EL SALVADOR

1. General trends

The Salvadoran economy grew by 2.3% in 2017, slightly less than the previous year's 2.6% expansion. This result is explained by the strong performance of exports and the buoyancy of domestic demand, spurred by increased remittances, the higher purchasing power of wages and the expansion of bank credit to both the production and the household sectors. Year-on-year (December-December) inflation rebounded to 2.04%, following deflation (-0.93%) in 2016. The current account deficit, at 2% of GDP, was similar to that of the previous year. The overall deficit of the non-financial public sector (NFPS), including pensions, came in at US$ 631 million, equivalent to 2.5% of GDP. The available employment data point to a slight (1.1%) increase for the year in the number of formal jobs registered with the Salvadoran Social Security Institute (ISSS).

As a result of the change in base year of El Salvador's System of National Accounts (SCNES), the GDP percentages differ from those of the previous 1990 base year.

In the legislative and municipal elections held in March 2018, the ruling party lost seats in the Legislative Assembly. Most of the 84 members of the Assembly belong to the Grand Alliance for National Unity (GANA), which has 37 deputies; while the governing party, the Farabundo Marti National Liberation Front (FMLN), was reduced to 23 seats. This result will make it hard to reach agreements to pass laws or reforms in the last year of this government.

According to ECLAC projections, the economy is expected to grow by 2.4% in 2018, fuelled by stronger exports, associated with the momentum of the United States economy, and an increase in remittances. Inflation is expected to end at 1.3%, but with a possible upside risk from the impact of the rise in the international oil price. On the public-finance front, the Ministry of Finance expects the NFPS fiscal deficit, including pensions, to reach 2.9% of GDP. The Central Reserve Bank envisages the current account deficit widening to 2.8% of GDP, owing to a deterioration in the terms of trade.

In January of this year the United States Government cancelled El Salvador's temporary protection status, which covers just over 200,000 Salvadorans. They have been granted 18 months (expiring on September 9, 2019) to regularize their immigration status or leave the United States. The effects of this decision will start to be felt in remittances and in the demand for jobs once the agreement expires.

2. Economic policy

Economic policy in 2017 focused on keeping the major macroeconomic aggregates in balance. Nonetheless, there were episodes of uncertainty caused by political disagreements in the Legislative Assembly on debt issuance; and this situation led the Salvadoran government to default on commitments valued at US$ 56.6 million in April. As a result, the rating agencies downgraded El Salvador's sovereign credit rating. Once the pension system reform had been approved, however, and the provisional debt restructured in October, the rating agencies then raised the country's sovereign risk rating once more.

(a) Fiscal policy

The primary balance (including pensions) posted a surplus of 0.7% of GDP in 2017, compared to the previous year's 0.2% deficit, as a result of greater fiscal discipline. The government's annual contribution to the pension fund grew to US$ 560.4 million in 2017, which represented a slight increase from 2.2% of GDP in 2016 to 2.3% in 2017.

In the non-financial public sector, total income (including grants) grew by 5.5% in real terms, thanks to the combined effect of an increase in tax revenue, due to larger collections from value-added tax (4%) on imports and from income tax (3.5%), supported by non-tax income, and a drop in the operating surplus of public enterprises (-5.5%). Income was also boosted in October 2017 by the tax amnesty contained in the Temporary Law to Facilitate Voluntary Compliance with Tax and Customs Obligations, which aimed to exempt the taxpayer from the payment of interest, surcharges and fines. The measure had generated income equivalent to US$ 35.5 million by the end of December. With the amnesty period extended until April 2018 it is estimated that US$ 100 million will be collected altogether. A total of US$ 59.8 million in tax revenue was transferred to the special contribution for public security; and, as a result, the tax burden represented 18.1% of GDP.

Expenditures totalled US$ 5.957 billion, equivalent to 24% of GDP, up by 2.5% in real terms. Current spending rose by 4.5%, as the combined effect of consumption (unchanged), interest payments (up by 12.3%) and transfers (up by 19.7%). Capital expenditure declined by 9.9%, owing to a sharp 12.9% reduction in gross investment, which shrank to 2.7% of GDP in 2017 from the previous year's 3.2%. The reduction was largely due to the low rate of budget execution, the time taken to pass the budget and delays in bidding processes.

In February 2017, the government made a 12-year eurobond issue of US$ 601.1 million at an interest rate of 8.625%. The NFPS debt stood at US$ 12.717 billion in December 2017, equivalent to 51.3% of GDP, which rises to US$ 17.291 million or 69.7% of GDP when the pension fund debt is included. The outstanding balance of treasury bills (LETES), which are a form of floating-rate debt used to finance the short-term deficit, was US$ 745.8 million in 2017, equivalent to 3% of GDP and down from 4.5% at the end of 2016.

