EL SALVADOR

1. General trends

Economic growth in El Salvador slowed slightly in 2013 to stand at 1.7%, which brought the annual average over the past four years to 1.8%. The relatively low rate of economic activity, coupled with price regulation in the health sector, kept inflation low so that average consumer prices increased by barely 0.8%, less than half the rate recorded in 2012.

Despite measures designed to curb current expenditure, the sustained outlays associated with social policy pushed up the total public spending of the non-financial public sector (NFPS). Meanwhile, although tax revenues increased, they were not sufficient to avoid a deterioration in the NFPS deficit, which, after accounting for social security costs, widened by more than half a percentage point to end 2013 at the equivalent of 4% of GDP. As in 2013, the government borrowed from domestic sources to finance the deficit.

The forecast for 2014 is for growth of 2.3%. This slightly less anaemic forecast is based on the expectation of a recovery in remittance flows, which should boost private consumption, a continuation of the pace of investment inflows and a recovery in the agricultural sector, which is expected to shore up exports.

2. Economic policy

(a) Fiscal policy

Although the savings and austerity policy introduced in early 2013 placed a limit on wage rises and on the creation of new posts in the public sector, current expenditure by the non-financial public sector, which had remained constant in real terms in 2012, expanded by 6.6% in real terms in 2013. The bulk of the increase is associated with social spending, mainly on health and education, both of which are exempt from the restrictions of the saving policy. Capital spending remained constant at the equivalent of 3.3% of GDP, bringing total expenditure to 22.4% of GDP.

A number of improvements to tax administration, especially in the area of income-tax management, boosted tax revenues by 8.2% in real terms, raising the tax burden by one percentage point to 15.4% of GDP. Despite these improvements, contractions in grants from abroad and in public corporation profits, reflecting in part the cost of subsidies for electricity and drinking water, detracted from the growth of total revenues and grants. These expanded by only 3% in real terms to stand at 20.2% of GDP. While the overall subsidy for electricity consumption was cut by approximately 12% in nominal terms to stand at US$ 175 million, the proportion of the subsidy absorbed by the Rio Lempa Hydro-electric Executive Committee, corresponding to the subsidies granted for residential consumption in excess of 99 kWh and non-residential consumption, increased from approximately 80% to 100% of the total subsidy.

Consequently, the overall NFPS deficit increased by half a percentage point and closed 2013 at 2.2% of GDP. With the expenditure on pensions equivalent to 1.8% of GDP, the NFPS deficit rose to 4% of GDP, almost one percentage point above the official target announced originally. Owing to external financing constraints, resulting from the suspension of the stand-by arrangement with the International Monetary Fund, the deficit was financed almost entirely by issuance of treasury bills (LETES).

The NFPS debt, including the social security debt, diminished slightly: from 56.5% of GDP to 55.3% of GDP. In addition, the debt portfolio was reconstituted in favour of domestic creditors. Bearing in mind the relatively high cost of short-term financing, at the beginning of May, the Government of El Salvador announced the issue of international bonds to the tune of US$ 800 million, its intention being to cancel the Treasury bill debt. These bonds will be added to the issue of a similar amount in 2012.

As provided for in the proposed budget, an NFPS deficit (including pensions) equivalent to 3.6% of GDP is projected for 2014. The measures geared to achieving this target include initiatives, presented in May 2014, for new taxes on luxury properties and financial transactions as well as reforms to existing taxes. Along with these initiatives, a bill on fiscal responsibility was presented in order to formalize the medium-term fiscal framework.

(b) Financial and macroprudential policy

Since the economy has been dollarized since 2001 and international capital moves freely into and out of El Salvador, the only way the Central Reserve Bank can influence liquidity is to adopt regulatory measures.

One such measure was the entry into force in February of the Prohibition of Usury Act, which sets ceiling rates for loans offered by financial institutions. Other notable measures include the signing of a loan agreement for US$ 100 million with the Inter-American Development Bank (IDB); and a 2% increase in the legal reserve ratio, which banks must observe. These last two measures were designed to guarantee liquidity on the market amid any potential uncertainty generated by the legislative and presidential elections that took place in early 2014.

