INTERNATIONAL MONETARY FUND

IMF Country Report No. 18/151

EL SALVADOR

2018 ARTICLE IV CONSULTATION—PRESS RELEASE; STAFF REPORT; AND STATEMENT BY THE EXECUTIVE DIRECTOR FOR EL SALVADOR

June 2018

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 2018 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 11, 2018, 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 11, 2018, following discussions that ended on February 16, 2018, 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 April 26, 2018.
- An **Informational Annex** prepared by the IMF staff.
- A **Statement by the Executive Director** for El Salvador.

The documents listed below have been or will be separately released.

Selected Issues Paper

The IMF's transparency policy allows for the deletion of market-sensitive information and premature disclosure of the authorities' policy intentions in published staff reports and other documents.

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May 17, 2018

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IMF Executive Board Concludes 2018 Article IV Consultation with El Salvador

On May 11, 2018, the Executive Board of the International Monetary Fund (IMF) concluded the Article IV consultation with El Salvador.[1]

Background

Real GDP grew above potential, at 2.3 percent in 2017, supported by lower oil prices, continued U.S. recovery, and a surge in remittances. However, El Salvador's growth continues to lag regional peers. Inflation remained low at 1 percent, anchored by dollarization. The current account deficit continued to shrink in line with the region through 2017.

The authorities' adjustment efforts have improved the fiscal balance since 2014 and stabilized debt. Higher revenues and expenditure restraint resulted in a primary surplus of 0.9 percent of GDP in 2017. However, the high interest bill led to an overall deficit of 2.5 percent of GDP. Revenues increased partly due to additional taxes on the profits of large firms and telecommunications services. Cash-based primary fiscal expenditure declined in 2015-17, reflecting measures to restrain spending on goods and services, subsidies and, to a smaller extent, limiting the indexation of the wage bill. Capital expenditure declined in 2017 due to weak execution, as well as the political stalemate that affected the approval of project financing. A downward adjustment of nominal GDP, due to the revision of the national accounts, increased the 2017 debt-to-GDP ratio from 63 to 71 percent.

The banking sector appears solid and credit growth is moderate, but sovereign risk concerns and declining margins are affecting the (mostly foreign-owned) banks. The banking system's capital adequacy ratio (16.6 percent) remains well above the required minimum of 12 percent. The NPL ratio is 2 percent and problem loans are amply provisioned. However, abundant liquidity, including due to the lack of viable investment projects, and a declining net interest spread continue to dent bank profitability. Credit growth is moderate at 6 percent in real terms, but is slightly below the CAPDR average, varying significantly by sector.

In 2018-19, growth is expected to remain above potential at 2.3 percent, reflecting the temporary acceleration of U.S. growth from the recent U.S. tax reform and higher grant-financed investment. The fiscal deficit would further fall to 2.2 percent of GDP in 2018, as savings from

[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.

the pension reform kick in, but would rise to 2.7 percent of GDP in 2019. The external deficit would increase both in 2018 and 2019 as remittances' growth moderates while imports expand, and the income balance worsens due to rising interest rates as U.S. monetary policy normalizes.

Key risks include tighter global financial conditions, due to the normalization of the U.S. monetary policy, and more restrictive U.S. immigration policies. El Salvador is also vulnerable to domestic policy slippages, which could delay the implementation of much needed structural reforms. On the upside, better-than-expected growth in the U.S. would have positive spillovers to the local economy. In addition, promoting regional cooperation, including the customs union with Guatemala and Honduras, could boost trade and economic growth.

Executive Board Assessment[2]

The Directors welcomed the continued economic recovery in El Salvador and the recent improvement of the public debt dynamics. However, they noted that potential growth continues to be lower than desirable, the debt level remains high, and large financing gaps are projected for 2019 and beyond. Against this background, Directors emphasized the need for further fiscal consolidation, strengthening the financial sector, and implementing far-reaching structural reforms to improve the business environment and support formal employment.

Directors commended the authorities for the progress achieved in improving the political dialogue between parties on key policy issues. They welcomed the substantial fiscal adjustment efforts, which contributed to a reduction in the deficit and stabilization of debt. However, Directors considered that further fiscal consolidation is needed due to high medium-term gross financing needs, the risk of global financial shocks, and of higher global interest rates. While a number of Directors favored a front-loaded adjustment to put debt on a firm declining trajectory, a number of others saw scope for a more gradual approach given the possible impact on growth and the need for a broad political consensus.

Directors welcomed the new pension reform, which reduces medium-term fiscal pressures and contributes to lowering the fiscal deficit. They saw merit in further strengthening the sustainability of the pension system by increasing the retirement age, while simultaneously allowing for improvement in benefits coverage for the poor.

Directors were encouraged by the authorities' efforts to improve the business environment and competitiveness, as reflected in the significant jump in the country's ranking in the 2018 World Bank's Doing Business report. They welcomed the implementation of the country's productive transformation plan, and noted that supporting growth requires continued efforts on structural reforms to foster investment and formal job creation. Private investment can be bolstered by

[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.

reducing red-tape and bureaucracy, and by fighting crime, while public investment can be increased by addressing weaknesses in planning, execution and monitoring of investment projects. Directors welcomed the progress made in the implementation of the "El Salvador Seguro" plan to reduce crime, and the ongoing adherence to the customs union with Guatemala and Honduras.

Directors noted that El Salvador's banking system is well capitalized and very liquid. Recent credit growth to the productive sectors has been encouraging, but further room for healthy credit expansion remains. Directors acknowledged the recent progress made in risk-based and cross-border supervision, and the approval in 2017 of the reforms to the law on financial inclusion. To further improve the resilience of the banking sector, they encouraged the authorities to accelerate the adoption of the crisis management and bank resolution draft law, to strengthen the financing of the lender of last resort facilities, and to create a bank liquidity fund. Directors encouraged continued efforts to strengthen the AML/CFT framework.

Directors commended the authorities for the publication of the revised national accounts in March 2018, which improves substantially the quality and the transparency of the national accounts statistics.

El Salvador: Selected Economic Indicators

I. Social Indicators

Rank in UNDP Development Index 2015 (of 188)	117	Population (million, 2016)	6.3
Per capita income (U.S. dollars, 2016)	4,224	Life expectancy at birth in years (2015)	73
Percent of pop. below poverty line (2016)	33	Infant mortality (per 1,000 live births, 2016)	13
Gini index (2015)	41	Primary education completion rate (percent, 2015)	100

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

	2011	2012	2013	2014	2015 2/	2016 2/	Est. 2017	Proj. 2018
Income and prices								
Real GDP growth (percent)	3.8	2.8	2.4	2.0	2.4	2.6	2.3	2.3
Consumer price inflation (average, percent)	5.1	1.7	0.8	1.1	-0.7	0.6	1.0	1.8
GDP deflator (percent)	5.9	2.5	0.4	0.8	0.2	0.6	1.4	2.3
Terms of trade, percent change	-2.5	0.5	-1.6	3.3	12.4	-2.9	0.0	0.3
Real effective exchange rate (+ = appreciation)	1.7	-1.5	-0.9	2.8	5.5	-1.2	-0.5	...
External sovereign bond spread (basis points)	374	448	378	400	497	600	520	...
Money and credit								
Credit to the private sector	45.3	44.8	47.1	48.9	50.1	51.1	51.7	51.9
Broad money	49.7	48.1	47.9	46.8	48.5	48.5	51.7	51.7
Interest rate (time deposits, percent)	1.8	2.5	3.4	3.8	4.2	4.4	4.4	...
External sector								
Current account balance 5/	-5.5	-6.0	-7.2	-5.4	-4.0	-2.2	-2.5	-3.5
Trade balance	-23.5	-23.0	-24.1	-23.0	-21.6	-19.4	-19.5	-20.5
Exports (f.o.b. excluding *maquila*)	20.9	19.8	19.7	18.8	18.9	17.5	18.3	18.3
Imports (f.o.b. excluding *maquila*)	-44.4	-42.8	-43.8	-41.9	-40.5	-36.9	-37.9	-38.7
Services and income (net)	-0.8	-1.7	-1.7	-1.1	-1.2	-2.0	-3.3	-3.4
Transfers (net)	18.9	18.7	18.6	18.7	18.8	19.1	20.3	20.3
Foreign direct investment	1.1	2.3	0.8	1.4	1.7	1.6	1.3	1.3
Gross international reserves (millions of U.S. dollars)	2,503	3,175	2,745	2,693	2,787	3,238	3,671	3,799
Nonfinancial public sector								
Overall balance 2/	-4.5	-4.3	-4.5	-3.9	-3.8	-3.4	-2.5	-2.2
Primary balance 2/	-1.9	-1.8	-1.8	-1.2	-1.0	-0.3	0.9	1.4
Of which: tax revenue	15.7	16.1	17.0	16.7	16.9	17.4	17.8	17.9
Public sector debt 2/ 3/	59.5	63.8	63.8	65.6	67.6	69.5	70.6	70.1
National savings and investment								
Gross domestic investment	17.8	17.8	17.2	16.4	15.6	15.1	16.9	15.7
Public sector 4/	2.2	2.6	2.5	2.2	2.2	2.2	2.2	2.5
Private sector 4/	14.1	14.0	15.1	13.4	13.4	13.2	13.3	13.2
National savings	12.3	11.8	10.0	11.0	11.6	12.9	14.4	12.2
Public sector	-2.2	-1.3	-1.3	-1.0	-1.0	-0.2	0.4	0.7
Private sector	14.5	13.1	11.3	12.1	12.6	13.0	14.0	11.5
Net foreign assets of the financial system								
Millions of U.S. dollars	2,811	3,229	2,473	2,211	1,931	2,013	2,678	2,937
Percent of deposits	28.8	32.6	24.0	21.6	17.8	18.0	21.8	23.0
Memorandum items:								
Nominal GDP (billions of U.S. dollars)	20.3	21.4	22.0	22.6	23.2	23.9	24.8	26.0

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

1/ The data reflects the discussions during the mission on February 2018, with the exception of the national accounts numbers, which were updated with the revised statistics published on March 23, 2018.

2/ Excludes impact of the pension reform on fiscal accounts, which may reduce the fiscal deficit by up to 0.8 percent of GDP starting from 2018, but net impact on the deficit could be smaller depending on the accounting treatment of new changes to the pension system that is under discussion.

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

4/ Fixed capital formation; disaggregation of inventories into public and private not available.

5/ The assessment is based on data as of February 2018 provided to the team during the mission. The most recent data indicate that the current account deficit declined to 2 percent of GDP in 2017.

INTERNATIONAL MONETARY FUND

EL SALVADOR

April 26, 2018

STAFF REPORT FOR THE 2018 ARTICLE IV CONSULTATION

KEY ISSUES

Context: In recent years, El Salvador has suffered from low growth, high and rising public debt, political polarization, and sovereign financial strains. A downward revision of nominal GDP, due to the rebasing of the national accounts, increased the 2017 debt-to-GDP ratio from 63 to 71 percent. The country has pursued a strategy to address the growth and fiscal problems through (i) pro-growth measures and (ii) gradual fiscal adjustment combined with a recent pension reform, which was facilitated by an improvement in collaboration across the political spectrum. The recent decision by the U.S. administration to end the temporary protection status (TPS) for Salvadoran immigrants and further restrictive immigration policies pose risks to remittances' inflows and growth going forward. Presidential elections are scheduled for early-2019.

Focus: Discussions focused on policies to boost growth and attain fiscal sustainability in the context of high debt, approaching domestic elections, and potential external headwinds.

Main policy issues

- Raising potential growth requires fostering jobs, improving business regulation, tackling crime and corruption, and prioritizing public resources to support investment.

- Implementing further fiscal consolidation remains essential to lower public debt and restore fiscal sustainability. Well-designed measures supported by robust financing and social protection, as well as by stronger public financial management, are needed.

- Further pension reform is needed to increase the retirement age and coverage to help sustainability.

- The banking system appears sound, but credit growth to corporates should expand to support growth. Frameworks for crisis resolution, supporting systemic liquidity, and strengthening supervision and regulation need to be further upgraded.

Approved By:
Cheng Hoon Lim (WHD) and Zeine Zeidane (SPR)

Discussions took place in San Salvador during February 5-16. The staff team comprised P. Mishra (head), F. Di Vittorio, A. Lariau, B. Lissovolik, I. Teodoru (all WHD), and R. Giri (SPR). Ms. Del Cid-Bonilla (OED) also participated in the meetings. The team met with President Mr. Sánchez Cerén, Vice President Mr. Ortiz, Technical Secretary Mr. Lorenzana, Minister of Finance Mr. Cáceres, Minister of Economy Mr. Solomon Lopez, Central Bank President Mr. Cabrera, members of Congress, other senior officials and representatives of the private sector and civil society.

