El Salvador

1. General trends

In 2009, the world financial crisis took a heavy toll on economic activity in El Salvador, as overall GDP contracted by 3.5% and per capita GDP by 4%. The economy is expected to recover slightly in 2010, by about 1.5%.

Domestic demand decreased by 10%, while external demand was down 16.7%. As a result of the sharp drop in domestic demand, imports plummeted by 23.7%. This mitigated the contraction in GDP, cutting the current account deficit from 7.6% of GDP in 2008 to 1.8% in 2009. Given the upswing in domestic demand, the current account deficit is expected to stand at about 3% in 2010.

Average inflation dropped from 7.3% in 2008 to just 0.5% in 2009. A rekindling of inflation is expected in 2010, with the 12-month inflation rate projected to stand at about 2.5% by the end of the year.

As a result of the economic slowdown, and despite the steps taken to mitigate growth in public spending, the fiscal deficit —including pensions and trust funds— rose to 5.6% of GDP in 2009, up from 3.1% in 2008. Consequently, non-financial public sector (NFPS) debt climbed from 35.9% of GDP to 44.2%. The fiscal deficit is expected to decline in 2010, falling to 4.7% of GDP.

Although the solvency and profitability of several banks worsened slightly, the financial system has remained stable. Real lending rates have remained relatively high, and were just shy of 8% until mid-2010. Bank credit to the private sector once again contracted, and unless this situation improves, a stronger economic recovery is unlikely.

2. Economic policy

(a) Fiscal policy

The economic slowdown throughout 2009 caused tax revenue (including social security contributions) to fall by 8.9%, which lowered the tax burden from 14.6% of GDP in 2008 to 14% in 2009.

The new government which took office in June 2009 responded by expanding the austerity measures introduced by the previous government. This included a 15% cut in the national budget, restrictions on public sector hiring and the postponement of several investment projects. According to official estimates these measures, in conjunction with a reduction in the transportation subsidy, resulted in savings equivalent to 1% of GDP in 2009.

Part of the saving was used to finance the new government's anti-crisis plan, which will remain in effect until 2011. The plan includes a temporary employment programme and loan guarantees for the construction of low-cost housing, eliminates health service co-payments and provides uniforms and meals for low-income students.

As a result, real growth in NFPS current spending (including transfers to pensions and trust funds) fell to 4.3% from 5.1% in 2008 —owing to a 1.1% contraction in current transfers— and capital expenditure declined by 3.3%.

Despite the spending cuts, the NFPS deficit (including pensions and trust funds) rose from 3.1% to 5.6% of GDP. In the first three months of 2010, the government financed the budget shortfall by issuing US$ 300 million in short-term debt on the domestic market and rechannelled US$ 650 million in loans from the Inter-American Development Bank (IDB) originally intended to amortize a bond that comes due in 2011.

In September 2009, a possible standby agreement with the International Monetary Fund was announced, increasing the government's access to fresh funds from the World Bank and IDB. A 10-year, US$ 800 million sovereign bond was then placed on the international market in November, in order to replace short-term debt.

In December 2009, the legislative assembly passed a tax reform to augment tax revenue by 0.7% of GDP by increasing certain selective taxes, introducing new ones and eliminating certain tax exemptions. Along with the tax reform, various administrative measures were introduced to strengthen revenue-raising capacity.

Because of worsening public finances, total NFPS debt reached 44.2% of GDP in 2009 compared with 35.82% in 2008. Total public debt rose to 53% of GDP, nine percentage points higher than in 2008. External liabilities accounted for 66.8% of total NFPS debt and 58.6% of total public debt.

The IMF standby agreement signed in 2010, replacing the January 2009 agreement, is precautionary, and calls for a US$ 800 million, 36-month arrangement.

For 2010, the goal of fiscal policy is to lower the NFPS deficit, including pensions and trust funds, to 4.7% of GDP. This goal seems reasonable, given that in the first half of 2010 fiscal indicators have performed above the targets set in the IMF agreement.

(b) Financial policy

The uncertainty surrounding the March 2009 presidential elections was exacerbated by the international financial crisis, leading to a steep hike in nominal interest rates starting in September 2008. The six-month deposit rate rose, in real terms, from -0.1% at the end of 2008 to 3.9% at the end of 2009. In contrast with 2008, when the deposit balance remained constant, in 2009 it grew by a nominal 1.2%.

The real lending rate on loans of up to one year rose from 3.9% to 8.6% over 2009, reaching 11.2% in August. Along with the worsening situation in the credit markets, the hike in real interest rates led to reduced lending to the private sector for the second consecutive year. The balance was US$ 8.194 billion at the end of 2009, nearly US$ 520 million (6%) less than in 2008. The hardest-hit sectors were construction and housing, commerce and personal loans.