Benchmark rates showed a slight upward trend, reflecting the higher cost of external borrowing, associated in part with the reduction in the sovereign debt rating and the resulting increase in the risk premium. The 180-day deposit yield averaged 2.6% in real terms, compared with 0.8% in 2012. The average cost of loans of up to one year increased by one percentage point to stand at 4.9% in real terms.

Thanks to the higher deposit rates, the monetary aggregate M2 showed a modest expansion of 1.4% in real terms, after contracting in 2010 and 2011 and remaining practically constant in 2012. By contrast, credit to the private sector does not seem to have been affected by the rise in deposit rates, expanding from 5% in real terms in 2012 to 6.7% in 2013. Most of the credit expansion occurred in consumer loans.

(c) Other policies

The Special Public-Private Partnerships Act was passed in May 2013. It seeks to boost investment in infrastructure and services projects. Furthermore, in October 2013, El Salvador joined the trade pillar of the Association Agreement between Central America and the European Union.

The first round of the presidential and legislative elections took place in February 2014, followed by the second round of the presidential elections in March. Salvador Sánchez Cerén, the winning candidate and representative of the Farabundo Martí Front for National Liberation (FMLN), took office on 1 June 2014.

On the whole, the new government is expected to pursue the same policies implemented by the administration of President Mauricio Funes (2009-2014). To date, the only significant change has been the country's accession to PetroCaribe, signed on 2 June in San Salvador. This will enable El Salvador to purchase petroleum on preferential terms and to pay up to half of the bill with goods and services.

3. The main variables

(a) The external sector

In 2013, the current account deficit grew by more than one percentage point to stand at a level equivalent to 6.5% of GDP, a figure exceeded only once in the last decade: in 2008. This result is attributable mainly to the deficit on the trade balance, which widened from 18.6% of GDP to 19.4% of GDP, since, notwithstanding the slowdown in remittance flows, the transfer balance remained practically unchanged at 16.8% of GDP.

Stronger prices for non-traditional exports helped to boost earnings for goods exports, offsetting the weaker prices for traditional goods. However, the rally from 0.6% growth in 2012 to 2.8% in 2013 was not sufficient to counteract the expansion in goods imports, which increased from 2.9% in 2012 to 5% in 2013.

The higher import bill was due to a rebound in capital goods imports, which, after a 0.9% contraction in 2012, went up by 15.8% in 2013, and to a lesser extent to the acceleration in consumer goods imports, which expanded from 4.3% in 2012 to 7% in 2013. The more gradual increase in the oil bill (3.7%) was significantly below the 12% increase observed in 2012, thanks to the relative stability of international fuel prices.

The current account deficit was financed mainly by loans contracted by the Salvadoran banking system and, to a lesser extent, by a reduction in reserve assets, as foreign direct investment flows slowed significantly, falling by the equivalent of 2% of GDP in 2012 to 0.6% of GDP in 2013.

As regards relative prices, the reduction of export prices and the relative stability of import prices resulted in a 1.7% deterioration in the terms of trade. Nevertheless, bearing in mind the inflation differential with the United States, according to official information the real effective exchange rate rose by 0.7% against the United States dollar.

(b) Economic activity

In 2013, the Salvadoran economy expanded by just 1.7%, slightly below the figure of 1.9% recorded in 2012. This lacklustre performance may be attributed to a sharp slowdown in household consumption, which recorded a mere 0.3% growth (compared with 2.6% in 2012) reflecting flagging remittance flows. The recovery in investment was not sufficient to offset the slowdown in consumption. Following a contraction of 1.4% in 2012, investment grew by 9.7% driven by renewal of the public transport automobile fleet as well as by investments in the telecommunications sector.

