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EL SALVADOR: CREDIT SUPPLY AND DEMAND

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PREFACE

This final report on Credit Supply and Demand in El Salvador is submitted in fulfillment of Contract # AID/SOD/PDC-C-0399, Work Order No. 12. The objective of this Contract was to provide the Government of El Salvador and USAID/El Salvador with a study of local currency credit supply and demand levels, an analysis of credit trends over recent years, and an estimation of expected credit shortfalls for Calendar Year 1983. The study was carried out by a team assembled by Checchi and Company and consisting of two senior credit specialists, Dr. Clarence Boonstra and Mr. Gustavo Gomez. The team members spent six weeks in El Salvador conducting research and preparing a draft version of the report, which was submitted to USAID prior to their departure. This final report incorporates comments on the draft.

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EXECUTIVE SUMMARY

This study examines the changing sources, volume, uses and character of credit supply and demand in El Salvador during the past eight years.

Before 1980, the banking and credit system of El Salvador was a conventional supplier largely of production credit to the private sector. In March, 1980, most credit institutions were nationalized and several additional public sector institutions became involved in dispensing credit. To meet increased demands for public sector financing, the Central Reserve Bank (BCR) increased greatly its loans and discounts to autonomous public agencies and to the central government.

There was relatively little expansion of private sector credit after 1980. The economy was in decline owing to internal hazards and uncertainties, weakening markets, and limited availabilities of foreign exchange for import of production inputs. After 1979-80, when central bank credit to the banking system was provided to offset a run on deposits, credit demand in real terms appears to have declined; in response, the supply increased only to keep pace with price increases and the rising levels of refinancing.

Nationalized commercial banks supply roughly two-thirds of the credit used by the private sector in El Salvador. Data in this study indicate that, since 1980, the credit supply has been sufficient to meet demands, within the limits of client credit-worthiness and the availability of foreign exchange. Additionally, the supply permitted a liberal policy toward rollovers and refinancing. At year-end 1982, approximately 34 percent of outstanding bank credit was listed as refinancing, compared to 14 percent in 1978.

The commercial banks lend mostly from their own resources, making only moderate use of central bank loans and discounts for highly seasonal agricultural loans. Most of the credit expansion and contraction activity is accounted for by lending to the private sector on the part of the autonomous public agencies. These agencies are heavy users of central bank credit to support their seasonal agricultural lending operations.

For this report, surveys were made of bank lending programs and of projected industrial credit demand for 1983. The survey findings indicate that supply and demand for private sector production credit are likely to remain in about the same balance this year as during 1982. Furthermore, if private sector demand increases, resources within the credit system appear adequate to finance some economic growth.

At present, the most immediate credit problems are related to the continued financing of large government deficits, the limited availabilities of foreign exchange for production inputs, the inadequacies of medium- and long-term credit facilities, the rising portfolios of overdue and refinanced loans, and the declining credit-worthiness of clients within a disrupted and declining economy. These credit problems urgently need attention. Some can be addressed now, while others require clarification of how the banking and credit system is to be restructured on a permanent basis. The system and its capacity differ considerably now from the way they were envisioned by the comprehensive banking law of 1970; at some point, this law will have to be updated.

Chapter I

THE CREDIT ENVIRONMENT

Demands on the credit facilities of El Salvador changed drastically, and increased enormously, from 1978 through 1982. The banking and credit system, previously a conventional supplier largely of rather modest volumes of production credit to the private sector, suddenly was called upon to finance rapid growth in the public sector, particularly of central government deficits. Simultaneously, most of the banking and credit institutions were nationalized, and additional public sector agencies dispensing credits were established.

All this took place in a declining economy. Production and exports trended downward in response to violence and terrorism internally, and to weakening demand in foreign markets. The gross domestic product in 1982, in real terms, was about two-thirds of that in 1978. Foreign exchange reserves had been wiped out by 1980. Capital flight, particularly in 1979-1981, became a serious problem. Consequent sharp reduction in imports forced declines not only in consumption but also in production; in El Salvador, the export crops and manufacturing sectors are heavily dependent on imported production goods.

The central government's pledges to compensate previous property holders affected by the 1979-80 agrarian reform and by the nationalization of the banks placed over the entire system a cloud of debt and contingent liabilities. Government agencies are now guarantors of much of the debt assumed by the new property holders; the dimensions of the eventual financial impact of this situation remain poorly defined.

Since El Salvador's credit system was structured mainly to provide short-term loans and working capital, the economy had depended heavily on direct investment and external sources for the refinancing of intermediate and long-term credit needs. Since 1979, however, these sources have supplied very little credit. In part, the gap is being filled within the local credit system by repeated rollovers on short-term loans, a practice which threatens to impair the adequacy of future short-term credit resources.

From 1979 through 1982, the BCR met new public sector demands by expanding greatly the credit supply. At year-end 1982, the BCR had outstanding loans and discounts of ₡ 3.5 billion, compared with ₡ 1.0 billion at the beginning of 1979. In 1978, BCR credits directed to the private sector represented 61 percent of the total; in 1982, the private sector share was only 23 percent. Growing fiscal deficits of the central government, and large expenditures by autonomous agencies implementing the reform programs, took most of this expanded credit supply.

Within the framework of the newly nationalized banking system and greater public sector control of credit supplies, bank credit available to the private sector rose only slightly after 1979. While the banks were able to satisfy most of the demand for short-term production credit, because of short foreign exchange supplies and the declining economy the financing of imports and long-term credit became steadily more difficult.

The large credit expansion in the public sector had a surprisingly moderate impact on money and prices. From 1979 to 1982, money supply rose 12 percent, market prices 36 percent, and consumer prices 47 percent. Moderating influences were the drawdowns of previously ample international reserves, capital inflows provided by the U.S. and other countries, declining private sector production and demand, and a notable BCR management restraint.

The balance of this report examines the changes in sources, volumes, uses and character of credit supply and demand that have taken place in El Salvador during the past eight years. For the private sector, it endeavors to establish the relationship between credit and production, and to project the probable supply and demand for credit in 1983.

Certain pressures on credit supply and demand can be identified as limiting factors in 1983. One is the availability of foreign exchange. El Salvador's economy is heavily import/export-oriented, selling products abroad and importing goods for production and consumption. Foreign exchange availability will be no larger this year than last. To avoid excessive inflationary impact, the supply of credit must be geared to the demand which can be accommodated by foreign exchange supply.

Other limitations on the credit market include:

- the understandings with respect to money and credit in El Salvador's agreement with the International Monetary Fund (IMF). These apply primarily to the expansion of BCR loans and discounts, and to public sector credit demand;

- the declining credit-worthiness of borrowers in El Salvador. The economic decline of recent years has increased overdue loan rates, impaired capital and reserves, and lowered credit ceilings;

- the limits imposed by production, price, and market considerations. The supply and use of credit is related to changing conditions in both domestic and world markets; relatively little change in either market is expected in 1983; and

- the continuing uncertainty regarding El Salvador's economic policies. The role of the private sector in the economy has not been clea.ly defined and may not be until after the scheduled March, 1984 elections.

At present, decisions regarding the supply, use, and demand for public sector credit are made by the central government. The guiding principal in 1983 is likely to be one of restraint, directed toward stabilizing the supply of credit to the public sector after the large expansion of 1979-1981. While credit supply and demand in the private sector are more responsive to market conditions, any changes from 1982 are likely to be moderate in light of the reduced public sector inputs and the similar situation with respect to wages, production, and markets that is expected to prevail.

Chapter II

SUPPLY AND USE OF CREDIT, 1975-1982

Overview

Monetary and credit policies in El Salvador are established and controlled by the Government's Monetary Board. The Board's President and Directors are the Ministers of Planning, Economy, Finance, Agriculture, and Foreign Commerce. Reporting directly to the Board are the Superintendency of Bank and Other Financial Institutions [1/] and the Central Reserve Bank of El Salvador (BCR).

Before 1979, the principal forces governing credit supply were the levels of economic activity, savings, capital formation, and external financing. Transfer in 1979-1980 of several private sector activities to the public sector, and the sudden expansion of public credit demands, shifted to the BCR the controlling position in establishing and managing the overall supply of credit.

BCR supplies credit to the public sector by means of advances, by loans and discounts, and by purchase of government and public agency bonds. Advances, loans, and discounts, when made from BCR resources, are limited by law to a one-year term. For the private sector, BCR provides credit primarily through loans and discounts. Existing authority to expand and contract credit by reducing or increasing legal reserves, and by engaging in open market operations, has been little used.

The commercial banks and the savings and loan associations are nationalized, and thus technically could be termed public sector institutions. However the BCR defines public sector credit to consist of funds used directly by the central government and the autonomous public agencies, and private sector credit to consist of funds passed through intermediaries to private

1/ A listing of financial institutions qualifying under the law of Credit Institutions and Auxiliary Organizations is provided in Appendix A.

borrowers. The long range intention is to operate the commercial banks as mixed enterprises, with the government holding only a controlling interest.

Credit Supply Trends and Distribution

Measured by balances outstanding at the end of year, the total volume of credit provided to the public and private sectors by the banking system[1/] in El Salvador grew from ₡ 1.6 billion in 1975 to ₡ 5.6 billion in 1982 (Table 1).

The growth between 1975 and 1978 (₡ 1.6 billion to ₡ 2.7 billion) was relatively moderate and in line with economic and monetary trends. In 1979, however, uncertainty regarding economic reforms and a run on deposits abruptly increased the needs for credit. Using credit from the BCR, the banking system expanded credit supplies in 1979 along by 22 percent. 1980 brought a further expansion of 28 percent, although since then, the increases have been more moderate (20 percent in 1981 and 12 percent in 1982). In the four-year period, 1979-1982, the outstanding credit balance at year-end more than doubled from ₡ 2.7 billion to ₡ 5.6 billion.

Public Sector Supply Trends

Most of the post-1978 expansion in credit supply was absorbed by the public sector. Prior to 1979, the public sector had used relatively little credit. BCR made seasonal advances to the central government and to the official autonomous agencies and provided a small market for their certificates and securities. The government budget being in balance, the total BCR operation had little impact on credit and money supplies.

All this changed in 1979. Expanding annual requirements and large deficits in the public sector beginning in that year were financed directly by BCR credit. This credit to the public sector became the determinant in overall credit supply; the operations of BCR since then have been geared

1/ Banking system credit is that provided by commercial banks, and by the BCR to lending institutions other than the commercial banks.

Table 1

EL SALVADOR'S BANKING SYSTEM
CREDIT OUTSTANDING AT YEAR-END
1975 - 1982

(million colones)

	To Private Sector		To Public Sector 2/				
			Commercial Banks				
Year	Commercial Banks	Banking System 1/	Central Govt.	Autonomous Agencies	Total	Banking System	Total
1975	1,128.3	1,322.5	10.4	7.5	17.9	295.9	1,618.4
1976	1,350.5	1,581.6	17.4	13.5	31.1	318.2	1,899.8
1977	1,647.1	1,922.0	21.7	30.4	52.1	434.5	2,356.4
1978	1,914.3	2,220.5	17.2	37.0	54.2	444.6	2,665.6
1979	2,127.8	2,487.8	13.2	78.2	91.4	758.9	3,246.7
1980	2,124.4	2,300.8	9.0	24.6	33.6	1,859.5	4,160.3
1981	2,243.5	2,436.1	61.7	47.5	154.2	2,556.8	4,992.8
1982	2,573.9	2,750.5	104.2	64.7	168.9	2,819.1	5,569.6

1/ Commercial banks (including commercial department of Banco Hipotecario, and branches of Banco de Londres and Citibank) plus credit provided by BCR to lending institutions other than commercial banks. These are Fedecredito, Fedecaces, COPAL, Financiera Salvadoreña (to 1980), Bank of America.

2/ Includes (1) autonomous public credit and marketing institutions: BFA, INCAFE, INAZUCAR, INSAFI, FNV, FINATA; (2) autonomous infrastructure institutions: CEL, ANTEL, ANDA, CEPA, IRA, ISTA, CEFIES; and (3) central government.

Source: Revista Mensual, BCR.

largely to supplying public sector demands. By the end of 1982, the volume of BCR credit outstanding to the public sector (central government and autonomous agencies) was ₡ 2.6 billion, about 7 times the comparable outstanding credit in 1978. Commercial banks provided another ₡ 169 million, bringing public sector usage to ₡ 2.8 billion at year-end 1982, or 51 percent of the total supply compared with 18 percent in 1978.

BCR credits to the public sector are used by the central government as well as by the autonomous public agencies. There are currently 26 such agencies, whose functions range from the provision of infrastructure (power, communications, water and sewage, ports, railroad, international airport) to the operation of a biennial trade fair and various social, cultural, and educational activities. Among the most recently established are the two agencies charged with implementing the agrarian reform program (ISTA and FINATA) which have powers to guarantee credits obtained by program beneficiaries.[1/]

Eight of the 26 autonomous agencies are classed as financial entities authorized to operate as lending institutions. Five of these were established to supply credit, respectively, to agriculture, industry, small business, credit unions, and housing; the remaining three are marketing agencies which both use and provide credit in their capacity as financial intermediaries. There are three autonomous institutions empowered to operate in the credit arena, basically as users of credit for housing, education, and social security.

The autonomous agencies were established with government-subscribed capital, have access to BCR loans and discounts, and have authority to operate independently, subject to central government controls. Their sources of funds include fees and charges, capital contributions, BCR credit, and external funds. They borrow only occasionally from the commercial banks or from other domestic institutions.

1/ A listing of public autonomous agencies that are major users and/or suppliers of credit may be found in Appendix B.

From 1975 through 1978, total BCR credit outstanding to all autonomous public agencies grew moderately from ₡ 219 million to ₡ 361 million. Most of this credit was in the form of advances in anticipation of revenues on current operations. The terms on these advances were short; most rolled over each year, the outstanding balances increased slowly, and the BCR purchased only a moderate volume of agency bonds.

In 1979, the demand for credit on the part of the autonomous agencies increased as their operations expanded and their access to external financing was reduced. Current revenues failed to cover the increasing costs and BCR advances to autonomous public agencies had risen to ₡ 1.3 billion by the end of 1980.

In 1981, this type of financing was brought under control. Financing responsibilities for the agencies were shifted in part from BCR to the central government and external financing sources. Advances were sharply curtailed and the short-term debt of public agencies to BCR was converted partly into bonds. By the end of 1982, BCR credit outstanding to the autonomous agencies was ₡ 1.1 billion, down 9 percent from 1981 (Table 2). Only 58 percent of this was in the form of advances compared to 82 percent in 1980.

Use of BCR credit by the central government began to grow in 1979, leaping upward thereafter as the result of large fiscal deficits and the assumption of autonomous agency debt. At year-end 1982, BCR advances to the central government and holdings of government securities amounted to ₡ 1.5 billion, compared with ₡ 121 million at the end of 1979.

<u>Private Sector Supply Trends</u>

Within the banking system, the supply of credit to the private sector rose from ₡ 1.3 billion outstanding at year-end 1975 to ₡ 2.2 billion in 1978, an increase of 67 percent (refer back to Table 1). This expansion was caused by greater credit demand within the growing economy. Practically all expansion took place in the commercial banks and was funded by a growth in deposits, larger money supplies, higher loan turnovers, external sources,

Table 2

BCR CREDIT OUTSTANDING AT YEAR-END
1975 - 1982
(million colones)

Year	Commercial Banks 1/	Other Lending Institutions 2/	Autonomous Public Agencies 3/	Central Government	Total
1975	243.3	194.2	219.2	58.8	715.5
1976	285.5	231.2	263.5	23.9	804.1
1977	336.1	274.9	373.0	9.3	993.3
1978	316.3	306.2	360.8	30.1	1,013.4
1979	533.4	360.0	546.7	120.8	1,561.0
1980	606.3	176.4	1,263.5	562.4	2,608.7
1981	585.5	192.6	1,249.8	1,197.8	3,225.6
1982	638.1	176.6	1,121.1	1,529.1	3,464.9

1/ Commercial banks and commercial department of Banco Hipotecario.

