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September 14, 2010

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

Economic outlook

We support the completion of this first review under the SBA and welcome the authorities' intention for the arrangement to remain precautionary. Performance under the SBA has generally been good, and the authorities' policies appear generally adequate to meet the program targets, support the recovery of the economy, and maintain external stability. Despite the electoral uncertainty and the economic slowdown in key trading partners, El Salvador's economy managed to hold up during the recent economic and financial crisis, and it is expected to grow slowly in 2010.

The authorities have been able to move their agenda forward, and the social and economic program is beginning to yield results. However, we urge them to make more efforts in bringing down poverty through structural reforms. We agree with staff that a protracted recession and/or unexpected difficulties in forging a political consensus for the government's fiscal strategy remain as key risks to the program.

Public finance

We agree with staff that strong political support to boost structural reforms and to impose strict control on government spending in 2010-2011 will be critical in managing risks for fiscal stability and growth sustainability. The delays in announcing subsidy reform are inadmissible, although the implementation is still planned by year-end. The authorities should also prevent further delays in enhancing coordination between the internal revenue service and customs. Faltering political support could endanger the authorities' fiscal strategy by delaying the approval of IFI loans or blocking a consensus-based fiscal pact. *Staff update on the progress made in these respects would be welcome.*

Financial sector

We encourage the authorities to further strengthen reforms in the financial sector and to enhance macro-financial stability and sustainability. Despite the recent recovery in bank profitability and the increase of bank deposits, the banking sector remains vulnerable and close monitoring of the sector should remain a high priority.

We concur with staff that the authorities should move expeditiously in particular in improving the systemic liquidity management and strengthening the lender-of-last resort capabilities of the central bank. Efforts to adopt an internationally accepted accounting framework for the financial statements of the central bank (e.g. IFRS) should be intensified. Publication of the audit opinions of the independent audit firm and a more systematic monitoring of audit recommendations to the central bank should also take place in a short period of time. We support some of recommendations of the FSAP to be set as structural benchmarks under the SBA.