Non-performing loans in proportion to total lending reached 3.7% in December 2009, up from 2.8% twelve months earlier. This has required the establishment of continually higher reserves for loan losses. The loan-loss coverage of the non-performing portfolio stood at 109.9% in late 2009.

The gross intermediation margin in the financial system —measured as the difference between revenue and costs as a proportion of gross productive assets— rose slightly from 2008 to 2009. Taking operating expenses, loan loss provisions and taxes into account, the net intermediation margin declined sharply, standing at 0.36% in late 2009, while financial system profitability fell from 7.9% to 2.6%.

Nevertheless, bank capitalization stood at 16.5% in December 2009, well above the legal requirement of 12%. Since December 2008, when the requirement for an additional 3% on the liquidity reserve began to be phased out, excess reserves have been held. Reserves were around US$ 500 million in mid-2009 and ended the year at US$ 220 million. This is attributed to a preference for liquidity in light of the perception of risk by financial institutions.

Net international reserves stood at US$ 2.949 billion in late 2009, equivalent to nearly five months' imports and approximately 35% of M2. The 17.5% growth from 2008 is largely the result of the allocation of nearly US$ 200 million in special drawing rights by IMF in August.

3. The main variables

(a) Economic activity

The real economic growth rate was negative in 2009 (-3.5%) owing to a sharp contraction in domestic and external demand. Although government final consumption was up by 4.4%, overall consumption shrank by 9.9% while gross capital formation was down 17.4%. By asset type, investment in construction contracted by 0.9% and investment in machinery and equipment by 22%. As a result of the international financial crisis and the consequent fall in external demand, exports of goods and services dropped by 16.7% from 2008. This decrease was, however, more than offset by the 23.7% plunge in imports of goods and services during the same period.

All productive sectors except housing rentals and government services —which account for a combined 13% of GDP— contracted in 2009.

Value added in the agricultural sector fell for the first time in eight years (-2.2%), mainly as result of tropical storm Ida, which struck the country in late 2009.

The manufacturing sector, which accounts for more than a fifth of the country's GDP and which had posted average growth of 4% over the past 15 years, shrank by 3.4% as a result of lower demand for goods.

The construction sector, hard hit since 2008 by tight credit, experienced negative growth for the third year running and ended 2009 with a 0.7% contraction. This performance —an improvement over the 3.2% and 5.4% declines posted in 2007 and 2008— resulted from the boost given to the sector by the low-cost housing programme "Housing for Everyone" and the construction work carried out to repair the damage caused by floods in late 2009. By contrast, mining activity declined steadily, and in 2009 value added in the sector dropped by 14.4%.

As a result of waning private consumption, commercial activity was down 5.2% and the value added of basic services declined by 3.7%. Although housing rentals and government services posted slight gains, other services dropped by 3.4%.

In the early months of 2010 economic activity improved somewhat. According to the economic activity index, average 12-month growth was positive in the first quarter of 2010, although it was merely 0.2% in April.

The economy is expected to grow by close to 1.5% in 2010, as a result of a slight upswing in domestic demand resulting from a moderate increase in remittances and increased credit access. This upturn is expected to provide a boost to the services sector. The agricultural sector is expected to bounce back from the effects of tropical storm Agatha, which struck in June 2010. In addition, the manufacturing sector stands to benefit from the recovery of the country's leading trading partners.

(b) Prices, wages and employment

Influenced by international food and fuel prices as well as the sharp contraction in domestic demand, 12-month inflation declined throughout 2009, falling to -1.6% in October. This trend levelled off in the fourth quarter of 2009, owing to the upturn in some international prices as well as the rise in some food prices because of damage to harvests from storms and floods in November 2009. Year-on-year inflation at the end of 2009 was -0.2%, while average inflation for the year was 0.5%.

In January 2010, the baseline for the national consumer price index was updated to December 2009. As measured with the updated baseline, inflation rose in the first months of 2010, reaching 0.9% in the first quarter owing to selective tax hikes, increased charges for electric power and the targeted use of some subsidies, especially the gas subsidy.

Although inflation rose at a lower rate in the second quarter, the economic rebound, the upswing in some international prices and the lower reference point for the second half of 2009 are expected to translate into a 12-month inflation of close to 2.5% at the end of 2010.

The real urban minimum wage rose by 9.4% in 2009, up from 0.2% in 2008. The unemployment rate, which dropped to its lowest level in nearly two decades (5.9%) in 2008, is expected to have risen in 2009.

