International Monetary Fund

El Salvador and the IMF

Press Release:
Press Release: IMF Completes Third Review of El Salvador's Stand-By Arrangement
September 30, 2011

El Salvador: Letter of Intent

September 13, 2011

The following item is a Letter of Intent of the government of El Salvador, which describes the policies that El Salvador intends to implement in the context of its request for financial support from the IMF. The document, which is the property of El Salvador, is being made available on the IMF website by agreement with the member as a service to users of the IMF website.

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Letter of Intent

San Salvador, September 13, 2011

Ms. Christine Lagarde
Managing Director
International Monetary Fund
Washington, D.C., 20431

Dear Ms. Lagarde:

1. Performance under our three-year stand-by arrangement with the Fund approved in March 2010 continues to be satisfactory. All quantitative performance criteria for end-March and end-June 2011 have been met, and no consultation clause under the program has been activated as financial stability has been maintained. Also, since the completion of the second review in March 2011, all structural benchmarks on financial sector reform and the public finances have been met.

2. High world energy and food prices have widened the trade deficit and slowed the economic recovery, with the cost of imported fuel projected to rise by 1½ percent of GDP in 2011. While exports and tax revenues have rebounded strongly, the near-term outlook has weakened. Owing to the deterioration in external conditions, real GDP growth for 2011 is now projected at 2 percent, while annual inflation may rise to 7 percent. To mitigate the effect of the adverse price shock on the incomes of the population, the Government adopted in recent months temporary relief measures. In particular, it raised the subsidy to public transport operators, expanded the coverage of the electricity subsidy, and suspended an excise tax on fuel. The measures are estimated to cost 0.2 percent of GDP in 2011, and are scheduled to expire by the end of the year.

3. We remain committed to reducing the overall fiscal deficit to US$817 million (about 3½ percent of GDP) in 2011. This would allow us to stabilize the public debt-to-GDP ratio at 52 percent, after the large increase following the onset of the 2008 global crisis. We intend to sustain the good performance of tax revenues by further enhancing control of large taxpayers and improving coordination among tax agencies. Also, the newly-created vice-ministry of revenue will be in charge of strengthening tax administration. Strict expenditure restraint will support the efforts on the revenue side, while we continue work on building a medium-term expenditure framework to improve the management of public spending.

4. Later this year, we will seek congressional approval of a budget for 2012 consistent with an overall fiscal deficit of about 2½ percent of GDP, in line with the objectives of our program. We will continue to seek broad agreement on a "fiscal pact" to achieve our goal of increasing net tax revenue to 16 percent of GDP by 2015.

5. We will take further actions to bolster the resilience of the financial system to adverse shocks. Building on recommendations from recent Fund technical assistance, we have developed an action plan to set up a limited lender-of-last-resort facility and identified its possible sources of funding. Also, the central bank will issue pending norms on risk-based

supervision and strengthen bank resolution processes, including by improving coordination among financial safety net providers. As provided by the financial law approved in January 2011, the supervisory agencies have been fully integrated and their regulatory powers shifted to the central bank. To further develop the financial system, we will seek congressional approval by year-end of a bill that creates a framework for investment funds.

6. Our initiatives to boost economic growth are moving ahead. We have submitted to congress a proposal for the operation of a major port (*Puerto de la Unión*) by private operators and a framework for public-private partnerships, which together with El Salvador's participation in a Partnership for Growth with the United States, are expected to foster private investment, including in infrastructure projects. We anticipate prompt congressional approval of a scheme to encourage long-term lending by state financial institutions. The modalities of this scheme were discussed at the time of the previous review and will be implemented in line with the program, so as to minimize any fiscal risk. We expect that these initiatives will help raise domestic investment from the low levels seen in recent years.