Although stronger demand from the United States gave rise to a 4.5% expansion in exports of Salvadoran goods and services, thus reversing the 7.5% contraction recorded in 2012, the higher demand for imported goods and services, associated with the surge in investment, meant that net imports lowered the 2013 performance by 0.8 percentage points.

On a per-sector basis, the lower growth rate was due to a 0.4% contraction in the agriculture and livestock sector, which contrasts with 3.5% growth in 2012. The former reflects to a great extent the negative impact of coffee leaf rust on coffee production, which was partially offset by the acceleration in manufacturing activity, which moved from 1.3% in 2012 to 2.1% in 2013, thanks to the impetus from external demand.

Available monthly indicators of activity for the first quarter of 2014 point to a continuation of the trend observed at the end of 2013, suggesting growth of approximately 2.3% for 2014. The slight improvement in the growth rate is attributable to a rebound in private consumption, and to the continuing growth in investment. On a per-sector basis, stronger growth is expected to come from the recovery in the agriculture and livestock sector, thanks to support provided by the family farming programme. Growth could be greater if some of the investment projects envisaged under the recently approved public-private partnership were to come to fruition.

(c) Prices, wages and employment

In 2013, there was a spike in food and beverage prices as well as in energy prices, as higher international prices were passed on to the consumer, and electricity rates were adjusted upward. Nevertheless, cumulative 12-month consumer price inflation was just barely 0.8%, the same rate as in 2012. This was due mainly to deflation in health services, attributable to the regulation of medication prices and, to a lesser extent, to the continued fall in the cost of communications services.

It is anticipated that 12-month inflation will be close to 2% at the end of 2014. This acceleration in inflation takes into account the possible effect of a new adjustment of electricity rates as well as the impact of the El Niño phenomenon on the prices of agricultural products. Up to May, cumulative inflation stood at 0.7%, while 12-month inflation reached 0.9%.

According to data released by the Salvadoran Social Security Institute (ISSS) in 2013, the average number of private-sector contributors rose by 4.8%, significantly higher than the 2.9% recorded in 2012. The bulk of this increase is estimated to have occurred in the financial sector. However, part of this increase reflects a better oversight of contributors' declarations. According to data from ISSS, real average wages, which had gone up by 2.3% in 2012, increased by a mere 0.7% in 2013, notwithstanding the 4% across-the-board increase in nominal minimum wages, which took effect in the second half of 2013. In the first quarter of 2014, the number of contributors went up by 4.2% over the same period of 2013, while real average wages inched up at an average rate of 1.1%.

