

The contents of this document are preliminary and subject to change.

GRAY/23/4143

March 16, 2023

**Statement by Mr. N'Sonde and Mr. Ondo Bile on El Salvador
(Preliminary)
Executive Board Meeting
March 20, 2023**

We thank staff for the comprehensive reports and Mr. Guerra and Mr. Chicas Cienfuegos for their helpful Buff statement.

We positively note that real GDP growth expanded in 2022--albeit at a slower pace than in 2021--driven by tourism activity, remittances-fueled private consumption, and robust labor market. However, macroeconomic imbalances and adverse external conditions weigh on the outlook. High global commodity prices fuel inflationary pressures and weaken the external position while public debt is rising and the country faces loss of access to international capital markets. In addition, the risks are tilted to the downside and relate to U.S. economic developments, global financial conditions and climate-related events. Against this backdrop, we urge the authorities to adopt a growth-friendly fiscal consolidation stance and improve fiscal policy framework to enhance debt sustainability, boost access to health and education and strengthen factor productivity. The fiscal space created should help sustain efforts to enhance social safety nets and, along with improved prospects for vulnerable groups, and better security conditions.

We broadly share staff's assessment and policy recommendations and would like to emphasize the following points.

Fiscal policy should be used to improve macroeconomic stability while fostering social inclusion. Given the difficult context of depleting fiscal buffers, constrained access to international bond markets, and increasing short-term debt, we agree with the need to adopt a

bold but growth-enhancing fiscal adjustment to bring public debt back on a sustainable path. In this regard, we encourage the authorities to pursue a comprehensive medium-term fiscal framework to boost revenue and prioritize high-quality spending. In addition, it is critical to make progress on pending reforms, including addressing the pension system's structural weaknesses and restoring and upgrading the Fiscal Responsibility Law to improve transparency and credibility of the fiscal policy. We positively note the authorities' readiness to tap the potential of digitalization of some tax processes.

Strengthening financial stability should also rank high in the authorities' policy agenda. As a small open economy with a highly dollarized banking system, El Salvador faces financial vulnerability to external shocks. Therefore, developing a robust financial plan to safeguard financial stability is of the essence. We encourage the authorities to minimize public debt exposure to the financial system and increase reserve requirements. More broadly, we welcome the proposed measures detailed on para. 26 of the report, aimed to safeguarding the financial stability from system-wide risks. We also support stepping up current efforts to close the regulatory gaps, by ensuring effective prudential oversight, proportionality for smaller entities, and adequate compliance with the AML/CFT framework. *We note the slow progress in the implementation of the 2020 Safeguard Assessment, which is critical to enhance the central bank's governance and independence and would welcome staff's elaboration on the factors behind such lack of engagement.*

Improving financial inclusion while addressing the risks associated with Bitcoin is important to reduce social inequalities in a prudent manner. The Central Reserve Bank's *Transfer365* contribution to boosting electronic transactions is commendable for financial inclusion. The authorities' commitment to the Bitcoin program and their objectives to expand financial inclusion in the country should entail stronger regulatory and governance frameworks to ensure transparency and efficiency and mitigate reliability concerns. We note the authorities' reassurance on this front under the Rules of Procedure of the Bitcoin Law, and their indication that there remain significant potential benefits for Bitcoin in the country including in tourism. Nonetheless, we encourage the authorities to comprehend the risks stemming from this under-regulated and under-supervised sector which has not thus far contributed to promote financial inclusion and digital remittances. *Can staff elaborate on whether the experience from other countries' successful digital payment initiatives for financial inclusion, reported in the Selected Issues paper has been discussed with the authorities and what the latter's views are?*

Structural reforms to strengthen resilience and growth potential are critical to achieve meaningful development progress. Upgrading human capital, boosting infrastructure, and improving the business environment should enhance El Salvador's

productivity and improve its growth trajectory. The recent engagement of the National Strategy for Trade Facilitation 2023–2027 is commendable. We agree that one of the significant hinderances to achieving sustainable and inclusive growth is the prevalence of crime in the country and note the authorities’ introduction of the State of Emergency measures that have resulted in a sharp drop in homicide. Similar decisive actions are required to mitigate the impact of climate change and build resilience against natural disasters. The adoption of such measures is critical for El Salvador given its exposure to earthquakes, volcanic activity, hurricanes, tropical storms, floodings and land sliding, which affect about 89 percent of the country’s geography and 96 percent of its population. *Against this backdrop, we would inquire about the authorities’ possible interest in a UCT-quality arrangement to meet balance-of-payment needs and in the RSF to help address climate-related challenges. Staff’s comments are welcome.*

With these remarks, we wish the authorities of El Salvador success in their endeavors.