
Country Report

El Salvador

November 2008

Economist Intelligence Unit
26 Red Lion Square
London WC1R 4HQ
United Kingdom

The Economist Intelligence Unit

The Economist Intelligence Unit is a specialist publisher serving companies establishing and managing operations across national borders. For 60 years it has been a source of information on business developments, economic and political trends, government regulations and corporate practice worldwide.

The Economist Intelligence Unit delivers its information in four ways: through its digital portfolio, where the latest analysis is updated daily; through printed subscription products ranging from newsletters to annual reference works; through research reports; and by organising seminars and presentations. The firm is a member of The Economist Group.

London

The Economist Intelligence Unit
26 Red Lion Square
London
WC1R 4HQ
United Kingdom
Tel: (44.20) 7576 8000
Fax: (44.20) 7576 8500
E-mail: london@eiu.com

New York

The Economist Intelligence Unit
The Economist Building
111 West 57th Street
New York
NY 10019, US
Tel: (1.212) 554 0600
Fax: (1.212) 586 0248
E-mail: newyork@eiu.com

Hong Kong

The Economist Intelligence Unit
60/F, Central Plaza
18 Harbour Road
Wanchai
Hong Kong
Tel: (852) 2585 3888
Fax: (852) 2802 7638
E-mail: hongkong@eiu.com

Website: www.eiu.com

Electronic delivery

This publication can be viewed by subscribing online at www.store.eiu.com.

Reports are also available in various other electronic formats, such as CD-ROM, Lotus Notes, online databases and as direct feeds to corporate intranets. For further information, please contact your nearest Economist Intelligence Unit office.

Copyright

© 2008 The Economist Intelligence Unit Limited. All rights reserved. Neither this publication nor any part of it may be reproduced, stored in a retrieval system, or transmitted in any form or by any means, electronic, mechanical, photocopying, recording or otherwise, without the prior permission of The Economist Intelligence Unit Limited.

All information in this report is verified to the best of the author's and the publisher's ability. However, the Economist Intelligence Unit does not accept responsibility for any loss arising from reliance on it.

ISSN 1473-9038

Symbols for tables

"n/a" means not available; "--" means not applicable

Printed and distributed by Patersons Dartford, Questor Trade Park, 151 Avery Way, Dartford, Kent DA1 1JS, UK.

El Salvador

Executive summary

- 2 Highlights

Outlook for 2009-10

- 3 Political outlook
- 4 Economic policy outlook
- 5 Economic forecast

Monthly review: November 2008

- 9 The political scene
- 10 Economic policy
- 11 Economic performance

Data and charts

- 14 Annual data and forecast
- 15 Quarterly data
- 16 Monthly data
- 17 Annual trends charts
- 18 Monthly trends charts

Country snapshot

- 19 Political structure

Editors: Ondine Smulders (editor); Martin Pickering (consulting editor)
Editorial closing date: October 31st 2008
All queries: Tel: (44.20) 7576 8000 E-mail: london@eiu.com
Next report: To request the latest schedule, e-mail schedule@eiu.com

Executive summary

Highlights

November 2008

Outlook for 2009-10

- The political focus will increasingly shift to the March 2009 presidential contest, which pits Rodrigo Ávila of the ruling Arena against the moderate Mauricio Funes of the leftist FMLN. As a result, legislative reforms will be slow.
- Our baseline forecast is premised on an Arena victory, but whichever candidate wins, policy implementation under the next government, which takes office in June 2009, will become more complicated.
- The government will remain committed to free trade, the promotion of foreign investment in key industries, such as *maquila*, and maintaining a tax regime that promotes corporate investment.
- GDP growth will decelerate to 1.8% in 2009, reflecting a deteriorating external environment and the lagged impact on consumption of higher inflation. Assuming a mild US recovery, GDP will recover gradually to 2.3% in 2010.
- After reaching 9% at end-2008, we expect that year-end inflation will ease to 6% in 2009 and 5.5% in 2010. Renewed commodities price pressures, albeit minor, will keep inflation from easing further than our forecast in 2010.
- After widening to 6.8% of GDP in 2008, the current-account deficit will narrow in 2009 and in 2010. We expect that it will be largely financed by long-term debt inflows as FDI inflows weaken substantially.

Monthly review

- In September Arena made a controversial choice for its vice-presidential ticket with the selection of Arturo Zablah, an open critic of government policy and not a party member.
- There is a risk that Mr Zablah could upstage the uninspiring Mr Ávila on the campaign trail, and that, once in power, he might try to wrestle control of certain policies away from the president.
- At a summit in mid-October, Mr Saca and the Mexican president, Felipe Calderón, pledged closer co-operation in key areas of mutual interest: migration, crime and trade.
- Interest rates have edged higher in recent months given rising interbank rates, growing central government bond issuance, and slowing deposit growth.
- Despite the US slowdown, export earnings rose by 19% during the first eight months of 2008 owing to robust coffee prices and continued strong growth in the *maquila* sector.
- A contraction in volume imports across all categories (except *maquila*) showed that El Salvador's economy has started to slow. The sharpest contraction was registered in capital goods followed by consumer goods.

Outlook for 2009-10

Political outlook

Domestic politics With six months left in office the president, Antonio Saca of the ruling right-wing Alianza Republicana Nacionalista (Arena), will see his influence over legislative activity wither, as the political focus moves to the election campaign and the prospect of a new government. Widespread disenchantment with his administration over rising inflation has undermined the president's popularity and boosted the prospects of Mauricio Funes, a popular media personality and candidate of the main left-wing opposition party, the Frente Farabundo Martí para la Liberación Nacional (FMLN). However, Rodrigo Ávila, the Arena candidate, has managed to narrow the gap with Mr Funes to a statistical dead heat, according to a September poll, underlining the fact that Mr Funes and the FMLN will need to address the more fundamental challenges to their party's electoral prospects to secure a victory.

Legislative activity and policy implementation has slowed given the nearing January 2009 legislative and municipal elections and the March 2009 presidential election. The Economist Intelligence Unit's baseline forecast is premised on a presidential victory for Arena. This outcome has become more plausible following the appointment of Arturo Zablah, who appeals to moderates and left-of-centre voters, as the vice-presidential candidate on the Ávila ticket. Regardless of which candidate wins, policy implementation under the next government, which takes office in June 2009, will become more complicated than under the current government, as neither the FMLN nor Arena will obtain a legislative majority, forcing the next government to rely on time-consuming consensus-building. Furthermore, an FMLN government may struggle even more to garner a majority to pass legislation, as most of the smaller parties in the legislature, the Partido de Conciliación Nacional (PCN) and the Partido Demócrata Cristiano (PDC), which together control 16 seats at present, have a right-of-centre ideology. The only other party with a left-wing ideology is the Cambio Democrático (CD), with two seats. The new incumbent will face an array of pressing challenges, from a weakening economy to an acute problem of violent crime.

