current account deficit consisted of interest charges on external debt. This interest debt has risen exponentially over the past few years.

3. There was a strong government investment program in the late 1970's and early 1980's favorable for growth of Honduras' infrastructure in terms of power and transportation projects. Public advocates investment to a lesser extent new democratic government.

Private investment is expected to increase as a result of incentives available under the Caribbean Basin Initiative (CBI).

4. GDP components for 1984

<u>Sector</u>	<u>% of Total</u>
Agriculture	30.9
Mining	2.2
Manufacturing	15.0
Construction	4.2
Electricity, water and gas	2.0
Transport	6.8
Commerce	12.0
Banking, finance and insurance	11.3
Government	5.0
Other	10.6

5. Labor force analysis

Total population: over 4 million
 Total labor force: over 1,210,510
 Literacy rate: over 47%
 Population growth rate: over 3.6%

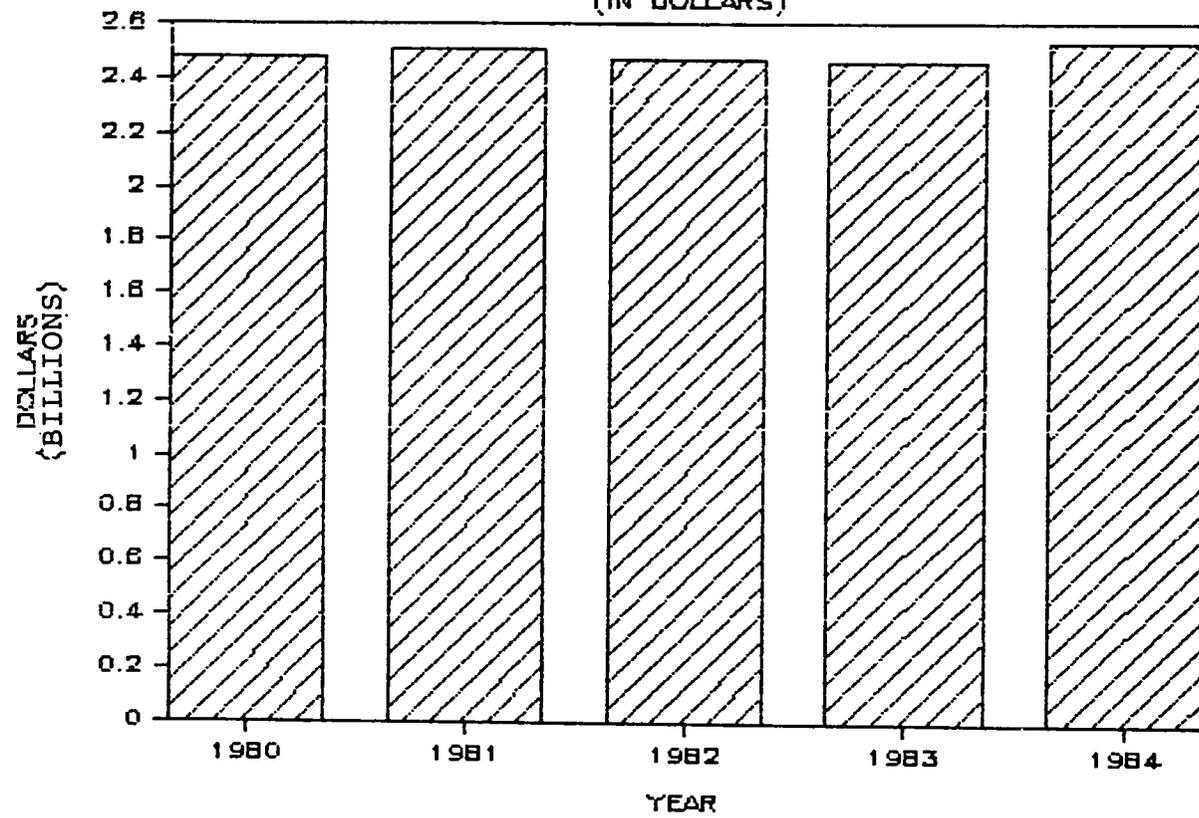
	<u>% of labor force</u>
Agriculture	57.7
Mining	0.3
Manufacturing	13.1
Construction	3.4
Utilities	0.4
Transportation and communications	3.0
Commerce	8.5
Finance	0.9
Other services	12.7