2/ Fedecredito, Fedecaces, COPAL, Financiera Salvadoreña (to 1980), Bank of America.

3/ Includes (1) credit and marketing institutions: BFA, INCAFE, INAZUCAR, INSAFI, FNV, FINATA, FIGAPE; and (2) autonomous infrastructure institutions: CEL, ANTEL, ANDA, CEPA, IRA, ISTA, CEFIES.

Source: Revista Mensual, BCR.

and a lowering in 1978 of reserve requirements from 30 percent to 20 percent. The gross domestic product at current prices (PIB) grew by 68 percent between 1975 and 1978 and money supply rose 71 percent; in both cases about the same percentage increase as in the use of credit.

In 1979, political changes of a revolutionary character and the advent of the agrarian reforms led to heavy withdrawal of deposits, halted economic growth, and cut off the supply of external funds. The commercial banks sought help from the BCR and BCR loans and discounts to the banks jumped 69 percent (from ₡ 316 million to ₡ 533 million) in 1979 alone. Thus, the supply of credit to the private sector was maintained and augmented by the central bank, not by market forces.

After the commercial banks were nationalized in March of 1980, deposits began to return and by year-end were slightly above their highest previous level. In the absence of external funding sources, the commercial banks continued using BCR loans and discounts near the 1979-80 level, but did not further expand them.

From 1980 through 1982, the predominant influence bearing on private sector credit supply appears once again to have been market forces. Gross domestic product at current prices rose about 16 percent (although it was strongly negative in real terms); money supply grew 14 percent; and commercial bank deposits rose 38 percent. Use of BCR credit for private sector financing leveled off. At the end of 1980, banking system credit outstanding to the private sector amounted to ₡ 2.3 billion, a drop of 8 percent from the abnormal high of 1979, but slightly higher than in any previous year. At the end of 1982, the figure was ₡ 2.8 billion, representing a growth of 20 percent since 1980.

From 1980 onward, BCR loans and discounts to the banking system increased very modestly, deposits grew, credit expansion was greater than production growth (at current prices), and there was a slight rise in excess reserves. All of these trends suggest that the relative stability of credit supplied to the private sector during 1980-82 is attributable to a relatively stable demand. This view is shared by bank managers, who in informal interviews consistently have reported that their loan capacity is sufficient to take care of the requirements of their credit-worthy clientele, apart from those desiring colones to purchase non-available foreign exchange.

In real terms, private sector credit expanded during 1982 while production declined. Presumably this pattern is associated with the greater need for credit in a disrupted and declining economy where loans become overdue and must be refinanced and where credit is required to reconstruct and replace damaged production facilities. In addition, cooperatives taking over large farms have needed credit to replace operating funds and assets removed by former owners and poor markets for export crops have increased the need for colones to finance inventories. Thus credit supply in 1979-1982 appears to have expanded to fill demands in real as well as in nominal terms, that did not exist in prior years.

Sources of Private Sector Credit Supplies

Most credit to the private sector is now provided by government-owned institutions. This resulted from the nationalization in March, 1980, of the commercial banks,[1/] which together with the commercial department of the government-controlled mortgage bank provide over 90 percent of bank credit to the private sector, and about 65 percent of all private sector credit. Most commercial banks operate country-wide and are structured to provide short-term production credit, seasonal marketing credit, and banking services. They hold most of the private sector deposits, and lend largely from their own resources (Table 3).

Next in importance to the commercial banks as a supplier of credit to the private sector (accounting for about 10 percent of the total credit)

1/ Ten domestic banks were nationalized, two of which merged in 1982. Additionally the Banco de Londres, and Citibank, operate as commercial banks; however, the banking reform of 1980 prevents them from taking deposits. A Bank of America branch operates as a lending institution, but is not classed as a commercial bank (see Appendix C).

Table 3

BANKING AND FINANCIAL INSTITUTIONS
PRINCIPAL SUPPLIERS OF CREDIT AND INVESTMENT TO PRIVATE SECTOR
1981

(million colones)

Institutions	Total	Percent	With BCR Resources	Percent
Commercial Banks	2,397.7	65.3	585.5	40.6
Financiera Salvadoreña 1/	16.2	2/	12.0	0.7
Bank of America	1.2	2/	-	-
Public Financial & Marketing Agencies	987.8	26.8	626.8	43.1
BFA	356.6	9.7	203.2	14.2
INCAFE	250.0	6.8	222.3	15.5
INAZUCAR	129.4	3.5	129.4	9.1
COPAL	207.5	5.6	59.1	4.2
FIGAPE	44.3	1.2	12.8	0.1
INSAFI	3/	3/	-	-
Other				
FNV (savings & loan)	102.1	2.8	33.9	2.4
Fedecredito	158.3	4.3	132.4	9.3
Fedecaces	11.4	2/	-	-
	3,674.7	100.0	1,443.9	100.0

1/ Merged with commercial bank in 1982.

2/ Less than 0.5 percent.

3/ Portfolio and operations being shifted to Banafi and Corsain.

Source: BCR.

is the Banco de Fomento Agropecuario (BFA), a public autonomous development bank for agriculture. BFA supplements the agricultural credit provided by the commercial banks and is the principal supplier of those lacking access to commercial institutions. It lends from its own resources, from funds provided by external resources, and heavily from credit lines extended by the BCR.

In third place are the large non-banking marketing agencies for coffee, sugar, and cotton which, together, accounted for about 16 percent of private sector credit supplies in 1981. The autonomous coffee marketing agency (INCAFE) provided seven percent and the similar agency for sugar (INAZUCAR) three percent;1/ for cotton, marketing is handled by a privately-owned cooperative (COPAL) which supplied about six percent of all credit used in the private sector in that year. INCAFE and INAZUCAR are heavily dependent for financing their purchases and inventories on BCR loans and discounts. COPAL has substantial resources of its own and uses BCR credit seasonally as needed.

Eight savings and loan associations are also classed as non-banking institutions. Nationalized in 1980, these associations have an importance beyond the three percent which they contributed in 1981 in the form of private sector loans. Under existing regulations they pay 9.5 percent interest on savings, a point higher than the commercial banks, and thereby attract a considerable volume of deposits. Their operations are coordinated and supplemented by Financiera Nacional de la Vivienda (FNV), a public autonomous agency. They lend both from their own resources and from those of FNV, utilizing its BCR credit and external resources.

From 1979 to November, 1982, deposits in savings and loan institutions rose by 43 percent, to a total of ₡ 669 million. This surpassed the percentage rise of commercial bank deposits, which amounted to ₡ 2.4 billion at year-end 1982 (Table 4).

1/ Subsequently INAZUCAR has been a user, not a provider of credit.

Table 4

DEPOSITS IN FINANCIAL INSTITUTIONS
BALANCES AT YEAR-END
1975 - 1982

(million colones)

Year	Commercial Banks	Non-banking: Savings & Loans	Non-banking: Total	Banking System 1/: Sight	Banking System 1/: Term	Banking System 1/: Total
1975	1,117.7	242.6	296.9	440.2	704.7	1,144.9
1976	1,390.0	356.8	525.4	619.1	853.7	1,472.8
1977	1,608.6	477.7	738.8	665.4	1,015.3	1,680.2
1978	1,784.3	553.5	719.3	689.7	1,154.4	1,844.1
1979	1,739.7	467.0	600.9	684.8	1,124.8	1,809.6
1980	1,893.7	530.0	728.4	840.1	1,134.7	1,974.8
1981	2,150.7	630.2	700.0	865.4	1,397.0	2,262.4
1982	2,408.8	669.0 2/	3/	896.3	1,633.1	2,529.4

1/ Commercial banks (including Hipotecario) plus Fedecredito, Fedecaces COPAL, Financiera Salvadoreña (to 1980), Bank of America.

2/ November 1982.

3/ Not available.

Source: Revista Mensual, BCR.

At present, the savings and loan associations provide mainly short-term credit for construction, rather than long-term mortgage financing. From 1975 through 1978, 62 percent of their loans were for construction purposes. During 1980-81, this percentage was 77 percent. Many of the associations' outstanding loans, which totalled ₡ 650 million in mid-1982, are overdue and have been refinanced, leaving them only a small current lending capability.

For longer-term housing loans, the principal sources at present are the specialized non-financial institutions. A number of funds exist pooling members' savings for use in home financing; the largest is the Fondo Social de Vivienda, funded largely by payroll deductions and employer contributions. These funds provide a vehicle through which government and external sources can channel assistance to promote low-cost housing. The specialized home financing institutions are essentially users, not suppliers, of credit; however, they do constitute a source of savings. As users of credit, they represent a demand which is far greater than the available supply.

Another important credit source in El Salvador is the system of private sector credit unions, which is supervised by the government-controlled Federacion de Cajas de Credito (Fedecredito). Individually, the credit unions receive member deposits and make small loans for production, commerce, and personal needs. They are assisted by Fedecredito which obtains credit from the BCR and from concessionary external sources. Providing about 4 percent of all private sector credit, the system is particularly important in small towns and rural areas.

A second and much smaller system of credit cooperatives, grouped together as Fedecaces, is privately controlled at all levels. Fedecaces operates in the area of very small loans, supplementing its resources with grants and concessionary financing from assisting groups and agencies.

FIGAPE, a public autonomous agency, also provides small loans to private sector borrowers for productive and commercial purposes, using resources provided by the government, by outside agencies, and by the BCR. Although it accounts for only about one percent of total private sector credit supplies, FIGAPE is important to small borrowers.

There are nine insurance companies operating in El Salvador, all of which are privately owned. These companies are required to hold their reserves within the country, and before 1979, were a minor source of intermediate and long-term credit, mainly in the residential and commercial building area. However, since 1979 they have been holding almost all of their reserves as time deposits in the commercial banks. Although this practice resulted in part from declines in construction activity, weakening loan demand, and higher risks, a more compelling influence appears to have been the interest rate ceiling on loans which provide no better return, after investment costs, than time deposits. Accordingly, the insurance companies are not at this time a source of credit, except to the extent that their resources increase commercial bank deposits.

In El Salvador, there are no institutions that provide production credit specifically for intermediate and long-term needs. Prior to 1979, such credit was provided by external sources, direct local investment, several private financieras, specialized BCR financing (FDE - Economic Development Fund) and a government-owned industrial development bank (INSAFI). At present, there is little inflow from external sources and the FDE has resources to meet only a small segment of the demand. The financieras were nationalized and subsequently merged with commercial banks. INSAFI depleted its reserves by investments in ill-fated ventures and, since 1979, has been inoperative. While its loan portfolios are being transferred to a newly-organized, government-held development bank, BANAFI, and its investments to a government holding company, CORSAIN, neither of these institutions is yet in a position to make new loans.

Operations of the Commercial Banks 1/

The commercial banks, which provide two-thirds of all credit used by the private sector, lend principally from their own deposits and capital reserves. Between 1975 and 1978, about 80 percent from their loans were made from bank resources with the balance coming largely from BCR loans and discounts. (An

1/ Further information on the situation of the commercial banks is provided in Appendix D.

exception was 1978 when their ratios were 85-15, due to an increase in resources which became available when the legal reserve requirement was reduced from 30 percent to 20 percent). From 1979 through 1982, the applicable percentages were 74 percent from bank resources, and 26 percent from rediscounts.

Portfolios are managed to keep bank resources fully committed without maintaining excess reserves. The cost of such money vis-a-vis the loan interest rates provides a spread of 3 to 5 points, compared with the usual 2-point margin on BCR rediscounts.[1/] Loan handling costs are also lower when the banks' own resources are used, as the banks can apply their own criteria and judgment, avoid delays, and keep their portfolios in balance. The use of rediscounts require that the BCR document and sometimes re-analyze each loan, resulting in delays and consequent portfolio imbalances.

Some commercial banks use BCR credit far more than others, however. At the end of 1982, one bank accounted for 44 percent of all outstanding BCR loans and discounts to the commercial banking system; and three banks accounted for 67 percent. The principal commercial users of BCR credit appear to be institutions having liquidity problems and/or declining deposits, or those

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1/ The prevailing interest rate to borrowers on most loans is 15 percent, a ceiling established by BCR. Most BCR credit to banks is at 13 percent, allowing a 2-point spread in use of its credit lines. BCR credit to agriculture for special purposes (i.e., cotton, food, crops, combating coffee rust) enables the banks to provide loans at 13 percnet. BCR rates on loans from external resources are flexible, in line with the cost of money.

No interest is paid by the commercial banks on sight deposits. The rates on savings and time deposits range from 8 3/4 percent to 10 percent for terms of up to one year; above that, rates are negotiable and are currently around 12 percent. While the cost of money from bank resources (allowing for the 20 percent legal reserve) varies among banks according to character of deposits, it is generally in the area of 10-11 percent. Thus there is a considerable incentive for the banks to lend from their own resources rather than from BCR credit.

with small deposits agressively marketing their loans. Stronger institutions make little use of BCR facilities; when they do, it is mainly to cover seasonally tight credit situations and for special purposes (for example, the 1981-1982 AID-supported BCR line for structural capital in industry). The largest, strongest, and most profitable of the commercial banks was funding slightly less than 10 percent of its loans with BCR credit at year-end 1982, a season when credit requirements are typically quite high.

Since the commercial banks always endeavor to keep their own resources fully loaned out, it is in the area of BCR loans and discounts that credit expansion or contraction generally takes place.

Given the situation described above, the impact of BCR decisions to expand or contract credit to the private sector is heaviest on the smaller, weaker commercial banks, as well as on the autonomous public agencies which depend on BCR credit for their loans to the private sector. This tendency was evident in 1981 and again in 1982. Overall private sector use of BCR credit in 1982 fell by ₡ 100 million, or about 6 percent. However, the contraction took place in public sector institutions (mainly BFA), and there was an increased use of BCR credit by the commercial banks. This appears to have been due to shifting of deposits among the banks and to illiquidity in the weaker banks, rather than to increased loan demand. Also, the AID-sponsored structural capital line was an incentive to several banks to use credit from the BCR.

A shift in deposits from the weaker to the stronger banks creates a demand among the former for BCR credit to offset their deposit declines and support their lending activities. Capital and reserves have not increased enough to contribute significantly to greater lending capability. From 1975 to 1979, commercial bank capital and reserves almost doubled, but between 1979 and 1982, the increase was only 28 percent, all from retained earnings. Because of extensive loan rollovers and heavy refinancing, the quality of the earnings and reserves is rather questionable, and thus not a good basis for increased lending.

Because of the need to hold colones awaiting BCR provision of foreign exchange for imports, sight deposits in the system are subject to large, relatively abrupt drawdowns. Some of the larger banks holding such deposits lend to other banks with temporary cash or reserve deficiencies on overnight or weekly terms.

Most commercial bank loans are for periods of 3 to 12 months, the average term being close to 6 months. Loans tend either to be very short or for the full 12-month term.