International relations El Salvador's overriding foreign policy priority will remain its relations with the US, its most important trade and investment partner. It is the only country in the region that still has troops in Iraq. In return, Mr Saca obtained a sixth extension of the Temporary Protection Status (TPS), which allows around 220,000 Salvadorans to work in the US until September 2010. Mr Saca will continue to seek US support to fight the *maras* (violent youth gangs), some of which are led by Salvadoran deportees from the US, and rising drug-related crime. The trade integration of the C4 countries (El Salvador, Guatemala, Nicaragua and Honduras) is expected to accelerate in the forecast period. An Ávila government would largely continue with current policies, whereas a Funes administration might refocus foreign policy, including re-establishing diplomatic ties with Cuba and closer relations with Venezuela. However, it would be likely

to remain pragmatic, maintaining relations with the US, where nearly 2.5m Salvadorans live, and adhere to trade accords.

Economic policy outlook

Policy trends Policymaking will be slow during Mr Saca's last months in office and the focus will remain on the economy and on the increasingly difficult fiscal position. The need for fiscal consolidation in the context of dollarisation limits policymakers' room for manoeuvre, but efforts at increasing the tax take and redirecting subsidies will allow the government to channel additional funding into social spending. The government will remain committed to free trade, maintaining a tax regime that promotes corporate investment, the promotion of foreign investment in important industries (manufacturing and tourism), and the development of additional policies to sustain the recent upturn in manufacturing. If Mr Ávila wins the presidential election, as we currently project, overall policy direction will remain fairly unchanged. Although pledges by the FMLN and Mr Funes have made it clear that they would not abandon dollarisation, default on sovereign debt obligations or take El Salvador out of the Dominican Republic-Central America Free-Trade Agreement (DR-CAFTA) with the US, many will still fear that the FMLN's leadership would seek a more radical policy shift. A win by Mr Funes would therefore raise policy uncertainty, affecting investment and consumption decisions.

Fiscal policy We expect the fiscal balance to deteriorate in 2009-10, with the risks to our forecast weighted on the downside, especially in 2009, when we expect the economy to slow markedly. A further deceleration in revenue growth and acceleration in spending growth in the first eight months of 2008 (largely owing to the growing cost of energy subsidies) shifted the overall balance into deficit. We expect these trends to continue in the remainder of 2008 and in 2009-10, with tax revenue weakening throughout the forecast period on the back of weak economic growth. Spending, in contrast, will rise in the remainder of 2008—owing to the high cost of energy subsidies, public-sector wage increases that came into effect in July 2008, higher interest payments on a growing domestic debt stock, and pre-election spending in a particularly closely fought campaign—and remain steady in 2009 owing to heavy electoral spending in the early part of the year. Although we expect that spending will be tightened when the next Arena government takes office in June, the deficit will rise to 2% as a result of the combination of higher spending in the first half and slowing tax revenue throughout the year. We therefore estimate that the fiscal deficit will widen to 2% in 2009 (from 1.3% in 2008) before easing to 1.3% in 2010 as tax revenue as a share of GDP starts to rise again. However, if consumer spending were to slide more than we currently project, tax revenue would be affected, leaving the fiscal deficit wider than forecast.

Monetary policy Dollarisation, which was adopted in 2001, has helped interest rates to converge closer with those in the US. Domestic interest rates have tended to move in line with US rates. Nevertheless, they will remain significantly above US levels, with the risk premium reflecting weaknesses in El Salvador's economy, including the relatively high level of public debt. Yields on short-term government paper have increased since the start of the year, owing to a combination of less liquidity and greater public-sector issuance. Although the weighted average lending rate remains below the 8% high reached in September and October 2007, reflecting tighter international credit conditions and some Salvadoran bank funding in the US market, it has started to move up again and stood at 7.6% in September, above its June rate of 7.2%. Similarly, the weighted average deposit rate, which averaged 4.8% in September-October 2007, started to move up again in March, when it reached 3.6%, and further, to 4.5%. Given the escalation of the global credit crisis, we expect that Salvadoran lending rates will continue to rise from their current levels in the remainder of 2008 and the early part of 2009 and that the spread with US rates will widen, before financing conditions ease moderately later in the forecast period.

Economic forecast

International assumptions

International assumptions summary

(% unless otherwise indicated)

	2007	2008	2009	2010
Real GDP growth				
World	4.9	3.8	2.6	3.4
US	2.0	1.6	-0.2	1.2
EU27	2.9	1.3	0.1	1.2
Exchange rates				
¥:US\$	117.8	105.1	100.0	98.0
US\$:€	1.369	1.485	1.360	1.315
SDR:US\$	0.651	0.627	0.652	0.659
Financial indicators				
¥ 3-month repo rate	0.61	0.68	0.88	1.55
US\$ 3-month commercial paper rate	5.06	2.30	2.43	3.20
Commodity prices				
Oil (Brent; US\$/b)	72.7	105.0	75.0	82.0
Coffee (Arabica; US cents/lb)	123.5	137.5	105.8	96.5
Food, feedstuffs & beverages (% change in US\$ terms)	30.9	30.2	-25.3	5.5
Industrial raw materials (% change in US\$ terms)	11.2	2.5	-15.3	-5.7

Note. Regional GDP growth rates weighted using purchasing power parity exchange rates.

We forecast a difficult global economic environment in the outlook period, reflecting the recession in the US, El Salvador's most important trading and investment partner. It will also have a heavy bearing on the GDP growth of El Salvador's Central American trading partners. Real GDP growth in the US is projected to contract by 0.2% in 2009, as a result of contracting private consumption. Importantly, US import demand is projected to fall by 6% in 2009. We expect a very weak recovery in 2010. El Salvador's preferential access to the US market through DR-CAFTA will cushion the direct impact of shrinking US import demand, but the country will be further hit by a

weakening of economic conditions in its four Central American trading partners (which account for more than one-third of its exports) and decelerating remittances from US-based migrant workers. Although the recent weakness in commodity prices for some of El Salvador's traditional exports will put pressure on the external accounts, declining oil prices in the remainder of 2008 and in 2009 will help to ease import spending. Although we expect that oil prices will rise marginally in 2010, there is a growing downside risk if global demand recovers at a slower pace than currently expected.

Economic growth

After slowing to 3.3% in 2008, GDP growth will decelerate markedly to 1.8% in 2009 before recovering gradually to 2.3% in 2010, in line with our assumption of a recession in the US in 2009, followed in 2010 by a weak recovery there and in other Central American countries. Second-quarter GDP data show that the slowdown evident in the first quarter deepened. Although second-quarter GDP growth remained robust at first glance, at 3.6% year on year, all sectors decelerated, with the exception of agricultural output, which accelerated to 8.9%. The slowing trend was confirmed by the Índice de Volumen de Actividad Económica (IVAE, the monthly economic activity index) in August—the index decelerated to 1.1% year on year, from over 4% in January and February. Furthermore, imports fell across the board in volume terms in the first eight months of 2008, with capital goods and consumer durables decreasing the most—both are good indicators of consumer demand and investment spending. A deceleration in fiscal revenue, especially in tax revenue, also pointed to a more marked economic slowdown.

