10-3-1996

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LADB Staff

LADB Article Id: 55507
ISSN: 1089-1560

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by LADB Staff
Category/Department: Honduras
Published: 1996-10-03

Two years ago, the exchange rate for the Honduran lempira was less than L8.60 per US$1.00, but by year-end 1996 it may reach L14.00 per US$1.00, representing a 63% devaluation of domestic currency since 1994. This rapid devaluation has brought increasing criticism of Central Bank policy, and it will likely become a key campaign issue during the 1997 elections. Earlier this year, the conservative opposition Partido Nacional issued a strongly worded attack on President Carlos Roberto Reina's economic policies during a press conference attended by the party's presidential candidate, Oswaldo Ramos Soto. The statement said that Reina had shown "extraordinary slowness" in making proposals to improve the economy and laid the blame squarely on the administration for the interconnected problems of devaluation, high inflation, high interest rates, and crippling payments on the foreign debt (see NotiSur, 02/22/96 and 03/21/96).

Reina, the economic cabinet, and the Central Bank (Banco Central de Honduras, BCH), have all come under attack from the private sector, impatient with the sluggishness of the economy. Essentially, business leaders see the source of the problem as insufficient production. Critics say that, instead of solving the production problem, the government spends scarce foreign exchange to import basic foodstuffs while simultaneously defending the currency by selling dollars (see EcoCentral, 09/05/96). Adolfo Facusse, president of the industrial association (Asociacion Nacional de Industriales, ANDI), complained recently that after six years of economic restructuring, the economy is still not sound, the country is "mortgaged" to international financial institutions, and Reina's policies "restrain production." Inflation, which was supposed to be held to 12% in 1996, passed that mark by mid-year and is expected to reach 20% by the end of the year.

Guillermo Bueso, coordinator of the economic cabinet, estimates that as much as 70% of the accumulated inflation was caused by devaluation, which raised the price of imported consumer goods and industrial inputs. Foreign-debt servicing represents major pressure on the currency. The budgeted amount for payments on the debt this year is US$633 million at the old exchange rate of L10.28 per US$1.00. At L12.00 or L14.00 per US$1.00, the annual payments threaten to hold the economy hostage to the cycle of devaluation, inflation, slow growth, and low production. According to Central Bank figures, the lempira dropped in value against the dollar by 18% during the first seven months of the year. In all of 1995, devaluation was only 9.5%. Government efforts to reduce the fiscal deficit and slow inflation have, to some extent, been successful (see NotiSur, 05/02/96).

However, these measures have also slowed growth, particularly in the export sector. Economists warn that, without higher growth levels and a reduction of the US$400 million trade deficit, devaluation will not be curbed. Nevertheless, the rate of devaluation began to decline somewhat in mid-July, and the Central Bank later predicted that the slippage of the lempira against the dollar will be held to no more than five centavos per week for the remainder of the year. At that rate, the year will end with a L14.00 per US$1.00 exchange, which would represent a 22% devaluation for 1996.

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The Central Bank has been selling dollars at an alarming rate to counteract downward pressures on the lempira. In just four weeks in June and July, the bank sold US$75 million, whereas only US $25 million were sold in the previous four weeks. The bank has attempted to set the base price of the dollar at a realistic level, taking into account the difference between the inflation rates of the lempira and the currency of the country's principal trading partners. In this way, the BCH hoped to reassure the private sector that devaluation will be regular and predictable. However, the trade gap, widened by the recent purchase of imported food commodities, continues to undermine the currency. Rolando Cardenas Paz, president of the National Assembly's Money and Banking Committee, urged the Central Bank to drop its policy of supporting the lempira with dollar auctions. He urged the administration to invest instead in policies to stimulate production and exports. He recommended a ban on the import of luxury goods and, if necessary, a moratorium on all imports until the trade gap is bridged.

While the private sector blames the government for devaluation, Central Bank officials blame public employees, who received salary increases this year totalling over US$12 million. The bank reasons that the consequent rise in demand for goods, including imports, helped push up the demand for foreign currency. Central Bank president Hugo Noe Pino also blamed speculation among bankers who believe that the International Monetary Fund (IMF) is about to suspend the release of loans in an attempt to force the government into greater compliance with macroeconomic commitments. Though there is no evidence that the IMF plans any such action, the rumor helped push demand for the dollar upward as businesses dumped lempiras.

Defending administration policies, Bueso said that it was the business sector, not the Central Bank, that demanded periodic dollar auctions to support the currency. He said that critics of the government's economic policies were only looking for political advantage. The overall effect of the lempira's sharp decline is the gradual "dolarization" of the economy. This process can readily be seen in bank deposits. Central Bank policy permits Hondurans to hold savings in dollar accounts, and while the banks are required to maintain all dollar deposits in cash reserves, 50% of it must be kept in foreign banks.

This policy is defended as an effective tool to prevent capital flight and to encourage domestic savings by reassuring depositors that their dollars will not be frozen or converted to devalued lempiras. But these protections also make the dollar especially attractive as a hedge against inflation and devaluation. In June, deposits in dollars increased by a whopping US$24 million as Hondurans sought to shield their savings against devaluation. Between January 1992 and May 1996, the percentage of bank deposits held in foreign currency rose from 8.6% to 24.6%. In 1995, the amount of domestic savings kept in dollar accounts rose by 40% over the previous year.

During the same period, the amount of deposits in lempiras grew by only 17.3%. Worse, the latter figure is misleading because, when adjusted for inflation, there was actually negative growth in lempira deposits in 1995. [Sources: Prensa de Honduras, 05/27/96, 05/28/96, 07/02/96, 07/31/96; Tiempo (Honduras), 05/25/96, 06/11/96, 06/14/96, 07/02/96, 07/06/96, 07/08/96, 07/09/96, 07/12/96, 07/31/96, 08/06/96, 08/10/96, 08/13/96; Agence France-Presse, 02/01/96, 08/28/96]

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