

## EL SALVADOR

### 1. General trends

El Salvador's economy grew by 2% in 2014, slightly above the average for the most recent five-year period, but almost 1 percentage point slower than in the five-year period preceding the financial crisis. The Economic Commission for Latin America and the Caribbean (ECLAC) forecasts economic growth of 2.2% in 2015, subject to the execution of investment projects, in particular the second phase of the Millennium Fund (FOMILENIO) project, financed with cooperation resources from the United States. This forecast matches the lowest growth estimate used by the Salvadoran authorities to prepare the 2015 budget.

Despite the fall in the international prices of oil and its derivatives, of which El Salvador is a net importer, average inflation rose slightly from 0.8% in 2013 to 1.1% in 2014 as the drought pushed up some food prices.

With regard to the public finances, the deficit of the non-financial public sector, including pensions, narrowed from 4% of GDP to 3.6% of GDP following significant public investment cuts. Nevertheless, total public debt continued to expand and closed 2014 at a level equivalent to 62% of GDP, driven by the growth of pension liabilities. The fiscal responsibility bill under discussion in the legislative assembly would establish a fiscal adjustment of 1.5% of GDP over three years, but international financial institutions estimate that this would not be enough to prevent the debt from continuing to expand further.

As a result of the fall in investment and the drop in the oil bill, the current account deficit narrowed from 6.5% of GDP in 2013 to 4.7% of GDP in 2014.

### 2. Economic policy

#### (a) Fiscal policy

In 2014, the primary surplus of the non-financial public sector widened by 0.5 percentage points to 0.7% of GDP. Interest payments equivalent to 2.4% of GDP and pension costs equivalent to 1.8% of GDP resulted in a deficit of 3.6% of GDP. The public finances improved in relative terms as the spending adjustment exceeded the slowdown in revenue.

Current revenue fell sharply from 5.6% of GDP in 2013 to just 0.8% of GDP in 2014. This reflects a 0.5% real contraction in tax revenues, resulting in a tax burden of 14.9% of GDP, 0.5 percentage points lower than in 2013. Value added tax (VAT) receipts were down by 1.7% in real terms owing to weaker economic activity and lower import prices. Furthermore, income tax revenues grew by only 1.7% in 2014, compared with real growth of 17.5% in 2013, as a result of the ruling by the Constitutional Court to cancel the introduction of a minimum tax on corporate income.

With respect to expenditure, total spending fell by 1.6% in real terms as current transfers and capital spending were curbed by 7.7% and 13.8%, respectively. It is striking that the expenditure adjustment was felt in these areas since the austerity measures introduced in 2013 were intended to target current consumption spending, which rose by 2.4% in real terms. Needless to say, the drop in investment limits the role of the public sector as a catalyst for investment at the aggregate level.

As has been the case in recent years, the government financed the deficit with short-term debt placements to the tune of over US\$ 800 million in the local market in August 2014. This debt was then replaced by a global bond issue in September, with a yield of 6.4%. While the non-financial public sector debt remained virtually unchanged at 46.3% of GDP, the increase in the pension debt pushed total public debt up to 62% of GDP.

The public finances deteriorated in the first four months of 2015, as evidenced by the 0.6% drop in total revenue and the decrease in non-tax revenue, which was not offset by the higher tax receipts received following the entry into force of the new tax on financial transactions. The state of the public finances worsened as total expenditure expanded by 4.9%, with the continuing rise of current spending, especially consumption expenditure, and the downward adjustment of capital spending.

During the same period, total public debt grew by more than US\$ 200 million compared with the end of 2014. This increase reflects the placement of Treasury bills worth over US\$ 500 million dollars at the end of the first four months of 2015. Anticipating a less favourable scenario under the new legislature, which was sworn in on 1 May 2015, the government pushed through a global bond issue worth up to US\$ 900 million in April. However, the options for financing the fiscal deficit have since been restricted by a ruling by the Constitutional Chamber of the Supreme Court, which banned the placement of debt while it decides whether approval by the Assembly violated the constitution.