We expect that private consumption growth will slow to 2.3% in 2009, reflecting the lagged impact on wages of high inflation in 2008 and falling remittances, while investment will contract by 2% given scarce funding availability and a US recession. The fastest-growing category of domestic demand will be public consumption, with spending rising sharply in the first quarter of 2009 ahead of the elections. Real import growth will decelerate sharply, in line with slowing consumption and contracting investment, but with export volumes also falling, the contribution to growth of the external balance will remain negative. Domestic demand will remain weak in 2010, given a tightening of fiscal policy by the new administration from mid-2009 and only a modest improvement in financing conditions. An increase in workers' remittances, reflecting a weak US recovery, should help consumer spending to pick up in 2010. A rise in import growth, partly driven by a modest recovery in consumption, indicates that the contribution to growth of the external balance will stay negative.

On the supply side, output from agriculture, a large employer, will decelerate in 2009-10 after a strong cycle. The services sector (especially transport, commerce and utilities) will slow in 2009, before experiencing a mild recovery in 2010. Despite large-scale building projects in and around the capital, San Salvador, and tourism projects supporting construction, another large employer, activity will remain weak, as falling workers' remittances and credit scarcity dampen residential construction throughout the forecast period. Manufacturing will continue to weaken in late 2008 and in 2009, largely as a result of a renewed deceleration in *maquila* (offshore assembly for re-export) exports, as the US

economy contracts. The recovery will not begin until the US starts to turn the corner in 2010.

Inflation Annual inflation decelerated to 8.7% in September, from 9.9% in August, in line with our expectation that inflation has peaked. Commodity prices have already started to fall and price pressures will ease further in 2009 and 2010 despite accelerating government investment spending ahead of the 2009 elections. The risk that price increases in the first half of 2008 will feed inflationary expectations and create second-round price rises has also receded owing to slowing domestic demand. We therefore expect that inflation will ease to 6% at end-2009 and 5.5% at end-2010. Nevertheless, inflation will remain above that in the US throughout the forecast period, implying a loss of export competitiveness in El Salvador's largest market.

Exchange rates There is little risk that dollarisation, adopted in 2001 and accepted across the political spectrum, will come under threat in the forecast period. Between 2003 and 2007 El Salvador's trade-weighted real exchange rate remained fairly stable. This was primarily attributable to low domestic inflation, but it also reflected the dollar's depreciation against regional and European currencies. There are growing concerns, however, over the competitiveness of Salvadoran goods, despite an acceleration of export growth, particularly in *maquila* sales, which suggests that not all sectors are suffering. Although we expect that the real exchange rate will weaken marginally in 2008—largely owing to real appreciations of the currencies of Central America, to which El Salvador sells one-third of its exports—it will appreciate by 5% in 2009 and by 4% in 2010, as the US dollar strengthens and other Central American currencies depreciate on the back of weaker growth. Further strains on dollarisation would stem from a deterioration of the public finances in the forecast period. Apart from some slippage in 2009 and 2010 owing to the upcoming national elections and the economic slowdown, fiscal policy will remain broadly disciplined.

External sector The current-account deficit will widen sharply in 2008, before narrowing in 2009 and 2010. Despite strong export earnings growth (up by 19% year on year in January-August), the trade deficit has widened in 2008, driven by strong import spending (up by 17% in the first eight months). However, from late 2008 onwards, we expect a deceleration in export growth reflecting recessionary conditions in the US and their impact on El Salvador's other main trading partners. Slowing domestic demand and falling commodity prices should stem import spending (which had slowed to 17% in January-August from 22% in early 2008), which will fall sharply in 2009, narrowing the trade deficit in terms of GDP. It will continue to narrow in 2010 as a result of a weak recovery in the US and Central America, which should boost export earnings, and a narrowing of the services deficit, as tourism recovers. Decelerating growth of workers' remittances as a consequence of the recession in the US will also contribute to a widening of the current-account deficit, to 6.8% of GDP in 2008. Although a US recession in 2009 will hurt exports, DR-CAFTA should provide a measure of protection against exporters competing in the US from outside the trade area. However, the impact on the overall current account of the improvement in the

trade balance in the forecast period will be partly offset by a fall in workers' remittances as a percentage of GDP.

Forecast summary

(% unless otherwise indicated)

	2007 ^a	2008 ^b	2009 ^c	2010 ^c
Real GDP growth	4.7 ^b	3.3	1.8	2.4
Industrial production growth	3.4	2.0	1.7	2.5
Gross agricultural production growth	8.6	7.7	5.0	2.7
Unemployment rate (av)	6.4 ^b	6.3	6.8	7.0
Consumer price inflation (av)	4.6	8.1	6.4	6.5
Consumer price inflation (year-end)	4.9	9.0	6.0	5.5
Lending interest rate	7.8	7.6	8.0	8.7
NFPS balance (% of GDP)	-0.2	-1.3	-2.0	-1.3
Exports of goods fob (US\$ bn)	4.0	4.6	4.5	4.7
Imports of goods fob (US\$ bn)	8.1	9.1	8.0	8.1
Current-account balance (US\$ bn)	-1.1	-1.6	-0.7	-0.5
Current-account balance (% of GDP)	-5.5	-6.8	-2.8	-1.9
External debt (year-end; US\$ bn)	9.6 ^b	10.2	10.1	9.8
Exchange rate Q:US\$ (av) ^d	7.63	7.81	7.90	7.70
Exchange rate US\$:¥100 (av)	0.85	0.95	1.00	1.02
Exchange rate US\$:€ (year-end)	1.46	1.38	1.35	1.31
Exchange rate US\$:SDR (year-end)	1.60	1.54	1.53	1.52

^a Actual. ^b Economist Intelligence Unit estimates. ^c Economist Intelligence Unit forecasts. ^d In January 2001 the US dollar became legal tender.