6. Non-Financial Parastatals

National Development Bank Food Marketing Agency (BANASUPRO)
 Honduran Banana Corporation (CONBANA)
 National Forestry Corporation (COHDEFOR)
 Olancho Industrial Forestry Corporation (CORFINO)
 Municipal Water Division of San Pedro Sula (DIMA)
 National Electric Power Company (ENEE)
 National Port Authority (ENP)
 Agua Fria Industrial Forestry Corporation (FIAFSA)
 National Railway Company (FNP)
 Honduran Telecommunications Corporation (HONDUTEL)
 National Agrarian Institute (INA)
 Western Rural Development Project (PRODERO)
 National Water and Sewerage Service (SANAA)
 National University (UNAH)

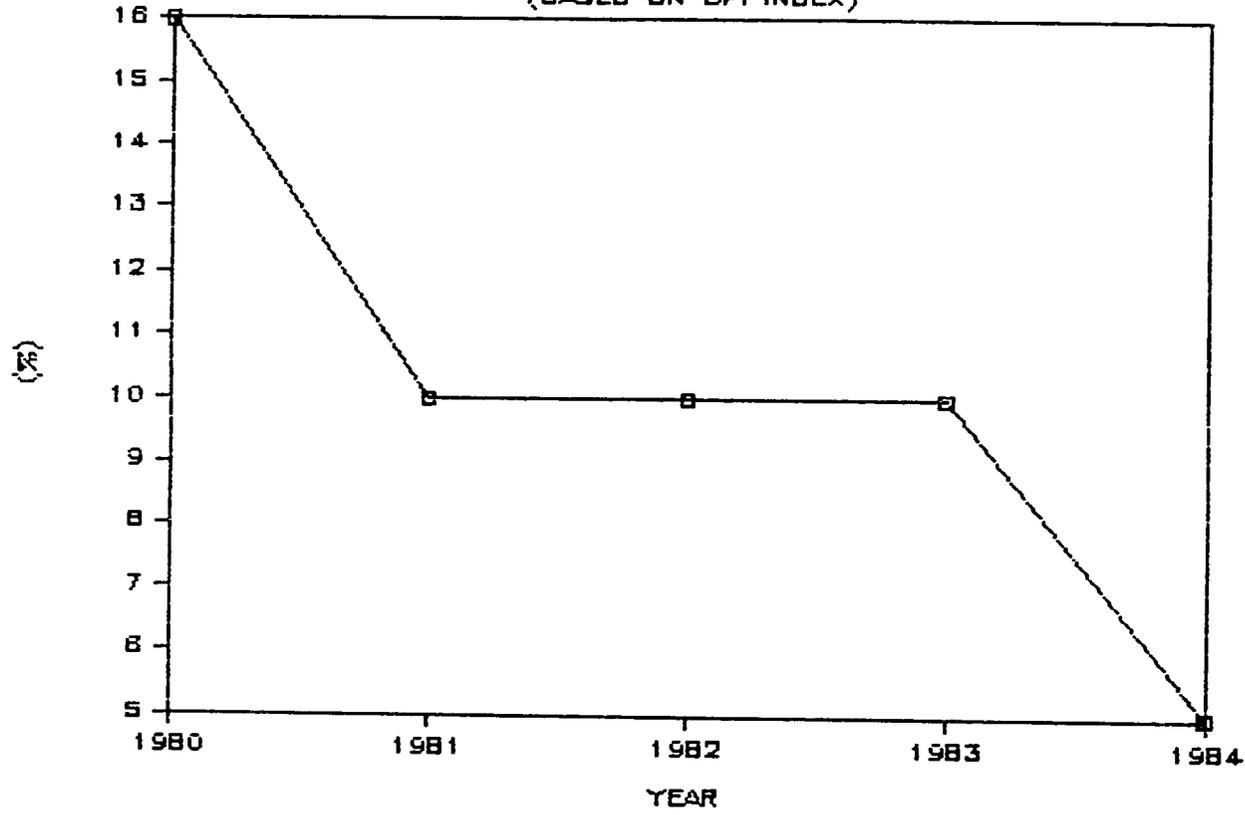
GROSS DOMESTIC PRODUCT

(IN DOLLARS)