In the light of developments in early 2015, the fiscal deficit of the non-financial public sector is expected to be slightly higher than in 2014, though it could be much higher if growth falls short of projections.

## **(b) Monetary policy**

Since the economy has been dollarized since 2001 and international capital moves freely into and out of El Salvador, the Central Reserve Bank has no monetary autonomy and can influence liquidity only through medium-term regulatory measures. In the short term, interest rates are determined by the supply and demand conditions between the financial intermediaries operating in the country.

Owing to meagre growth in bank deposits and sustained demand for credit, the 180-day deposit rate rose by 45 basis points to stand at 4.1% in real terms at the end of 2014. Similarly, the deterioration of aggregate credit conditions drove up rates on loans of up to one year by nearly 50 basis points, to 6.1% in real terms at the end of 2014.

Despite the increase in lending rates, the growth in bank lending to the private sector remained broadly unchanged at around 6% in real terms. Almost half of the new credit went to household consumption, which accounts for about a third of the loan portfolio.

In the first quarter of 2015, deposit rates continued their upward trend to stand at almost 4.5% in real terms. In contrast, both lending rates and credit growth remained around the levels seen in late 2014.

### 3. The main variables

#### (a) The external sector

Exports of Salvadoran goods fell by 4% in 2014, reflecting a drop of 32.1% in traditional exports and 11.6% in maquila exports, which were not offset by the modest 1.3% growth of non-traditional exports. The fall in traditional exports is mainly attributable to the decline in production volumes caused by coffee-leaf rust, combined with persistent low international prices. Moreover, delays caused by the introduction of X-ray equipment at customs at land border posts in the first half of 2014 hit non-traditional exports, which account for 75% of goods exports, mainly to the rest of Central America. The drop in maquila exports highlights the sector's loss of competitiveness compared with other countries.

Goods imports were down by 2.4%, primarily reflecting the impact of the lower international oil prices on the oil bill, which fell by 11.2%, and to a lesser extent, the decline in imports of capital goods, particularly those from by the commerce sector.

As a result, the Salvadoran trade deficit narrowed to 20.6% of GDP. On the back of robust remittance flows, which grew by 5.4% in nominal terms in 2014 to represent 16.6% of GDP, the current account deficit fell by almost 2 percentage points to stand at 4.7% of GDP. The current account was financed largely through portfolio investment, since foreign direct investment amounted to just US\$ 239 million.

In the first four months of 2015, imports fell by 3.2% as oil prices remained low and imports of consumption goods decreased by 4.6%, which was not offset by moderate 2.8% growth in imports of capital goods. By contrast, exports rallied and were up by 8.3%. Traditional exports rebounded as El Salvador began to export sugar to China and international coffee prices rose as a result of drought in Brazil. Non-traditional exports expanded by 5.3% as exports to Central America compared favourably with the previous year and strong growth was seen in textiles, which are exported primarily to the United States. Maquila exports grew by 5.2%.

Given the momentum of external demand and favourable international prices in 2015, the current account deficit is expected to narrow in comparison with 2014.

#### (b) Economic activity

The modest 2% growth was attributable to the manufacturing industry, which expanded by 2.5%, driven by the demand for goods from the United States, as well as to the 3.2% increase in commerce, owing to renewed growth in remittances from abroad.

Almost half of the growth on the spending side can be attributed to household consumption, which rose by 2% and partially offset the 6.4% decline in gross fixed capital formation. Investment has fallen owing to the fiscal adjustment and the negative impact that weakening business confidence has had on private investment. As a result of the high capital goods content of imports, the decline in investment led to a fall in imports, which offset the 0.9% contraction in exports associated with the impact of coffee leaf-rust on traditional exports. Net exports contributed almost 1 percentage point of GDP to growth.

Monthly indicators point to a marginal rise in economic activity, with more robust growth in the agricultural and manufacturing sectors. However, the trend indicator of the commerce sector shows signs of deterioration, reflecting the slowdown in the creation of formal jobs and remittance receipts. In this context, a slight upturn in economic activity is expected, in the order of 2.2%.