CONTENTS

ECONOMIC AND POLITICAL CONTEXT 4

RECENT DEVELOPMENTS 6

OUTLOOK AND RISKS 9

FISCAL POLICY 11

FINANCIAL SECTOR STABILITY AND SUPPORT TO GROWTH 16

SUPPLY SIDE REFORMS 18

STATISTICS 20

STAFF APPRAISAL 20

BOX
1. Implementation of Fund Advice 23

FIGURES
1. Long-Term Growth and Poverty 24
2. Balance of Payments Developments 25
3. Fiscal Developments 26
4. Financial Sector Developments 27

TABLES

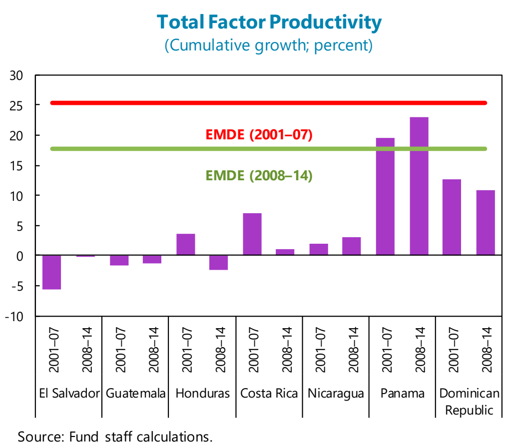
1. Selected Economic Indicators 28
2. Medium-Term Baseline Scenario 29
3. Balance of Payments 30
4. External Financing Requirements and Sources 31
5. Operations of the Nonfinancial Public Sector 32
6. Summary Accounts of the Financial System 33
7. Selected Vulnerability Indicators 34
8. Public Sector Financing Requirements and Sources 35

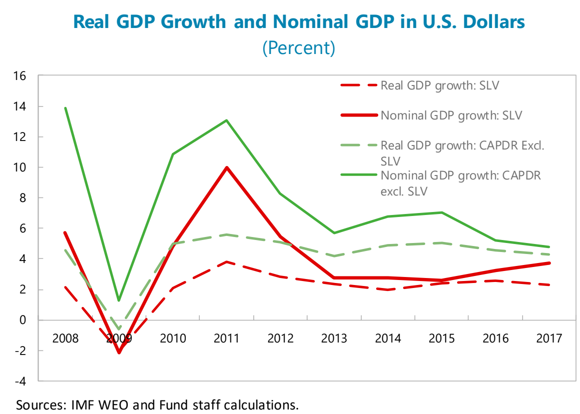
ANNEXES

I. Debt Sustainability Analysis 36
II. External Stability Assessment 48
III. National Accounts Revision 52

ECONOMIC AND POLITICAL CONTEXT

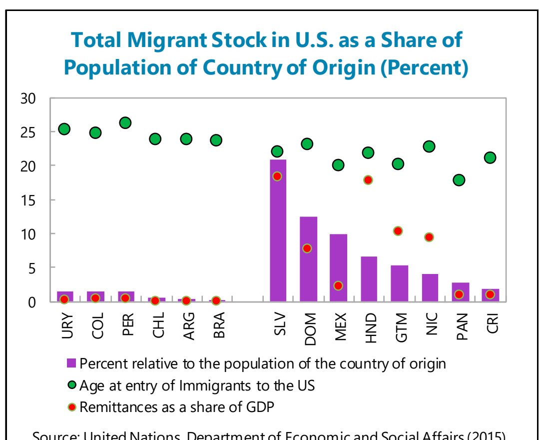
1. The economy has been steadily recovering since 2009, but is held back by modest potential. Real GDP growth averaged 2½ percent during 2011-17, slightly above its 20-year average and its estimated potential of 2.2 percent. Total factor productivity growth has severely underperformed regional and global peers. While official dollarization has anchored inflation, it also entailed subdued nominal GDP growth.





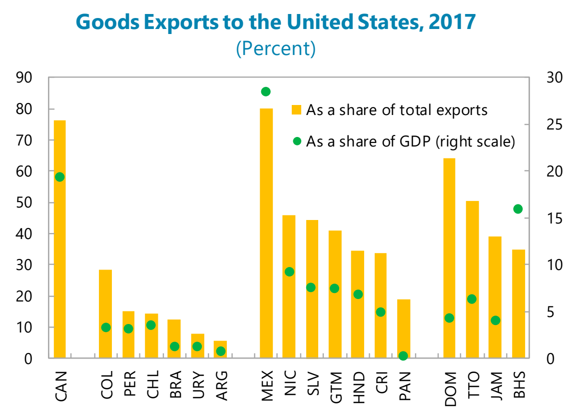
2. The subpar growth reflects an interaction of structural and macroeconomic impediments, and susceptibility to shocks. El Salvador has one of the lowest investment rates in the region. On the structural side, high crime, limited human capital, and institutional and competitiveness weaknesses (reflected in low business environment rankings) discourage investment. On the macroeconomic side, a comparatively low domestic saving rate further constrains investment. Government finances have not been sufficiently strong to ensure support for growth through infrastructure development, education, security, and overall confidence in policy sustainability.

3. Emigration is high and concentrated among the young. El Salvador is an outlier in terms of its emigration rate, with the U.S. receiving over 95 percent of Salvadoran emigrants. The reasons for the high and sustained Salvadoran emigration are varied and include an early trigger of the civil war in the 1980s. The effects of migration can be mixed. It increases migrants' own incomes, but reduces the supply of labor in origin countries, and increases the wages of those left behind (see selected issues paper). It also generates remittances that have significant macro-stabilizing and poverty-alleviation

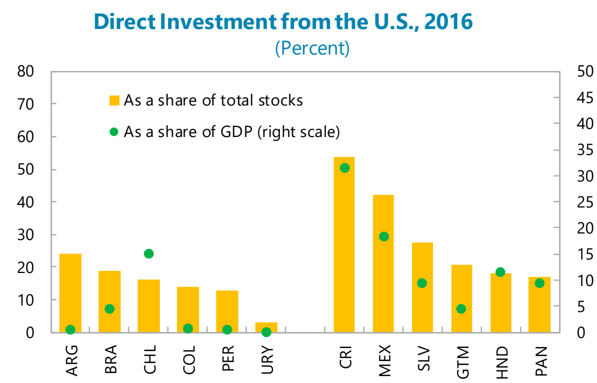


benefits.[1] Staff's analysis suggest that emigration is likely to have positive net benefits for the El Salvador economy (see selected issues paper).

4. **Economic links to the U.S. are strong and broad-based.** The U.S. accounts for over 90 percent of the total migrant and remittances inflows (over 17 percent of GDP), one-half of goods exports from El Salvador, one-third of the FDI stock, and extensive financial system linkages. The Salvadoran diaspora in the U.S. counts over 2 million individuals (it is the fifth largest foreign-born group, dwarfing all non-micro-states as a share of own population). Total income generated by the diaspora is estimated to even exceed Salvadoran GDP.



Sources: IMF, Direction of Trade Statistics database; IMF, World Economic Outlook database; and IMF staff calculations.



Sources: IMF, Coordinated Direct Investment Survey database; IMF, World Economic Outlook database; and IMF staff calculations.

5. **Low growth is an obstacle to further advancing the authorities' notable progress in reducing poverty and inequality.** Efforts to combat crime and improve education and social protection are hindered as fiscal revenues remain subdued due to low growth. And while remittances can help lessen poverty, they are not a panacea, as these private transfers need to be complemented by efficient social insurance schemes. Moreover, remittances tend to raise reservation wages, denting incentives to work.

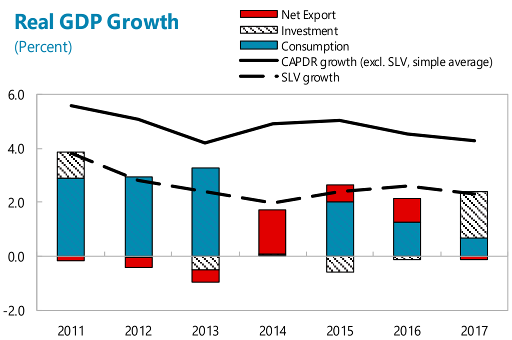
6. **High political uncertainty persists in the context of the current electoral cycle.** Political polarization has been a major policy bottleneck, but positive breakthroughs in inter-party cooperation have taken place since 2017. The opposition parties gained 2/3 of the seats after the March 4 Congressional elections, reaching the required supermajority for important decisions such as financing approval. However, dissatisfaction with traditional parties is paving the way for an independent presidential candidate, who is currently leading the polls.

[1] See IMF Working Paper No 17/144.

RECENT DEVELOPMENTS

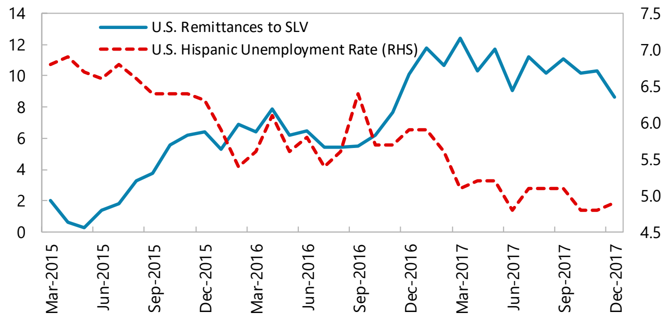
7. Growth has been slightly above potential, helped by low oil prices and a recent surge in remittances. GDP growth was 2.3 percent in 2017, slightly up from 2.2 percent in 2013-14 supported by lower oil prices and continued U.S. recovery. Remittances growth has accelerated since late-2016 as with the rest of Central America. This likely reflects precautionary reasons, in anticipation of a potential increase in return migration due to a change in U.S. immigration policies. The output gap is estimated to be almost closed.

Real GDP Growth
(Percent)



Sources: IMF WEO and Fund staff calculations.

Remittances and U.S. Hispanic Unemployment Rate
(y-o-y growth, 3-months moving average; percent)



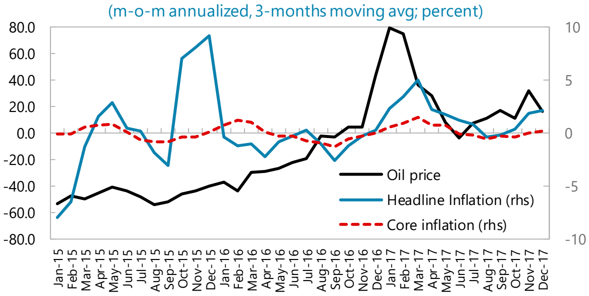
Sources: National authorities and Fund staff calculations.

8. Low energy prices helped contain inflation. Since the 2014 fall of global oil prices, inflation has been low or negative, with core inflation around zero. Relatively good harvests contributed to the low inflation pattern and helped dampen inflationary effects from large increases in minimum wages in late-2016 (ranging from 20 percent for urban workers to almost 100 percent for certain categories of agricultural workers).

9. The current account deficit has shrunk since 2013, but it is estimated to widen in 2017. The current account deficit continued to shrink in line with the region through mid-2017. The reduced petroleum import bill explains 80 percent of the improvement in the external deficit in 2016 relative to 2013 (Figure 2). Despite the sharp recovery in merchandise exports and the continued buoyancy of remittances, the current account deficit is estimated to widen in 2017. This reflects an acceleration in merchandise imports in the second half 2017, driven by intermediate goods and oil, and a worsening of the services and income balance.

Headline and Core Inflation, and Oil Price Growth

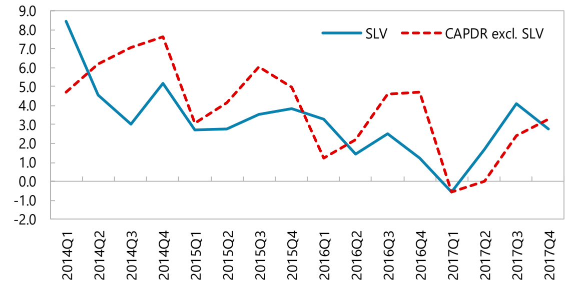
(m-o-m annualized, 3-months moving avg; percent)



Sources: National authorities and IMF staff calculations.

Current Account Deficit

(Percent of GDP)

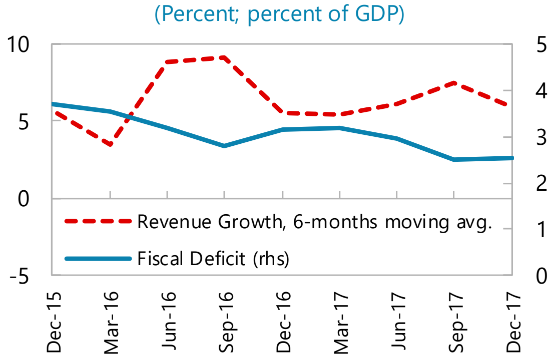


Sources: IMF WEO and Fund staff calculations.

10. The fiscal deficit has declined significantly on a cash basis since 2014 (Figure 3). Revenues increased as a percent of GDP, partly due to additional taxes on the profits of large firms and telecommunications services. Cash-based primary fiscal expenditure declined in 2015-17 in terms of GDP, and also relative to budget projections. This reflects measures to restrain spending on goods and services, subsidies and, to a smaller extent, limiting the indexation of the wage bill. Capital expenditure declined in 2017 due to weak execution, as well as the political stalemate that affected the approval of project financing. Public debt reached 71 percent of GDP at end-2017 (see Annex I).

Revenue and Fiscal Deficit

(Percent; percent of GDP)



Sources: WEO and IMF staff calculations.

Improvement in the Fiscal Deficit in 2015-2017

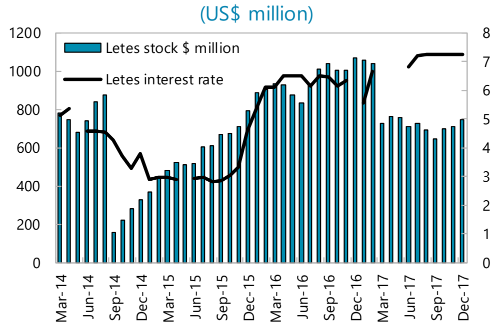
(Percent of GDP)

Change in the Primary balance	1.5
Revenue	0.9
New taxes to finance security	0.4
Non-tax revenue	0.2
Other (including tax buoyancy)	0.2
Primary spending	-0.6
Wage bill	0.1
Goods and services	-0.6
Subsidies	-0.4
Other	0.3

Source: Staff estimates.

11. The sovereign financing situation was challenging in 2017, but has improved recently. In late 2016, an initial bipartisan deal authorized the issuance of a $600 million Eurobond. However, renewed political tensions caused a missed payment on pension bonds in April 2017, triggering sovereign downgrades and tightening financing. This crisis had a sobering effect across the political spectrum, and a similar stand-off was avoided in September through a bipartisan deal to finance the remainder of 2017 and amend the pension system. The deal and the subsequent 2018 budget agreement were received well by foreign investors, with EMBI spreads declining by almost 150 bps since late-September. By contrast, rating agencies have remained cautious, only marginally upgrading El Salvador. Domestic banks have also been reluctant to increase their exposure to government short-term debt (LETES). Indeed, LETES yields increased and were at record-high levels at the turn of 2017-18 (7¼ percent).

Stock of Short-term T-bills
(US$ million)



Sources: National authorities, national stock market, and Fund staff calculations.