There is at present a very limited supply of new intermediate and long-term credit to maintain productive capacity. For a variety of reasons - losses associated with agrarian reform, violence, depressed market prices, capital flight-businesses have inadequate structural capital. Since 1979, borrowers have been obtaining commercial bank loans on a short-term basis to cover their intermediate and long-term needs. The consequences are extensive refinancing, reduced capacity in the banking system to expand short-term credit, and liquidity problems both for the banks and their customers. Because of declining short-term credit demand the commercial banks so far have been able to carry this load; however, their resources would be strained in an economic upturn. Depending primarily on deposits, with small equity and with a one-year limit on rediscounts, the system is not structured to provide much in the way of longer-term loans, particularly not in the present high-risk environment.

Users of Credit

Agriculture and Livestock

The agriculture and livestock sector accounts for nearly 40 percent of the credit used by private borrowers in El Salvador. Coffee production and marketing absorb about half of this amount. Cotton is the next largest user, followed by sugar. Food crops and livestock account for about one-fourth of all agricultural credit use.

In 1981, ₡ 1.4 billion in credit was disbursed to the agriculture and livestock sector, of which ₡ 555 million, or 40 percent, was provided by commercial banks (Table 5). Other sources included the BFA (₡ 264 million), INCAFE (₡ 250 million), INAZUCAR (₡ 129 million) and COPAL (₡ 208 million).1/ Large agricultural cooperatives over 500 hectares, and medium-sized privately-owned enterprises with between 100 and 500 hectares, were the principal beneficiaries of loans from the commercial banks and of credits from INCAFE, INAZUCAR, and COPAL. BFA was the principal supplier of credit to smaller enterprises,financing in 1981 76 percent of the rice plantings, 50 percent of the beans, and 34 percent of the corn. Sugarcane and cotton are also important on small farms and the BFA provided credits for 36 percent and 25 percent, respectively, of the total area planted in these crops; however, for coffee, it provided credit for only 4 percent of the 1981 planted area.

Between 1975 and 1978, the trend in agricultural credit use was sharply upward; commercial bank loans to agriculture in those years rose by 66 percent. From 1979 to 1982, however, reduced plantings and expanded availability of agricultural credits from public institutions were reflected in a small decline in disbursements by the commercial banks. INCAFE, INAZUCAR and COPAL took over much of the coffee, sugar and cotton financing which had previously come from the commercial banks. Total credit outstanding to agriculture at the end of 1981 was ₡ 521 million, up only slightly from 1979 (Table 6). The figure for 1982 is expected to again show only a small increase.

With so significant a portion of their loan portfolios in agriculture and livestock, the commercial banks experience considerable seasonal fluctuation in lending activity. The amount of agricultural credit outstanding is usually lowest in May-June, then rises steadily to peak in December, January and February (Table 7).

1/ Several minor credit sources (Fedecredito, Fedecaces, Figape) also supplied some agricultural credit but not enough to figure significantly in the total.

Table 5

COMMERCIAL BANKS
CREDIT DISBURSED, BY SECTORS
1975 - 1982

(million colones)

Year	Agriculture	Industrial	Construction	Commerce	Refinancing	Other	Total
1975	351.5	198.3	79.9	638.0	183.0	28.5	1,479.2
1976	500.3	240.5	104.3	774.7	135.7	36.2	1,791.7
1977	655.6	320.4	136.3	1,001.3	267.8	58.8	2,440.2
1978	585.9	324.4	172.8	986.6	291.5	46.6	2,407.8
1979	563.5	296.6	143.2	1,000.9	234.8	90.6	2,329.6
1980	505.4	197.2	76.8	787.1	374.5	29.7	1,970.7
1981	554.7	191.6	57.6	594.2	495.8	37.8	1,931.7
1982 1/	475.4	113.8	44.5	214.9	265.6	33.4	1,147.6

1/ January-June 1982.

Source: Revista Mensual, BCR

Table 6

COMMERCIAL BANKS
CREDIT OUTSTANDING AT YEAR-END, BY SECTORS
1975 - 1982

(million colones)

Year	Agriculture	Industrial	Construction	Commerce	Refinancing	Other	Total
1975	292.1	115.9	119.8	408.1	163.0	24.6	1,123.5
1976	384.4	157.8	133.9	478.8	162.0	29.5	1,346.4
1977	431.2	219.1	163.5	572.8	213.7	35.5	1,635.8
1978	442.1	266.5	215.3	674.8	262.7	48.6	1,910.0
1979	511.8	297.0	252.4	689.4	321.8	51.2	2,123.6
1980	467.7	281.2	257.1	574.1	492.6	47.4	2,120.1
1981	521.3	270.6	227.6	539.5	619.2	52.3	2,230.5
1982 1/	399.0	250.4	235.0	492.9	723.7	57.7	2,158.5

1/ June 1982.

Source: Revista Mensual, BCR.

Table 7

SEASONAL CREDIT FLUCTUATION
COMMERCIAL BANK LOANS OUTSTANDING TO AGRICULTURE
AT MONTH-END, AS PERCENTAGE OF TOTAL OUTSTANDING BANK LOANS

Month	1975-1978 %	1979-1981 %
January	26	24
February	24	24
March	19	23
April	15	20
May	15	16
June	16	15
July	18	16
August	19	16
September	21	17
October	22	19
November	24	20
December	26	23

Source: Revista Mensual, BCR.

During 1975-1978, 26 percent of commercial bank loans in December-January went to the agriculture and livestock sector, while in April-May the percentage was only 15 percent. For 1979-81, the high occurred in January-February (24 percent) and the low in June (15 percent). There was a tendency for the seasonal figures to peak later and to fall more slowly in 1979-81 compared with 1975-78, which may be associated with the greater financial problems being experienced by growers in the latter period.

In 1979-81, the seasonal low in agricultural lending was 63 percent of the peak. Commercial bank lending activity to all sectors combined shows much less fluctuation (normally less than 10 percent). The fact that the banks lend mainly from their own resources gives them an incentive to increase short-term loans to non-agricultural borrowers during the seasonal agricultural low. To the extent that they experience an overall reduction in outstanding credit, the contraction takes place in their use of BCR credit facilities.

Unlike the commercial banks, BFA, INCAFE, INAZUCAR and COPAL have most of their portfolios in the highly seasonal agricultural sector and thus make peak use of rediscounting privileges during the winter months. Since their operations depend more directly on BCR credit, they account for most of the seasonal expansion and contraction within the total credit system.

Commerce

The commercial sector, which includes many trading activities (import, export, wholesaling, retailing), surpassed agriculture as a user of credit until 1982. Almost all credit disbursed for commercial activities, other than for marketing of export crops, is provided by the commercial banks. Credit disbursements to this sector exceeded ₡ 1 billion in 1979, but by 1981 had dropped off 41 percent to ₡ 594 million. In 1981, commerce accounted for only 31 percent of all commercial bank credit, compared to 42 percent in 1975-78. Among the causes of this decline were the stagnating economy, the sharply reduced availability of foreign exchange, and increasingly tight controls placed on imports. Also, claims on private sector credit were reduced in 1980 when INCAFE and INAZUCAR took over much of the marketing activity that had previously been financed by the commercial banks.

Manufacturing

Manufacturing industries are dependent on the commercial banks for almost all of their credit needs. Between 1975 and 1978 usage grew by 64 percent to a peak of ₡ 324 million, but then declined 41 percent to ₡ 192 million in 1981 after many industries had reduced production or ceased operations owing to violence, lack of foreign exchange to import raw materials, rising costs, and weakening export and domestic markets. However, several surveys have found that usage would have been closer to the ₡ 300 million level if foreign exchange had been available, since just over half of the credit needed by industry is for financing imports of raw materials and capital goods.

Construction

Principal sources of short-term construction credit are the commercial banks and the savings and loan associations. Commercial bank credit extended for this purpose more than doubled between 1975 and 1978, but declined from a 1978 peak of ₡ 173 million to ₡ 58 million in 1981. Meanwhile, savings and loan construction credit rose from ₡ 15 million in 1978 to an average ₡ 100 million annually in 1979-81. In 1981, short-term construction credit provided by both sources represented about 4 percent of the credit supply.

Prior to 1979, long-term mortgage financing was available from the savings and loan associations and from various specialized funds and agencies. The latter were assisted by BCR credit and by financing from abroad. Since 1979, however, these sources have been holding largely frozen portfolios, and thus have been unable to provide much new credit. Long-term home financing now comes mainly from pooled savings, assisted by the government, and from external sources.

Refinancing

This is the growth sector in the use of commercial banking system credit. From 1975 through 1978, credit disbursed by commercial banks for this purpose grew 69 percent. During 1979-1981 it grew another 70 percent. In 1981, commercial bank loans in this category totalled ₡ 496 million, or 26 percent of all loan disbursements. By the end of June, 1982, the proportion had risen to 34 percent.

Comparable data is not available for public institutions which lend to the private sector, but judging from partial data, their disbursements for refinancing since 1979 have been as large or larger than those of the commercial banks. Of total BCR credit used in 1981 by financial institutions other than the banks, 68 percent was for refinancing, while of BCR credit provided to the autonomous public agencies, 41 percent fell into this category. During January-June 1982, 82 percent of BCR credit disbursed to financial institutions and to the autonomous public agencies was for refinancing purposes. Estimating conservatively from these data, it appears that in 1982 more than a third of all new loans to the private sector were used to refinance previous loans.

Other Sub-Sectors

As mentioned earlier, infrastructure services in El Salvador are financed directly by the central government and by the network of autonomous public agencies. Utilities, transportation, communications, storage, ports, railroads, airports, and many services are financed directly by the government, BCR, and external sources, using very little credit from local banks and financial institutions. During the periods under study (1975-1978 and 1979-1982), the demands on the banking system of these other sub-sectors accounted for an insignificant portion of the total credit volume.

Summary

Since 1979, public sector demand for credit has exceeded the supply, which is limited by foreign exchange availabilities and by the need to curb inflationary pressures. The problem is thus one of allocating this limited supply among competing demands in order to fill those with highest priority.

For the private sector, credit supply expanded steadily from 1975 to 1979 in response to growing demand. Thereafter it rose more slowly and the character of demand drastically changed. Because of the declining economy, limited foreign exchange availabilities, smaller crops, and factory shutdowns, demand for production credit fell but demand for rollover credit and refinancing increased. Supply was sufficient to permit the financial institutions to adopt a liberal attitude toward extending overdue loans and to provide credit as needed in a declining economy.

This conclusion is supported by the less than vigorous demand for BCR credit during 1980-82 on the part of commercial banking institutions. These banks believe they satisfied most of the demands for credit by lending from their own resources, with only minimal use of BCR loans and discounts. The public institutions involved in financing private sector activities, which operate principally with BCR credit, did not significantly increase their scale of operations.

While a short-term credit shortage did exist, it was in foreign exchange, not in colones. There was also a growing inadequacy in medium- and long-term credit facilities.

Chapter III

PROJECTED 1983 CREDIT SUPPLY AND FINANCIAL INDICATORS

Credit Supply

The rate of credit expansion in El Salvador slowed significantly in 1982. While public sector demand remained high, the supply was controlled by limits placed on provision of BCR credit to the central government and the public autonomous agencies. In the private sector, the growth rate continued to fall off due to the sagging economy and the limited availability of foreign exchange. A further large credit expansion would have produced foreign exchange demands well beyond the system's capacity to handle, stimulating inflation and capital flight.

This foreign exchange limitation will continue through 1983, and may become even more restrictive. Continuing management will be needed to coordinate colon credit and the limited foreign exchange supplies in order to direct foreign exchange toward the most urgent national objectives. One of these objectives is to curb economic decline and to assist the process of economic recovery wherever possible.

BCR financing of the fiscal deficit will continue in 1983 to exert a significant influence on credit supply. As before, such financing will be in the form of advances and purchases of government obligations.

In accordance with its IMF approved program, the government during 1983 will limit the overall provision of BCR loans, discounts, advances and investments. This will be accomplished primarily by holding down the growth of the central government's fiscal deficit, by increasing the use of external resources in financing the deficit, and by placing a ceiling on BCR credit to be used for these and other purposes.

During 1982, the amount of BCR credit outstanding to the public sector increased very little, totaling ₡2.6 billion at year end. Overall, the outstanding debt to BCR of the autonomous agencies decreased, but central government indebtedness rose 16 percent. In 1983, another increase in BCR loans and discounts for the public sector is expected, probably in the area of 13 percent.

With respect to the private sector, outstanding BCR credit at the end of 1982 was ₡815 million, only five percent larger than a year before. A rise of nine percent in BCR credit outstanding to the commercial banks was partially offset by an eight percent drop in private sector lending by other institutions. In 1983, the expansion of BCR credit to the private sector is likely to be small, in line with needs, but probably under 15 percent.

Money Supply

The money supply (currency and sight deposits) increased only 3.9 percent in 1982, following an increase of 0.6 percent in 1981. In view of the depressed economic conditions, growth in demand for currency in 1983 is not likely to exceed the rate of inflation.

Deposits

In 1982, total deposits in the commercial banks rose by 12 percent, compared with a 14 percent growth rate realized in the previous year. Since BCR credit to the public sector (a principal source of deposit growth in recent years) is tapering off and since sudden growth in exports and foreign exchange appears unlikely, little can be expected in the form of increased deposits from these sources. Therefore, deposits available to financial institutions for lending to the private sector are likely to grow only moderately in 1983, probably at about the 1982 rate of 12 percent.

External Sources

In 1983 as in recent years, there will be little external financing of the type which increases money, deposits, and internal credit supply. Substantial deficits will continue on current account and in the balance of payments. External resources will be used to cover part of this deficit, and to minimize losses in net international reserves.

Level of Economic Activity

Measured in current prices, El Salvador's gross domestic product grew 12 percent in 1979 and 3.8 percent in 1980, followed by a decline of 1.8 percent in 1981 and a growth of 10 percent in 1982. In real terms, the changes were all negative: -1.7 percent, -9 percent, -9.5 percent, and -5.4 percent.

Assuming zero real growth in 1983, and a 10 percent increase in prices, gross domestic product at current prices should reach about 10.7 billion in 1983. Even without any real growth in the economy, this would stimulate a comparable increase in demand for credit as well as in deposits of the commercial banks and savings institutions.

Capital and Reserves of Banking System

Growth in capital and reserves of the banking system in recent years has been modest, adding very little to loan capability. At year-end 1982, total reserves in the system amounted to ₡489 million, up 4 percent from 1981. However, the rise in reserves held by the commercial banks was 16 percent (from ₡181 million to ₡291 million). Since nationalization in 1980, commercial bank earnings have been retained and placed in reserves, this being the only source of equity increases.

Summary

During 1982, El Salvador successfully curbed the previously explosive rise in public credit. Money supply increased 3.8 percent, banking system credit to the private sector 13 percent, credit to the public sector 10 percent, and total banking system credit 11.5 percent. For 1981, the comparable figures were 0.6 percent in money supply, 6 percent in private sector credit, 37 percent in public sector credit, and 20 percent overall.

Expansion of bank credit will continue in 1983, owing primarily to BCR financing of the fiscal deficit. Present intentions are to keep this expansion near the level of 1982. The public sector increase is expected to be about 13 percent, or a little over ₡400 million. Based on this and on estimated demand, money supply is expected to grow by about ₡120 million (7 percent) and bank deposits by up to ₡300 million (12 percent). BCR credit available to commercial banks and institutions financing the public sector is likely to rise by at least ₡100 million, due in part to the availability of $40 million in foreign exchange from the proceeds of an IBD loan for financing additional imports of industrial raw materials and capital goods.