The number of private sector workers who contributed to the Salvadoran Social Security Institute fell by nearly 18,000 (3.8%), and in December 2009 the number stood at a level similar to that seen in late 2006. The sectors that shed the most jobs were manufacturing, commerce and construction, with a combined total of nearly 16,500 job losses.

(c) The external sector

The current account deficit fell from 7.6% of GDP in 2008 to 1.8% in 2009. This sharp reduction stemmed mainly

Table 1
EL SALVADOR: MAIN ECONOMIC INDICATORS

	2001	2002	2003	2004	2005	2006	2007	2008	2009[a]
					Annual growth rates [b]				
Gross domestic product	1.7	2.3	2.3	1.9	3.3	4.2	4.3	2.4	-3.5
Per capita gross domestic product	1.2	1.9	2.0	1.5	2.9	3.8	3.9	2.0	-4.0
Gross domestic product, by sector									
Agriculture, livestrock, hunting, forestry and fishing	-2.6	0.4	0.9	2.8	5.1	5.7	8.5	7.3	-2.2
Mining and quarrying	11.4	5.7	3.4	-16.0	5.3	4.4	-2.1	-6.7	-14.4
Manufacturing	4.0	2.9	2.2	1.0	1.5	3.0	3.5	2.7	-3.4
Electricity, gas and water	4.6	7.4	4.5	3.4	3.8	4.7	2.8	2.4	-1.4
Construction	9.6	6.6	3.2	-9.8	4.0	6.5	-3.2	-5.4	-0.7
Wholesale and retail commerce, restaurants and hotels	1.9	1.5	2.7	2.4	4.4	4.9	4.3	1.4	-5.2
Transport, storage and communications	4.3	5.0	3.4	5.4	6.7	6.9	4.8	2.1	-3.9
Financial institutions, insurance, real estate and business services	-0.8	2.7	2.6	2.5	2.7	2.6	3.0	0.9	-2.1
Community, social and personal services	-0.3	-0.6	0.5	1.3	0.8	2.8	3.8	2.1	-0.1
Gross domestic product, by type of expenditure									
Final consumption expenditure	3.2	1.5	1.9	2.8	4.8	4.8	7.9	3.9	-9.0
Government consumption	4.6	0.1	-0.3	1.1	2.1	2.2	-2.0	5.6	4.4
Private consumption	3.1	1.6	2.1	2.9	5.0	5.0	8.7	3.8	-9.9
Gross capital formation	5.1	-2.7	7.8	-3.9	4.4	15.5	-5.5	-4.7	-17.4
Exports (goods and services)	-0.2	6.0	4.7	3.6	-0.9	5.4	6.9	5.5	-16.7
Imports (goods and services)	4.2	1.5	4.8	2.6	3.4	9.4	8.4	4.7	-23.7
					Percentages of GDP				
Investment and saving [c]									
Gross capital formation	16.7	16.4	17.0	16.2	15.8	17.0	15.9	14.9	13.1
National saving	15.6	13.6	12.3	12.1	12.3	12.8	9.9	7.3	11.3
External saving	1.1	2.8	4.7	4.1	3.5	4.2	6.0	7.6	1.8
					Millions of dollars				
Balance of payments									
Current account balance	-150	-405	-702	-642	-610	-783	-1 221	-1 682	-374
Goods balance	-1 933	-1 865	-2 287	-2 660	-2 938	-3 533	-4 105	-4 394	-2 845
Exports, f.o.b.	2 892	3 020	3 153	3 339	3 447	3 759	4 039	4 611	3 861
Imports, f.o.b.	4 824	4 885	5 439	6 000	6 385	7 291	8 144	9 004	6 706
Services trade balance	-250	-240	-107	-79	-128	-192	-291	-584	-425
Income balance	-266	-323	-423	-458	-579	-531	-576	-536	-664
Net current transfers	2 298	2 023	2 114	2 555	3 035	3 472	3 750	3 832	3 561
Capital and financial balance [d]	-27	282	1 019	589	551	855	1 502	2 016	802
Net foreign direct investment	289	496	123	366	398	268	1 408	719	562
Other capital movements	-316	-214	895	224	153	587	93	1 297	240
Overall balance	-178	-124	316	-52	-59	72	280	334	429
Variation in reserve assets [e]	178	124	-316	53	59	-72	-280	-334	-429
Other external-sector indicators									
Real effective exchange rate (index: 2000=100) [f]	99.8	99.6	100.2	98.9	100.8	101.4	102.7	104.4	101.8
Terms of trade for goods (index: 2000=100)	102.5	101.6	97.7	96.8	96.8	95.5	94.6	91.9	94.9
Net resource transfer (millions of dollars)	-293	-42	595	132	-28	324	925	1.480	138
Gross external debt (millions of dollars) [g]	3 148	3 987	7 917	8 211	8 761	9 586	9 075	9 711	9 710
					Average annual rates				
Employment									
Labour force participation rate [h]	53.3	51.2	53.4	51.7	52.4	52.6	62.1	62.7	62.8
Open unemployment rate [i]	7.0	6.2	6.2	6.5	7.3	5.7	5.8	5.5	7.1
Visible underemployment rate [j]	3.8	4.3	4.8	4.5	6.2	4.9	5.3	6.3	7.7
					Annual percentages				
Prices									
Variation in consumer prices (December-December)	1.4	2.8	2.5	5.4	4.3	4.9	4.9	5.5	-0.2
Variation in wholesale prices (December-December)	...	0.3	2.6	6.8	7.5	3.9	10.8	-6.9	2.7

