INTERNATIONAL MONETARY FUND

IMF Country Report No. 19/143

EL SALVADOR

May 2019

2019 ARTICLE IV CONSULTATION—PRESS RELEASE; STAFF REPORT; AND STATEMENT BY THE EXECUTIVE DIRECTOR FOR EL SALVADOR

Under Article IV of the IMF's Articles of Agreement, the IMF holds bilateral discussions with members, usually every year. In the context of the 2019 Article IV consultation with El Salvador, the following documents have been released and are included in this package:

- A **Press Release** summarizing the views of the Executive Board as expressed during its May 22, 2019, consideration of the staff report that concluded the Article IV consultation with El Salvador.
- The **Staff Report** prepared by a staff team of the IMF for the Executive Board's consideration on May 22, 2019, following discussions that ended on March 22, 2019, with the officials of El Salvador on economic developments and policies. Based on information available at the time of these discussions, the staff report was completed on May 7, 2019.
- An **Informational Annex** prepared by the IMF staff.
- A **Statement by the Executive Director** for El Salvador.

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May 24, 2019

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Washington, D. C. 20431 USA

IMF Executive Board Concludes 2019 Article IV Consultation with El Salvador

On May 22, 2019, the Executive Board of the International Monetary Fund (IMF) concluded the Article IV consultation with El Salvador.[1]

Background

During the past decade El Salvador has made considerable strides in social development: poverty, inequality and migration to the U.S declined, especially after 2015, due to sustained social spending and a growing economy.

Fueled by strong domestic consumption and investment, real GDP grew by 2½ percent in 2018. The primary fiscal surplus increased to about 1 percent of GDP, driven by strong import tax revenues and one-off tax measures. Nevertheless, the rising interest bill offset the improvement in the primary balance, leading to a slight deterioration of the overall fiscal deficit. Public debt (including pensions) remained at about 70 percent of GDP at end-2018. The banking sector continued to be solid and used the remittance-fueled increase in deposits to expand credit to the private sector.

Real GDP is projected to grow at 2½ percent in 2019 and converge to its potential of 2.2 percent over the medium-term, in line with the global growth outlook. Inflation is expected to remain anchored at 1 percent, and remittances growth will decline to its long-term rate. Public debt would drift upwards under the baseline, as the fiscal balance will deteriorate due the expected loss in temporary revenues and a rising interest bill.

Downside risks to the outlook stem from weaker-than-expected global growth, rising protectionism, and domestic policy slippages, especially if spending measures are adopted without identifying appropriate funding resources. On the upside, global financial conditions may tighten less than expected.

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[1] Under Article IV of the IMF's Articles of Agreement, the IMF holds bilateral discussions with members, usually every year. A staff team visits the country, collects economic and financial information, and discusses with officials the country's economic developments and policies. On return to headquarters, the staff prepares a report, which forms the basis for discussion by the Executive Board.

Executive Board Assessment[2]

Executive Directors commended the authorities' policies that contributed to the strong macroeconomic performance and a decline in poverty and inequality. Noting that risks remain tilted to the downside, Directors emphasized the need for prompt fiscal adjustment to reduce the high public debt, and structural reforms to raise potential growth, including measures to combat crime, improve governance, and reduce poverty.

Directors welcomed the authorities' fiscal consolidation efforts and the fiscal laws recently passed by the Legislative Assembly, including the revised Fiscal Responsibility Law. In view of the high public debt and the large financing needs, Directors called for the authorities to adopt frontloaded fiscal measures to put debt on a firmly declining path, while noting, in line with staff recommendations, that the measures should be calibrated in a growth-friendly way without adversely affecting social outcomes. In that context, Directors also stressed the importance of improving revenue collection and tax administration.

Directors commended the authorities' efforts to improve the business environment and competitiveness, including through the implementation of the *El Salvador Seguro* plan, regulatory improvements to complete the Northern Triangle customs union, and policies to help human capital formation. They noted that potential growth could be further raised by increasing investment in public infrastructure, including through public-private partnerships, improving security, removing barriers to trade and investment, and reducing informality and the gender gap in labor force participation.

Directors noted that the banking sector is well capitalized and welcomed the recent progress in risk-based and cross-border banking supervision. To further improve the resilience of the banking sector, they encouraged the authorities to approve the bank resolution law, strengthen the emergency liquidity assistance framework, and ensure full compliance with the risk-based supervision framework. Director also noted the importance of further promoting financial inclusion, including by expanding access to fintech services.

Directors supported the recently adopted measures to improve the governance, anticorruption and Anti-Money Laundering and Combating the Financing of Terrorism (AML/CFT) frameworks. Nevertheless, these frameworks should be strengthened further by enhancing fiscal transparency of the 2020 budget law, by improving the audit of fiscal operations, and establishing better spending controls. Directors recommended promptly implementing electronic invoicing, and also noted that changes to the anticorruption legal framework should be comprehensive, ensure harmonization of laws and consider the impact on the budget.

[2] At the conclusion of the discussion, the Managing Director, as Chairman of the Board, summarizes the views of Executive Directors, and this summary is transmitted to the country's authorities. An explanation of any qualifiers used in summing up can be found here: http://www.imf.org/external/np/sec/misc/qualifiers.htm.

El Salvador: Selected Economic Indicators

I. Social Indicators

Per capita income (U.S. dollars, 2018)	3,701	Population (million, 2017)	6.4
Percent of pop. below poverty line (2017)	29	Gini index (2017)	38

II. Economic Indicators (percent of GDP, unless otherwise indicated)

					Proj.		
	2015	2016	2017	2018	2019	2020	2021
Income and prices							
Real GDP growth (percent)	2.4	2.5	2.3	2.5	2.5	2.3	2.2
Consumer price inflation (average, percent)	-0.7	0.6	1.0	1.1	0.6	1.3	1.1
Terms of trade, percent change	12.4	-2.9	-2.1	-3.9	-0.9	0.9	0.1
External sovereign bond spread (basis points)	497	600	520	424	...	...	...
Money and credit							
Credit to the private sector	49.5	50.6	51.5	52.4	53.2	53.1	53.3
Broad money	47.9	48.0	51.4	52.0	52.7	52.7	52.8
Interest rate (time deposits, percent)	4.2	4.4	4.4	4.2	...	...	...
External sector							
Current account balance	-3.2	-2.3	-1.9	-4.8	-4.4	-4.4	-4.5
Trade balance	-21.2	-19.3	-19.4	-22.8	-23.1	-22.9	-22.9
Transfers (net)	18.6	18.8	20.2	20.6	21.2	21.1	21.0
Foreign direct investment	1.7	1.4	3.6	3.2	2.5	2.5	2.2
Gross international reserves (millions of U.S. dollars)	2,787	3,238	3,567	3,569	3,728	3,882	4,039
Nonfinancial public sector							
Overall balance	-3.6	-3.1	-2.5	-2.7	-3.4	-3.5	-2.9
Primary balance 1/	-0.9	-0.2	0.7	0.9	0.7	0.4	1.2
Of which: tax revenue	16.7	17.2	17.7	17.9	17.6	17.6	17.6
Public sector debt 2/	66.8	68.8	70.3	69.8	70.8	71.2	71.2
National savings and investment							
Gross domestic investment	16.0	16.0	16.6	20.4	19.0	17.6	17.7
Private sector 3/	13.5	13.5	14.2	18.1	16.8	15.5	15.5
National savings	12.8	13.7	14.8	15.7	14.5	13.2	13.1
Private sector	13.6	13.6	14.5	15.2	14.9	13.7	12.9
Net foreign assets of the financial system							
Millions of U.S. dollars	1,931	2,021	2,689	2,771	2,910	3,043	3,241
Memorandum items							
Nominal GDP (billions of U.S. dollars)	23.4	24.2	24.9	26.1	27.0	28.2	29.5

Sources: Central Reserve Bank of El Salvador, Ministry of Finance, and IMF staff estimates.

1/ The baseline scenario does not include planned revenue measures (electronic invoicing, the *monotributo*, and transfer pricing).

2/ Includes gross debt of the nonfinancial public sector and external debt of the central bank.

3/ Includes inventories.

INTERNATIONAL MONETARY FUND

EL SALVADOR

STAFF REPORT FOR THE 2019 ARTICLE IV CONSULTATION

May 7, 2019

KEY ISSUES

Context. Structural reforms, strengthened policy frameworks and the ongoing smooth political transition have laid the foundations for sustained growth. Surging remittances pushed real GDP growth above potential in 2018, adding to tax revenues and raising the primary fiscal surplus to about 1 percent of GDP. Nevertheless, public debt at about 70 percent of GDP is high, expensive to roll over, and leaves little room for funding new initiatives unless structural measures are implemented. It remains the main vulnerability of the economy.

Focus. Discussions focused on policies that build on these achievements and address fiscal vulnerabilities, boost long-term growth, and strengthen the governance, anticorruption and AML/CFT frameworks.

Main Policy Recommendations:

1. Frontload fiscal consolidation measures of about 2 percent of GDP over 2019-20;

2. Adopt policies that raise long-term output, and reduce crime and informality;

3. Improve the governance and anticorruption frameworks by increasing the fiscal transparency of the 2020 budget laws, strengthening audit and spending controls, and promptly implementing electronic invoicing.

Approved by:
Aasim M. Husain (WHD) and María Gonzalez (SPR)

Discussions took place in San Salvador during March 11-22. The staff team comprised A. Carare (head), F. Di Vittorio, A. Lariau, Y. Yakhshilikov (all WHD), and R. Giri (SPR). Ms. Del Cid-Bonilla (OED) also participated in the meetings. The team met with President Mr. Sánchez Cerén, President-elect Mr. Bukele, Vice President Mr. Ortíz, Secretary of Communications and Governance Mr. Lorenzana, Minister of Finance Mr. Fuentes, Minister of Economy Ms. Rodríguez, Central Bank President Mr. Cabrera, members of Congress, other senior officials and representatives of the private sector and civil society.

CONTENTS

ECONOMIC AND SOCIAL CONTEXT 4

ECONOMIC PERFORMANCE 4

OUTLOOK AND RISKS 7

FRONTLOAD THE FISCAL ADJUSTMENT 8

RAISE LONG-TERM GROWTH 14

ENHANCE FINANCIAL SECTOR STABILITY 17

STRENGTHEN THE GOVERNANCE FRAMEWORKS 19

STATISTICS 21

STAFF APPRAISAL 21

BOXES
1. Timing and Composition of the Fiscal Adjustment 11
2. The Fight Against Crime in El Salvador and Lessons from International Experience 15
3. Financial Inclusion in El Salvador 19
4. Implementation of Fund Advice 24

FIGURES
1. Long-term Growth and Poverty 25
2. Balance of Payments Developments 26
3. Fiscal Developments 27
4. Financial Sector Developments 28

TABLES

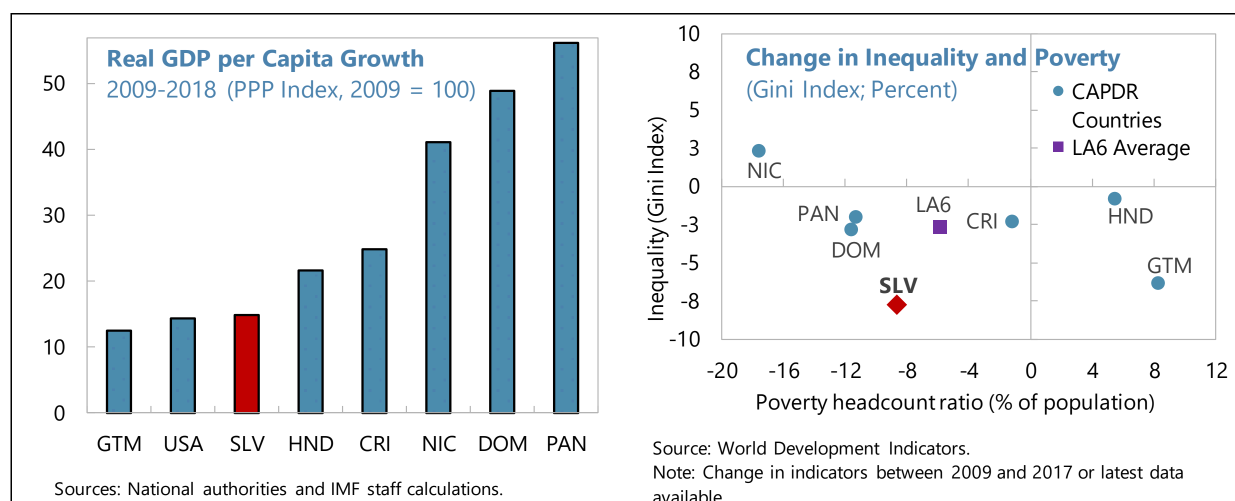
1. Selected Economic Indicators 29
2. Medium-term Baseline Scenario 30
3. Balance of Payments 31
4. External Financing Requirements and Sources 32
5. Operations of the Nonfinancial Public Sector 33
6. Summary Accounts of the Financial System 34
7. Selected Vulnerability Indicators 35
8. Public Sector Financing Requirements and Sources 36
9. Financial Soundness Indicators Heatmap 37

ANNEXES

I. Public Debt Sustainability Analysis 38
II. External Sector Assessment 49
III. Liquidity Management and Emergency Liquidity Assistance 52

ECONOMIC AND SOCIAL CONTEXT

1. **El Salvador made considerable strides in social development during the past decade.** GDP grew by 15 percent over the past decade in real per capita terms (purchasing power parity). Sustained growth allowed for an increase in social spending, leading to a considerable decline in inequality and poverty (text chart and Figure 1). Human and social indicators also improved significantly. Migration to the U.S. declined, especially after 2015. The election in February of President-elect Bukele, who assumes office on June 1, marks a break from the two-party system that has dominated El Salvador politics since the end of the civil war in 1992.



Sources: National authorities and IMF staff calculations.

Source: World Development Indicators.
Note: Change in indicators between 2009 and 2017 or latest data available.

2. **Nevertheless, social challenges persist.** Poverty remains high (30 percent of the population, national definition). The number of new jobs, generated every year, is not sufficient to eradicate poverty and curtail outmigration faster. Gangs continue to operate in the poorest areas and run extortion syndicates.[1] Few firms expand, relegating economic activities to informal markets and depressing potential output. The 2018 Global Competitiveness Report (WEF) identifies corruption as the second most problematic factor for doing business, after crime and theft.

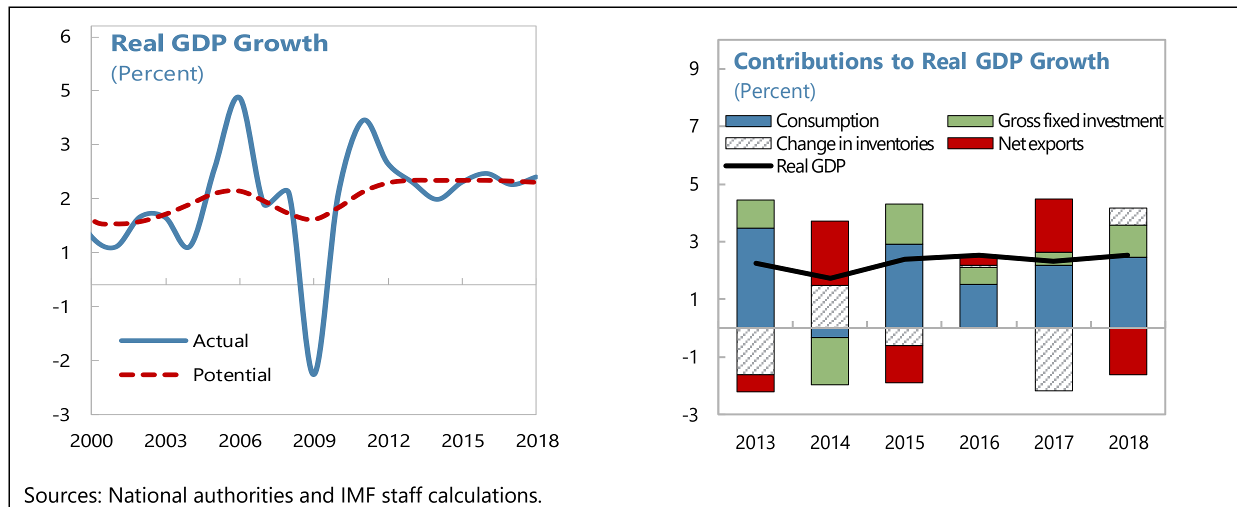
ECONOMIC PERFORMANCE

3. **The economy is performing well.** In the first half of the year, real GDP grew by 2.8 percent (year-on-year) fueled by remittances and an increase in public capital expenditure. In the second half of the year, domestic demand remained strong, but the economy slowed because of stagnant merchandise exports[2] and low agricultural production due to drought. Overall, real GDP growth in 2018 was 2½ percent, ¼ percent above the estimated potential. The solid performance continued

[1] In 2017, ninety percent of SMEs were subject to extortion according to estimates by the National Council of Small Enterprises (CONAPES) and the Chamber of Commerce and Industry.

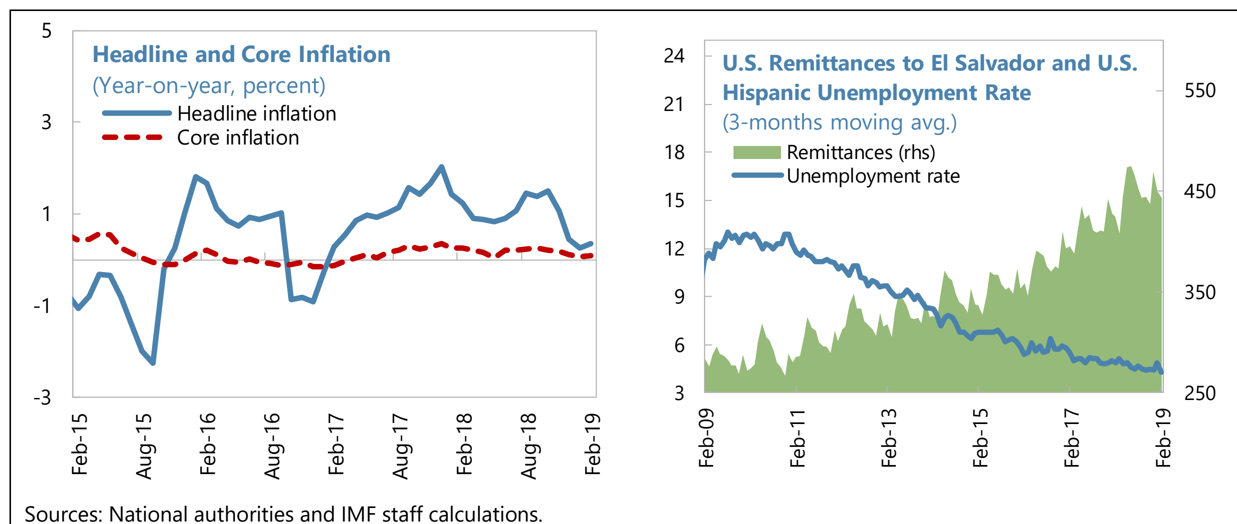
[2] Coffee and sugar prices declined, and there was a temporary interruption in regional trade due to road blockades in Nicaragua.

into 2019, with economic activity growing at 2.7 percent in January (year-on-year), mostly driven by construction and services.



Sources: National authorities and IMF staff calculations.

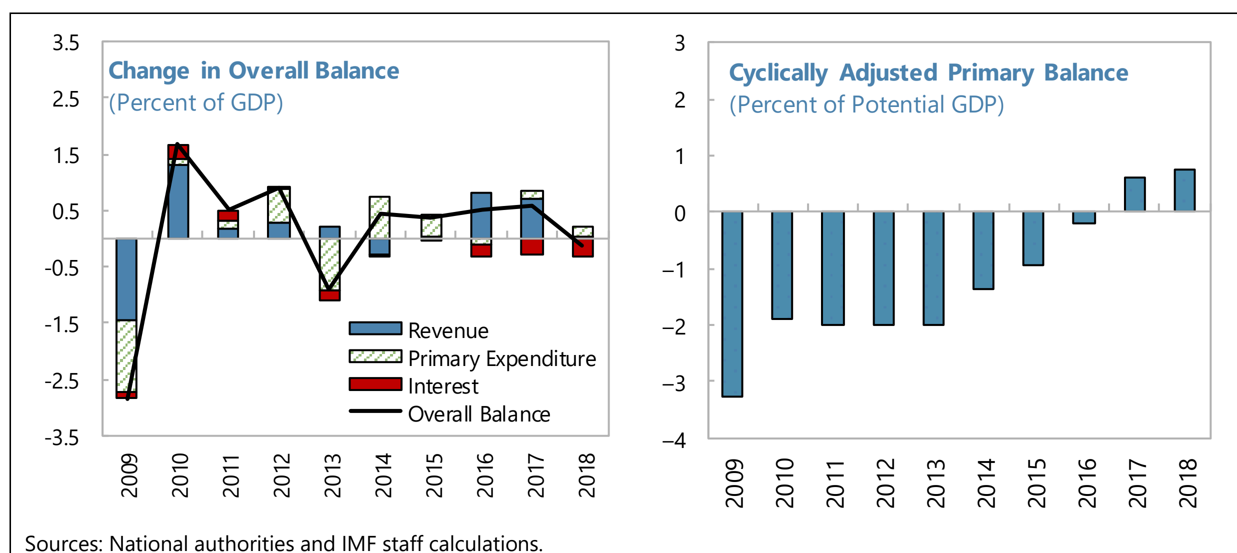
4. Continued U.S. dollar appreciation led to a significant decline in inflation and widening of the current account deficit. Despite solid growth, core inflation remained low, and headline inflation declined to 0.4 percent in February 2019, reflecting the decline in oil prices in late 2018 (see chart). The current account deficit widened to 4.8 percent in 2018, owing to the sharp slowdown in exports and broad-based increase in imports, including oil imports. Remittance inflows reached a record-high level of US$5.4 billion in 2018 (20.7 percent of GDP), and continued to grow in 2019, but at a rate closer to the long-term average of 4 percent.[3]



Sources: National authorities and IMF staff calculations.

[3] Given that outmigration to the U.S. has been on a decline since 2010, the accelerated growth rate of remittances (11 and 8 percent respectively) during 2017-18 was mainly due to the steady improvements in the U.S. labor market (chart) and possibly also to precautionary motives related to the uncertainty surrounding the cancellation of the Temporary Protected Status (TPS).

5. The primary fiscal surplus increased to about 1 percent of GDP in 2018. Tax revenues increased (Table 5), driven by higher import tax revenues[4] and one-off tax measures, including a tax amnesty and a financial transaction tax.[5] Capital expenditure rebounded after political stalemate caused a sharp decline in 2017. The pension reform generated savings of about 0.8 percent of GDP in 2018. Nevertheless, the primary balance was not sufficient to offset the rising interest bill, and the overall deficit deteriorated slightly, to 2.7 percent of GDP. Public debt (including pensions) remained around 70 percent of GDP at end-2018 (Annex I).



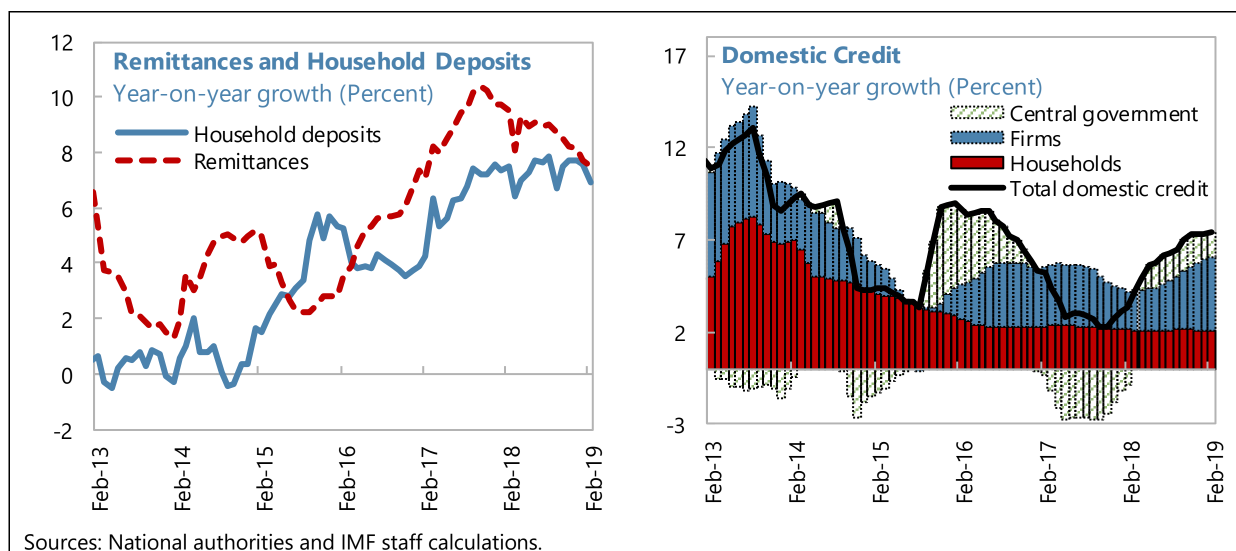
Sources: National authorities and IMF staff calculations.

6. The banking sector remains solid and credit expanded in 2018. Banks reduced their external liabilities as global financial conditions tightened, remained well-capitalized, and used the remittance-fueled surge in deposits to expand credit. Credit to the private sector grew by 6.4 percent,[6] was broad based, and particularly strong to businesses in the manufacturing sector. Although demand for credit has increased, balance sheet risks remained moderate as the deposit-to-loan coverage remained stable at 95 percent, and the cyclical position of credit expansion was within the norm (Table 9). Non-performing loans declined below 2 percent, provisioning increased, and profitability reached a three-year high.

[4] VAT on imports increased by 0.4 percent of GDP in 2018, and it explains about 50 percent of the 2018 increase in tax revenue.

[5] As the Supreme Court declared unconstitutional, the financial transaction tax is not part of the 2019 budget.

[6] Nominal GDP grew by 4.5 percent.



Sources: National authorities and IMF staff calculations.

7. The external position in 2018 is assessed to be moderately weaker than the level implied by fundamentals and desirable policies, with a real exchange rate overvaluation of 4-6 percent (Annex II). In 2018 the real exchange rate appreciated by 3 percent. Gross international reserves increased by US$2 million, remaining at about US$3.6 billion. While reserves provide sufficient coverage for imports and short-term debt, they remain below the adequate level implied by the risk-weighted Assessing the Reserve Adequacy (ARA) metric and need to be increased.[7]

OUTLOOK AND RISKS

8. The baseline GDP growth projections are closely aligned with the outlook for the U.S. economy and assume no major changes in domestic policies:

- In 2019 staff expect real GDP growth to remain above potential, at 2½ percent, oil prices to decline and inflation to remain low. A continued elevated level of remittance inflows is expected to compensate for a high trade balance deficit. Remittance-fueled deposits would continue to support credit expansion in line with the robust economic activity.

- In 2020-24, staff expects growth to slow down along with the U.S. economy through lower external demand and converge to its estimated potential of 2.2 percent. Inflation will remain anchored at around 1 percent as oil prices soften. An expected decline in remittances growth to its long-run trend rate will lead to a mild widening of the current account, despite contributing to lower import growth, as exports growth also declines.

