El Salvador

1. General trends

Most macroeconomic indicators for El Salvador worsened in 2008. Real GDP increased by 2.5%, two percentage points less than in 2007, while per capita GDP rose by 0.9%, only a third of the previous year's increase. As in 2007, the sector with the highest rate of growth was agriculture.

Although family remittances (17.1% of GDP) increased at a lower rate than before, they still helped lift private consumption and mitigate the impact of higher international oil and food prices on the balance-of-payments current account, which posted a deficit equivalent to 7.2% of GDP. The non-financial public sector deficit increased by almost one percentage point above its 2007 level, to 1% of GDP. Inflation was 5.5%, half a percentage point above the level recorded in 2007.

Mauricio Funes was sworn in as President in June 2009, and will head the country's first left-leaning government. His government has vowed to implement more active, forward-looking public policies, prioritize social policies and tackle the lack of public security head on.

As a consequence of the unfavourable external context, ECLAC projects that GDP growth in El Salvador in 2009 will fall by 2% owing to sharp drops in exports, remittances, consumption and investment. Clearly, this outlook would improve if the external context were to change, especially in terms of the United States economy and the steps taken by the new administration to curb the slowdown in growth. The anti-crisis plan calls for spending US$ 475 million, but the authorities do not have the full amount available. The new government's measures to counteract the negative effects of the crisis are therefore unlikely to have significant results in 2009.

2. Economic policy

(a) Fiscal policy

The tax burden of the central government without social security contributions fell to 13% of GDP in 2008, slightly below the 2007 level. Non-tax revenue on the other hand rose by 0.4 points of GDP. Thus, current revenue remained constant in GDP terms.

Current expenditure increased by 3.8%, mainly because of higher transfers and purchases of goods and services. Subsidies on electric power, water and liquefied natural gas remained in place, as did those on public transport, and they accounted for approximately US$ 440 million in expenditure (2% of GDP). Total spending rose to the equivalent of 15.3% of GDP. The central government deficit (including pensions) increased from 0.2% of GDP in 2007 to 0.6% in 2008. The deficit of the non-financial public sector (including pensions) was equivalent to 1% of GDP, 0.8 percentage points above its 2007 level. Starting in February 2009, only users who consumed less than 99 kW a month were eligible for the subsidy on residential electricity consumption (US$ 163 million, equivalent to 0.7% of GDP). These users account for 80% of total demand.

External debt of the non-financial public sector rose by 2.4% in 2008, to US$ 5.41 billion. The reason for this was new borrowing (equivalent to half of total indebtedness) from multilateral agencies including the World Bank and Inter-American Development Bank as a result of the exceptional circumstances related to the economic crisis. Domestic public debt grew by 15.1% from 2007, to US$ 2.494 billion. The debt of the non-financial public sector thus fell to 35.7% of GDP, almost one percentage point below its 2007 level. A total of US$ 553 million in short-term treasury notes was issued.

International rating agencies lowered their long-term sovereign debt rating for El Salvador in 2008. Standard & Poor's and Fitch Ratings downgraded their outlook for foreign-currency-denominated bonds from El Salvador from stable to negative. In May 2009, Standard and Poor's once again downgraded the country's sovereign risk, from BB+ to BB, with a stable outlook. In June, Fitch also downgraded its rating for the country.

The new government's fiscal policy in 2009 has been focused on countering the reduction in revenue, ensuring State financing and using resources for countercyclical purposes. Tax receipts are expected to decline by an amount equivalent to 2% of GDP, owing to lower collections of value-added tax and import duty. Consequently, and in the light of the slump in production, the current national budget will have to be revised. For now, the government will redirect its loans and issue bonds to cover the shortfall not covered by the budget. In June 2009, the new government announced that it would implement a series of new anti-crisis measures to boost fiscal revenue, encourage efficient spending and improve the targeting of subsidies.

(b) Monetary and exchange-rate policy

Real interest rates fell slightly in 2008. Adjusted for inflation, the average yield on 180-day term deposits declined to -2.8%. Real average interest rates on one-year loans fell from 3.1% in 2007 to 0.6% in 2008.

Because of the lack of liquidity in the financial system, lending to the private sector by commercial banks and financial institutions was sharply curtailed. Credit shrank by 6.4% in nominal terms and 12% in real terms compared with 2007. The activities most affected in real terms were mining and quarrying (-77.6%), services (-39.6%) and construction and housing (-28.4%). Lending to the public sector increased by 19.5%, although it accounted for a small share of total lending (4%). At year-end, the country had US$ 3.349 billion in net international reserves, up 8.3% from 2007 and equivalent to 2.8 months of goods and services imports.