Any improvement in economic conditions during the year would probably have little effect on the public sector credit projections. However, restoration of confidence in the economy and increase in foreign exchange would provide for more loan turnover, greater deposits, less refinancing, and more efficient use of BCR credit, thus increasing private sector lending capacity within the banking and financial system.

On the more likely assumption of zero real growth, the increased credit availability may be a little more than that needed to offset a rise in the general price level, forecast in the area of 10 to 12 percent. In the event that real growth in private sector credit demand exceeds the 1982 rate by 3 to 5 percent, the production increases by themselves could induce comparable growth in deposits, velocity, and use of BCR credit, enabling credit growth in the same dimensions.

Chapter IV

1983 PRIVATE SECTOR CREDIT DEMAND

For purposes of this study, three approaches were used to estimate credit demand in 1983.[1/] First, credit disbursement plans were obtained from the lending institutions providing information for most of the private sector.[2/] Second, a sample survey of industrial firms was conducted and the results used to project the maximum demand for credit on the part of the industrial sector. Third, similar projections of macimum credit demand were prepared for the other economic sectors based on assumed growth in agricultural planted areas and commercial activities.

Planned Disbursements by Lending Institutions

The institutional lenders providing information on their credit disbursement plans for 1983 are the nine commercial banks, the commercial department of the Banco Hipotecario, the BFA, INCAFE, Fedecredito, Fedecaces, and FIGAPE. As a group, these institutions do not represent the entire banking system nor all suppliers of credit to the private sector; however, they account for most of the supply and are good indicators of overall trends in credit use.

The lenders expect to provide ₡2.7 billion in credit to private sector borrowers during 1983, of which ₡1.9 billion, or 70 percent, would represent new loans. Disbursements for short-term loans are projected at ₡2.0 billion (75 percent), with the balance of ₡700 million (25 percent) planned for medium and long-term lending. While the amount of new loans is similar to the amount provided in 1981, in real terms it is 21 percent lower.

1/ All estimates are in current prices.

2/ A copy of the questionnaire used to obtain this information may be found in Appendix F.

The lenders report that weak demand is the main constraint on credit expansion. Weak demand was mentioned by 30 percent of the lenders surveyed with respect to agriculture, 50 percent for industry, and 35 percent for commerce. Risk of environment was mentioned as a problem for agriculture by 39 percent of the lenders, and for industry by 30 percent.

If credit disbursements are made as planned, the lenders' portfolios at the end of 1983 will total ₡3.7 billion, about ₡350 million more than they reported at year-end 1982. The lenders believe that their resources including present levels of BCR credit are adequate to support this level of expansion.

Potential Credit Demand by Economic Sector

Industrial Sector

Projections of maximum industrial credit demand are based on data provided by 33 members of the Salvadoran Association of Industries (ASI).[1/] The firms in the sample represent about 14 percent of ASI's membership and employ 5,400 workers, or about 9.3 percent of the total industrial labor force as of 1978. In 1981, they received credit equal to 35.6 percent of all credit obtained by industry from commercial banks and Banco Hipotecario.

The following assumptions were used to interpret the survey data and develop demand projects: (1) industry would be able to obtain all needed credit and foreign exchange in a timely manner to produce at market potential; (2) the increase in the outstanding debt of the industrial sector would be proportional to the increase in the outstanding debt of the firms in the sample; (3) the firms in the sample would repay, during the year, 25 percent of their short-term borrowings; (4) the ratio of outstanding debt at the end of 1983 to the amount of credit disbursed during the year would be 1.39,

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1/ A copy of the survey questionnaire and an analysis of findings are found in Appendix G.

as in 1981; (5) the commercial banks and Banco Hipotecario would supply all the sector's credit needs, including needs for long-term credit; and (6) the inflation rate in 1983 would be 12 percent.

Based on these assumptions, potential credit demand for the industrial sector is projected at ₡330 million, exclusive of refinancing. This projected level of maximum potential credit demand represents in real terms an increase of 35 percent by comparison with the amount of credit supplied to industry by the banks in 1981. Such expansion could be induced by sales growth in real terms of 8.5 percent over 1982, and by an increase in inventory of raw materials and finished products which appears depleted at present. Since over half of the demand would be for imported goods and in view of the continuing foreign exchange shortage, it is unlikely that this potential will translate into real credit demand.

About ₡300 million (91 percent) of the projected demand would be for new short-term loans and the balance of ₡30 million (9 percent) for long-term credit (Table 8). As mentioned, the major part of the borrowing (₡220 million, or 65 percent) would be to finance imports of raw material; spare parts, and equipment, making foreign exchange availability a prerequisite for satisfying demand. Projected local currency financing would account for ₡110 million, or 34 percent of the total requirements (Table 9).

Table 8

INDUSTRY: PROJECTED MAXIMUM DEMAND FOR SHORT AND LONG-TERM CREDIT, 1983 a/

Term	1983 Estimated Disbursements (million colones)	1983 % Share	1982 % Share
Short Term: New Loans	302	90.1	87.4
Long Term: New Loans	30	9.9	12.6
Total	332	100.0	100.0

a/ Sample information.

Table 9

INDUSTRY: ESTIMATED 1983 CREDIT USE
BY FINANCING OBJECTIVE a/

Objective	1983 % Share	1982 % Share
New Loans to Finance Imports	65.8	62.3
New Loans to Finance Local Expenses	34.2	37.7
Total	100.0	100.0

a/ Sample information.

Agricultural Sector

Exclusive of refinancing, the agricultural sector's maximum 1983 credit demand is projected at ¢1,160 million, 20 percent higher than in 1981-82 in current prices. In real terms, however, this would represent a decrease of about 7 percent. The projection is based on the following assumptions: (1) that the amount of credit obtained in 1981-82 was sufficient to satisfy sector demand; (2) that production costs will rise by about 4.5 percent in 1983 compared with 1982; (3) that 1983 credit demand will be roughly equal to credit obtained in 1981-82, after allowances are made for anticipated increases in production costs resulting from higher input prices and for changes in area planted for each major crop.1/ ¢1.137 million, or about 98 percent, of the projected total credit demand would be for short-term loans to finance production expenses, leaving ¢24 million to satisfy long-term credit needs.

In El Salvador's present political and economic environment, farmers are reluctant to make investments in fixed assets, and thus the forecasted demand for long-term credit (assuming that such credit were available) is relatively small. Nevertheless, imports of machinery decreased steadily from ¢56 million in 1978 to ¢15 million in 1982 (in current prices), indicating that farm machinery presently in use is wearing out, that maintenance

1/ See Appendix H for information on projected changes in planted area.

costs are high, and that there exists an immediate need to replace at least some of this equipment. Demand for equipment and major spare parts could be significantly higher than imports in 1982, if sufficient credit and foreign currency could be made available.

The projected 18 percent increase in short-term production credit demand over 1981 reflects a rise in crop input prices and other expense items and an anticipated expansion in the area planted in certain major crops (Table 10). The structure of credit demand by crop would probably be similar to 1981, with the largest proportion (approximately 70 percent) being allocated to export crops (coffee, cotton, and sugarcane).

Table 10

AGRICULTURE: ACTUAL (1981) AND PROJECTED (1983)

Crops	1981 Actual (million colones)	1981 Actual Percent of Total	1983 Projected (million colones)	1983 Projected Percent of Total
Export Crops:	676	70.3	791	69.6
Coffee	424		508	
Cotton	201		212	
Sugarcane	51		71	
Basic Grains:	135	14.0	144	12.7
Corn	91		88	
Beans	19		30	
Rice	25		26	
Other Crops	36	3.7	65	5.7
Subtotal	847	88.0	1,000	88.0
Other agricultural activities (cattle, swine, poultry, fishing, etc.)	114	12.0	137	12.0
Total	961	100.0	1,137	100.0

Table 11

AGRICULTURE: BREAKDOWN OF 1983 PROJECTED CREDIT NEEDS FOR FINANCING INPUTS AND LOCAL EXPENSES FOR CROP PRODUCTION

Crop	Total Short-Term Credit Need a/ (million colones)	Proportion of Imports b/ (%)	Cost of Imported Inputs c/ (million colones)	Local Currency Expenses (million colones)
Export Crops:				
Coffee	508	15	76	432
Cotton	212	42	89	123
Sugarcane	71	28	20	51
Basic Grains:				
Corn	88	30	26	62
Beans	30	22	7	23
Rice	26	30	8	18
Other Crops	65	30	20	45
Total	1,000	25	246 d/	754

a/ Does not include "other agricultural activities."
b/ Estimated from data provided by the Ministry of Agriculture.
c/ At local market prices.
d/ The CIF value of imported crop inputs was ₡193 million in 1981; ₡102 million in 1982.

Commercial Sector

Demand from institutional lenders for credit for commercial purposes is estimated at around ₡450 million[1/] in 1983. In real terms, this projected amount represents 58 percent of the credit obtained by the sector in 1981, and a decrease of around four percent by comparison with 1982. The following assumptions were made in forecasting this level of credit demand:

1/ This figure does not include direct Central Bank lending for marketing activities of public and private agencies.

(1) the sector would use only short-term credit; (2) the inflation rate would be about 12 percent; and (3) the national economy would not decline any further in 1983.

In El Salvador, the level of activity in the commercial sector depends on the value added by agriculture and industry. While the agricultural sector is not expected to expand significantly in 1983, the industrial sector could expand. However, the increase in value added in both sectors combined may be small in real terms, and the economic recovery of the commercial sector can be expected to lag somewhat behind the recovery of agriculture and industry. On the other hand, it is possible that imports of consumer goods will decline even further in 1983, due to the shortage of foreign exchange and the implementation of a more selective import policy.

Construction Sector

Maximum credit demand from this sector is projected at around ₡65 million for 1983,[1/] which is 11 percent less in real terms than the amount of credit granted to the sector by institutional lenders in 1981. It is possible that the demand level may be below that of 1982 (₡40 million disbursed as of May 31, 1982) because of declines in government-sponsored construction activities and the likelihood that private sector construction will not expand.

Transportation and Services Sector

1983 maximum demand for credit by the transportation and services sector is projected at around ₡36 million, which is about 12 percent higher than the estimated amount of credit obtained by this sector in 1982. The 1983 projection does not take into account any credit to replace buses

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1/ Does not include credit extended by savings and loan institutions.

burned by the terrorists. The government has already imported more than 100 buses and is now studying a financing mechanism which would facilitate the purchase of the buses by transportation cooperatives.

Small Industries and Business

Potential credit demand from this sector is estimated at ₡45 million for 1983, exclusive of refinancing. This estimate is based on Fedecredito, Fedecaces, and Figape's projections of credit demand by their respective target populations. (Figape's clientele is limited to businesses with total assets under ₡300,000.)

Comparative Analysis

The total maximum credit demand projected for all economic sectors of ₡2.3 billion compares with ₡1.9 billion in planned disbursements by the principal lending institutions (Table 12). Refinancing would add about ₡800 million to each total, bringing the maximum demand estiamte to ₡3.1 billion and the planned disbursement amount to ₡2.7 billion. Due to foreign exchange limitations, the planned disbursement probably more closely approximates real demand than does the calculated maximum.1/

In the lenders' plans, long-term credit makes up 18 percent of total disbursements, whereas in the estimate of maximum credit demand, this proportion is only 4 percent. However, if lenders' debt refinancing plans are taken into account, the share of total disbursements represented by long-term commitments rises to 23 percent (37 percent if planned new loans are not included).

About 97 percent of the banks' planned 1983 disbursement for long-term loans is in reality for medium-term loans (up to five years). Medium-term credit, while important, does not remedy permanently the

1/ A breakdown of the structure of 1983 credit demand by sector and lending source is provided in Appendix I.

Table 12

COMPARISON OF LENDERS' [a] PLANNED DISBURSEMENTS AND ESTIMATED MAXIMUM CREDIT DEMAND, BY SECTOR: 1983

Activities	(1) Estimated Maximum Credit Demand (E.C.D.) Amount (million colones)	Percent of Total	(2) Lenders' Planned Disbursements Amount (million colones)	Percent of Total	(3) Difference (E.C.D. - Lenders' Plan) Amount (million colones)	(4) Lenders' Planned Refinancing Amount (million colones)	Percent of Total
1. Agriculture	1,161	51	1,004	53	157	385	48
Short-term	1,137		941			295	
Long-term	24		63			90	
2. Industry	332 [b]	15	262	24	70	181	23
Short-term	302		177			110	
Long-term	30		85			71	
3. Commerce	450	20	261	14	189	129	16
Short-term	450		194			67	
Long-term	-		67			62	
4. Construction	65	3	47	3	18	23	3
Short-term	65		15			14	
Long-term	-		32			9	
5. Small Business	45	2	121	6	-	27	3
Short-term	45		61			15	
Long-term	-		60			12	
6. Transportation & Services	36	1	c/	-	36	-	
Short-term	36		-			-	
Long-term	-		-			-	
7. Other	185 [d]	8	185	10		56	7
Short-term	148		148			29	
Long-term	37		37			27	
Total	2,274	100	1,880	100	394	801	100
Short-term	2,183	96	1,536	82		530	63
Long-Term	91	4	344	18		271	37

a/ Institutional lenders include the commercial banks, Banco Hipotecario, Banco de Fomento Agropecuario (BFA), Incafe, Fedecredito, Fedecaces y Figape.

b/ Includes demand by small industry from the commercial banks. If small industry loans were included in the industry line of column (2), the lenders' planned disbursement figure would increase by ₡76 million to ₡333 million (₡207 million and ₡131 million for short-term and long-term loans, respectively), and the entries in the small business line would decline by an equivalent amount.

c/ Included under Other.

d/ Based on planned disbursements.

structural deficiency with respect to long-term credit noted elsewhere in this report. Nevertheless, the lenders' plans for 1983 appear adequate to satisfy anticipated demand for long-term credit to finance new fixed investment, which is at present low due to political and economic circumstances.

Planned medium/long-term disbursements for agriculture and industry are ₡63 million and ₡85 million, respectively. The commercial banks account for ₡17 million of the planned lending to agriculture and all of the planned lending to industry.

Some of the commercial banks provide medium-term credit for working capital to their industrial, commercial, and small business clientele. In 1983, the main suppliers of this type of credit will be Banco Agricola Comercial and Banco de Comercio de El Salvador. Working capital loans totaling ₡100 million will account for approximately 75 percent of the planned medium-term credits extended by these two institutions to large industry; 90 percent of the credit to commerce; and 50 percent of the credit to small business. The term of these loans ranges between 18 months and three years. Loans to commerce and small business are to be repaid in monthly installments. Because these loans have a high turnover, their weight in the bank's portfolio is not as great as that of long-term loans for fixed investments.

The same two banks account for ₡30 million, or 93 percent of all planned long-term credit to the construction sector, which is provided mainly to individuals for home repairs and construction of new houses.

<u>Summary</u>

If credit disbursements are made as planned, the lenders' portfolios at the end of 1983 would total ₡3,676 million, an increase of about ₡~~350~~ 356 million over the ₡3,320 million total reported at year-end 1982.

