EL SALVADOR

Table 1	2021
Population, million	6.5
GDP, current US$ billion	28.7
GDP per capita, current US$	4408.2
International poverty rate ($2.15)[a]	1.4
Lower middle-income poverty rate ($3.65)[a]	6.6
Upper middle-income poverty rate ($6.85)[a]	28.8
Gini index[a]	38.8
School enrollment, primary (% gross)[b]	106.3
Life expectancy at birth, years[b]	73.5
Total GHG emissions (mtCO2e)	13.5

Source: WDI, Macro Poverty Outlook, and official data.
a/ Most recent value (2019), 2017 PPPs.
b/ WDI for School enrollment (2014); Life expectancy (2020).

GDP rebounded in 2021. As challenges are mounting, growth is projected to slow. The country is facing a delicate macroeconomic situation: high inflation, widening current account deficit; and large fiscal imbalances and public debt. Poverty declined after the pandemic but is still higher than prior to the pandemic. To accelerate growth, the country needs to address fiscal imbalances and improve fiscal management to recover market access. This needs to be complemented with productivity-enhancing reforms and deeper trade integration.

Key conditions and challenges

El Salvador is a small, dollarized economy, vulnerable to external shocks. It has one of the highest inflows of remittances in the world (26.9 percent of GDP). The country had one of the highest, though recently declining, homicide rates in the world. Despite modest economic growth, poverty declined before the COVID-19 crisis. From 2012 to 2019, moderate poverty decreased from 38.9 to 22.3 percent. This, however, was accompanied by an expansion of vulnerable people, from 43.6 to 48.2 percent.

The country is facing three short-term challenges: (i) fiscal imbalances, (ii) large financing needs; and (iii) inflation.

The fiscal response to COVID-19 was able to partially mitigate the impact of the crisis but left the country with high public debt. Policy choices, such as raising the minimum pension, added to the deficit and debt, which together with structural issues, such as pensions and vulnerability to climate change, are increasing uncertainty and fiscal risks.

The response to COVID-19 and higher commodity prices widened the CAD by expanding consumption, including of fuel, demand for which further increase as subsidies depressed domestic prices. BoP financing is becoming more difficult due to the external environment, lower remittance's growth, and the government's fiscal situation that makes private external borrowing practically unaffordable.

The banking sector's stability was not significantly affected by the COVID-19 crisis. Banks are profitable, have adequate levels of capital, and have low non-performing loans. According to some analysts, the introduction of Bitcoin as a legal tender has sparked concerns by investors and contributed to the increase of sovereign spreads.

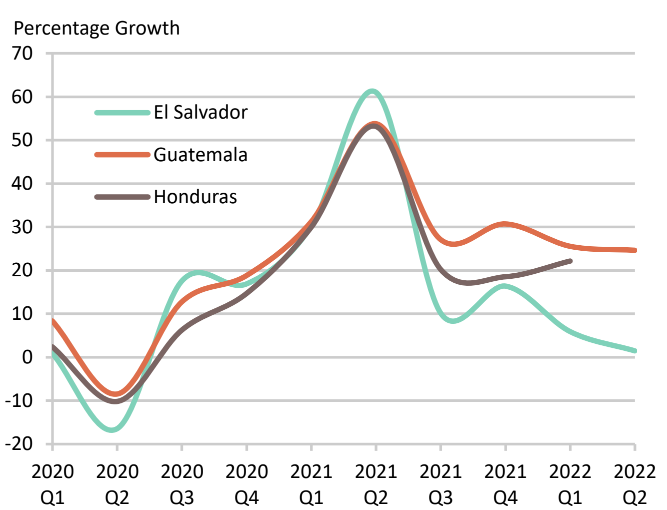
Inflation is growing due to supply disruptions, changes in consumption patterns, and commodities' prices. However, local factors such as increasing government consumption and subsidies are driving inflation.