Most of the important indicators for the banking system had worsened as of December 2008. The country's banks reported an increase in non-performing loans in proportion to total lending, higher costs of funds and greater difficulties in obtaining them, and a need to raise provisions to counteract the increase in non-performing loans. The situation does not appear to be alarming, however, given the equity worthiness built up by the banks over the last three years. To lessen these negative effects, in April 2009, the Central Reserve Bank of El Salvador began to return 3% of the liquidity provision (1.3% of GDP) that had been established for contingencies in connection with financial volatility and the presidential elections.

(c) Other policies

Between 2005 and 2008, the Solidarity Network programme —the aim of which is to reduce extreme poverty among families in 100 municipalities— distributed more than US$ 22.4 million in education and health vouchers in 77 municipalities, benefitting 83,654 families. In addition, US$ 53.2 million was invested in basic social infrastructure such as drinking water (38%), electric power (29%) and other types of infrastructure and technical assistance (33%).

In 2009, some US$ 40 million from the Millennium Fund (FOMILENIO) is expected to be used to build the northern longitudinal highway and to initiate connectivity, rural electrification, productive development and educational projects. Still, some projects are likely to be reconsidered, since their costs now surpass the initial estimates made three years ago. The Solidarity Network programme is expected to reach 120,000 families, including 37,000 new households in the last 23 (extremely high poverty) municipalities selected. In the second half of 2009, the new government will conduct studies to allow this programme to cover not only rural areas but also urban ones.

Between mid-2008 and early 2009, to soften the consequences of the global crisis, the outgoing government implemented a series of measures including the provision of subsidies, increased liquidity in the financial system through the return of 3% of the liquidity provision, the strengthening of the agricultural sector through the provision of improved seeds, the strengthening of the Solidarity Network and the implementation of 19 measures known as the "Family Alliance," intended to address the negative effects of higher prices on the purchasing power of middle-income families.

On 16 January 2009, the Executive Board of the International Monetary Fund approved a US$ 800 million stand-by agreement to support the country's economic strategy.

In 2008 and the first half of 2009, several rounds of negotiations were held for an association agreement between the European Union and Central America. The resulting accord is to go beyond a free trade agreement and will include significant cooperation funding. Negotiations are expected to be concluded this year.

3. The main variables

(a) Economic activity

Real economic growth was 2.5% in 2008, mainly because of the buoyancy of the agricultural sector. The moderate increase in consumption (3.8%) was due to smaller rises in remittances and in the country's economic activity. Fixed gross investment decreased by 5.3% as a result of the contraction in private investment (6.5%), unlike public investment, which rose by 5%. Investment in machinery fell by 4.6%, the largest decline in a decade. Exports of goods and services rose by 6.8% while imports increased by 4.8%. Per capita GDP rose only by 0.9%.

The agricultural sector performed favourably for the fifth consecutive year, with a 7.3% growth rate, driven primarily by higher international prices for basic grains. Output in the crop-growing sector rose by 10.8%, the highest increase in five years. Production in the livestock sector (which includes forestry, hunting and fishing) was up 2.2%.

Manufacturing GDP (representing 22.7% of total production activity) expanded by 2.7%, one percentage point less than in the previous year. Industrial maquila services, by contrast, increased significantly (5.1%), after four years of continuous decline.

The construction sector contracted by 6% as a result of lower private investment in housing and, to a certain extent, the public sector's failure to use its entire allotted budget in some infrastructure projects. Mining experienced a significant slowdown, with 1.7% growth, five percentage points lower than in 2007. Activity in basic services and other services increased by 2.6% and 1.6%, respectively, nearly 2.5 percentage points less than in 2007.

The economy showed clear signs of slowing in the first few months of 2009, and may fall into recession. In March, economic activity measured on the basis of the volume of cycle-trend activity decreased by 6.2% year-on-year, a decline of 10 percentage points with respect to the growth rate of the same month in the previous year. This was the result of the slowing of the mining and quarrying, construction, commerce and transportation sectors.

(b) Prices, wages and employment

Inflation stood at 5.5% in 2008, half a percentage point above the 2007 level. This was the result of higher international prices for oil and food, which pushed up the prices of other goods and services until August 2008, when year-on-year inflation rose to 9.9%. In May 2009, year-on-year inflation stood at 1.2%, seven percentage points below the level recorded a year earlier.

The minimum wage rose by 5%, on average, for all economic activities except the maquila sector in 2008. Nevertheless, the average real minimum wage fell by 2%. The government has offset price hikes by subsidizing rates charged for electric power, liquefied natural gas, water and public transport. In January 2009, the average minimum wage was raised once again by a nominal 7.5%, for both agricultural and non-agricultural workers except those in the maquila industry.