[7] Reserves are needed to respond to unexpected demand for liquidity in the banking system and to serve as a buffer for government financing, and not for stabilizing the exchange rate, since El Salvador is a fully dollarized economy. See Annex II for staff and authorities' calculations for ARA metrics for dollarized economies.

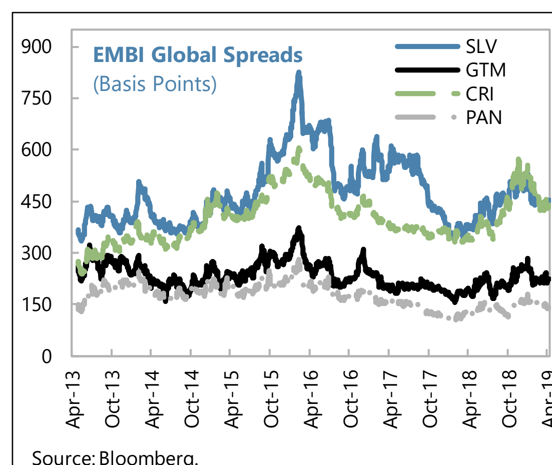
9. Risks are tilted to the downside (Risk Assessment Matrix). Global downside risks stem from weaker-than-expected global growth and rising protectionism,[8] which would moderate remittances[9] and trade flows. There are also downside domestic risks: (i) policy slippages, including on the needed fiscal adjustment, if spending measures are adopted without identifying appropriate funding resources, and (ii) lower growth if the new administration fails to secure the required legislative support to implement its agenda. On the upside, global financial conditions may tighten less than expected.

Authorities' Views

10. The authorities agreed with staff's economic and fiscal outlook. They noted the good performance of the economy in 2018, and the high level of public and foreign direct investment, which has continued into 2019. The authorities agreed that debt would continue to drift upward in the absence of measures, and that weaker-than-expected global growth could have a negative impact on the domestic economy. The authorities emphasized their commitment to guarantee a smooth political transition by sharing information with the new administration and by inviting the Audit Office to oversee the handover process.

FRONTLOAD THE FISCAL ADJUSTMENT

11. The Legislative Assembly approved several important fiscal laws in December 2018. The Fiscal Responsibility Law (FRL) was strengthened by requiring debt to be put firmly on a declining path and by introducing an anchor for the public debt (including pension liabilities) of 60 percent of GDP by 2030. For the first time in three years, the budget and its financing were passed on time, and with a significantly lower overall deficit compared to the initial proposal (by about 0.4 percent of GDP). Furthermore, the Assembly authorized external financing for US$1.3 billion (about 5 percent of GDP) mostly to cover the US$800 million Eurobond payment due in December. The law financing the implementation of the electronic invoicing was also approved; it is expected to improve tax compliance and the ease of doing business.



Source: Bloomberg.

[8] While the fiscal impact of a cut in U.S. aid would be limited, it may have a perverse impact on migration as the loss of grants and technical assistance would slow trade facilitation and fight against crime and corruption.

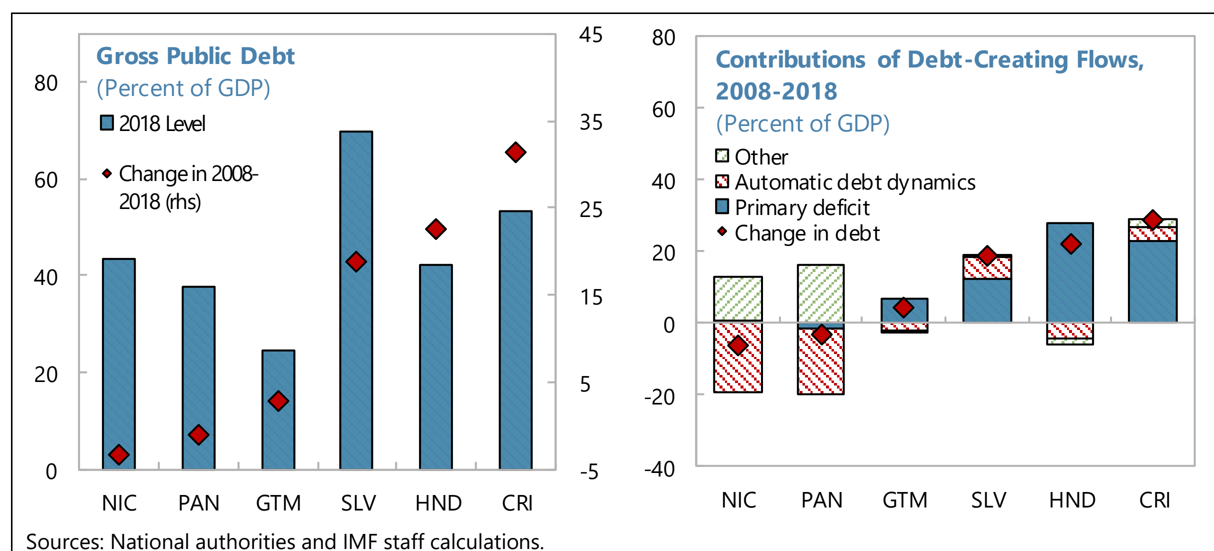
[9] There are currently 1.4 million Salvadoran migrants in the U.S., of which only 14 percent (195,000) have temporary protected status, extended until January 2020. Assuming 25 percent of TPS holders are deported, remittances would decline by US$225 million (4 percent of total inflows).

12. The political cooperation to secure the agreements on fiscal laws and financing were well received by the credit rating agencies. Standard & Poor's upgraded the rating of El Salvador's sovereign debt to B- in December 2018. The EMBI Global spread declined and is in line with regional peers.

Agency Ratings and Outlook of El Salvador's Sovereign Debt

	S&P		Moody's		Fitch	
	Rating	Outlook	Rating	Outlook	Rating	Outlook
April 20, 2017	Selective Default	n/a	Caa1	Stable	Restricted Default/CCC foreign	n/a
February 21, 2019	B-	Stable	B3	Stable	B-	Stable

13. Steadfast implementation of the FRL is necessary, as public debt would drift upwards under unchanged policies. The fiscal balance is expected to deteriorate in the near-term mainly due to the loss in the temporary revenues and the rising interest bill. Debt dynamics continue to be unfavorable, as borrowing rates remain higher than the GDP growth rate (text chart and Annex I),[10] and medium-term financing needs remain sizeable. Fiscal buffers are needed to insure against macroeconomic and natural disasters shocks,[11] and to ensure compliance with the FRL.



Sources: National authorities and IMF staff calculations.

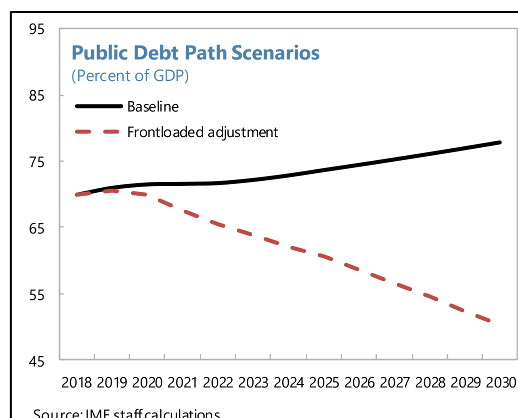
14. A fiscal adjustment of about 2 percent of GDP over 2019-21 is needed to comply with the FRL. The FRL requires a primary fiscal adjustment of 3 percent of GDP over 2017-21 and that public debt (including pensions) reaches 60 percent of GDP by 2030. As the primary fiscal balance has already improved by 1.1 percent of GDP over 2017-18, a further adjustment of 1.9 percent of GDP by 2021 is needed to comply with the FRL primary balance operational target. However, the pace of the adjustment is crucial to achieve the debt target. If the adjustment is not frontloaded,

[10] Despite a real growth rate around 2.4 percent over the past four years, and an improvement in the primary fiscal balance of about 2 percent of GDP, public debt increased by 4 percent of GDP during the same period.

[11] These shocks could increase public debt by about 8 and 20 percent of GDP, respectively.

the 60 percent target may not be achievable by 2030 without significant further consolidation, which may be more difficult to undertake under weaker cyclical conditions.

15. Frontloading the adjustment to 2019-20 would put debt firmly on a declining path and ensure compliance with the FRL. Implementing fiscal consolidation measures of 1.9 percent of GDP (implying primary balance improvement of 1.1 percent of GDP; see text table) during 2019-20 is feasible. It will enhance policy credibility and engender a further significant improvement in the public debt dynamics, as debt would decline to 50 percent of GDP by 2030, a level considered safe for El Salvador.[12] Implementing this adjustment would not stall the growth momentum, as fiscal multipliers—the impact on growth of the fiscal measures—tend to be lower during periods of economic expansion (Box 1).



Fiscal Indicators in an Adjustment Scenario (percent of GDP) 1/										
	2016	2017	2018	2019	2020	2021	2022	2023	2024	2030
GDP growth (percent)	2.6	2.3	2.5	2.1	1.4	2.4	2.4	2.4	2.3	2.3
Revenue	21.8	22.5	22.6	22.1	23.1	23.0	23.1	23.1	23.1	23.1
Expenditure	24.9	25.1	25.2	24.9	24.7	23.7	23.9	24.0	24.0	24.1
Primary balance 2/	-0.2	0.7	0.9	1.2	2.0	2.8	2.9	3.0	3.0	3.0
Overall balance	-3.1	-2.5	-2.7	-2.9	-1.6	-0.7	-0.8	-0.9	-0.9	-1.0
Public debt	68.5	70.0	69.8	70.6	69.8	67.6	65.5	63.8	62.0	50.2
Memorandum items										
Primary balance baseline	-0.2	0.7	0.9	0.7	0.4	1.2	1.3	1.3	1.3	1.3

Source: Fund staff estimates.

1/ Consolidation measures of 0.6 percent of GDP in 2019 and 1.3 percent of GDP in 2020

2/ Fiscal consolidation measures of 1.9 percent of GDP over 2019-20 will result in a primary balance improvement of only 1.1 percent of GDP, owed to a temporary deterioration of the baseline primary balance (0.5 percent of GDP) and the impact of fiscal measures on GDP growth (0.3 percent of GDP). However, the baseline primary balance will improve by 0.8 percent of GDP in 2021, as pension payments are expected to decline.

[12] A safe debt level for El Salvador is considered to be 50 percent of GDP (In IMF Country Report 15/13 staff applied four different methods and took into account dollarization). The frontloaded adjustment ensures compliance with this debt target, and recommendations for emerging markets (Annex I).

Box 1. Timing and Composition of the Fiscal Adjustment

- **The strong economic performance is an opportunity to further improve the fiscal position.** Estimated fiscal multipliers are 50 percent smaller in expansions than in downturns, as credit-constrained agents cannot borrow to smooth their consumption during recessions.[1] In emerging economies, fiscal multipliers tend to be larger during recessions, given the high level of informality, the procyclicality of fiscal policy, and the lack of extensive automatic stabilizers (World Bank Semiannual Report, April 2017). In addition, high levels of remittance inflows, associated with expansionary periods, also help smooth consumption and contain the negative impact of fiscal consolidation on growth.

- **A frontloaded adjustment increases credibility.** Well-designed fiscal consolidations trigger a surge in confidence, cushioning the public sector contraction through a private sector expansion. In countries with elevated public debt, such as El Salvador, confidence effects could ensue relatively quickly and have large effects (REO April 2018), given the known need for adjustment and credible measures.

- **The composition of the adjustment matters:**

  - **Current spending cuts are recommended over public investment cuts.** Current spending multipliers tend to be lower than the ones for capital spending.[2] Well-designed reforms to curb the public wage bill have the most long-lasting effects and tend to have a lower drag on growth, while across-the-board cut measures, usually implemented during periods of duress, should be avoided (IMF Fiscal Monitor, April 2014). The Central Bank of El Salvador (2019) also notes that a fiscal adjustment is preferable during the expansionary phase of the business cycle, but through progressive taxation.

  - **A small VAT increase and excise taxes are easier to implement technically and have a limited impact on growth.** These measures would generate sustainable revenues.[3] Moreover, the multiplier effect of these measures is expected to be small as the current tax rate in El Salvador is low (Gunter et al, 2018). An increase in the VAT rate, as opposed to direct taxes, would not harm competitiveness as El Salvador's VAT rate remains lower than those of regional peers and competitors.

- **Increases in tax rates should be accompanied by better compliance and stricter enforcement.** The planned implementation of electronic invoicing will simplify tax payments, improve efficiency and reduce opportunities for corruption and evasion. Empirical evidence suggests that tax policy reforms in tandem with revenue administration measures yield larger gains (Akitoby, 2018).

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[1] See Battini et al. (2014) for details.

[2] The IMF WHD REO (April 2018) finds that, in LAC, the two-year multiplier for public investment is 1.5 while the overall public expenditure multiplier is only 0.5. For El Salvador, multipliers are 0.1 for current spending and 0.4 for capital spending at the impact, and 0.7 cumulatively (Estevão and Samake, 2013).

[3] VAT and excise taxes are preferred over alternative indirect taxes because: (i) the VAT is more broad-based and helps improve tax compliance; and (ii) the excise taxes can quickly raise revenue without major changes to the tax system (Akitoby, 2018).

16. Implementing fiscal consolidation measures of 1.9 percent of GDP in 2019-20 should be a policy priority. On the revenue side, staff strongly support the steadfast adoption of the electronic invoicing, the technical preparations for a simplified tax code for small businesses ("*monotributo*"), and the transfer pricing initiative. However, these tax administration measures are not sufficient to ensure compliance with the FRL, as their full yield will take time to materialize. Therefore, additional structural revenue measures are needed. Staff recommend introducing excise taxes on luxury goods and a small increase in the VAT rate[13] from 13 to 14.5 percent (see text table). On the expenditure side, efficiency gains could be achieved by rationalizing current expenditure. Staff recommend containing the wage bill (through hiring freezes and by facilitating the retirement of some public employees) and approving and implementing the civil service reform as quickly as possible. Additional measures comprise centralizing the procurement system and extending competitive bidding processes, such as the reverse auction mechanism ("*subasta inversa*"), to the full set of public entities, and goods and services.

Measures	2019	2020
Electronic invoicing		0.3
Tax administration measures (*monotributo* , customs)		0.1
Excise tax on luxury goods		0.2
VAT increase to 14.5 percent/other direct tax increases		0.8
Goods and services	0.2	0.2
Wage bill	0.2	
Other savings (elections, lower energy subsidies, etc.)	0.2	
Social support to offset VAT regressive effects		-0.3
Total Measures	0.6	1.3

17. Staff recommend improving the efficiency and quality of subsidies and social spending. Social assistance and subsidies to the top two quintiles of the income distribution represent about 0.7 percent of GDP. They could be eliminated and partly redirected to the poor. It is crucial to strengthen efforts in monitoring and evaluation of programs, investing in information systems to better target beneficiaries, and integrating social assistance programs under a common strategy. The government's decision to adopt results-based budgeting is a step in the right direction.

18. Staff recommend finding comprehensive and long-lasting solutions in the medium-term to address fiscal challenges. A comprehensive fiscal reform is needed to eliminate distortions arising from temporary and ad hoc measures accumulated over the years and to expand the narrow tax base. Moreover, any public sector initiative should identify funding sources to avoid worsening public debt dynamics and preserve fiscal sustainability:

- A property tax—a key progressive taxation measure—could help fund transfers to municipalities. Moreover, a clear delineation of responsibilities between the central and local governments, coupled with enhanced accountability framework for local governments, is also needed to provide public goods efficiently.

[13] Targeted fiscal transfers could be put in place to soften the regressive impact of the VAT increase on the most vulnerable in society.

- Any reform proposal to address the fairness and equity of the pension system should be budget neutral and fiscally sustainable in the long term. To this end, staff recommend improving benefits coverage for the poor, funded with an increase of the retirement age, and a reduction of pension fund fees.

19. Supporting financial market development and strengthening public debt management could help contain financing costs. Developing a well-functioning secondary market for LETES should complement the fiscal consolidation strategy. This would make public debt instruments more liquid, help extend current maturities, further deepen the domestic financial markets and lower domestic borrowing costs. Moreover, strengthening public debt management, including by developing a medium-term debt strategy framework, would help improve the profile of public debt, and ultimately lower borrowing costs.

20. Further strengthening of the FRL should be considered. The FRL could be improved further by incorporating a permanent operational target. The multiplicity of targets in the FRL (on tax revenues and expenditures) weakens the disciplining role of the main debt anchor. Moving the other targets to the medium-term fiscal framework appendix should help reduce the risk of conflicting fiscal policy objectives. An independent fiscal council could also be established given the poor track-record of compliance with the previous FRL.

Authorities' Views

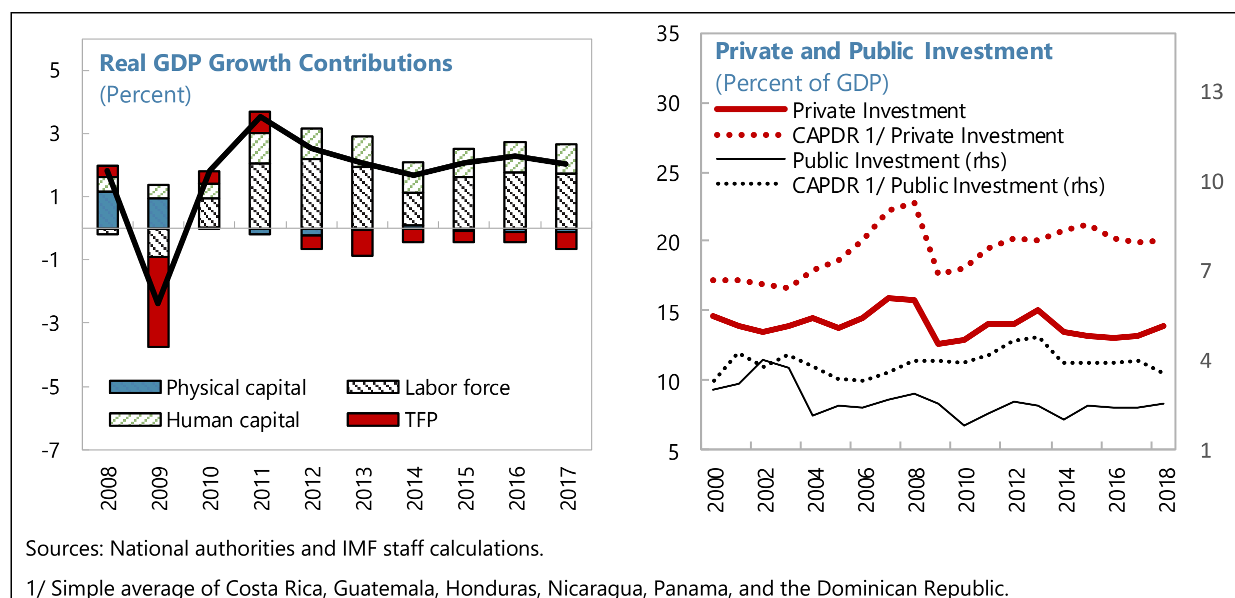
21. The authorities agreed with the size of the recommended adjustment. The authorities highlighted that several measures proposed by staff, both on the revenue and the spending side, are being prepared by the government. The authorities underscored progress in the technical preparation of several tax administration reforms, including electronic invoicing, the "*monotributo*", as well as the initiative to combat base erosion and profit shifting ("*precios de transferencia*"). They recognized that these measures are not sufficient and would take time to yield higher revenue and agreed with staff on the need to adopt additional structural revenue measures, such as excise taxes on luxury goods. They believe that public procurement could be improved by extending competitive bidding processes ("*subasta inversa*") to all public entities, and the wage bill could be curbed by facilitating the voluntary retirement of public employees.

22. The authorities underscored the need for a comprehensive fiscal reform over the medium term. The authorities thought that comprehensive fiscal reform is needed to eliminate distortions arising from temporary and ad hoc measures accumulated over the years. Harmonizing and simplifying the tax code could improve fairness, equity, competition and growth. They also agreed that any public sector reform, including the pension reform proposals and higher transfers to local governments, should identify funding sources to avoid worsening public debt dynamics and ensure fiscal sustainability.

RAISE LONG-TERM GROWTH

23. Raising potential output would alleviate poverty and contribute to a faster decline in debt. The contributions of physical capital and TFP to output growth were lackluster in recent years, and El Salvador lags behind most regional peers in private investment rates and human capital (chart). About 45,000 additional jobs are needed annually to absorb new entrants to the labor market.[14] Provisioning for public infrastructure and education, reducing crime and informality, improving the regulatory and governance frameworks, and increasing lending to businesses and fostering financial inclusion (see Financial Sector section) will boost private investment and help increase jobs.

24. Increasing the provision of public infrastructure could serve as a catalyst for private investment growth. The government should continue its efforts to improve transportation infrastructure and enhance the logistics platform (expansion of the airport and port concessions), particularly those financed through grants such as FOMILENIO. Public-private partnerships (PPP) could be explored to limit the fiscal impact of improvements in infrastructure. The PPP framework should be strengthened by improving fiscal accounting, ensuring proper oversight, and clearly delineating responsibilities and accountability of each partner. Improvements in the planning and execution of public investment projects would help raise their impact on output growth.



Sources: National authorities and IMF staff calculations.

1/ Simple average of Costa Rica, Guatemala, Honduras, Nicaragua, Panama, and the Dominican Republic.

25. Continuing to combat crime could have positive effects on investment and further reduce outward migration. The rehabilitation and prevention efforts of *El Salvador Seguro* plan have contributed to substantially lower the homicide rate (see Box 2 for details), thus starting to

[14] In 2017 of the 70,000 Salvadorans who entered the working-age population, only 25,000 managed to obtain employment, most of them in the informal sector, according to the household survey (EHPM).

improve the business climate and the country's competitiveness. Ensuring its continuity and increased funding is important. Strengthening police presence at the local level and improving its deployment, based on a systematic analysis of crime trends, would deter criminal activity, including extortions. Expanding technological surveillance programs beyond the capital[15] and continuing to foster community involvement would also be effective deterrents. Better coordination between the police, financial intelligence unit, and the investigators in the General Attorney's office would address extortions more effectively.

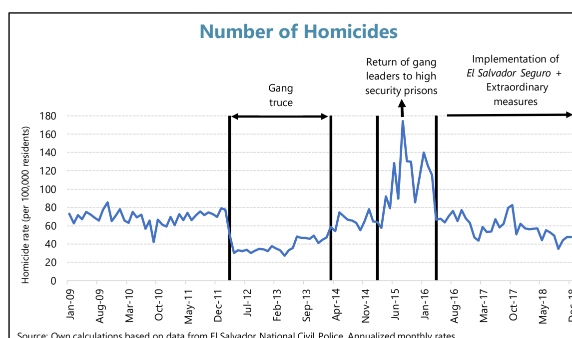
Box 2. The Fight Against Crime in El Salvador and Lessons from International Experience

The government and the public opinion attribute the violence to gangs. The government's fight against gangs in El Salvador went through several stages.

- ***'Mano Dura' and 'Super Mano Dura':*** Up to 2011 the fight against gangs had a repressive nature and did not lead to a reduction in violence.

- **The gang truce (2012-13):** In 2012, the government negotiated a truce with the leaders of the two largest gangs, '*MS-13*' and '*Barrio 18*'. While the truce was effective in drastically reducing the number of homicides, it did not prove to be a long-run solution.

- ***El Salvador Seguro* (2014-present):** The plan combines repressive actions, such as the extraordinary measures introduced in 2016, with strong prevention and rehabilitation efforts to address the root causes of violence. It had very positive results in terms of reduction of the homicide rate.



Source: Own calculations based on data from El Salvador National Civil Police. Annualized monthly rates.

Successful strategies from international experience could be adopted in El Salvador to eradicate gang violence. Efforts to incorporate prevention as in Honduras and Jamaica, could be combined with a data-driven approach to fight crime, like in Colombia, which adopted a data-driven epidemiological analysis to fight crime in several cities. A mapping of crimes, through the compilation of detailed homicide statistics, combined with training of police officers and recovery of urban spaces, allowed Cali, Medellin and Bogota to reduce substantially their crime rates.

26. Investing in education will contribute to higher human capital accumulation and increase competitiveness. The early childhood education coverage in El Salvador is low, high school dropout rates are high, and the workforce lacks the skills demanded by businesses. Increasing investments in early childhood education would enable higher female participation in the labor force; it could be partially supported with grants and community involvement. The support and further development of flexible education and vocational training programs would facilitate the reinsertion of dropouts to the education system and prepare youth for the labor market. These initiatives should be focused at the secondary level to provide alternatives to crime and gang

[15] The "Smart City" project is expected to be implemented in San Salvador in 2019.

involvement.[16] The authorities and experts expect that the 2017 amendment to the family code to ban child marriage and the development of a national policy to prevent teenage pregnancy will help reduce the gender gap in education attainment.

27. A concrete plan to reduce informality and the gender gap in labor force participation would also help raise potential output. Reducing the high degree of informality requires stronger tax enforcement efforts and incentivizing firms to formalize, through simplified taxes and regulations (see Governance and Fiscal sections) and enhanced access to affordable credit. As part of the plan to recover San Salvador's downtown, two large markets will be created in the upcoming years to give street vendors (mostly women) a safe and clean space to operate in. While the gender gap in the labor force participation rate, at 30 percent, is lower than in neighboring countries,[17] it is expected to be reduced further by leveraging the efforts of the recently introduced National Gender Equality Plan and the Gender Seal certification program.[18]

28. Removing barriers to trade and investment and facilitating diversification will also boost long-term growth. The regulatory improvements brought by the customs union, and better infrastructure at border crossing points, significantly reduced the costs and time in processing exports. To further enhance efficiency, staff recommend minimizing the processing time of acquiring construction permits, completing the adoption of the electronic signature, and simplifying the issuance of tax identification numbers. Staff recommend continuing the implementation of the development, diversification and productive transformation policy[19] as, in recent years, it may have supported increases in labor productivity growth and labor reallocation out of the low-productivity agricultural sector into other sectors such as manufacturing (see chart).[20]

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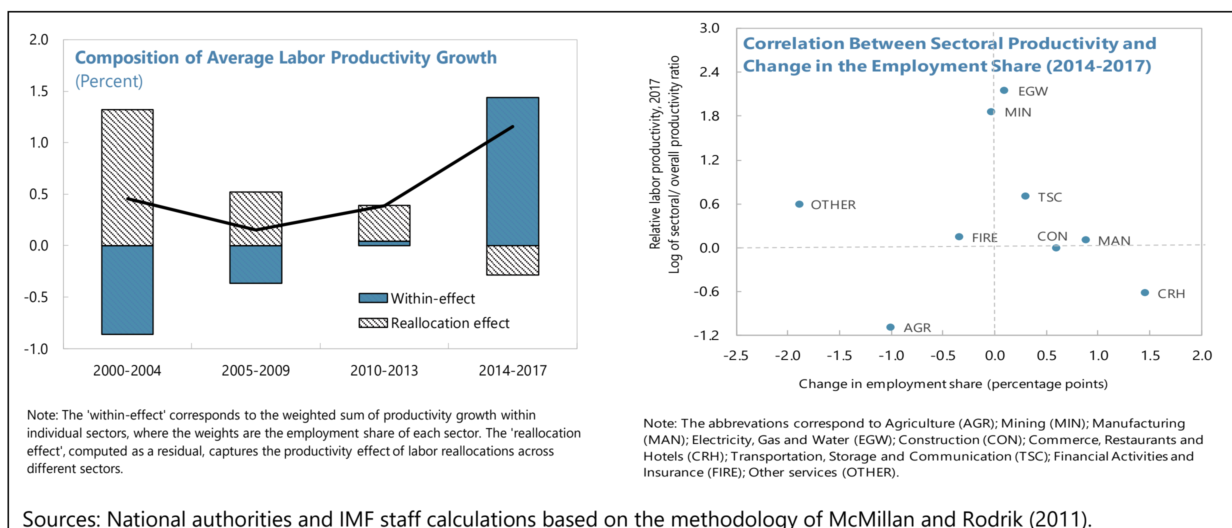
[16] Youth in grades seven to nine are most prone to drop out, and vulnerable to gang recruitment or pregnancies.