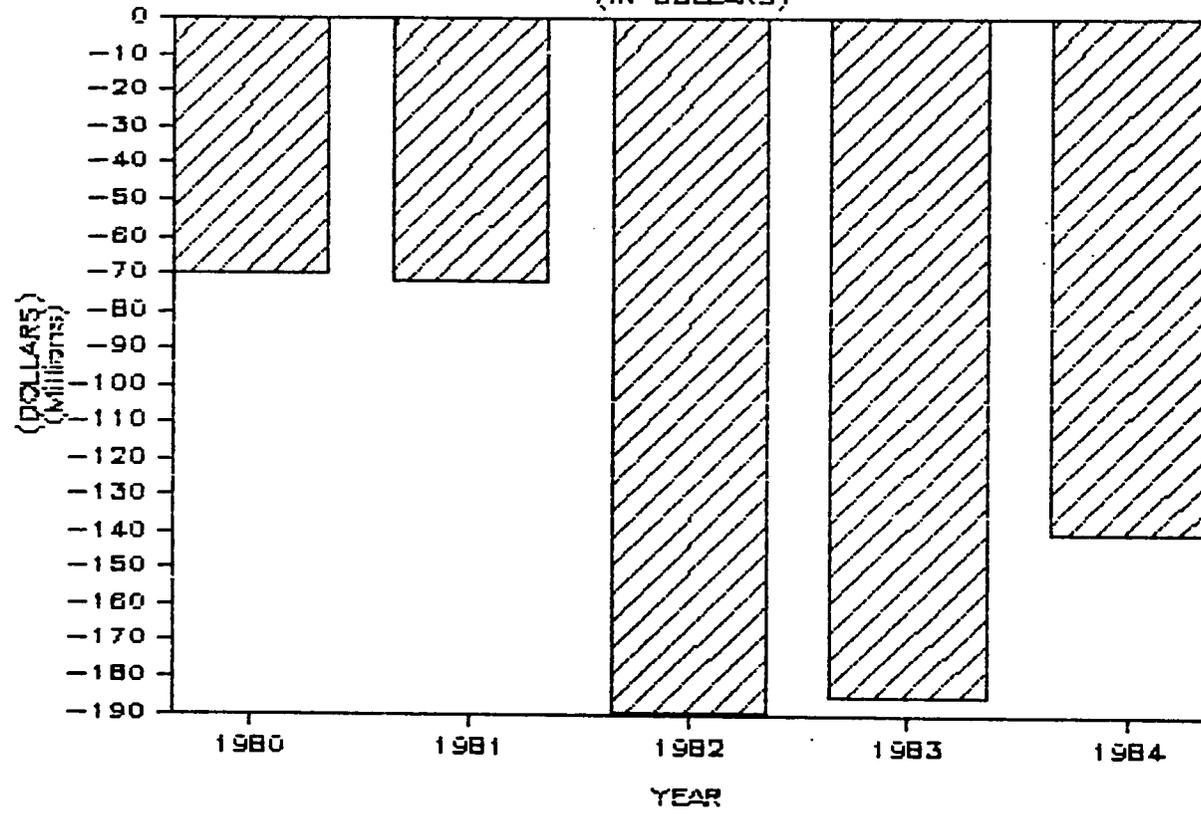
HONDURAS' INFLATION RATE

(BASED ON CPI INDEX)



OVERALL DEFICIT/SURPLUS

(IN DOLLARS)



C. GOVERNMENT ATTITUDES

1. Preferential treatment for parastatals

The military government before 1982 promoted heavy government investment in power, transportation and agricultural projects. This government relied on increased revenue from the growing economy to pay the future debt charge. These goals were not met and the GOH experienced an unprecedented level of external borrowing. The newly elected liberal party in 1982 acquired a huge economic crisis - a public debt of \$US 1.5 billion in 1983. The policies of the new state advocated lessening of the government's role in the economy. The GOH would only control large infrastructure projects and depend more on foreign investment for advancement of other sectors of the economy.

2. Funds for private investment

The gross savings rate has risen from 13% to 25% during 1980-1985. However, short-term funds are only available to those with substantial assets and banking contacts. Medium and long-term debt is even scarcer, available only from two banks at 19% interest and 120% colateralization.

3. Foreign investment

The Liberal Party in power welcomes foreign investment to support their ailing economy. During the economically troubled period in the early 1980's, the U.S. provided 80% of total foreign capital (US\$230 million). Only Japan provided capital nearing this amount (US \$18 million). Four of the five largest corporations in Honduras, including the large banana enterprises are U.S.-owned (Bananas - 52% of investment from U.S.; Mining - 23% of investment from U.S.).

4. Privatization

- a) The National Investment Corporation (CONADI) has been ordered to divest its assets to the private sector.
- b) FINAVI, the National Mortgage parastatal, has been dissolved.

D. REGULATORY CLIMATE

1. Labor movement

Labor unions are well organized. They are considered one of the strongest movements in the region. The labor movement consists of 200 unions with 20% participation of the labor force.

2. Labor laws

There was no official increase in minimum wage in 1984. Basic tenet holds that rates of pay are subject to an employer-employee agreement and cannot be less than minimum wage stated by law.

The average wage for an agricultural worker is between \$4.60/day and \$5/day.

