EL SALVADOR

1. General trends

El Salvador's economy grew by 2.4% in 2016, slightly above the 2.3% registered in 2015. The main drivers of economic activity were domestic demand and, in particular, private consumption, which was strengthened by improved real wages, family remittances and an increase in personal loans. This performance, coupled with increased investment and public consumption, partially offset the drop in external demand. Year-on-year inflation stood at -0.9% in December, down from 1.0% in 2015, as a result of the lower international prices for major food commodities. As a result of the drop in the oil bill, the current account deficit shrank to 2.0% of GDP (compared with 3.6% in 2015). In the public finance domain, the fiscal deficit of the non-financial public sector (NFPS), including pensions, narrowed from 3.3% of GDP in 2015 to 2.8% of GDP in 2016 as a result of greater tax collection. On the formal employment front, the number of workers affiliated to the Salvadoran Social Security Institute (ISSS) rose, on average, by 1.8% (compared with 1.6% in 2015).

ECLAC forecasts economic growth of 2.5% in 2017, spurred by domestic demand, new public and private investment projects, and recovery of the external sector. The Central Reserve Bank of El Salvador forecasts higher inflation (around 5%) in 2017, as the effect of lower imported raw materials prices wears off and the subsidies and tariffs of electricity, transportation and water services normalize. The balance-of-payments current account deficit is expected to widen, closing the year at 3.7% of GDP as a result of the anticipated rise in manufactured exports and the continued inflow of family remittances. According to Ministry of Finance estimates, the fiscal deficit of the non-financial public sector will rise to 3.9% of GDP. On the employment front, new formal job creation is expected to continue, increasing 2% year-on-year, on the back of an anticipated upturn in the domestic economy and projected improvements in the external sector.

2. Economic policy

In 2016, macroeconomic policy was geared towards creating an economic climate that would stimulate growth and investment. The year was marked by the uncertainty about long-term funding for the payment of public pensions.

(a) Fiscal policy

Salvadoran fiscal policy was contractionary in 2016. The primary fiscal surplus, excluding pensions, rose from 1.1% of GDP in 2015 to 1.8% of GDP in 2016. The payment of pensions increased to US$ 519.9 million in 2016 (equivalent to 1.9% of GDP), representing a real annual growth of 6.5%. Meanwhile, the overall deficit of the non-financial public sector, including pensions, dropped from 3.3% of GDP in 2015 to 2.8% of GDP in 2016 as a result of improved tax collection.

Total non-financial public sector income rose, by 6.5% in real terms, to 20.6% of GDP in 2016. Real tax revenues were up 5.7%, fuelled by income tax contributions and the increase in revenues from special contributions for security. Consequently, the net tax burden stood at 15.5% of GDP in 2016, surpassing the 15.0% of GDP registered in 2015.

To meet the priorities set out by the Plan for a Safe El Salvador, the Legislative Assembly approved two new special taxes at the end of 2015 to finance specific programmes aimed at enhancing national security. In 2016, revenues from the tax on telecommunications services and the acquisition of equipment totalled US$ 48.5 million and revenues from the earnings of large taxpayers, US$ 7.0 million.

On the expenditure side, total spending climbed 3.6% in real terms. This was the result of a 2.0% rise in current expenditures attributable to the purchase of goods and services and the payment of government wages and salaries, as well as a 14.3% spike in capital spending, primarily in the energy and transportation sectors, on projects such as the extension of the international airport and the maintenance of port facilities. Total expenditure amounted to 21.5% of GDP. Current transfers continued the downward trend seen over the past four years, with a year-on-year decline of 11.6% in real terms, primarily as a result of the targeting of subsidies.

As has been the case in recent years, the government financed the deficit with short-term local debt placements through the issue of treasury bills (LETES), whose balance exceeded US$ 1 billion in December 2016 (equivalent to 3.8% of GDP).

At the end of 2016, total non-financial public sector debt stood at US$ 12.307 billion, equivalent to 46.1% of GDP. With the inclusion of debt from pensions, the total rose to US$ 16.323 billion, up 5.3% in nominal terms from 2015. At the end of the year it amounted to 61.1% of GDP, 1.1 percentage points higher than the previous year.

The Legislative Assembly passed the Fiscal Responsibility Act in November 2016, with a view to ensuring medium- and long-term fiscal sustainability, shoring up macroeconomic stability and reducing public debt. The Act provides for the establishment of primary surplus and tax collection targets and caps on current expenditure growth, particularly with regard to wages and salaries.