Recent developments

After growing 10.2 percent in 2021, GDP growth slowed in the first quarter of 2022 (2.7 percent). Inflation (12-month average) jumped from 1.1 percent in July 2021 to 6.4 percent in July 2022, largely driven by overall food prices. Energy prices have been declining due to price caps and subsidies, which are increasing government expenditures by 1.1 percentage points of GDP.

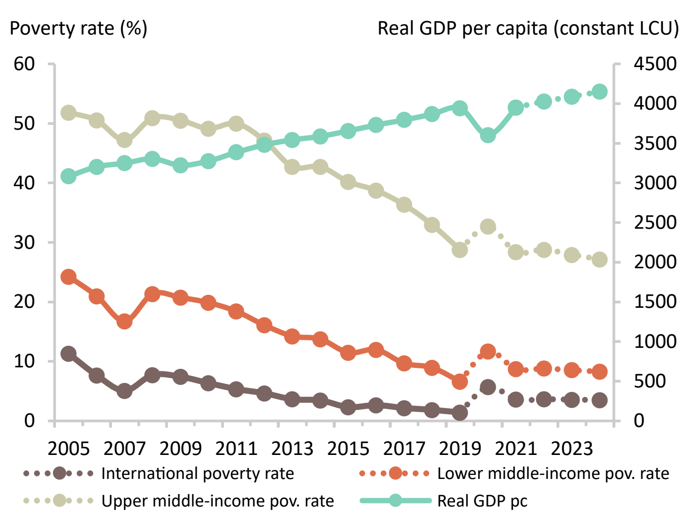
The fiscal deficit between January and July has gone from US$721.8 million in 2021 to US$258.8 million in 2022 due to high revenue growth (15.5 percent in the same period), led by increases in income tax (29 percent). Expenditures grew moderately – 4 percent – led by interest payments (7.9 percent). As a result, total public debt increased by 0.9 percent in nominal terms - mostly in domestic debt.

FIGURE 1 El Salvador / Quarter-on-quarter growth in remittances



Sources: Banco Central de Reserva de El Salvador, Banco Central de Honduras, and Banco Central de Guatemala.

FIGURE 2 El Salvador / Actual and projected poverty rates and real GDP per capita



Source: World Bank. Notes: see Table 2.

In an effort to reduce uncertainty, a debt buyback program was launched to repurchase Eurobonds maturing in 2023 and 2025. On September 21st, the authorities announced they had successfully completed the buyback operation, which yielded US$275 million in savings. Outstanding Eurobond debt maturing in January 2023 was reduced from US$800 million to US$ 667 million.

The current account went from a surplus of nearly 1 percent of GDP in 2020 to a deficit of more than 5 percent of GDP in 2021, on the back of higher consumption that increased imports by nearly 50 percent in 2021. The CAD continued to expand, driven by higher import of goods (27.2 percent growth in the first half of 2022, while exports grew 16.8 percent) and slower growth of remittances (3.5 percent growth in 1H22 vis-à-vis 26.8 percent in 2021). It is not clear yet why remittances' growth is slowing, while for other CA countries they are still growing strongly.

Moderate poverty declined from 32.7 to 28.4 percent of the population from 2020 to 2021, below 2019 (28.7 percent). The vulnerable population (between US$6.85 and US$14 per capita per day) shrunk from 41.1 in 2019 to 37.9 in 2020, bouncing back to 39.4 percent in 2021.

Outlook

GDP is projected to grow by 2.4 percent in 2022 and slow to 2 percent in 2023. The CAD is expected to widen in 2022 due to higher import prices and lower growth in remittances. It should come down slightly as commodities prices decline but should remain at elevated levels due to lower remittances growth and higher imports fueled by expansionary fiscal policy.

Inflation is expected to peak at 7 percent in 2022 and then come down gradually in the upcoming years. However, the permanence or removal of energy subsidies and tax cuts as well as a faster than expected expansion of demand in an electoral year are a risk to the forecast.