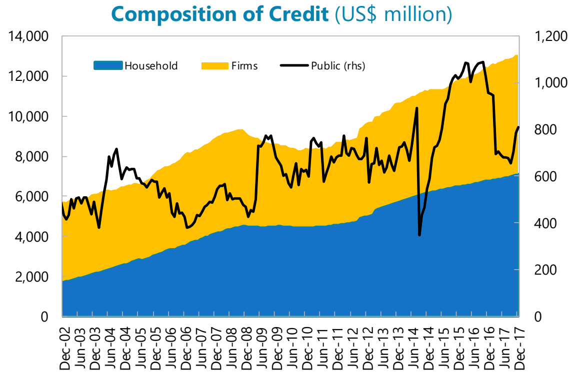
Sovereign Downgrades and Subsequent Upgrades by Rating Agencies

	S&P	Moody's	Fitch
February 1, 2017	B-	B3	B
April 20, 2017	Selective Default	Caa1	Restricted Default local/CCC foreign
May 3-5, 2017	CC	Caa1	CCC
October 3-6, 2017	CCC+	Caa1	B-
February 23, 2018	CCC+	B3	B-

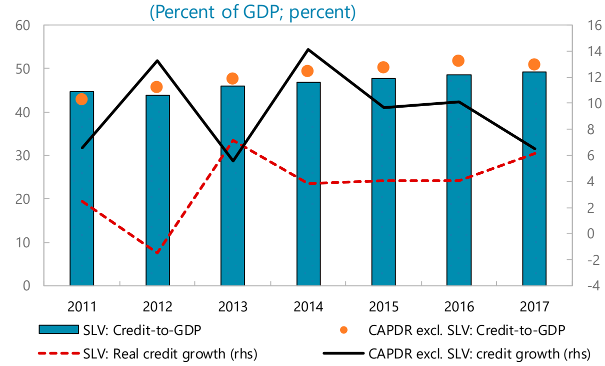
Sources: S&P, Moody's, and Fitch credit rating.

12. The banking sector appears solid and credit growth is moderate, but sovereign risk concerns and declining margins are affecting the (mostly foreign-owned) banks (Figure 4). The banking system's capital adequacy ratio (16.6 percent) remains well above the required minimum of 12 percent. The NPL ratio is 2 percent and problem loans are amply provisioned. However, abundant liquidity, including due to the lack of viable investment projects, and a declining net interest spread continue to dent bank profitability. Credit growth is moderate at 6 percent in real terms, but is slightly below the CAPDR average, varying significantly by sector (see selected issues paper). Banks' exposure to the sovereign has declined. This follows a partial repayment on LETES by the government with proceeds from the Eurobond issuance. Banks are, however, hesitant to rebuild their exposure to the sovereign despite high yields. Excessive liquidity holdings by both banks and corporates may be a factor in limiting opportunities for risk-taking, investment, and growth.

Composition of Credit (US$ million)



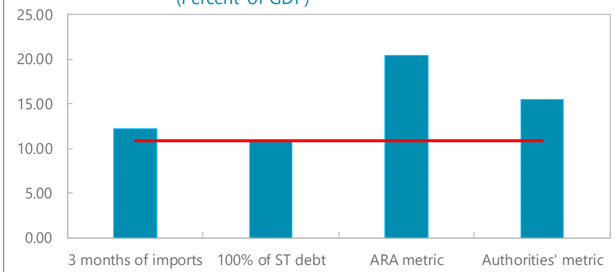
Credit: Level and Real Growth Rate
(Percent of GDP; percent)



Sources: SECMCA, IMF WEO and Fund staff calculations.

13. While El Salvador's external balance has improved since 2013, the external position is moderately weaker than implied by fundamentals and desired medium-term policies (Annex II), suggesting that the real exchange rate is overvalued by 6 to 9 percent. The improvement in external position is likely to be temporary. Imports are expected to pick up due to the firming up of oil prices. Moreover, the recent remittance surge is likely to fade as uncertainty surrounding U.S. immigration policy diminishes. There is ample scope to further improve non-price competitiveness. Staff's analysis of more granular competitiveness indicators (see selected issues paper) suggests that the intensity of competition for Salvadoran export products has increased from Vietnam and Cambodia, to whom El Salvador has been losing market share. The level of international reserves is substantially lower than that assessed through risk-weighted benchmarks, and also falls slightly short against the metric of short-term debt coverage.

Reserve Adequacy Metrics, 2017
(Percent of GDP)



Sources: National authorities and Fund staff estimates.
Notes: The ARA metric for fixed exchange rate regimes is calculated as follows: 10% × Exports + 10% × Broad Money + 30% × Short-term Debt + 20% × Other Liabilities.
The Authorities' metric includes coverage of: (i) liquidity requirements and a liquidity fund, amounting to 22 percent of deposits, (ii) a newly created lender of last resort, with resources amounting to 8 percent of deposits over the medium term, and (iii) deposit insurance with 5 percent of deposits.

OUTLOOK AND RISKS

14. While short-term prospects are projected to benefit from higher U.S. growth, the medium-term outlook remains tepid (Tables 2-5).

- In 2018-19, growth is expected to remain above potential at 2.3 percent, reflecting the temporary acceleration of U.S. growth from the recent U.S. tax reform and higher grant-financed investment. The fiscal deficit would further fall to 2.2 percent of GDP in 2018, as savings from the pension reform kick in, but would return to 2.7 percent of GDP in 2019. The external deficit would increase both in 2018 and 2019 as remittances' growth moderates while imports expand, and the income balance worsens due to rising interest rates as U.S. monetary policy normalizes.

- The effects from the recent decision by the U.S. authorities not to renew the TPS are expected to be modest. About 200,000 legal migrants, who send remittances of 2½ percent of GDP, are estimated to enjoy TPS status. Some TPS migrants are set to be regularized before the program expires in September 2019. Only a small percentage is expected to return in the absence of a major step-up in enforcement.

- In 2020-23, the outlook assumes no further significant change in policies by the authorities or by the U.S. administration and continued access to external financing by both public and private sectors. Growth would ease toward its potential rate of 2.2 percent as U.S. growth moderates while inflation would be anchored by dollarization at 2 percent. The fiscal deficit is expected to increase to 3.3 percent of GDP by 2023 due to a higher interest bill, which would be partly offset by further savings on pension payments. Public capital spending would remain at current modest levels, and public debt would return to an upward trend by 2021-23. The windfall from the lower import bill, which has so far been largely saved by the private sector, would progressively be spent as the national saving rate declines to pre-2014 levels while the investment rate remains stable. This would be consistent with imports outpacing exports, and the current account deficit steadily rising to 4.5 percent of GDP by 2023.

Medium-Term Scenario
(In percent of GDP, unless otherwise noted)

			Projections						
	2015	2016	2017	2018	2019	2020	2021	2022	2023
Real GDP growth (percent)	2.4	2.6	2.3	2.3	2.3	2.2	2.2	2.2	2.2
Inflation (percent, end of period)	1.0	-0.9	2.0	2.2	2.0	2.0	2.0	2.0	2.0
Nonfinancial public sector balance	-3.8	-3.4	-2.5	-2.2	-2.7	-2.8	-2.9	-3.0	-3.3
Public sector gross debt	67.6	69.5	70.6	70.1	69.9	69.9	70.0	70.3	70.9
External current account balance	-4.0	-2.2	-2.5	-3.5	-3.4	-3.3	-3.7	-4.0	-4.5

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

15. Risks to the outlook are tilted to the downside and dominated by spillovers from further potential policy shifts by the U.S. administration and domestic policy risks. Staff has conducted a spillover analysis to understand these issues in more detail.

- A more aggressive enforcement of the TPS termination, involving deportation of 50,000 individuals over 2019-20 would reduce GDP growth by 0.1 percentage points in 2019 and 0.4 percentage points in 2020, mainly because remittances' growth would fall by 1.4 and 4.1 percentage points, respectively. The return migration may raise fiscal costs and is unlikely to tangibly boost near-term growth given high crime and poor conditions for scaling up employment opportunities for migrants. However, over the long term, the return of skilled migrants could have a positive impact on growth.

- Higher deportations of illegal migrants could also dent remittances and growth, with more protracted effects than in the case of TPS migrants. In a scenario where 75 percent of illegal immigrants are deported over 10 years, real GDP growth is projected to be lower on average by 0.2 percentage points per year over 2019-23.

- Downward surprises in U.S. growth could also depress Salvadoran growth.

- Tighter global financial conditions could limit access or raise the cost of external fiscal financing, adding to fiscal strains.

- Increased pressure on corresponding banking relationships could increase intermediation costs and hamper the flow of remittances to El Salvador, dampening consumption and growth.

- Domestic policy slippages, such as a potential reversal of the fiscal deficit reduction, a stand-off over financing, or a policy paralysis could hurt confidence and further depress growth. The

GDP data revision and the resulting higher debt ratios could spur sovereign downgrades and raise the cost of borrowing.

Authorities' Views

16. The authorities broadly agreed with the economic and fiscal outlook. The authorities agreed that the termination of the TPS does not represent a major risk for the economy, as mass deportation seems unlikely in practice, and a significant share of the current TPS beneficiaries are well-placed to seek alternative immigration status. They also argued that returning TPS migrants are likely to contribute positively to the economy due to their higher skill levels. They acknowledged the risk of an acceleration in the normalization of U.S. monetary policy to the cost of financing. At the same time, they expect these financing costs to be contained by potential budget support from multilateral organizations, and the recent decline in country risk.

FISCAL POLICY

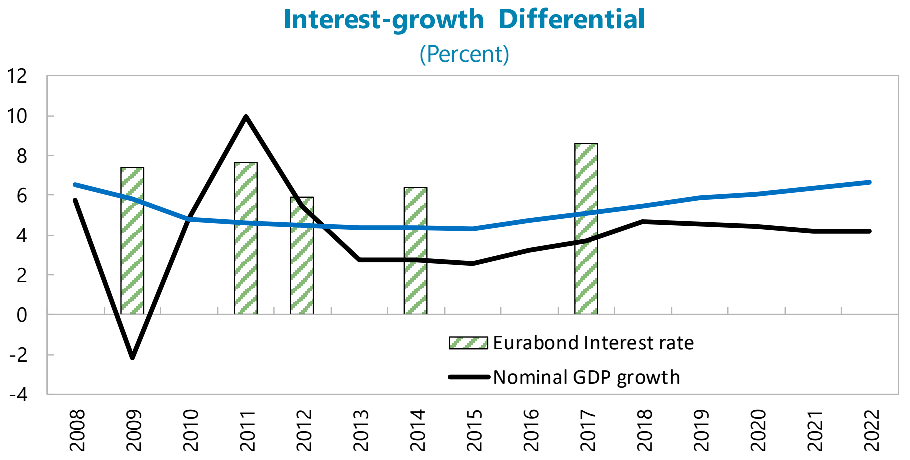
The country has adopted a strategy that comprises gradual fiscal adjustment and pension reform to address the high level of public debt. These actions were facilitated by a welcome improvement in collaboration across the political spectrum. While progress has been made in reducing the fiscal deficit and stabilizing debt, significant further efforts are needed to put debt on a declining trajectory.

17. Despite progress on fiscal consolidation to date, high debt, sizable financing gaps, and unfavorable growth-interest differential argue for further significant adjustment. The authorities' adjustment efforts, combined with the pension reform, are projected to deliver a cumulative improvement in the primary balance of 1¾ percent of GDP over 2017-18. However, the following considerations argue for further adjustment:

- **Debt level and risks.** Debt-to-GDP is estimated at 71 percent of GDP at end-2017 with the nominal GDP revision. While the ratio in the medium term would stay around the 70 percent level, substantial risks remain both due to possible shocks and potential reversals of the gains in fiscal consolidation (see Annex I). There is a need to place debt on a robustly declining path, with clearly set objectives to improve fiscal credibility.

- **Financing gaps.** While the 2018 budget made a welcome breakthrough in authorizing the needed sovereign borrowing for the entire year, substantial gaps loom for 2019 and beyond (Table 8).

- **Growth interest differential.** Despite the relatively favorable cyclical and financial conditions, the average growth-interest differential has remained negative and is projected to widen. The differential is particularly high with respect to the Eurobond rates, which are a proxy for the long-term cost of debt. Moreover, the high and rising interest bill crowds out productive (social and infrastructure) spending.



Sources: National authorities and Fund staff calculations.

18. **Implementing an additional fiscal adjustment of 2 percent of GDP in 2019-20 should be a policy priority.** This adjustment would put debt on a firmly declining path, reducing it, as an intermediate target, below 60 percent of GDP by 2024, and to a more comfortable level of below 50 percent of GDP before 2030. The adjustment would also improve the financing situation. Sensitivity analysis shows that the effects of reversing adverse public debt dynamics are robust to plausible multiplier scenarios. Based on published research[2] and recent evidence in El Salvador and regional peers, staff believes that the output costs of fiscal adjustment are likely to be contained. Growth would decline by about ¾ percentage point in 2019-20 due to the adjustment, but would not be affected negatively thereafter.

Fiscal Indicators in an Adjustment Scenario (percent of GDP) 1/

	2018	2019	2020	2021	2022	2023	2024	2025
GDP growth (percent)	2.3	1.6	1.4	2.4	2.4	2.4	2.3	2.3
Overall balance	-2.2	-1.8	-0.7	-0.6	-0.6	-0.6	-0.7	-0.7
Primary balance	1.4	2.0	3.2	3.4	3.5	3.5	3.5	3.5
Gross financing need	6.7	8.8	4.1	4.5	4.5	6.4	n.a.	n.a.
Public debt	70.1	69.5	67.9	65.8	63.6	61.7	59.8	58.0

Source: Fund staff estimates.
1/ Consolidation measures of 1 percent of GDP in 2019 and 1.3 percent of GDP in 2020, with multipliers of 0.7 short term and 0.3 long-term, followed by an increase in capital spending by 0.2 percentage point starting from 2021.

19. **Given the assumed multipliers, the adjustment would require well-designed measures of 2.3 percent of GDP, both on the revenue and expenditure side.** On revenues, there is scope both for raising taxes but also for streamlining distortionary taxes. Improvements in tax and customs administration could usefully complement this strategy. On spending, across-the-board cuts should

[2] IMF Working Paper 13/136.

be avoided in favor of targeted measures, which could be informed by technical assistance and the forthcoming public expenditure review by the World Bank. Rationalization of current spending should also create room for public investment, thereby creating an upside for economic growth.

Potential Menu of Measures in 2019–20
(percent of GDP)

	2019	2020
Wage bill	0.4	0.4
VAT increase to 15%	0.0	1.1
Adoption of full-fledged property tax	0.2	0.4
Savings in good and services	0.2	0.0
Targeting subsidy	0.1	0.0
Removal of tax exemptions	0.1	0.0
Streamlining of "nuisance taxes"	0.0	-0.3
Social support to offset VAT regressive effects	0.0	-0.3
Total:	**1.0**	**1.3**

Source: Fund staff estimates.

20. The adjustment package must provide adequate social support for the vulnerable. To this effect, technical preparations for the introduction of a property tax—a key progressive taxation measure—need to be completed. As an intermediate step, a luxury property tax, which was proposed but not adopted in mid-2014, could be considered. Similarly, regressive effects of the VAT hike should be carefully assessed and targeted support rolled out in advance to protect the most vulnerable.