Monthly review: November 2008

The political scene

A bold choice completes the Arena presidential line-up

With five months until the presidential election in March 2009, the ruling right-wing Alianza Republicana Nacionalista (Arena), has made a controversial choice for its vice-presidential ticket—Arturo Zablah is an open critic of government policy and not a party member. However, Mr Zablah appeals to moderates and left-wing voters, and appears to have provided a boost to the Arena campaign. He comes from a wealthy Salvadoran business family, served as minister of the economy in the administration of a former president, Alfredo Cristiani (1989-94), and then as head of the state Comisión Ejecutiva Portuaria Autónoma (Cepa, the ports committee) during the government of Armando Calderón Sol (1994-99). Subsequently, Mr Zablah distanced himself from the governing party and became known for his criticism of Arena. In 2007 he formed a loose political movement, Alianza por el Cambio (the alliance for change) with the aim of unseating Arena, which has held the presidency since 1989. Mr Zablah was also mentioned as a possible presidential nominee, first for the main left-wing party, the Frente Farabundo Martí para la Liberación Nacional (FMLN), and then for the centre-left coalition of the Frente Democrático Revolucionario (FDR) and Cambio Democrático (CD). Having failed to secure agreements with these parties, Mr Zablah then became a favourite for Arena's vacant vice-presidential nomination. Referring to his apparent change of allegiance, Mr Zablah told reporters that it was "the time to make corrections" in government policy, but not to bring about changes that would create "even greater problems".

The latest opinion polls carried out before Mr Zablah joined the Arena ticket led by Rodrigo Ávila present a mixed picture. A September poll for a conservative daily, *La Prensa Gráfica*, carried out by LPG Datos, put Arena and the FMLN in a statistical dead heat, whereas a survey published in early October by the Jesuit Universidad Centroamericana (UCA) gave Mauricio Funes of the FMLN a 32.7% lead over Mr Ávila's 23.9%—36% of those questioned were undecided. Arena will be counting on Mr Zablah's arrival to boost Mr Ávila's appeal beyond the party faithful, by presenting a reformed and centrist face to Arena. There is a risk that Mr Zablah could upstage the uninspiring Mr Ávila on the campaign trail, and that, once in power, he might try to wrestle control of certain policies away from the presidency. According to press reports, Mr Zablah demanded concessions in exchange for accepting the candidacy, including a review of plans to part-privatise the running of the two major ports (he is reportedly calling for a larger state stake than originally envisaged), as well as a rise in the basic wage and a reduction in the high price of locally-produced medicines.

El Salvador and Mexico pledge closer ties

Relations with Mexico, a large regional player, form an important part of the foreign policy agenda of the president, Antonio Saca. At a summit in mid-October, Mr Saca and the Mexican president, Felipe Calderón, pledged closer co-operation in key areas of mutual interest: migration, crime and trade. Mexico is a major route to the US for Salvadoran migrants, who often complain of

abuse and bad treatment at the hands of the Mexican authorities. Many border towns in Mexico now have large itinerant Salvadoran populations, leading to resentment and discrimination among locals. Not for the first time, the two governments have agreed to promote greater respects for the migrants' rights, and Mexico has also offered access for Salvadorans to educational facilities in Mexican schools. Around 114,000 illegal migrants from Central America were detained on or near Mexico's southern border last year, according to officials. On the trade front, Mexican firms have expanded their investments in El Salvador rapidly over the past two years to around US\$1bn. El Salvador exported just 1% of its total exports to Mexico in the first eight months of 2008 but spent 9% of total imports on Mexican goods.

Both El Salvador and Mexico have a serious violent crime problem. According to Charles Glazer, the US Ambassador in San Salvador (the capital), US investors remain concerned about security conditions in El Salvador. In his sober warning he recognised that the Salvadoran authorities had made great efforts to improve security but that "much was still to be done". Whichever party wins the presidential election, overcoming the country's violent image abroad will be a challenge for the next government, although it can expect continued US support to combat crime. Part of this will come through the so-called Plan Mérida, a scheme under which US\$350m-400m in funding would be destined for Mexico and Central America. Additionally, the Central American governments are involved in a scheme to share information and resources with the US to track *maras* (criminal street gangs) which operate both across borders and in the US. The Salvadoran authorities claim that the establishment of the Centro Transnacional Anti-Pandillas (CAT, regional anti-gang centre) in October 2007, with the aid of the Federal Bureau of Investigation (FBI), has already resulted in several important arrests of gang members, both in El Salvador and in the US. An issue that has remained unresolved, however, is the US practice of deporting convicted gang members instead of jailing them. The Policía Nacional Civil (PNC, the national police force) has complained on repeated occasions that this undermines local policing efforts, especially since the deportees cannot be arrested in El Salvador until they commit a crime there.

Economic policy

Monetary indicators tighten as banks retrench

With its dollarised economy and the major banks foreign-owned, El Salvador is showing signs of exposure to the global financial crisis. According to the Banco Central de Reserva de El Salvador (BCR, the Central Bank), interbank lending rates rose to 5.5% in mid-October, compared with rates of 3.5% in June-July 2008, reflecting a growing reluctance of financial institutions to lend to each other. A combination of growing liquidity problems and decelerating deposit growth (owing partly to a reduction in disposable income as a result of high inflation for most of 2008) are forcing banks to maintain attractive deposit rates. With deposit growth slowing to 2.1% year on year in September (from 11% in March), average rates for deposits up to 180 days reached 4.45% in September, while the average rate for a 360-day deposit was at 4.58%, the highest levels seen this year according to BCR data.

The cost of lending has also risen, in part owing to the pressure from spiralling domestic inflation for most of 2008 (in August inflation reached a ten-year high of 9.9%), but also owing to the unwillingness of the banks to stretch their limited resources. Borrowing rates have also been forced up by the Treasury issuing Letras de Tesoro (letes, Treasury bills) with yields of up to 8%, reflecting the central government's need to cover its short-term borrowing requirements. While the average borrowing rate reaching 7.55% for loans up to one year and 9.76% for loans over one year (the highest rates in five months), some coffee growers, for instance, were reporting a rate rise from 9.5% to 12.5% on loans during the past three months. According to the Asociación Nacional de la Empresa Privada (Anep, the private sector association), its members are having difficulty in accessing credit, while loans for house building have reportedly dropped by 22.5% over the 12-month period to September 2008. Higher borrowing rates will inevitably affect growth across the economy as firms find it increasingly difficult to finance their working capital requirements and expand their businesses.

Interest rates

(%)

	2007			2008								
	Oct	Nov	Dec	Jan	Feb	Mar	Apr	May	Jun	Jul	Aug	Sep
Savings rate (up to 180 days)	4.46	4.32	4.37	4.12	3.72	3.59	3.71	3.74	3.87	4.07	4.12	4.45
Lending rate (up to one year)	8.27	7.69	7.65	7.61	7.69	7.55	7.3	7.43	7.2	7.35	7.49	7.55
Spread	3.81	3.37	3.28	3.49	3.97	3.96	3.59	3.69	3.33	3.28	3.37	3.10

Source: Banco Central de Reserva de El Salvador.