[17] Honduras, Guatemala, Nicaragua, and Costa Rica.

[18] Over 60 units in charge of gender issues have been created in the public sector to institutionalize gender mainstreaming. The second program is implemented with support from UNDP.

[19] The policy, in place since 2014, supports the development of strategic sectors by (i) creating technological centers to help firms move up the product quality ladder; (ii) facilitating financing through the provision of seed capital to entrepreneurs; and (iii) supporting the accumulation of human capital through alliances between the businesses and the Salvadoran Vocational Training Institute.

[20] Between 2014 and 2017, the employment share in agriculture declined by 1 percentage point, while it increased by 0.9 and 0.3 percentage points in manufacturing and communication services, respectively.



Note: The 'within-effect' corresponds to the weighted sum of productivity growth within individual sectors, where the weights are the employment share of each sector. The 'reallocation effect', computed as a residual, captures the productivity effect of labor reallocations across different sectors.

Note: The abbreviations correspond to Agriculture (AGR); Mining (MIN); Manufacturing (MAN); Electricity, Gas and Water (EGW); Construction (CON); Commerce, Restaurants and Hotels (CRH); Transportation, Storage and Communication (TSC); Financial Activities and Insurance (FIRE); Other services (OTHER).

Sources: National authorities and IMF staff calculations based on the methodology of McMillan and Rodrik (2011).

Authorities' Views

29. The authorities are committed to boost inclusive growth through structural reforms. They highlighted the government's achievements in reducing poverty, inequality and outmigration. They stressed the success of the government's agenda to promote growth, based on cutting red tape, the implementation of the productive transformation strategy, and efforts to increase financial inclusion. Additional actions are also being taken, including expediting the process to obtain the tax ID, improving the platform to register a new enterprise and obtain the construction permits. Moreover, they believe that the completion of the Northern Triangle customs union with Honduras and Guatemala is a key step to increase intra-regional trade and investment, thereby boosting growth. On security, the authorities stressed the success of *El Salvador Seguro Plan* in reducing the homicide rate and acknowledged that further actions should be taken to combat extortion, including by expanding technological surveillance and police presence in the country, and by improving coordination between the police and the officials of the Extorsion Unit.

ENHANCE FINANCIAL SECTOR STABILITY

30. Maintaining financial stability is important to support long-term growth. Key elements include: (i) continuing efforts to appropriately fund the emergency lending assistance framework, (ii) approving the bank resolution legislation in line with best practices, (iii) continuing to strengthen supervision practices, and (iv) promoting greater financial inclusion.

- **Emergency Liquidity Assistance (ELA).** Central Bank is working towards bolstering its ELA resources (Annex III), to provide liquidity, in response to a large idiosyncratic shock impacting one or more institutions, to ensure financial stability.[21] Staff recommend ensuring that the reactivated interbank market functions smoothly to increase banks' efficiency in managing

[21] ELA resources consist of: net international reserves in excess of liquid liabilities, government deposits, and a contingent credit line from the Central American Bank for Economic Integration; see also Annex III.

liquidity, and that banks use first the money markets and access their own reserves, to decrease the need for emergency liquidity, and alleviate any burden on the public sector. Staff also recommend that any funding agreements reached for boosting ELA resources (reviving an expired Inter-American Development Bank credit line or acquiring new bilateral lines)[22] should have terms and conditions that are well aligned with the function that they proposed to serve, particularly on BCR access.[23]

- **Crisis management and resolution.** The draft law on the banking resolution framework has been benefitting from the Fund's technical assistance and is currently going through negotiations between the Central Bank and the Superintendency. To complete the process, regulators need to agree on (i) additional regulatory requirements for systemically important financial entities and (ii) the legal framework for recovery process.

- **Supervision and regulation.** The Central Bank and Superintendency are advancing efforts to align their regulations to Basel III standards, including by modifying the existing normative acts for liquidity, market, and credit risk management. Moreover, several measures need to be taken to enhance the current risk-based supervision by ensuring: (i) adequate access to credit information for all credit bureaus and (ii) that measures supporting credit growth in certain sectors fully comply with the risk-based supervision to avoid regulatory forbearance.[24] Staff also welcome authorities' plans to align reserve requirements for cooperative banks with other commercial banks.

- **Financial inclusion.** Better intermediation of remittances through the financial sector is needed to support long-term economic growth.[25] Staff welcome the authorities' efforts to increase financial inclusion and encourage further actions on this front, including by promoting the use of simplified bank accounts for lower risk customers and facilitating wider access for fintech services (see Box 3).

Authorities' Views

31. The authorities concurred with staff's recommendations for enhancing financial sector stability. They agreed with the need to accelerate the approval of the bank resolution law, and they remain committed to further strengthen cross-border cooperation and appropriately fund the emergency lending assistance framework. They highlighted recent accomplishments in increasing banks' efficiency in liquidity management, including the reactivation of the interbank market, cross-

[22] BCR is negotiating with China various lending opportunities, including a contingent credit line for ELA.

[23] Conditions for banks accessing ELA are spelled in Annex III and are broadly in line with best practices.

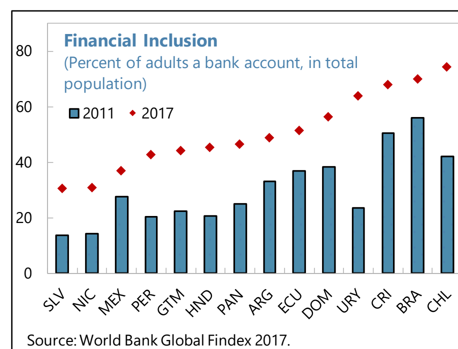
[24] Banks are allowed to hold less reserves than mandated by reserve requirements, by 10 percent of the credit extended to some sectors of the economy. This requirement is unrelated to return considerations or liquidity risks, which may compromise the effectiveness of the liquidity management measures.

[25] Only 25 percent of remittances flowed through the banking system in 2018 and remained in deposits. Authorities should take more steps to alleviate regulatory obstacles and attract more remittances to banks for better intermediation (Box 3).

border cooperation, and supervision. The Superintendence highlighted progress in supervision and monitoring of financial flows, which are critical as the authorities prepare to rejoin the Egmont Group, a group of Financial Intelligence Units, supporting international efforts to combat money laundering.

Box 3. Financial Inclusion in El Salvador

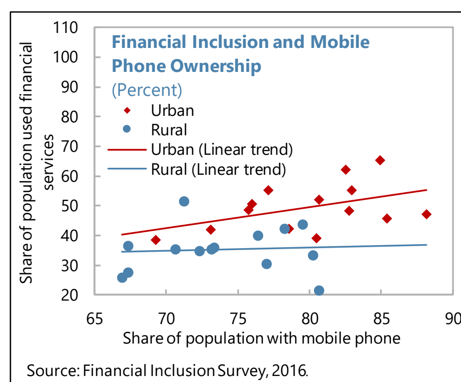
El Salvador has made progress in financial inclusion, although levels remain low relative to the region. Bank account ownership has doubled from 14 percent in 2011 to 30 percent in 2017, driven by increases in rural accounts and female-owned accounts. An obstacle for wider bank ownership is the tax ID requirement for individuals, which takes long time to obtain, as there are only five offices nationwide. Within the country, financial inclusion is uneven across regions, with lower financial inclusion in the remote regions.



Source: World Bank Global Findex 2017.

Authorities are intensifying efforts to further advance financial inclusion. Presidential executive order in July 2018 established National Council for Financial Inclusion (CNIF), the inter-agency support group for financial inclusion and financial education program of El Salvador. Simplified bank accounts, for limited balances and transactions, was introduced in 2015. They do not require a tax ID; 400 of these accounts were opened since the end of 2018.

Financial inclusion could benefit from wider access of Fintech services. Mobile Money (MOMO) is expected to join the mobile money market in El Salvador. Considering that access to mobile services in El Salvador is one of the highest in the region—157 mobile accounts per 100 people—significant gains in financial inclusion could be achieved with the help of mobile/e-money. As opposed to the traditional bank accounts, which display gender disparity (24 percent women have a bank account versus 38 percent of men), there is no gender difference in mobile money use.



Source: Financial Inclusion Survey, 2016.

The microfinance sector is diverse and competitive, but capacity is an issue. There is high demand for microcredits; up to 40 percent of small and microenterprises continue to have limited access to credit. Existing regulations and information asymmetry prevent banks' expansion of microfinance services. The Association for small enterprises (CONAMYPE) works with banks and entrepreneurs to help them obtain credit and by providing seed capital.

STRENGTHEN THE GOVERNANCE FRAMEWORKS

32. The current administration has adopted several measures to improve the governance frameworks. The Attorney General has significantly strengthened investigation and prosecution activities to curb the illicit use of public funds at the highest level. To support the anti-money laundering/countering financing of terrorism (AML/CFT) efforts, the Superintendency of the Financial System has put in place a system for high-frequency monitoring of financial flows. The independence and autonomy of the Financial Investigation Unit has been legally ensured to restore the exchange of information with a worldwide network of financial investigative agencies, and to

enhance the governance and anti-corruption framework. In addition, a plan has been developed and implemented by the Presidency to increase citizen participation in the design, implementation, and monitoring of public policies at the national and local level, and to receive direct corruption complaints.

33. Nevertheless, the governance framework should be strengthened further. There are two major governance framework weaknesses and corruption vulnerabilities that are macro-critical:

- *Fiscal governance:* The main weaknesses relate to revenue outcomes, due to the high informality and low compliance (see Fiscal and Raising Long-Term growth sections). On fiscal transparency, there is room to improve accountability and spending controls. In particular, under the current regulation, the office of the presidency is entitled every year to a special fund, with no clear accountability requirements, thus giving rise to the risk for mismanagement or even illicit use of public funds.[26]

- *Regulatory framework:* The ease of doing business has improved in recent years but, according to the World Bank's 2019 Doing Business Report, setting up a new firm and dealing with construction permits still require long and costly procedures (rank 147 and 173 out of 190, respectively).

34. Staff recommend prioritizing the governance goals. Overhauling the entire governance framework takes time and resources. Therefore, staff recommend to strategically prioritize the following actions that could deliver high-yielding and rapid results, while reducing corruption vulnerabilities.

- *Fiscal governance:* Building on the 2019 budget, which delineated the purpose of the presidency's account, the budget law for 2020 should clearly ensure transparency and accountability by establishing proper auditing, and spending controls, especially for the account of the office of the presidency, according to international best practices.

- *Regulatory framework:* Promptly implement electronic invoicing to make it easier to conduct business activities and improve tax collection.

35. Staff also recommend additional actions to fully address the weaknesses in the governance and anti-corruption framework. Changes to the anti-corruption legal framework should be comprehensive, ensuring harmonization of laws and considering their ultimate impact on the budget. The Audit Office should be strengthened by: (i) ensuring its supervisory power over the presidential funds; (ii) increasing its independence; and (iii) providing it with enough resources to conduct audits, including at the local government level, along with the Attorney General.

[26] The General Attorney's office initiated and advanced cases against two former presidents in 2017-18. Mr. Antonio Saca (ARENA) was convicted of diversion and laundering of US$300 million of public funds. Mr. Mauricio Funes (FMLN, 2019-14), has been accused of embezzling US$351 million, and his extradition from Nicaragua has been approved.

Additional Actions on Governance and Corruption

Weakness	Recommendations
Fiscal transparency	- Explicitly prohibit transactions or funds off-budget; - Introduce digitalized processes to limit discretionary administrative decisions; - Implement a single tax account system; - Use effectively the formal internal assurance mechanisms; - Regularly monitor public confidence in the tax administration; - Strengthen appraisal, procurement, implementation and monitoring of projects.
Financial integrity	- Further strengthen the AML/CFT framework in preparation for the next round of assessment under the CFATF, in 2021.
Governance and regulatory framework	- Continue the efforts to simplify regulation and to strengthen legal institutions, particularly those in charge of enforcement; - Enhance the overall anticorruption framework in line with the United Nations Convention Against Corruption (UNCAC); - Strengthen the capabilities and overall effectiveness of the Anti-Corruption Unit and the Ethics Tribunal; - Improve the coordination of all the agencies fighting corruption.

Authorities' Views

36. The authorities are intensifying efforts to strengthen the governance framework. The fight against corruption continues to be a top priority. Some officials acknowledged that the Law on Access to Public Information had not succeeded in significantly improving public perception of corruption in the country, despite the improvements in transparency and the recent actions to fight corruption. The authorities believe that public trust could be regained by ensuring the accountability and supervision of the use of public funds. Moreover, they stressed the need for further reforms to ensure a comprehensive audit of public accounts, such as (i) harmonizing the existing legal framework; (ii) strengthening the Audit Office by expanding its supervisory role to all public institutions; and (iii) modernizing the audit processes through extensive adoption of technology.

STATISTICS

37. National Accounts are adequate and governance statistics should be strengthened. The National Accounts were updated and published in early 2018. Revisions and improvements with the help of CAPTAC-DR technical assistance led to publishing updated statistics on March 29, 2019. El Salvador would benefit from strengthening governance indicators and from the development of unified and consistent crime statistics.

STAFF APPRAISAL

38. El Salvador's economy continues to perform well. The economy grew above its estimated potential in 2018, fueled by strong domestic consumption and investment. The growth momentum is expected to continue in 2019, as suggested by high frequency indicators and positive investment

prospects. Public debt remains relatively high at about 70 percent of GDP at end-2018, and sizable gross fiscal financing needs are projected beyond 2019. The banking system remains solid, with low nonperforming loans, high provisioning, and abundant liquidity.

39. Staff welcome progress on fiscal consolidation so far and recommend further fiscal adjustment of 1.9 percent of GDP over 2019-20. The authorities' fiscal consolidation efforts resulted in an improvement in the primary balance of 1.1 percent of GDP over 2017-18. Nevertheless, public debt is expected to drift upward under the baseline outlook as the stock of debt is high, and the rate of interest is higher than the rate of economic growth. Fiscal consolidation measures of 1.9 percent of GDP distributed over 2019-20 would ensure compliance with the Fiscal Responsibility Law, further improve the financing situation, and put debt on a firmly declining path. The drag on growth would be limited as fiscal multipliers—the impact on growth of the fiscal measures—tend to be lower during periods of economic expansion.

40. Improving the business environment and competitiveness is critical to boost growth. The government has laid the foundation for sustained growth, by implementing several structural reforms, including the productive transformation plan, *El Salvador Seguro* and introducing several regulatory improvements to complete the Northern Triangle customs union with Honduras and Guatemala. Potential growth could be further raised by (i) increasing the provision of public infrastructure, including through public-private partnerships, (ii) continuing to improve security, (iii) investing in education to improve human capital accumulation, (iv) reducing informality, by introducing the "*monotributo*" and cutting red tape further, (v) reducing the gender gap, and (vi) removing barriers to trade and investment, including by reducing the time to acquire permits, completing the adoption of the electronic signature, and simplifying the issuance of tax identification numbers.

41. Maintaining financial stability is important to support long-term growth. This could be achieved by (i) adopting the bank resolution legislation in line with best practices; (ii) ensuring that the reactivated interbank market functions smoothly to increase banks' efficiency in managing liquidity, decrease their need for emergency liquidity, and the burden on the public sector; (iii) ensuring that measures supporting credit growth in certain sectors fully comply with the risk-based supervision framework, to avoid regulatory forbearance; and (iv) continuing to promote financial inclusion, including by expanding access to fintech services by allowing additional players in the mobile money market and enhancing microfinance capacity; these measures would help intermediate remittances more efficiently and raise long-term output.

42. The governance framework should be further enhanced. Staff recommend the following actions in the short-term: (i) increase the fiscal transparency of the 2020 budget law, building on the experience of the 2019 budget, strengthen the audit of fiscal operations, and establish better spending controls; (ii) promptly implement electronic invoicing to improve tax collection. Changes to the anticorruption legal framework should be comprehensive, ensuring harmonization of laws and considering their ultimate impact on the budget.

43. Staff recommends that the next Article IV Consultation be held on the standard 12-month cycle.

Risk Assessment Matrix
Potential Deviations from Baseline (as of April 2019)[1]

Source of risk	Likelihood	Impact	Policy response
		Global risks	
Weaker-than-expected global growth	Medium. The global growth slowdown could be synchronized as weakening outlooks in the U.S., Europe and China feed off each other and impact on earnings, asset prices and credit performance. In the U.S., confidence wanes against a backdrop of a long expansion with stretched asset valuations, rising leverage, and unwinding of the fiscal stimulus, leading to abrupt closure of the output gap rather than a smooth landing.	Medium. El Salvador would likely see depressed economic growth due to lower external demand and remittances flows.	Given limited fiscal space, implement reforms to attract private investment, including better business climate, export diversification, and competitiveness. Strengthen tax administration and expenditure management to protect the fiscal position.
Rising protectionism and retreat from multilateralism	**High.** In the near term, escalating and sustained trade actions threaten the global trade system, regional integration, as well as global and regional collaboration. Additional barriers and the threat of new actions reduce growth both directly and through adverse confidence effects (increasing financial market volatility). In the medium term, geopolitical competition and fraying consensus about the benefits of globalization lead to economic fragmentation and undermine the global rules-based order, with adverse effects on growth and stability.	**High.** El Salvador's open economy would be particularly vulnerable to changes in policies of key trading partners. There is potential for reductions in international financing aid, higher migrant deportations and lower remittances. FDI flows would also be significantly affected by changes in advanced country policies aimed at discouraging investment abroad.	Improve external buffers. Implement reforms to attract private investment and foster job creation, including better business climate, export diversification, and competitiveness, as well as prioritizing investment in security, education and health.
Sharp tightening of global financial conditions	Medium. This causes higher debt service and refinancing risks; stress on leveraged firms, households, and vulnerable sovereigns; capital account pressures; and a broad-based downturn. The tightening could be a result of: ・**Market expectation of tighter U.S. monetary policy** triggered by strong wage growth and higher than-expected inflation. ・**Sustained rise in risk premium** in reaction to concerns about debt levels in some euro area countries; a disorderly Brexit; or idiosyncratic policy missteps in large emerging markets.	Medium. A global interest rate shock would both constrain access to international capital markets and increase the cost of external financing, worsening public debt dynamics. These effects would be mitigated by an increased capacity of the financial system and the government to access domestic financing. Further appreciation of the U.S. dollar could undermine El Salvador's competitiveness relative to non-dollarized neighboring countries.	Implement fiscal consolidation to both reduce external financing needs and improve debt dynamics. Improve fiscal and external buffers. Implement structural reforms to improve competitiveness.
Large swings in energy prices	Medium. Risks to prices are broadly balanced, reflecting offsetting—but large and uncertain—supply and demand shocks. In the near term, uncertainty surrounding the shocks translates to elevated price volatility, complicating economic management and adversely affecting investment in the energy sector. As shocks materialize, they may cause large and persistent price swings. While, on aggregate, higher oil prices would harm global growth, they would benefit oil exporters.	Medium/**High**. Lower energy prices would support higher consumption and growth, while helping to keep inflation and the current account deficit contained.	Save a part of the windfall from lower energy prices.
		Regional risks	
Spillovers from Nicaragua's political turmoil	Medium. Nicaragua is a relatively small trading partner but a thoroughfare for regional trade.	Low. A heightened crisis in Nicaragua would further disrupt intra-regional trade in Central America. In particular, it would make difficult the trade between El Salvador and countries such as Panama and Costa Rica. However, these countries have a low share in total exports, so the impact would be contained.	Coordinate with regional trading partners for alternative trade routes (transportation logistics).
		Domestic risks	
Domestic policy slippages	Medium. Political parties in the Legislative Assembly may reach fiscal agreements that entail both upside and downside risks. On the upside, they could agree on limiting the budget to the Executive as a way of ensuring fiscal discipline. On the downside, they could adopt populist measures without identifying funding sources, which could deteriorate the fiscal position.	**High.** The impact will depend on the balance of risks. If downside risks prevail over upside risks, this could lead to higher financing costs and a disorderly adjustment, worsening macroeconomic imbalances and affecting confidence and growth.	Forge consensus in the Legislative Assembly, and with the Executive, on the fiscal agenda. Implement fiscal consolidation to reduce external financing needs and improve debt dynamics.
Political fragmentation	Medium. A political system that allows for relatively frequent elections exposes El Salvador to political uncertainty.	Medium. Political paralysis could ensue and exacerbate macroeconomic imbalances because of ineffective policy-making. The high frequency of elections prevents the implementation of bold reforms.	Ensure a broad-based policy dialogue to support macroeconomic stability.
Natural disasters	Medium. El Salvador is exposed to earthquakes, floods, droughts, and hurricanes.	Medium/**High**. The economic impact could be significant through its effects on economic growth and fiscal pressures.	Ensure that fiscal buffers (including official loans) are adequate to support vulnerable segments of the population. Prepare and assess enrollment in insurance schemes against natural disasters.

1/ The Risk Assessment Matrix (RAM) shows events that could materially alter the baseline path (the scenario most likely to materialize in the view of IMF staff). The relative likelihood of risks listed is the staff's subjective assessment of the risks surrounding the baseline ("low" is meant to indicate a probability below 10 percent, "medium" a probability between 10 and 30 percent, and "high" a probability between 30 and 50 percent). The RAM reflects staff views on the source of risks and overall level of concern as of the time of discussions with the authorities. Non-mutually exclusive risks may interact and materialize jointly.

Box 4. Implementation of Fund Advice

Fiscal policy

Recommendations: Implement a primary fiscal adjustment of 2 percent of GDP (equally distributed) over 2019-20, relying on a mix of spending and revenue measures. Improve the fiscal responsibility law (FRL) in line with best practices, including a commitment to a more ambitious anchor. Advance in improving public financial management. Introduce additional reforms to strengthen the sustainability and fairness of the pension system.

Outcomes. Under current projections, the primary balance will deteriorate over 2019-2020 compared to 2018. The approved 2019 budget takes into account the loss in revenues, especially from the removal of the tax on financial transactions and transfer pricing, introduced in 2018 and then declared unconstitutional, and a rising interest bill. The authorities strengthened the FRL in December 2018 and updated the targets to incorporate the revised national accounts (in March 2018). The two major changes to the FRL were: (i) the extension of the fiscal adjustment of 3 percent of GDP period until 2021(by 2 years), and (ii) the introduction of an appropriate debt anchor of 60 percent of GDP or less by 2030, which would put debt on a declining path from the current level of around 70 percent of GDP. Progress in public financial management is generally slow, and additional reforms of the pension system are currently being analyzed by the Ministry of Finance.

Financial sector

Recommendations: Provide adequate funding for ELA facilities; approve legislation improvements to the bank resolution and crisis management framework; advance the implementation of risk-based supervision and Basel II/III; maintain sound AML/CFT standards.

Outcomes: Public ELA facility received funding from the BCIE, but it is insufficient. The Central Bank is currently negotiating additional funding for ELA with China; amounts and conditions remain unknown. The law on bank resolution and crisis management is in negotiations between the Central Bank, Financial Superintendency, and the Deposit Guarantee Fund. Progress on Basel II/III implementation is mixed: there are advances in a few areas but also delays in setting up the relevant working groups. The authorities have enhanced AML/CFT by establishing a high frequency monitoring system of capital flows and maintain international cooperation with the U.S. Department of Treasury.

Structural reforms

Recommendations: Increase execution of public investment; reduce barriers to trade; reduce informality; advance regulatory simplification to reduce red tape; continue to fight against crime and corruption.

Outcomes: Following years of low execution, public investment increased in 2018. Trade and competitiveness are expected to improve with the completion of the customs union with Honduras and Guatemala, the enhanced infrastructure at the border points, and the continued implementation of the productive transformation policy that increased productivity. Informality remains high at 70 percent of total employment, and the authorities are designing measures (including a simplified tax code), which will be implemented in 2019 and subsequent years, to address this problem. Progress in reducing red tape was made by approving the law of administrative procedures in early 2018 (became effective in February 2019), launching the National Registry of Procedures, and approving the law of regulatory simplification in December 2018. In terms of governance, the Attorney General significantly strengthened investigation and prosecution activities to ensure a transparent use of public funds. Continued implementation of "El Salvador Seguro" plan and the permanent adoption of some of the extraordinary measures introduced in 2016, brought further down homicides in 2018; extortions continue to be a problem, which mostly affects SMEs.

Statistics

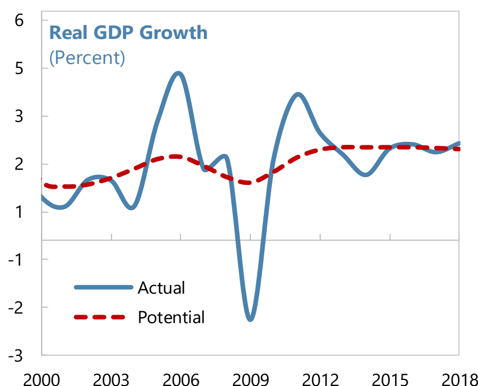
Recommendation: Publish revised GDP statistics.

Outcome: The updated National Accounts were published on March 23, 2018, as planned. Further revisions and improvements were incorporated to the data, with support from CAPTAC-DR's technical assistance, and updated statistics were published on March 2019.

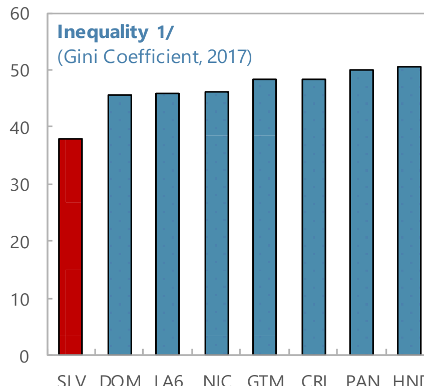
Figure 1. El Salvador: Long-term Growth and Poverty

Structural bottlenecks have inhibited long-term growth

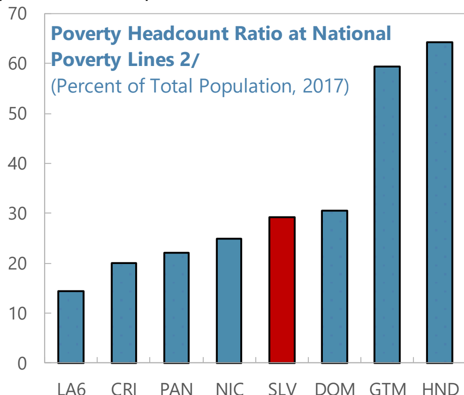
The country has experienced solid economic growth in recent years …



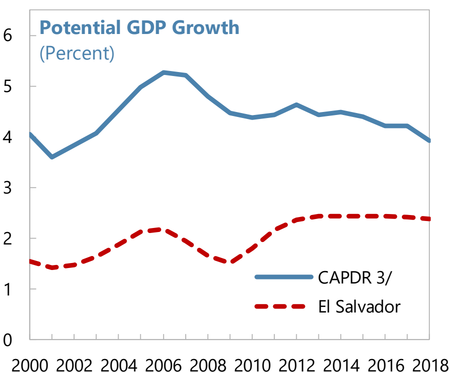
… leading to a decline in inequality, which reached the lowest level in the region.



