EL SALVADOR

Table 1	2021
Population, million	6.5
GDP, current US$ billion	27.9
GDP per capita, current US$	4281.0
International poverty rate ($1.9)[a]	1.3
Lower middle-income poverty rate ($3.2)[a]	5.7
Upper middle-income poverty rate ($5.5)[a]	22.3
Gini index[a]	38.8
School enrollment, primary (% gross)[b]	90.3
Life expectancy at birth, years[b]	73.3
Total GHG Emissions (mtCO2e)	13.7

Source: WDI, Macro Poverty Outlook, and official data.
a/ Most recent value (2019), 2011 PPPs.
b/ Most recent WDI value (2019).

El Salvador's GDP rebounded in 2021, largely fueled by remittances. Growth prospects are threatened by high debt and financing needs, slow progress on productivity-enhancing reforms, and policy uncertainty. Poverty is not estimated to return to its pre-pandemic levels in 2021. Limited fiscal space and lack of effective and adaptive safety nets limit poverty reduction. Given its dollarization, establishing a credible fiscal framework and implementing growth-enhancing reforms are critical for El Salvador to respond to shocks amid an uncertain global environment.

Key conditions and challenges

The COVID-19 crisis intensified El Salvador's structural weakness. Productivity has been declining since 2002, nevertheless, the country experienced a low and stable growth rate in the decade prior to the crisis, fueled by some of the highest remittance inflows in the region. The crisis led to a collapse in economic activity in 2020, followed by a sharp recovery in 2021. The government has made significant progress in vaccination against COVID-19; 70 percent of the population has received at least one dose. However, to support this recovery and grow productivity, El Salvador needs to make progress in productivity-enhancing reforms, including reforms related to trade facilitation and the business environment, innovation and competition, and regulations for private sector participation in infrastructure.

The country experienced a significant reduction in poverty before the COVID-19 crisis; however, vulnerability to poverty has been rising and it is among the highest in LAC. The sustainability of poverty reduction is limited by: (i) slow human capital accumulation, (ii) low progressivity of safety nets, (iii) negligible coverage of well-targeted conditional cash transfer (CCT) programs; and (iv) employment barriers disproportionately affecting those at the bottom.

Fiscal accounts, which have been a structural weakness, have worsened during the crisis and there is no clear and feasible fiscal consolidation plan. As a result, it is not clear that the country will be able to meet its financing needs and avoid a debt distress situation, this is reflected in the record level of sovereign risk (near 2,000 basis points).

Finally, the recent weakening of checks and balances and the introduction of bitcoin as legal tender have introduced significant policy uncertainty that is detrimental to investments. Although the liquidity and technology in cryptocurrencies can be leveraged to help El Salvador to develop, potential adverse impacts need to be taken into account.

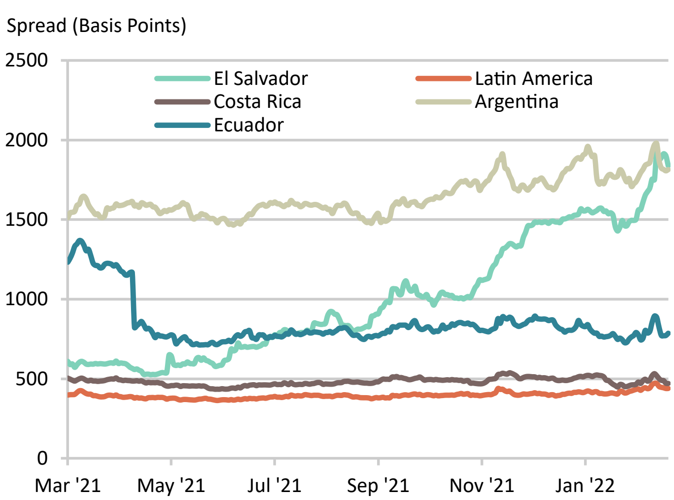
Recent developments

GDP rebounded in 2021, with an estimated growth rate of 10.7 percent, led by manufacturing, commerce, and transport. On the demand side, private consumption (boosted by remittances) and investment led growth. The employment-to-population ratio grew from 65 percent pre-pandemic to 69.6 percent in June 2021, but increases in formal employment were concentrated in the public sector.

Remittances grew 27 percent in 2021 boosting imports, which grew 46 percent. Exports rebounded at a slower pace (31.4 percent). The trade deficit increased more than remittances, resulting in a current account deficit estimated at 3.6 percent of GDP, financed by FDI and debt.

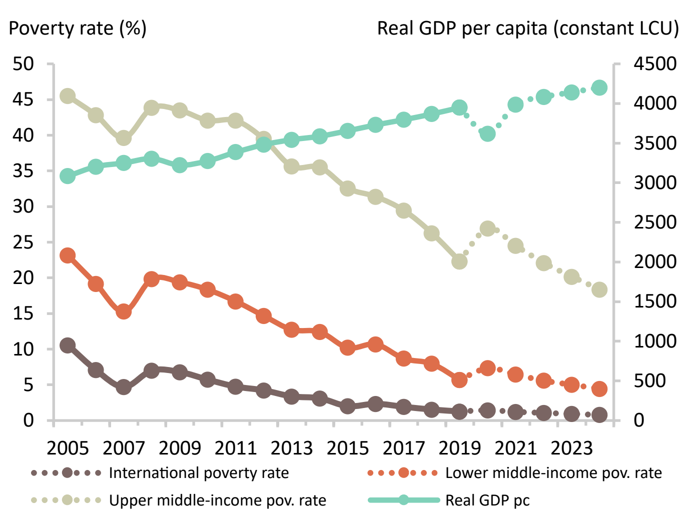
Inflation averaged 3.5 percent in 2021 (from -0.4 percent in 2020), largely due to external

FIGURE 1 El Salvador / Emerging markets bond global index



Source: JPMorgan Chase.

