El Salvador

The economy of El Salvador did not perform as well as anticipated, so projected growth for 2010 is 1%. Inflation is expected to approach the 2% mark, owing to food and energy price hikes late in the year. The current account deficit will be 2.8% of GDP because of a rise in the trade deficit and a slowdown in the flow of remittances.

The relative improvement in economic activity, combined with the impact of the 2009 tax reform and the cutback in subsidies for the electricity sector, pushed the non-financial public sector (NFPS) deficit down to the equivalent of 4.8% of GDP.

In view of the lagged impact of the economic recovery in the United States, the effect of public investment and greater availability of credit for the private sector, growth is expected to top 2% in 2011. The 12-month inflation rate is expected to be in the area of 3%, as is the current account deficit. The NFPS deficit is projected to be 3.7%.

For 2010, the goal of fiscal policy was to lower the NFPS deficit to ensure the sustainability of public debt, which estimates put at 50% of GDP. Although the tax reform has had a less-than-expected impact because the modest upturn in economic activity delayed implementation of some measures, total receipts for the first nine months of 2010 were up by 8.7% in real terms.

During the same period total expenditure rose by 1.2% in real terms. Protecting social spending has been a priority, but the combination of real increases in personnel expenses and procurement of goods and services (1.7%) and stagnating real capital expenditure (down by 0.3%) is not sustainable over time.

The NFPS deficit, including pensions and trust funds, is projected to be the equivalent of 4.8% of GDP. Delays in the approval of international loans held up disbursements by international financial institutions, forcing the authorities to turn to domestic sources of financing.

The 2011 budget calls for an NFPS deficit equivalent to 3.5% of GDP, thanks to more efficient collection and a freeze on current expenditure in real terms. With the wage and pension increases announced for the public sector, the deficit is expected to reach 3.7% of GDP.

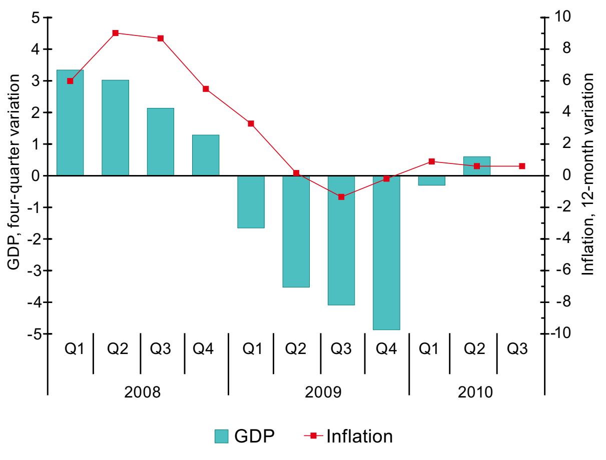
The medium-term fiscal outlook is for total public sector debt as a percentage of GDP to start to fall in 2011.

Although interest rates have not returned to their pre-crisis levels, they are coming down gradually. Despite this decrease, deposits had grown by 2% in real terms up to September. During the same period, lending to the private sector contracted by 4.4% in real terms, although the pace of this decline has slowed.

The private sector credit situation stands in contrast with ample levels of capitalization and liquidity in the banking sector; banks have used the excess liquidity to improve their liabilities profile and become more profitable.

Negotiations on the Association Agreement between the European Union and Central America finalized in May.

EL SALVADOR: GDP AND INFLATION



Source: Economic Commission for Latin America and the Caribbean (ECLAC), on the basis of official figures.

The agreement seeks to foster Central American integration and will enable El Salvador to diversify its exports and attract greater flows of foreign direct investment (FDI) from the European Union.

GDP grew by only 0.6% in the second quarter of 2010 after falling for five straight quarters. For the entire year, GDP is projected to expand by 1% (0.5% per capita), spurred by the agricultural sector that, after severe losses in 2009, has grown by more than 3% in 2010. Because of weak domestic demand (which is expected to increase by 3.2% after contracting 12.8% in 2009), the manufacturing and services sectors are expected to grow by less than 1%.

