El Salvador

Over the first half of 2013, slack domestic demand meant that El Salvador's economy expanded by around 1.5%, despite an improvement in external demand. Growth of 1.7% is expected for the year as a whole. As a result of this slight slowdown from the 1.9% growth posted in 2012 and the relative stability in food and fuel prices, average inflation has not exceeded 1% over the year, and is not expected to do so before year-end. Tax revenues have continued to increase, despite the slow growth in the economy, a sign that the tax reform undertaken in late 2011 continues to bear fruit. However, government spending has risen significantly, and the non-financial public sector deficit may therefore reach 4.5% of GDP. Notwithstanding the recovery of the maquila sector, its structural deficit, coupled with the slowdown in remittances, points to a slight deterioration of the current-account deficit, which had equalled 5.3% of GDP in 2012. The economy is forecast to grow by some 2.5% in 2014, on the back of expectations of brisker growth in private investment, greater public spending in the run-up to the presidential elections in February, and a broader recovery in the export sector.

Despite the slowdown in economic activity, real growth of 8.8% was seen in tax receipts until September as a result of significant rises in income tax revenue, whose maximum rates were raised in the aforementioned tax reform. However, a contraction in non-tax revenue and the falling profitability of State-owned enterprises shackled growth in non-financial public sector income, which grew by 2.8% in real terms up to the third quarter of 2013, down from 7.3% in the same period of 2012. The reduced profits of State-owned enterprises are a reflection of higher energy prices and the costs incurred as a result of the delay in awarding the concession for the new port of La Unión Centroamericana.

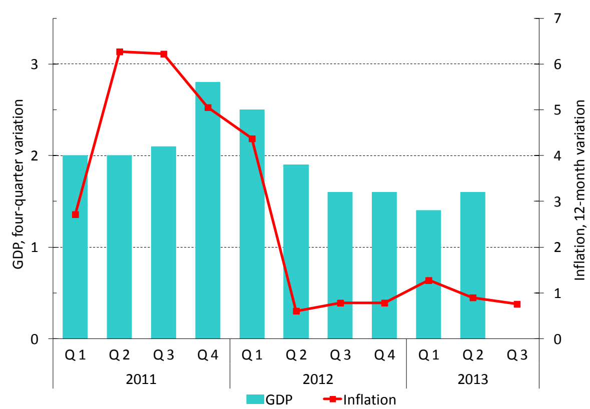
Despite sluggish growth in income, total government spending until September soared from 1.9% in real terms in 2012 to 7.1% in 2013. This was chiefly attributable to rising current expenditure — particularly social spending, which was spared from the public-sector savings and cutbacks under the austerity programme adopted earlier this year— as well as, to a lesser extent, the increased cost of servicing the public debt. Public investment, which had seen real growth of 11.4% up until September 2012, increased by just 1.9% in real terms over the same period in 2013.

The non-financial public sector deficit, including pension liabilities, is therefore expected to reach around 4.5% of GDP, more than one percentage point higher than in 2012. The 2014 budget passed by the Legislative Assembly foresees a deficit of 3.6% of GDP, which is contingent on GDP growth of 2.6%.

Lending to the private sector jumped 6.4% in real terms until the third quarter, with consumer credit accounting for over two thirds of this growth, since credit to the industrial sector contracted over the third quarter.

In early October the trade pillar of the Association Agreement between Central America and the European Union, to which Costa Rica, Honduras, Nicaragua and Panama are also parties,

El Salvador: GDP and inflation, 2011-2013



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

entered into force. This agreement sets out tariff preferences that had hitherto been granted under the Generalized System of Preferences, and is expected to have the greatest impact on sugar, fruit and textile exports.

El Salvador: main economic indicators, 2011-2013

	2011	2012	2013 [a]
	Annual growth rate		
Gross domestic product	2.2	1.9	1.7
Per capita gross domestic product	1.7	1.3	1.1
Consumer prices	5.1	0.8	0.5 [b]
Real average wage [c]	-2.9	-2.8	...
Money (M1)	10.4	4.4	2.1 [d]
Real effective exchange rate [e]	1.3	0.4	1.4 [b]
Terms of trade	0.0	-3.4	-0.8
	Annual average percentage		
Open urban unemployment rate	6.6	6.2	...
Central government			
Overall balance / GDP	-2.3	-1.7	-2.2
Monetary policy rate	1.8	1.6	1.3 [b]
Nominal lending rate [f]	6.0	5.6	5.7 [b]
	Millions of dollars		
Exports of goods and services	6 474	6 767	7 042
Imports of goods and services	10 753	11 096	11 766
Current account balance	-1 070	-1 258	-1 712
Capital and financial balance [g]	656	1 907	1 387
Overall balance	-414	649	-326

Source: Economic Commission for Latin America and the Caribbean (ECLAC), on the basis of official figures.
[a] Estimates.
[b] Figures as of October.
[c] Gross salary.
[d] Figures as of September.
[e] A negative rate indicates an appreciation of the currency in real terms.
[f] Basic lending rate for up to one year.
[g] Includes errors and omissions.

At the mid-point of the year, the Special Public-Private Partnerships Act entered into force, then in September, the United States Government pledged a donation of US$ 277 million, to be administered by the Millennium Fund (FOMILENIO), to finance institutional capacity-building and education and infrastructure projects in coastal areas.

The nominal 1.1% contraction in exports in the first three quarters of 2012 gave way to a 3.9% rise over the same period of 2013 on the back of an upturn in maquila exports, which grew by 8.7% until September 2013, after having contracted by 6.3% over the same period of 2012. This offset a 3.4% fall in traditional exports, hit by the continuing slide in international coffee prices from late 2011 onwards, which was compounded in 2013 by an outbreak of coffee-leaf rust.

More dynamic growth in the maquila sector led to a nominal increase of 5.6% in imports between January and September, as opposed to growth of 1.6% over the same period in 2012. The balance-of-trade deficit therefore widened by 7.5% in nominal terms over this period (compared with growth of 4.8% until the third quarter of 2012). A slowdown in remittance inflows was also seen, with growth of just 1.3% recorded until September, well below the 6.9% posted in the same period of 2012.

Although manufacturing expanded by 2% over the first half of 2013, the economy as a whole grew by only 1.5%, following growth of 2.2% in the same period in 2012. This can be traced back to the impact of coffee-leaf rust on agriculture —which grew by just 1.2% in the first half of 2013, down from 3.6% in the first six months of 2012— and persistently slack domestic demand, which led to a slowdown in trade from 2.9% in the first half of 2012 to 1.6% in 2013. Economic growth of 1.7% is expected for the year as a whole.

Inflation barely reached 0.8% on average in the 12 months to September 2013, chiefly as a result of price trends in food and non-alcoholic beverages. Inflation of around 1% is forecast for the year as a whole, reflecting the impact that the mid-year hike in fuel prices could have on consumer prices in the last quarter.

In contrast to the sluggish growth in economic activity, formal employment —measured in terms of numbers of workers contributing to the Salvadoran Social Security Institute (ISSS)— rose by 5% from January to August, compared with figures from the same period in 2012. This growth, almost double the 2.8% expansion recorded in the same period of 2012 (on figures from the previous year), was driven by relatively strong growth in manufacturing and increased demand for labour in the financial sector.

Unfortunately, this increase in the number of formal jobs in the private sector has not been accompanied by similar increases in real average wages. Despite the relatively low level of inflation, wage growth slowed from an average of 2.5% in the 12 months to August 2012 to 1.4% in the 12 months to August 2013. The nominal 4% increase in minimum wages in early July is expected to see real wages bounce back by the end of the year.