Table 1 (concluded)

	2001	2002	2003	2004	2005	2006	2007	2008	2009[a]
Variation in real minimum wage	-3.6	-1.8	2.1	-1.4	-4.5	-0.7	2.5	0.2	9.5
Nominal deposit rate [k]	5.5	3.4	3.4	3.3	3.4	4.4	4.7	4.2	4.6
Nominal lending rate [l]	9.6	7.1	6.6	6.3	6.9	7.5	7.8	7.9	9.3
					Percentages of GDP				
Non-financial public sector									
Total revenue [m]	14.9	15.5	16.2	16.3	16.2	17.3	18.0	18.2	17.0
Current revenue	14.4	14.7	15.7	16.0	15.9	17.1	17.7	17.9	16.5
Tax revenue	12.3	13.0	13.3	13.3	14.0	14.9	15.0	14.6	14.0
Capital revenue	0.0	0.5	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Total expenditure [n]	19.3	19.9	19.9	18.7	19.2	20.2	19.9	21.3	22.5
Current expenditure	14.8	15.0	16.3	16.3	16.4	17.1	17.0	17.6	19.4
Interest	1.4	1.7	2.0	2.1	2.2	2.4	2.5	2.4	2.5
Capital expenditure	4.5	4.9	3.7	2.3	2.8	3.1	2.8	3.0	3.0
Primary balance	-2.9	-2.7	-1.7	-0.3	-0.8	-0.5	0.5	-0.7	-3.0
Overall balance	-4.4	-4.4	-3.7	-2.4	-3.0	-2.9	-1.9	-3.1	-5.6
Non-financial public sector debt	33.6	38.6	40.3	40.5	39.4	39.5	36.5	35.8	44.2
Domestic	11.7	11.6	11.4	12.0	12.6	10.7	10.6	11.3	14.7
External	21.9	27.0	28.9	28.6	26.8	28.8	25.9	24.5	29.6
Money and credit [o]									
Domestic credit	40.4	42.1	40.1	39.4	38.0	38.1	38.7	36.9	34.6
To the public sector	1.5	0.9	0.9	1.0	1.3	0.6	1.4	1.7	0.9
To the private sector	40.2	44.5	42.3	42.1	41.9	42.3	42.1	40.8	40.5
Others	-1.3	-3.4	-3.1	-3.7	-5.1	-4.7	-4.8	-5.6	-6.7
Currency outside banks and local-currency deposits (M2)	44.9	42.0	40.2	39.2	36.9	37.8	40.9	42.4	45.0

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 figures in dollars at current prices.
[d] Includes errors and omissions.
[e] A minus sign (-) denotes an increase in reserves.
[f] Annual average, weighted by the value of goods exports and imports.
[g] Figures refer to total external debt; up to 2002, figures refer to public external debt.
[h] Economically active population as a percentage of the working-age population; nationwide total.
[i] Percentages of the economically active population; nationwide total.
[j] Percentages of the economically active population; urban total.
[k] Reference rate for deposits of up to 180 days in the financial system.
[l] Reference rate for 1-year loans in the financial system.
[m] Includes grants.
[n] Includes net lending.
[o] The monetary figures are end-of-year stocks.

from the decline in the trade deficit from 22.5% to 15.5% of GDP in the same period. The relative improvement in the trade balance offset the higher income balance deficit as well as the lower surplus in the transfers balance.

After rising by 14.2% in 2008, goods exports plummeted by 16.5% in 2009 as a result of falling demand from the country's leading trading partners. By destination, exports outside Central America declined by 17.6% while those to the rest of Central America dropped by 14.8%.