In the first quarter of 2018, NFPS income (including grants) grew at a rate of 5.6% in real terms, with tax revenues up by 6.4% and non-tax revenues increasing by 15%, in both cases an improvement on the year-earlier period. Total expenditure grew by 10.6%, driven by interest payments (29.6%) and gross investment (26.4%). The NFPS debt as of March was equivalent to 67.9% of GDP. The LETES balance in April stood at US$ 855.8 million.

One year after the "selective default", Moody's upgraded the country's risk rating again in February 2018, from Caa1 to B3 with a stable outlook, as it expected the debt-to-GDP ratio to stabilize as a result of the improving trend of the fiscal deficit, the lower risks of liquidity crises due to political agreements, pension reform and the forecast economic growth.

(b) Financial and exchange-rate policy

As the Salvadoran economy has been dollarized since 2001, the Central Reserve Bank does not have monetary autonomy, so it is the market that sets the interest rate through supply and demand. As there were no significant changes in 2017 lending remained buoyant.

Interest rates, in their different categories and maturities, registered marginal movements. The average 180-day nominal deposit rate was virtually unchanged in 2017 at 4.43%. The lending rate for maturities of up to one year averaged 6.47%, ten basis points above the 2016 level. The greatest increase occurred in the interest rate on individual loans, at 9.42 %, whereas corporate lending rates remained unchanged.

At the end of 2017, deposits were the banks' main source of funding; and in December they totalled US$ 12.312 million, up by 10.3%. The balance of credit grew by 4.8% to US$ 13.039 billion. The highest rates of credit growth were concentrated in the manufacturing (10.7%), transport (9.9%) and construction (8.4%) sectors, while personal credit grew by 4.2%.

Net international reserves grew by 12% to stand at US$ 3.273 billion in December 2017, equivalent to four months' imports and representing 26.6% of the M2 monetary aggregate. Total liquidity, which includes M3 and securities issued, stood at US$ 14.807 billion, up by US$ 933 million on the 2016 level.

In the first quarter of 2018, the financial sector reported a credit growth of 4.7%, led by financing to the construction industry (13.6%), mainly for residential buildings. In March, the interest rate on 180-day deposits stood at 4.29%, compared to 4.54% a year earlier. The lending rate, measured as the cost of financing for firms on terms of up to one year, was 6.56%, compared to 6.08% in March 2017.

(c) Other policies

The country's foreign trade agenda has featured new intra- and extraregional trade agreements, with a view to diversifying the export basket, encouraging investment and promoting productive activity. These include negotiations for El Salvador's accession to the Customs Union between Honduras and Guatemala, in which the different rounds have addressed issues such as customs, tariffs, rules of origin, sanitary and phytosanitary measures, and migration.

The free trade agreement between the Republic of Korea and Central America, signed in February 2018, is expected to boost sales of agricultural and agribusiness products —in particular exports of unrefined sugar, under preferential conditions, with immediate access and without quotas or tariffs.

Following four rounds of negotiations beginning in 2012, in February 2017 El Salvador signed a Partial-scope Economic Complementation Agreement with Ecuador involving tariff reductions, zero-rated products and immediate access. Salvadoran industry will be able to export 214 products duty-free to Ecuador (medicines, clothing and paper bags, among others), while Ecuador will be able to sell 207 products duty-free to El Salvador (including white-line goods, ceramics and cocoa products).

3. The main variables

(a) The external sector

At the end of 2017, El Salvador's goods exports amounted to US$ 5.760 billion (23.2% of GDP), representing year-on-year growth of 6.3%. These exports were spurred by the strong economic performance in the United States, El Salvador's main trading partner. In volume terms, exports grew by 8.6%, while the average price fell by 2.2%. Traditional exports increased by 31.2%, thanks to vigorous growth of sugar (49.2%) and coffee (10.5%). In contrast, non-traditional exports grew by 6.6%, while exports from the maquila industry flatlined. Exports of plastic products and chips made up for the decline of textile and garment maquila sales.

Trade with the countries with which El Salvador has trade agreements totalled US$ 5.281 billion, of which 48.6% went to the United States and 43.2% to the Central American Common Market. In the latter, Guatemala and Honduras absorbed 70% of El Salvador's exports inside the subregion.