21. The recently enacted Fiscal Responsibility Law (FRL) represents a step in the right direction, but the law and its supporting elements would benefit from further updates and refinements. The staff recommends:

- **A more ambitious anchor.** The FRL envisions a public debt anchor of 65 percent of GDP (inclusive of pension debt). This is high for a dollarized economy and reducing it to about 50 percent of GDP is recommended.[3] The FRL could explicitly commit to the debt anchor as a steady-state target, which would apply beyond the envisioned 10-year horizon.

- **Consistency of targets.** The law stipulates multiple targets, including on debt anchors with or without pension debt, primary balance, a floor on the tax burden (17 percent of GDP after 2019), a cap on current expenditures (18.5 percent of GDP) and on public wages and goods and services. It also envisions fiscal adjustment of 3 percent of GDP over 2017-19. Updating and clarifying the targets' consistency and hierarchy would strengthen transparency and communication.

- **Well-calibrated operational target.** The FRL envisions a key rule that the primary balance (the operational target) be non-negative. However, a positive primary balance alone is not sufficient to stabilize debt (under plausible macro-parameters), let alone reduce it (staff's baseline scenario already assumes significant primary surpluses of around 1.4 percent of GDP).

- **Rule-based corrective mechanisms.** In the case of slippages, the Ministry of Finance has full discretion to stipulate the timeline and path of permitted deviations. Instead, the FRL could define the specific path and parameters (e.g., over 3-5 years) to return fiscal deficits back to the target.

[3] See IMF Country report 15/13 for estimates of the country-specific debt threshold for El Salvador.

- **Commitment-based ceilings.** Establishing accrual-based expenditure limits would eliminate incentives to accumulate arrears to technically meet spending targets.

22. Public financial management (PFM) should continue to be strengthened. The new Medium- and Long-Term Fiscal Framework (MTLFF) documents several PFM-related improvements in the context of an improved assessment of fiscal outlook and risks. Further tasks include: (i) an integrated presentation of budget laws (comprising MTLFF updates, all budget annexes and fiscal targets, and pension system projections); (ii) a comprehensive monitoring of arrears and strengthened auditing of fiscal operations; (iii) better spending controls, including further improvements in rationalizing public procurement and implementation of the treasury single account; (iv) improved government statistics (including migration plan and better data on contingent liabilities, nonfinancial assets, public enterprises, and municipalities); (v) enhanced efficiency and governance of tax and customs administrations; (vi) results-based budgeting; and (vii) better evaluation and execution of public investment projects and their multi-year budgeting.

23. Institutional improvements and further political agreements are needed to address future financing needs. There is scope to facilitate sovereign financing at several levels: (i) following the 2018 budget experience, the financing needs should be reported transparently in future budgets; (ii) the key medium-term financing needs, including the $800 million Eurobond repayment in 2019, should be addressed early; negotiations on a medium-term financing agreement, already initiated, should be carried forward; (iii) bottlenecks for low-cost project loans by donors that are currently stalled in Congress should be addressed and the approval process simplified; and (iv) low-cost borrowing from the IFIs could be further explored.

24. Pension reforms are essential to solve the system's fiscal and social problems. The transition to a fully-fledged defined contribution (DC) system underway since 1998 sputtered shortly thereafter as disappointing asset returns led the government to grandfather early DC retiree cohorts by guaranteeing them high defined benefits (DBs). These decisions have greatly increased "transition costs" that need to be covered by the budget, which became difficult to finance by 2017. At the same time, future benefits under the DC system are set to fall sharply for the cohorts who will not be subsidized. Also, the system's coverage has been very low (only about a quarter of economically active population is in the system and an even smaller proportion is expected to earn rights to a stable pension) and benefits are highly unequal.

25. The September 2017 reform addresses some of the problems in the pension system. The legal amendments aim to salvage the existing, privately-managed DC system by raising and re-directing payroll contributions, restructuring public pension-related debt, changing pension benefits, improving pension fund returns, and introducing institutional changes. Overall, the reform aims to spread the fiscal burden of the pension system over time, while ameliorating some of the inequities in pension benefits. Private sector pension funds have been tasked with administering the new changes, while the government created a dedicated budget allocation for pensions and provided guarantees, which are expected to become significant starting from around 2040.

Main Parameters of the Pension System
(Percent of payroll, unless otherwise noted)

	Prior to 2017 reform	After 2017 reform
Social contributions	13	15
Pension funds commissions	2.2	1.9
Individual accounts 1/	10.8	8.1
Collective fund 1/		5
Longevity benefits		2
Payment of DBs 1/		3
Retirement age (years) 2/	55/60	55/60

1/ 3 percent of payroll would be (temporarily) diverted from individual accounts to the collective fund to pay for DBs on a declining schedule, to be fully phased out by 2050. The government committed to reimburse the diverted contributions to account holders with ineterest.
2/ An increase in retirement age would be considered in 2022.
Source: Salvadoran authorities.

26. The reform significantly reduces medium-term fiscal pressures, but falls short of a comprehensive fix to the system. The fiscal deficit will initially be lower by 0.8 percent of GDP annually. This largely reflects the temporary diversion of social contributions to pay for public DB obligations, but also some cuts in defined pension benefits and savings on the minimum pension guarantee. However, the government's guarantee of future reimbursement of diverted flows generates a long-term fiscal liability. The liability is initially small and would only be partially realized as it does not envision survivor benefits. Beyond the impact on the fiscal deficit, debt service is expected to be lower by a further 0.5 percent of GDP over the next few years due to reduced principal repayments. Existing actuarial studies of the impact of including this liability indicate that the fiscal costs of pensions would be moderate and declining as a share of GDP through 2100. Most importantly, the reform only marginally tackles the problems of high (including inter-generational) inequality of pension benefits and low coverage and replacement rates.

27. Deeper reforms are needed to further strengthen the fiscal and social sustainability of the system, including:

- Increasing the retirement age, which has been unchanged for over 2 decades and is among the lowest in the region. A very modest increase in the retirement age would be considered only in 2022. More ambitious and frontloaded increases in retirement ages would improve future replacement rates in the DC system while limiting contingent pressures from longevity benefits.

- Improving benefits coverage for the poor. The reform improves coverage only among contributors to the system but not the most vulnerable segments. Old age security could be enhanced via expanding the non-contributory basic pension, which is relatively modest (US$50 per month, a quarter of the contributory minimum pension). The total cost of this pension to all individuals over 70 is estimated at around 0.8 percent of GDP, but coverage could be expanded gradually starting from the lowest income categories at a much more modest cost.

- Enhancing cost-efficiency. Pension fund fees are still too high and should be reduced given the low risk profile of the investments (mainly government bonds). At the same time, the anticipated withdrawal of balances for consumption should be monitored and re-considered in case of significant administrative and other costs to the system.

- Backstopping from the budget. The solvency of the pension system ultimately hinges on the budget. The envisioned budget allocation (of about 0.5 percent of GDP) would be insufficient to cover pension obligations in most years, while the broader fiscal guarantee mechanism is yet to be fully clarified. To ensure credibility, the pension system accounts should be integrated in fiscal decisions, with full costing of their implications.

Authorities' Views

28. The authorities acknowledged that additional adjustment would be needed to reduce public debt. However, they indicated that the staff-recommended scenario entailed a risk of excessively frontloaded fiscal consolidation that could have an adverse impact on growth. They thus argued for a more moderate and gradual adjustment effort, to be achieved mainly through revenue collection, including through better tax administration. They cautioned that raising the VAT would have significant adverse effects on inclusive growth and could not be considered by the current Presidential administration. The authorities noted some potential for further rationalization of spending, which could be supported by reforms such as results-based budgeting. They also agreed that a revision of the FRL is needed. On sovereign financing, they emphasized ongoing work to reach a bipartisan agreement to pre-authorize key financing need for the 2019-24 period. They argued that the rise in the debt-to-GDP ratio stemming from the recent national accounts revision did not reflect a change in the country's underlying fiscal situation. While there was some indication that markets could have already internalized the revision, they acknowledged the need for a well-designed communication strategy in announcing the new data. On pensions, the authorities thought that the institutional improvements contained in the law, including the required periodic financial reviews and the actuarial committee, would be key steps toward ensuring the system's sustainability.

FINANCIAL SECTOR STABILITY AND SUPPORT TO GROWTH

Credit growth is moderate, and is unevenly distributed across firms. Large firms have easy access to credit through the domestic banking system, or intra-group credit as in the case of foreign corporations. On the contrary, small and medium enterprises face credit constraints. Financial sector reforms are needed to promote a sound expansion of credit to productive small and medium enterprises, including by limiting excessive liquidity holdings in the banking sector and by improving credit reporting systems.

29. Despite good prudential fundamentals and ongoing progress, several long-standing financial sector reforms need to be accelerated. The authorities are implementing AML/CFT measures and maintain international cooperation with the U.S. Department of Treasury. Progress has been made in risk-based supervision and financial inclusion by approving a new law in January 2017.

The authorities should continue to strengthen the AML/CFT framework in preparation for the next round of assessment under the CFATF, in 2022.The Financial Sector Superintendency and the Central Bank have made substantial progress in strengthening consolidated supervision and cross-border cooperation by exchanging information and conducting simultaneous onsite exams with other regional supervisors. However, efforts could be intensified in the areas of systemic liquidity, banking resolution and crisis management procedures, cross-border supervision, and data availability. These steps would help promote a sound banking system and expansion of credit to productive sectors (see selected issues paper), including by limiting excessive liquidity holdings.

- **Systemic liquidity.** Adequate funding of lender of last resort (LOLR) facilities set up at the BCR is needed since reserves play a crucial role in addressing shocks to the banking sector of a fully dollarized economy. Moreover, the creation of a liquidity reserve fund could help expand lending capacity by reducing volatility in bank-specific liquidity and lessening the need for self-insurance.

- **Crisis management and resolution**. Progress has been made on the crisis management and bank resolution draft law, but a prompt agreement between the Financial Superintendency and the Central Bank is needed to accelerate the adoption of the new law. The draft law prompted by Fund TA could be further improved by (i) clarifying the role of the Committee of Financial Stability; (ii) enhancing and expanding resolution tools (bridge bank, purchase and assumption, asset management companies), (iii) augmenting the deposit insurance scheme and simplifying the payout process, and (iv) strengthening the legal protection of supervisors.

- **Supervision and regulation.** Staff welcome steps taken in risk-based supervision. However, supervisors could further strengthen cross-border cooperation by signing MOUs and setting up contingency plans to manage a crisis, including the event of broad loss of correspondent banking relationships, in coordination with foreign supervisors. Moreover, supervisory and prudential policies should be modernized in line with Basel II/III standards. Staff recommends introducing the liquidity coverage ratio and advancing on legislation to adopt new capital requirements to cover for credit risks.

- **Data quality and dissemination.** Data coverage is broadly adequate. However, comprehensive data on household and corporate balance sheets, and housing prices should be collected. Credit reporting systems should be upgraded through an oversight framework for credit bureaus to integrate data sources and expand access to credit information to all creditors and credit bureau members.

Authorities' Views

30. The authorities agreed with the need to fund LOLR facilities and they are currently exploring funding options. They highlighted the progress achieved in modernizing supervision and enhancing cross-border cooperation. They agree with the need to accelerate approval of the bank resolution law and to further strengthen cross-border cooperation with foreign supervisors by developing contingency plans in case of a bank crisis. They noted that significant progress has been made in data collection and analysis, although data coverage could be further strengthened.

SUPPLY SIDE REFORMS

Raising potential growth will require sustained action across multiple fronts. Staff analysis suggests that to seize its demographic dividend from a still young population, El Salvador needs more public and private investment in human and physical capital, improved business climate, and higher formal job creation in the tradable sector, which has higher productivity and wages than El Salvador's predominantly informal job market (see selected issues paper).

31. El Salvador's rise in the World Bank's 2018 Doing Business ranking[4] by 22 notches is encouraging, but scope for further progress remains substantial. The improved ranking highlights progress in a few areas, particularly the ease of paying taxes and obtaining construction permits, although methodological changes also contributed to the improvement. However, additional policy action is needed in the following areas:

- **Labor market.** El Salvador ranks poorly in the World Economic Forum's labor market efficiency index[5] relative to other CAPDR and LA-5 economies and is affected by one of the largest levels of informality in Latin America (70 percent). Raising women labor participation and reducing informality requires greater efficiency of institutions, revamping benefits, and improving the quality of education. Regarding minimum wages, while short-term effects on employment from the end-2016 wage hikes do not appear to be large, they are likely to disproportionately affect tradable firms. Further increases in minimum wages should be avoided.

- **Regulatory simplification.** El Salvador's procedures are often more burdensome than those of its peers in the region. Accelerating the implementation of the law on administrative procedures (adopted in December 2017) and of the electronic signature law (adopted in 2016), expanding the eRegulations initiative, and enhancing the clout of the Regulatory Improvement Agency would hasten business approvals.

- **Trade and customs.** Time to import and export is long due to burdensome documentation requirements, lack of transparency and regulatory coherence. Reforming the Law on Customs Simplification and aligning customs laws and regulations with regional treaties are recommended. Moreover, the adherence to the customs union with Honduras and Guatemala will facilitate trade, amplify gains from CAFTA, and provide easier access to ports.

[4] Survey-based indicators reflect investors' perceptions on the business environment.

[5] The labor market efficiency index is part of the Global Competitiveness Index, which combines both official data and survey responses from business executives on several dimensions of competitiveness.

At the same time, expanding export markets globally would help to diversify trade and boost growth.

- **Competition.** Enhancing capacity and clout of the Competition Authority would reduce entry barriers and anti-competitive behavior of incumbent firms. This could be done by increasing its staffing and identifying and eliminating legal and logistical obstacles to resolving the backlog of pending court cases on anti-competitive practices.

- **Public investment can be supported through the adoption of a coherent and integrated medium-term framework.** Public investment execution would benefit from better planning and effective monitoring. To spur private investment, amendments to the PPP law could be helpful, including an expansion of the economic sectors open to private investors and a simplification of the congressional approval process. In parallel, fiscal risks from PPPs should be carefully reviewed and contingent fiscal liabilities from PPPs should be systematically recorded into the budget and the government's accounts.

- **Crime.** The government has made efforts to fight crime, but the homicide rate remains among the highest in the world, and extortion is a significant drag on growth of small and medium enterprises. Implementing the "El Salvador Seguro" plan and supplementing it with adequate resources and grant funding would be important.