Table 1
El SALVADOR: MAIN ECONOMIC INDICATORS

	2005	2006	2007	2008	2009	2010	2011	2012	2013 a/
	Annual growth rates b/								
Gross domestic product	3.6	3.9	3.8	1.3	-3.1	1.4	2.2	1.9	1.7
Per capita gross domestic product	3.2	3.5	3.4	0.8	-3.6	0.8	1.7	1.3	1.1
Gross domestic product, by sector									
Agriculture, livestock, hunting, forestry and fishing	5.1	5.7	8.5	3.0	-2.9	3.1	-2.5	3.5	-0.4
Mining and quarrying	5.3	4.4	-2.1	-6.7	-15.4	-11.6	13.6	3.1	0.0
Manufacturing	1.7	2.2	2.5	2.3	-3.0	1.9	2.7	1.3	2.1
Electricity, gas and water	3.8	4.7	2.8	2.3	-1.1	-0.6	0.5	0.8	1.0
Construction	3.8	6.4	-6.9	-7.3	-2.8	-5.0	8.9	0.3	0.0
Wholesale and retail commerce, restaurants and hotels	5.2	4.6	4.3	1.0	-5.4	1.5	2.3	2.6	2.1
Transport, storage and communications	6.7	6.9	4.8	-0.8	-5.9	-0.2	4.6	1.6	2.2
Financial institutions, insurance, real estate and business services	2.7	2.6	3.0	0.9	-1.3	1.9	1.8	0.2	1.9
Community, social and personal services	0.8	2.5	3.8	2.0	1.3	1.8	3.3	2.5	2.8
Gross domestic product, by type of expenditure									
Final consumption expenditure	5.1	4.8	5.9	1.7	-9.2	2.2	2.5	2.5	0.8
Government consumption	2.1	2.2	0.4	-0.4	5.8	2.2	3.9	2.5	6.0
Private consumption	5.3	5.0	6.3	1.8	-10.3	2.2	2.4	2.6	0.3
Gross capital formation	3.6	11.6	2.8	-5.4	-19.2	2.4	13.8	-1.4	9.7
Exports (goods and services)	0.9	5.9	7.1	6.9	-16.0	11.6	9.3	-7.5	4.6
Imports (goods and services)	4.3	8.9	8.8	3.3	-24.8	10.4	10.8	-4.5	4.5
Investment and saving c/	**Percentajes of GDP**								
Gross capital formation	16.1	16.8	16.3	15.2	13.4	13.3	14.4	14.1	15.1
National saving	12.4	12.7	10.3	8.1	11.9	10.8	9.6	8.7	8.6
External saving	3.6	4.1	6.1	7.1	1.5	2.5	4.8	5.4	6.5
Balance of payments	**Millions of dollars**								
Current account balance	-622	-766	-1,217	-1,532	-312	-533	-1,112	-1,288	-1,577
Goods balance	-3,530	-4,084	-4,740	-5,114	-3,506	-4,022	-4,772	-4,927	-5,295
Exports, f.o.b.	1,864	2,255	2,794	3,276	2,924	3,473	4,243	4,235	4,334
Imports, f.o.b.	5,394	6,339	7,534	8,389	6,430	7,495	9,015	9,162	9,629
Services trade balance	363	284	234	224	308	398	449	508	584
Income balance	-490	-438	-456	-389	-556	-538	-618	-890	-966
Net current transfers	3,035	3,472	3,746	3,747	3,442	3,629	3,830	4,021	4,100
Capital and financial balance d/	431	812	1,496	1,866	735	237	698	1,939	1,250
Net foreign direct investment	398	267	1,455	824	366	-226	218	484	137
Other capital movements	33	545	40	1,042	369	462	479	1,455	1,113
Overall balance	-190	47	279	333	423	-296	-414	651	-327
Variation in reserve assets e/	190	-47	-279	-333	-423	296	414	-651	327

Table 1 (concluded)

