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IMF Executive Board Approves Precautionary Stand-By Arrangement for El Salvador of About $800 Million

The Executive Board of the International Monetary Fund today approved a 14½ month SDR 513.9 million (about US$800 million) precautionary Stand-By Arrangement for El Salvador to support the country's economic strategy to cope with the adverse effects of the global financial crisis. The Salvadorian authorities do not intend to draw on the funds.

As El Salvador is not facing any immediate balance of payment needs, the authorities' program supported by the Fund is a precautionary measure that forms part of an overall strategy to strengthen the country's financial defenses. The program's main goal is to help provide adequate liquidity to the country's economy. Despite its solid macroeconomic fundamentals, the authorities are taking these preventive measures to stave off any adverse effects El Salvador could be facing in 2009 as a result of the global financial turmoil, the U.S. recession and uncertainties related to the Salvadorian electoral cycle.

As part of this strategy, El Salvador has also negotiated loans with the World Bank and the Inter-American Development Bank for a total of US$950 million. The Fund arrangement is designed to foster investor and depositor confidence by reducing uncertainty about macroeconomic policies in the run-up to the elections, and during the first few months of the new administration.

Following the Executive Board discussion on El Salvador, Mr. Murilo Portugal, Deputy Managing Director and Acting Chair, said:

"El Salvador's macroeconomic fundamentals are solid following years of prudent policies and structural reforms. However, the global financial turmoil and the recession in the United States entail risks to the outlook in 2009. The authorities' program, supported by the precautionary Stand-By Arrangement with the Fund, aims to reduce these risks by strengthening the financial system, maintaining a prudent fiscal stance, and increasing the economy's liquidity buffers.

"The authorities' fiscal program aims to safeguard medium-term sustainability, while raising public investment and sheltering the most vulnerable groups in society from the effects of the slowdown. These objectives will be supported by measures to increase government revenue and improve spending efficiency, including improvements in tax administration and lower electricity subsidies to create additional space for better-targeted social spending.

"The authorities have responded proactively to the global financial turmoil by taking action to enhance monitoring of bank liquidity and borrowing, maintain prudential requirements for bank reserves and liquid assets at current levels, and improve the functioning of the interbank market. They plan to seek congressional approval of a law to strengthen financial sector supervision and regulation.

"El Salvador's banking system is well positioned to withstand a significant temporary shortfall of liquidity in situations of stress. Access to substantial Fund resources will increase further the economy's liquidity buffer and bolster confidence in the financial system.

"The two main presidential candidates have publicly endorsed the main elements of the program, and reiterated their commitment to macroeconomic stability, official dollarization, and prudent fiscal policy. This endorsement will contribute to policy continuity and strengthen confidence during the political transition," Mr. Portugal said.

ANNEX

Recent Economic Developments

El Salvador's macroeconomic fundamentals are solid and have improved in recent years thanks to prudent policies, well-oriented structural reforms, and a favorable external environment. Fiscal consolidation led to a reduction in the public debt-to-GDP ratio, and in 2006–07, the country experienced the highest growth rates in a decade.

However, the global financial crisis has significantly affected the country's dollarized economy. Real GDP growth is projected to slow to 3.2 percent in 2008, compared to 4.7 percent in 2007, reflecting lower growth in remittances, a tightening of external financing conditions, and a decline in investments. Exports, however, have remained buoyant despite weaker external demand. The banking system remains liquid and well-capitalized, although nonperforming loans have increased and profitability is declining. While the country's linkages to global financial markets are strong, the impact of the financial turmoil has, so far, been moderate.

The U.S. recession is likely to continue having an adverse effect on El Salvador. The U.S. is El Salvador's main export market, and there are also strong financial sector linkages. Remittances from the U.S. amount to about 18 percent of GDP.

Program Summary

The authorities' economic program will focus on crisis preparedness, continued prudent fiscal policies, and financial sector reforms:

- **Financial contingency measures:** Including closely monitoring bank liquidity and short-term borrowing.

- **Short-term fiscal policy:** Maintain fiscal restraint by keeping the nonfinancial public sector deficit not exceeding 2.8 percent of GDP in 2009.

- **Structural reforms:** Further strengthening of financial sector regulation and supervision and enhancing the banking system's ability to weather shocks.

El Salvador joined the IMF on March 14, 1946, and its quota is SDR 171.3 million (about US$258.8 million). El Salvador has had no outstanding IMF credits since 1991.