**(c) Prices, wages and employment**

The 12-month inflation rate stood at 0.5% at the end of 2014. Prices of food and non-alcoholic beverages rose by 3.7% as the drought affected the production of basic grains, leading to shortages. Nevertheless, as a result of the drop in international oil prices, transport prices fell by 3.6% and prices for housing, water, electricity and other fuels contracted by 2.9%. Consequently, inflation was slightly lower than the rate of 0.8% recorded in 2013.

This trend sharpened in early 2015 as food prices continued to rise and the price of energy products and transport continued to fall in line with international oil prices. This resulted in year-on-year deflation of 0.3% in the general level of prices in April 2015, which contrasts with inflation of 0.6% over the year-earlier period. Once the statistical effect of low energy prices dissipates, inflation is expected to pick up in the second half of 2015.

Where employment is concerned, the records of the Salvadoran Social Security Institute point to a significant slowdown in formal job creation from 4.8% in 2013 to barely 2.4% in 2014. The bulk of the new jobs were created in the financial sector. Employment in each sector reflected its performance: in the agricultural sector, the rate of new job creation doubled to 3.1%, whereas the manufacturing, trade and financial sectors lost momentum, falling from 4.2%, 4.3% and 13.7% in 2013 to 1%, 3% and 8% in 2014, respectively, and the construction sector saw a decline of 5.5%.

The average wages of private-sector contributors to the Salvadoran Social Security Institute grew by an average of 1.5% in real terms, with the largest increases in manufacturing (2.7%), commerce (4.4%) and the financial sector (2.6%). These increases were influenced positively by the 4% upward adjustment in nominal minimum wages, effective from January 2014. In January 2015, the third 4% adjustment in nominal minimum wages was applied, as agreed in mid-2013.

Table 1  
EL SALVADOR: MAIN ECONOMIC INDICATORS

	2006	2007	2008	2009	2010	2011	2012	2013	2014 a/
	<b>Annual growth rates b/</b>								
Gross domestic product	3.9	3.8	1.3	-3.1	1.4	2.2	1.9	1.8	2.0
Per capita gross domestic product	3.5	3.4	0.8	-3.6	0.8	1.7	1.3	1.2	1.3
Gross domestic product, by sector									
Agriculture, livestock, hunting, forestry and fishing	5.7	8.5	3.0	-2.9	3.1	-2.5	3.5	-0.4	1.6
Mining and quarrying	4.4	-2.1	-6.7	-15.4	-11.6	13.6	3.1	1.1	-3.3
Manufacturing	2.2	2.5	2.3	-3.0	1.9	2.7	1.3	3.1	2.5
Electricity, gas and water	4.7	2.8	2.3	-1.1	-0.6	0.5	0.8	1.1	2.2
Construction	6.4	-6.9	-7.3	-2.8	-5.0	8.9	0.3	0.0	-10.5
Wholesale and retail commerce, restaurants and hotels	4.6	4.3	1.0	-5.4	1.5	2.3	2.6	1.5	3.2
Transport, storage and communications	6.9	4.8	-0.8	-5.9	-0.2	4.6	1.6	1.8	1.7
Financial institutions, insurance, real estate and business services	2.6	3.0	0.9	-1.3	1.9	1.8	0.2	2.3	2.2
Community, social and personal services	2.5	3.8	2.0	1.3	1.8	3.3	2.5	3.1	2.5
Gross domestic product, by type of expenditure									
Final consumption expenditure	4.8	5.9	1.7	-9.2	2.2	2.5	2.4	1.0	2.1
Government consumption	2.2	0.4	-0.4	5.8	2.2	3.9	2.5	3.7	3.2
Private consumption	5.0	6.3	1.8	-10.3	2.2	2.4	2.4	0.7	2.0
Gross capital formation	11.6	2.8	-5.4	-19.2	2.4	13.8	-1.4	9.3	-6.4
Exports (goods and services)	5.9	7.1	6.9	-16.0	11.6	9.3	-7.3	4.8	-0.9
Imports (goods and services)	8.9	8.8	3.3	-24.8	10.4	10.8	-4.6	4.5	-2.2
Investment and saving c/	<b>Percentajes of GDP</b>								
Gross capital formation	16.8	16.3	15.2	13.4	13.3	14.4	14.1	15.0	13.6
National saving	12.7	10.3	8.1	11.9	10.8	9.6	9.0	8.5	8.8
External saving	4.1	6.1	7.1	1.5	2.5	4.8	5.2	6.5	4.7
Balance of payments	<b>Millions of dollars</b>								
Current account balance	-766	-1,217	-1,532	-312	-533	-1,112	-1,235	-1,574	-1,194
Goods balance	-4,084	-4,740	-5,114	-3,506	-4,022	-4,772	-4,927	-5,295	-5,208
Exports, f.o.b.	2,255	2,794	3,276	2,924	3,473	4,243	4,235	4,334	4,256
Imports, f.o.b.	6,339	7,534	8,389	6,430	7,495	9,015	9,162	9,629	9,463
Services trade balance	284	234	224	308	398	449	532	618	739
Income balance	-438	-456	-389	-556	-538	-618	-861	-997	-1,044
Net current transfers	3,472	3,746	3,747	3,442	3,629	3,830	4,021	4,100	4,318
Capital and financial balance d/	812	1,496	1,866	735	237	698	1,886	1,248	1,161
Net foreign direct investment	267	1,455	824	366	-226	218	484	176	274
Other capital movements	545	40	1,042	369	462	479	1,402	1,072	887
Overall balance	47	279	333	423	-296	-414	651	-327	-33
Variation in reserve assets e/	-47	-279	-333	-423	296	414	-651	327	33