In 1983 the GOH instigated positive measures for the worker through a provision guaranteeing "seventh day pay for six days worked", and "13th month pay for 12 months worked." This is tantamount to a salary increase of 16.7 percent and 8.3 percent respectively. Also, these sectors negotiated an average wage increase of 18 percent to 42 percent over several years.

3. Foreign investors operate under the same laws, protectionism, and incentives as domestic investors.

There are tough ownership restrictions for the following activities:

- Lumber industry
- Fisheries
- Broadcasting
- Transportation

E. FINANCIAL SYSTEM

1. Central Bank of Honduras

The Central Bank functions in a traditional manner. Its activities include developing monetary policy, currency issuance, banking supervision and economic planning. The Bank controls 20% of the country's financial assets.

- a) The Office at the Bank Superintendency is specifically responsible for banking supervision including auditing of financial statements.
- b) The National Industrial Development Fund (FONDEI), established within the Central Bank, manages the funds supplied by the World Bank and other donors for industry and tourism. Thus far US \$50 million have been disbursed as loans.

2. Development banks

There are two working development banks and one which has ceased functioning. All are parapublic. In 1984, they controlled 10% of the country's assets. The banks have been hampered by problems of mismanagement, political favoritism in loan decisions and excessive government intervention.

- a) CONAVI
The National Finance Corporation has been ordered to divest its holdings.
- b) BANADESA
The National Development Bank for Agriculture is facing serious financial difficulties.
- c) BNF
The National Development Bank is much smaller than the other two.

3. Commercial banks

- a) Their role in the financial system
There are fifteen commercial banks and three foreign branches in Honduras (see Appendix). They hold 70% of the country's financial assets. Three banks (Bankco Atlantida, BANCAHSA and Banco del Ahorro Hondureno) control 45% of the commercial banking total assets and 50% of the private sector's mobilized savings.
- b) Banking activities
The commercial banks major source of business is making short-term loans (> 1 year) for commercial,

industrial and agri-business activities. The loans carry the maximum interest rate (19%) and require a collateral equalling 100 to 160% of the loan value. The banks also deal in trade bills or discounts (similar to B.A.) carrying 19% interest with terms up to 18 months for durable consumer goods and automobiles. The banks will offer promissory notes collateralized with liens on inventories to their stable industrial clients with terms of up to 24 months.

Only two banks offer long-term loans for projects: Bancomer & BANHCASA. In order to raise long-term funds the banks sell mortgage bonds with term of 5, 10 and 15 years respectively. Although the interest in these bonds is low (6%) the banks have attracted some savers by setting up a system. Every month a few mortgage bondholders are selected receiving the total principal and interest of their bonds. Banks are restricted from offering new services and engaging in new activities because of antiquated laws.

4. Finance Companies

The seven Honduran finance companies engage mostly in mortgage lending. Mortgages are usually medium term (5 years) at 19% interest. Low cost housing has been funded by INVA (using USAID funds), by pension funds (for members only) and by private sector firms (for employees).

5. Leasing Companies

Banco Alantida owns the major leasing company in Honduras. There are two other companies but they are very small. Leasing companies finance computers, autos, office equipment and other items.

6. Pension Funds

The civil service pension funds (INJUPEP) and the teachers' association pension fund are the largest funds in the country. The funds provide consumer financing and mortgages for members. They are also used for purchasing government bonds.

Insurance Companies

There are seven insurance companies in Honduras, five domestic and two American. Six of the companies offer life insurance although it is estimated that less than one percent of the public is covered. As of 1983, the industry had 28% of its funds in government bonds, 7% in

term deposits, 54% as direct loans, and the rest in fixed assets and "other investments." Overall, the insurance companies role in the financial market is small. Their total value, as a percent of GNP, was 4% for 1983.

7. Securities Markets

There is no official securities exchange so that no data is available on the volume of securities trading hands. The country does have several "informal" securities traders. They are not regulated.

Available funds for investment (ratios):

- a) 1984 Gross Domestic Savings/GDP = 24%
- b) 1984 Private Sector Credit/Total Domestic Credit = 72.9%
- c) 1982 GDP/Capita = US \$800

APPENDIX

Commercial Banks in Honduras

Bancahsa
Banco Atlantida
Banco Continental
Banco del Comercio
Banco Hondureno del Cafe
Banco Capitalizadora Hondurena
Banco de Honduras
Banco de las Fuerzas Armadas
Banco de los Trabajadores
Banco el Ahorro Hondureno
Banco de Occidente
Banco Municipal Autonoma
Banco Sogerin
Asociaciones des Ahorro y Prestamo
Banco de America

Foreign Branches

Banco del Cafe
Bank of London & Montreal
Chase Manhattan Bank