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September 14, 2010

**Statement by Mr. Legg and Mr. B.Pereira on El Salvador
(Preliminary)
Executive Board Meeting 10/89
September 15, 2010**

We thank Staff for their well-focused report and Mr. Guzman and Mr. Gramajo-Marroquin for their informative statement.

The economy of El Salvador has been affected severely in 2009, as consumption, investment and exports were reduced, and its growth also declined. However, the pickup in external demand in 2010 fuelled a rebound in growth. The authorities are commended for the implementation of appropriate macroeconomic policies which, supported by a precautionary Stand-By-Arrangement (SBA), have mitigated the impact of the crisis and provided a platform for recovery. With all quantitative performance targets for end-June 2010 met and external stability maintained, we therefore support the completion of the first review under the SBA.

As we are in broad agreement with staff's recommendations and policy direction, we limit our comments to the **strategy for gradual fiscal consolidation** and **measures to strengthen the resilience of the financial sector**.

The **strategy for gradual fiscal consolidation** provides comfort in terms of the three-year SBA. Nevertheless, the projected fiscal stance for 2010 remains crucial. With the near-term fiscal strategy hinging on subsidy reform, continued expenditure restraint, and strengthened tax administration, we consider the gradual bringing forward of the increases in tax revenue critical to fiscal sustainability and to provide fiscal room to respond to future shocks. The economy remains vulnerable to such shocks, given its dependence on external financing and the sharp increase in public debt. In the event of a shock to growth, we see the scaling back of much needed public investment plans a last resort. The structural benchmark, requiring approval of a budget deficit for 2011 of 3.5% of GDP is critical to the success of the program. Technical assistances from the IMF and World Bank on public financial management (including the ROSC) and debt management should assist the authorities in accepting and implementing staff's recommendations, to ensure fiscal and debt sustainability. We also encourage the authorities to a timely rollover of the US\$650 million Eurobond to take advantage of the current market conditions and to minimize fiscal and financing risks.

The congressional approval of the financial supervision and regulation (FSR) bill will be one of the central **measures to strengthen the resilience of the financial sector** and remains critical to the success of the program. Like staff, we urge the authorities to a much needed progress on FSR and further implementation of the recommendations in the FSSA. The approval of the Investment Funds bill shortly after the FSR is a logical and natural progression to keep the financial sector reform momentum. We welcome the introduction of two new structural benchmarks - *the issuance of norms on corporate governance of commercial banks* to enhance banking supervision, and the *test bank resolution exercise* to upgrade the bank resolution framework. The effective implementation of these structural benchmarks will help establish a permanent domestic backstop to the financial system.

On another issue, the Staff's ex post evaluation report reiterates that El Salvador's request for a Fund-supported program has been appropriate and well-founded. The securing of broad support from both leading political candidates is a valuable feature in these precautionary programs as they will be crucial to the program's continuity and success. The commitment of adequate resources and frontloading of disbursements has provided adequate assurances for depositors' confidence and mitigated a financial sector crisis. The early engagement of the Board and well-targeted program conditionality are critical to the maintenance of fiscal prudence and to strengthen the financial sector. That said, program conditionality requirements should always be parsimonious and focused on those requirements crucial to the success of the program.

With these comments, we wish the authorities success in their program implementation.