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



Source: World Bank. Notes: see Table 2.

factors like supply disruptions and commodity prices. Food and transport prices grew 2.3 and 6.9 percent, respectively.

The fiscal deficit declined from 9.2 percent of GDP in 2020 to 4.5 in 2021. Expenditures grew by 6.2 percent, led by the generous response to the pandemic, bitcoin set-up costs, and the wage bill. Revenues grew by 23.7 percent fueled by economic activity and tax administration efficiency. The debt stock increased by US$1.7 billion in 2021. However, the debt-to-GDP ratio dropped from 91.8 in 2020 to 85.6 percent of GDP in 2021.

The poverty rate (US$5.5) is estimated to decline in 2021 but will still be 2.2 percentage points higher than in 2019. Vulnerability to poverty is estimated to decline to 42.2 percent and about one-quarter of the population is estimated to be in the middle class in 2021. The COVID-19 crisis led to an increase in poverty, despite the generous fiscal response and large increase in remittances. Mitigation measures were not well-targeted, and remittances did not compensate for labor income losses at the bottom of the distribution, as only a small share of poor and vulnerable households receive them.

Outlook

GDP will still grow above its potential in 2022 as a result of a large growth carry-over from 2021, remittances, and government consumption. The war in Ukraine will reduce growth in 2022 due to lower US growth and higher commodity prices. After 2022, growth will be around 2 percent as progress in productivity-enhancing reforms remains limited and policy uncertainty remains high. Inflation will peak in 2022 due to higher fuel and food prices, but is projected to moderate afterwards.

The current account will remain in deficit given the increase in imports, high commodity prices and a moderation in remittance growth. Financing the current account deficit will become increasingly challenging, given modest FDI prospects and limited access to external financing.

In the absence of a credible fiscal consolidation plan, the fiscal deficit is expected to increase due to higher interest payments and public sector wage bill. The deficit could remain above five percent of GDP after 2022, while debt may reach 90 percent of GDP. Since there is no clear financing path for such fiscal policy trajectory, the baseline scenario assumes that El Salvador would have to pursue at least a modest fiscal consolidation with the aim of stabilizing its debt-to-GDP ratio. In this scenario, debt would stabilize around 85 percent of GDP due to slower growth in public investments and current expenditures.

Risks to this scenario are substantial. The geopolitical environment could deteriorate further, reducing global growth, increasing inflation, and weakening the external account of oil- and food-importing countries like El Salvador. Changes in fiscal policy may not be sufficient or timely enough to avoid debt distress. Meaningful poverty reduction requires fiscal space and resources shifts toward progressive and pro-poor social programs and human capital investments, tackling critical employment barriers is also necessary.

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

	2019	2020	2021e	2022f	2023f	2024f
Real GDP growth, at constant market prices	2.6	-8.0	10.7	2.9	1.9	2.0
Private Consumption	3.2	-10.6	8.0	2.7	1.5	1.8
Government Consumption	0.6	6.1	5.5	4.8	2.4	0.9
Gross Fixed Capital Investment	6.7	-7.9	54.5	3.6	6.1	5.5
Exports, Goods and Services	6.2	-21.3	20.5	3.9	3.0	2.0
Imports, Goods and Services	2.9	-10.2	23.0	4.1	4.0	3.2
Real GDP growth, at constant factor prices	2.9	-7.9	10.7	2.9	1.9	2.0
Agriculture	-0.5	-2.3	4.8	2.1	2.1	2.1
Industry	4.4	-10.0	5.1	2.8	2.2	2.3
Services	2.5	-7.5	13.6	3.0	1.7	1.9
Inflation (Consumer Price Index)	0.1	-0.4	3.5	4.7	2.4	1.6
Current Account Balance (% of GDP)	-0.6	0.5	-3.6	-3.4	-4.3	-4.9
Net Foreign Direct Investment (% of GDP)	2.4	0.8	2.3	2.5	2.9	2.7
Fiscal Balance (% of GDP)[a]	-3.0	-9.2	-4.5	-4.4	-4.5	-3.8
Debt (% of GDP)[b]	73.6	91.8	85.6	85.3	85.8	85.7
Primary Balance (% of GDP)[a]	0.7	-4.8	-0.4	-0.4	0.0	0.4
International poverty rate ($1.9 in 2011 PPP)[c,d]	1.3	1.4	1.2	1.1	0.9	0.8
Lower middle-income poverty rate ($3.2 in 2011 PPP)[c,d]	5.7	7.4	6.4	5.6	5.0	4.5
Upper middle-income poverty rate ($5.5 in 2011 PPP)[c,d]	22.3	26.9	24.5	22.1	20.2	18.4
GHG emissions growth (mtCO2e)	3.2	-5.3	4.1	1.3	0.9	0.2
Energy related GHG emissions (% of total)	53.9	53.4	53.9	53.7	53.4	52.8

Source: World Bank, Poverty & Equity and Macroeconomics, Trade & Investment Global Practices. Emissions data sourced from CAIT and OECD.

a/ Fiscal and Primary Balance correspond to the non-financial public sector.

b/ Debt is total public debt.

c/ Calculations based on SEDLAC harmonization, using 2019-EHPM.Actual data: 2019. Nowcast: 2020-2021. Forecasts are from 2022 to 2024.

d/ Projections using microsimulation methods.