Preliminary data indicate that the open unemployment rate was 5.9% in 2008, down from 6.3% in 2007. Many workers were laid off, however, particularly in the construction and maquila sectors. There may be significant job losses in 2009, with serious social repercussions. The Salvadoran Social Security Institute had 590,000 contributors in September 2008, but by March 2009 35,000 formal-sector jobs had been lost.

(c) The external sector

Despite the global economic crisis, goods exports by El Salvador continued to be robust in 2008, in part because the country's economic performance lagged behind that of the United States. At 14.2%, the increase in goods exports was nearly twice that seen in 2007, mainly on account of the higher volume exported to countries other than the United States. Non-traditional exports grew by 19%, while traditional exports posted a 29% increase, in part because of the favourable price effect. As in 2007, maquila exports (42.4% of total exports) continued to grow, increasing by 6.9%. Services exports (travel and transportation, among others) barely rose (1.1%), down from 4.7% growth in 2007. Total goods imports expanded by 12%. Intermediate and consumer goods imports rose by 26.4% and 5.4%, respectively, whereas those of capital goods decreased by 1.7%, owing to the economic crisis and the consequent lack of investment incentives. Services imports increased by 15%, one percentage point less than in 2007. In 2009, exports and imports are expected to decrease by 15% and 20%, respectively.

The oil bill rose to US$ 1.865 billion in 2008, equivalent to 8.4% of GDP (1.5 percentage points more than in 2007) and was equivalent to 17% of all goods

Table 1
EL SALVADOR: MAIN ECONOMIC INDICATORS

	2000	2001	2002	2003	2004	2005	2006	2007	2008 [a]
					Annual growth rates [b]				
Gross domestic product	2.2	1.7	2.3	2.3	1.9	3.1	4.2	4.7	2.5
Per capita gross domestic product	0.2	-0.2	0.4	0.5	0.1	1.3	2.4	2.9	0.9
Gross domestic product, by sector									
Agriculture, hunting, forestry and fishing	-3.1	-2.6	0.4	0.9	2.8	4.9	7.5	8.6	7.3
Mining and quarrying	-4.7	11.7	5.5	3.5	-16.0	2.6	4.9	6.5	1.7
Manufacturing	4.1	4.0	2.9	2.2	1.0	1.5	3.2	3.7	2.7
Electricity, gas and water	-2.3	4.7	7.3	4.4	3.4	4.4	4.6	2.4	2.6
Construction	-3.4	9.6	6.7	3.2	-9.8	3.4	5.5	1.2	-6.0
Wholesale and retail commerce, restaurants and hotels	3.6	1.9	1.5	2.7	2.4	4.4	4.4	5.3	1.4
Transport, storage and communications	6.1	4.3	5.0	3.4	5.4	5.4	5.1	5.1	2.6
Financial institutions, insurance, real estate and business services	3.0	-0.8	2.7	2.6	2.5	2.7	3.0	3.6	1.6
Community, social and personal services	1.1	-0.3	-0.6	0.5	1.3	0.3	2.4	2.9	2.1
Gross domestic product, by type of expenditure									
Final consumption expenditure	3.7	3.2	1.5	1.9	2.9	4.1	4.6	6.9	4.1
Government consumption	0.9	4.6	0.1	-0.3	1.1	1.8	2.8	1.1	1.8
Private consumption	3.9	3.1	1.6	2.1	3.0	4.3	4.8	7.3	4.2
Gross domestic investment	2.7	5.1	-2.7	7.8	-3.9	2.4	7.3	6.0	-5.3
Exports (goods and services)	16.8	-0.2	6.0	4.7	5.7	3.8	8.1	3.9	6.9
Imports (goods and services)	14.5	4.2	1.5	4.8	4.1	5.0	8.4	8.1	5.4
					Percentages of GDP				
Investment and saving [c]									
Gross domestic investment	16.9	16.7	16.4	17.0	16.2	15.7	16.1	16.1	15.0
National saving	13.6	15.6	13.6	12.3	12.2	12.4	12.5	10.3	7.7
External saving	3.3	1.1	2.8	4.7	4.0	3.3	3.6	5.8	7.2
					Millions of dollars				
Balance of payments									
Current account balance	-431	-150	-405	-702	-628	-569	-671	-1 183	-1 596
Goods balance	-1 740	-1 933	-1 865	-2 287	-2 660	-2 938	-3 533	-4 105	-4 394
Exports, f.o.b.	2 963	2 892	3 020	3 153	3 339	3 447	3 759	4 039	4 611
Imports, f.o.b.	4 703	4 824	4 885	5 439	6 000	6 385	7 291	8 144	9 004
Services trade balance	-235	-250	-240	-107	-64	-87	-79	-252	-498
Income balance	-253	-266	-323	-423	-458	-579	-531	-576	-536
Net current transfers	1 797	2 298	2 023	2 114	2 555	3 035	3 472	3 750	3 832
Capital and financial balance [d]	385	-27	282	1 019	575	510	742	1 463	1 930
Net foreign direct investment	178	289	496	123	366	398	268	1 408	719
Other capital movements	207	-316	-214	895	209	112	475	55	1 211
Overall balance	-46	-178	-124	316	-52	-59	72	280	334
Variation in reserve assets [e]	46	178	124	-316	53	59	-72	-280	-334
Other external-sector indicators									
Real effective exchange rate (index: 2000=100) [f]	100.0	99.7	99.7	100.2	98.9	101.0	101.4	102.7	103.7
Terms of trade for goods (index: 2000=100)	100.0	102.5	101.6	97.7	96.8	96.8	95.5	94.6	91.0
Net resource transfer (millions of dollars)	131.9	-293.1	-41.8	595.4	117.4	-68.9	211.5	887.4	1 393.7
Gross external debt (millions of dollars) [g]	2 831	3 148	3 987	7 917	8 211	8 761	9 586	9 075	9 711
					Average annual rates				
Employment									
Labour force participation rate [h]	52.2	53.3	51.2	53.4	51.7	52.4	52.6	62.1	62.7
Open unemployment rate [i]	6.7	7.0	6.2	6.9	6.8	7.8	6.6	6.3	5.9
Visible underemployment rate [j]	3.7	3.8	4.3	4.8	4.5	6.2	4.9	5.3	6.3
Prices					**Annual percentages**				
Variation in consumer prices (December-December)	4.3	1.4	2.8	2.5	5.4	4.3	4.9	4.9	5.5
Variation in wholesale prices (December-December)	4.9	-4.8	4.9	-0.6	13.0	6.9	0.6	13.9	-6.0
Variation in real minimum wage	-2.2	-3.6	-1.8	2.1	-1.4	-4.5	-0.7	2.5	0.2
Nominal deposit rate [k]	6.5	5.5	3.4	3.4	3.3	3.4	4.4	4.7	4.2
Nominal lending rate [l]	10.7	9.6	7.1	6.6	6.3	6.9	7.5	7.8	7.9