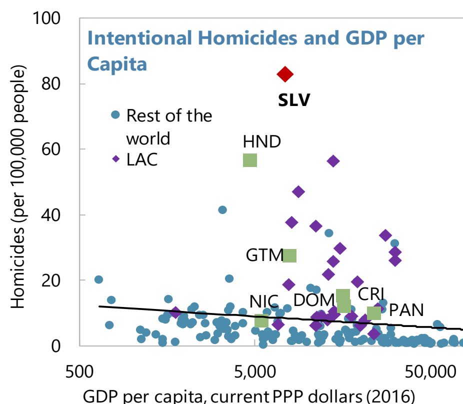
Although poverty declined in the last decade, it is still high compared to some peers …



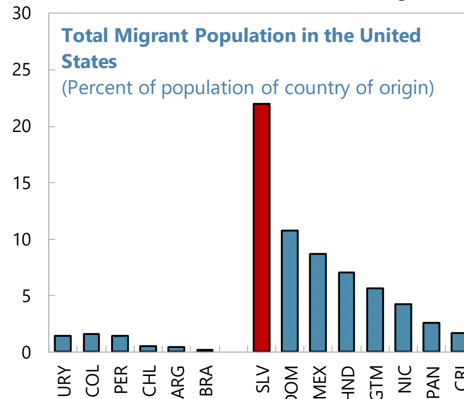
… and job and investment opportunities are limited due to low potential growth.



Crime remains high …



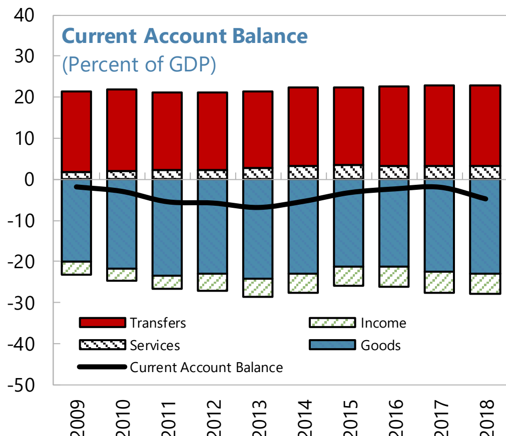
… and along with poverty, low growth, and other "pull" causes, contributed over time to outward migration.



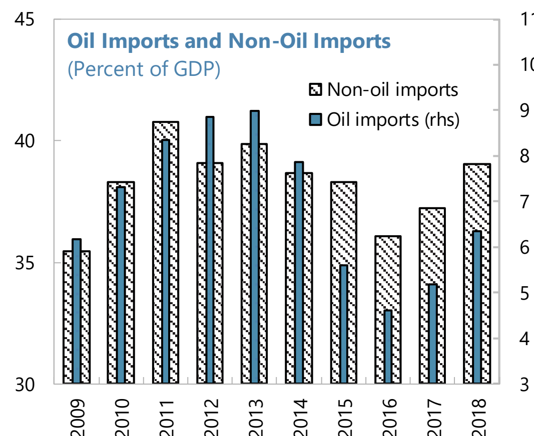
Sources: Central Reserve Bank of El Salvador; IMF staff calculations; ECLAC; and World Development Indicators, The World Bank.
1/ Gini coefficient for GTM and NIC are as of 2014. Simple average of Brazil, Chile, Colombia, Mexico, Peru and Uruguay.
2/ El Salvador poverty line covers the percent of population lacking household income required to access a basket of goods and services needed to achieve adequate living conditions. Poverty numbers are as of 2014 for GTM and 2016 for PAN, NIC and DOM.
3/ Simple average of Costa Rica, Guatemala, Honduras, Nicaragua, Panama, and the Dominican Republic.

Figure 2. El Salvador: Balance of Payments Developments

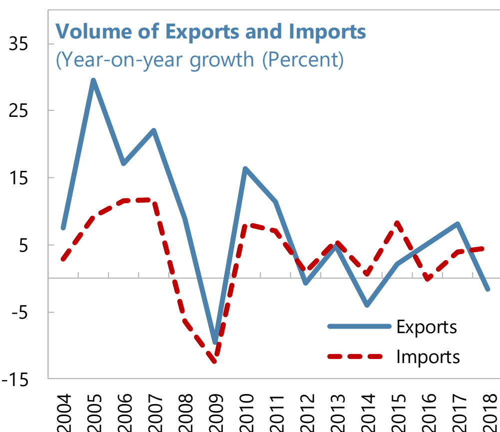
After shrinking during 2014-2017, the current account deficit increased ...



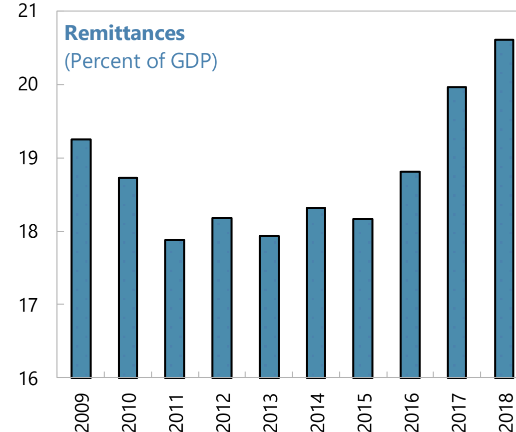
... due to stagnant exports and broad-based increase in imports.



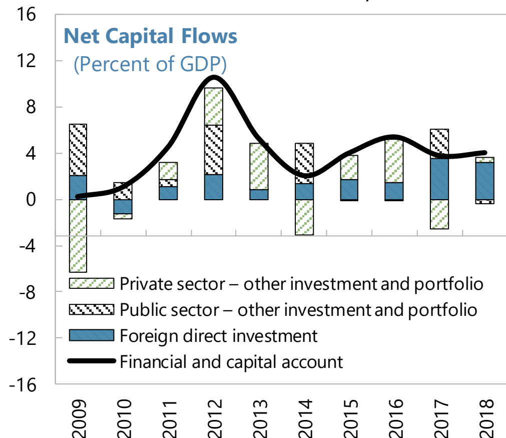
The real appreciation hurt export volume growth while imports grew ...



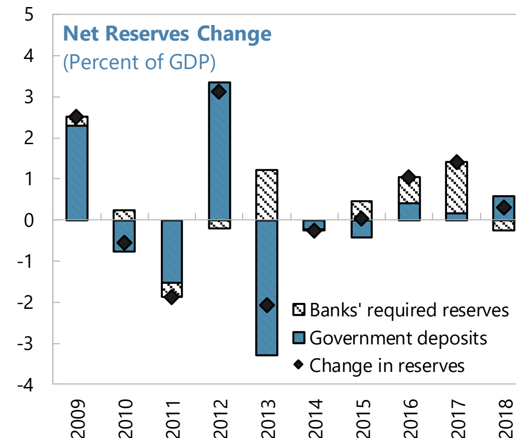
... also fueled by the surge in remittances that started in 2016.



FDI and other private sector borrowing are the major contributors to the financial account surplus ...



... and reserves are broadly stable.

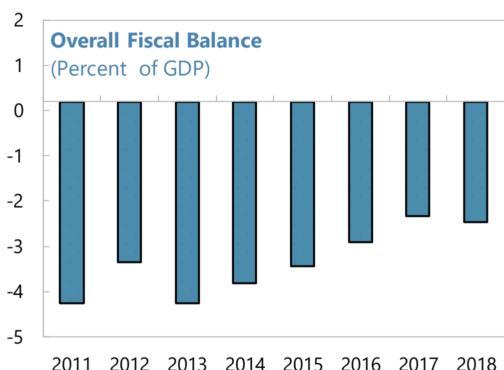


Sources: Central Reserve Bank of El Salvador, Haver Analytics, and IMF staff calculations.

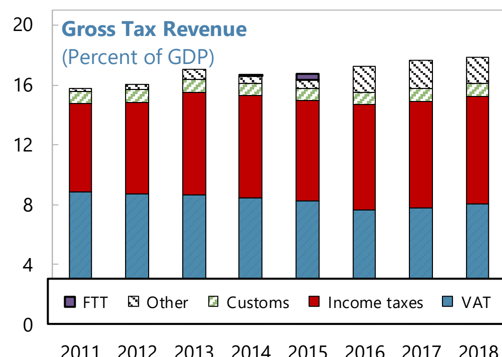
Figure 3. El Salvador: Fiscal Developments

Spending restraint helped cut primary deficit, but financing remains a concern

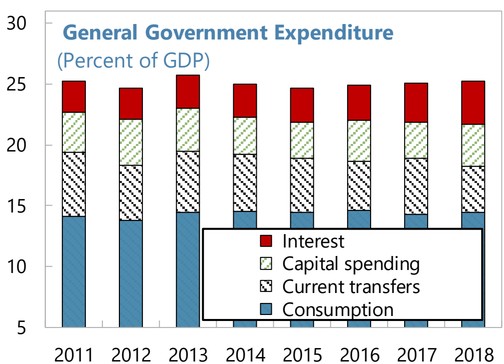
The overall fiscal deficit slightly deteriorated in 2018 …



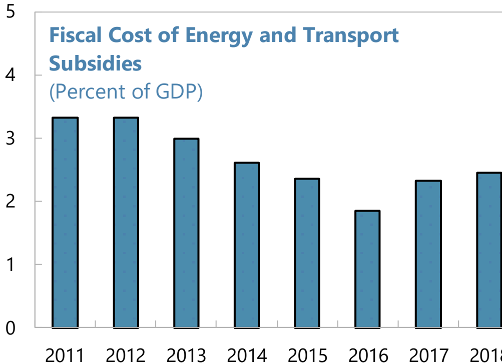
… despite higher revenues, mostly from VAT…



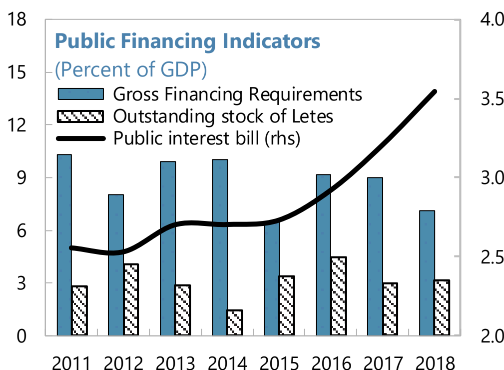
… and broadly stable spending…



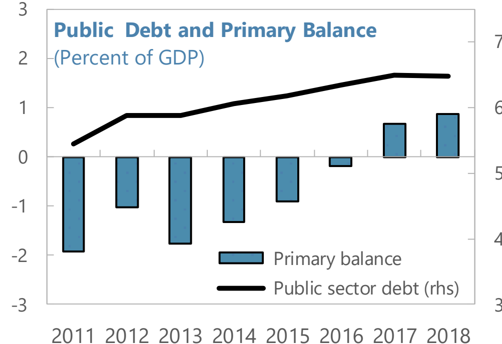
… as lower petroleum prices helped contain subsidies.



The interest bill continues to rise …



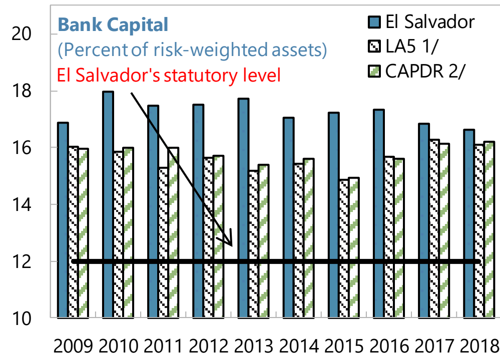
… with public debt trending up despite improved primary balances.



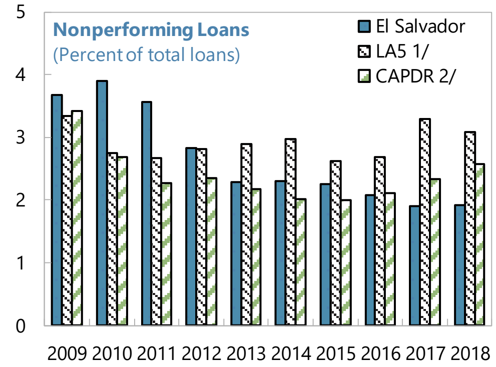
Sources: National authorities and IMF staff calculations.

Figure 4. El Salvador: Financial Sector Developments

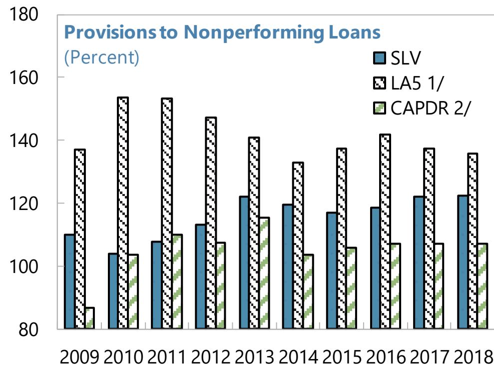
Banks' capital buffers remain high ...



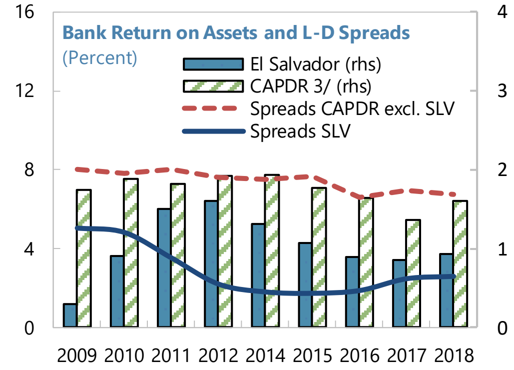
... and banks' asset quality is strong.



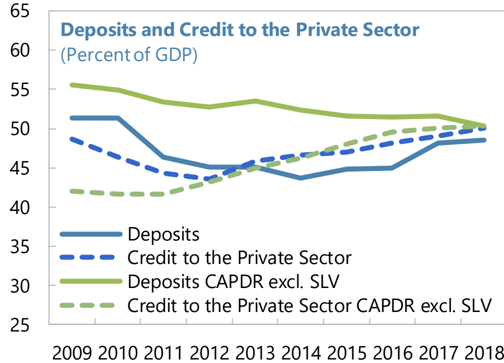
High provisioning and ...



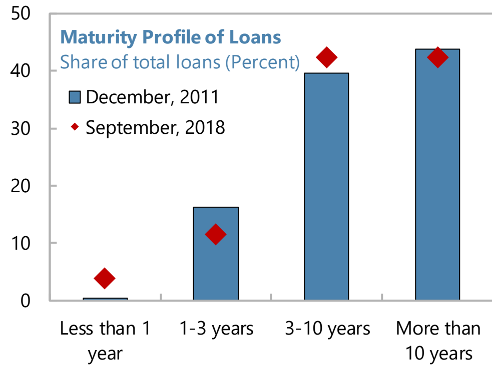
... low net interest spreads continue to strain banks' profitability.



Credit to the private sector continues recovering ...



... but maturity profile shifted to the short-term loans.



Sources: National authorities, IMF Financial Soundness Indicators, and Fund staff calculations.

1/ Simple average of Brazil, Chile, Colombia, Mexico, and Peru.

2/ Simple average of Costa Rica, Guatemala, Honduras, Panama, and the Dominican Republic.

3/ CAPDR for year 2015 includes Costa Rica, Honduras and Guatemala.

Table 1. El Salvador: Selected Economic Indicators

I. Social Indicators

Rank in UNDP Development Index 2017 (of 189)	121	Population (million, 2017)	6.4
Per capita income (U.S. dollars, 2018)	3,701	Life expectancy at birth in years (2017)	74
Percent of pop. below poverty line (2017)	29	Infant mortality (per 1,000 live births, 2017)	13
Gini index (2017)	38	Primary education completion rate (percent, 2017)	91

II. Economic Indicators (percent of GDP, unless otherwise indicated)

								Proj.		
	2012	2013	2014	2015	2016	2017	2018	2019	2020	2021
Income and prices										
Real GDP growth (percent)	2.8	2.2	1.7	2.4	2.5	2.3	2.5	2.5	2.3	2.2
Consumer price inflation (average, percent)	1.7	0.8	1.1	-0.7	0.6	1.0	1.1	0.6	1.3	1.1
GDP deflator (percent)	2.5	0.6	1.0	1.3	0.5	0.9	1.9	1.1	2.3	2.1
Terms of trade, percent change	0.5	-1.6	3.3	12.4	-2.9	-2.1	-3.9	-0.9	0.9	0.1
Real effective exchange rate (+ = appreciation)	-1.8	-1.0	1.8	4.5	-1.0	-3.5	1.5	…	…	…
External sovereign bond spread (basis points)	448	378	400	497	600	520	424	…	…	…
Money and credit										
Credit to the private sector	44.8	47.1	48.9	49.5	50.6	51.5	52.4	53.2	53.1	53.3
Broad money	48.1	47.9	46.8	47.9	48.0	51.4	52.0	52.7	52.7	52.8
Interest rate (time deposits, percent)	2.5	3.4	3.8	4.2	4.4	4.4	4.2	…	…	…
External sector										
Current account balance	-5.8	-6.9	-5.4	-3.2	-2.3	-1.9	-4.8	-4.4	-4.4	-4.5
Trade balance	-23.0	-24.1	-23.4	-21.2	-19.3	-19.4	-22.8	-23.1	-22.9	-22.9
Exports (f.o.b. excluding *maquila*)	19.8	20.0	19.0	18.9	17.9	18.7	18.2	17.9	17.8	17.8
Imports (f.o.b. excluding *maquila*)	-42.8	-44.0	-42.4	-40.1	-37.2	-38.2	-41.0	-40.9	-40.6	-40.7
Services and income (net)	-1.6	-1.5	-0.7	-0.6	-1.8	-2.6	-2.6	-2.6	-2.6	-2.7
Transfers (net)	18.8	18.6	18.8	18.6	18.8	20.2	20.6	21.2	21.1	21.0
Foreign direct investment	2.2	0.8	1.4	1.7	1.4	3.6	3.2	2.5	2.5	2.2
Gross international reserves (millions of U.S. dollars)	3,175	2,745	2,693	2,787	3,238	3,567	3,569	3,728	3,882	4,039
Nonfinancial public sector										
Overall balance	-3.6	-4.5	-4.0	-3.6	-3.1	-2.5	-2.7	-3.4	-3.5	-2.9
Primary balance 1/	-1.0	-1.8	-1.3	-0.9	-0.2	0.7	0.9	0.7	0.4	1.2
Of which: tax revenue	16.1	17.0	16.7	16.7	17.2	17.7	17.9	17.6	17.6	17.6
Public sector debt 2/	63.8	63.8	65.6	66.8	68.8	70.3	69.8	70.8	71.2	71.2
National savings and investment										
Gross domestic investment	17.7	17.0	16.4	16.0	16.0	16.6	20.4	19.0	17.6	17.7
Public sector	2.6	2.5	2.0	2.5	2.4	2.4	2.3	2.2	2.1	2.2
Private sector 3/	15.1	14.6	14.4	13.5	13.5	14.2	18.1	16.8	15.5	15.5
National savings	11.9	10.1	11.0	12.8	13.7	14.8	15.7	14.5	13.2	13.1
Public sector	-0.6	-1.2	-1.2	-0.8	0.1	0.3	0.5	-0.4	-0.5	0.2
Private sector	12.5	11.3	12.2	13.6	13.6	14.5	15.2	14.9	13.7	12.9
Net foreign assets of the financial system										
Millions of U.S. dollars	3,229	2,473	2,211	1,931	2,021	2,689	2,771	2,910	3,043	3,241
Percent of deposits	32.6	24.0	21.6	17.8	18.1	21.8	21.3	21.5	21.5	21.9
Memorandum items										
Nominal GDP (billions of U.S. dollars)	21.4	22.0	22.6	23.4	24.2	24.9	26.1	27.0	28.2	29.5

Sources: Central Reserve Bank of El Salvador, Ministry of Finance, and IMF staff estimates.

1/ The baseline scenario does not include revenue measures such as the electronic invoicing, the *monotributo*, and the transfer pricing initiative.

2/ Includes gross debt of the nonfinancial public sector and external debt of the central bank.

3/ Includes inventories.

Table 2. El Salvador: Medium-term Baseline Scenario

	2013	2014	2015	2016	2017	2018	Projections 2019	2020	2021	2022	2023	2024
	(Annual percentage change)											
Real GDP growth	2.2	1.7	2.4	2.5	2.3	2.5	2.5	2.3	2.2	2.2	2.2	2.2
Output gap (percent of potential output)	0.7	0.0	0.0	0.0	-0.1	0.1	0.2	0.2	0.2	0.2	0.2	0.0
Inflation (average)	0.8	1.1	-0.7	0.6	1.0	1.1	0.6	1.3	1.1	1.1	1.0	1.0
GDP deflator	0.6	1.0	1.3	0.5	0.9	1.9	1.1	2.3	2.1	2.0	2.0	2.0
Nominal GDP growth	2.8	2.7	3.7	3.1	3.2	4.5	3.6	4.7	4.3	4.3	4.2	4.2
	(Contributions to growth, percentage points)											
Private consumption	3.0	-0.8	3.3	1.7	1.9	2.3	2.3	2.1	2.0	2.0	2.0	2.0
Private investment 1/	-0.5	0.9	-0.6	0.7	-1.7	1.8	0.9	0.6	0.4	0.4	0.3	0.4
Government	0.3	-0.6	1.0	-0.1	0.3	0.1	0.2	0.5	0.5	0.4	0.4	0.4
Net exports	-0.6	2.2	-1.3	0.3	1.8	-1.6	-0.8	-0.9	-0.7	-0.6	-0.6	-0.6
	(Percent of GDP)											
Nonfinancial public sector balance	-4.5	-4.0	-3.6	-3.1	-2.5	-2.7	-3.4	-3.5	-2.9	-3.0	-3.2	-3.4
Primary balance 2/	-1.8	-1.3	-0.9	-0.2	0.7	0.9	0.7	0.4	1.2	1.3	1.3	1.3
Public sector gross debt 3/	63.8	65.6	66.8	68.8	70.3	69.8	70.8	71.2	71.2	71.3	71.6	72.2
External current account balance	-6.9	-5.4	-3.2	-2.3	-1.9	-4.8	-4.4	-4.4	-4.5	-4.7	-4.8	-5.0
Exports of goods	20.0	19.0	18.9	17.9	18.7	18.2	17.9	17.8	17.8	17.8	17.8	17.8
Imports of goods	-44.0	-42.4	-40.1	-37.2	-38.2	-41.0	-40.9	-40.6	-40.7	-40.7	-40.7	-40.8
Current transfers	18.6	18.8	18.6	18.8	20.2	20.6	21.2	21.1	21.0	20.9	20.9	20.8
Gross domestic investment	17.0	16.4	16.0	16.0	16.6	20.4	19.0	17.6	17.7	17.7	17.6	17.6
Private 1/	14.6	14.4	13.5	13.5	14.2	18.1	16.8	15.5	15.5	15.5	15.4	15.4
Public	2.5	2.0	2.5	2.4	2.4	2.3	2.2	2.1	2.2	2.2	2.2	2.2
Gross national saving	10.1	11.0	12.8	13.7	14.8	15.7	14.5	13.2	13.1	13.0	12.8	12.6
Private	11.3	12.2	13.6	13.6	14.5	15.2	14.9	13.7	12.9	12.8	12.9	12.8
Public	-1.2	-1.2	-0.8	0.1	0.3	0.5	-0.4	-0.5	0.2	0.1	-0.1	-0.2
External saving	6.9	5.4	3.2	2.3	1.9	4.8	4.4	4.4	4.5	4.7	4.8	5.0

Sources: Central Reserve Bank of El Salvador, Ministry of Finance, and IMF staff estimates.

1/ Includes inventories.

2/ The baseline scenario does not include revenue measures such as the electronic invoicing, the monotributo, and the transfer pricing initiative.

3/ Includes gross debt of the nonfinancial public sector and external debt of the central bank.