Table 1 (concluded)

	2006	2007	2008	2009	2010	2011	2012	2013	2014 a/
<b>Other external-sector indicators</b>									
Real effective exchange rate (index: 2005=100) f/	100.3	100.9	101.7	99.6	101.2	102.4	103.1	104.1	105.3
Terms of trade for goods (index: 2010=100)	104.5	103.5	100.6	103.9	100.0	100.0	96.6	96.2	99.6
Net resource transfer (millions of dollars)	375	1,040	1,477	179	-302	79	1,025	251	117
Total gross external debt (millions of dollars)	9,692	9,349	9,994	9,882	9,698	10,670	12,521	13,238	14,177
<b>Employment</b>									
	<b>Average annual rates</b>								
Labour force participation rate g/	52.6	62.1	62.7	62.8	62.5	62.7	63.2	63.6	63.6
Open unemployment rate h/	5.7	5.8	5.5	7.1	6.8	6.6	6.2	5.6	...
Visible underemployment rate h/	4.9	5.3	6.3	7.7	7.0	3.4	5.8	5.8	...
<b>Prices</b>									
	<b>Annual percentages</b>								
Variation in consumer prices (December-December)	4.9	4.9	5.5	-0.2	2.1	5.1	0.8	0.8	0.5
Variation in industrial producer prices (December-December)	0.6	13.9	-6.0	4.9	6.2	7.0	2.4	-0.2	-5.8
Variation in average real wage	0.4	-2.4	-3.1	3.5	1.1	-2.9	0.2	0.5	0.7
Nominal deposit rate i/	4.4	4.7	4.2	4.5	2.9	1.8	2.5	3.4	3.8
Nominal lending rate j/	7.5	7.8	7.9	9.3	7.6	6.0	5.6	5.7	6.0
<b>Central government</b>									
	<b>Percentajes of GDP</b>								
Total revenue	14.5	14.8	15.1	13.8	15.0	15.4	15.8	16.3	15.8
Tax revenue	13.4	13.6	13.5	12.6	13.5	13.8	14.4	15.4	15.0
Total expenditure	14.9	15.0	15.8	17.6	17.7	17.6	17.5	18.1	17.3
Current expenditure	12.3	12.4	13.0	14.7	14.5	14.6	14.2	15.0	14.6
Interest	2.4	2.5	2.4	2.5	2.3	2.2	2.2	2.4	2.4
Capital expenditure	2.7	2.6	2.8	2.9	3.2	3.1	3.3	3.0	2.8
Primary balance	2.0	2.3	1.8	-1.2	-0.4	-0.1	0.5	0.6	0.8
Overall balance	-0.4	-0.2	-0.6	-3.7	-2.7	-2.3	-1.7	-1.8	-1.6
Central government public debt	37.7	34.9	34.4	42.6	42.6	41.7	45.7	44.0	44.2
Domestic	10.8	10.7	11.6	14.9	14.3	14.8	15.5	14.5	11.9
External	26.9	24.2	22.8	27.6	28.3	26.9	30.2	29.5	32.3
<b>Money and credit</b>									
	<b>Percentages of GDP, end-of-year stocks</b>								
Domestic credit	53.1	55.0	54.5	56.2	56.8	56.7	57.2	62.2	63.9
To the public sector	14.6	17.0	18.2	21.0	24.3	26.5	26.0	29.3	29.5
To the private sector	43.4	43.6	43.0	42.4	40.9	39.8	40.2	42.5	43.9
Others	-4.9	-5.6	-6.7	-7.2	-8.4	-9.5	-9.0	-9.6	-9.5
Monetary base	9.3	10.3	10.7	11.0	11.0	9.8	9.4	10.2	9.8
Money (M1)	8.9	9.6	9.1	11.2	12.3	12.0	11.7	11.9	11.6
M2	48.8	52.9	49.1	52.0	50.3	45.5	44.7	44.6	43.3