- **Corruption.** El Salvador's governance scores are in line with regional averages, but the control-of-corruption index, which is part of the Worldwide Governance Indicators,[6] has deteriorated over the past decade. The judicial system suffers from inefficiency and lack of capacity. It would be important to further strengthen the personnel and effectiveness of the Anti-Corruption Unit and the Ethics Tribunal, enhance the AML/CFT framework, achieve better coordination between agencies fighting corruption, ensure transparency of the election of the four members of the Constitutional Court (due in July 2018), and strengthen the independence of the Court of Accounts.

Authorities' Views

32. The authorities agreed on the need to boost potential growth and to accelerate structural reforms. They pointed to various successes in implementing their productive transformation strategy, which includes shifting the energy matrix towards renewable sources, supporting agroindustry and developing infrastructure (e.g. expansion of the airport and concession of the Puerto de la Union) to improve the logistics platform. They also pointed to other growth-enhancing initiatives, including (i) the expansion of trade by joining the Northern Triangle customs union and by signing a free trade agreement with South Korea; (ii) the promotion of investment by reducing bureaucracy and supporting PPP projects, and (iii) the fight against crime by improving the infrastructure of the prison system and by supporting targeted community programs. The

[6] Survey-based indicators reflect respondents' perceptions on the quality of governance.

authorities highlighted their commitment to fighting corruption; the prosecution of important corruption cases of former Presidents of El Salvador is proceeding in due course.

STATISTICS

33. **The authorities published the rebased national accounts series on March 23, 2018.** The new GDP data moves the base year from 1990 to 2005 and incorporates large historical revisions to prices of agricultural products, intermediate consumption, and population (see Annex III). The most important takeaway is an 11 percent downward revision in nominal GDP for 2016. The new data are necessary to better inform policymaking and broader public debate and will be key to effective surveillance.

STAFF APPRAISAL

34. **Despite recent improvements, El Salvador's growth continues to be modest.** The economy has been recovering since 2009, but is held back by substantial bottlenecks, such as high inequality, crime, and low investment. Public debt dynamics has improved through a significant reduction of fiscal deficits, but debt remains high, and sizable financing gaps are projected for next year and beyond.

35. **Staff welcomes progress on fiscal consolidation so far but further fiscal adjustment is needed to ensure debt sustainability.** The authorities' adjustment efforts, combined with the pension reform, have already contributed to reduce fiscal deficits and stabilize debt. However, high medium-term gross financing needs, potential global shocks, and higher global interest rates require further fiscal consolidation. A fiscal adjustment of 2 percent of GDP distributed over 2019-20 would improve the financing situation and put debt on a firmly declining path. The adjustment should be complemented with several PFM-related reforms.

36. **The pension reform provides substantial medium-term fiscal relief, but additional reforms are required to improve the system.** The reform will reduce the fiscal deficit significantly. However, the fiscal and social sustainability of the pension system can be further strengthened by increasing the retirement age, improving benefits coverage for the poor, reducing pension fund fees and integrating the pension system accounts into fiscal decisions.

37. **Improving business environment and competitiveness is critical to boost growth.** The rise of El Salvador in the 2018 World Bank's doing business ranking is encouraging in the context of the authorities' growth agenda. Raising potential growth, however, requires sustained action to support investment and formal job creation. Private investment can be bolstered by reducing red-tape and bureaucracy, and by fighting crime. Public investment can be increased by addressing weaknesses in planning, execution and monitoring, and by accelerating financing approvals of public sector investment programs. Formal job creation should focus on tradable sector jobs, which have higher productivity and wages than El Salvador's predominantly informal job market. To this aim, staff welcomes ongoing adherence to the customs union with Honduras and Guatemala.

38. **Changes to the banking sector regulatory framework are needed, which would also foster healthy credit growth by limiting excessive liquidity holdings.** The banking system is well capitalized and very liquid, and progress has been made in risk-based and cross-border supervision. However, it is important to accelerate the adoption of the crisis management and bank resolution draft law and strengthen the liquidity safety net of the banking system through the financing of the LOLR facilities and the creation of a liquidity fund. These steps would promote a sound expansion of credit to productive sectors.

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

Risk Assessment Matrix[1]

Source of risk	Likelihood	Impact	Policy response
Global risks			
U.S. policy uncertainty	Medium. Two-sided risks to U.S. growth with difficult-to-predict policies, and uncertainty about U.S. migration policy with respect to Central America.	High. Potential for lower remittances to El Salvador, higher migrant deportations, and lower migrant arrivals in the U.S.	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.
Tighter global financial conditions	High. Fed normalization increases global rates and term premia, strengthens the U.S. dollar vis-à-vis the other currencies, and corrects market valuations.	High. A global interest rate shock would both constrain access to international capital markets and cost of external financing would spike, worsening public debt dynamics (almost half of public debt is linked to the US LIBOR). A surge in the US dollar could further 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.
Further pressure on traditional bank business models	Medium. Limited correspondent bank profitability could result in a reduction of correspondent banking services, which in turn could curtail cross-border payments, trade finance, and remittances, disrupt foreign credit lines and reduce banking sector liquidity.	Medium. A loss of correspondent bank relationships (CBRs) could potentially increase costs related to transfer of funds, which could have adverse implications for the relatively large flow of remittances to El Salvador, dampening consumption and growth.	Further strengthen the AML/CFT framework to minimize a loss of CBRs and the bank resolution framework.
Weaker-than-expected global growth	High. Structurally weak growth in key AEs given low productivity growth. Medium. Significant U.S. slowdown, given a potential fiscal contraction associated the withdrawal of tax stimulus and market fears of overheating. Low/Medium. Significant China slowdown given financial sector risks and potentially unsustainable policies over the medium-term.	Medium. El Salvador would likely see depressed economic growth, particularly as spillover effects to growth are likely to be larger in the absence of the exchange rate as a shock absorber.	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.
Lower energy prices	Low. Lower energy prices could be driven by stronger-than-expected U.S. shale and/or recovery of oil production in the African continent.	Medium/High. Persistently 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.
Domestic risks			
Domestic policy slippages	High. While the 2018 budget made a positive breakthrough in authorizing the needed sovereign borrowing for the entire year, substantial gaps loom for 2019 and beyond.	High. Higher financing costs and a potential for disorderly adjustment, worsening macroeconomic imbalances and affecting confidence and growth.	Forge consensus in Congress on the fiscal agenda. Implement fiscal consolidation to both reduce external financing needs and improve debt dynamics.
Political fragmentation and worsening security	Medium. El Salvador is exposed to political uncertainty. Also, security, which is the worst across the region, is among the critical factors affecting the business climate.	Medium. Political paralysis will exacerbate macroeconomic imbalances because of ineffective policy making and markets could become more discriminating in terms of fiscal financing. Lack of security would adversely affect investment.	Broad based policy dialogue to support macroeconomic stability. Develop and implement coherent and comprehensive policies to improve domestic security, including by effectively implementing the AML and anti-corruption frameworks.
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 1. Implementation of Fund Advice

Fiscal policy

Recommendations: Implement a fiscal consolidation of 3 percent of GDP over 2017-19, relying on a mix of high-quality spending and revenue measures, supported by a parametric pension reform. Advance in improving budget procedures and adopt a well-designed fiscal responsibility law (FRL).
Outcomes: Fiscal consolidation legislated in the FRL but implemented partially, on a piecemeal basis. Pension reform adopted, but focused on short-to-medium term fiscal relief with limited parametric reform components. FRL adopted but requires further improvement, including new targets based on revised GDP. Progress in public financial management generally moderate, except the new Medium and Long Term Fiscal Framework document, which has been substantially improved.

Financial sector

Recommendations: Create a liquidity fund, fund LOLR, legislate improvements to bank resolution and crisis management framework, progress with implementation of risk-based supervision and Basel II/III, maintain sound AML/CFT standards.
Outcomes: Progress on the liquidity fund sputtered because of opposition of banks. LOLR received some funding from IFIs, but it has been insufficient. The law on bank resolution and crisis management has been drafted but is progressing slowly. Progress on Basel II/III implementation is mixed: there are advances in a few areas but also delays in setting up relevant working groups.

Structural reforms

Recommendations: Reduce crime, contain minimum wage increases, ease barriers to competition, and boost educational attainment.
Outcomes: There was moderate progress in reducing crime, based on violent statistics and reflecting some extraordinary measures adopted in 2016 (but the situation deteriorated again at the turn of 2017-18). Minimum wage was increased in late-2016 well above prudent benchmarks. Notable progress made on the ease of paying taxes and construction permits, which drove a major improvement in the World Bank’s 2018 doing business.

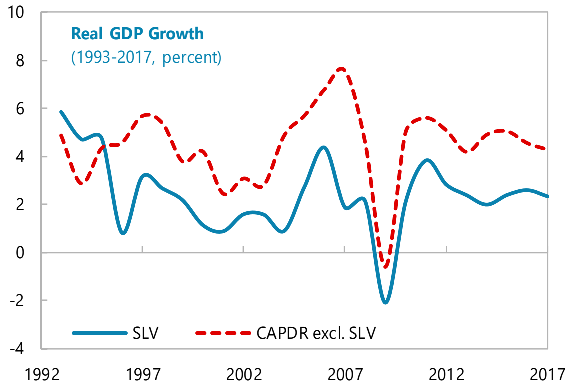
Statistics

Recommendation: Publish revised GDP statistics.
Outcome: Revised national accounts statistics were published on March 23, 2018.

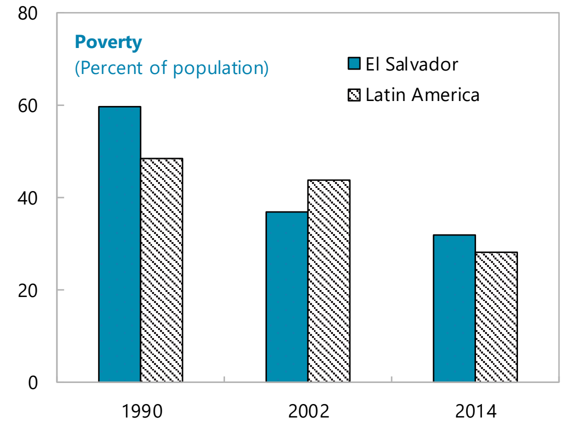
Figure 1. El Salvador: Long-Term Growth and Poverty

Structural bottlenecks have inhibited long-term growth

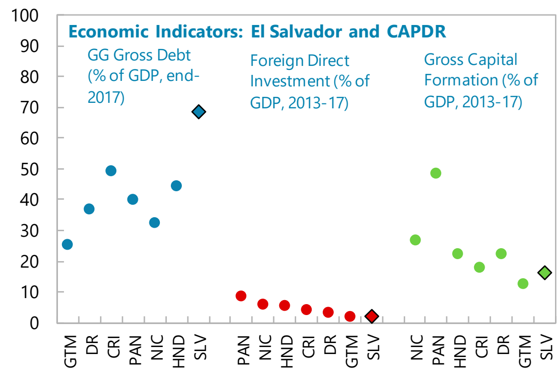
Growth has been among the lowest in the Americas...



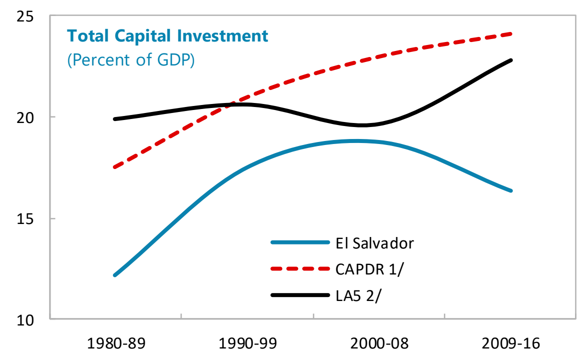
...and poverty remains high.



Key investment and fiscal indicators lag behind peers...

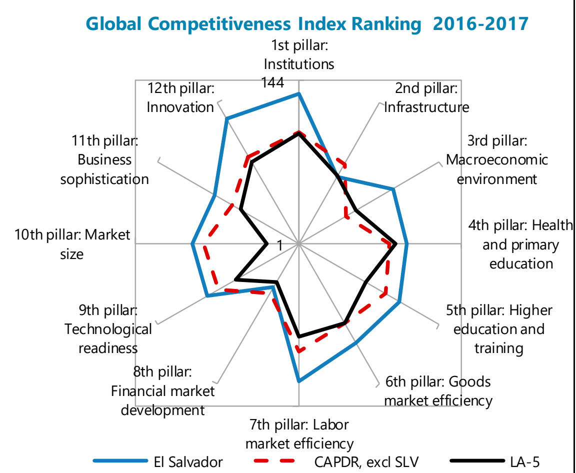


...and capital investment is among the lowest in the region.



Doing business indicators have recently improved...

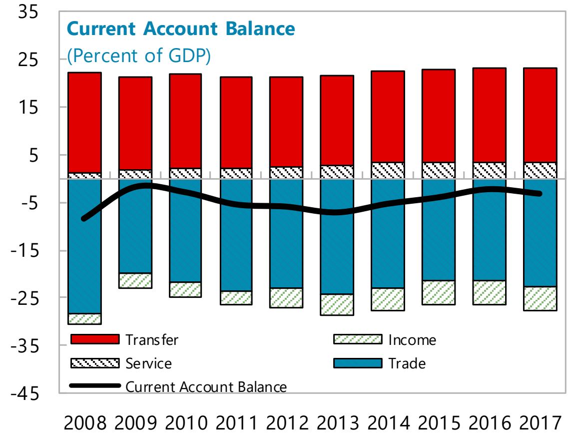
...but competitiveness indicators still point to institutional, human capital, and labor market weaknesses.



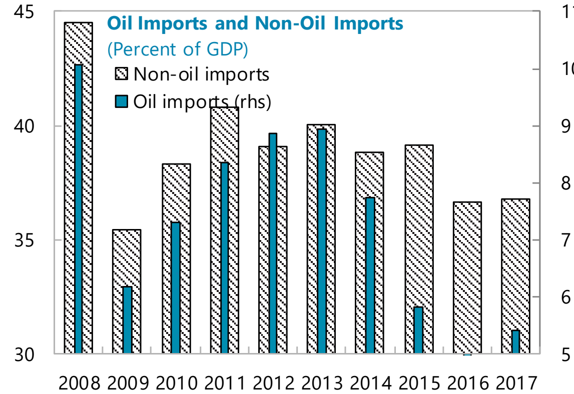
Sources: ECLAC; and World Bank, World Development Indicators, Doing Business Indicators, and Global Competitiveness Indicators.
Note: Doing Business and Global Competitiveness Indicators - higher ranking means worse standing.
1/ Simple average of Costa Rica, Guatemala, Honduras, Nicaragua, Panama, and the Dominican Republic.
2/ Simple average of Brazil, Chile, Colombia, Mexico, and Peru.