As of May 2017, the cumulative NFPS deficit, including pensions and trust funds, stood at US$ 0.4 million, compared to a surplus of US$ 57.3 million for the same period the previous year. Total income dropped by 0.7% year-on-year in real terms and current revenue fell by 0.6%. Total expenditure climbed 1.1% in real terms on the back of a 3.5% increase in current expenditure. In the same period, the total NFPS debt including pensions rose to US$ 16.719 billion; while this was up 2.9% on the figure registered in December 2016, in GDP terms, it represented a slight drop to 59.0% of GDP.

As of 31 May 2017, the balance of treasury bills (LETES) totalled US$ 717.9 million. In February 2017, the government issued 12-year sovereign bonds (eurobonds) worth US$ 600 million in the international market to finance its debt. The bonds mature in 2029 and bear an interest rate of 8.625%.

Despite this good performance, the Government of El Salvador declared default in April 2017 after it failed to meet commitments outstanding in pension-related local debt. This led the three leading international rating agencies to downgrade the country’s credit rating to substantial risk, with little prospect for recovery. A politically polarized Legislative Assembly has hampered the government’s financing options and stymied the approval of any significant fiscal measures for counteracting the deterioration of public finances. The changes in ratings reflect persistent challenges in meeting financing needs for 2017, in the absence of a political agreement that would facilitate access to additional external borrowing.

(b) Monetary policy

The Central Reserve Bank lacks complete monetary autonomy since the economy has been dollarized since 2001 and international capital moves freely into and out of El Salvador. Thus, in the short term, interest rates are determined by the supply and demand between financial intermediaries operating in the country. In 2016, liquidity conditions remained stable.

Deposit rates were up slightly in 2016, owing, in part, to higher demand for domestic funding from banks. The average nominal interest rate paid on 180-day deposits was 4.41%, up from the previous year's average 4.24%. In that same period, the nominal rate charged on loans of up to one year increased 20 basis points, to stand at 6.37%. In December 2016, the financial system saw a 3% year-on-year increase in total deposits, fuelled by private sector deposits. Private sector lending to both households and businesses was buoyant throughout 2016, with respective year-on-year growth rates of 4.3% and 7.1%.

Net international reserves rose by 9.5% to US$ 2.923 billion at the end of 2016, equivalent to almost 3.6 months of imports.

As of May 2017, the total lending portfolio of other credit institutions showed annual growth of 5.9% (up 5.5% on the same month in 2016), the majority of which was directed towards consumption and home loans. The total deposits of banks, cooperative banks and savings and loan corporations up to May rose by 6.8% year-on-year (compared with 3.5% during the same period the previous year). The interest rate paid on 180-day deposits was 4.39% (compared with 4.37% registered in May 2016) and the interest rate on loans of up to one year was 6.51% (6.41% for the same period the previous year). Net international reserves totalled US$ 3.368 billion in May 2017, up 15.2% on the total in December 2016.

(c) Other policies

In March 2016, the Superintendency of the Financial System and the Office of the Attorney General of the Republic signed agreements to strengthen their efforts to counter money-laundering and the financing of terrorism, by allowing confidential information to be shared between the two institutions. The Electronic Signatures Act, which gives electronic signatures the same legal status as a manuscript signature and establishes the regulations for service providers, came into effect in April of that same year.

In the area of trade policy, negotiations on a free trade agreement with the Republic of Korea, and to which all other Central American countries are party, were concluded in 2016. This treaty is expected to enter into force in 2018

3. The main variables

(a) The external sector

As a result of a global decline in trade activity and, in particular, lower demand from the United States, China and the Central American subregion, 2016 saw the value of Salvadoran exports contract by 2.7% (compared with growth of 4% in 2015). While the average price of exports rose by 2.2% year-on-year, in volume terms, total exports fell by 4.8%. Traditional exports plunged by 28.4% in terms of value on account of declines in the main export products, such as sugar (-29.9%) and coffee (-26.6%); non-traditional exports fell by 2.4%. Exports from the maquila sector alone registered positive growth of 3.8% —notwithstanding a drop of almost five percentage points compared with the previous year— owing to the sale of textiles and made-up articles, chemicals, electrical equipment and plastic products. The United

States remains the main destination for Salvadoran exports (more than 47.9% of the total), followed by Honduras, Guatemala and Nicaragua.

Imports fell by 5.4% in 2016. In terms of volume, they rose by 4%, but the value dropped owing to the 9.0% year-on-year drop in international prices. Imports of intermediate goods fell by 9.8% and imports of consumer goods by 2.5%. The oil bill amounted to US$ 1.089 billion, US$ 263 million lower than the previous year, which had a positive impact on the terms of trade (up 7.5%). The trade deficit was 7.3% lower than the figure registered in 2015, standing at US$ 4.637 billion (equivalent to 17.3% of GDP).