Total imports grew by 7.8% in value terms, as a result of a 2% drop in volume and price increases averaging 10%. While imports of the maquila sector increased by 39.6%, intermediate goods imports also grew by 10.7%. Imports of insulated wires and cables for electricity, electric power and cotton yarns also grew strongly. The oil bill surpassed its 2016 level to reach US$ 1.289 billion, posting annual growth of 15.8%. Within this, imports of liquefied gas grew by 34.6%, kerosene grew by 28.5% and diesel by 24.3%. Hydrocarbon imports represented 5.2% of GDP. This caused the terms of trade to deteriorate by 2.9%, following the previous year's 2.8% improvement. The balance of the trade balance posted a deficit of US$ 4.833 billion, equivalent to 19.5% of GDP.

Remittance flows continued to fuel the consumption of goods and services, totalling US$ 5.043 billion in 2017, which was US$ 462 million more than in the previous year and equivalent to 20.3% of GDP. This increase was driven by the robust performance of the United States economy and its impact on job creation in sectors such as construction, and hotels and restaurants, where most Salvadoran immigrants are employed. To guard against more restrictive migration policies in the United States, the diaspora sent a larger volume of remittances fearing future barriers.

Net foreign direct investment (FDI) topped US$ 792 million —the second largest amount since the US$ 903 million recorded in 2008 and US$ 444 million more than in 2016. These flows represented 3.2% of GDP. By activity sector, most FDI was absorbed by manufacturing industry, wholesale commerce, energy, financial and insurance activities. Much of this investment came from other countries in the subregion, such as Honduras and Panama.

In the first quarter of 2018, exports grew by 3.1% in value terms year-on-year, driven by garments and food processing. By volume, however, exports declined by 3.5%. In contrast, imports increased by 7.6% in value and by 6% in volume, largely owing to manufacturing activity. The oil bill grew to US$ 369.1 million, US$39.2 million more than in the same month of 2017. As of April, cumulative remittances totalled US$ 1.730 billion, representing growth of 9.2% (the highest first-quarter rate so far this decade).

(b) Economic activity

In March 2018, the Central Reserve Bank officially presented the new System of National Accounts of El Salvador. The base year was changed from 1990 to 2005 pursuant to the System of National Accounts 2008. The results for the new base year show that: (a) the economy was actually smaller than previously thought (for example, in 2016 GDP was 10.8% less than estimated using the previous base year); (b) agriculture and manufacturing suffered reductions in their shares of total GDP, while the tertiarization of the economy strengthened; and (c) the new data show higher growth rates in the last few years.

Although the economy recorded positive growth for the eighth consecutive year, the rate of expansion remained around 2%. The fastest-growing sectors were transport and storage (4.2%), construction (4%), financial and insurance activity (3.9%), and manufacturing (3.4%), and the 2016 result was improved on. The slowest growing sectors were agriculture (0.6%) and electricity supply (0.9%). Agriculture is still suffering from the major drought of recent years.

On the demand side, household consumption grew by 0.7% in real terms, spurred by the effect of remittances, wages and, to a certain extent, the stability of consumer prices. In contrast, government consumption increased by 0.8%, following a 1% drop in 2016. Gross domestic investment posted growth of 12.3%, which, together with exports of goods and services (up by 2.2%), stimulated economic activity. Private investment in real estate activity was also vigorous.

As of March 2018, the economic activity volume index (IVAE) was down by 0.6% year-on-year, mainly owing to a 3.2% decrease in construction (compared to 16.5% growth in March 2017) and a 2.7% drop in professional activities. These reductions were partially offset by growth in financial activities (4%) and in communications (2.8%).

(c) Prices, wages and employment

Inflation gathered pace relative to earlier years and by end-2017 the year-on-year consumer price index was up by 2.04%. This basically reflected price increases in three items: water, electricity, and gas and other fuels (up by 5.2%), in contrast to the previous year's fall of 1.2%; transport (+3.6%) and food and non-alcoholic beverages (+2.5%). The first of these items is associated with the increase in the price of propane gas products and the hikes in electricity rates, while the price of fuels and transport services reflected the rise in international oil prices. Core inflation was 0.36% in December.

Real wages in the formal sector of the economy rose by 3.8% in 2017. The available data on employment, corresponding to workers registered with ISSS, show employment growing by an average of 8,730 jobs up to December relative to the year-earlier level, created mainly in the private sector.

The general level of prices in April was up by 0.87% year-on-year, similar to the increase in the same period of 2017, reflecting sector-level rises in transport (3.57%), electricity and fuel (2.14%) and restaurants and hotels (1.76%), which offset lower prices in the footwear and clothing category (- 1.84%).