Table 3. El Salvador: Balance of Payments

							Projections					
	2013	2014	2015	2016	2017	2018	2019	2020	2021	2022	2023	2024
						(Millions of U.S. dollars)						
Current Account	**-1,518**	**-1,214**	**-754**	**-550**	**-465**	**-1,242**	**-1,193**	**-1,254**	**-1,339**	**-1,449**	**-1,523**	**-1,665**
Merchandise trade balance	-5,289	-5,287	-4,970	-4,654	-4,845	-5,936	-6,226	-6,462	-6,739	-7,042	-7,345	-7,701
Export of goods (f.o.b.)	4,395	4,294	4,437	4,322	4,667	4,735	4,826	5,019	5,243	5,465	5,692	5,933
Import of goods (f.o.b.)	-9,684	-9,581	-9,407	-8,976	-9,512	-10,671	-11,052	-11,481	-11,982	-12,507	-13,037	-13,635
Services	671	868	959	808	733	800	841	881	928	975	1,049	1,107
Exports of processing services	494	456	611	663	482	514	518	521	527	532	537	542
Income	-990	-1,035	-1,092	-1,246	-1,388	-1,472	-1,540	-1,629	-1,718	-1,817	-1,916	-2,022
Of which: interest on public debt	326	327	433	428	458	632	697	727	770	820	845	891
Current transfers	4,090	4,240	4,349	4,542	5,034	5,366	5,731	5,956	6,191	6,434	6,688	6,952
Workers' remittances (credits)	3,944	4,139	4,257	4,544	4,978	5,370	5,746	5,976	6,215	6,463	6,722	6,991
Financial and Capital Account	**1,165**	**465**	**943**	**1,309**	**945**	**1,055**	**1,353**	**1,408**	**1,497**	**1,599**	**1,665**	**1,799**
Capital account	101	64	65	70	85	203	97	104	112	120	127	112
Public sector financial flows	13	788	-14	-13	631	193	662	13	34	40	-777	-76
Disbursements	269	1,059	247	292	955	548	1,782	353	340	340	340	340
Amortization	-256	-271	-261	-305	-323	-355	-1,120	-340	-306	-300	-1,117	-416
Private sector financial flows	193	1,101	455	713	1,210	751	953	968	919	957	963	969
Foreign direct investment	179	306	396	348	889	840	686	701	652	690	697	702
Portfolio investment	13	794	59	365	321	-89	267	267	267	267	267	267
Other 1/ 2/	859	-1,487	437	540	-982	-92	-360	322	432	482	1,351	795
Errors and Omissions	**27**	**716**	**-77**	**-307**	**-172**	**189**	**0**	**0**	**0**	**0**	**0**	**0**
Change in Reserves (- = increase)	**327**	**33**	**-113**	**-452**	**-308**	**-2**	**-159**	**-154**	**-158**	**-150**	**-142**	**-134**
						(Percent of GDP)						
Current Account	**-6.9**	**-5.4**	**-3.2**	**-2.3**	**-1.9**	**-4.8**	**-4.4**	**-4.4**	**-4.5**	**-4.7**	**-4.8**	**-5.0**
Merchandise trade balance	-24.1	-23.4	-21.2	-19.3	-19.4	-22.8	-23.1	-22.9	-22.9	-22.9	-22.9	-23.1
Export of goods (f.o.b.)	20.0	19.0	18.9	17.9	18.7	18.2	17.9	17.8	17.8	17.8	17.8	17.8
Import of goods (f.o.b.)	-44.0	-42.4	-40.1	-37.2	-38.2	-41.0	-40.9	-40.6	-40.7	-40.7	-40.7	-40.8
Petroleum and products	-9.0	-7.9	-5.6	-4.6	-5.2	-6.3	-5.4	-5.3	-5.1	-5.0	-4.9	-4.8
Services	3.1	3.8	4.1	3.3	2.9	3.1	3.1	3.1	3.1	3.2	3.3	3.3
Exports of processing services	2.2	2.0	2.6	2.7	1.9	2.0	1.9	1.8	1.8	1.7	1.7	1.6
Income	-4.5	-4.6	-4.7	-5.2	-5.6	-5.6	-5.7	-5.8	-5.8	-5.9	-6.0	-6.1
Current transfers	18.6	18.8	18.6	18.8	20.2	20.6	21.2	21.1	21.0	20.9	20.9	20.8
Workers' remittances (credits)	17.9	18.3	18.2	18.8	20.0	20.6	21.3	21.2	21.1	21.0	21.0	20.9
Financial and Capital Account	**5.3**	**2.1**	**4.0**	**5.4**	**3.8**	**4.0**	**5.0**	**5.0**	**5.1**	**5.2**	**5.2**	**5.4**
Capital account	0.5	0.3	0.3	0.3	0.3	0.8	0.4	0.4	0.4	0.4	0.4	0.3
Public sector financial flows	0.1	3.5	-0.1	-0.1	2.5	0.7	2.5	0.0	0.1	0.1	-2.4	-0.2
Private sector financial flows	0.9	4.9	1.9	3.0	4.9	2.9	3.5	3.4	3.1	3.1	3.0	2.9
Foreign direct investment	0.8	1.4	1.7	1.4	3.6	3.2	2.5	2.5	2.2	2.2	2.2	2.1
Portfolio investment	0.1	3.5	0.3	1.5	1.3	-0.3	1.0	0.9	0.9	0.9	0.8	0.8
Other 1/ 2/	3.9	-6.6	1.9	2.2	-3.9	-0.4	-1.3	1.1	1.5	1.6	4.2	2.4
						(Annual percentage change)						
Merchandise Trade (f.o.b.)												
Exports (nominal)	3.6	-2.3	3.3	-2.6	8.0	1.4	1.9	4.0	4.5	4.2	4.2	4.2
Volume	4.8	-4.1	2.1	5.1	8.2	-1.7	3.2	3.0	3.6	3.6	3.3	3.3
Price	-1.6	1.5	1.9	-7.3	-0.2	3.2	-1.1	1.0	0.9	0.7	0.8	0.9
Imports (nominal)	5.7	-1.1	-1.8	-4.6	6.0	12.2	3.6	3.9	4.4	4.4	4.2	4.6
Volume	5.6	0.7	8.3	-0.1	3.9	4.5	3.8	3.8	3.6	3.4	3.3	3.2
Price	0.1	-1.7	-9.3	-4.5	2.0	7.4	-0.2	0.1	0.7	1.0	0.9	1.3
Terms of trade	-1.6	3.3	12.4	-2.9	-2.1	-3.9	-0.9	0.9	0.1	-0.3	-0.1	-0.4
Memorandum Items												
Gross international reserves (US$ million) 3/	2,745	2,693	2,787	3,238	3,567	3,569	3,728	3,882	4,039	4,189	4,331	4,465
In months of imports (excluding maquila) 4/	3.0	3.0	3.1	3.6	3.8	3.4	3.4	3.4	3.4	3.4	3.4	3.3
In percent of total short-term external debt	150	138	146	125	175	172	174	175	174	173	171	168
External debt (in percent of GDP)	63.8	65.5	64.9	67.8	66.1	63.9	64.3	64.0	64.0	63.9	63.9	63.9
Of which : public sector debt	34.2	37.3	35.5	37.0	36.8	34.6	35.8	35.7	36.4	37.2	36.8	37.3
Of which : private sector debt	29.7	28.2	29.4	30.8	29.3	29.4	28.5	28.3	27.6	26.7	27.1	26.6
External public debt servicing (US$ million)	582	598	694	733	781	987	1,817	1,067	1,076	1,120	1,962	1,307
Percent of exports of goods and services	8.9	9.0	10.0	10.7	10.8	13.1	23.6	13.3	12.8	12.8	21.5	13.7
Gross external financing requirement (US$ million)	3,852	3,876	3,407	3,210	3,387	3,974	4,909	4,251	4,401	4,838	5,820	5,420
Percent of GDP	17.5	17.2	14.5	13.3	13.6	15.3	18.2	15.0	14.9	15.7	18.2	16.2

Sources: Central Reserve Bank of El Salvador and IMF staff estimates.

1/ Presented in BPM6 format.

2/ Assumed to include both private and potential public sector flows, including 70 percent of the fiscal financing gap.

3/ Beginning in 2010, gold in international reserves is valued at the price determined by the London Bullion Market (resulting in a valuation gain of US$170 million).

4/ Expressed in terms of following year's imports.

Table 4. El Salvador: External Financing Requirements and Sources

	2013	2014	2015	2016	2017	2018	2019	2020	2021	2022	2023	2024
							Projections					
	(Millions of U.S. dollars)											
Gross Financing Requirements	**815**	**1,449**	**1,900**	**2,110**	**2,458**	**1,491**	**2,522**	**1,743**	**1,722**	**1,940**	**2,773**	**2,090**
Current account deficit	-1,518	-1,214	-754	-550	-465	-1,242	-1,193	-1,254	-1,339	-1,449	-1,523	-1,665
Debt amortization	2,660	2,695	2,540	2,208	2,615	2,731	3,556	2,843	2,904	3,239	4,155	3,621
Public sector	256	271	261	305	323	355	1,120	340	306	300	1,117	416
Private sector	2,404	2,424	2,279	1,903	2,291	2,376	2,437	2,503	2,598	2,940	3,038	3,205
GIR accumulation	-327	-33	113	452	308	2	159	154	158	150	142	134
Gross Financing Sources	**3,852**	**3,876**	**3,407**	**3,210**	**3,387**	**3,974**	**4,909**	**4,251**	**4,401**	**4,838**	**5,820**	**5,420**
Public sector disbursements	269	1,059	247	292	955	548	1,782	353	340	340	340	340
Private sector net inflows	3,583	2,817	3,160	2,918	2,433	3,426	3,127	3,898	4,061	4,498	5,480	5,080
Foreign direct investment	179	306	396	348	889	840	686	701	652	690	697	702
Other	3,404	2,511	2,764	2,570	1,544	2,587	2,441	3,196	3,409	3,808	4,783	4,378
	(Percent of GDP)											
Gross Financing Requirements	**3.7**	**6.4**	**8.1**	**8.7**	**9.9**	**5.7**	**9.3**	**6.2**	**5.8**	**6.3**	**8.7**	**6.3**
Current account deficit	-6.9	-5.4	-3.2	-2.3	-1.9	-4.8	-4.4	-4.4	-4.5	-4.7	-4.8	-5.0
Debt amortization	12.1	11.9	10.8	9.1	10.5	10.5	13.2	10.1	9.9	10.5	13.0	10.8
Public sector	1.2	1.2	1.1	1.3	1.3	1.4	4.1	1.2	1.0	1.0	3.5	1.2
Private sector	10.9	10.7	9.7	7.9	9.2	9.1	9.0	8.9	8.8	9.6	9.5	9.6
Gross Financing Sources	**17.5**	**17.2**	**14.5**	**13.3**	**13.6**	**15.3**	**18.2**	**15.0**	**14.9**	**15.7**	**18.2**	**16.2**
Public sector disbursements	1.2	4.7	1.1	1.2	3.8	2.1	6.6	1.3	1.2	1.1	1.1	1.0
Private sector net inflows	16.3	12.5	13.5	12.1	9.8	13.1	11.6	13.8	13.8	14.6	17.1	15.2
Foreign direct investment	0.8	1.4	1.7	1.4	3.6	3.2	2.5	2.5	2.2	2.2	2.2	2.1
Other	15.5	11.1	11.8	10.6	6.2	9.9	9.0	11.3	11.6	12.4	14.9	13.1

Sources: Central Reserve Bank of El Salvador and IMF staff estimates.

Table 5. El Salvador: Operations of the Nonfinancial Public Sector

							Projections					
	2013	2014	2015	2016	2017	2018	2019	2020	2021	2022	2023	2024
	(Millions of U.S. dollars)											
Revenue and Grants	**4,679**	**4,739**	**4,922**	**5,272**	**5,617**	**5,880**	**5,959**	**6,211**	**6,489**	**6,781**	**7,066**	**7,363**
Current revenue	4,608	4,692	4,869	5,226	5,573	5,820	5,901	6,172	6,455	6,746	7,035	7,343
Tax revenue	3,746	3,772	3,918	4,166	4,407	4,653	4,748	4,971	5,202	5,440	5,674	5,924
Nontax revenue	756	797	843	938	1,050	996	1,031	1,073	1,120	1,168	1,217	1,269
Operating surplus of the public enterprises	107	124	108	122	116	172	122	127	133	139	145	151
Capital revenue	0	0	0	0	0	0	0	0	0	0	0	0
Official grants	71	46	53	46	44	60	58	38	35	35	30	20
Expenditure	**5,660**	**5,646**	**5,773**	**6,023**	**6,248**	**6,575**	**6,872**	**7,209**	**7,345**	**7,709**	**8,103**	**8,507**
Current expenditure	4,870	4,957	5,062	5,206	5,505	5,686	6,008	6,320	6,402	6,711	7,055	7,405
Wages and salaries	2,117	2,232	2,324	2,437	2,511	2,642	2,765	2,881	3,006	3,134	3,267	3,406
Goods and services	1,061	1,059	1,061	1,096	1,056	1,117	1,123	1,186	1,238	1,291	1,345	1,402
Interest	594	610	640	705	800	924	1,099	1,111	1,220	1,324	1,451	1,572
Current transfers	1,099	1,055	1,037	968	1,138	1,003	1,022	1,141	938	961	992	1,025
Nonpension payments	657	588	552	448	578	637	667	698	728	753	785	818
Pension payments	442	467	485	520	560	366	356	443	210	208	207	207
Capital expenditure	790	689	711	817	744	889	864	890	943	999	1,047	1,102
Primary Balance 1/	**-387**	**-297**	**-212**	**-46**	**169**	**230**	**185**	**113**	**364**	**396**	**414**	**428**
Overall Balance	**-981**	**-907**	**-851**	**-751**	**-631**	**-695**	**-913**	**-999**	**-856**	**-928**	**-1,037**	**-1,144**
Financing	**981**	**907**	**851**	**751**	**631**	**695**	**913**	**999**	**856**	**928**	**1,037**	**1,144**
External	**13**	**788**	**-14**	**-13**	**631**	**193**	**662**	**13**	**34**	**40**	**-777**	**-76**
Disbursements	269	1,059	247	292	955	548	1,782	353	340	340	340	340
Amortization	-256	-271	-261	-305	-323	-355	-1,120	-340	-306	-300	-1,117	-416
Domestic	**968**	**120**	**866**	**764**	**0**	**501**	**250**	**395**	**-22**	**-61**	**180**	**183**
Change in deposits at central bank (- = increase)	758	-5	24	-116	15	0	0	0	0	0	0	0
Banking system	-171	-225	277	16	-602	104	-73	0	0	0	0	0
Private sector 2/	381	350	565	865	586	397	323	395	-22	-61	180	183
Unidentified financing	**…**	**…**	**…**	**…**	**…**	**…**	**0**	**591**	**844**	**949**	**1,634**	**1,037**
Memorandum Items:												
Current revenue minus current expenditure	-261	-265	-193	20	68	134	-107	-147	53	36	-20	-62
Gross financing needs	2,174	2,264	1,518	2,214	2,237	1,860	2,898	2,147	2,154	2,257	2,941	2,344
Public sector debt (gross) 3/	14,031	14,827	15,663	16,611	17,514	18,198	19,116	20,119	20,976	21,907	22,946	24,095
	(Percent of GDP)											
Revenue and Grants	**21.3**	**21.0**	**21.0**	**21.8**	**22.5**	**22.6**	**22.1**	**22.0**	**22.0**	**22.1**	**22.1**	**22.1**
Current revenue	21.0	20.8	20.8	21.6	22.4	22.3	21.9	21.9	21.9	22.0	22.0	22.0
Tax revenue	17.0	16.7	16.7	17.2	17.7	17.9	17.6	17.6	17.6	17.7	17.7	17.7
Nontax revenue	3.4	3.5	3.6	3.9	4.2	3.8	3.8	3.8	3.8	3.8	3.8	3.8
Operating surplus of the public enterprises	0.5	0.5	0.5	0.5	0.5	0.7	0.5	0.5	0.5	0.5	0.5	0.5
Official grants	0.3	0.2	0.2	0.2	0.2	0.2	0.2	0.1	0.1	0.1	0.1	0.1
Expenditure	**25.7**	**25.0**	**24.6**	**24.9**	**25.1**	**25.2**	**25.5**	**25.5**	**24.9**	**25.1**	**25.3**	**25.5**
Current expenditure	22.1	21.9	21.6	21.6	22.1	21.8	22.3	22.4	21.7	21.8	22.0	22.2
Wages and salaries	9.6	9.9	9.9	10.1	10.1	10.1	10.2	10.2	10.2	10.2	10.2	10.2
Goods and services	4.8	4.7	4.5	4.5	4.2	4.3	4.2	4.2	4.2	4.2	4.2	4.2
Interest	2.7	2.7	2.7	2.9	3.2	3.5	4.1	3.9	4.1	4.3	4.5	4.7
Current transfers	5.0	4.7	4.4	4.0	4.6	3.9	3.8	4.0	3.2	3.1	3.1	3.1
Nonpension payments	3.0	2.6	2.4	1.9	2.3	2.4	2.5	2.5	2.5	2.5	2.5	2.5
Pension payments	2.0	2.1	2.1	2.2	2.2	1.4	1.3	1.6	0.7	0.7	0.6	0.6
Capital expenditure	3.6	3.1	3.0	3.4	3.0	3.4	3.2	3.2	3.2	3.3	3.3	3.3
Primary Balance 1/	**-1.8**	**-1.3**	**-0.9**	**-0.2**	**0.7**	**0.9**	**0.7**	**0.4**	**1.2**	**1.3**	**1.3**	**1.3**
Overall Balance	**-4.5**	**-4.0**	**-3.6**	**-3.1**	**-2.5**	**-2.7**	**-3.4**	**-3.5**	**-2.9**	**-3.0**	**-3.2**	**-3.4**
Memorandum Items												
Current revenue minus current expenditure	-1.2	-1.2	-0.8	0.1	0.3	0.5	-0.4	-0.5	0.2	0.1	-0.1	-0.2
Gross financing needs	9.9	10.0	6.5	9.2	9.0	7.1	10.7	7.6	7.3	7.3	9.2	7.0
Public sector debt (gross) 3/	63.8	65.6	66.8	68.8	70.3	69.8	70.8	71.2	71.2	71.3	71.6	72.2
Nominal GDP	21,991	22,593	23,438	24,154	24,928	26,057	26,990	28,248	29,475	30,730	32,033	33,391

Sources: Central Reserve Bank of El Salvador, Ministry of Finance, and IMF staff estimates.

1/ The baseline scenario does not include revenue measures such as the electronic invoicing, the monotributo, and the transfer pricing initiative.

2/ Includes financing for education, health, pension trust funds, and other non-depositary corporations.

3/ Includes gross debt of the nonfinancial public sector and external debt of the central bank.

Table 6. El Salvador: Summary Accounts of the Financial System

	2011	2012	2013	2014	2015	2016	2017	2018	Proj. 2019
	(End of period stocks; in millions of U.S. dollars)								
I. Central Bank									
Net Foreign Assets	**2,177**	**2,831**	**2,290**	**2,275**	**2,393**	**2,630**	**3,032**	**3,152**	**3,311**
Of which : Net international reserves 1/	2,502	3,173	2,721	2,661	2,670	2,923	3,273	3,354	3,513
Net Domestic Assets	**300**	**-450**	**278**	**309**	**285**	**167**	**118**	**102**	**102**
Nonfinancial public sector (net)	688	-49	710	704	726	609	623	616	616
Claims	833	832	832	831	830	829	829	835	835
Liabilities	145	881	122	127	103	220	205	219	219
Rest of the financial system (net)	175	186	119	139	93	146	106	122	122
Nonfinancial private sector (claims)	0	0	0	0	0	0	0	0	0
Other items (net)	-563	-587	-551	-533	-534	-588	-612	-635	-635
Liabilities	**2,476**	**2,381**	**2,566**	**2,582**	**2,675**	**2,794**	**3,147**	**3,252**	**3,413**
Base Money	2,275	2,229	2,481	2,474	2,569	2,701	3,009	3,107	3,268
Currency in circulation	5	4	4	4	4	3	3	2	5
Liabilities to depositary corporations	2,271	2,224	2,476	2,470	2,565	2,698	3,006	3,104	3,264
Other liabilities to the public	201	152	85	109	107	94	138	145	145
II. Depository corporations									
Net Foreign Assets	**295**	**-62**	**-417**	**-672**	**-963**	**-995**	**-671**	**-721**	**-734**
Net Domestic Assets	**9,383**	**9,985**	**10,614**	**10,853**	**11,809**	**12,192**	**13,035**	**13,800**	**14,479**
Nonfinancial public sector (net)	465	578	373	258	762	717	582	754	673
Claims	681	762	672	546	1,015	956	807	993	912
Liabilities	215	184	299	287	254	239	225	238	238
Rest of the financial system (net)	1,888	1,981	2,150	2,158	2,214	2,060	2,386	2,329	2,463
Credit to the private sector	8,984	9,332	10,078	10,539	11,028	11,628	12,241	13,045	13,753
Other items (net)	-1,955	-1,907	-1,988	-2,102	-2,195	-2,213	-2,174	-2,328	-2,412
Liabilities to the Private Sector	**9,678**	**9,923**	**10,196**	**10,181**	**10,846**	**11,197**	**12,364**	**13,079**	**13,744**
Deposits	9,413	9,638	9,907	9,863	10,498	10,853	11,997	12,646	13,295
Securities	264	285	289	318	348	344	367	433	449
III. Other financial corporations 2/									
Net Foreign Assets	**339**	**460**	**600**	**608**	**501**	**386**	**329**	**340**	**333**
Net Domestic Assets	**6,108**	**6,687**	**7,121**	**7,794**	**8,500**	**9,319**	**10,073**	**10,065**	**10,484**
Nonfinancial public sector (net)	4,960	5,660	6,036	6,448	7,019	7,678	8,116	8,135	8,502
Rest of the financial system (net)	1,121	987	1,007	943	1,105	1,218	1,599	1,614	1,672
Credit to the private sector	215	242	279	508	569	584	586	597	601
Other items (net)	-188	-201	-201	-198	-277	-235	-296	-338	-350
Liabilities to the Private Sector	**6,447**	**7,147**	**7,721**	**8,402**	**9,001**	**9,705**	**10,402**	**10,405**	**10,817**
Pension fund contributions	6,247	6,931	7,470	8,133	8,729	9,395	10,082	10,079	10,479
IV. Financial System									
Net Foreign Assets	**2,811**	**3,229**	**2,473**	**2,211**	**1,931**	**2,021**	**2,689**	**2,771**	**2,910**
Net Domestic Assets	**13,519**	**13,997**	**15,533**	**16,484**	**18,027**	**18,977**	**20,217**	**20,861**	**21,801**
Net claims on nonfinancial public sector	6,113	6,189	7,118	7,410	8,507	9,004	9,322	9,505	9,791
Credit to private sector	9,199	9,574	10,357	11,047	11,597	12,212	12,827	13,642	14,354
Other	-1,793	-1,766	-1,942	-1,973	-2,077	-2,239	-1,933	-2,286	-2,344
Liabilities to the Private Sector	**16,331**	**17,226**	**18,006**	**18,695**	**19,957**	**20,999**	**22,906**	**23,632**	**24,711**
Money	2,669	2,681	2,759	2,788	3,108	2,964	3,487	3,612	3,744
Quasi-money	7,415	7,614	7,777	7,775	8,120	8,640	9,337	9,940	10,488
Pension fund contributions	6,247	6,931	7,470	8,133	8,729	9,395	10,082	10,079	10,479
Memorandum Items	(Percent changes relative to previous year's liabilities to the private sector)								
Net domestic assets	6.7	2.9	8.9	9.0	14.6	8.5	10.7	5.0	6.9
Nonfinancial public sector	5.7	0.5	5.4	2.8	10.4	4.4	2.7	1.4	2.1
Credit to the private sector	2.8	2.3	4.5	6.6	5.2	5.5	5.3	6.4	5.3
Liabilities to the private sector	3.1	5.5	4.5	6.5	11.9	9.3	16.4	5.7	8.0
	(Percent of GDP)								
Credit to the private sector	45.3	44.8	47.1	48.9	49.5	50.6	51.5	52.4	53.2
Liabilities to the private sector	80.5	80.5	81.9	82.7	85.1	86.9	91.9	90.7	91.6
Excluding pension contributions	49.7	48.1	47.9	46.8	47.9	48.0	51.4	52.0	52.7
	(Annual percentage change, unless otherwise noted)								
Credit to the private sector	5.1	4.1	8.2	6.7	5.0	5.3	5.0	6.4	5.2
Private sector deposits in depository corporations	-0.6	2.4	2.8	-0.4	6.4	3.4	10.5	5.4	5.1
Depository corporations liquid deposits at central bank									
(In percent of total deposits)	24.1	23.1	25.0	25.0	24.4	24.9	25.1	24.5	24.5
(In percent of NIR)	90.7	70.1	91.0	92.8	96.1	92.3	91.8	92.6	92.9

Sources: Central Reserve Bank of El Salvador and IMF staff estimates.

1/ Beginning in 2010, gold in international reserves is valued at the price determined by the London Bullion Market (resulting in a valuation gain of US$170 million).

Table 7. El Salvador: Selected Vulnerability Indicators

(In percent of GDP; unless otherwise indicated)

	2010	2011	2012	2013	2014	2015	2016	2017	2018	Proj. 2019
Fiscal Indicators										
Overall balance of the nonfinancial public sector	-5.0	-4.5	-3.6	-4.5	-4.0	-3.6	-3.1	-2.5	-2.7	-3.4
Primary balance of the nonfinancial public sector	-2.2	-1.9	-1.0	-1.8	-1.3	-0.9	-0.2	0.7	0.9	0.7
Gross public sector financing requirement	9.3	10.3	8.0	9.9	10.0	6.5	9.2	9.0	7.1	10.7
Public sector debt (gross) 1/	60.6	59.5	63.8	63.8	65.6	66.8	68.5	70.0	69.8	70.8
Public sector external debt	34.4	31.6	34.5	34.2	37.3	35.5	37.0	36.8	34.6	35.8
External interest payments to total fiscal revenue (percent)	8.5	7.8	7.2	7.7	7.6	8.0	7.8	8.0	8.9	10.2
External amortization payments to total fiscal revenue (percent) 2/	8.1	22.4	6.4	5.5	5.7	5.3	5.8	5.8	6.0	18.8
Financial Indicators										
Broad money (percent change, end-of-period)	3.5	-0.2	2.1	2.3	0.3	6.3	3.3	10.5	5.7	5.0
Private sector credit (percent change, end-of-period)	0.0	5.1	4.1	8.2	6.7	5.0	5.3	5.0	6.4	5.2
Ratio of capital to risk-weighted assets	17.6	17.1	17.3	17.3	16.6	16.8	16.9	16.3	16.1	...
Ratio of loans more than 90 days past due to total loans	3.9	3.6	2.9	2.3	2.4	2.3	2.0	1.9	1.9	...
Ratio of provisions to total loans	4.3	3.8	3.3	2.9	2.8	2.7	2.4	2.4	2.5	...
Ratio of provisions to loans more than 90 days past due	107.9	107.8	113.3	121.6	119.0	115.9	118.0	122.5	129.0	...
Return on average equity	7.3	12.2	12.4	12.4	10.0	7.9	6.9	7.3	7.6	...
Return on average total assets	0.9	1.5	1.6	1.6	1.3	1.0	0.9	0.9	0.9	...
Loans as percent of deposits	84.5	88.9	93.7	97.2	103.2	102.1	107.1	102.0	103.2	...
Ratio of liquid assets to total deposits	42.0	37.0	31.9	30.7	28.1	32.3	30.9	34.6	32.5	...
External Indicators										
Exports of goods and services (percent change, 12-month basis)	17.9	18.3	3.9	7.0	1.3	4.4	-0.6	5.1	4.3	2.4
Imports of goods and services (percent change, 12-month basis)	15.9	18.7	2.9	6.3	-1.0	-1.0	-1.9	5.8	11.8	3.4
Current account balance	-2.9	-5.5	-5.8	-6.9	-5.4	-3.2	-2.3	-1.9	-4.8	-4.4
Capital and financial account balance	1.1	4.5	10.6	5.3	2.1	4.0	5.4	3.8	4.0	5.0
Gross international reserves (millions of U.S. dollars)	2,882	2,503	3,175	2,745	2,693	2,787	3,238	3,567	3,569	3,728
Months of imports of goods and services, excluding maquila	3.6	3.1	3.6	3.2	3.1	3.3	3.6	3.6	3.5	3.5
Percent of short-term debt	345	217	208	150	138	146	125	175	172	174
Percent of gross external financing requirements	127	73	99	71	69	82	101	105	90	76
Percent of broad money	28.5	24.8	30.8	26.1	25.5	24.8	27.9	27.8	26.3	26.2
Public external debt service 2/	3.0	6.1	2.7	2.6	2.6	3.0	3.0	3.1	3.8	6.7
External debt to exports of goods and services (percent)	229	202	205	215	224	220	238	228	221	225
External interest payments to exports of goods and services (percent)	11.5	11.1	15.1	15.9	16.9	17.1	19.4	20.9	21.8	22.3
External amortization to exports of goods and services (percent) 2/	34.9	39.2	32.4	35.7	40.2	38.4	38.7	40.5	36.3	48.2
REER, depreciation is negative (percent change, end-of-period)	-1.6	1.6	-1.8	-1.0	1.8	4.5	-1.0	-3.5	1.5	0.0

Sources: Central Reserve Bank of El Salvador, Ministry of Finance, Financial Superintendency, and IMF staff estimates.

1/ Includes gross debt of the nonfinancial public sector and external debt of the central bank.

2/ In 2011, includes rollover of a maturing external bond.