Family remittance inflows registered a nominal increase of 7.2% in 2016, rising to US$ 4.576 billion, or 17.1% of GDP, a record high for El Salvador. This rise was driven by higher employment levels in the United States, in sectors that are important sources of work for Salvadoran workers, such as construction, hotels and restaurants. The uncertainty that reigned during that country's electoral process led to an uptick in the flows of remittances in the last quarter. Foreign direct investment (FDI) flows totalled US$ 374 million in 2016, a 6.3% drop against 2015 figures. These flows go mainly to the manufacturing, financial services and trade sectors.

In the first five months of 2017, the value of total exports rose by 3.6% year-on-year (a 20.3% spike in volume), spurred by a turnaround in sugar and clothing exports. In that same period, while imports were up 4.6% in terms of value on the back of intermediate goods for the manufacturing industry, which saw an 11.4% rise in value, total imports fell by 4.0% in volume terms. The cumulative inflow of remittances amounted to US$ 2.041 billion in May, representing year-on-year growth of 10.8%.

(b) Economic activity

In 2016, all sectors registered positive performance, with the exception of electricity, gas and water. The strongest performers were the agriculture, hunting and fishing and the community, social and personal services sectors, whose growth (4.6% and 3.0%, respectively) outdid that of the overall economy. Manufacturing grew by 2%, down 1.8 percentage points on the previous year as a result of the global decline in consumer durables sales. During the year, GDP growth accelerated from 2.1% in the first quarter to a high of 2.6% in the last quarter.

On the spending side, final consumption boosted GDP, with private consumption contributing 1.1 percentage points thanks to higher household disposable incomes resulting from remittance inflows, lower inflation and higher real wages. By contrast, the contribution of exports to GDP growth was negative by 0.1 percentage points in 2016. Gross fixed capital formation dipped in 2016 (-0.1% in real terms, year-on-year) as a result of the 0.2% fall in private investment rates. That fall was offset, however, by real growth in public investment of 0.4% year-on-year (compared with 11.4% in 2015).

Driven by favourable conditions in the global economy and still solid domestic demand, the Salvadoran economy expanded by 2.3% in real terms in the first quarter of 2017. This upturn was sparked primarily by the real estate and business services sector (4.6%), the agriculture sector (3.2%), construction (3.1%) and the financial services sector (3.1%). The only sector to shrink in the first three months of 2017 was electricity, gas and water (1.5%).

(c) Prices, wages and employment

Annual inflation to December stood at -0.9%, lower than the 1% registered in December 2015. While yearly inflation remained positive over the first nine months of 2016, it was negative in the last three months of the year. The fall in the consumer price index is attributable to a favourable climate that saw a decline in the prices of the main food products. Long-term inflation, measured by the core inflation index, remained low throughout the year and in December 2016 registered negative growth of -0.14% year-on-year.

On the employment front, ISSS records reveal a modest acceleration of formal job creation. The average number of affiliates rose by 1.8% year-on-year in 2016, versus 1.6% for 2015. The largest gains in job numbers were reported in commerce, restaurants and hotels; financial services and insurance; manufacturing; and transport, storage and communications.

In December 2016, the national minimum wage council (CNSM) reached a landmark agreement on a new, differentiated minimum wage for the agriculture sector based on the type of work (harvesting or processing). In the maquila sector, the new minimum wage was set at US$ 295 per month, representing a nominal increase of 39.9% (41.1% in real terms) on 2016. The new minimum wage in the industrial sector and the trade and services sector was set at US$ 300 per month, representing, respectively, a nominal increase of 21.7% (22.7% in real terms) and 19.2% (20.3% in real terms).

In the first five months of 2017, inflation rose primarily as a result of the effects of lower subsidies for services such as water and electricity. Year-on-year inflation to May stood at 1.0%, with the strongest upward pressure coming from accommodation, water, electricity and others (6.3%), alcoholic beverages, tobacco and others (3.5%) and restaurants and hotels (1.9%). Core inflation remained very low, at 0.1%.