7. In light of this performance and our commitment to the program, we request the completion of the third review under the Stand-By Arrangement. Our intention is to continue treating the arrangement as precautionary. The quarterly performance criteria, consultation clauses, and indicative targets under the program are set out in Table 1. New structural benchmarks have been added regarding the phasing out of temporary energy measures and congressional approval of both a fiscal budget for 2012 consistent with the program and the revenue effort described above (Table 2). Program implementation will continue to be monitored through semi-annual reviews.

8. We believe that the policies set forth in this letter, which supplement our letter and Memorandum of Economic and Financial Policies of March 1, 2010, our letter of September 1, 2010, and our letter of March 17, 2011, are adequate to meet the objectives of our economic program. We stand ready to take additional measures that may be needed for this purpose and will maintain the usual close and proactive policy dialogue with the Fund.

Sincerely yours,

_______________/s/_________________ _______________/s/_________________

Alexander Ernesto Segovia
Technical Secretary of the Presidency

Carlos Enrique Cáceres
Minister of Finance

_______________/s/_________________

Carlos Acevedo
President of the Central Reserve Bank of El Salvador

Table 1. El Salvador: Quantitative Performance Criteria

(In millions of U.S. dollars)

	2011								2012
	SBA 1/	Adjusted PC End-Mar.	Actual	SBA 1/	Adjusted PC End-Jun.	Actual	End-Sep.	End-Dec.	End-Dec. 2/
Performance criteria									
Overall balance of the nonfinancial public sector (cumulative floor) 3/	-320	-306	-263	-390	-373	-371	-575	-817	-617
Gross debt of the nonfinancial public sector (cumulative flow) 4/	310	964	870	365	1,019	916	545	701	627
External debt service arrears of the nonfinancial public sector 5/	0	0	0	0	0	0	0	0	0
Domestic payment arrears of the nonfinancial public sector 6/	0	0	0	0	0	0	0	0	0

Consultation clauses

If at any point during the arrangement the sum of private-sector bank deposits and external short-term bank liabilities falls below US$7,732.9 million (10 percent below the end-June 2011 level), the authorities will contact Fund staff to discuss possible remedial actions.

If at any point during the arrangement the authorities consider it necessary to modify the reserve requirements or liquid asset requirements, they will contact Fund staff to discuss such actions.

1/ IMF Country Report No. 11/90.
2/ Indicative targets.
3/ Adjusted upward for 50 percent of overperformance of tax revenue.
4/ Adjusted upward for any debt placed for prefinancing that would result in an equivalent increase in central bank deposits, until the pre-financed liabilities mature; and for any issue of government guarantees (up to US$40 million) on the debt of the newly-created state development fund.
5/ Continuous ceiling. Defined as unpaid debt service payments by the nonfinancial public sector to nonresidents beyond 30 days after the due date.
6/ Continuous ceiling. Defined as unpaid obligations overdue by more than 60 days.

Table 2. El Salvador: Structural Benchmarks 1/

	Test Date
Tax Policy and Administration	
Enhance coordination in the tax collection process across DGII and DGA	Dec. 31, 2011
Harmonize taxpayer registry between DGII and DGA for 500 large taxpayers	Dec. 31, 2011
Implement revenue measures yielding 1.5 percent of GDP.	June 30, 2012
Public Financial Management	
Publish a statement of approved budgets for NFPS institutions	Feb. 29, 2012
Congressional approval of budget for 2012 consistent with deficit of 2.5 percent of GDP	Dec. 31, 2011
Phase out temporary energy measures 2/	Dec. 31, 2011
Financial System Development and Supervision	
Issue specific norms on management of liquidity risk for financial institutions	Dec. 31, 2011
Congressional approval of investment funds law	Dec. 31, 2011

1/ Measures are described in TMU of March 2011 (IMF Country Report No. 11/90) unless otherwise noted.

2/ Consists of the following actions: (i) the subsidy to transport operators returns to levels prevailing before April 2011 by end-October 2011; (ii) electricity tariffs for consumers of more than 100 kWh per month reflect the price formula in effect before April 12, 2011 by October 13, 2011; and (iii) the excise tax on fuel is restored to the level of April 2011 by January 1, 2012.