Disbursements at the projected maximum demand level would raise their portfolios to ₡3,950 million, about 7.5 percent higher than is currently planned (Table 13).[1/]

Table 13

COMPARISON OF YEAR-END 1982 AND 1983 TOTAL[a/] LOAN PORTFOLIOS BASED ON PLANNED DISBURSEMENTS AND ESTIMATED MAXIMUM CREDIT DEMAND

(million colones)

(1) Year-End 1982 Actual	(2) Projected on Basis on Planned Disbursements	(3) Projected on Basis on Estimated Credit Demand[b/]	(4) Difference (3) - (1)	(5) Difference (3) - (2)
3,318	3,673	3,949	631	276

a/ The difference between total portfolio (gross portfolio) and net portfolio is provision for loan losses.

b/ Lenders' projected portfolio, plus 70 percent of the difference between the maximum credit demand and the lenders' planned credit disbursements. It is assumed that 30 percent of the difference will not become due in 1983.

The lenders' credit disbursement plans are well within their resource capabilities as discussed in the previous chapters of this report. If deposits rise as expected in line with higher prices, it is possible that the planned disbursements can be made with less use of BCR credit than was the case in 1983. At the calculated maximum demand level, the lenders would need about ₡220 million in BCR credit over and above the amount outstanding at the end of 1982, and their debt to BCR would rise to ₡1,320 million by year-end 1983.

1/ Appendix J contains an analysis of portfolio quality.

Chapter V

BANKING AND CREDIT OUTLOOK FOR 1983-1984

From the preceding chapters it is evident that several conclusions can be drawn regarding the credit supply and demand situation in El Salvador, and that these depend on the source of demand as well as on the type of credit in question. With respect to the public sector, demand for credit is determined by what can be supplied within the constraints of central government availabilities and commitments. In the private sector, the supply of short-term credit for internal use by credit-worthy customers has been and remains adequate to meet the current demand and, additionally, to fund a steadily-increasing load of rollovers and refinancing. However, the supply of credit to finance imports of production goods has been and remains seriously inadequate, owing to the limited availability of foreign exchange.

The supply of medium- and long-term credit appears to be less than the demand, a situation which would create immediate problems if the business environment should improve. However, the character of the supply/demand relationship is complex and not subject to easy remedies. The level of demand depends in part on the availability of foreign exchange for import of capital goods, and in part on perceptions of the investment climate. Also, long-term credit is in demand more for reconstruction than for new production purposes; often, it is needed primarily to restructure enterprises in order to make them more credit-worthy for short-term production loans.

On the supply side, previous efforts to provide medium- and long-term credit through public sector intermediaries are perceived within the private sector as having been disastrous. There is greater confidence in the commercial banks; however, in structure and policy, the commercial banks are designed primarily to provide short-term loans.

In 1983, unless the foreign exchange situation improves, the relationship between supply and demand for credit in the private sector is likely to be much the same as in 1982. Last year, the system had the capability to expand short-term production credit in line with price increases and to refinance overdue loans, and it will have that capability again in 1983.

Assuming zero real economic growth in 1983 and price rises on the order of 10 percent to 12 percent, both the supply of and the demand for private sector credit is likely to be 12 percent to 15 percent higher than in 1982. If the economy grows by three percent or five percent, the credit supply would tend to rise by an amount sufficient to meet short-term demands. Economic growth would produce increases in foreign exchange, deposits, loan turnover, collections, and external financing. These, plus BCR loans and discounts, would increase the system's supply capability.

For medium- and long-term credit, on the other hand, a stabilizing or growth economy is likely to convert the present, partly latent demand very quickly into a large effective demand. Simultaneously there could be increased demand for both short-term working capital and long-term loans to finance production facilities. Bank resources might be adequate to handle the former, but could accommodate the latter only in part. The resulting credit problem could be an obstacle to steady growth.

Because of declining demand for new loans during 1980-82, the commercial banks thus far have carried the extraordinary load of refinancing and of short-term lending in lieu of longer-term credit without too much difficulty. It is very likely that this load has significantly increased the high risk content of their portfolios. At some point, this will become a constraint on their lending capabilities, and for some banks, pose a possible threat to solvency.

Maintaining the financial strength of the commercial banks is a requisite to stabilizing and advancing private sector growth. Because these banks depend on deposits and have relatively little equity, their ability to handle short-term business would decrease rapidly if medium and long-term loans were to become a significant (over 10 percent) portion of their annual credit disbursement. Also, in the present environment medium and long-term loans are highly risky; unless interest rates or spreads on such loans are much higher than present levels, it is not good business for the commercial banks to extend this type of credit. Their present tendency to expand in this area, in large part forced by the refinancing and emergency needs of their clientele, may cause trouble in the future.

From this it appears that efforts to improve credit availability would be most productive if directed toward correcting the medium- and long-term credit deficiency. Several approaches are possible. One is to provide BCR credit lines to the banks for use in refinancing overdue portfolios. However, since BCR credit lines are limited by law to a one-year term, such provision would represent an expedient but not a solution. More appropriate would be to establish funds for refinancing and for providing medium- and long-term credit, preferably administered by one or more specialized institutions. Using a commercial bank [1/] for this purpose might be less costly, more efficient, and better accepted in the private sector than creating a new public sector institution.

There appears to be some possibility for reviving the private financieras such as existed before 1980, using local and external funds; the nationalization decree of March, 1980 abolished the existing financieras but did not prohibit the creation of new ones. Also, there are possibilities of involvement on the part of some minor credit sources; insurance companies, for example, might be influenced by higher long-term interest rates to make medium- and long-term loans rather than to hold their reserves in banks as time deposits.

It has been suggested that a moratorium be placed on debt resulting from circumstances beyond the control of present borrowers and lenders, such as loss of working capital because of capital flight, property destruction caused by civil violence, and reduced cash flows due to the declining economy. Action along these lines could reduce the demand for new loans to restructure private sector enterprises.

The strength and lending capacity of the commercial banks could also be augmented in various conventional ways. Among these would be increases in capital, particularly for the smaller banks; however, it would first be necessary to prepare a more adequate valuation of assets than now exists, and to

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1/ As recommended in Checchi industrial sector study of December, 1981.

complete the transfer of shares to employees and stockholders. Meanwhile, only retained earnings are available to augment resources. The banks' earnings and resources could be improved by allowing a greater spread on BCR loans and discounts, which would provide them with a greater incentive than now exists to use BCR credit. However, pushing the banks to expand their credit, without adequately protecting them against insolvency, could be counterproductive; the emphasis should be on using resources wisely. There is a close relationship between the financial health of the commercial banks and the prospects for recuperation of productive activity in the private sector. Under prevailing circumstances, the highest credit and investment risk for both banks and business enterprises is probably the political and economic environment. This risk is enhanced by a weakening financial sector; conversely, it might be reduced if the financial institutions were growing stronger.

Under nationalization, the commercial banking system has become a closed one and there are no clear indications as to whether or how new banks can be added. At present, there is evident a tendency for the stronger banks to increase their market shares at the expense of the weaker institutions. This could create a problem for the private sector if, with fewer banks, competition eventually is reduced.

There may be opportunities for reducing loan processing costs by streamlining procedural requirements. In recent years these have become increasingly cumbersome due to the less personalized management style of the nationalized banks, more intensive loan scrutiny by the BCR in providing discounts, greater loan risk in the declining economy, and the limited capability of the banks in credit analysis. Greater efficiency, particularly in the area of credit analysis, could enhance considerably the capability of the system.

Basic decisions are still to be made regarding the desired structure of the banking system. These may have to await the new constitution and the elected government expected in 1984, but meanwhile the alternatives will be open to discussion and study. Nationalization of the existing banks left open the question of whether new private banks could be established.

Extension of the deadline for deposit liquidation by foreign banks continues the uncertainty regarding these institutions' future role. The expansion of the operations of the autonomous public institutions, particularly those in the marketing area, has blurred the distinctions between users and suppliers of credit, and between banking and non-banking financial institutions.

The comprehensive banking law of 1970, under which credit institutions still operate, provided adequately for the system until 1980. Since then, the structure has been changed drastically by the decrees relating to nationalization, public autonomous credit institutions, agrarian reform, and the increased responsibilities of the BCR. There is a need to update the 1970 law, taking account of these structural changes and clarifying the framework for credit operations.

Appendix A

FINANCIAL INSTITUTIONS QUALIFYING UNDER THE LAW OF CREDIT INSTITUTIONS AND AUXILIARY ORGANIZATIONS

January 1983

1. Nationalized banks (10)

2. Branches of foreign banks (4)

3. Investment division of bank (1)

4. Nationalized savings and loan associations (8)

5. Autonomous public financial institutions (8)

   Instituto Salvadoreño de Fomento Industrial (INSAFI)
   Financiera Nacional de la Vivienda (FNV)
   Federacion de Cajas de Credito (Fedeccredito)
   Banco de Fomento Agropecuario
   Fondo de Financiamiento y Garantia Para la Pequeña Empresa (FIGAPE)
   Fondo Social para la Vivienda (FSV)
   Instituto de Prevision Social de la Fuerza Armada
   Fondo de Garantia para el Credito Educativo

6. Domestic insurance companies (11)

7. Foreign insurance companies (3)

8. Bonded warehouses (5)

Source: 1981 statistics, Superintendency of Banks and other financial institutions.

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Appendix B

PRINCIPAL USERS AND SUPPLIERS OF CREDIT AMONG THE PUBLIC AUTONOMOUS INSTITUTIONS

Comisión Ejectiva Hidroelectrica del Rio Lempa (CEL). Constructs and operates electric power facilities, largely hydro and geothermal. Imports national petroleum supplies. A large new investment was underway at the time of the 1979-80 reforms.

Administración Nacional de Telecomunicaciones (ANTEL). Constructs and operates all telecommunications. Has made large current investments to expand infrastructure.

Administración Nacional de Acueductos y Alcantarillados (ANDA). Constructs and operates water and sewage systems throughout the country. Has large current investments for facilities expansion.

Comisión Ejecutiva Portuaria Autóma (CEPA). Operates ports, railroad, international airport.

Instituto Regulador de Abastecimientos (IRA). Buys, stores, and sells food products; operates programs stabilizing prices for growers and consumers; large user of credit.

Instituto Nacional de Transformacion Agrícola (ISTA). Charged with implementation of agrarian reform program vis a vis large farms.

Financiera Nacional de Tierras Agrícolas (FINATA). Charged with implementation of agrarian reform program for small farms.

Banco de Fomento Agropecuario (BFA). Agricultural development bank.

Instituto Nacional del Café (INCAFE). Buys and markets coffee.

Instituto Nacional del Azúcar (INAZUCAR). Produces, buys, and markets sugar.

Financiera Nacional de la Vivienda (FNV). Supervises and assists savings and loan associations.

Fondo de Financiamiento y Garantía Para la Paqueña Empresa (FIGAPE). Makes small production loans.

Instituto Salvadoreño de Fomento Industrial (INSAFI). The now defunct development bank. Portfolio being transferred to CORSAIN and BANAFI (see below).

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Corporación Salvadoreña de Industrias (CORSAIN). Will inherit the investment portfolio of INSAFI.

Banco de Fomento Industrial (BANAFI). Will inherit the loan portfolio of INSAFI and make new loans.

Federacion de Cajas de Credito (FEDECCREDITO). Supervises and assists a network of 42 independent credit cooperatives.

Fondo Social para la Vivienda (FSV). Supervises and assists a network of employee-worker organizations providing funds for housing.

Instituto de Prévision Social de la Fuerza Armada. Administers retirement plan for armed forces.

Fondo de Garantia para el Credito Educativo. Provides educational credits.

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Appendix C

FOREIGN BANKS IN EL SALVADOR

The bank nationalization law of March 1980 permitted foreign bank branches to operate in El Salvador, but terminated the authority of these branches to accept deposits and gave them one year to liquidate their deposit accounts. This liquidation period subsequently was extended several times, most recently by Decree No. 126, to December 1985. The preamble to Decree No. 126 states that liquidation is not considered convenient since it would bring about a reduction in foreign investment and delay economic recovery. This statement gives rise to speculation that foreign banks at some future date may again provide full banking services; in effect, the decree postpones that decision beyond March 1984, so that an elected government can define the appropriate policy.

Of the four foreign banks having branches in El Salvador, only two have ever been authorized to take local deposits: the Bank of London and Montreal (Lloyds), established in 1917; and Citibank, established in 1965. Deposits in the Bank of London totaled ₡105.5 million in March 1980, but as of December 31, 1982, had dropped to ₡14.3 million. Citibank deposits fell from ₡40.4 million to ₡4.7 million over the same 21-month period.

At present, the four foreign bank branches (the other two being Bank of America and Banco de Santander y Panama, both established in 1977) continue to provide services and manage small remaining loan portfolios. Outstanding loan balances as of December 31, 1982 were ₡10.1 million for Bank of London, ₡9 million for Citibank, and ₡0.7 million for Bank of America.

Bank of London and Citibank deposits and loans are included in the statistics compiled by BCR for commercial banks. Loans provided by non-deposit banking institutions (Bank of America) are covered in the statistics for other lending institutions.

Appendix D

SITUATION OF COMMERCIAL BANKS

El Salvador's nine commercial banks, plus the large commercial department of the mortgage bank, provide about 65 percent of all credit used in the private sector and hold most of the deposits. Other credit institutions are supplemental to the commercial banks; they are designed to lend for special purposes.

The mortgage bank (Banco Hipotecario) has always been a government-controlled institution. After 1979, the slump in business and construction almost wiped out the supply and demand for mortgage credit; the larger part of the bank's current operations are now commercial. Its large, illiquid mortgage portfolio is a heavy burden on overall operations. However, the bank is the largest single holder of deposits (about 20 percent of those in the commercial banking system) and accounts for about 25 percent of the outstanding commercial credit. Because of its low liquidity, it is a much larger user of BCR credit (almost 45 percent of its loans) than the nine commercial banks (an average of 25 percent).

Before their nationalization in 1980, control and management of the commercial banks were heavily interlinked with the ownership of large and medium agricultural, commercial, and industrial enterprises. Production and working capital loans were made largely on the basis of personal contacts and long-standing client relationships. Few loans exceeded a one-year term; intermediate and long-term capital was provided primarily by direct local investment and external financing. The banks relied mainly on their own resources and made only minor use of BCR rediscounting privileges. Under these circumstances, there was little need to develop any substantial capacity in credit analysis and client assistance.

Initially, nationalization had surprisingly little impact on this system. Except for top management, there was little change of personnel, and loans tended to be made on much the same basis as before. However, to support the agrarian reform, the government required the banks to provide production credit to the new cooperatives instead of their previous landholding clientele.

Under the nationalization decree, the commercial banks are to become mixed government-private enterprises, with the government holding 51 percent of the stock, employees up to 20 percent, and the public 29 percent, with no individual or entity having more than a one percent interest. Compensation to previous owners and the value of shares offered to the public are to be based on net worth at the time of nationalization. As of February 1983, these net worths had been only partially established. A principal problem is the valuation of overdue loans, which because of the previous intermeshing of lenders and borrowers, relates in some cases to compensation for expropriated properties. While for some banks the

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valuation process may soon be completed and shares offered to employees and the public, the overall restructuring of the banks as mixed enterprises may take another year or two.

Under the interim control of the BCR, which is exercised by appointment of bank directors and top managers, each of the commercial banks operates as an independent competitive entity. One of the smaller, weaker institutions (Banco Internacional) merged during 1982 with one of the largest and strongest (Banco Cuscatlan). Since nationalization, the combined deposits of the ten commercial banking entities (nine banks plus Hipotecario) have risen from ₡1.7 million to ₡2.4 million (41 percent) and outstanding credit and investments jumped from ₡2.1 million to ₡2.7 million (28 percent). In both cases, growth since nationalization has exceeded or kept pace with the rate of price increases (28 percent).