Figure 2. El Salvador: Balance of Payments Developments

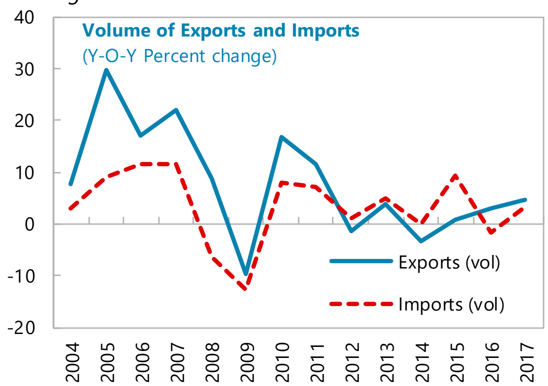
After increasing during 2009-2013, the current account deficit has shrunk...



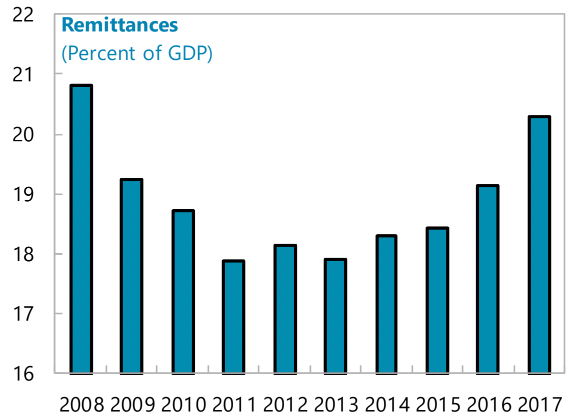
... largely due to a declining oil import bill until 2016....



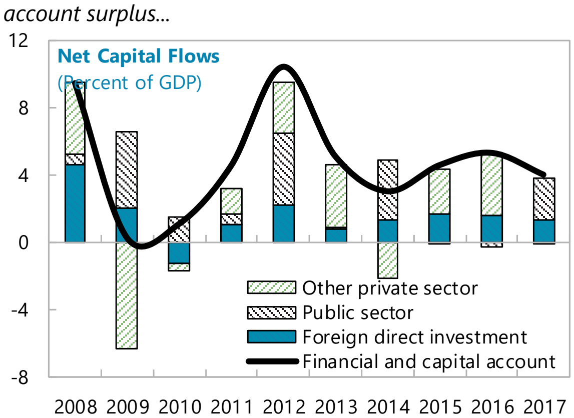
... while both export and import volume growth have been trending down.



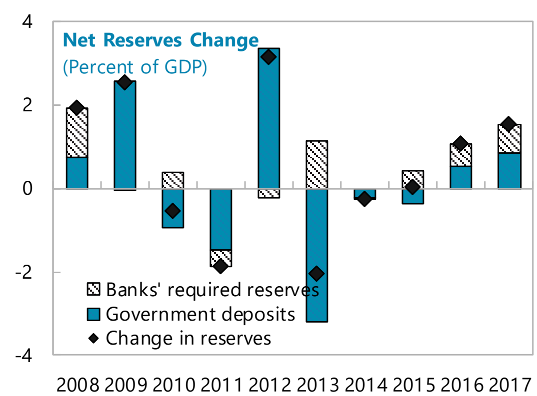
Remittances have picked up, with a strong surge in 2016-17.



Public borrowing and FDI have contributed to the financial account surplus...



...with reserves broadly stable.

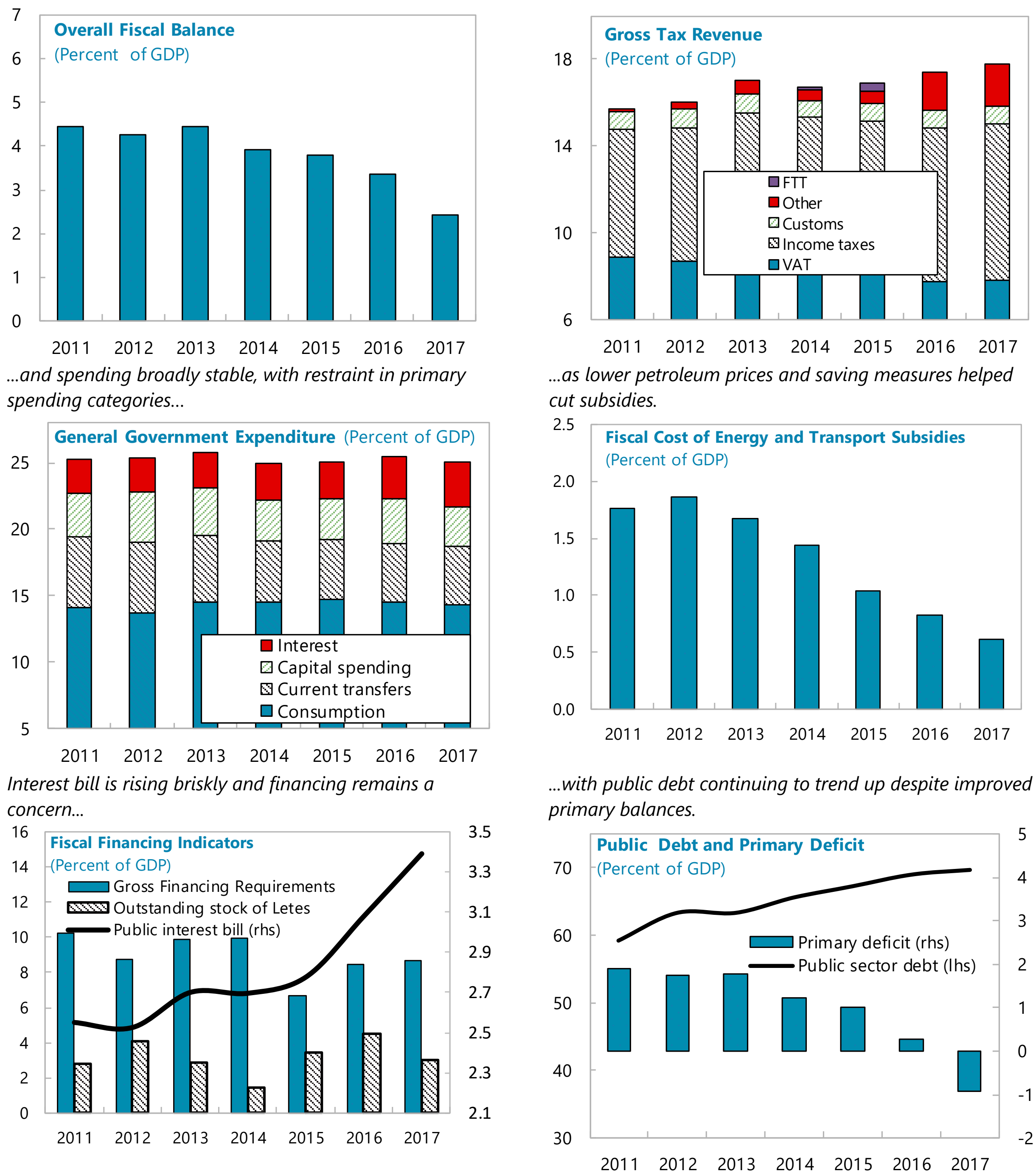


Sources: Central Reserve Bank of El Salvador, Haver Analytics, and Fund staff calculations.

Figure 3. El Salvador: Fiscal Developments

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

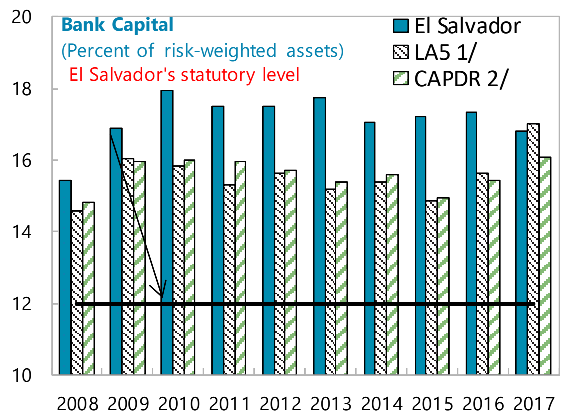
The fiscal deficit has been edging down… *…with revenue helped by new security taxes….*



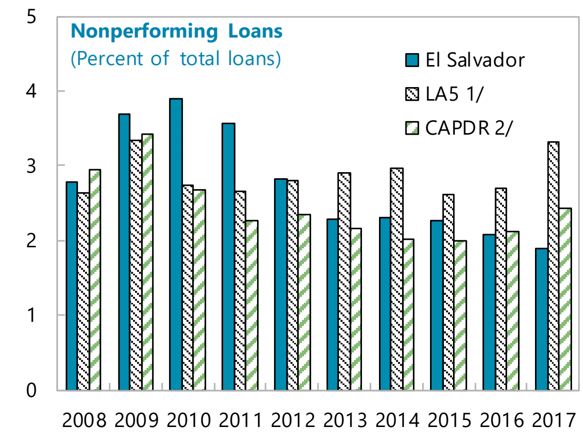
Sources: National authorities and Fund staff calculations.

Figure 4. El Salvador: Financial Sector Developments

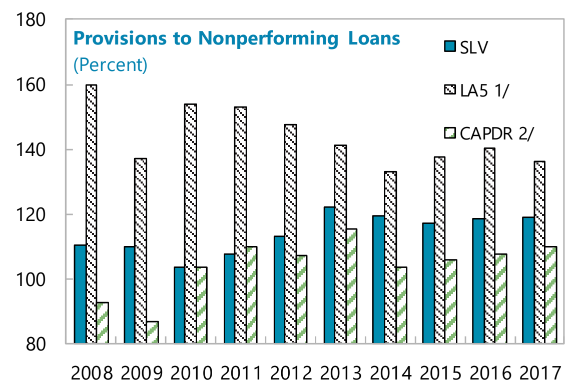
Banks' capital buffers remain high...



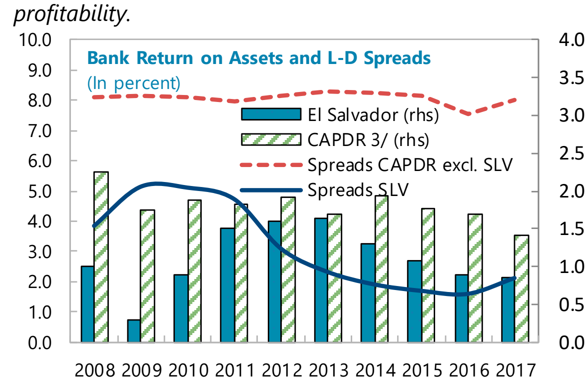
...and banks' asset quality improved.



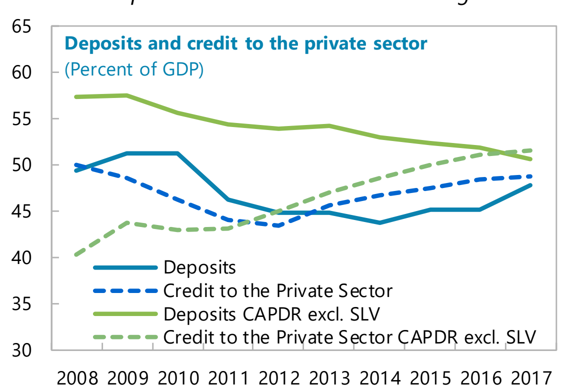
High provisioning and...



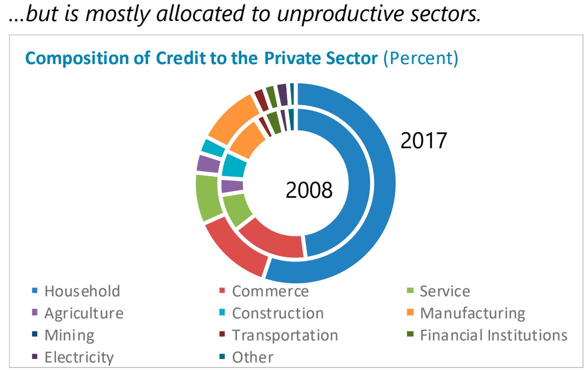
...low net interest spreads continue to strain banks' profitability.



Credit to the private sector continues recovering...



...but is mostly allocated to unproductive sectors.