Economic performance

Import spending continues to slow as slowdown hits

Robust coffee prices and the continued strong growth in the *maquila* (offshore assembly plants) sector ensured that export earnings growth remained at an elevated level—export earnings expanded by 19% during the first eight months of 2008. The good results come despite the downturn in the US (which contracted by 0.3% in the third quarter), El Salvador's largest investment and trade partner. Trade has been buoyed by sales from the 2007/08 coffee season, with exports up 42% on last year, reflecting a 15% price rise for Salvadoran coffee on the world market over the past 12 months. Non-traditional products have also continued to underpin export growth, with sales up by 22% year on year—export earnings of ethanol and medicines accounted for 7% and 4% of total exports respectively. Exports to Central America rose by 23%, reflecting the expansion of non-traditional exports beyond the US market.

The *maquilas* have continued to benefit from increased demand, driven by El Salvador's preferential access to the US market through the Dominican Republic-Central American Free-Trade Agreement (DR-CAFTA, a bilateral free-trade agreement between the US and Costa Rica, El Salvador, Guatemala, Honduras, Nicaragua and the Dominican Republic). While *maquila* sales were unchanged in the 12 months to August 2007, they grew by 12.5% year on year in January-August 2008. The 7% rise in import spending by the *maquila* sector suggests that Salvadoran firms are optimistic as they continue to expand production—in volume terms *maquila* imports rose by 20%. However, the

Economist Intelligence Unit expects that demand will soon peak as current orders are completed, the US moves into recession and financing dries up, both of which will undermine the future order flow.

Merchandise trade

(US\$ m, Jan-Aug)

	2007	2008	% change
Exports (fob)	2,654	3,147	18.6
Traditional exports	220	290	31.8
Coffee	159	226	42.1
Sugar	60	64	6.7
Non-traditional exports	1,249	1,524	22.0
<i>Maquila</i> ^a	1,185	1,333	12.5
Imports (cif)	5,700	6,672	17.1
Consumer goods	1,774	1,976	11.4
Intermediate goods	2,207	2,874	30.2
Capital goods	884	924	4.5
<i>Maquila</i> ^a	836	897	7.3
Trade balance	-3,046	-3,525	15.7

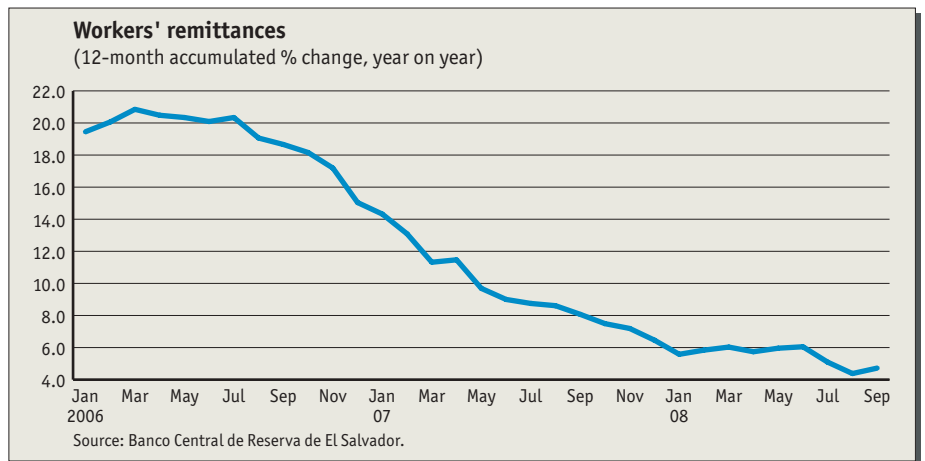
^a Offshore assembly for re-export.

Source: Banco Central de Reserva de El Salvador.

Although the import bill rose by 17.1% in the first eight months of 2008, this was largely a result of higher prices as all import categories registered decreases in volume terms (with the exception of *maquila* imports). This highlights a trend seen in recent months of accelerating declines in import volumes, clear evidence that the Salvadoran economy is slowing. The sharpest contraction was registered in capital goods which fell by 11.5% in volume terms (up by 4.5% in value terms), followed by consumer goods which fell by 2.7% in volume terms (but rose by 11% in value terms) and intermediate goods (down 2.3% in volume terms and up 30% in value terms). Specifically, a contraction in value and volume terms in durable consumer goods and car imports suggests that concerns over the economy and the outcome of the 2009 elections are forcing consumers to reign in spending.

Workers' remittances remain resilient up to September

The monthly average of remittances sent by Salvadorans to their families was US\$320m in the first nine months of 2008, compared with US\$304m in 2007, suggesting that flows have remained fairly resilient despite the economic malaise in the US. Although remittances fell in August, the first year-on-year fall in recent years, they rose by 8% in September, bringing the year-to-date increase to 5.3%. However, measured on a month-on-month basis, remittances have been falling since June. Monthly variations in remittances are quite common, often caused by seasonal changes, or sudden changes in confidence brought about by external factors—unemployment among Hispanics in the US reached 7.8% in August but recovered to 7.4% in September, according to the Banco Central de Reserva de El Salvador (BCR, the Central Bank). We expect that confidence among the Salvadoran community in the US was boosted by the recent announcement of an 18-month extension to the Temporary Protection Status (TPS) scheme that benefits around 220,000 Salvadorans working in the US. However, the spiralling of the global financial crisis in October and its impact on US growth are likely to affect workers' remittances.



