

El Salvador

The international financial crisis had a devastating effect on external demand in El Salvador, as well as on remittances and FDI. Uncertainty surrounding the legislative and presidential elections held at the beginning of 2009 impacted consumption and investment. Given the general slowdown in economic activity, ECLAC estimates that GDP decreased by 2.5% in 2009, with per capita GDP falling by 3%. The flooding at the end of the year had a minimal effect on economic activity.

Although 12-month inflation was negative up to October 2009, inflation for the year as a whole is expected to come in at around 0.5%. Given the worsening situation of public finances, a deficit of 5.5% of GDP is projected for the non-financial public sector (including pensions), 2.4 percentage points higher than in 2008. Owing to the sharp decline in imports, the current account deficit is expected to reach approximately 2% of GDP, down from 7.6% in 2008. For 2010, ECLAC is projecting a moderate recovery, with both GDP growth and inflation at 2%, a current account deficit of 3% of GDP and a non-financial public sector deficit (including pensions) of 4.5% of GDP.

In regard to public finances, the government faced a difficult situation. While income tax receipts grew by 2.5%, value added tax (VAT) receipts declined by 14.7% owing to the economic slowdown. As a result, the central government's current revenues fell by 12%. On the expenditures side, wage payments rose by 10%, while investment fell by nearly 5% after having increased by nearly 30% in 2008. A deficit of 5.5% is projected for the non-financial public sector, including the broader public sector and pensions.

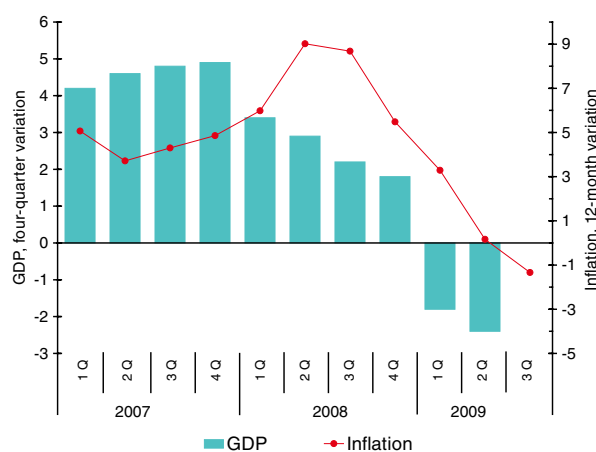
In light of this situation, the government had to renegotiate the terms of its foreign-loan agreements, and throughout the year treasury bills were used intensively to cover current expenditures. At the end of September the government announced that it intended to sign a new precautionary loan agreement with the International Monetary Fund for US\$ 800 million, with a term of 3 years. This would replace the agreement signed by the previous government in January 2009.

The total debt of the non-financial public sector in 2009, including pensions, is estimated to swell by an

amount equivalent to five percentage points of GDP to reach 45% of GDP. It is then expected to continue increasing and to peak at 50% of GDP in 2011. Thus, in mid-2009, both Standard and Poor's and Fitch Ratings lowered their ratings for El Salvador's sovereign debt. Nevertheless, at the end of November, the country issued bonds in the international market for close to US\$ 800 million, which will be used to pay down short-term debt.

Greater risk aversion on the part of Salvadoran commercial banks meant that loans to the private sector decreased by 5% in real terms. Banks took advantage of available liquidity to almost halve their external debt, as well as to improve the time profile of their risks.

EL SALVADOR: GROWTH AND INFLATION



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

Economic growth slowed in practically all sectors, with the exception of government services. The slump in manufacturing and trade, triggered by the sharp drop in foreign and domestic demand, had the largest impact on overall growth. Although economic activity was low and growth remained negative, the slowdown moderated during the second half of 2009. At the beginning of November, the central part of the country was hit by floods caused by hurricane Ida. Though some municipalities suffered severe damage, the overall impact was mild. As a result, the decline in GDP in 2009 is projected by ECLAC to be 2.5%.

As far as spending is concerned, gross domestic investment dropped by 14.5% owing to the tighter credit conditions described earlier and the significant reduction in FDI flows. At the same time, private consumption fell by approximately 10% on account of the reduction in remittances and the worsening situation in the job market.

Up to August, the number of workers contributing to the Salvadoran Institute of Social Security declined by nearly 20,000 (6.7%). The worst-hit sector was construction, where nearly 30% of jobs were lost. Given the low levels of inflation, real minimum wages increased by around 9% in 2009 compared with 2008, when they rose by barely 0.2%.

Beginning in the third quarter of 2008, the drop in international prices for commodities led to a pronounced slowdown in the food and beverages and transportation components of the consumer price index. Consequently, inflation plummeted, with prices falling by 1.6% in the 12 months leading up to October and by 0.7% in relation to December 2008. Prices are expected to rise again in the final months of the year in comparison with those seen at the end of 2008. Thus, in December, the 12-month inflation rate is expected to be around 0.5%.

Exports of goods decreased by approximately 15%. Two thirds of the decline is attributable to the fall-off in exports from the maquila industry and the remaining third to declines in non-traditional exports, with traditional exports remaining at a level similar to that of 2008. As a result of the severe contraction in domestic demand, as well the approximately 50% drop in the oil bill, imports of goods are estimated to have fallen by about 25%. In terms of volumes imported, the main reductions were in imports of durable consumer goods and capital goods. Thus, for the year overall, the deficit of the balance of

EL SALVADOR: MAIN ECONOMIC INDICATORS

	2007	2008	2009 ^a
Annual percentage growth rates			
Gross domestic product	4.7	2.5	-2.5
Per capita gross domestic product	4.2	2.1	-3.0
Consumer prices	4.9	5.5	-1.6 ^b
Real minimum wage	2.5	0.2	9.3
Money (M1)	16.5	1.6	1.7 ^c
Real effective exchange rate ^d	1.2	1.0	-4.5 ^e
Terms of trade	-0.9	-2.8	7.9
Annual average percentages			
Urban unemployment rate	5.8	5.5	...
Central government			
overall balance/GDP	-0.2	-0.6	-2.3
Nominal deposit rate	4.7	4.2	4.7 ^f
Nominal lending rate	7.8	7.9	9.4 ^f
Millions of dollars			
Exports of goods and services	5 169	5 652	5 334
Imports of goods and services	9 564	10 629	8 659
Current account balance	-1 221	-1 682	-524
Capital and financial account balance ^g	1 502	2 016	644
Overall balance	280	334	120

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

^a Preliminary estimates.

^b Twelve-month variation to October 2009.

^c Twelve-month variation to September 2009.

^d A negative rate indicates an appreciation of the currency in real terms.

^e Year-on-year average variation, January to October.

^f Average from January to October, annualized.

^g Includes errors and omissions.

goods and services is expected to shrink by more than US\$ 1.7 billion to US\$ 3.325 billion (14.9% of GDP).

In contrast, the income account deficit is expected to widen slightly. Remittances, which represent 16% of GDP, declined by around US\$ 400 million. Thus, the current account deficit is estimated to have contracted from more than US\$ 1.2 billion to US\$ 418 million (2% of GDP). FDI inflows to El Salvador in 2009 are estimated to have dropped by approximately US\$ 700 million, while total remittances have amounted to barely US\$ 88 million over the course of the year.

For 2010, a moderate revival is projected for both foreign and domestic demand, meaning that once again net exports will be in the negative range. Although the flow of remittances is expected to increase, this will not be sufficient to prevent a slight increase in the current account deficit, which is estimated to reach 3% of GDP.