Table 8. El Salvador: Public Sector Financing Requirements and Sources

	2016	2017	2018	Projections 2019	2020	2021	2022	2023	2024
				(Millions of U.S. dollars)					
Gross financing requirements	**2,214**	**2,237**	**1,860**	**2,898**	**2,147**	**2,154**	**2,257**	**2,941**	**2,344**
Overall deficit	751	631	695	913	999	856	928	1,037	1,144
Public debt amortizations	1,463	1,605	1,165	1,985	1,148	1,298	1,329	1,904	1,200
External	305	323	355	1120	340	306	300	1117	416
Multilaterals and bilaterals	305	323	355	320	340	306	300	317	416
Bonds	0	0	0	800	0	0	0	800	0
Domestic	1158	1282	811	865	808	992	1029	787	784
Of which: Short-term debt (letes) 1/	1000	1047	768	833	760	760	760	760	760
Sources of financing	**2,214**	**2,237**	**1,860**	**2,898**	**2,147**	**2,154**	**2,257**	**2,941**	**2,344**
External	292	955	548	1,782	353	340	340	340	340
Multilaterals and bilaterals	292	354	548	485	353	340	340	340	340
Bonds	0	601	0	1,297	0	0	0	0	0
Domestic	1,922	1,282	1,312	1,116	1,203	970	968	967	967
Pension funds	-520	-560	366	356	443	210	208	207	207
Use of BCR deposits	-116	15	0	0	0	0	0	0	0
Short-term debt (letes) 1/	1,243	732	833	760	760	760	760	760	760
Others, including floating debt	1,316	1,095	113	0	0	0	0	0	0
Unidentified financing	0	0	0	0	591	844	949	1,634	1,037
Memorandum items									
Nominal GDP	24,154	24,928	26,057	26,990	28,248	29,475	30,730	32,033	33,391
				(Percent of GDP)					
Gross financing requirements	**9.2**	**9.0**	**7.1**	**10.7**	**7.6**	**7.3**	**7.3**	**9.2**	**7.0**
Overall deficit	3.1	2.5	2.7	3.4	3.5	2.9	3.0	3.2	3.4
Public debt amortizations	6.1	6.4	4.5	7.4	4.1	4.4	4.3	5.9	3.6
External	1.3	1.3	1.4	4.1	1.2	1.0	1.0	3.5	1.2
Multilaterals and bilaterals	1.3	1.3	1.4	1.2	1.2	1.0	1.0	1.0	1.2
Bonds	0.0	0.0	0.0	3.0	0.0	0.0	0.0	2.5	0.0
Domestic	4.8	5.1	3.1	3.2	2.9	3.4	3.3	2.5	2.3
Of which: Short-term debt (letes) 1/	4.1	4.2	2.9	3.1	2.7	2.6	2.5	2.4	2.3
Sources of financing	**9.2**	**9.0**	**7.1**	**10.7**	**7.6**	**7.3**	**7.3**	**9.2**	**7.0**
External	1.2	3.8	2.1	6.6	1.3	1.2	1.1	1.1	1.0
Multilaterals and bilaterals	1.2	1.4	2.1	1.8	1.3	1.2	1.1	1.1	1.0
Bonds	0.0	2.4	0.0	4.8	0.0	0.0	0.0	0.0	0.0
Domestic	8.0	5.1	5.0	4.1	4.3	3.3	3.2	3.0	2.9
Pension funds	-2.2	-2.2	1.4	1.3	1.6	0.7	0.7	0.6	0.6
Use of BCR deposits	-0.5	0.1	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Short-term debt (letes) 1/	5.1	2.9	3.2	2.8	2.7	2.6	2.5	2.4	2.3
Others	5.4	4.4	0.4	0.0	0.0	0.0	0.0	0.0	0.0
Unidentified financing	0.0	0.0	0.0	0.0	2.1	2.9	3.1	5.1	3.1

Sources: Central Reserve Bank of El Salvador; Ministry of Finance; and IMF staff estimates.

1/ The entire amount of LETES is recorded under domestic financing given that the market has always been dominated by resident investors. However, a relatively small amount of LETES (about 80 million of U.S dollars at end-2017) has been held by foreign residents.

Table 9. El Salvador: Financial Soundness Indicators Heatmap

El Salvador	2016Q2	2016Q3	2016Q4	2017Q1	2017Q2	2017Q3	2017Q4	2018Q1	2018Q2	2018Q3	2018Q4	Latest
Overall Financial Sector Rating	L	L	L	L	L	L	L	L	L	L	L	L
Credit cycle	L	L	L	L	L	L	L	L	L	L	L	L
Change in credit / GDP ratio (pp, annual)	1.0	1.0	1.0	0.9	0.9	0.8	0.7	0.8	0.9	1.0	1.1	1.1
Growth of credit / GDP (%, annual)	2.1	2.1	2.1	2.0	1.8	1.6	1.5	1.7	1.9	2.1	2.2	2.2
Credit-to-GDP gap (st. dev)	-1.7	-1.7	-1.6	-1.6	-1.5	-1.4	-1.3	-1.0	-0.8	-0.5	-0.2	-0.2
Balance Sheet Soundness	L	L	L	L	L	L	L	L	L	L	L	L
Balance Sheet Structural Risk	L	L	L	L	L	L	L	L	L	L	L	L
Deposit-to-loan ratio	94.8	94.0	94.0	95.7	93.4	94.1	95.4	96.9	97.1	95.1	95.2	95.2
FX liabilities % (of total liabilities)	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
FX loans % (of total loans)	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Balance Sheet Buffers	L	L	L	L	L	L	L	L	L	L	L	L
Leverage	L	L	L	L	L	L	L	L	L	L	L	L
Leverage ratio (%)	13.4	13.5	13.5	12.9	13.1	13.3	13.3	12.9	13.1	13.2	13.0	13.0
Profitability	L	L	L	L	L	L	L	L	L	L	L	L
ROA	0.9	0.9	0.9	0.9	0.9	0.9	1.0	1.0	1.0	1.0	1.1	1.1
ROE	6.4	6.6	6.6	7.1	6.5	6.8	7.4	7.4	7.8	7.7	8.7	8.7
Asset quality	L	L	L	L	L	L	L	L	L	L	L	L
NPL ratio	2.1	2.1	2.1	1.9	2.0	1.9	1.9	1.9	1.9	1.9	1.8	1.8
NPL ratio change (%, annual)	-10.8	-13.6	-7.7	-14.7	-5.3	-7.2	-9.0	-2.9	-3.0	-2.6	-2.5	-2.5

Memo items:	2016Q2	2016Q3	2016Q4	2017Q1	2017Q2	2017Q3	2017Q4	2018Q1	2018Q2	2018Q3	2018Q4	Latest
Credit-to-GDP (%)	48.1	48.4	48.6	48.8	49.0	49.2	49.3	49.6	49.9	50.2	50.5	50.5
Credit-to-GDP gap (%; HP filter)	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Credit growth (%; annual)	5.0	5.2	5.4	5.4	5.4	5.3	5.3	5.6	5.9	6.3	6.6	6.6
CAR (in %)	17.3	17.4	17.3	16.6	16.6	16.7	16.8	16.6	16.6	16.6	16.6	16.6
Tier 1 CAR (in %)	14.4	14.3	14.1	13.8	13.7	13.7	13.8	13.9	13.7	13.5	13.2	13.2

Annex I. Public Debt Sustainability Analysis

The debt stock was 69.8 percent of GDP at end-2018, well above prudent levels for El Salvador. Primary deficit reduction and the pension reform have contributed to temporarily stabilizing the debt in 2018 and curb the projected debt path well below the historical trend. However, gross public financing needs remain relatively high for a dollarized economy, and debt remains vulnerable to risks, including growth and financing shocks. These risks are mitigated by the long maturity of the existing debt and a stable investor base.

A. Key Assumptions

1. Debt definition. The public debt sustainability analysis focuses on a definition of gross debt which comprises the nonfinancial public sector[1] (NFPS) and the external debt of the central bank. The series is published by the Ministry of Finance regularly in their reports and public presentations. In staff's definition, the NFPS includes pension-related debt (the so-called *CIP-A* bonds that are issued to finance current public pension payments).

2. Macroeconomic outlook. The baseline reflects the estimated growth potential of 2.2 percent. No further fiscal adjustment is assumed; hence the dynamics of the primary balance reflect mainly the declining pension payments due to the pension reform. The interest bill is projected to rise over the medium-term to reflect the current tighter global financial conditions, widening further the negative growth/interest differential. The latter is the main driver of the public debt dynamics. The scenario assumes that financing gaps are filled mainly with long-term loans from private external creditors and short-term domestic bonds. Inflation is expected to remain anchored at about 1 percent over the medium term.

B. Results and Assessment

3. Baseline scenario results. The public debt would drift to 72.2 percent of GDP by 2024 and continue its mildly upward trajectory thereafter (see first table and charts). Financing needs, averaging 8.2 percent of GDP over 2019-24, are driven by a deterioration of the primary balance and a rise in domestic amortization payments that reflect the observed increase in short-term debt (LETES) in 2018. The high public debt ratio and economic growth already at potential have de facto erased the fiscal space.

4. Drivers. Interest rates are the major contributor to the upward debt dynamics, averaging about 3 percent of GDP contribution on an annual basis (see second table). Primary surpluses and real GDP growth mitigate these increases, with annual contributions reducing debt, by about 1 and 1½ percent of GDP, respectively.

[1] The NFPS debt definition excludes municipal debt (1½ percent of GDP), pension system's recognition bonds (CIP-B bonds) and some SOEs debt.

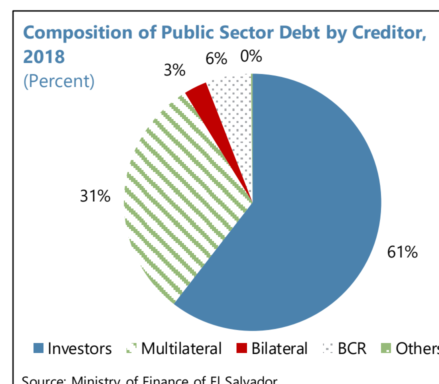
5. Stress scenario. Assumptions. Mostly standard shock scenarios (declines by one standard deviation of the main variable shocked) have been considered for comparability. The impact of a natural disaster assumes a decline of GDP growth by 3 percentage points the first year and 2 percentage points the following year. **Results.** Real GDP and contingent liability shocks have a relatively significant impact, the latter being particularly costly since it increases financing needs significantly. A combined macro-fiscal shock and a natural disaster shock would also be challenging.

6. Assessment. Most standard debt profile characteristics are of concern (heat-map). Moreover, the heat-map may understate some risks, because: (i) the gross financing threshold of the heat map (15 percent of GDP) does not account that it is harder for dollarized economies to mobilize financing, (ii) the measured share of "foreign currency" debt (close to zero) reflects the legal adoption of the U.S. dollar, not the implied benefits of issuing own-currency liabilities.

7. Idiosyncratic risks and issues. A major risk to the debt dynamics is the reversal of the recent deficit reduction. Moreover, under tightening global financial conditions, greater financing needs due to a higher interest bill or reversal of deficit reduction would magnify vulnerabilities.

8. Vulnerability. The main vulnerability of the El Salvador public debt stems from its high level. Simulations show that combined macro-economic shocks could increase debt by about 8 percent of GDP, and a natural disaster by about 33 percent.

Composition of Public Sector Debt by Creditor, 2018
(Percent)



Source: Ministry of Finance of El Salvador

9. Mitigating factors. The relatively long average debt maturity (12 years) of existing debt, and a stable investor base (over one-half of the debt is held by domestic pension funds and official creditors) partly mitigate debt vulnerabilities.

10. Based on past fiscal performance and multiple methodologies, the appropriate public debt level for El Salvador is 50 percent of GDP.

- Emerging market economies have been unable to generate adequate primary surpluses, in part due to weak revenue bases (lower yields and higher volatility) and less effectiveness to control expenditure during economic expansion. Mendoza and Oviedo (2004), building on Buiter (1985) and Blanchard et al. (1990), find that the sustainable level of debt for emerging markets is 45 percent of GDP. More recent research (e.g., Ostry et al. (2010)) recommends a median long-run debt level of about 50 percent of GDP.

- Estimations for El Salvador, taking into account its features, including dollarization, suggested a prudent debt level of about 40 percent of GDP in 2015. Due to the downward revision of the national accounts in March 2018, which pushed debt as a percent of GDP up, the 2018 Staff report suggested subsequently 50 percent of GDP as a prudent and achievable level of debt by 2030.

Therefore, reducing the public debt from the current level of about 70 percent of GDP at end-2018 to 50 percent of GDP by 2030 would help create fiscal space and reduce financing needs.

Figure AI.1. El Salvador: Public Sector Debt Sustainability Analysis (DSA) - Baseline Scenario

(In percent of GDP unless otherwise indicated)

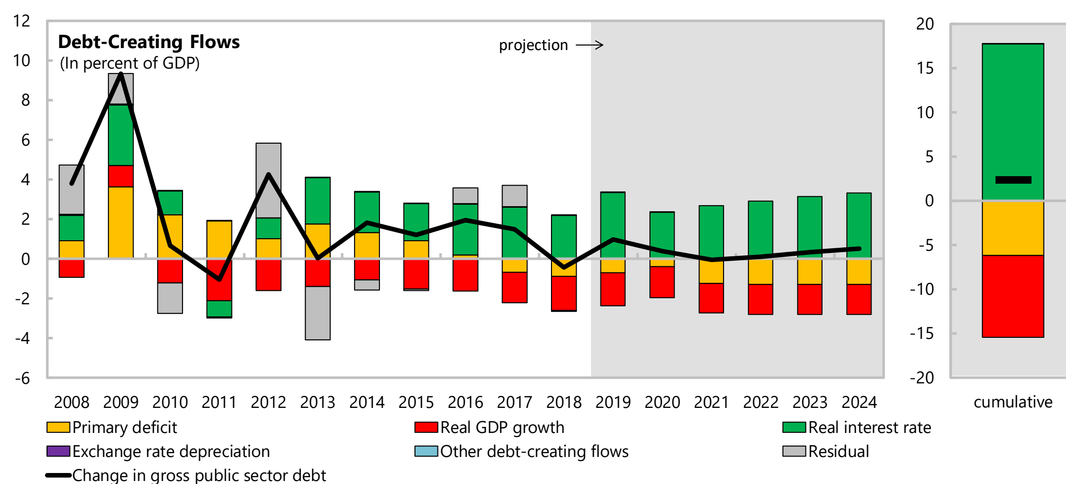
Debt, Economic and Market Indicators 1/

	Actual			Projections					
	2008-2016 2/	2017	2018	2019	2020	2021	2022	2023	2024
Nominal gross public debt	62.2	70.3	69.8	70.8	71.2	71.2	71.3	71.6	72.2
Public gross financing needs	9.2	9.0	7.1	10.7	7.6	7.3	7.4	9.3	7.0
Real GDP growth (in percent)	2.0	2.3	2.5	2.5	2.3	2.2	2.2	2.2	2.2
Inflation (GDP deflator, in percent)	2.0	0.9	1.9	1.1	2.3	2.1	2.0	2.0	2.0
Nominal GDP growth (in percent)	4.0	3.2	4.5	3.6	4.7	4.3	4.3	4.2	4.2
Effective interest rate (in percent) 4/	4.9	4.8	5.3	6.0	5.8	6.1	6.3	6.6	6.9

As of April 04, 2019		
Sovereign Spreads		
EMBIG (bp) 3/		442
5Y CDS (bp)		n.a.
Ratings	Foreign	Local
Moody's	B3	B3
S&Ps	B-	B-
Fitch	B-	B-

Contribution to Changes in Public Debt

	Actual			Projections							
	2008-2016	2017	2018	2019	2020	2021	2022	2023	2024	cumulative	debt-stabilizing primary balance /9
Change in gross public sector debt	2.4	1.5	-0.4	1.0	0.4	-0.1	0.1	0.3	0.5	2.3	
Identified debt-creating flows	2.0	0.4	-0.4	1.0	0.4	-0.1	0.1	0.3	0.5	2.3	
Primary deficit	1.5	-0.7	-0.9	-0.7	-0.4	-1.2	-1.3	-1.3	-1.3	-6.2	1.8
Primary (noninterest) revenue and gran	20.8	22.5	22.6	22.1	22.0	22.0	22.1	22.1	22.1	132.3	
Primary (noninterest) expenditure	22.4	21.9	21.7	21.4	21.6	20.8	20.8	20.8	20.8	126.1	
Automatic debt dynamics 5/	0.5	1.1	0.5	1.7	0.8	1.2	1.4	1.6	1.8	8.5	
Interest rate/growth differential 6/	0.5	1.1	0.5	1.7	0.8	1.2	1.4	1.6	1.8	8.5	
Of which: real interest rate	1.6	2.6	2.2	3.3	2.3	2.7	2.9	3.1	3.3	17.7	
Of which: real GDP growth	-1.2	-1.5	-1.7	-1.7	-1.6	-1.5	-1.5	-1.5	-1.5	-9.3	
Exchange rate depreciation 7/	0.0	0.0	0.0	…	…	…	…	…	…	…	
Other identified debt-creating flows	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	
0 (negative)	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	
Contingent liabilities	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	
Please specify (2) (e.g., ESM and Euroa	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	
Residual, including asset changes 8/	0.4	1.1	-0.1	0.0	0.0	0.0	0.0	0.0	0.0	0.0	



Source: IMF staff.

1/ Public sector is defined as non-financial public sector.

2/ Based on available data.

3/ Long-term bond spread over U.S. bonds.

4/ Defined as interest payments divided by debt stock (excluding guarantees) at the end of previous year.

5/ Derived as $[(r - \pi(1+g) - g + ae(1+r)]/(1+g+\pi+g\pi))$ times previous period debt ratio, with r = interest rate; π = growth rate of GDP deflator; g = real GDP growth rate; a = share of foreign-currency denominated debt; and e = nominal exchange rate depreciation (measured by increase in local currency value of U.S. dollar).

6/ The real interest rate contribution is derived from the numerator in footnote 5 as $r - \pi (1+g)$ and the real growth contribution as -g.

7/ The exchange rate contribution is derived from the numerator in footnote 5 as $ae(1+r)$.

8/ Includes asset changes and interest revenues (if any). For projections, includes exchange rate changes during the projection period.

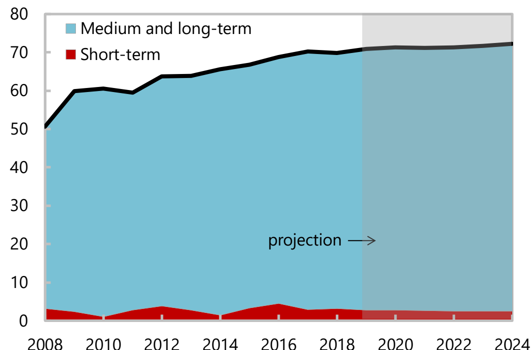
9/ Assumes that key variables (real GDP growth, real interest rate, and other identified debt-creating flows) remain at the level of the last projection year.

Figure AI.2. El Salvador: Public DSA – Composition of Public Debt and Alternative Scenarios

Composition of Public Debt

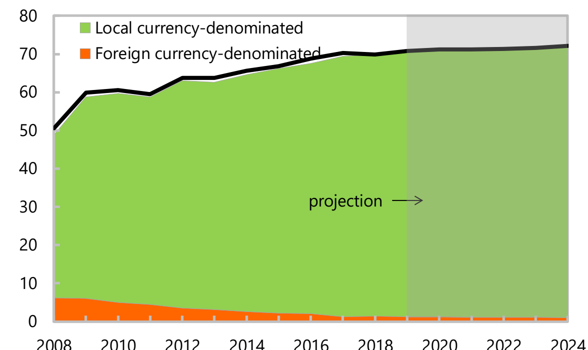
By Maturity

(In percent of GDP)



By Currency

(In percent of GDP)

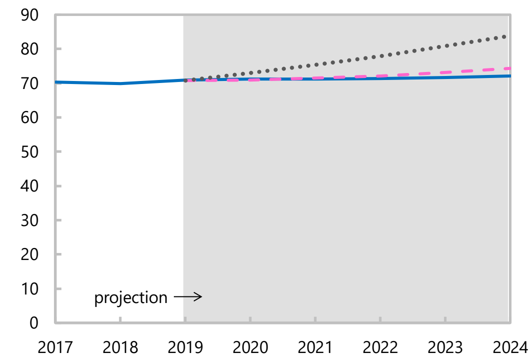


Alternative Scenarios

Baseline   Historical   Constant Primary Balance

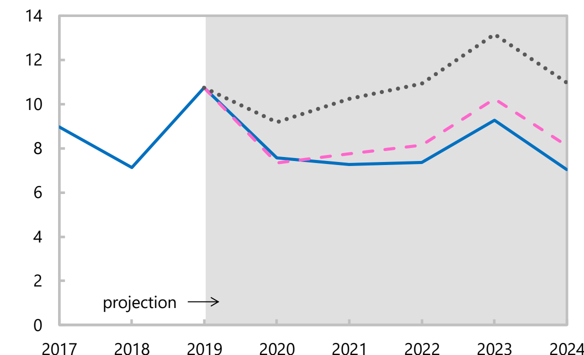
Gross Nominal Public Debt

(In percent of GDP)



Public Gross Financing Needs

(In percent of GDP)



Underlying Assumptions

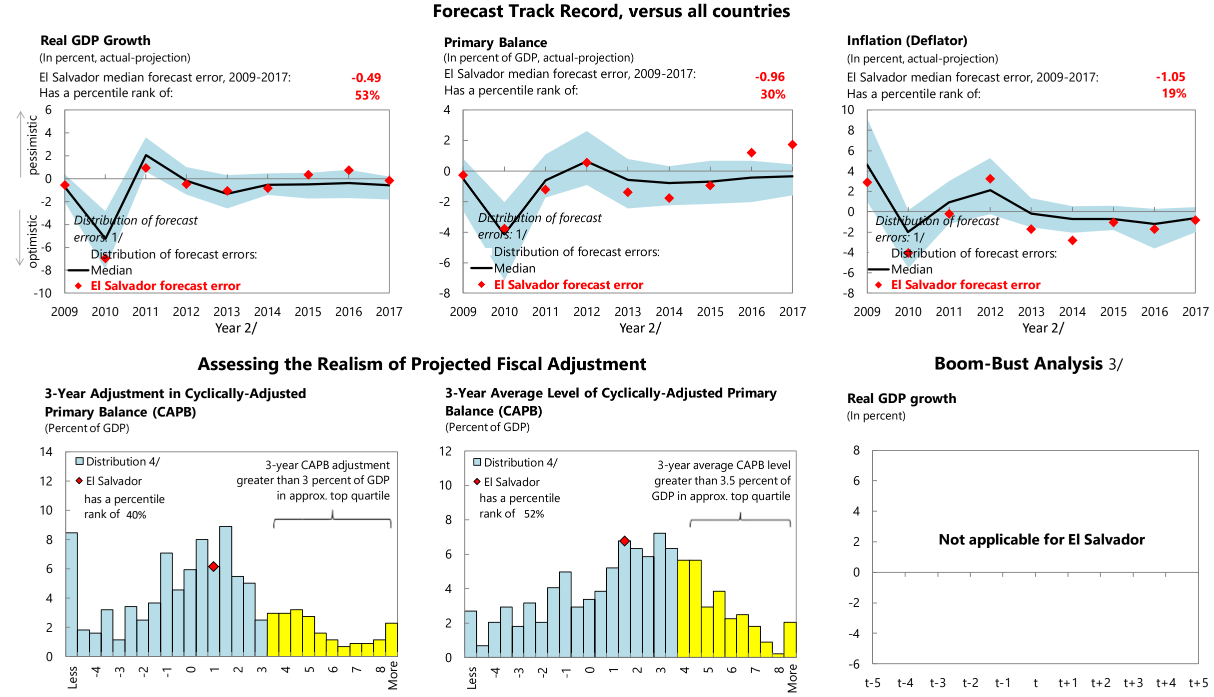
(In percent)

Baseline Scenario	2019	2020	2021	2022	2023	2024
Real GDP growth	2.5	2.3	2.2	2.2	2.2	2.2
Inflation	1.1	2.3	2.1	2.0	2.0	2.0
Primary Balance	0.7	0.4	1.2	1.3	1.3	1.3
Effective interest rate	6.0	5.8	6.1	6.3	6.6	6.9
Constant Primary Balance Scenario						
Real GDP growth	2.5	2.3	2.2	2.2	2.2	2.2
Inflation	1.1	2.3	2.1	2.0	2.0	2.0
Primary Balance	0.7	0.7	0.7	0.7	0.7	0.7
Effective interest rate	6.0	5.8	6.1	6.3	6.7	6.9

Historical Scenario	2019	2020	2021	2022	2023	2024
Real GDP growth	2.5	2.0	2.0	2.0	2.0	2.0
Inflation	1.1	2.3	2.1	2.0	2.0	2.0
Primary Balance	0.7	-1.1	-1.1	-1.1	-1.1	-1.1
Effective interest rate	6.0	5.8	5.9	6.1	6.4	6.5

Source: IMF staff.

Figure AI.3. El Salvador: Public DSA – Realism and Baseline Assumptions

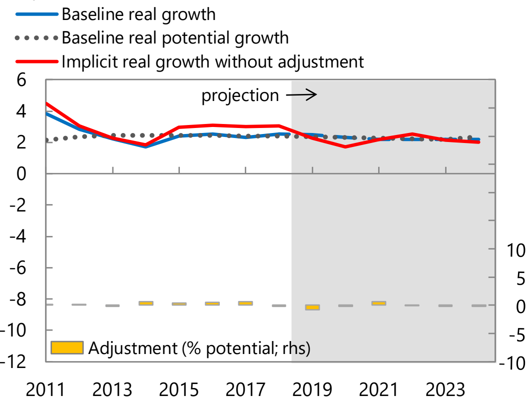


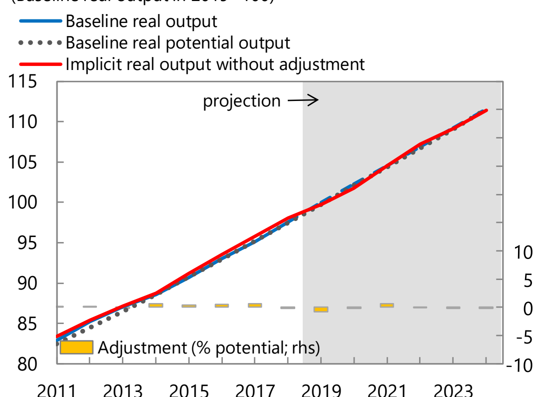
Source: IMF Staff.
1/ Plotted distribution includes all countries, percentile rank refers to all countries.
2/ Projections made in the spring WEO vintage of the preceding year.
3/ Not applicable for El Salvador, as it meets neither the positive output gap criterion nor the private credit growth criterion.
4/ Data cover annual obervations from 1990 to 2011 for advanced and emerging economies with debt greater than 60 percent of GDP. Percent of sample on vertical axis.