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

a/ Preliminary figures.

b/ Based on figures in local currency at constant 1990 prices.

c/ Based on values calculated in national currency and expressed in current dollars.

d/ Includes errors and omissions.

e/ A minus sign (-) indicates an increase in reserve assets.

f/ Annual average, weighted by the value of goods exports and imports.

g/ Nationwide total. New measurements have been used since 2007; the data are not comparable with the previous series.

h/ Urban total.

i/ Basic rate for deposits of up to 180 days.

j/ Basic lending rate for up to one year.

Table 2  
EL SALVADOR: MAIN QUARTERLY INDICATORS

	2013				2014				2015	
	Q.1	Q.2	Q.3	Q.4	Q.1	Q.2	Q.3	Q.4	Q.1	Q.2 a/
Gross domestic product (variation from same quarter of preceding year) b/	1.7	1.8	2.0	1.9	2.3	2.2	1.6	1.7	2.3	...
Gross international reserves (millions of dollars)	3,110	3,146	3,005	2,855	2,942	2,937	2,927	2,939	2,939	2,955 c/
Real effective exchange rate (index: 2005=100) d/	103.4	104.2	104.1	104.6	104.9	106.3	105.3	104.8	104.5	104.6 c/
Consumer prices (12-month percentage variation)	1.0	0.4	0.9	0.7	0.6	0.9	1.8	1.2	-0.9	-0.3 c/
Wholesale prices (12-month percentage variation)	-3.5	-3.5	-3.0	-2.5	-1.9	1.0	4.4	6.9	...	...
Nominal interest rates (average annualized percentages)										
Deposit rate e/	3.3	3.3	3.4	3.6	3.5	3.7	3.8	4.1	4.2	4.4 f/
Lending rate g/	5.7	5.7	5.9	5.7	6.0	5.9	6.1	6.0	6.0	6.1 c/
Sovereign bond spread, Embi Global (basis points to end of period) h/	350	436	409	389	420	376	383	414	459	443
International bond issues (millions of dollars)	310	-	-	-	-	-	800	-	-	300
Domestic credit (variation from same quarter of preceding year)	4.6	3.9	5.2	8.3	10.8	12.0	9.2	6.2	6.8	6.2 f/
Non-performing loans as a percentage of total credit	2.9	2.8	2.7	2.5	2.4	2.5	2.6	2.5	2.4	2.4 c/

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

a/ Preliminary figures.

b/ Based on figures in local currency at constant 1990 prices.

c/ Figures as of May.

d/ Quarterly average, weighted by the value of goods exports and imports.

e/ Basic rate for deposits of up to 180 days.

f/ Figures as of April.

g/ Basic lending rate for up to one year.

h/ Measured by J.P.Morgan.