	2005	2006	2007	2008	2009	2010	2011	2012	2013 a/
Other external-sector indicators									
Real effective exchange rate (index: 2005=100) f/	100.0	100.7	101.7	103.0	100.4	102.0	103.2	103.6	105.0
Terms of trade for goods									
(index: 2005=100)	100.0	98.7	97.7	95.0	98.1	94.4	94.4	91.2	90.8
Net resource transfer (millions of dollars)	-59	375	1,040	1,477	179	-302	79	1,049	284
Total gross external debt (millions of dollars)	8,877	9,692	9,349	9,994	9,882	9,698	10,670	12,530	13,113
Employment	**Average annual rates**								
Labour force participation rate g/	52.4	52.6	62.1	62.7	62.8	62.5	62.7	63.2	...
Open unemployment rate h/	7.3	5.7	5.8	5.5	7.1	6.8	6.6	6.2	...
Visible underemployment rate h/	6.2	4.9	5.3	6.3	7.7	7.0	3.4	5.8	...
Prices	**Annual percentages**								
Variation in consumer prices									
(December-December)	4.3	4.9	4.9	5.5	-0.2	2.1	5.1	0.8	0.8
Variation in industrial producer prices									
(December-December)	6.9	0.6	13.9	-6.0	4.9	6.2	7.0	2.4	-0.2
Variation in average real wage	-2.4	0.4	-2.4	-3.1	3.5	1.1	-2.9	0.2	0.5
Nominal deposit rate i/	3.4	4.4	4.7	4.2	4.5	2.9	1.8	2.5	3.4
Nominal lending rate j/	6.9	7.5	7.8	7.9	9.3	7.6	6.0	5.6	5.7
Central government	**Percentajes of GDP**								
Total revenue	13.5	14.5	14.8	15.1	13.8	15.0	15.4	16.2	16.5
Tax revenue	12.5	13.4	13.6	13.5	12.6	13.5	13.8	15.5	15.9
Total expenditure	14.5	14.9	15.0	15.8	17.6	17.7	17.6	17.9	18.3
Current expenditure	12.0	12.3	12.4	13.0	14.7	14.5	14.6	14.8	15.0
Interest	2.2	2.4	2.5	2.4	2.5	2.3	2.2	2.2	2.3
Capital expenditure	2.6	2.7	2.6	2.8	2.9	3.2	3.1	3.1	3.3
Primary balance	1.1	2.0	2.3	1.8	-1.2	-0.4	-0.1	0.5	0.6
Overall balance	-1.0	-0.4	-0.2	-0.6	-3.7	-2.7	-2.3	-1.7	-1.8
Central government public debt	37.5	37.7	34.9	34.4	42.6	42.6	41.7	45.7	44.2
Domestic	12.6	10.8	10.7	11.6	14.9	14.3	14.8	15.5	14.6
External	24.9	26.9	24.2	22.8	27.6	28.3	26.9	30.2	29.6
Money and credit	**Percentages of GDP, end-of-year stocks**								
Domestic credit	52.1	53.1	55.0	54.5	56.2	56.8	56.7	57.2	62.4
To the public sector	15.6	14.6	17.0	18.2	21.0	24.3	26.5	26.0	29.4
To the private sector	42.9	43.4	43.6	43.0	42.4	40.9	39.8	40.2	42.7
Others	-6.4	-4.9	-5.6	-6.7	-7.2	-8.4	-9.5	-9.0	-9.7
Monetary base	9.9	9.3	10.3	10.7	11.0	11.0	9.8	9.4	10.2
Money (M1)	8.5	8.9	9.6	9.1	11.2	12.3	12.0	11.7	11.9
M2	47.9	48.8	52.9	49.1	52.0	50.3	45.5	44.7	44.8

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

	2012				2013				2014	
	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/	2.5	1.9	1.7	1.5	1.3	1.7	1.9	1.8	2.0	...
Gross international reserves (millions of dollars)	2,616	2,656	2,505	2,747	3,110	3,146	3,005	2,855	2,942	3,026 c/
Real effective exchange rate (index: 2005=100) d/	104.4	103.2	103.1	102.3	103.1	103.0	103.8	104.4	104.3	105.2 c/
Consumer prices (12-month percentage variation)	4.7	1.3	0.3	0.8	1.0	0.4	0.9	0.7	0.6	0.8 c/
Wholesale prices (12-month percentage variation)	2.3	-2.9	-4.4	-4.5	-3.5	-3.5	-3.0	-2.5	-1.9	0.6 e/
Nominal interest rates (annualized percentages)										
Deposit rate f/	2.1	2.3	2.6	3.1	3.3	3.3	3.4	3.6	3.5	3.7 c/
Lending rate g/	5.6	5.5	5.6	5.8	5.7	5.7	5.9	5.7	6.0	5.9 c/
Sovereign bond spread, Embi Global (basis points to end of period) h/	453	480	426	396	350	436	409	389	420	383
International bond issues (millions of dollars)	-	-	-	800	310	...	...	...	...	...
Domestic credit (variation from same quarter of preceding year)	10.3	12.0	8.9	7.3	4.6	3.9	5.2	8.3	10.8	11.3 c/
Non-performing loans as a percentage of total credit	3.8	3.6	3.4	3.1	2.9	2.8	2.7	2.5	2.4	...

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/ Figures as of April.
f/ Basic rate for deposits of up to 180 days.
g/ Basic lending rate for up to one year.
h/ Measured by J.P.Morgan.

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