The fiscal deficit is expected to improve from 5 percent of GDP in 2021 to 4.5 percent in 2022 due to an increase in revenues coming from improvements in tax enforcement and moderation in expenditure growth. However, the strong revenue growth is not expected to last into 2023, while structural issues like automatic wage increases for civil servants and policy decisions such as an expansion of security forces will increase the fiscal deficit.

Public debt faces significant sustainability and refinancing risks as EMBIG spreads were near 2,438 basis points by September 23, 2022. The government has close to US$2.5 billion in domestic debt rollover in the next 12 months in addition to the Eurobond maturing in January 2023. The forecast assumes that financing in 2022 will come from increased borrowing from domestic markets and multilaterals. There are significant risks to the outlook, given the presidential election in 2024, a deterioration in the external environment, and high uncertainty regarding financing sources in 2023.

Consistent with GDP growth slowdown, the extreme poverty rate would increase in 2022 from 3.59 to 3.63 percent. In the next years, poverty reduction will slow down.

TABLE 2 El Salvador / Macro poverty outlook indicators (annual percent change unless indicated otherwise)

	2019	2020	2021	2022e	2023f	2024f
Real GDP growth, at constant market prices	2.4	-8.1	10.2	2.4	2.0	2.0
Private Consumption	1.7	-10.9	15.5	2.2	2.0	2.0
Government Consumption	0.6	9.9	7.1	2.0	1.0	1.0
Gross Fixed Capital Investment	6.7	-7.9	24.2	1.3	0.5	0.6
Exports, Goods and Services	8.5	-20.9	26.0	6.1	3.5	3.4
Imports, Goods and Services	4.5	-10.9	26.9	3.4	2.0	2.0
Real GDP growth, at constant factor prices	2.6	-8.2	9.6	2.4	2.0	2.0
Agriculture	0.9	-2.7	2.3	3.5	2.1	2.1
Industry	4.5	-9.7	9.1	2.2	2.2	2.3
Services	2.0	-8.0	10.4	2.4	1.9	1.9
Inflation (Consumer Price Index)	0.1	-0.4	3.5	7.0	4.0	2.5
Current Account Balance (% of GDP)	-0.4	0.8	-5.1	-6.1	-6.1	-5.7
Net Foreign Direct Investment Inflow (% of GDP)	2.4	1.1	1.1	2.3	2.2	2.1
Fiscal Balance (% of GDP)[a]	-3.0	-9.3	-5.0	-4.5	-4.9	-6.3
Debt (% of GDP)[b]	73.7	92.1	84.8	85.0	85.7	87.8
Primary Balance (% of GDP)[a]	0.7	-4.8	-0.4	-1.4	-1.3	-2.4
International poverty rate ($2.15 in 2017 PPP)[c,d]	1.4	5.7	3.6	3.6	3.6	3.5
Lower middle-income poverty rate ($3.65 in 2017 PPP)[c,d]	6.6	11.7	8.7	8.8	8.5	8.3
Upper middle-income poverty rate ($6.85 in 2017 PPP)[c,d]	28.8	32.7	28.4	28.8	27.9	27.1
GHG emissions growth (mtCO2e)	7.8	-5.9	3.1	-0.2	1.0	0.6
Energy related GHG emissions (% of total)	54.7	53.8	54.0	53.1	53.0	52.5

Source: World Bank, Poverty & Equity and Macroeconomics, Trade & Investment Global Practices. Emissions data sourced from CAIT and OECD.
Notes: e = estimate, f = forecast. Poverty lines are expressed in 2017 PPP, resulting in changes from earlier editions that used 2011 PPP. See pip.worldbank.org.
a/ Fiscal and Primary Balance correspond to the non-financial public sector.
b/ Debt is total public debt.
c/ Calculations based on SEDLAC harmonization, using 2019-EHPM. Actual data: 2019. Nowcast: 2020-2021. Forecasts are from 2022 to 2024.
d/ Projections using microsimulation methodology.