Consumption, which is projected to grow by some 3%, has been affected by the labour situation in El Salvador and in the United States. Persistently high unemployment among the population of Latin American origin in the United States has slowed the growth of remittance flows. The 0.7% decline in the construction sector, combined with the contraction of credit for the private sector, will translate into a 0.3% drop in gross fixed capital formation.

According to official projections, the Salvadoran economy will expand by 2.5% in 2011 owing to the lagged impact of the recovery in the United States and the catalysing effect of public investment projects.

Thanks to the slow growth of domestic demand (due in part to the scarcity of credit for the private sector) and to a lag in some price pass-throughs, accumulated inflation to the third quarter of 2010 was just 1.1%. However, it is estimated that year-on-year inflation will be in the area of 2% because of the effect that rains had on some agricultural prices in October and because of energy price subsidies. Inflation is projected to be nearly 3% in 2011 as domestic demand picks up.

While most of the 18,000 formal jobs lost in 2009 have been recovered, there are still 20,000 fewer workers contributing to the Salvadoran Social Security Institute than before the crisis (580,000). Minimum wages held steady in nominal terms in 2010 (equivalent to a real drop of 0.6%), but a substantial hike in the minimum wage and in public sector employee pensions was announced late in the year and will take effect in 2011.

In the external sector, the expansion of non-traditional exports (benefiting from rising demand in the United States) was not enough to offset the upturn in imports. This upturn was due in part to recovering consumption but was triggered above all by an oil bill increase of more than 40%.

Under the integrated export promotion policy that is part of the Five-Year Development Plan 2010-2014, export credit guarantees have been available from the Multisectoral Investment Bank since October. Taking into account the 2.5% growth in remittances (16% of GDP), projections show a current account deficit equivalent to 2.8% of GDP. Because of the delay in disbursements from international financial institutions, approximately half of that deficit will be financed with international reserves. These reserves will end 2010 at some US$ 2.700 billion (9.3% less than in 2008), which is equivalent to four months' imports.

The remainder of the deficit will be financed equally from the capital and financial accounts. The approximately 16% drop in FDI flows contrasts with the extraordinary levels posted in 2009, associated with the sale of assets in the financial sector. Nearly half of these assets will go to the commerce and financial sectors.

As of October 2010 the real effective exchange rate had depreciated by 1.6%, owing to the appreciation of the other Central American currencies and of the Mexican peso against the dollar. This should benefit the export sector in the short run. If the economy continues to recover in 2011, the current account deficit is expected to surpass 3%.

EL SALVADOR: MAIN ECONOMIC INDICATORS

	2008	2009	2010[a]
	Annual percentage growth rates		
Gross domestic product	2.4	-3.5	1.0
Per capita gross domestic product	2.0	-4.0	0.5
Consumer prices	5.5	-0.2	3.2[b]
Real minimun wage	0.2	9.5	...
Money (M1)	1.6	12.4	24.1[c]
Real effective exchange rate [d]	1.7	-2.5	2.3[e]
Terms of trade	-2.8	3.2	-3.7
	Annual average percentages		
Urban unemployment rate	5.5	7.1	...
Central government overall balance / GDP	-0.6	-3.7	-3.0
Nominal deposit rate	4.2	4.5	3.1[f]
Nominal lending rate	7.9	9.3	7.8[f]
	Millions of dollars		
Exports of goods and services	5 652	4 696	5 447
Imports of goods and services	10 629	7 966	9 248
Current account	-1 682	-374	-789
Capital and financial account [g]	2 016	802	389
Overall balance	334	429	-400

Source: Economic Commission for Latin America and the Caribbean (ECLAC), on the basis of official figures.
[a] Preliminary estimates.
[b] Twelve-month variation to November 2010.
[c] Twelve-month variation to October 2010.
[d] A negative rate indicates an appreciation of the currency in real terms.
[e] Year-on-year variation, January to October average.
[f] Average from January to October, annualized.
[g] Includes errors and omissions.