In view of this growth and their continuing stable share of overall credit supply, it appears that the commercial banks have not lost any ground because of nationalization. Nevertheless, there are some serious problems within the system. Increasingly, credit is being tied up in refinanced or overdue loans, which now exceed 30 percent of the total loans outstanding. Because demand for new loans is weak, the system has been able to carry this so far; however, if demand turns upward, it will very quickly find itself hard-pressed for loan resources. Reliance on BCR credit to meet growth in demand would add further to the already excessive burden of the BCR in providing public sector credit. Additionally, since this credit would indirectly be financing the banks' problem portfolios, it would only exacerbate the structural problems of the banks and would delay a proper valuation of assets promoting public participation in bank ownership.

Another problem is the poor current earnings of several of the banks. While the nine commercial banks together reported a 17 percent return on capital and a 12 percent return on equity in 1982, two of the banks reported figures under five percent. The commercial department of the mortgage bank also lost money, reporting a negative 2.4 percent return. Equally serious is that the figures on earnings reported by other banks (over 14 percent on capital, over 10 percent on equity) are of doubtful quality due to the high proportion of overdue loans in their portfolios, few of which have been written off.

Some of the banks are undercapitalized. The capital and reserves of the commercial banking system, including Hipotecario's commercial department, make up eight percent of deposits and 14 percent of the outstanding loans. However, the commercial department of the mortgage bank has no equity and negative earnings, and thus cannot accept large writeoffs of bad debts. Several of the commercial banks could also be wiped out if they had to make substantial writeoffs. Meanwhile, the only new capital entering the system is in the form of earnings after taxes and, in some cases, after a 10 percent deduction for distribution to employees.

The banks with the least earnings and capital tend to be the heaviest users of BCR credit. For Banco Hipotecario, the percentage of outstanding loans financed through the BCR was 44 percent at year-end 1982. For the highest earning bank (Cuscatlan), the percentage was only 10 percent; while two other banks with good earnings (Agricola and Comercio) reported seven percent and 13 percent. In some cases, the use of BCR credit reflects the bank's style of operations (Desarrollo e Inversiones, a relatively profitable bank, had BCR credit equivalent to 55 percent of its loans in 1982), but in general, the tendency is for the weaker banks to use disproprotionately large volumes of BCR credit.

Among the commercial banks there is increasingly strong competition for deposits, and for providing loans and services. The more aggressive better-managed banks are gaining larger deposit and loan shares at the expense of the weaker institutions. It is quite possible that some of the latter will be merged with the former, a process facilitated by the fact that all are government owned. If this happens, the credit needs of the private sector would be handled by progressively fewer suppliers.

Another continuing problem in the banking system is related to human resources, and particularly to the lack of personnel skilled in credit analysis. Most of the banks are faced with serious portfolio problems and must operate in an environment of uncertainty, high risk, and public pressure to get the economy moving. Austerity limits the hiring of new personnel, pay scales are frozen at unattractive levels, and there is limited availability of people possessing the necessary skills.

The stronger banks are making good progress in building up their credit analysis capabilities, and in 1982 an AID-supported project contributed substantially toward such improvement. However, there remains a great deal to be done in this area and additional assistance could be well used.

An upward turn in the economy would create an urgent demand for intermediate and long-term credit. During the 1960's and 1970's, El Salvador had some term-lending institutions in the form of private financieras and a government development bank. However, the financieras have disappeared and the development bank, which failed, has yet to be replaced by any operating institution. Thus, the initial demands for investment capital in a recovering economy probably will be handled by the commercial banks. To meet these demands, these banks will have to increase their resources and their analytical and service capabilities. Within the system, there may soon be needed a specialized lending facility, either as part of one or more of the commercial banks, or closely associated elsewhere with the private sector.

Appendix E

SUPPLEMENTARY TABLES

Table E-1

PRICE INDICES AND GROSS NATIONAL PRODUCT
1975 - 1982

Year	Consumer 1978 = 100	Wholesale 1955 = 100	Market 1962 = 100	Gross National Product (million colones)
1975	-	147.6	143.4	4,559.9
1976	79.3	198.8	175.7	5,705.9
1977	88.6	292.9	208.1	7,167.1
1978	100.0	234.7	209.9	7,692.2
1979	114.8	265.9	239.3	8,618.7
1980	136.2	273.0	272.8	8,943.6
1981	152.0	288.8	296.1	8,785.7
1982	168.9 1/	314.3 1/	326.1 2/	9,675.9 2/

1/ September 1982.

2/ Estimated December 1982.

Source: Revista Manual, BCR.

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Table E-2

USES OF PRIVATE SECTOR CREDIT DISBURSED BY BCR[1/]
1975 - 1982

(million colones)

Year	Agriculture and Livestock: Total	Agriculture and Livestock: Coffee	Agriculture and Livestock: Cotton	Commerce[2/]	Industry	Construction	Refinancing	Other	Total
1975	430.9	47.2	295.2	206.6	73.8	29.6	282.1	6.3	1,029.4
1976	439.8	111.0	228.7	289.3	123.6	67.5	160.7	17.3	1,098.1
1977	536.1	132.7	298.1	358.8	130.7	70.3	195.5	13.7	1,400.1
1978	547.6	81.0	339.7	292.0	117.5	81.3	333.7	43.6	1,415.6
1979	496.1	171.9	185.1	484.6	76.9	105.9	244.1	32.1	1,439.7
1980	499.1	296.7	114.9	1,864.2[2/]	177.8	478.2	630.6	218.1	3,868.1
1981	621.8	410.0	164.5	753.3	97.0	110.6	1,159.8	380.6	3,123.0
1982[3/]	119.2	94.4	12.9	43.3	40.2	0.6	1,040.2	20.5	1,264.0

1/ Loans and discounts to commercial banks, to other private credit institutions, and to public agencies lending to the private sector.

2/ Increased financing of coffee export operations (INCAFE).

3/ January - June.

Source: Revista Mensual, BCR.

Table E-3

BCR CREDIT TO THE PRIVATE SECTOR
BALANCES OUTSTANDING AT YEAR END
1975 - 1982

(million colones)

Year	Commercial Banks					Other Financial Institutions[1/]					Totals[2/] All Sub-sectors
	Agriculture	Industry	Construction	Commerce	Total[2/]	Agriculture	Industry	Construction	Commerce	Total[2/]	
1975	165.0	11.5	8.6	35.2	243.3	90.8	29.0	13.3	177.2	324.4	567.7
1976	204.3	12.2	12.4	35.5	285.5	111.1	6.5	17.1	173.0	352.7	638.2
1977	231.4	24.4	15.1	39.7	336.1	265.0	86.2	28.3	51.0	449.8	714.8
1978	199.2	29.3	25.7	28.7	316.3	260.8	93.2	33.4	51.6	488.1	804.4
1979	317.5	53.9	29.5	39.1	533.4	220.2	132.8	110.9	166.6	672.0	1,205.4
1980	226.2	56.7	43.7	43.6	606.3	385.1	190.5	77.7	385.6	1,124.3	1,730.6
1981	309.2	27.0	27.6	28.5	585.5	376.1	317.5	43.8	238.5	1,061.7	1,647.2
1982	426.4	51.9	23.7	19.5	638.1	251.3	342.6	25.3	184.4	909.9	1,548.0

1/ Includes Fedeccredito, COPAL, Fedecaces, BFA, Insafi, Inazucar, Figape, Incafe, Finata, FNV, and Financiera Salvadoreña.

2/ Totals include services and other activities.

Source: BCR.

Table E-4

BCR CREDIT TO COMMERCIAL BANKS
1974 - 1982
(million colones)

Year	BCR Credit to Banks	Bank Deposits in BCR	Total Bank Deposits	Banks Legal Reserve	Banks Excess Reserves
1974	286.6	274.3	890.6	267.2	28.2
1975	243.3	349.7	1,117.7	335.3	42.8
1976	285.5	448.9	1,390.0	417.0	67.4
1977	336.1	492.2	1,608.6	482.6	46.7
1978	316.3	372.3	1,784.3	356.9	62.5
1979	533.4	345.7	1,739.7	347.9	45.0
1980	606.3	439.7	1,893.7	378.7	129.4
1981	585.5	496.7	2,150.7	430.1	66.6
1982	638.1	559.2	2,408.2	481.6	77.6

Table E-5

FNV AND SAVINGS AND LOAN ASSOCIATIONS:
DEPOSITS AND PRIVATE SECTOR LOANS OUTSTANDING AT YEAR END
1975 - 1982

(million colones)

Year	Deposits	Construction Loans	Long-term Loans	Total Credit Outstanding
1975	242.6	77.1	30.5	175.0
1976	356.8	60.8	30.4	228.8
1977	477.7	114.9	84.0	338.3
1978	553.5	110.4	79.3	467.8
1979	467.0	54.8	50.1	543.0
1980	530.0	89.3	21.6	547.3
1981	630.2	139.3	39.1	605.1
Nov. 1982	669.0	-	-	671.3

Source: Banco Central de Reserva and
Financiera Nacional de la Vivienda.

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Table E-6

INTEREST RATES AS ESTABLISHED BY BCR
December 1982

	BCR to Bank %	Bank to User %	Spread
External Resources			
Short-term[1/]	15.0	17.9	2
Medium and long-term:			
Small business	14.0	16.0	2
Other	17.0	19.0	2
Structured-industry:			
Medium and large business	8.0	10.0	2
Small business	4.0	7.0	3
Cooperatives	5.0	7.0	2
Coffee rust:			
Small producers	8.0	10.0	2
Medium producers	11.0	13.0	2
Large producers	Cost	Cost + 1-3/4	1-3/4
Internal Resources			
Export and pre-export:			
CACM	13.0	15.0	2
Other	11.0	13.0	2
Ind. working capital:			
Small	11.0	13.0	2
Large	13.0	15.0	2
Coffee:			
Small producers	11.0	13.0	2
Medium producers	13.0	15.0	2
Large producers	Cost	Cost + 2	2
Cotton	11.0	13.0	2
Cereals, etc.	11.0	13.0	2
Sugarcane	11.0	13.0	2
Cattle	13.0	15.0	2

1/ Adjustable each month.
2/ Adjustable every 6 months.

Table E-7

MONEY SUPPLY AND GROSS NATIONAL PRODUCT, EL SALVADOR
1975 - 1982

(million colones)

Year	M_1[1/]	M_2[2/]	M_3[3/]	Gross National Product[4/]
1975	693.0	1,397.7	1,268.0]	4,559.9
1976	998.7	1,852.4	1,570.3	5,705.9
1977	1,097.3	2,112.6	2,090.8	7,167.1
1978	1,190.2	2,344.6	2,469.7	7,692.2
1979	1,427.8	2,552.6	2,816.2	8.618.7
1980	1,558.8	2,693.5	2,968.3	8.943.6
1981	1,568.5	2,965.5	3,156.9	8.785.7
1982	1,628.3	3,261.4	3,930.4	9,675.9[5/]

1/ Currency and sight deposits.

2/ M_1 plus savings and time deposits.

3/ M_1 and M_2 plus savings and loan deposits.

4/ At current prices.

5/ Estimated December 1982.

Source: Banco Central de Reserva.

Table E-8

COMMERCIAL BANKS INCLUDING HIPOTECARIO:
SELECTED FINANCIAL STATISTICS
December 31, 1982

(million colones)

Bank	Total Assets	Total Liabilities	Total Deposits[1/]	Loans and Discounts Outstanding[1/]	Debt to BCR	Capital	Reserves[2/]	Net Worth	1982 Earnings
Cuscatlan	736.0	692.0	383.6	337.8	32.8	31.5	12.5	44.0	7.6
Agrícola	488.4	450.5	405.1	278.4	20.6	30.0	7.9	37.9	4.9
Salvadoreño	447.5	418.7	319.1	259.5	41.0	25.0	3.8	28.8	1.3
Comercio	375.6	333.4	264.5	207.9	27.5	35.0	7.2	42.2	4.9
Capitalizador	317.0	298.8	200.9	154.9	26.1	14.0	4.2	18.2	3.0
Credito Popular	365.1	336.4	125.1	141.0	62.4	5.0	23.7	28.7	3.1
Desarrollo e Inversiones	202.5	179.7	66.9	121.8	67.3	17.0	5.8	22.8	2.3
Mercantil	136.6	122.7	71.8	84.6	25.9	10.0	3.9	13.9	1.7
Financiero	61.7	58.2	31.4	39.7	15.4	3.0	0.5	3.5	0.1
Totals	3,130.4	2,890.4	1,868.4	1,625.6	319.0	170.5	69.5	240.0	28.8
Hipotecario (total)	1,181.7	1,146.2	521.3	845.6	270.9	9.9	34.6	35.5	0.3
Hipotecario (without mortgage dept.)	637.8	637.8	521.3	571.7	250.8	-	-	-	2.4
Totals[3/]	3,768.2	3,528.2	2,389.7	2,197.3	569.8	170.5	104.1	240.0	26.4

1/ Excludes trust departments.

2/ Includes reserves, legal reserve, and surplus.

3/ Excludes Hipotecario mortgage department.

Source: Balance sheets and earnings statements, December 31, 1982.

Table E-9

BALANCE SHEET STATISTICS FOR SELECTED FINANCIAL INSTITUTIONS
Year-end 1982
(million colones)

Institution	Assets	Liabilities	Deposits	Loans	Net Worth
BFA	529.5	433.5	33.9	345.4	96.0
Figape	62.9	18.5	-	41.7	44.4
FNV 1/	1,026.4	975.2	669.0	671.3	51.2
FSV	490.6	431.7	396.9	339.8	58.9
Citibank	14.5	8.9	4.7	9.0	5.6
Bank of London	38.8	21.0	14.3	10.1	17.8
Bank of America	7.6	5.7	-	0.7	1.9

1/ As of November 30, 1982. Includes the eight savings and loan associations.

APPENDIX F

ENCUESTA DEL SECTOR FINANCIERO

Introducción

La Compañía "Checchi & Co." de los Estados Unidos, bajo contrato con la Agencia para el Desarrollo Internacional (A.I.D.), está realizando un estudio para analizar la demanda de crédito y las disponibilidades de fondos del sector financiero para satisfacer dicha demanda.

La información que se solicita en los tres cuadros adjuntos es de mucha utilidad para la realización del estudio indicado.

Observaciones con Relación al Llenado de los Cuadros Adjuntos

1) No se incluirán decimales. Los datos se redondearán al número entero más próximo.

2) Si en los cuadros se solicita algún dato que la Institución no desea dar, anote una letra "x" en el lugar correspondiente al dato.

3) Si en los cuadros se solicita algún dato que la Institución no tiene disponible, le rogamos que trate de estimarlo a su mejor criterio y anteponga una letra "Y" mayúscula al dato estimado.

4) Si el dato solicitado no es aplicable a la empresa por favor anote en el lugar correspondiente las letras n.a.

5) Cuadro No. 1: Las cuentas del mayor del balance general que no aparezcan específicamente mencionadas en el cuadro, se considerarían como "otros activos" u "otros pasivos" y se deberían tomar en consideración al calcular la diferencia "otros pasivos menos otros activos", la cual aparece en una de las líneas del cuadro.