The hardest hit category of products was maquila exports, which fell by 22.9%, owing largely to lower demand in the United States. Exports of non-traditional products, which account for more than half of all exports, contracted by 12.9%. Traditional exports fell by just 4.7%, because the 11% reduction in coffee exports was partially offset by sharply higher sugar prices, thanks to which the value of sugar exports climbed by 17%.

Lower goods exports were offset by a substantial fall in imports (25.6%). More than a third of this reduction stemmed from the fall in international oil prices, which lowered the oil bill from US$ 1.865 billion (8.4% of GDP) to US$ 1.085 billion (5.1% of GDP).

Despite fewer visits by Salvadorans residing abroad, in 2009 the services balance rallied somewhat, partly owing to lower transport costs, and ended the year with a surplus of 2% of GDP.

The deficit in the income balance rose by 0.7% to 3.1% of GDP, owing to the higher profits repatriation and dividend payments to foreign firms as well as lower interest received.

Table 2
EL SALVADOR: MAIN QUARTERLY INDICATORS

	2008				2009 [a]				2010 [a]	
	I	II	III	IV	I	II	III	IV	I	II
Gross domestic product (variation from same quarter of preceding year) [b]	3.3	3.0	2.1	1.3	-1.7	-3.5	-4.1	-4.9	-0.5	...
Goods exports, f.o.b. (millions of dollars)	1.055	1.249	1.195	1.050	968	956	965	908	1.084	718 [c]
Goods imports, c.i.f. (millions of dollars)	2.309	2.660	2.598	2.187	1.763	1.778	1.799	1.915	1.988	1.409 [c]
Gross international reserves (millions of dollars)	2.275	2.305	2.263	2.545	2.524	2.788	2.751	2.987	2.608	2.684
Real effective exchange rate (index: 2000=100) [d]	105.5	106.4	105.2	100.6	99.2	100.7	102.8	104.4	102.8	103.8 [c]
Consumer prices (12-month percentage variation)	6.0	9.0	8.7	5.5	3.3	0.2	-1.3	-0.2	0.9	0.1 [c]
Wholesale prices (12-month percentage variation)	14.9	17.7	11.9	-6.9	-11.4	-14.7	-12.6	2.7	4.8	4.8 [e]
Average nominal exchange rate (colones per dollar)	8.75	8.75	8.75	8.75	8.75	8.75	8.75	8.75	8.75	8.75
Nominal interest rates (annualized percentages)										
Deposit rate [f]	3.8	3.8	4.2	5.0	5.2	4.9	4.2	3.7	3.5	3.2 [c]
Lending rate [g]	7.6	7.3	7.5	9.1	9.6	9.5	9.3	8.9	8.5	8.0 [c]
Interbank rate	...	3.6	4.0	5.6	…	…	…	…	…	0.7 [c]
Domestic credit (variation from same quarter of preceding year)	10.3	11.4	11.6	3.5	0.4	-1.5	-4.1	-10.5	-7.4	-7.3 [c]
Non-performing loans as a percentage of total credit	2.4	2.4	2.8	2.9	3.2	3.8	4.2	3.8	4.0	4.3 [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] Data to May.
[d] Quarterly average, weighted by the value of goods exports and imports.
[e] Data to April.
[f] Reference rate for deposits of up to 180 days in the financial system.
[g] Reference rate for 1-year loans in the financial system.

As a result of the jump in the Hispanic unemployment rate in the United States, which reached 13.1% in October, remittance receipts were down US$ 322.8 million, or a nominal 9%, in 2009. The transfers balance fell to US$ 3.55 billion (16.8% of GDP).

In 2009, the capital account increased by close to US$ 50 million owing mainly to transfers related to the Millennium Fund (FOMILENIO), an entity created by the government of El Salvador to administer cooperation funds provided by the United States to develop the north of the country.

The financial account surplus fell from 7.4% of GDP in 2008 to 4% in 2009, as a result of a significant reduction in bank liabilities, as banks utilized the excess liquidity to pay down their external debt. FDI inflows totalled US$ 430.7 million in 2009, or US$ 350 million less than in 2008. A third of this amount corresponds to FDI in the form of inter-company loans, while much of the remainder went to the financial sector (US$ 95.2 million), the maquila industry (US$ 71.7 million) and manufacturing (US$ 55.9 million).

The impact of the international financial crisis on international food and fuel prices meant that terms of trade for El Salvador improved by close to 10% in the 12 months ending in October 2009. Given the low rate of inflation, both the real effective exchange rate and the bilateral exchange rate with the United States dollar appreciated by approximately 2% in 2009 following a depreciation of close to 4% in 2008.