Table 1 (concluded)

	2000	2001	2002	2003	2004	2005	2006	2007	2008 [a]
					Percentages of GDP				
Non-financial public sector									
Total income [m]	15.8	14.9	15.5	16.2	16.3	16.3	17.4	18.0	18.2
Current income	14.9	14.4	14.7	15.7	16.0	16.0	17.1	17.7	17.9
Tax income	12.4	12.3	13.0	13.3	13.3	14.1	15.0	15.0	14.6
Capital income	0.1	0.0	0.5	0.0	0.0	0.0	0.0	0.0	0.0
Total expenditure [n]	18.8	18.5	18.8	18.3	16.9	17.4	18.4	18.2	19.2
Current expenditure	15.5	14.0	13.9	14.6	14.6	14.6	15.3	15.4	16.2
Interest	1.5	1.4	1.7	2.0	2.1	2.2	2.4	2.5	2.3
Capital expenditure	3.3	4.5	4.9	3.7	2.3	2.8	3.1	2.8	3.0
Primary balance	-1.5	-2.2	-1.6	-0.0	1.5	1.1	1.4	2.2	1.3
Overall balance	-3.0	-3.6	-3.3	-2.1	-0.6	-1.1	-1.1	-0.2	-1.0
Non-financial public sector debt	30.0	33.6	38.6	40.3	40.5	39.7	39.7	36.6	35.7
Domestic	9.6	11.7	11.6	11.4	12.0	12.7	10.7	10.6	11.3
External	20.4	21.9	27.0	28.9	28.6	27.1	28.9	25.9	24.5
Money and credit [o]									
Domestic credit	...	40.4	42.1	40.1	39.4	38.4	38.3	38.7	36.9
To the public sector	...	1.5	0.9	0.9	1.0	1.3	0.6	1.4	1.7
To the private sector	...	40.2	44.5	42.3	42.1	42.3	42.5	42.1	40.8
Currency outside banks and local-currency deposits (M2)	...	-1.3	-3.4	-3.1	-3.7	-5.2	-4.8	-4.8	-5.6