Table 1
El SALVADOR: MAIN ECONOMIC INDICATORS

	2008	2009	2010	2011	2012	2013	2014	2015	2016 a/
	Annual growth rates b/								
Gross domestic product	1.3	-3.1	1.4	2.2	1.9	1.8	1.4	2.3	2.4
Per capita gross domestic product	0.9	-3.5	1.0	1.8	1.5	1.4	1.0	1.9	1.9
Gross domestic product, by sector									
Agriculture, livestock, hunting, forestry and fishing	3.0	-2.9	3.1	-2.5	3.5	-0.4	1.3	-1.8	4.6
Mining and quarrying	-6.8	-15.4	-11.4	13.7	2.8	1.3	-1.6	2.3	1.8
Manufacturing	2.3	-3.0	1.9	2.7	1.3	3.1	1.6	3.8	2.0
Electricity, gas and water	2.3	-1.0	-0.6	0.4	0.8	1.0	2.3	0.3	-0.9
Construction	-7.3	-2.8	-5.0	8.9	0.3	-0.1	-10.7	1.7	2.3
Wholesale and retail commerce, restaurants and hotels	1.0	-5.4	1.5	2.3	2.6	1.5	2.4	3.2	2.3
Transport, storage and communications	-0.8	-5.9	-0.2	4.6	1.6	1.8	0.9	3.5	1.1
Financial institutions, insurance, real estate and business services	0.9	-1.3	1.9	1.8	0.2	2.3	2.1	1.6	2.0
Community, social and personal services	2.0	1.3	1.8	3.4	2.5	3.1	2.7	1.8	3.0
Gross domestic product, by type of expenditure									
Final consumption expenditure	1.7	-9.2	2.2	2.5	2.4	1.0	1.3	2.3	1.2
Government consumption	-0.4	5.8	2.2	3.9	2.5	3.7	-0.4	5.1	1.2
Private consumption	1.8	-10.3	2.2	2.4	2.4	0.7	1.4	2.1	1.2
Gross capital formation	-5.4	-19.2	2.4	13.8	-1.4	9.3	-6.4	8.1	-0.1
Exports (goods and services)	6.9	-16.0	11.6	9.3	-7.3	4.8	-0.6	2.2	-0.3
Imports (goods and services)	3.3	-24.8	10.4	10.8	-4.6	4.5	-2.5	3.9	-2.2
Investment and saving c/	**Percentajes of GDP**								
Gross capital formation	15.2	13.4	13.3	14.4	14.1	15.0	13.6	13.9	13.6
National saving	8.1	11.9	10.8	9.6	8.8	8.4	8.8	10.3	11.7
External saving	7.1	1.5	2.5	4.8	5.4	6.5	4.8	3.6	2.0
Balance of payments	**Millions of dollars**								
Current account balance	-1 532	-312	-533	-1 112	-1 279	-1 586	-1 212	-926	-531
Goods balance	-5 113	-3 506	-4 022	-4 772	-4 927	-5 295	-5 206	-5 003	-4 637
Exports, f.o.b.	3 276	2 924	3 473	4 243	4 235	4 334	4 257	4 381	4 186
Imports, f.o.b.	8 389	6 430	7 495	9 015	9 161	9 629	9 463	9 384	8 823
Services trade balance	224	308	398	449	532	618	794	805	756
Income balance	-389	-556	-538	-618	-891	-992	-1 034	-1 091	-1 225
Net current transfers	3 747	3 442	3 629	3 830	4 006	4 083	4 234	4 363	4 576
Capital and financial balance d/	1 866	735	237	698	1 930	1 259	1 179	1 039	983
Net foreign direct investment	824	366	-226	218	484	176	311	399	374
Other capital movements	1 042	369	462	479	1 447	1 083	868	640	609
Overall balance	333	423	-296	-414	651	-327	-33	113	453
Variation in reserve assets e/	-333	-423	296	414	-651	327	33	-113	-453

Table 1 (concluded)