Figure AI.3. El Salvador: Public DSA – Realism and Baseline Assumptions (concluded)

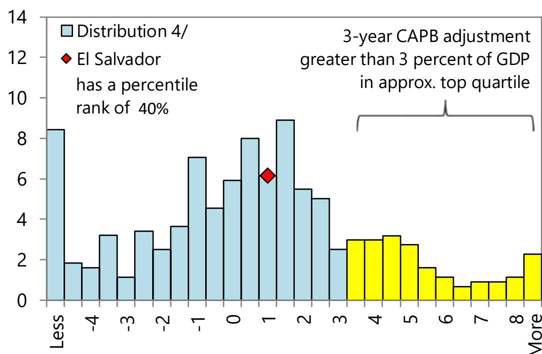
Growth and Level of Output in Absence of Fiscal Adjustment

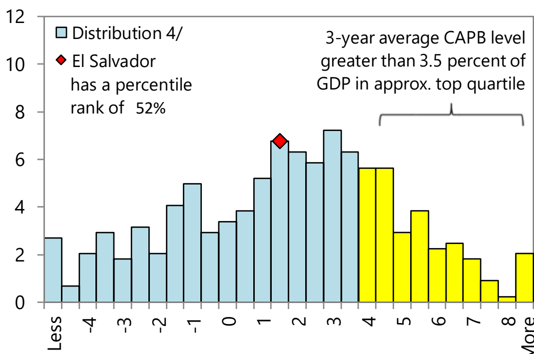
Assumed multiplier of 0.7, persistence of 0.3





Assessing the Realism of Projected Fiscal Adjustment

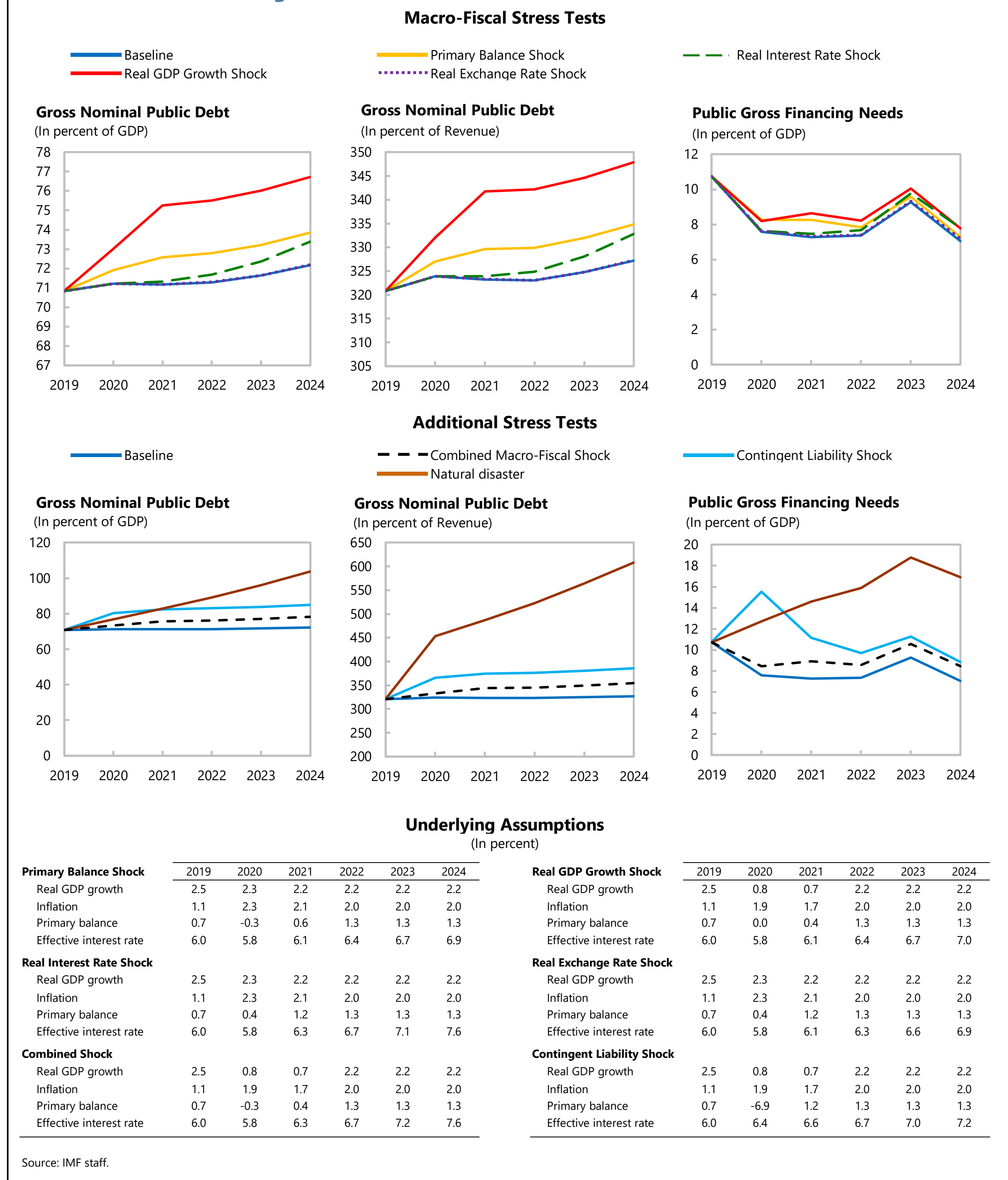




Source: IMF staff.

4/ Data cover annual obervations from 1990 to 2011 for advanced and emerging economies with debt greater than 60 percent of GDP. Percent of sample on vertical axis.

Figure AI.4. El Salvador: Public DSA – Stress Test



Underlying Assumptions

(In percent)

Primary Balance Shock	2019	2020	2021	2022	2023	2024
Real GDP growth	2.5	2.3	2.2	2.2	2.2	2.2
Inflation	1.1	2.3	2.1	2.0	2.0	2.0
Primary balance	0.7	-0.3	0.6	1.3	1.3	1.3
Effective interest rate	6.0	5.8	6.1	6.4	6.7	6.9
Real Interest Rate Shock						
Real GDP growth	2.5	2.3	2.2	2.2	2.2	2.2
Inflation	1.1	2.3	2.1	2.0	2.0	2.0
Primary balance	0.7	0.4	1.2	1.3	1.3	1.3
Effective interest rate	6.0	5.8	6.3	6.7	7.1	7.6
Combined Shock						
Real GDP growth	2.5	0.8	0.7	2.2	2.2	2.2
Inflation	1.1	1.9	1.7	2.0	2.0	2.0
Primary balance	0.7	-0.3	0.4	1.3	1.3	1.3
Effective interest rate	6.0	5.8	6.3	6.7	7.2	7.6

Real GDP Growth Shock	2019	2020	2021	2022	2023	2024
Real GDP growth	2.5	0.8	0.7	2.2	2.2	2.2
Inflation	1.1	1.9	1.7	2.0	2.0	2.0
Primary balance	0.7	0.0	0.4	1.3	1.3	1.3
Effective interest rate	6.0	5.8	6.1	6.4	6.7	7.0
Real Exchange Rate Shock						
Real GDP growth	2.5	2.3	2.2	2.2	2.2	2.2
Inflation	1.1	2.3	2.1	2.0	2.0	2.0
Primary balance	0.7	0.4	1.2	1.3	1.3	1.3
Effective interest rate	6.0	5.8	6.1	6.3	6.6	6.9
Contingent Liability Shock						
Real GDP growth	2.5	0.8	0.7	2.2	2.2	2.2
Inflation	1.1	1.9	1.7	2.0	2.0	2.0
Primary balance	0.7	-6.9	1.2	1.3	1.3	1.3
Effective interest rate	6.0	6.4	6.6	6.7	7.0	7.2

Source: IMF staff.

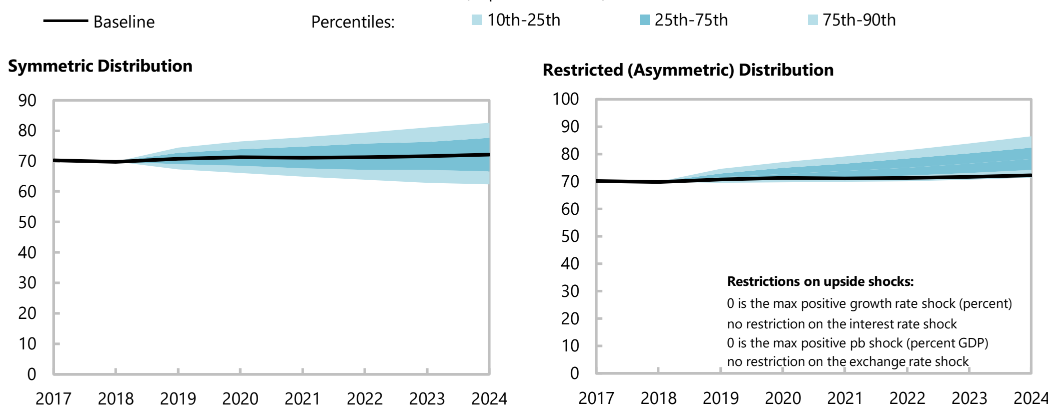
Figure AI.5. El Salvador: Public DSA Risk Assessment

Heat Map

Debt level 1/	Real GDP Growth Shock	Primary Balance Shock	Real Interest Rate Shock	Exchange Rate Shock	Contingent Liability shock
Gross financing needs 2/	Real GDP Growth Shock	Primary Balance Shock	Real Interest Rate Shock	Exchange Rate Shock	Contingent Liability Shock
Debt profile 3/	Market Perception	External Financing Requirements	Change in the Share of Short-Term Debt	Public Debt Held by Non-Residents	Foreign Currency Debt

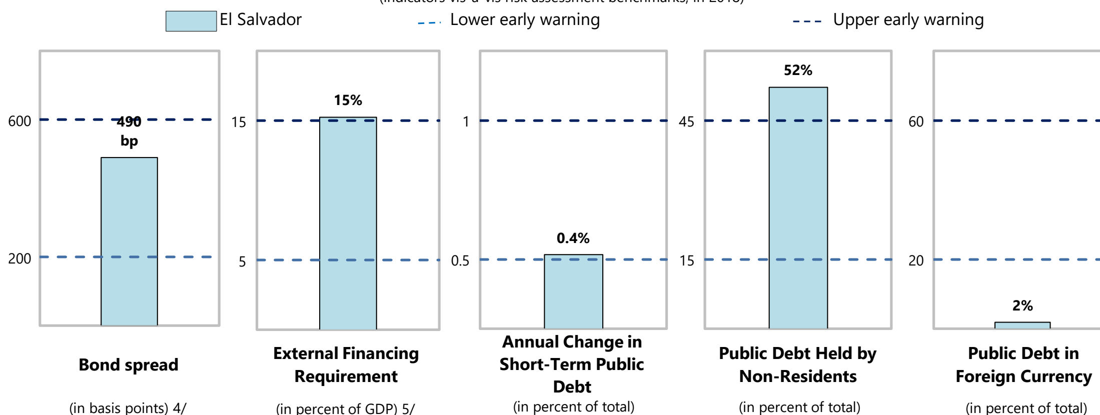
Evolution of Predictive Densities of Gross Nominal Public Debt

(In percent of GDP)



Debt Profile Vulnerabilities

(Indicators vis-à-vis risk assessment benchmarks, in 2018)



Source: IMF staff.

1/ The cell is highlighted in green if debt burden benchmark of 70% is not exceeded under the specific shock or baseline, yellow if exceeded under specific shock but not baseline, red if benchmark is exceeded under baseline, white if stress test is not relevant.

2/ The cell is highlighted in green if gross financing needs benchmark of 15% is not exceeded under the specific shock or baseline, yellow if exceeded under specific shock but not baseline, red if benchmark is exceeded under baseline, white if stress test is not relevant.

3/ The cell is highlighted in green if country value is less than the lower risk-assessment benchmark, red if country value exceeds the upper risk-assessment benchmark, yellow if country value is between the lower and upper risk-assessment benchmarks. If data are unavailable or indicator is not relevant, cell is white.
Lower and upper risk-assessment benchmarks are:

200 and 600 basis points for bond spreads; 5 and 15 percent of GDP for external financing requirement; 0.5 and 1 percent for change in the share of short-term debt; 15 and 45 percent for the public debt held by non-residents; and 20 and 60 percent for the share of foreign-currency denominated debt.

4/ Long-term bond spread over U.S. bonds, an average over the last 3 months, 04-Jan-19 through 04-Apr-19.

5/ External financing requirement is defined as the sum of current account deficit, amortization of medium and long-term total external debt, and short-term total external debt at the end of previous period.

C. External DSA

11. The current account deficit, after seeing a sustained improvement during 2014-17, worsened to 4.8 percent in 2018. This is mainly due to the sharp deterioration in the merchandise trade balance, while remittances continued to surge. After peaking in 2019, remittances are expected to fall back to its trend rate in the medium-term, which combined with steadily worsening income balance will result in a mild widening of the current account deficit to 5 percent by 2024. External debt is expected to remain stable, with an expansion of public sector debt offset by a reduction in private sector debt.

12. The external debt path does not show much sensitivity to the interest rate and growth shocks. The non-interest current account shock and combined shock have larger effects, along with the combination of interest rate, growth and current account shocks. The largest negative effect is observed in response to the real exchange rate depreciation shock, which in case of El Salvador assumes a one period shock to the nominal 1-1 peg given the dollarization.

Table AI.1. El Salvador: External Debt Sustainability Framework, 2013-23

(In percent of GDP, unless otherwise indicated)

	Actual							Projections						
	2014	2015	2016	2017	2018	10-Year Historical Average	10-Year Standard Deviation	2019	2020	2021	2022	2023	2024	Debt-stabilizing non-interest current account /6
Baseline: External debt	65.5	64.9	67.8	66.1	63.9			**64.3**	**64.0**	**64.0**	**63.9**	**63.9**	**63.9**	**0.0**
Change in external debt	1.7	-0.6	2.9	-1.7	-2.1			0.4	-0.3	-0.1	0.0	0.0	0.0	
Identified external debt-creating flows (4+8+9)	2.9	-0.1	-0.8	-5.2	-0.2			1.0	1.2	1.6	1.7	1.8	2.1	
Current account deficit, excluding interest payments	2.4	0.0	-1.2	-1.9	0.7			0.2	0.2	0.3	0.5	0.6	0.8	
Deficit in balance of goods and services	19.6	17.1	15.9	16.5	19.7			19.9	19.8	19.7	19.7	19.7	19.7	
Exports	29.3	29.5	28.4	29.0	28.9			28.6	28.4	28.4	28.4	28.5	28.5	
Imports	48.9	46.6	44.4	45.5	48.6			48.5	48.2	48.1	48.2	48.1	48.2	
Net non-debt creating capital inflows (negative)	-0.8	-0.9	-1.2	-4.9	-2.1			-1.8	-1.8	-1.6	-1.6	-1.6	-1.5	
Automatic debt dynamics 1/	1.3	0.8	1.5	1.7	1.2			2.7	2.8	2.9	2.9	2.8	2.8	
Contribution from nominal interest rate	3.0	3.2	3.5	3.8	4.1			4.3	4.2	4.2	4.2	4.1	4.1	
Contribution from real GDP growth	-1.1	-1.5	-1.6	-1.5	-1.6			-1.5	-1.4	-1.4	-1.3	-1.3	-1.3	
Contribution from price and exchange rate changes 2/	-0.6	-0.8	-0.3	-0.6	-1.3			...	...	...	...	...	...	
Residual, incl. change in gross foreign assets (2-3) 3/	-1.2	-0.5	3.7	3.5	-1.9			-0.7	-1.5	-1.7	-1.8	-1.8	-2.1	
External debt-to-exports ratio (in percent)	223.6	220.1	238.3	228.0	221.2			225.2	225.4	225.0	224.9	224.3	224.1	
Gross external financing need (in billions of U.S. dollars) 4/	3.9	3.4	3.2	3.4	4.0			4.9	4.3	4.4	4.8	5.8	5.4	
in percent of GDP	17.2	14.5	13.3	13.6	15.3			18.2	15.0	14.9	15.7	18.2	16.2	
Scenario with key variables at their historical averages 5/								**64.3**	**64.3**	**64.0**	**63.5**	**62.9**	**62.0**	**-1.0**
Key Macroeconomic Assumptions Underlying Baseline														
Real GDP growth (in percent)	1.7	2.4	2.5	2.3	2.5	2.0	1.5	2.5	2.3	2.2	2.2	2.2	2.2	
GDP deflator in U.S. dollars (change in percent)	1.0	1.3	0.5	0.9	1.9	1.7	1.7	1.1	2.3	2.1	2.0	2.0	2.0	
Nominal external interest rate (in percent)	4.8	5.1	5.5	5.7	6.4	4.8	0.9	6.9	6.9	6.9	6.8	6.7	6.8	
Growth of exports (U.S. dollar terms, in percent)	1.3	4.4	-0.6	5.1	4.3	4.9	8.8	2.4	4.1	4.4	4.2	4.5	4.3	
Growth of imports (U.S. dollar terms, in percent)	-1.0	-1.0	-1.9	5.8	11.8	3.4	11.9	3.4	3.9	4.3	4.3	4.2	4.5	
Current account balance, excluding interest payments	-2.4	0.0	1.2	1.9	-0.7	-1.1	2.1	-0.2	-0.2	-0.3	-0.5	-0.6	-0.8	
Net non-debt creating capital inflows	0.8	0.9	1.2	4.9	2.1	1.6	1.3	1.8	1.8	1.6	1.6	1.6	1.5	

1/ Derived as [r - g - r(1+g) + ea(1+r)]/(1+g+r+gr) times previous period debt stock, with r = nominal effective interest rate on external debt; r = change in domestic GDP deflator in US dollar terms, g = real GDP growth rate, e = nominal appreciation (increase in dollar value of domestic currency), and a = share of domestic-currency denominated debt in total external debt.

2/ The contribution from price and exchange rate changes is defined as [-r(1+g) + ea(1+r)]/(1+g+r+gr) times previous period debt stock. r increases with an appreciating domestic currency (e > 0) and rising inflation (based on GDP deflator).

3/ For projection, line includes the impact of price and exchange rate changes.

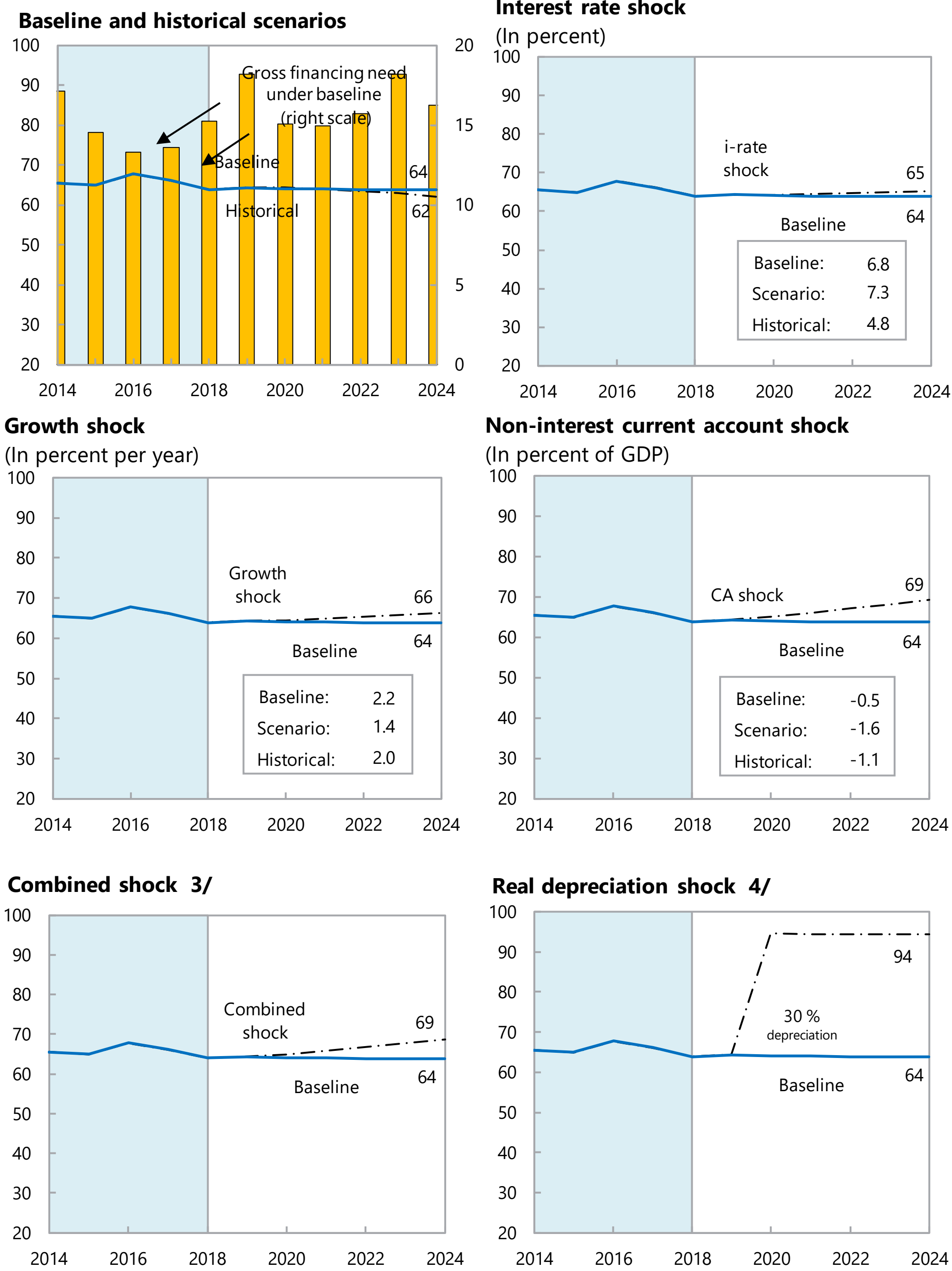
4/ Defined as current account deficit, plus amortization on medium- and long-term debt, plus short-term debt at end of previous period.

5/ The key variables include real GDP growth; nominal interest rate; dollar deflator growth; and both non-interest current account and non-debt inflows in percent of GDP.

6/ Long-run, constant balance that stabilizes the debt ratio assuming that key variables (real GDP growth, nominal interest rate, dollar deflator growth, and non-debt inflows in percent of GDP) remain at their levels of the last projection year.

Figure AI.6. El Salvador: External Debt Sustainability: Bound Test 1/ 2/

(External debt in percent of GDP)



Sources: International Monetary Fund, Country desk data, and staff estimates.

1/ Shaded areas represent actual data. Individual shocks are permanent one-half standard deviation shocks. Figures in the boxes represent average projections for the respective variables in the baseline and scenario being presented. Ten-year historical average for the variable is also shown.

2/ For historical scenarios, the historical averages are calculated over the ten-year period, and the information is used to project debt dynamics five years ahead.

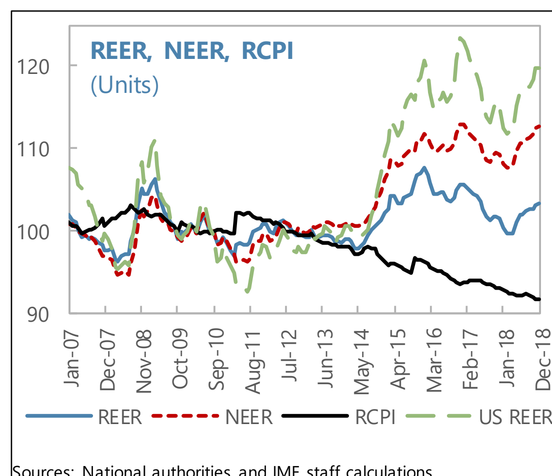
3/ Permanent 1/4 standard deviation shocks applied to real interest rate, growth rate, and current account balance.

4/ One-time real depreciation of 30 percent occurs in 2019.

Annex II. External Sector Assessment

The sustained improvement in El Salvador's current account balance since 2014 was reversed in 2018. This was the result of stagnant exports and a broad-based ramp up in imports. The external position for 2018 is assessed to be moderately weaker than that suggested by fundamentals and desirable policies, implying a real effective exchange rate overvaluation of 4-6 percent.

1. The current account deficit worsened, as the real effective exchange rate appreciated. The steady shrinking of the current account (CA) deficit observed since 2014 was reversed in 2018.[1] The CA deficit widened to 4.8 percent of GDP in 2018 from a low of 1.9 percent in 2017, owing to the sharp slowdown in exports and broad-based increase in imports, including oil imports due to higher oil prices. Export stagnancy was the result of a decline in coffee and sugar prices, regional trade disruption due to unrest in Nicaragua, and slowdown in textile and clothing exports (largest export sector). The surge in remittances continued, which partly offset the worsening trade balance. The real effective exchange rate (REER) appreciated by 3 percent during 2018, owing to the strengthening of the U.S. dollar against currencies of the main trading partners. As a result, about half of the REER correction that took place during 2016-17, following the appreciation of 2014-15, has been erased.



Sources: National authorities and IMF staff calculations.

2. The external balance position for 2018 is assessed to be moderately weaker than the level implied by fundamentals and desirable policies.

- The CA norm deficit, determined by desirable policies and current fundamentals, is estimated to be 5.0 percent of GDP. Though this is larger than the actual 2018 deficit of 4.8 percent, the resulting a CA gap is -0.3 percent (after accounting for cyclical and multilateral adjustments), of which the policy gap is -1.7 percent (largely due to changes in reserves and public health expenditure). The implied REER gap is 1.1 percent, and hence *the EBA-lite approach signals an overvaluation of 1 percent.*

- *The REER approach shows an overvaluation of 5.8 percent.*

[1] Initiated by the oil prices decline after 2014 and later supported by a surge in remittances after 2015.

- Given the sizeable negative net foreign asset position (NFA) of 62.3 percent of GDP for 2018, staff also puts weight on external sustainability. The *External Sustainability (ES) approach estimates the CA gap to be -1 percent and implies an overvaluation of 4.3 percent.*[2]

- ***Therefore, overall the staff assesses the external balance to be moderately weaker, with an overvaluation of the REER in the range of 4 to 6 percent.***

El Salvador: Current Account and Exchange Rate Assessment

	CA norm 1/ (% of GDP)	CA actual (% of GDP)	CA Gap (Cyclically and multi-laterally adjusted)	REER Gap 2/
EBA-lite CA methodology	-5.0	-4.8	-0.3	1.1%
	ln(REER) norm	ln(REER) actual		REER Gap
EBA-lite REER methodology	4.56	4.62		5.8%

Source: Fund staff estimates and projections.
1/ Oil prices are assumed to affect the CA norm and underlying CA symmetrically
2/ Positive REER gap implies overvaluation. In the CA approach, export elasticity is -0.44 and import elasticity is 0.29.