6) Cuadro No. 2: a) Los refinanciamientos se incluirían como entregas de préstamos y se anotarían en la columna correspondiente de acuerdo al plazo al cual se proyecta que se concedería el refinanciamiento; b) Bajo la columna "nuevos préstamos" se anotarían las cifras correspondientes a desembolsos o entregas de préstamos que no son considerados refinanciamientos por la Institución; c) En el caso de los préstamos agrícolas, las cifras que la Institución no haya desglosado a nivel de actividad en sus proyecciones, se anotarían en la línea "1.1. agrícolas"; d) En cada estrato de plazos de préstamos (1 año, mayor de 1 año y hasta 5 años, o mayor de 5 años) para cada línea de actividad, se anotarían los códigos de los tres principales factores que limitan un mayor volumen de entregas de préstamos (favor referirse a los códigos al calce del Cuadro No. 2). Los códigos correspondientes se escribirían bajo la columna "3 principales factores limitantes de las entregas".

7) Cuadro No. 3: a) La columna saldo total se refiere al total de la cartera de cada actividad, incluyendo cartera en situación corriente, cartera refinanciada y cartera vencida; b) La cartera vencida incluiría todos los tipos de préstamos vencidos; c) Se le ruega anotar al calce del cuadro, la norma que usa la Institución con relación al período de envejecimiento a partir del cual un saldo de cuota vencida se registra como cartera vencida.

8) El Ing. Gustavo A. Gómez, de la Compañía Checchi & Co., con mucho gusto atendería cualquier llamada relacionada al llenado de los Cuadros adjuntos. Tel.: 26-7100 ext. 344.

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Cuadro No. 1

Nombre del Banco:

PROYECCION DEL ESTADO DE FUENTE Y USO DE RECURSOS

Miles de Colones

	Dic. 31,1983 Proyectado Saldos	Dic. 31,1982 Realizado Saldos	Variación[a]
A. Fuentes de Recursos			
Depósitos			
A la vista			
A plazo			
En divisas			
Fideicomisos			
Comisiones de Inversión			
Fideicomisos puros			
Préstamos del B.C.R.			
Préstamos del Exterior			
Otros Pasivos menos Otros Activos			
Patrimonio			
Capital y Reservas			
Superavit			
Suma			
B. Uso de Recursos			
Disponibilidades			
Divisas			
Préstamos Totales			
Préstamos y Descuentos			
Cartera Fiduciaria			
Inversiones			
Suma			

[a] Anotar entre paréntesis las cifras que resulten negativas al restar los saldos proyectados para 1983 de los saldos de 1982.

Provisiones para Cartera			

Cuadro No. 2

Nombre del Banco:

PROYECCIONES DE ENTREGAS DE CREDITO PARA 1983

Miles de Colones

Actividad	Préstamos hasta 1 año de plazo			Plazo mayor de 1 año y hasta 5 años			Plazo mayor de 5 años		
	Refinanciamiento	Nuevos Préstamos	3 Principales factores limitantes de las entregas*	Refinanciamiento	Nuevos Préstamos	3 Principales factores limitantes de las entregas*	Refinanciamiento	Nuevos Préstamos	3 Principales factores limitantes de las entregas*
1. Crédito Agropecuario									
1.1 Agrícola									
a) café									
b) algodón									
c) Caña de Azúcar									
d) maíz									
e) frijol									
f) arroz									
g) otros									
1.2 Ganadería mayor									
1.3 Avicultura									
1.4 Pesca y otros									
Sub-Total Agropecuario									
2. Industria Manufacturera Mediana y Grande									
3. Comercio Mediano y Grande									
4. Industria de la Construcción									
5. Pequeño Comercio e Industria									
6. Otros									
Suma Total									

*De izquierda a derecha, en su orden de importancia, se anotarán los códigos de los tres factores principales que impiden que las entregas sean mayores. Los Códigos son los siguientes:

- Falta de Demanda - - - - - - - - - - - - - A
- Riesgos de la calidad crediticia de la demanda de crédito - - - - - - - - - - B
- Riesgos del entorno, no controlables por el Banco - - - - - - - - - - - - - - - - - C
- Riesgos de la actividad - - - - - - - - - D
- El Banco como política no otorga préstamos a la actividad - - - - - - - - - - - E
- Insuficiencia de los recursos accesibles al Banco - - - - - - - - - - - - - - - - - - F
- Condiciones restrictivas de los financiamientos accesibles al Banco - - - - - - - G
- Parámetros financieros establecidos por el Banco para su estructura financiera - - - - - - - - - - - - - - - H
- Política de consolidación organizativa y administrativa del Banco - - - I

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Cuadro No. 3

Nombre del Banco:

ESTRUCTURA DE LA CARTERA DE PRESTAMOS

Miles de Colones

Actividad	A Dic. 31, 1981 Saldo Total	Refinanciada en corriente 1/	Cartera vencida en total	A Dic. 31, 1982 Saldo Total	Refinanciada en corriente 1/	Cartera vencida en total	Perspectiva para 1983 2/
1. Agropecuaria							
2. Industria Manufacturera Mediana y Grande							
3. Comercio Mediano y Grande							
4. Industria de la Construcción							
5. Pequeño Comercio e Industria							
6. Otros							
Suma							

1/ Se refiere a saldos de cartera refinanciada que no está en situación vencida (mora).

2/ Se refiere a si la proporción de cartera vencida sobre el saldo total de cartera mejorará o empeorará. Favor indicar con una "A" si se cree que mejorará y con una "B" si se cree que empeorará.

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Appendix G

INDUSTRIAL SECTOR SURVEY RESULTS

The findings reported below are based on a sample of 33 member firms of the Salvadoran Association of Industries (ASI). The firms in the sample represented about 14 percent of ASI's membership, and employed 5,400 workers, equivalent to 9.3 percent of El Salvador's industrial labor force in 1978.

Market Potential and Financial Structure

Sales

Sales revenues of all sample firms combined are expected to grow in real terms by 8.5 percent in 1983. Assuming a 12-percent rate of inflation, the percentage increase in current prices would be around 22 percent. The proportion of sales to other countries of Central America could increase from 17 percent in 1982 to 20 percent; whereas the proportion of sales to the local market could decrease from 77 percent to 75 percent. The proportion of sales outside the region may be about the same as in 1982, when it was five percent.

The sales increase anticipated by the sample firms may be somewhat higher than for the industrial sector as a whole, since these are the principal exporters to the Central American market, where growth is more likely to take place. In 1980, their exports accounted for 66 percent of all Salvadoran industrial exports to countries in Central America.

The sales revenue (in real terms) of the firms in the sample decreased at an annual rate of 4.6 percent during the five years from 1978 to 1982. Projected sales for 1983 would be similar in real terms to sales in 1981 (Table G.1).

The anticipated 8.5 percent increase in sales revenues appears somewhat optimistic in light of existing political and economic conditions of El Salvador and the other Central American countries. Nevertheless, the

Table G.1

INDUSTRIAL SECTOR: ESTIMATED SALES REVENUES, BY MARKET AREA: 1978-1983
(sample information in million colones)

Sales		1978	1979	1980	1981	1982	1983
Total Sales in Current Prices	₡	341	389	414	419	457	556
	%	(100.0)	(100.0)	(100.0)	(100.0)	(100.0)	(100.0)
Domestic Sales	₡	224	270	283	308	355	416
	%	(65.7)	(69.4)	(68.4)	(73.5)	(77.7)	(74.8)
Regional Sales	₡	70	89	102	90	79	113
	%	(20.1)	(22.9)	(24.6)	(21.5)	(17.3)	(20.3)
Extra-regional Sales	₡	47	30	29	21	23	27
	%	(13.8)	(7.7)	(7.0)	(5.0)	(5.0)	(4.9)
Total Sales at Constant (1978) Prices	₡	341	341	318	297	282	306
% Change from Previous Year		--	0	(6.7)	(6.7)	(5.1)	8.5

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firms in the sample believe that they will be able to achieve their growth objectives if they can obtain the foreign exchange required to satisfy their import requirements for raw materials, spare parts, and equipment. The industrial sector is losing sales opportunities because the inadequate supply of foreign exchange prevents it from satisfying its import needs in a timely fashion. Members of the industrial and banking communities are unanimous in their view that the shortage of foreign exchange is a principal constraint on industrial growth.

Financial Structure

Most of the firms sampled had an adequate total debt to equity structure, but a significant number faced liquidity problems. The firms with the weaker financial structure were the smaller ones in terms of total assets and possibly had a lower rate of return (profitability) on these assets as well.

The proportion of firms reporting a ratio of liability to net worth of 2:1 or better was 70 percent (Table G.2). The median debt/equity ratio was

Table G.2

RATIO OF TOTAL LIABILITY TO NET WORTH
(sample information)

December 31, 1982

Debt/Equity Ratio	Number of Firms	% of Total
Up to 2:1	23	70
Greater than 2:1 and up to 3:1	3	9
Greater than 3:1 and up to 4.2:1	5	15
Greater than 4.2:1	2	6
Total:	33	100

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0.8:1 for firms with ratios of 2:1 or lower, and 3.6:1 for the firms with ratios above 2:1. About half of the firms (51 percent) had part of their outstanding debt (an average of 20 percent) in arrears, and were presumably facing liquidity problems. The proportion of firms with outstanding debt in arrears was 48 percent for the group with debt/equity ratios of 2:1 or lower, and 60 percent for the group with ratios higher than 2:1. The average value of total assets was ₡ 17.6 million for firms in the former category, but only ₡ 11.7 million for firms in the latter group (Table G.3). These weaker firms may also have been less profitable; their sales in 1982 accounted for only 15 percent of the sales revenues, whereas their assets represented 23 percent of the total assets.

Table G.3

FINANCIAL STRUCTURE
(sample information in thousand colones)

	Average for Industries with Debt/Equity Ratios of 2:1 or lower	Average for Industries with Debt/Equity Ratios higher than 2:1
Total Assets	17,564	11,702
Liabilities:		
Overdue debt	1,095	982
Short-term debt	2,415	1,443
Other short-term liabilities	1,949	3,123
Long-term debt	1,382	3,542
Total Liabilities	6,841	9,090
Net Worth	10,723	2,612

Credit

Credit Requirements

The financially healthier firms (those showing debt/equity ratios no higher than 2:1) accounted for 76 percent (¢ 144 million) of the new credit requirements of the sample firms, and 56 percent (¢ 28 million) of the re-financing needs. These firms' overall credit requirements thus amount to ¢ 172 million, or 72 percent of the total for all firms (Table G.4). This proportion is generally in line with asset size in that the healthier firms account for 77 percent of the total assets.

Table G-4

ESTIMATED 1983 CREDIT REQUIREMENTS
(sample information in million colones)

Type of Credit	Credit Requirements in ¢ millions by Financial Structure of Firms: Up to 2:1 amount	%	Higher than 2:1 amount	%	All Sample Firms amount	%
1. New Loans						
To finance imports	85	68.5	39	31.5	124	100
To finance local expenses	59	89.4	7	10.6	66	100
Sub-total	144	75.8	46	24.2	190	100
2. Refinancing	28 a/	56.0	22 a/	44.0	50	100
Total	172	71.7	68 ±	28.3	240	100]

---

a/ The proportion of firms requiring refinancing was 17 percent for the group with debt/equity ratios of up to 2:1 and 50 percent for the group with higher debt/equity ratios. In the latter group, one firm accounted for 67 percent of refinancing requirements. However, another firm of the same group indicated a need for refinancing but did not state the amount required.

The short- and long-term new credit needs of all the firms in the sample are ₡ 173 million and ₡ 17 million, respectively. On the other hand, most refinancing is needed for long-term purposes (₡ 17 million compared with ₡ 4 million in short-term refinancing requirements). Based on the survey results, the percentage of total credit needs representing needs for new long-term credit will decline from 10.5 percent in 1982 to seven percent in 1983, whereas the percentage representing long-term refinancing needs will rise from 7.4 percent to 19.2 percent (Table G.5).

Table G.5

ACTUAL (1982) AND PROJECTED (1983) CREDIT NEEDS
(sample information in million colones)

	1982 Disbursed Amount	% of Total	1983 Planned Amount	% of Total
Short-term:				
New loans	69	72.6	173	72.1
Refinancing	9	9.5	4	1.7
Sub-total	78	82.1	177	73.8
Long-term:				
New loans	10	10.5	17	7.0
Refinancing	7	7.4	46	19.2
Sub-total	17	17.9	63	26.2
Total	95	100.0	240	100.0

Credit Use

Firms in the sample population expect their use of new credit for purchasing imports to increase by 153 percent from ₡ 49 million in 1982 to ₡ 124 million in 1983, and their use of credit for local expenses to increase by 120 percent, from ₡ 30 million to ₡ 66 million. In 1983, about 66 percent of all new credit would be used for imports (Table G.6).

Table G.6

NEW CREDIT REQUIREMENTS, BY TYPE OF USE: 1982 and 1983
(sample information in million colones)

	1982 Actual Amount	% of Total	1983 Amount	% of Total	% Change: 1982-1983
For Imports	49	62.3	124	65.8	153
For Local Expenses	30	37.7	66	34.2	120
Total	79	100.0	190	100.0	140

Credit demand for both imports and local expenses will be fairly even throughout the year. For imports it will be 27.4 percent in the first quarter and decrease gradually to 22.6 percent in the last quarter; for local expenses it will start at 28.9 percent and decline to 22.7 percent (Table G.7).

Table G.7

SEASONABILITY OF NEW CREDIT DEMAND: 1983
(sample information in million colones)

New Credit Demand a/	January March	April June	July Sept.	October Dec.	Total
To Finance Imports:					
Amount needed in million colones	34	33	29	28	124
Percentage of annual requirements	27.4	26.6	23.4	22.6	100
To Finance Local Expenses:					
Amount needed in million colones	19	16	16	15	66
Percentage of annual requirements	28.9	24.2	24.2	22.7	100
Total Quarterly Requirements					
Amount needed in million colones	53	49	45	43	190
Percentage of annual requirements	27.8	25.8	23.7	22.6	100

a/ Exclusive of refinancing.

Estimate of Maximum Credit Demand

The maximum credit demand (excluding refinancing) of the industrial sector was estimated at ₡ 332 million on the basis of the sample information. (The computations performed to arrive at this figure are shown on the following page) (Table G.8).

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Table G-8

COMPUTATION OF MAXIMUM CREDIT DEMAND ESTIMATE

I. Short-Term Credit (sample information)

a)	Disbursements (excluding refinancing)	¢ 173 million
b)	Outstanding debt at the beginning of the year	105 "
c)	Repayments	105 "
d)	Outstanding debt at year-end 1983	134 "

173 x 3/4 = ¢ 130 million

plus refinancing = ¢ 4 million

II. Long-Term Credit (sample information)

a)	Disbursements	¢ 17 million
b)	Outstanding debt at the beginning of the year	67 "
c)	Repayments	23 "
d)	Outstanding debt at year-end 1983	107 "

17 + (67-23) = ¢ 61 million

plus refinancing = ¢ 46 million

III. Increase in Outstanding Debt (sample information)

a)	(134 + 107) - (105 + 67) =	¢ 69 million
b)	Percentage increase: (69/105 + 67) =	40 percent
c)	Ratio of refinancing to total disbursements: (4 + 46)/(134 + 107) =	20.8 percent

IV. Portfolio Projection

a)	Portfolio at year-end 1982	¢ 414 million
b)	Portfolio at year-end 1983: 414 x 1.40 =	¢ 580 "

V. Credit Demand Estimate for 1983

a)	Ratio of Portfolio to credit disbursement, 1.39 in 1981; 1.36 in 1980	
b)	Credit disbursement estimate including refinancing 580/1.39 =	¢ 417 million
c)	Credit demand excluding refinancing 417 (1.000 - 0.208) =	¢ 332 "

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ENCUESTAS DEL SECTOR INDUSTRIAL

Objetivo: Estimar a nivel del sector: a) los requerimientos de crédito, b) las proyecciones de ventas y c) la estructura financiera. También se desea obtener sugerencias, si las hubiera, con relación a las Políticas y Sistemas de crédito del sector bancario.