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 1/

I. Social Indicators

Rank in UNDP Development Index 2015 (of 188)	117	Population (million, 2016)	6.3
Per capita income (U.S. dollars, 2016)	4,224	Life expectancy at birth in years (2015)	73
Percent of pop. below poverty line (2016)	33	Infant mortality (per 1,000 live births, 2016)	13
Gini index (2015)	41	Primary education completion rate (percent, 2015)	100

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

	2011	2012	2013	2014	2015 2/	2016 2/	2017	2018
							Est.	Proj.
Income and prices								
Real GDP growth (percent)	3.8	2.8	2.4	2.0	2.4	2.6	2.3	2.3
Consumer price inflation (average, percent)	5.1	1.7	0.8	1.1	-0.7	0.6	1.0	1.8
GDP deflator (percent)	5.9	2.5	0.4	0.8	0.2	0.6	1.4	2.3
Terms of trade, percent change	-2.5	0.5	-1.6	3.3	12.4	-2.9	0.0	0.3
Real effective exchange rate (+ = appreciation)	1.7	-1.5	-0.9	2.8	5.5	-1.2	-0.5	…
External sovereign bond spread (basis points)	374	448	378	400	497	600	520	…
Money and credit								
Credit to the private sector	45.3	44.8	47.1	48.9	50.1	51.1	51.7	51.9
Broad money	49.7	48.1	47.9	46.8	48.5	48.5	51.7	51.7
Interest rate (time deposits, percent)	1.8	2.5	3.4	3.8	4.2	4.4	4.4	…
External sector								
Current account balance	-5.5	-6.0	-7.2	-5.4	-4.0	-2.2	-2.5	-3.5
Trade balance	-23.5	-23.0	-24.1	-23.0	-21.6	-19.4	-19.5	-20.5
Exports (f.o.b. excluding *maquila*)	20.9	19.8	19.7	18.8	18.9	17.5	18.3	18.3
Imports (f.o.b. excluding *maquila*)	-44.4	-42.8	-43.8	-41.9	-40.5	-36.9	-37.9	-38.7
Services and income (net)	-0.8	-1.7	-1.7	-1.1	-1.2	-2.0	-3.3	-3.4
Transfers (net)	18.9	18.7	18.6	18.7	18.8	19.1	20.3	20.3
Foreign direct investment	1.1	2.3	0.8	1.4	1.7	1.6	1.3	1.3
Gross international reserves (millions of U.S. dollars)	2,503	3,175	2,745	2,693	2,787	3,238	3,671	3,799
Nonfinancial public sector								
Overall balance 2/	-4.5	-4.3	-4.5	-3.9	-3.8	-3.4	-2.5	-2.2
Primary balance 2/	-1.9	-1.8	-1.8	-1.2	-1.0	-0.3	0.9	1.4
Of which: tax revenue	15.7	16.1	17.0	16.7	16.9	17.4	17.8	17.9
Public sector debt 2/ 3/	59.5	63.8	63.8	65.6	67.6	69.5	70.6	70.1
National savings and investment								
Gross domestic investment	17.8	17.8	17.2	16.4	15.6	15.1	16.9	15.7
Public sector 4/	2.2	2.6	2.5	2.2	2.2	2.2	2.2	2.5
Private sector 4/	14.1	14.0	15.1	13.4	13.4	13.2	13.3	13.2
National savings	12.3	11.8	10.0	11.0	11.6	12.9	14.4	12.2
Public sector	-2.2	-1.3	-1.3	-1.0	-1.0	-0.2	0.4	0.7
Private sector	14.5	13.1	11.3	12.1	12.6	13.0	14.0	11.5
Net foreign assets of the financial system								
Millions of U.S. dollars	2,811	3,229	2,473	2,211	1,931	2,013	2,678	2,937
Percent of deposits	28.8	32.6	24.0	21.6	17.8	18.0	21.8	23.0
Memorandum items:								
Nominal GDP (billions of U.S. dollars)	20.3	21.4	22.0	22.6	23.2	23.9	24.8	26.0

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

1/ The data reflects the discussions during the mission on February, 2018, with the exception of the national accounts numbers, which were updated with the revised statistics published on March 23, 2018

2/ Excludes impact of the pension reform on fiscal accounts, which may reduce the fiscal deficit by up to 0.8 percent of GDP starting from 2018, but net impact on the deficit could be smaller depending on the accounting treatment of new changes to the pension system that is under discussion.

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

4/ Fixed capital formation; disaggregation of inventories into public and private not available.

Table 2. El Salvador: Medium-Term Baseline Scenario 1/

	2012	2013	2014	2015	2016	2017	Projections 2018	2019	2020	2021	2022	2023
					(Annual percentage change)							
Real GDP growth	2.8	2.4	2.0	2.4	2.6	2.3	2.3	2.3	2.2	2.2	2.2	2.2
Inflation (end of period)	0.8	0.8	0.5	1.0	-0.9	2.0	2.2	2.0	2.0	2.0	2.0	2.0
Inflation (average)	1.7	0.8	1.1	-0.7	0.6	1.0	1.8	1.9	2.0	2.0	2.0	2.0
Output gap (percent of potential output)	0.4	0.4	0.0	-0.1	0.1	0.0	0.0	0.0	0.0	0.0	0.0	0.0
					(Percent of GDP)							
Nonfinancial public sector balance	-4.3	-4.5	-3.9	-3.8	-3.4	-2.5	-2.2	-2.7	-2.8	-2.9	-3.0	-3.3
Primary balance	-1.8	-1.8	-1.2	-1.0	-0.3	0.9	1.4	1.2	1.3	1.4	1.4	1.4
Public sector gross debt 2/	63.8	63.8	65.6	67.6	69.5	70.6	70.1	69.9	69.9	70.0	70.3	70.9
External current account balance	-6.0	-7.2	-5.4	-4.0	-2.2	-2.5	-3.5	-3.4	-3.3	-3.7	-4.0	-4.5
Exports of goods	19.8	19.7	18.8	18.9	17.5	18.3	18.3	18.4	18.5	18.6	18.3	18.0
Imports of goods	-42.8	-43.8	-41.9	-40.5	-36.9	-37.9	-38.7	-38.7	-38.7	-39.0	-38.9	-38.9
Current transfers	18.7	18.6	18.7	18.8	19.1	20.3	20.3	20.2	20.1	20.0	20.0	20.0
Gross domestic investment	17.8	17.2	16.4	15.6	15.1	16.9	15.7	15.8	15.7	15.8	15.8	15.9
Private 3/	15.2	14.8	14.2	13.4	12.9	14.7	13.2	13.3	13.4	13.5	13.6	13.6
Public 3/	2.6	2.5	2.2	2.2	2.2	2.2	2.5	2.6	2.3	2.2	2.2	2.2
Gross national saving	11.8	10.0	11.0	11.6	12.9	14.4	12.2	12.4	12.4	12.1	11.8	11.3
Private	13.1	11.3	12.1	12.6	13.0	14.0	11.5	12.2	12.2	12.0	11.8	11.6
Public	-1.3	-1.3	-1.0	-1.0	-0.2	0.4	0.7	0.2	0.2	0.1	0.0	-0.3
External saving	6.0	7.2	5.4	4.0	2.2	2.5	3.5	3.4	3.3	3.7	4.0	4.5

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

1/ The data reflects the discussions during the mission on February, 2018, with the exception of the national accounts numbers, which were updated with the revised statistics published on March 23, 2018.

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

3/ Fixed capital formation; disaggregation of inventories into public and private not available.

Table 3. El Salvador: Balance of Payments 1/

							Projections					
	2012	2013	2014	2015	2016	2017	2018	2019	2020	2021	2022	2023
					(Millions of U.S. dollars)							
Current Account	**-1,279**	**-1,586**	**-1,212**	**-926**	**-531**	**-628**	**-917**	**-922**	**-939**	**-1,084**	**-1,238**	**-1,454**
Merchandise trade balance	-4,927	-5,295	-5,206	-5,003	-4,637	-4,839	-5,319	-5,498	-5,707	-6,021	-6,326	-6,700
Export of goods (f.o.b.)	4,235	4,334	4,257	4,381	4,186	4,550	4,742	4,998	5,258	5,486	5,633	5,777
Import of goods (f.o.b.)	-9,161	-9,629	-9,463	-9,384	-8,823	-9,389	-10,061	-10,496	-10,965	-11,507	-11,959	-12,478
Services	532	618	794	805	756	638	726	799	850	889	922	953
Exports of processing services	424	440	375	464	596	480	497	506	514	519	513	507
Income	-891	-992	-1,034	-1,091	-1,225	-1,454	-1,599	-1,704	-1,778	-1,872	-1,986	-2,103
Current transfers	4,006	4,083	4,234	4,363	4,576	5,028	5,274	5,481	5,696	5,920	6,153	6,395
Workers' remittances (credits)	3,880	3,937	4,133	4,270	4,576	5,021	5,272	5,483	5,703	5,931	6,168	6,415
Financial and Capital Account	**2,232**	**1,121**	**681**	**1,058**	**1,269**	**1,061**	**1,045**	**1,095**	**1,115**	**1,257**	**1,418**	**1,639**
Capital account	201	101	64	65	70	71	74	77	81	84	88	91
Public sector financial flows	912	13	788	-14	-69	618	400	-905	-55	-16	-36	-818
Disbursements	1,202	269	1,059	247	236	942	755	242	300	340	340	340
Amortization	-290	-256	-271	-261	-305	-323	-355	-1,147	-355	-356	-376	-1,158
Private sector financial flows	1,118	1,008	-170	1,007	1,269	372	571	1,923	1,089	1,189	1,366	2,366
Foreign direct investment	484	176	311	399	374	325	348	370	389	408	424	441
Portfolio investment	871	13	794	53	304	30	30	30	30	30	16	16
Other 2/ 3/	-236	818	-1,276	556	591	17	193	1,523	670	751	926	1,909
Errors and Omissions	**-302**	**138**	**498**	**-20**	**-286**	**0**	**0**	**0**	**0**	**0**	**0**	**0**
Change in Reserves (- = increase)	**-651**	**327**	**33**	**-113**	**-453**	**-433**	**-128**	**-173**	**-175**	**-173**	**-180**	**-185**
					(Percent of GDP)							
Current Account	**-6.0**	**-7.2**	**-5.4**	**-4.0**	**-2.2**	**-2.5**	**-3.5**	**-3.4**	**-3.3**	**-3.7**	**-4.0**	**-4.5**
Merchandise trade balance	-23.0	-24.1	-23.0	-21.6	-19.4	-19.5	-20.5	-20.3	-20.1	-20.4	-20.6	-20.9
Export of goods (f.o.b.)	19.8	19.7	18.8	18.9	17.5	18.3	18.3	18.4	18.5	18.6	18.3	18.0
Import of goods (f.o.b.)	-42.8	-43.8	-41.9	-40.5	-36.9	-37.9	-38.7	-38.7	-38.7	-39.0	-38.9	-38.9
Petroleum and products	-8.9	-8.9	-7.7	-5.8	-4.6	-4.9	-5.3	-5.0	-4.7	-4.6	-4.5	-4.4
Services	2.5	2.8	3.5	3.5	3.2	2.6	2.8	2.9	3.0	3.0	3.0	3.0
Exports of processing services	2.0	2.0	1.7	2.0	2.5	1.9	1.9	1.9	1.8	1.8	1.7	1.6
Income	-4.2	-4.5	-4.6	-4.7	-5.1	-5.9	-6.2	-6.3	-6.3	-6.3	-6.5	-6.6
Current transfers	18.7	18.6	18.7	18.8	19.1	20.3	20.3	20.2	20.1	20.0	20.0	20.0
Workers' remittances (credits)	18.1	17.9	18.3	18.4	19.1	20.2	20.3	20.2	20.1	20.1	20.0	20.0
Financial and Capital Account	**10.4**	**5.1**	**3.0**	**4.6**	**5.3**	**4.3**	**4.0**	**4.0**	**3.9**	**4.3**	**4.6**	**5.1**
Capital account	0.9	0.5	0.3	0.3	0.3	0.3	0.3	0.3	0.3	0.3	0.3	0.3
Public sector financial flows	4.3	0.1	3.5	-0.1	-0.3	2.5	1.5	-3.3	-0.2	-0.1	-0.1	-2.6
Private sector financial flows	5.2	4.6	-0.8	4.3	5.3	1.5	2.2	7.1	3.8	4.0	4.4	7.4
Foreign direct investment	2.3	0.8	1.4	1.7	1.6	1.3	1.3	1.4	1.4	1.4	1.4	1.4
Portfolio investment	4.1	0.1	3.5	0.2	1.3	0.1	0.1	0.1	0.1	0.1	0.1	0.1
Other 2/ 3/	-1.1	3.7	-5.6	2.4	2.5	0.1	0.7	5.6	2.4	2.5	3.0	6.0
					(Annual percentage change)							
Merchandise Trade (f.o.b.)												
Exports (nominal)	-0.2	2.3	-1.8	2.9	-4.4	8.7	4.2	5.4	5.2	4.3	2.7	2.6
Volume	-1.2	4.0	-3.3	1.0	3.0	5.6	1.5	3.1	3.0	3.0	2.8	2.8
Price	1.1	-1.6	1.5	1.9	-7.3	2.9	2.7	2.2	2.1	1.3	-0.1	-0.2
Imports (nominal)	1.6	5.1	-1.7	-0.8	-6.0	6.4	7.2	4.3	4.5	4.9	3.9	4.3
Volume	1.0	5.0	0.0	9.3	-1.6	3.4	4.7	3.3	3.3	3.4	3.5	3.9
Price	0.6	0.1	-1.7	-9.3	-4.5	2.9	2.3	1.0	1.2	1.5	0.4	0.5
Terms of trade	0.5	-1.6	3.3	12.4	-2.9	0.0	0.3	1.2	0.9	-0.3	-0.5	-0.6
Memorandum Items:												
Gross international reserves (US$ million) 4/	3,175	2,745	2,693	2,787	3,238	3,671	3,799	3,972	4,147	4,321	4,501	4,686
In months of imports (excluding maquila) 5/	3.4	3.0	3.0	3.2	3.7	3.9	3.8	3.8	3.8	3.8	3.8	3.8
In percent of total short-term external debt	209	151	138	146	126	137	137	138	139	139	138	136
External debt (in percent of GDP)	62.4	63.9	65.5	65.7	68.0	68.8	69.0	69.3	69.7	70.2	70.8	71.4
Of which: public sector debt	34.5	34.2	37.3	35.9	37.2	38.3	39.6	38.0	37.6	37.8	38.1	37.5
Of which: private sector debt	27.9	29.7	28.2	29.7	30.8	30.5	29.4	31.3	32.1	32.4	32.7	33.9
External public debt servicing (US$ million)	580	582	598	694	733	781	900	1,755	988	1,039	1,128	1,980
Percent of exports of goods and services	9.5	9.1	9.2	10.3	11.0	11.2	12.2	22.6	12.1	12.2	12.9	22.0
Gross external financing requirement (US$ million)	3,257	3,913	3,867	3,579	3,191	3,570	3,986	4,858	4,265	4,558	5,166	6,340
Percent of GDP	15.2	17.8	17.1	15.5	13.3	14.4	15.3	17.9	15.0	15.4	16.8	19.8

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

1/ The data reflects the discussions during the mission on February, 2018, with the exception of the national accounts numbers, which were updated with the revised statistics published on March 23, 2018.