	2008	2009	2010	2011	2012	2013	2014	2015	2016 a/
Other external-sector indicators									
Real effective exchange rate (index: 2005=100) f/	101.7	99.6	101.2	102.4	103.1	104.1	104.6	103.7	103.7
Terms of trade for goods									
(index: 2010=100)	107.1	105.1	100.0	100.8	97.1	96.5	101.2	109.5	111.3
Net resource transfer (millions of dollars)	1 477	179	-302	79	1 039	267	145	-52	-242
Total gross external debt (millions of dollars)	9 994	9 882	9 698	10 670	12 521	13 238	14 885	15 217	16 253
Employment	**Average annual rates**								
Labour force participation rate g/	62.7	62.8	62.5	62.7	63.2	63.6	63.6	62.8	62.1
Open unemployment rate h/	5.5	7.1	6.8	6.6	6.2	5.6	6.7	6.8	...
Visible underemployment rate h/	6.3	7.7	7.0	3.4	5.8	5.8	6.7	6.8	...
Prices	**Annual percentages**								
Variation in consumer prices									
(December-December)	5.5	-0.2	2.1	5.1	0.8	0.8	0.5	1.0	-0.9
Variation in industrial producer prices									
(December-December)	-6.0	4.9	6.2	7.0	2.4	-0.2	-5.8	-6.0	0.2
Variation in average real wage	-3.1	3.5	1.1	-2.9	0.2	0.5	0.7	7.9	...
Nominal deposit rate i/	4.2	4.5	2.9	1.8	2.5	3.4	3.8	4.2	4.4
Nominal lending rate j/	7.9	9.3	7.6	6.0	5.6	5.7	6.0	6.2	6.4
Central government	**Percentajes of GDP**								
Total revenue	15.1	13.8	15.0	15.4	15.8	16.3	15.8	15.9	16.4
Tax revenue	13.5	12.6	13.5	13.8	14.4	15.4	15.1	15.0	15.5
Total expenditure	15.8	17.6	17.7	17.6	17.5	18.1	17.4	17.0	16.8
Current expenditure	13.0	14.7	14.5	14.6	14.2	15.0	14.6	14.4	14.2
Interest	2.4	2.5	2.3	2.2	2.2	2.4	2.4	2.4	2.5
Capital expenditure	2.8	2.9	3.2	3.1	3.3	3.0	2.8	2.6	2.6
Primary balance	1.8	-1.2	-0.4	-0.1	0.5	0.6	0.8	1.3	2.1
Overall balance	-0.6	-3.7	-2.7	-2.3	-1.7	-1.8	-1.6	-1.1	-0.4
Central government public debt	34.4	42.6	42.6	41.7	45.7	44.0	44.4	44.3	44.3
Domestic	11.6	14.9	14.3	14.8	15.5	14.5	11.9	13.5	13.2
External	22.8	27.6	28.3	26.9	30.2	29.5	32.4	30.8	31.1
Money and credit	**Percentages of GDP, end-of-year stocks**								
Domestic credit	54.5	56.2	56.8	56.7	57.2	62.2	64.2	67.6	69.3
To the public sector	18.2	21.0	24.3	26.5	26.0	29.3	29.6	32.7	33.6
To the private sector	43.0	42.4	40.9	39.8	40.2	42.5	44.1	44.5	45.6
Others	-6.7	-7.2	-8.4	-9.5	-9.0	-9.6	-9.5	-9.6	-9.9
Monetary base	10.7	11.0	11.0	9.8	9.4	10.2	9.9	9.9	10.1
Money (M1)	9.1	11.2	12.3	12.0	11.7	11.9	11.7	12.5	11.7
M2	49.1	52.0	50.3	45.5	44.7	44.6	43.5	44.6	44.7

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.
h/ The series 2009 and 2010-2016 are not comparable, owing to the changes in methodology that took place in 2010.
i/ Non-adjustable 90-360 day operations.
j/ Does not include publicly guaranteed debt.
k/ The monetary figures are December averages.

Table 2
EL SALVADOR: MAIN QUARTERLY INDICATORS

	2015				2016				2017	
	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/	2.2	2.1	2.5	2.4	2.1	2.4	2.4	2.6	2.3	...
Gross international reserves (millions of dollars)	2 939	2 911	2 913	2 813	3 115	3 235	3 475	3 326	3 615	3 668 c/
Real effective exchange rate (index: 2005=100) d/	104.0	104.2	104.3	102.4	102.2	103.7	104.6	104.5	104.3	105.6 c/
Consumer prices (12-month percentage variation)	-0.8	-0.8	-2.3	1.0	1.1	0.9	1.0	-0.9	0.5	0.9 e/
Wholesale prices (12-month percentage variation)	-8.0	-6.6	-9.3	-6.03	-6.5	-4.4	-0.6	0.17	4.2	1.2 c/
Nominal interest rates (average annualized percentages)										
Deposit rate e/	4.2	4.3	4.2	4.3	4.3	4.4	4.5	4.5	4.5	4.4 e/
Lending rate g/	6.0	6.1	6.3	6.3	6.2	6.4	6.4	6.5	6.3	6.4 e/
Sovereign bond spread, Embi Global (basis points to end of period) h/	459	443	610	634	667	671	486	536	553	578 c/
International bond issues (millions of dollars)	-	300	-	-	-	-	-	-	951	- c/
Domestic credit (variation from same quarter of preceding year)	6.8	5.6	6.7	9.9	8.9	8.7	8.6	6.3	4.3	3.9 e/
Non-performing loans as a percentage of total credit	2.4	2.4	2.5	2.4	2.4	2.3	2.2	2.2	2.0	2.0 e/

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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