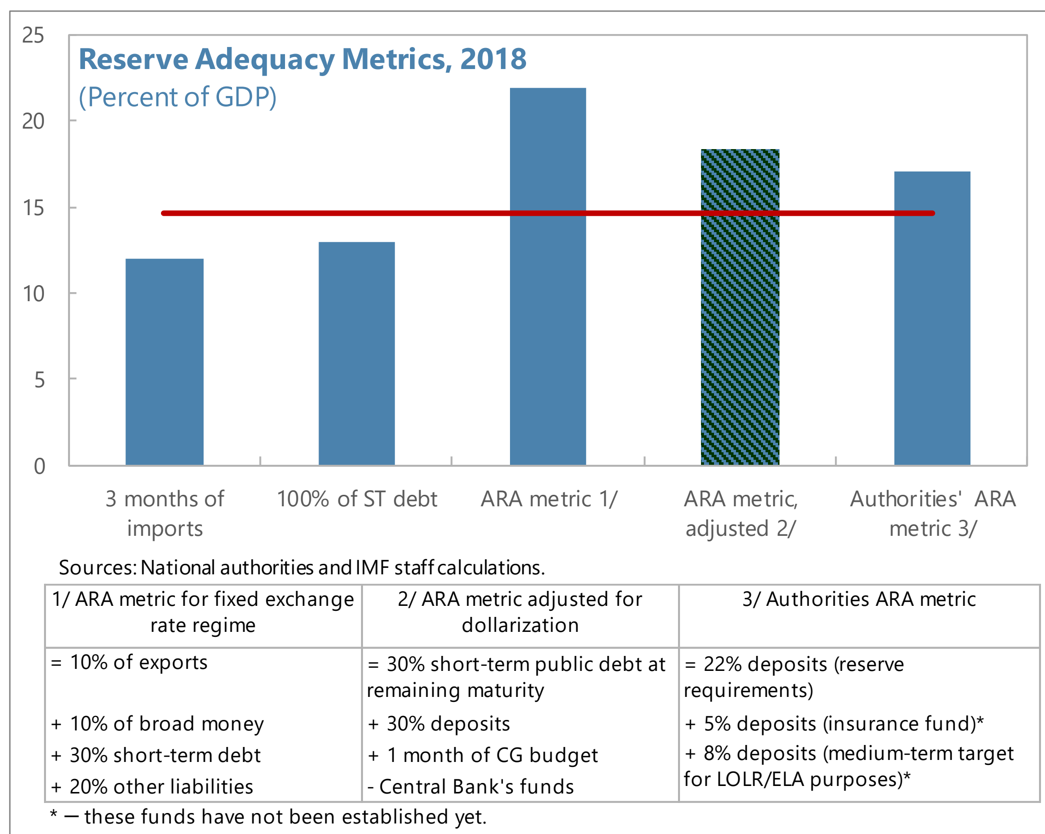
3. Improving export competitiveness will require a multi-pronged approach. The key areas of focus include: (i) invest in education and training (exports tend to be of higher quality); (ii) increase access to finance (exporting involves high fixed/sunk costs); (iii) support for investment in research, technology, and innovation (to move up the product quality ladder); and (iv) provision of reliable infrastructure and an entrepreneur enabling regulatory environment. The global competitiveness rankings (2017-18) show that El Salvador lags behinds its peers in Central and Latin America in the domains of business dynamism, innovation capability, institutions, skills and labor markets. Additionally, the Doing Business (2019) indicators show that there are significant gaps to bridge in costs of starting a business and in dealing with construction permits, while there has been a significant reduction in time and cost of trading across borders. Lastly, according to the 2016 World Bank enterprise surveys, crime, theft and disorder was rated as the top constraint across firms, unfair competition from informal firms ranked second for small firms, lack of access to finance ranked third for medium sized firms, and cumbersome licensing and permits procedures ranked third for the largest firms.[3]

[2] However, this estimate relies on data up to 2016, which is based on the old GDP series. After the data revision in 2018, the 2016 NFA position shot up to 66 percent of GDP from the pre-revision level of 60 percent. In the 2017 external sector assessment, staff estimated that improving the net IIP position to -50 percent would yield a CA norm of -2.5 percent and a CA gap of -2 percent which translated into an overvaluation of 15 percent.

[3] Lack of political stability was among the top 3 constraints for firms of all sizes.

4. The level of international reserves continues to be significantly below the adequate level implied by the risk-weighted Assessing the Reserve Adequacy (ARA) metric. Despite the recovery since 2014, due to the improvement in trade balance and sustained increase in remittance inflows, reserves remain below the ARA benchmark at 62 percent of the level deemed adequate. Additionally, the level of reserves is also lower than the level determined adequate by the authorities' metric. Against the traditional metrics—3 months of import coverage and 100 percent of short-term debt coverage—the level of reserves in 2018 appears to be adequate.

5. The adjusted ARA metric for a dollarized economy shows that reserves need to be at 18.3 percent of GDP. This is a level between the standard Fund's ARA level for fixed exchange rate regimes and the authorities' metric (chart).



Sources: National authorities and IMF staff calculations.

1/ ARA metric for fixed exchange rate regime	2/ ARA metric adjusted for dollarization	3/ Authorities ARA metric
= 10% of exports	= 30% short-term public debt at remaining maturity	= 22% deposits (reserve requirements)
+ 10% of broad money	+ 30% deposits	+ 5% deposits (insurance fund)*
+ 30% short-term debt	+ 1 month of CG budget	+ 8% deposits (medium-term target for LOLR/ELA purposes)*
+ 20% other liabilities	- Central Bank's funds	

* — these funds have not been established yet.

Annex III. Liquidity Management and Emergency Liquidity Assistance

1. Statutory requirements in El Salvador are:

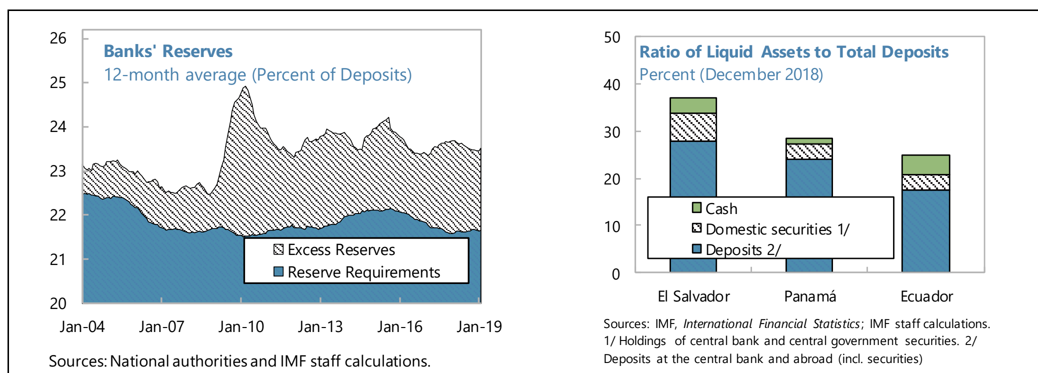
- *Reserves* - 21.6 percent of deposits (currently). Banks tend to hold excess reserves as a precaution against volatility in liquidity flows (see text chart);

- *Liquidity* - 3 percent of liabilities should be held in foreign liquid assets or El Salvador government securities. These are required to be of high-grade rating and easily tradable.

2. In case of liquidity needs, a bank can borrow liquidity from the interbank market, or access its required reserves deposited at the BCR. Salvadorans banks are well capitalized and have abundant liquidity (more so than regional dollarized peers, see chart). Capital adequacy ratio is well above the required limit, and credit portfolio is balanced. In case of liquidity needs, a bank could borrow funds from the interbank money market, or access its own reserves at the central bank. The latter could be done in three stages, sequentially on tighter terms: (i) the first tranche (25 percent of total banks reserves) at no cost, (ii) the second (25 percent) at LIBOR plus a penalty, and the third (50 percent), at no cost but subject to the approval by the Superintendence of Financial System (SSF), by submitting a regularization plan. After accessing tranches, I and II, banks could also access the required liquid assets to meet their liquidity needs.

3. The Central Bank can provide bilateral ELA to a bank that remains solvent and has exhausted the above-mentioned traditional facilities. When normal market functioning is disrupted, and solvent bank's tranche II reserves are accessed, the central bank can provide emergency liquidity up to 100 percent value of the required capital of an individual bank under stress. The authorized ELA tools are: (i) repurchase agreements using appropriate capital, (ii) temporal acquisition of banks' investments portfolio, and (ii) liquidity credits to banks.

4. Central bank is working to bolster the funds it could use in the case of a systemic shock, based on previous CAPTAC DR technical assistance (see Financial Stability section and IMF Country Report 18/151).



INTERNATIONAL MONETARY FUND

EL SALVADOR

May 7, 2019

STAFF REPORT FOR THE 2019 ARTICLE IV CONSULTATION—INFORMATIONAL ANNEX

Prepared by: The Western Hemisphere Department

CONTENTS

FUND RELATIONS 2

RELATIONS WITH OTHER FINANCIAL INSTITUTIONS 5

STATISTICAL ISSUES 6

FUND RELATIONS

(As of May 22, 2019)

Membership Status: Joined: March 14, 1946

General Resources Account:	**SDR Million**	**% Quota**
Quota	287.20	100.00
Fund holdings of currency (Exchange Rate)	287.20	100.00
Reserve Tranche Position	0.00	0.00

SDR Department:	**SDR Million**	**% Allocation**
Net cumulative allocation	163.81	100.00
Holdings	165.58	101.08

Outstanding Purchases and Loans:

None

Latest Financial Arrangements:

Type	Date of Arrangement	Expiration Date	Amount Approved (SDR Million)	Amount Drawn (SDR Million)
Stand-By	03/17/2010	03/16/2013	513.90	0.00
Stand-By	01/16/2009	03/16/2010	513.90	0.00
Stand-By	09/23/1998	02/22/2000	37.68	0.00

Projected Payments to Fund
(SDR Million; based on existing use of resources and present holdings of SDRs):

	Forthcoming				
	2016	2017	2018	2019	2020
Principal	0.00	0.00	0.00	0.00	0.00
Charges/Interest	0.00	0.00	0.00	0.00	0.00
Total	**0.00**	**0.00**	**0.00**	**0.00**	**0.00**

Exchange Rate Arrangement. The U.S. dollar is legal tender and circulates freely. The dollar is used as a unit of account and a medium of exchange, with no limitations. All payments may be made in either dollars or colones. The BCR has the obligation to exchange colones for dollars upon request from banks, at a fixed and unalterable exchange rate of C8.75 per U.S. dollar. As a result, El Salvador has an exchange rate arrangement with no separate legal tender category. El Salvador has accepted the obligations of Article VIII, Sections 2(a), 3, and 4, and maintains an exchange system that is free of restrictions on the making of payments and transfers for current international transactions.

Article IV Consultation. The last Article IV consultation was concluded on May 11, 2018 (Country Report No. 18/151).

FSAP participation and ROSCs. An FSAP Update was conducted in 2010 and the report was considered by the Executive Board on September 15, 2010. A fiscal ROSC was conducted in 2011. A data module ROSC was conducted in 2004.

Technical Assistance.

Department	Delivery date	Purpose
	Tax Administration	
FAD	8/8/2016 8/16/2016 11/7/2016	Improve services to taxpayers
	8/22/2016 11/21/2016 7/3/2017	Strengthening the management of the tax administration
	2/15/2017 1/29/2018 3/5/2018	Strengthening the control of VAT credit
	2/20/2017 3/21/2019	Strengthening the taxpayer registry
	3/5/2018 11/1/2018 2/26/2019 3/15/2019	Strengthening tax audits
	8/17/2018	Improve management of declarations
	10/17/2018	Tax Administration Diagnostic Administration Tool (TADAT)
	2/22/2019	Strengthen Voluntary Compliance
	8/10/2019	Improve management of declarations
	Customs Administration	
FAD	4/24/2017	Risk Management in Customs
	9/28/2017	OAS program launch
	10/16/2017 4/30/2018 8/24/2018 12/14/2018	Integral cargo control
	11/20/2017 3/12/2018	Improvement of dispatch and registry process in Customs
	11/20/2017	Risk-based segmentation of traders
	2/8/2019	Post clearance audit
	Public Financial Management	
FAD	10/17/2016 4/3/2017	Treasury Single Account
	4/9/2018	Budget-PIMA
	3/22/2017	Workshop- Treasury Management

Department	Date Delivery	Purpose
Financial Supervision and Regulation		
MCM	11/21/2016 12/5/2016 3/13/2017 8/21/2017 4/9/2018 3/27/2017	Liquidity risk supervision
	7/10/2017 7/12/2017 3/19/2018	Credit risk supervision
	8/21/2017 3/19/2018 1/25/2019	Insurance supervision
	12/7/2018 4/26/2019	IT risk supervision
	10/19/2018 3/22/2019	Market risk supervision
Central Banking		
MCM	7/18/2016 3/12/2018 3/26/2018	Strengthening projection and overall analysis
	10/16/2017 10/25/2017	Strengthening capacities for producing and evaluating systemic risk indicators
National Accounts and Price Statistics		
STA	9/18/2017	Economic Activity Volume Indicators
	2/26/2018	Monthly Activity Indicators
	8/24/2018 3/1/2019 5/3/2019	National accounts
Government Finance Statistics		
STA	10/2/2017 8/24/2018	Diagnostic mission for Government Finance Statistics
	10/9/2017	Strengthening the delivery of TA in GFS
	10/9/2017	GFS implementation
	10/9/2017	Strengthening CD in GFS topics
	3/5/2019	Regional GFS Harmonization
	4/12/2019	Quarterly Data Compilation
External Sector Statistics		
STA	4/5/2019	Strengthening source data for the compilation of external sector statistics

Resident Representative: Gerardo Peraza (based in Guatemala) is the Regional Resident Representative for Central America, Panama and the Dominican Republic.

RELATIONS WITH OTHER FINANCIAL INSTITUTIONS

World Bank

http://www.worldbank.org/en/country/elsalvador

Inter-American Development Bank

https://www.iadb.org/en/countries/el-salvador/overview

STATISTICAL ISSUES

(As of April 2019)

I. Assessment of Data Adequacy for Surveillance
General: Data provision is adequate for surveillance.
National Accounts: The Central Reserve Bank of El Salvador disseminates annual and quarterly national accounts, following the *System of National Accounts 1993* (*1993 SNA*), and including key recommendations from the *2008 SNA*. The series, available for 2005-18, with benchmark year 2005, are disseminated by the production and expenditure approaches, and Supply and Use Tables are disseminated for 2014-16 and Input-Output Tables for 2005 and 2014. In addition, a monthly index of economic activity (IVAE), which is consistent with the quarterly and annual national accounts, is disseminated on a regular basis. The rebased national accounts and monthly index of economic activity series were published on March 23, 2018.
Price Statistics: Price statistics are disseminated at monthly frequency. Consumer Price Index weights are based on the 2005-06 Household Income and Expenditure Survey. A broad PPI, with base year 2009, is compiled and disseminated on the website of the Central Reserve Bank.
Government Finance Statistics: Local government statistics are not separately identified within "other general government," while local government debt is not included in the definition of public debt as reported by the Ministry of Finance. Nonfinancial public enterprise statistics are reported on a consolidated basis but are not comprehensive as the criterion of over 50 percent public ownership is not always followed. The coverage and periodicity of data on central government financing and debt is adequate. The country participates in a regional capacity development program for the harmonization of GFS for Central America, Panama, and the Dominican Republic led by the IMF's Regional Center for Technical Assistance (CAPTAC-DR). A workshop to launch this program was conducted on September 2017, where all country participants discussed the status in applying the GFS methodology in their countries, and defined expected outcomes and priorities under this program. The next technical assistance mission from CAPTAC-DR under this program is scheduled for August 2018.
Monetary and Financial Statistics: The Central Reserve Bank of El Salvador (CRBS) compiles and disseminates monetary and financial statistics (MFS), with concepts, definitions, and classification that are broadly in line with the *Monetary and Financial Statistics Manual (MFSM) 2000*. The CRBS uses standardized report forms based on accounting data to report data to the Fund. The CRBS regularly reports monthly financial soundness indicators (FSIs) to the IMF for publication. Currently, the BCB reports all core and 5 encouraged FSIs. Plans are under way to compile the rest of the encouraged FSIs.

<table>
<tr><td colspan="2">Financial Sector Statistics: Data coverage is broadly adequate. However, comprehensive data on household and corporate balance sheets, as well as on housing prices, which are currently not available, would be useful for more effective surveillance.</td></tr>
<tr><td colspan="2">External Sector Statistics: The Central Bank of El Salvador compiles and reports all key ESS datasets, except for the Coordinated Portfolio Investment Survey (CPIS). Authorities expressed interest in disseminating CPIS in 2019. The Coordinated Direct Investment Survey (CDIS) is incomplete, with inward direct investment reported and limited coverage for outward direct investment. Further work on improving coverage of nonfinancial private sector transactions is needed as well as comprehensive granularity in the reporting of external debt statistics.</td></tr>
<tr><td colspan="2">II. Data Standards and Quality</td></tr>
<tr><td>El Salvador is a subscriber to the Fund's Special Data Dissemination Standard (SDDS) since 1998. El Salvador is taking a flexibility option for the periodicity of the labor market and wages/earnings data category and will continue at this time to publish annual data with a timeliness of one quarter after the end of the reference year.</td><td>A data ROSC was published in December 2004.</td></tr>
</table>

El Salvador: Common Indicators Required for Surveillance (As of April 15, 2019)					
	Date of Latest Observation	Date Received	Frequency of Data[7]	Frequency of Reporting[7]	Frequency of Publication[7]
Exchange Rates	NA	NA	NA	NA	NA
International Reserve Assets and Reserve Liabilities of the Monetary Authorities[1]	Mar-2019	Mar-2019	M	M	M
Reserve/Base Money	Feb-2019	Mar-2019	M	M	M
Broad Money	Feb-2019	Mar-2019	M	M	M
Central Bank Balance Sheet	Feb-2019	Mar-2019	M	M	M
Consolidated Balance Sheet of the Banking System	Feb-2019	Mar-2019	M	M	M
Interest Rates[2]	Apr-2019	Apr-2019	W	W	W
Consumer Price Index	Mar-2019	Apr-2019	M	M	M
Revenue, Expenditure, Balance and Composition of Financing[3]—General Government[4]	Feb-2019	Mar-2019	M	M	M
Revenue, Expenditure, Balance and Composition of Financing[4]—Central Government	Feb-2019	Mar-2019	M	M	M
Stocks of Central Government and Central Government-Guaranteed Debt[5]	Feb-2019	Mar-2019	M	M	M
External Current Account Balance	Dec-2018	Mar-2019	Q	Q	Q
Exports and Imports of Goods	Feb-2019	Mar-2019	M	M	M
Exports and Imports of Services	Dec-2018	Mar-2019	Q	Q	Q
GDP/GNP	Dec-2018	Mar-2019	Q	Q	Q
Gross External Debt	Dec-2018	Mar-2019	Q	Q	Q
International Investment Position[6]	Dec-2018	Mar-2019	Q	Q	Q

[1] Any reserve assets that are pledged or otherwise encumbered should be specified separately. Also, data should comprise short-term liabilities linked to a foreign currency but settled by other means as well as the notional values of financial derivatives to pay and to receive foreign currency, including those linked to a foreign currency but settled by other means.
[2] Both market-based and officially-determined, including discount rates, money market rates, rates on treasury bills, notes and bonds.
[3] Foreign banks, domestic banks, and domestic nonbank financing.
[4] The general government consists of the central government (budgetary funds, extra budgetary funds, and social security funds) and state and local governments.
[5] Including currency and maturity composition.
[6] Includes external gross financial asset and liability positions vis-à-vis nonresidents.
[7] Daily (D); weekly (W); monthly (M); quarterly (Q); annually (A); irregular (I); and not available (NA).

Statement by Leonardo Villar, Executive Director for El Salvador
May 22, 2019

On behalf of our Salvadoran authorities, we would like to thank staff for its candid and constructive policy dialogue during the 2019 Article IV consultation. The authorities broadly agree with staff's assessment and policy recommendations. The economy's performance in 2018 was strong with growth above potential at 2.5 percent, reflecting benign global conditions, strong internal demand and high levels of public and private investment, supported by a robust financial system. Inflation remained low and stable and fiscal balances improved. Sustained growth and a consistent and comprehensive agenda in the social area, have allowed real per capita GDP to increase by around 15 percent over the past decade, leading to a considerable decline in inequality and poverty and a significant improvement in human and social indicators, as highlighted in the report.

Recent Developments

The economy is expected to grow at 2.4 percent in 2019. Results from relevant macroeconomic indicators during the first quarter point in this direction: credit to the private sector increased 6.4 percent (year-to-year), mainly driven by a strong growth of credit to enterprises which grew 10.3 percent, reflecting dynamism in many productive sectors, particularly construction. The primary fiscal surplus was 0.4 percent compared to 0.3 percent in the first quarter of 2018, and inflation remain low at 0.7 percent. Remittances increased 5.9 percent, higher than the 5.3 percent observed over the same period in 2018. The total liquidity of the economy grew 4.9 percent providing a good cushion for supporting the economic dynamism. The authorities share staff's view on the main risks to the outlook. Weaker-than-expected global growth could have a negative impact on the economy, and debt could continue to drift upward in the absence of measures or if spending or public sector reforms are approved without identifying suitable funding sources.

Fiscal Discipline and Adjustment

The strong fiscal discipline and measures implemented allowed the primary fiscal balance to improve 1.1 percent of GDP between 2017 and 2018. Over the past year, the authorities continued efforts started in 2017 to reach political agreements aimed at moving forward with the country's economic and social agenda. Consequently, an important number of fiscal laws were approved by the Legislative Assembly in December 2018: The Fiscal Responsibility Law (FRL) was strengthened by requiring debt to be put firmly on a declining path and by introducing an anchor for public debt of 60 percent of GDP by 2030; the budget and its financing were passed on time for the first time in three years, with a primary surplus of 0.7 percent of GDP. The Assembly also authorized external financing for US$1.3 billion, including to cover the US$800 million Eurobond payment due in December and an IADB loan to finance the program for strengthening tax administration that includes the implementation of the electronic invoicing. Because of the strong political cooperation and agreements that made possible the approval of these important fiscal laws, Standard & Poor's upgraded the rating of El Salvador's sovereign debt to B in December 2018 and the EMBI Global spread declined and is in line with regional peers.

The authorities agreed with the size of the recommended adjustment and considered that a more gradual pace of implementation (three years) would still be consistent with observing the Fiscal Responsibility Law (FRL). They are aware that a further fiscal adjustment of about 1.9 percent of GDP by 2021 is needed to comply with the FRL. To this end, they are preparing several measures, both on the revenue and the expenditure sides, and are also progressing in the technical preparation of tax administration reforms, including electronic invoicing, the "*monotributo,"* as well as the initiative to combat base erosion and profit shifting ("*precios de transferencia*"). They agreed with staff on the need to adopt additional structural revenue measures, such as excise taxes on luxury goods. The authorities do not see plausible an increase in the VAT in the short term, considering that this type of measure would require consensus among different sectors of the population given its potential negative impact on household's consumption. Going forward, the authorities consider that a comprehensive fiscal reform is needed to eliminate distortions arising from temporary and ad hoc measures accumulated over the years. Harmonizing and simplifying the tax code could improve fairness, equity, competition and growth.

To improve the efficiency of public expenditure, the authorities are planning to centralize the procurement system and extend competitive bidding processes such as reverse auction mechanism to all public entities; to this end, a reform to the procurement law is in process. The authorities are also working on strengthening public debt management and have requested Fund's technical assistance for this purpose.

Policies to Foster Higher Growth

The ease of doing business has improved in recent years and the authorities are committed to further improve the business climate and the country's competitiveness. Policies to reduce poverty, inequality and emigration are bearing fruits and the government is committed to advance even more through strengthening programs in education, health, housing, water and sanitation, and urban and rural development. The agenda to promote growth has also been successful based on cutting red tape, implementing the development, diversification and productive transformation strategy in place since 2014, and on intensifying efforts to increase financial inclusion. In addition, actions are being taken to expedite the process to obtain the tax ID, improve the platform to register new enterprises and obtain construction permits. Completion of the Northern Triangle Customs Union with Honduras and Guatemala would allow to increase intra-regional trade and investment, thereby contributing to boosting growth. Regulatory improvements brought by the customs union, and better infrastructure at border crossing points, will significantly reduce the costs and processing time for exports.

The rehabilitation and prevention efforts through El Salvador Seguro plan launched in 2014 are contributing to substantially lower the homicide rate, as evidenced in Box 2 of the staff report, helping to improve the business climate and the country's competitiveness. The authorities plan to advance the plan further by securing budgetary funds to expand two detention centers, implement public spaces recovery programs and strengthen youth violence prevention programs. They acknowledge that further actions should be taken to combat extortion, including by expanding technological surveillance and police presence in the country, and by continuing to foster

community involvement. In this regard, the City Hall of San Salvador launched last April a "Smart City" project with support from Spain.

The authorities continue working on increasing the provision of public infrastructure as a catalyst for private investment growth; they plan to complete this year the expansion of the passenger air terminal and implement other important projects to enhance both country's roads and ports network. They will also develop specific projects oriented at tourism such as the touristic marine coastal strip, and the productive development program, as well as continuing with customs modernization.

The authorities are confident that reducing informality and the gender gap in labor force will contribute to raise potential output. As part of the plan to recover San Salvador's downtown, two large markets will be created in the upcoming years to give street vendors (mostly women) a safe and clean space to operate. The gender gap in the labor force participation rate (30 percent), is lower than in neighboring countries and the authorities expect to reduce it further by leveraging efforts of the recently introduced National Gender Equality Plan and the Gender Seal certification program. Over 60 units have been created in the public sector to institutionalize gender mainstreaming. The second program is implemented with support from UNDP. In addition, the authorities and experts expect that the 2017 amendment to the family code to ban child marriage and the development of a national policy to prevent teenage pregnancy will help reduce the gender gap in education attainment.

Financial Sector Stability

The banking sector remains solid and credit continued to expand during the first quarter of 2019. Banks reduced their external liabilities as global financial conditions tightened, remained well-capitalized and used the remittance-fueled surge in deposits to expand credit. Balance sheet risks remained sound as the deposit-to-loan coverage remained stable at 95 percent, and the cyclical position of credit expansion was within the norm. Non-performing loans declined below 2 percent, provisioning increased, and profitability reached a three-year high.

The authorities concurred with staff's recommendations for enhancing financial sector stability. They agreed with the need to accelerate approval of the bank resolution law and remain committed to further strengthening cross-border cooperation, and appropriately fund the emergency lending assistance framework, which includes the creation of a liquidity fund facility in line with prior Fund's recommendations. Banks' efficiency in liquidity management, including the reactivation of the interbank market, cross-border cooperation and supervision, has increased, and the Superintendence has enhanced supervision and monitoring of financial flows—which are critical in preparation to rejoin the Egmont Group (group of 159 Financial Intelligence Units established to provide a platform for the secure exchange of expertise and information for AML/CT).

Financial Inclusion

The authorities are making progress in promoting financial inclusion. Bank account ownership has doubled from 14 percent in 2011 to 30 percent in 2017, driven by increases in rural accounts and female-owned accounts. A Presidential executive order in July 2018 established the National Council for Financial Inclusion, the inter-agency support group for financial inclusion and financial education program of El Salvador. Simplified bank accounts, for limited balances and transactions, were introduced in 2015 and 400 of these accounts were opened since the end of 2018. In addition, another electronic money provider, MOMO-Mobile Money, is in process to join the mobile money market.

Governance Framework

The authorities have adopted several measures to improve the governance framework. The Attorney General has significantly strengthened investigation and prosecution activities to curb the illicit use of public funds at the highest level. To support the anti-money laundering (AML/CFT) efforts, the Superintendency of the Financial System has put in place a system for high-frequency monitoring of financial flows. Independence and autonomy of the Financial Investigation Unit has been legally ensured to restore the exchange of information with a worldwide network of financial investigative agencies, and to enhance the governance and anti-corruption framework. In addition, a plan has been developed and implemented by the Presidency to increase citizen participation in the design, implementation, and monitoring of public policies at the national and local levels, and to receive direct corruption complaints. Going forward, the authorities believe it is important to continue strengthening the accountability and supervision of public funds and see space for improvement through further reforms that ensure a comprehensive audit of public accounts, such as (i) harmonizing the existing legal framework; (ii) strengthening the Audit Office by expanding its supervisory role to all public institutions; and (iii) modernizing audit processes through extensive adoption of technology.