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 local currency expressed 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 up to 2002 refer to public external debt. From 2003 onward, figures refer to total external debt
[h] Economically active population as a percentage of the working-age population; nationwide total.
[i] Unemployed as a percentage of the economically active population; nationwide total.
[j] Underemployed as a percentage 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.

and services imports.[1] The consequences included a deterioration in the terms of trade for goods and services (-3.7%) for the sixth straight year. This trend may be reversed in 2009 if the global economic crisis leads to lower relative prices for imported goods. In 2008, moreover, the real exchange rate continued to appreciate (3%), which eroded its competitiveness in the United States market.[2]

Exports to the rest of Central America increased by 21.3% in 2008, compared with a 10.6% increase in exports to the rest of the world (64.2% of total exports). The country's imports from Central America climbed by 14.1% and those from the rest of the world increased by 11.5%.

The Dominican Republic-Central America-United States Free Trade Agreement took effect on 1 March 2006. Three years later, in 2008, exports from El Salvador to the United States (48.8% of total exports), including from the maquila sector, rose by 9% over 2007. As imports also increased (by 6.5%), El Salvador's trade deficit with the United States remained (0.7% of GDP).

The economy once again benefited substantially from inflows of family remittances (US$ 3.788 billion), although their growth rate fell to 2.5% (from 6.5% in 2007) because of the economic crisis in the United States. Remittances covered 77.4% of the trade deficit, and were equivalent to 22% of GDP. The balance-of-payments current account deficit rose to 7.2% of GDP, 1.5 percentage points higher than in 2007. In 2009, these inflows are expected to decline as a result of the economic crisis, tougher immigration policy and falling employment of Hispanics in the United States. This casts doubt on the ability of remittances to offset the country's large trade balance deficit in a sustained manner. In the first five months of 2009, remittances were down 10%.

Revenue from the 1,875,000 tourists who visited the country in 2008 was US$ 734 million (3.3% of GDP),

1 The oil bill refers to imports of crude oil and derivative products.
2 The real exchange rate refers to the nominal exchange rate deflated by the ratio between the price index of El Salvador and that of the United States.

Table 2
EL SALVADOR: MAIN QUARTERLY INDICATORS

	2007				2008 [a]				2009 [a]	
	I	II	III	IV	I	II	III	IV	I	II
Gross domestic product (variation from same quarter of preceding year) [b]	4,2	4,6	4,8	4,9	3,4	2,9	2,2	1,8	-1,5	...
Goods exports, f.o.b. (millions of dollars)	975	963	1 063	983	1 055	1 249	1 195	1 050	968	...
Goods imports, c.i.f. (millions of dollars)	2 009	2 229	2 222	2 252	2 309	2 660	2 598	2 187	1 763	...
Gross international reserves (millions of dollars)	1 911	2 144	2 420	2 198	2 275	2 305	2 263	2 545	2 524	2 788
Real effective exchange rate (index: 2000=100) [c]	100,7	102,7	102,8	103,8	104,8	105,8	104,5	99,6	98,0	99,2 [d]
Consumer prices (12-month percentage variation)	5,1	3,7	4,3	4,9	6,0	9,0	8,7	5,5	3,3	0,2
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 [e]	4,9	5,0	4,6	4,4	3,8	3,8	4,2	5,0	6,8	9,5
Lending rate [f]	7,8	7,8	7,8	7,9	7,6	7,3	7,5	9,1	8,1	4,9
Domestic credit (variation from same quarter of preceding year)	7,8	9,5	8,2	10,4	10,3	11,4	11,6	3,5	0,4	-1,5 [d]
Non-performing loans as a percentage of total credit	2,1	2,1	2,1	2,1	2,4	2,4	2,8	2,9	3,2	3,7 [d]

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] Quarterly average, weighted by the value of goods exports and imports.
[d] Data to May.
[e] Reference rate for deposits of up to 180 days in the financial system.
[f] Reference rate for 1-year loans in the financial system.

but was still less than the total amount of FDI inflows. The economic crisis is expected to have a substantial, adverse effect on tourism in 2009 and cause revenue to fall by about 10%.

The financial account posted a positive balance of US$ 1.634 billion as a result of the US$ 784 million in FDI (3.5% of GDP), stemming, in turn, from sales of telecommunication assets (which accounted for 68% of all FDI) and investment in the financial, commercial and services sectors, the maquila industry and mining. Nevertheless, the country faces the challenge of attracting more foreign investment and domestic private investment; meeting this challenge in the global economic crisis in 2009 will not be easy.