Data and charts

Annual data and forecast

	2004 ^a	2005 ^a	2006 ^a	2007 ^a	2008 ^b	2009 ^c	2010 ^c
GDP							
Nominal GDP (US\$ m)	15,798	17,070	18,654	20,373	22,858	24,708	27,100
Real GDP at constant 1990 prices	8,166	8,391	8,747 ^b	9,154 ^b	9,452	9,624	9,853
Real GDP growth (%)	1.8	2.8	4.2 ^b	4.7 ^b	3.3	1.8	2.4
Expenditure on GDP (% real change)							
Private consumption	2.8	2.6	5.9 ^b	6.5 ^b	5.0	2.3	2.8
Government consumption	1.9	1.7	2.8 ^b	1.1 ^b	4.0	3.0	4.0
Gross fixed investment	-5.0	5.8	6.8 ^b	6.4 ^b	3.0	-2.0	2.0
Exports of goods & services	6.6	0.4	10.2 ^b	4.5 ^b	4.8	-0.4	2.0
Imports of goods & services	4.3	0.8	11.3 ^b	7.3 ^b	6.8	1.1	2.1
Origin of GDP (% real change)							
Agriculture	2.9	4.8	7.5	8.6	7.7	5.0	2.7
Industry	-0.6	1.8	3.5	3.4	2.0	1.7	2.5
Services	2.8	3.3	3.9	4.4	2.9	1.1	2.2
Population and income							
Population (m)	6.6	6.7	6.8	6.9	7.0	7.1	7.1
GDP per head (US\$ at PPP)	3,594	3,762	3,994	4,230 ^b	4,444	4,596	4,741
Recorded unemployment (av; %)	6.3 ^b	6.5 ^b	6.6 ^b	6.4 ^b	6.3	6.8	7.0
Fiscal indicators (% of GDP)							
Public-sector balance ^d	-0.6	-1.1	-1.1	-0.2	-1.3	-2.0	-1.3
Public-sector debt interest payments	2.1	2.2	2.4	2.5	2.4	2.5	2.4
Public-sector primary balance	1.5	1.1	1.4	2.2	1.1	0.5	1.1
Net public debt	42.7	40.7	40.3	37.3 ^b	35.5	36.8	35.4
Prices and financial indicators							
Consumer prices (end-period; %)	5.4	4.3	4.9	4.9	9.0	6.0	5.5
Stock of money M1 (% change)	12.6	7.9	15.6	15.3	7.2	5.1	7.7
Stock of money M2 (% change)	1.2	2.7	11.9	18.1	5.5	4.2	5.6
Commercial prime interest rate (av; %)	6.3	6.9	7.5	7.8	7.6	8.0	8.7
Current account (US\$ m)							
Trade balance	-2,660	-2,938	-3,542	-4,073	-4,477	-3,500	-3,418
Goods: exports fob	3,339	3,447	3,758	4,035	4,610	4,516	4,726
Goods: imports fob	-6,000	-6,385	-7,300	-8,108	-9,087	-8,017	-8,144
Services balance	-65	-86	-79	-242	-416	-504	-460
Income balance	-458	-579	-528	-579	-579	-567	-585
Current transfers balance	2,555	3,035	3,472	3,776	3,920	3,879	3,946
Current-account balance	-628	-568	-677	-1,119	-1,552	-691	-517
External debt (US\$ m)							
Debt stock	8,400	8,455	9,136	9,574 ^b	10,217	10,128	9,781
Debt service paid	989	819	1,133	1,005 ^b	850	853	956
Principal repayments	467	385	614	463 ^b	405	396	467
Interest	522	434	519	541 ^b	445	458	489
International reserves (US\$ m)							
Total international reserves	1,893	1,833	1,899	2,199	2,149	1,874	1,739

^a Actual. ^b Economist Intelligence Unit estimates. ^c Economist Intelligence Unit forecasts. ^d Receipts exclude proceeds from sales of state assets (privatisations).

Source: IMF, *International Financial Statistics*.

Quarterly data

	2006		2007			2008		
	3 Qtr	4 Qtr	1 Qtr	2 Qtr	3 Qtr	4 Qtr	1 Qtr	2 Qtr
Central government finance (US\$ m)								
Revenue & grants	631	655	677	883	675	737	767	977
Expenditure & net lending	675	735	714	721	722	859	756	876
Balance	-44	-80	-37	162	-47	-122	11	101
Output								
GDP at constant 1990 prices (US\$ m)								
Agriculture	267	269	284	282	289	294	306	308
Industry	509	519	516	530	531	539	530	542
Commerce	452	454	450	466	475	480	469	478
Total	2,204	2,235	2,242	2,282	2,310	2,346	2,330	2,363
Total (% change, year on year)	4.1	3.9	4.2	4.6	4.8	4.9	4.0	3.6
Prices								
Consumer prices (2000=100)	124.1	124.2	126.8	127.2	128.7	131.1	133.7	131.1
Consumer prices (% change, year on year)	4.8	3.5	5.2	4.0	3.7	5.5	5.5	3.1
Producer prices (2000=100)	126.2	120.7	121.4	128.7	131.6	138.2	144.9	158.7
Producer prices (% change, year on year)	3.6	-2.5	-0.7	1.2	4.3	14.4	19.4	23.3
Coffee price (US cents/lb) ^a	108.1	121.5	121.1	115.3	122.8	133.8	148.4	140.5
Financial indicators								
Deposit rate (av; %)	4.6	4.7	4.9	5.0	4.6	4.4	3.8	3.8
Lending rate (av; %)	7.5	7.6	7.8	7.8	7.8	7.9	7.6	7.3
Money market rate (av; %)	n/a	n/a	n/a	n/a	n/a	5.3	n/a	n/a
M1 (end-period; US\$ m)	1,454	1,563	1,738	1,599	1,615	1,802	1,843	1,712
M1 (% change, year on year)	17.9	15.6	17.4	10.8	11.0	15.3	6.0	7.0
M2 (end-period; US\$ m)	6,893	7,188	7,599	7,871	8,242	8,488	8,572	8,414
M2 (% change, year on year)	10.9	11.9	12.0	15.5	19.6	18.1	12.8	6.9
Foreign trade (US\$ m)								
Exports fob	960	893	963	977	1,038	1,001	1,054	1,247
<i>Maquila</i> ^b	491	417	405	456	484	457	453	503
Imports cif	-1,904	-2,057	-2,003	-2,100	-2,121	-2,453	-2,307	-2,636
<i>Maquila</i> ^b	286	283	310	307	290	330	320	354
Trade balance	-944	-1,164	-1,040	-1,123	-1,083	-1,451	-1,254	-1,389
Foreign payments (US\$ m)								
Merchandise trade balance fob-fob	-973	-1,038	-894	-1,054	-1,006	-1,121	-1,073	-1,166
Services balance	-20	108	-57	-72	-66	-41	-123	-102
Income balance ^c	694	746	710	832	829	824	803	899
Current-account balance	-299	-184	-243	-294	-244	-338	-393	-370
Reserves excl gold (end-period)	1,938	1,815	1,829	2,061	2,334	2,110	2,183	2,209

^a ICO Indicator. ^b Offshore assembly for re-export. ^c Including current transfers balance.

Sources: IMF, *International Financial Statistics*; Banco Central de Reserva de El Salvador.