OBSERVACIONES CON RELACION AL LLENADO DE LA BOLETA DE LA ENCUESTA

a) No se incluirán decimales en el llenado de la boleta. Los datos se redondearán al número entero más próximo.

b) Si en la boleta se le solicita suministrar algún dato que la empresa no desea dar, anote una letra "x" en el lugar correspondiente al dato.

c) Si en la boleta se le solicita algún dato que la empresa no tiene disponible, le rogamos que trate de estimarlo a su mejor criterio y anteponga una letra "Y" mayúscula al dato estimado.

d) Cuadro No. 1: Los datos de ventas se refieren a las ventas totales incluyendo aquellas en las que la empresa pudiera haber concedido crédito al comprador.

e) Cuadro No. 2: El activo total es neto de depreciaciones acumuladas y cualquier otra provisión. En la parte del pasivo, los intereses acumulados por pagar formarían parte del rubro "todos los demás pasivos de corto plazo".

f) Cuadro No. 3: Las proyecciones de ventas deberán reflejar el valor de ventas más probable a juicio de la empresa, bajo la suposición que la empresa solicita y obtiene oportunamente los préstamos que requeriría para cumplir con el programa de ventas.

g) Cuadro No. 4: Se refiere únicamente a las cancelaciones y amortizaciones de deudas con el sistema financiero institucional con base a los vencimientos acordados con la institución acreedora (bajo la suposición que no se requeriría refinanciamiento).

h) Cuadro No. 5 y 6: Favor tener en cuenta que al separar en estos cuadros los préstamos o partes de préstamos que se usarían para importaciones, lo que se pretende es conocer las necesidades de crédito que involucrarían necesidades de divisas. Los valores de las importaciones que se harían con los préstamos se deberán expresar a precios C.I.F.

i) Cuadro No. 7: Se refiere a los préstamos recibidos (desembolsados de los Bancos) y los refinanciamientos.

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ENCUESTA DEL SECTOR INDUSTRIAL

Enero 1983

Nombre de la Empresa:
Teléfono:

Productos de la Empresa:

Materia Prima Principal (M.P.):

País de Origen M.P.

Número de Empleados y Obreros a la fecha:

Cuadro No. 1

Datos Históricos

Valor de Ventas en Miles de Colones

Mercados	1978	1979	1980	1981	1982
El Salvador					
Otros Países de C.A.					
Fuera de C.A.					
Suma					

Cuadro No. 2

Datos del Ultimo Balance General

Miles de Colones

Fecha del Balance:

Activo Total Neto	
Pasivos:	
Saldos vencidos -	
Deuda con vencimiento final en 1983	
Todos los demás pasivos de corto plazo con vencimiento en 1983	
Deuda con vencimiento final antes de 1986	
Deuda con vencimiento final después de 1985	
Suma de Pasivos	
Patrimonio Total	

Cuadro No. 3

Proyección para 1983

Ventas en Miles de Colones

Trimestre del año	El Salvador	Otros países de C.A.	Fuera de C.A.	Suma
Enero a Marzo				
Abril a Junio				
Julio a Septiembre				
Octubre a Dicbre.				
Suma				

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Cuadro No. 4

Proyección para 1983
Vencimiento de Obligaciones de Crédito

Miles de Colones

Trimestre del año	Crédito de Corto Plazo	Crédito de Refinanciamiento	Crédito de Largo Plazo	Suma
Enero a Marzo				
Abril a Junio				
Julio a Sepbre.				
Octubre a Dicbre.				
Suma				

Cuadro No. 5

Proyección para 1983
Requerimientos de Crédito de hasta 12 mesed de Plazo

Miles de Colones

Trimestre del año	Para Importaciones			Gastos Locales y Refinanciamiento		
	Materia Prima	Repuestos y Otros	Suma	Gastos Locales	Refinanciamiento	Suma
Enero a Marzo						
Abril a Junio						
Julio a Sepbre.						
Octubre a Dicbre.						
Suma						

Cuadro No. 6

Proyección para 1983
Requerimientos de Crédito a Plazos Mayores de 12 Meses

Miles de Colones

Trimestre del año	Para Importación			Compra Local			Refinanciamiento
	Maquinaria y Equipo	Otros	Suma	Construcciones	Otros	Suma	
Enero a Marzo							
Abril a Junio							
Julio a Sepbre.							
Octubre a Dicbre.							
Suma							
	Años de plazo requeridos:			Años de plazo:			Plazo:

No. 7 Préstamos Desembolsados de los Bancos de El Salvador - Miles de Colones

Objeto del Préstamo	1981 Plazos de los Préstamos		1982 Plazos de los Préstamos	
	Hasta 1 año	Mayor de 1 año	Hasta 1 año	Mayor de 1 año
Refinanciamiento				
Para Importaciones				

Appendix H

AGRICULTURAL SECTOR

Any effort to significantly expand agricultural production in 1983 would face the same problems that caused the production declines observed over the last four years. These constraints are: low market prices for export crops; guerilla activity in the rural areas; and possible difficulty of expanding the production area for some crops due to lack of adequate farm land and/or deficiencies in agricultural support services, production promotion, or market outlets.

The total crop area is expected to increase by no more than four percent in 1983 by comparison with 1982, and the level of activity with respect to the production of other agricultural products is expected to remain about the same (Table H-1).

Table H-1

TOTAL CROP AREA

(thousand hectares)

Crops	1982 Actual a/	1983 Estimated	% Change	Constraints on Expansion b/
Export Crops:				
Coffee	186	186	0	A, C
Cotton	46	50	8.7	B, A
Sugarcane	32	33	3.1	A, C
Basic Grains:				
Corn	238	263	10.5	B
Beans	55	55	0	C, B
Rice	11	12	9.1	B
Other Crops	196	196	0	C, B
Total	764	795	4	

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a/ Source, Ministry of Agriculture.

b/ A, world market prices; B, guerilla activity in rural areas; C, difficulty in expanding production beyond traditional levels.

Total crop area declined by 8.2 percent from 833,000 hectares in 1979 to 764,000 hectares in 1982. The proportion of the total crop area devoted to export crops decreased in the same period from 36 percent to 35 percent, due to a reduction in cotton plantings. For basic grains, the share fell from 42 percent to 40 percent, because of a drop in corn production. The area cultivated in non-traditional crops increased from 22 percent to 25 percent of the total (Table H-2).

Table H-2

BREAKDOWN OF PLANTED AREA BY CROP, 1979 - 1983

(thousand hectares)

	Actual								Estimated	
	1979		1980		1981		1982		1983	
Crops	Area	%	Area	%	Area	%	Area	%	Area	%
Export Crops	297	36	272	34	273	36	264	35	269	34
Coffee	185		186		186		186		186	
Cotton	85		58		58		46		50	
Sugarcane	27		28		29		32		33	
Basic Grains	346	42	362	45	340	44	304	40	330	42
Corn	276		292		276		238		263	
Beans	55		53		50		55		55	
Rice	15		17		14		11		12	
Other Crops	190	22	170	21	153	20	196	25	196	24
Total	833		804		766		764		795	

Source: Ministry of Agriculture and COPAL.

The risks to farmers and agricultural creditors increased during this period due to the constraints mentioned above and possibly also to a decline in agricultural productivity (ratio of production volume to cost). Crop yields (production volume per unit of planted area) have fallen off for all major crops except cotton. This decline has been particularly apparent during the past two years (Table H-3).

Table H-3

AVERAGE YIELDS OF MAJOR CROPS: 1978/79 - 1982/83

(in hundreds of pounds per hectare)

	1978/79	1979/80	1980/81	1981/82	1982/83 b/
Export Crops					
Coffee	19.8	18.6	20.9	16.6	17.7
Cotton a/	43.1	47.9	43.7	47.0	44.1
Sugarcane	1,800.0	1,600.0	1,485.0	1,542.0	1,542.0
Basic Grains					
Corn	41.7	41.1	39.3	39.3	37.8
Beans	18.0	18.3	16.6	16.7	14.9
Rice	79.4	84.7	78.6	78.6	68.6

a/ Unginned cotton.

b/ Climatic conditions were unfavorable for agriculture in 1982/83.

Much of the agricultural sector will need production credit financing; in the case of cotton, sugarcane, and rice, the entire planted area could require at least partial financing from institutional lenders, as in 1981 (Table H-4).

Table H-4

PROPORTION OF PLANTED AREA NEEDING CREDIT FROM INSTITUTIONAL LENDERS IN 1983

Crops	Total Area (thousand ha.)	Area Financed by Institution Lenders (thousand ha.) a/	Area Financed by Institution Lenders % of Total Area
Export Crops			
Coffee	186	105	56.5
Cotton	50	51	100.0
Sugarcane	33	35	100.0
Basic Grains			
Corn	263	103	39.2
Beans	55	37	67.2
Rice	12	14	100.0
Other Crops	196	116	59.2
Total	795	461	58.0

a/ Estimated from data contained in Financial Assessment of BFA (November 23, 1982), Annex 8, page 318.

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Appendix I

STRUCTURE OF CREDIT SUPPLY AND DEMAND

Based on maximum estimated credit demand and taking into account the lenders' refinancing plans, total credit disbursements to the private sector could amount to as much as ¢ 3.1 billion in 1983. The commercial banks would be the most important credit sources, providing an estimated 66 percent of the total short-term and 71 percent of the total long-term credit. Banco Hipotecario and B.F.A. would each provide about 13 percent of the short-term credit and around 14 percent of the long-term needs. Commercial bank credit for refinancing would be around ¢ 604 million, representing 75 percent of total refinancing needs. About 40 percent of this amount would be in the form of medium- to long-term loans. On a sectoral basis, the commercial banks' participation in overall credit disbursements (including refinancing) is calculated at 51 percent for agriculture; 97 percent for industry; 86 percent for commerce; 100 percent for construction; 71 percent for small business; and 48 percent for other economic sectors (Table I-1).

Table 1.1

ESTIMATED TOTAL CREDIT DISBURSEMENTS BY INSTITUTIONAL LENDERS, 1983
(million colones)

Credit Disbursements	Commercial Banks	Banco Hipotecario	B.F.A.	Incafe	Others 2/	Total
Short-Term:						
a) New Credit: Planned Amount	901	202	258	96	79	1,536
b) New Credit: Additional Demand 1/	483	58	76	18	11	646
c) Refinancing: Planned Amount	367	80	-	15	1	463
d) Sub-total	1,751	340	334	129	91	2,645
e) % Share	66	13	13	5	3	100
Long-Term:						
a) New Credit: Planned Amount	257	9	40	-	37	343
b) New Credit: Additional Demand 1/	(188)	(7)	(29)	-	(28)	(252)
c) Refinancing: Planned Amount	237	63	30	3	6	339
d) Sub-total	306	65	41	3	15	430
e) % Share	71	15	10	1	3	100
TOTAL	2,057	405	375	132	106	3,075
% SHARE	67	13	12	4	4	100
Sectoral Breakdown						
Agriculture:						
a) New Credit: Planned Amount	475	177	274	30	47	1,004
b) New Credit: Additional Demand 1/	74	28	43	5	7	157
c) Refinancing: Planned Amount	234	101	30	18	2	385
d) Sub-total	783	306	347	53	56	1,546
e) % Share	51	20	22	3	5	100
Industry:						
a) New Credit: Planned Amount	260	3	-	-	-	263
b) New Credit: Additional Demand 1/	69	1	-	-	-	70
c) Refinancing: Planned Amount	171	10	-	-	-	181
d) Sub-total	500	14	-	-	-	514
e) % Share	97	3	-	-	-	100
Commerce:						
a) New Credit: Planned Amount	232	28	-	-	-	260
b) New Credit: Additional Demand 1/	169	20	-	-	-	189
c) Refinancing: Planned Amount	99	30	-	-	-	129
d) Sub-total	500	78	-	-	-	578
e) % Share	86	14	-	-	-	100
Construction:						
a) New Credit: Planned Amount	47	-	-	-	-	47
b) New Credit: Additional Demand 1/	18	-	-	-	-	18
c) Refinancing: Planned Amount	23	-	-	-	-	23
d) Sub-total	88	-	-	-	-	88
e) % Share	100	-	-	-	-	100
Small Business:						
a) New Credit: Planned Amount	76	-	-	-	45	121
b) New Credit: Additional Demand 1/	(48)	-	-	-	(28)	(76)
c) Refinancing: Planned Amount	23	-	-	-	4	27
d) Sub-total	51	-	-	-	21	72
e) % Share	71	-	-	-	29	100
Others:						
a) New Credit: Planned Amount	67	4	24	66	24	185
b) New Credit: Additional Demand 1/	13	2	4	13	4	36
c) Refinancing: Planned Amount	54	-	-	-	2	56
d) Sub-total	134	6	28	79	30	277
e) % Share	48	2	10	28	12	100
Total:						
a) New Credit: Planned Amount	1,157	212	298	96	116	1,880
b) New Credit: Additional Demand 1/	295	51	47	18	(17)	394
c) Refinancing: Planned Amount	604	141	30	18	8	801
d) Sub-total	2,056	404	375	132	107	3,075
e) % Share	67	13	12	4	4	-

1/ The difference between the estimated maximum demand and the planned amount was distributed among the lenders in the same proportion as represented in the planned amount.

2/ Fedecredito, Fedecaces and Figape.

Appendix J

QUALITY OF INSTITUTIONAL LOAN PORTFOLIOS

The consolidated portfolio of institutional lending sources in El Salvador is considered highly risky. As of 12/31/82, the outstanding balance in arrears was ₡ 690 million, or about 21 percent of the total ₡ 3.3 billion portfolio, and the refinanced portion (in good standing as of that date) accounted for an additional 23 percent. Thus, the portfolio in arrears plus refinancing represented 44 percent of the total (Table J.1). The loan portfolio is practically the only significant earning asset of almost all the lending institutions.

Table J.1

CONSOLIDATED INSTITUTIONAL LOAN PORTFOLIO: 12/31/82
(million colones)

	Amount	%
Total Portfolio	3,317	100.0
In Good Standing	2,627	79.2
New Credit	1,868	56.3
Refinancing	759	22.9
In Arrears	690	20.8

Even though this report does not include a thorough analysis of the lenders' financial situation, it is worthwhile to mention that the financial structure of some lenders is probably weak and that this could become a constraint to credit expansion in the medium term if the present economic and political situation in El Salvador does not improve. Provision for loan losses averaged 36 percent of the outstanding balance in arrears for five out of nine commercial banks (not including foreign banks) who provided this information. If refinancing in good standing are added to the amounts in arrears, however, the loss provision drops to only nine percent. Furthermore, debt-equity ratios appear higher than might be financially prudent under the circumstances. This ratio was over 10:1 for six of the commercial banks and above 15:1 for the remaining three.

Previous profits reported by the banks may prove to be inflated if these portfolio problems are not solved. The banks accrue interest on a large portion of their refinanced portfolios, which otherwise would be in arrears and not accruing interest; on the other hand, by keeping their provision for loan losses relatively low, the banks could be underestimating their expense charges.

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The expansion of their portfolios could represent an opportunity for the lenders to compensate, through higher net interest earnings, for the losses that could be generated by their present portfolios. Nevertheless, a strategy to compensate for potential losses by this means would be successful only if the loans carried much lower risks.

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