Table 1
EL SALVADOR: MAIN ECONOMIC INDICATORS

	2009	2010	2011	2012	2013	2014	2015	2016	2017 a/
	Annual growth rates b/								
Gross domestic product	-2.1	2.1	3.8	2.8	2.4	2.0	2.4	2.6	2.3
Per capita gross domestic product	-2.5	1.7	3.4	2.4	2.0	1.6	2.0	2.2	1.9
Gross domestic product, by sector									
Agriculture, livestock, hunting, forestry and fishing	-5.3	5.0	-4.2	4.4	-7.2	0.8	-2.8	8.5	0.6
Mining and quarrying	-17.5	-4.4	18.2	-7.1	8.3	-4.2	6.4	-3.2	2.6
Manufacturing	-4.1	1.9	4.2	1.5	0.4	1.6	3.3	1.3	3.4
Electricity, gas and water	-8.9	2.9	5.5	1.5	-2.4	3.8	-14.2	14.6	1.0
Construction	-9.0	6.4	13.4	4.4	3.2	-2.1	-0.8	3.9	4.0
Wholesale and retail commerce, restaurants and hotels	1.4	0.8	2.1	5.9	5.9	6.9	3.9	2.3	3.5
Transport, storage and communications	-7.6	4.8	6.1	-1.3	2.9	-4.4	3.7	3.9	2.8
Financial institutions, insurance, real estate and business services	-2.2	-4.3	-1.6	5.1	2.4	3.5	3.2	3.7	2.8
Community, social and personal services	0.8	1.7	7.4	4.6	2.3	-1.2	17.1	23.2	36.8
Gross domestic product, by type of expenditure									
Final consumption expenditure	-5.6	1.2	3.0	3.0	3.3	0.0	2.1	1.3	0.7
Government consumption	-0.1	2.6	10.8	1.9	2.8	-1.7	2.1	-1.0	0.8
Private consumption	-6.5	0.9	1.6	3.3	3.5	0.4	2.1	1.7	0.7
Gross capital formation	-28.0	10.1	7.4	0.9	-1.8	0.0	-2.4	1.5	12.3
Exports (goods and services)	-9.3	13.5	7.2	0.3	4.6	2.3	2.8	1.6	2.2
Imports (goods and services)	-22.4	9.0	5.2	1.1	4.2	-2.5	0.4	-1.2	2.0
Investment and saving c/	**Percentajes of GDP**								
Gross capital formation	14.1	16.7	17.8	17.8	17.2	16.4	15.6	15.1	16.9
National saving	12.3	13.8	12.3	12.0	10.3	11.1	12.4	13.0	14.9
External saving	1.8	2.9	5.5	5.8	6.9	5.3	3.2	2.1	2.0
Balance of payments	**Millions of dollars**								
Current account balance	-312	-533	-1 112	-1 240	-1 518	-1 191	-748	-500	-501
Goods balance	-3 506	-4 022	-4 772	-4 917	-5 289	-5 287	-4 970	-4 633	-4 837
Exports, f.o.b.	2 924	3 473	4 243	4 242	4 395	4 294	4 437	4 321	4 662
Imports, f.o.b.	6 430	7 495	9 015	9 159	9 684	9 581	9 407	8 954	9 499
Services trade balance	308	398	449	531	671	868	947	783	692
Income balance	-556	-538	-618	-871	-990	-1 035	-1 093	-1 229	-1 448
Net current transfers	3 442	3 629	3 830	4 016	4 090	4 263	4 368	4 580	5 092
Capital and financial balance d/	735	237	698	1 891	1 192	1 158	861	952	809
Net foreign direct investment	366	-226	218	466	179	306	396	348	792
Other capital movements	369	462	479	1 425	1 013	852	465	605	18
Overall balance	423	-296	-414	651	-327	-33	113	453	308
Variation in reserve assets e/	-423	296	414	-651	327	33	-113	-453	-308

Table 1 (concluded)