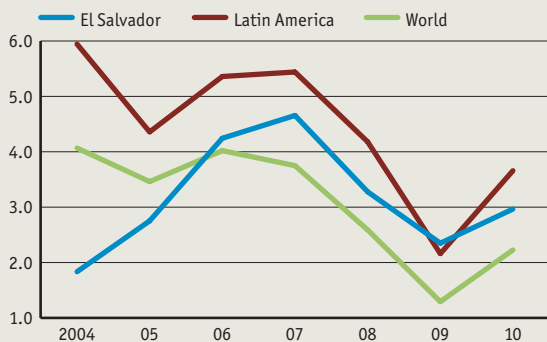
Monthly data

	Jan	Feb	Mar	Apr	May	Jun	Jul	Aug	Sep	Oct	Nov	Dec
M1 (% change, year on year)												
2006	16.6	11.9	14.6	15.6	7.0	20.9	24.9	13.6	17.9	13.9	12.8	15.6
2007	15.7	14.5	17.4	6.9	12.7	10.8	5.8	15.3	11.0	7.6	8.3	15.3
2008	5.2	3.2	6.0	6.6	7.7	7.0	4.7	n/a	n/a	n/a	n/a	n/a
M2 (% change, year on year)												
2006	6.3	7.0	9.3	10.6	7.9	10.8	12.4	10.8	10.9	12.9	12.2	11.9
2007	11.9	10.5	12.0	9.7	14.8	15.5	18.7	21.0	19.6	18.0	17.0	18.1
2008	15.3	14.1	12.8	12.7	8.7	6.9	2.6	n/a	n/a	n/a	n/a	n/a
Consumer prices (av; % change, year on year)												
2006	3.4	3.8	4.0	4.3	3.6	4.4	5.5	4.7	4.2	1.8	3.8	4.9
2007	5.6	4.8	5.1	4.3	3.9	3.7	3.2	3.6	4.4	5.5	6.2	4.9
2008	4.7	5.8	6.0	6.8	8.4	9.0	9.6	9.9	n/a	n/a	n/a	n/a
Producer prices (av; % change, year on year)												
2006	10.5	8.5	7.1	9.7	11.2	8.6	8.3	5.8	-3.0	-6.9	-0.6	0.4
2007	-2.5	-0.2	0.6	-0.4	1.5	2.4	2.2	3.4	7.5	11.4	14.4	17.5
2008	19.6	18.5	19.9	20.1	23.2	26.6	28.0	n/a	n/a	n/a	n/a	n/a
Total exports fob (US\$ m)												
2006	291.6	279.4	352.1	267.8	345.5	317.2	338.3	295.3	326.4	304.2	316.8	271.9
2007	303.8	317.9	341.3	292.1	340.1	345.0	354.3	338.7	345.3	333.6	341.8	326.0
2008	331.8	375.5	346.2	436.0	416.8	393.9	450.7	396.6	381.5	n/a	n/a	n/a
Total imports cif (US\$ m)												
2006	573.8	509.3	687.7	543.4	701.7	694.5	658.1	625.0	620.4	628.6	785.1	643.0
2007	631.7	640.7	730.3	633.4	794.4	672.5	799.2	637.5	684.3	778.7	1,002.7	671.2
2008	731.8	823.9	751.7	871.4	942.4	822.2	917.3	811.0	877.3	n/a	n/a	n/a
Trade balance fob-cif basis (US\$ m)												
2006	-282.2	-229.9	-335.6	-275.6	-356.2	-377.3	-319.8	-329.7	-294.0	-324.4	-468.3	-371.1
2007	-327.9	-322.8	-389.0	-341.3	-454.3	-327.5	-444.9	-298.8	-339.0	-445.1	-660.9	-345.2
2008	-400.0	-448.4	-405.5	-435.4	-525.6	-428.3	-466.6	-414.4	-495.8	n/a	n/a	n/a
Foreign-exchange reserves excl gold (US\$ m)												
2006	1,646	1,775	1,681	2,074	2,034	1,934	2,180	1,993	1,938	1,941	1,940	1,815
2007	1,838	1,830	1,829	2,115	2,084	2,061	2,363	2,307	2,334	2,317	2,201	2,110
2008	2,134	2,189	2,183	2,223	2,315	2,209	2,169	2,210	n/a	n/a	n/a	n/a

Sources: IMF, *International Financial Statistics*; Haver Analytics.

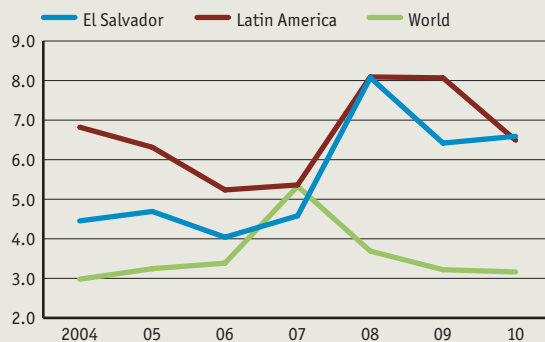
Annual trends charts

Real GDP growth
(% change)



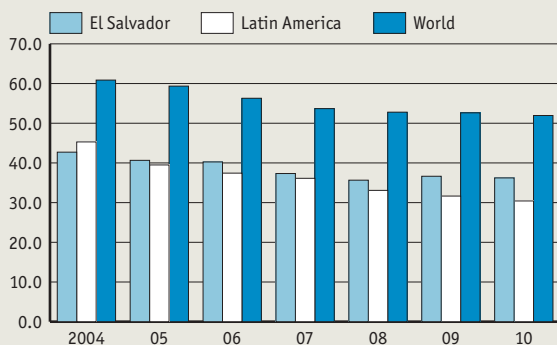
Source: Economist Intelligence Unit.

Consumer price inflation
(av; %)



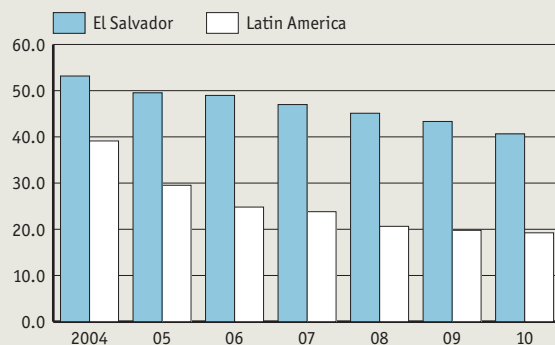
Source: Economist Intelligence Unit.

Public debt
(% of GDP)



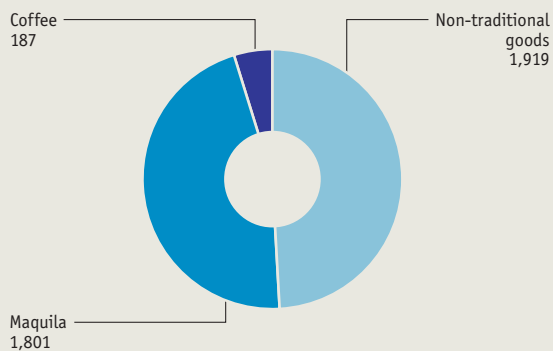
Source: Economist Intelligence Unit.

Total external debt
(% of GDP)



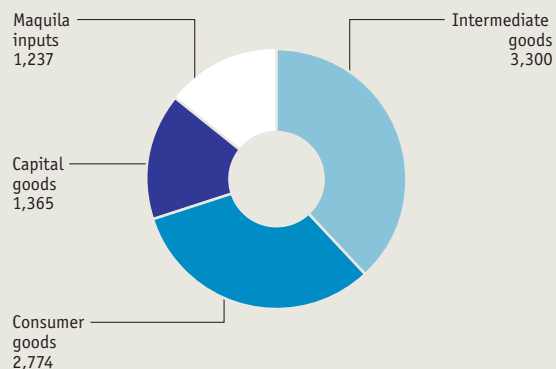
Source: Economist Intelligence Unit.