	2009	2010	2011	2012	2013	2014	2015	2016	2017
Other external-sector indicators									
Real effective exchange rate (index: 2005=100) f/	99.6	101.2	102.4	103.1	104.0	104.6	103.7	104.0	107.6
Terms of trade for goods									
(index: 2010=100)	105.9	100.0	97.5	97.1	94.5	96.7	105.6	108.6	106.2
Net resource transfer (millions of dollars)	179	-302	79	1 020	201	123	-232	-277	-639
Total gross external debt (millions of dollars)	11 307	11 399	11 858	13 353	14 035	14 800	15 217	16 253	16 006
Employment	**Average annual rates**								
Labour force participation rate g/	62.8	62.5	62.7	63.2	63.6	63.6	62.8	62.1	61.9
Open unemployment rate h/	7.1	6.8	6.6	6.2	5.6	6.7	6.5	6.9	6.8
Visible underemployment rate h/	7.7	7.0	3.4	5.8	5.8	6.7	6.8	7.7	7.6
Prices	**Annual percentages**								
Variation in consumer prices									
(December-December)	-0.2	2.1	5.1	0.8	0.8	0.5	1.0	-0.9	2.0
Variation in industrial producer prices									
(December-December)	4.9	6.2	7.0	2.4	-0.2	-5.8	-6.0	0.2	1.4
Variation in average real wage	3.5	1.1	-2.9	0.2	0.5	0.7	2.5	1.4	…
Nominal deposit rate i/	4.5	2.9	1.8	2.5	3.4	3.8	4.2	4.4	4.4
Nominal lending rate j/	9.3	7.6	6.0	5.6	5.7	6.0	6.2	6.4	6.5
Central government	**Percentajes of GDP**								
Total revenue	16.2	17.4	17.5	17.6	18.0	17.6	17.9	18.3	19.3
Tax revenue	14.8	15.6	15.7	16.1	17.0	16.7	16.9	17.4	17.8
Total expenditure	20.6	20.6	20.1	19.5	20.0	19.3	19.1	19.2	19.3
Current expenditure	17.2	16.9	16.6	15.8	16.6	16.2	16.2	16.3	16.6
Interest	2.9	2.7	2.5	2.5	2.7	2.6	2.7	2.8	3.1
Capital expenditure	3.4	3.7	3.5	3.7	3.3	3.1	2.9	3.0	2.8
Primary balance	-1.4	-0.4	-0.1	0.6	0.7	0.9	1.5	1.9	3.0
Overall balance	-4.4	-3.1	-2.6	-1.9	-2.0	-1.7	-1.2	-0.9	-0.1
Central government public debt	50.0	49.4	47.6	50.9	49.2	49.6	50.2	50.2	49.1
Domestic	17.5	16.6	16.9	17.3	16.3	13.4	15.4	14.6	13.5
External	32.4	32.8	30.7	33.6	33.0	36.2	34.9	35.5	35.6
Money and credit	**Percentages of GDP, end-of-year stocks**								
Domestic credit	65.9	65.9	64.7	63.7	68.9	71.2	76.0	77.6	79.7
To the public sector	24.6	28.3	30.2	29.0	32.4	32.8	36.8	37.7	37.6
To the private sector	49.7	47.5	45.3	44.8	47.1	48.9	50.1	51.1	51.7
Others	-8.4	-9.9	-10.8	-10.0	-10.7	-10.6	-10.8	-11.1	-9.6
Monetary base	13.0	12.8	11.2	10.4	11.3	11.0	11.1	11.3	12.1
Money (M1)	13.1	14.3	13.7	13.1	13.2	12.9	14.0	13.1	14.7
M2	53.1	52.8	47.7	46.0	46.2	44.8	46.4	46.5	49.5

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.
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

	2016				2017				2018	
	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/	2.1	2.4	2.4	2.6	2.2	2.3	2.4	...	...	...
Gross international reserves (millions of dollars)	3 115	3 235	3 475	3 326	3 615	3 697	3 745	3 665	3 765	3 804
Real effective exchange rate (index: 2005=100) c/	102.3	103.9	104.8	104.8	104.9	106.7	108.9	110.0	107.4	105.5
Consumer prices (12-month percentage variation)	1.1	0.9	1.0	-0.9	0.5	0.9	1.6	2.0	0.9	0.9
Wholesale prices (12-month percentage variation)	-1.3	-1.1	-0.6	0.17	1.1	1.8	1.2	1.43	1.3	1.3
Nominal interest rates (average annualized percentages)										
Deposit rate d/	4.3	4.4	4.5	4.5	4.5	4.4	4.4	4.4	4.3	4.2 e/
Lending rate f/	6.2	6.4	6.4	6.5	6.3	6.5	6.5	6.6	6.5	6.5 e/
Sovereign bond spread, Embi Global (basis points to end of period) g/	667	671	486	536	553	561	448	383	380	450
International bond issues (millions of dollars)	-	-	-	-	951	-	-	-	0	0
Domestic credit (variation from same quarter of preceding year)	8.9	8.7	8.6	6.3	4.3	3.7	4.1	5.3	6.0	5.7 e/
Non-performing loans as a percentage of total credit	2.4	2.3	2.2	2.2	2.0	2.1	2.1	2.0	2.0	2.0

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/ Quarterly average, weighted by the value of goods exports and imports.
d/ Basic rate for deposits of up to 180 days.
e/ Figures as of May.
f/ Basic lending rate for up to one year.
g/ Measured by J.P.Morgan.