Principal exports, 2007
(US\$ m)



Source: Economist Intelligence Unit.

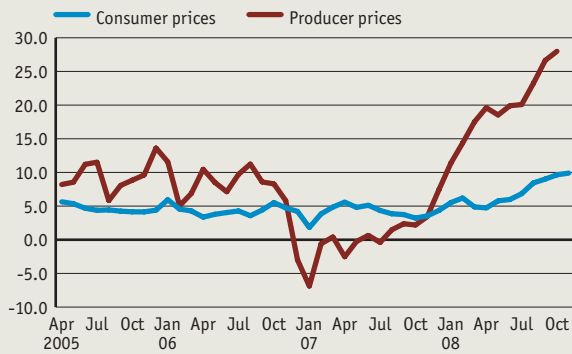
Principal imports, 2007
(US\$ m)



Source: Economist Intelligence Unit.

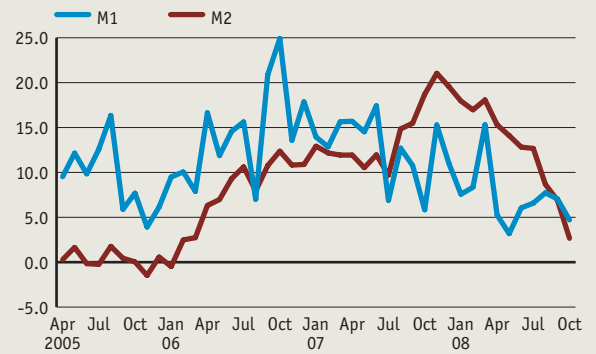
Monthly trends charts

Price inflation
(% change, year on year)



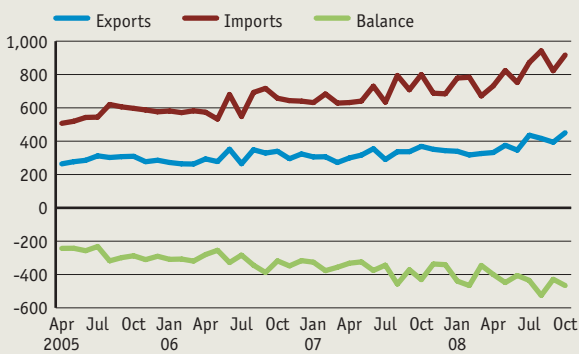
Source: Economist Intelligence Unit.

Monetary aggregates
(% change, year on year)



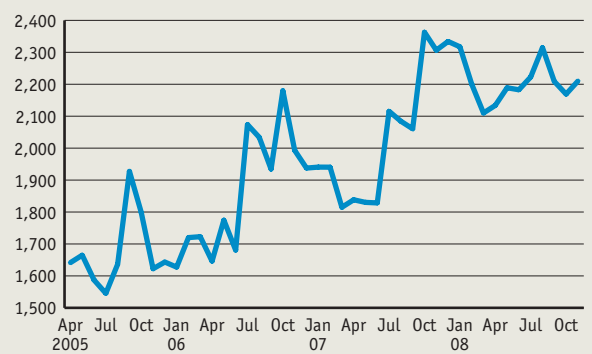
Source: Economist Intelligence Unit.

Monetary aggregates
(% change, year on year)



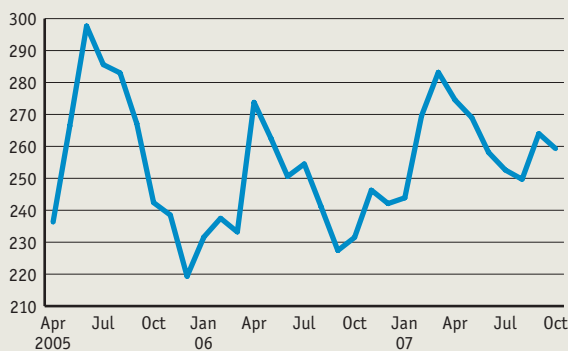
Source: Economist Intelligence Unit.

Foreign-exchange reserves
(US\$ m)



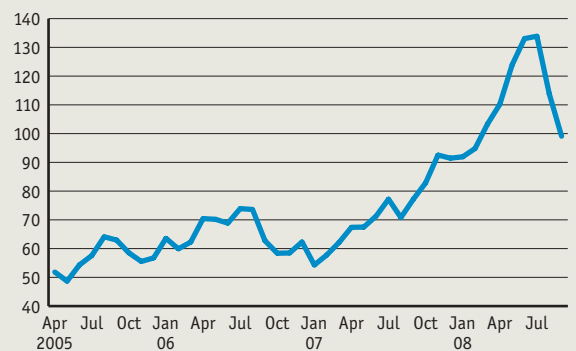
Source: Economist Intelligence Unit.

Coffee: Arabica, ICO price
(US cents/kg; av)



Source: Economist Intelligence Unit.

Oil: Brent crude price
(US\$/b; av)



Source: Economist Intelligence Unit.

Country snapshot

Political structure

Official name	Republic of El Salvador	
Form of state	Unitary republic	
Legal system	US-style Supreme Court system	
National legislature	Unicameral Legislative Assembly, comprising 64 locally and 20 nationally elected deputies, elected every three years	
Electoral system	Universal adult suffrage	
National elections	March 2004 (presidential), March 2006 (legislative and municipal); next elections due on 18 January 2009 (legislative and municipal) and 15 March 2009 (presidential)	
Head of state	President elected for a single term of five years	
National government	The president, currently Antonio Saca, governs with the support of Arena, which holds 34 seats in the legislature; he appoints and presides over a Council of Ministers	
Main political organisations	Government: Alianza Republicana Nacionalista (Arena) Opposition: Frente Farabundo Martí para la Liberación Nacional (FMLN); Partido de Conciliación Nacional (PCN); Partido Demócrata Cristiano (PDC); Cambio Democrático (CD)	
	President	Elías Antonio Saca González
	Vice-president	Ana Vilma Albanez de Escobar
Key ministers	Agriculture	Mario Salaverria Nolasco
	Defence	Jorge Alberto Molina
	Economy	Roberto Esmahan d'Aubuisson
	Education	Darlyn Meza
	Environment	Carlos José Guerrero
	Finance	William Handal Hándal
	Foreign relations	Marisol Arqueta de Barillas
	Health	José Guillermo Maza Brizuela
	Interior	Juan Miguel Bolaños
	Labour & social security	José Roberto Espinal Escobar
	Public security & justice	René Figueroa Figueroa
	Public works	Jorge Nieto Menéndez
	Tourism	Rúben Rochi Parker
Central Bank president	Luz María Serpas de Portillo	