2/ Presented in BPM6 format

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

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

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

Table 4. El Salvador: External Financing Requirements and Sources 1/

	2012	2013	2014	2015	2016	2017	Projections 2018	2019	2020	2021	2022	2023
					(Millions of U.S. dollars)							
Gross Financing Requirements	**3,257**	**3,913**	**3,867**	**3,579**	**3,191**	**3,570**	**3,986**	**4,858**	**4,265**	**4,558**	**5,166**	**6,340**
Current account deficit	1,279	1,586	1,212	926	531	628	917	922	939	1,084	1,238	1,454
Debt amortization	1,327	2,654	2,689	2,541	2,207	2,508	2,941	3,763	3,150	3,301	3,748	4,700
Public sector	290	256	271	261	305	323	355	1,147	355	356	376	1,158
Private sector	1,037	2,397	2,417	2,280	1,902	2,185	2,586	2,616	2,795	2,945	3,372	3,542
GIR accumulation	651	-327	-33	113	453	433	128	173	175	173	180	185
Gross Financing Sources	**3,257**	**3,913**	**3,867**	**3,579**	**3,191**	**3,570**	**3,986**	**4,858**	**4,265**	**4,558**	**5,166**	**6,340**
Public sector disbursements	1,202	269	1,059	247	236	942	755	242	300	340	340	340
Private sector net inflows	2,055	3,644	2,808	3,332	2,955	2,628	3,231	4,616	3,965	4,218	4,826	6,000
Foreign direct investment	484	176	311	399	374	325	348	370	389	408	424	441
Other	1,572	3,468	2,497	2,934	2,581	2,303	2,883	4,246	3,576	3,810	4,402	5,559
					(Percent of GDP)							
Gross Financing Requirements	**15.2**	**17.8**	**17.1**	**15.5**	**13.3**	**14.4**	**15.3**	**17.9**	**15.0**	**15.4**	**16.8**	**19.8**
Current account deficit	6.0	7.2	5.4	4.0	2.2	2.5	3.5	3.4	3.3	3.7	4.0	4.5
Debt amortization	6.2	12.1	11.9	11.0	9.2	10.1	11.3	13.9	11.1	11.2	12.2	14.7
Public sector	1.4	1.2	1.2	1.1	1.3	1.3	1.4	4.2	1.3	1.2	1.2	3.6
Private sector	4.9	10.9	10.7	9.8	8.0	8.8	10.0	9.6	9.9	10.0	11.0	11.1
Gross Financing Sources	**15.2**	**17.8**	**17.1**	**15.5**	**13.3**	**14.4**	**15.3**	**17.9**	**15.0**	**15.4**	**16.8**	**19.8**
Public sector disbursements	5.6	1.2	4.7	1.1	1.0	3.8	2.9	0.9	1.1	1.2	1.1	1.1
Private sector net inflows	9.6	16.6	12.4	14.4	12.4	10.6	12.4	17.0	14.0	14.3	15.7	18.7
Foreign direct investment	2.3	0.8	1.4	1.7	1.6	1.3	1.3	1.4	1.4	1.4	1.4	1.4
Other	7.3	15.8	11.1	12.7	10.8	9.3	11.1	15.6	12.6	12.9	14.3	17.3

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

1/ The data reflects the discussions during the mission on February, 2018, with the exception of the national accounts numbers, which were updated with the revised statistics published on March 23, 2018.

Table 5. El Salvador: Operations of the Nonfinancial Public Sector 1/

(In millions of U.S. dollars)

							Projections					
	2012	2013	2014	2015	2016	2017	2018	2019	2020	2021	2022	2023
							(Millions of U.S. dollars)					
Revenue and Grants	**4,508**	**4,679**	**4,739**	**4,919**	**5,272**	**5,615**	**5,952**	**6,167**	**6,352**	**6,595**	**6,869**	**7,129**
Current revenue	4,330	4,608	4,693	4,867	5,226	5,570	5,822	6,022	6,292	6,571	6,845	7,105
Tax revenue	3,434	3,746	3,772	3,918	4,166	4,405	4,649	4,820	5,037	5,264	5,482	5,686
Nontax revenue	734	756	797	840	938	1,049	1,052	1,075	1,122	1,169	1,218	1,269
Operating surplus of the public enterprises	162	107	124	108	122	116	121	127	133	138	144	150
Capital revenue	0	0	0	0	0	0	0	0	0	0	0	0
Official grants	178	71	46	53	46	44	130	145	60	24	24	24
Expenditure	**5,427**	**5,666**	**5,624**	**5,801**	**6,078**	**6,225**	**6,536**	**6,907**	**7,147**	**7,441**	**7,801**	**8,177**
Current expenditure	4,609	4,890	4,927	5,098	5,263	5,478	5,642	5,957	6,240	6,533	6,855	7,190
Wages and salaries	2,005	2,115	2,228	2,326	2,442	2,524	2,650	2,783	2,905	3,026	3,153	3,285
Goods and services	935	1,075	1,049	1,083	1,046	1,032	1,080	1,129	1,179	1,228	1,280	1,333
Interest	541	594	609	644	737	841	952	1,064	1,154	1,258	1,378	1,492
Current transfers	1,128	1,106	1,041	1,045	1,039	1,082	960	981	1,001	1,020	1,043	1,081
Nonpension payments	709	664	574	560	519	521	557	580	603	626	650	675
Pension payments	419	442	467	485	520	560	403	401	398	393	393	405
Capital expenditure	818	776	698	703	815	747	894	950	907	909	947	986
Primary Balance	**-379**	**-393**	**-276**	**-238**	**-69**	**230**	**368**	**324**	**360**	**412**	**445**	**445**
Overall Balance	**-920**	**-987**	**-885**	**-881**	**-806**	**-611**	**-584**	**-740**	**-794**	**-846**	**-933**	**-1,047**
Financing	**920**	**987**	**885**	**881**	**806**	**611**	**584**	**740**	**794**	**846**	**933**	**1,047**
External	**912**	**13**	**788**	**-14**	**-69**	**618**	**400**	**-905**	**-55**	**-16**	**-36**	**-818**
Disbursements	1,202	269	1,059	247	236	942	755	242	300	340	340	340
Amortization	-290	-256	-271	-261	-305	-323	-355	-1,147	-355	-356	-376	-1,158
Domestic	**7**	**975**	**98**	**896**	**875**	**-8**	**184**	**186**	**318**	**111**	**77**	**218**
Change in deposits at central bank (- = increase)	-739	758	-5	24	-116	15	15	-30	-30	-30	-30	-30
Banking system	162	-171	-267	277	72	-601	0	-150	0	0	0	0
Private sector 2/	584	388	370	595	920	578	169	366	348	141	107	248
Unidentified financing	**...**	**...**	**...**	**...**	**...**	**...**	**...**	**1,459**	**532**	**751**	**892**	**1,647**
Memorandum Items:												
Current revenue minus current expenditure	-280	-282	-234	-231	-37	92	180	65	52	38	-10	-85
Gross financing needs	1,878	2,180	2,243	1,549	2,041	2,184	1,743	2,622	1,750	2,004	2,145	2,912
Public sector debt (gross) 3/	13,641	14,031	14,827	15,663	16,611	17,514	18,213	18,984	19,808	20,684	21,647	22,724
							(Percent of GDP)					
Revenue and Grants	**21.1**	**21.3**	**21.0**	**21.2**	**22.0**	**22.6**	**22.9**	**22.7**	**22.4**	**22.3**	**22.3**	**22.2**
Current revenue	20.2	21.0	20.8	21.0	21.9	22.5	22.4	22.2	22.2	22.3	22.2	22.2
Tax revenue	16.1	17.0	16.7	16.9	17.4	17.8	17.9	17.8	17.8	17.8	17.8	17.7
Nontax revenue	3.4	3.4	3.5	3.6	3.9	4.2	4.0	4.0	4.0	4.0	4.0	4.0
Operating surplus of the public enterprises	0.8	0.5	0.5	0.5	0.5	0.5	0.5	0.5	0.5	0.5	0.5	0.5
Official grants	0.8	0.3	0.2	0.2	0.2	0.2	0.5	0.5	0.2	0.1	0.1	0.1
Expenditure	**25.4**	**25.8**	**24.9**	**25.0**	**25.4**	**25.1**	**25.2**	**25.4**	**25.2**	**25.2**	**25.4**	**25.5**
Current expenditure	21.6	22.3	21.8	22.0	22.0	22.1	21.7	21.9	22.0	22.1	22.3	22.4
Wages and salaries	9.4	9.6	9.9	10.0	10.2	10.2	10.2	10.2	10.2	10.2	10.2	10.2
Goods and services	4.4	4.9	4.6	4.7	4.4	4.2	4.2	4.2	4.2	4.2	4.2	4.2
Interest	2.5	2.7	2.7	2.8	3.1	3.4	3.7	3.9	4.1	4.3	4.5	4.7
Current transfers	5.3	5.0	4.6	4.5	4.3	4.4	3.7	3.6	3.5	3.5	3.4	3.4
Nonpension payments	3.3	3.0	2.5	2.4	2.2	2.1	2.1	2.1	2.1	2.1	2.1	2.1
Pension payments	2.0	2.0	2.1	2.1	2.2	2.3	1.6	1.5	1.4	1.3	1.3	1.3
Capital expenditure	3.8	3.5	3.1	3.0	3.4	3.0	3.4	3.5	3.2	3.1	3.1	3.1
Primary Balance	**-1.8**	**-1.8**	**-1.2**	**-1.0**	**-0.3**	**0.9**	**1.4**	**1.2**	**1.3**	**1.4**	**1.4**	**1.4**
Overall Balance	**-4.3**	**-4.5**	**-3.9**	**-3.8**	**-3.4**	**-2.5**	**-2.2**	**-2.7**	**-2.8**	**-2.9**	**-3.0**	**-3.3**
Memorandum Items												
Current revenue minus current expenditure	-1.3	-1.3	-1.0	-1.0	-0.2	0.4	0.7	0.2	0.2	0.1	0.0	-0.3
Gross financing needs	8.8	9.9	9.9	6.7	8.5	8.8	6.7	9.7	6.2	6.8	7.0	9.1
Public sector debt (gross) 3/	63.8	63.8	65.6	67.6	69.5	70.6	70.1	69.9	69.9	70.0	70.3	70.9
Nominal GDP	21,386	21,977	22,586	23,166	23,912	24,805	25,970	27,152	28,351	29,532	30,771	32,050

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

1/ The data reflects the discussiones during the mission on February 2018, with the exception of the national accounts numbers, which were updated with the revised statistics published on March 23, 2018.

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 1/

	2010	2011	2012	2013	2014	2015	2016	Act. 2017	Proj. 2018
	(End of period stocks; in millions of U.S. dollars)								
	I. Central Bank								
Net Foreign Assets	**2,550**	**2,177**	**2,831**	**2,290**	**2,275**	**2,393**	**2,630**	**3,032**	**3,159**
Of which: Net international reserves 2/	2,881	2,502	3,173	2,721	2,661	2,670	2,923	3,273	3,401
Net Domestic Assets	**36**	**300**	**-450**	**278**	**309**	**285**	**167**	**71**	**41**
Nonfinancial public sector (net)	490	688	-49	710	704	726	609	579	549
Claims	833	833	832	832	831	830	829	829	829
Liabilities	343	145	881	122	127	103	220	251	281
Rest of the financial system (net)	109	175	186	119	139	93	146	106	106
Nonfinancial private sector (claims)	1	0	0	0	0	0	0	0	0
Other items (net)	-564	-563	-587	-551	-533	-534	-588	-614	-614
Liabilities	**2,586**	**2,476**	**2,381**	**2,566**	**2,582**	**2,675**	**2,794**	**3,103**	**3,246**
Base Money	2,354	2,275	2,229	2,481	2,474	2,569	2,701	3,009	3,152
Currency in circulation	5	5	4	4	4	4	3	3	5
Liabilities to depositary corporations	2,349	2,271	2,224	2,476	2,470	2,565	2,698	3,006	3,147
Other liabilities to the public	232	201	152	85	109	107	94	94	94
	II. Depository corporations								
Net Foreign Assets	**697**	**295**	**-62**	**-417**	**-672**	**-963**	**-995**	**-671**	**-737**
Net Domestic Assets	**8,987**	**9,383**	**9,985**	**10,614**	**10,853**	**11,809**	**12,192**	**13,170**	**13,815**
Nonfinancial public sector (net)	445	465	578	373	258	762	717	717	717
Claims	627	681	762	672	546	1,015	956	807	807
Liabilities	182	215	184	299	287	254	239	225	225
Rest of the financial system (net)	1,928	1,888	1,981	2,150	2,158	2,214	2,060	2,318	2,427
Credit to the private sector	8,559	8,984	9,332	10,078	10,539	11,028	11,628	12,241	12,877
Other items (net)	-1,946	-1,955	-1,907	-1,988	-2,102	-2,195	-2,213	-2,107	-2,206
Liabilities to the Private Sector	**9,683**	**9,678**	**9,923**	**10,196**	**10,181**	**10,846**	**11,197**	**12,364**	**12,944**
Deposits	9,474	9,413	9,638	9,907	9,863	10,498	10,853	11,997	12,560
Securities	209	264	285	289	318	348	344	367	384
	III. Other financial corporations 3/								
Net Foreign Assets	**132**	**339**	**460**	**600**	**608**	**501**	**377**	**448**	**419**
Net Domestic Assets	**5,789**	**6,108**	**6,687**	**7,121**	**7,794**	**8,500**	**9,319**	**9,926**	**10,630**
Nonfinancial public sector (net)	4,281	4,960	5,660	6,036	6,448	7,019	7,678	8,116	8,534
Rest of the financial system (net)	1,490	1,121	987	1,007	943	1,105	1,218	1,599	1,674
Credit to the private sector	195	215	242	279	508	569	584	600	629
Other items (net)	-177	-188	-201	-201	-198	-277	-235	-242	-253
Liabilities to the Private Sector	**5,921**	**6,447**	**7,147**	**7,721**	**8,402**	**9,001**	**9,705**	**10,402**	**11,097**
Pension fund contributions	5,734	6,247	6,931	7,470	8,133	8,729	9,395	10,082	10,769
	IV. Financial System								
Net Foreign Assets	**3,378**	**2,811**	**3,229**	**2,473**	**2,211**	**1,931**	**2,013**	**2,678**	**2,937**
Net Domestic Assets	**12,463**	**13,519**	**13,997**	**15,533**	**16,484**	**18,027**	**18,986**	**20,228**	**21,246**
Net claims on nonfinancial public sector	5,216	6,113	6,189	7,118	7,410	8,507	9,004	9,322	9,755
Credit to private sector	8,755	9,199	9,574	10,357	11,047	11,597	12,212	12,827	13,490
Other	-1,508	-1,793	-1,766	-1,942	-1,973	-2,077	-2,230	-1,921	-1,999
Liabilities to the Private Sector	**15,841**	**16,331**	**17,226**	**18,006**	**18,695**	**19,957**	**20,999**	**22,906**	**24,183**
Money	2,542	2,669	2,681	2,759	2,788	3,108	2,964	3,487	3,653
Quasi-money	7,565	7,415	7,614	7,777	7,775	8,120	8,640	9,337	9,761
Pension fund contributions	5,734	6,247	6,931	7,470	8,133	8,729	9,395	10,082	10,769
Memorandum Items:	(Percent changes relative to previous year's liabilities to the private sector)								
Net domestic assets	3.9	6.7	2.9	8.9	9.0	14.6	8.5	10.7	7.9
Nonfinancial public sector	6.0	5.7	0.5	5.4	2.8	10.4	4.4	2.7	3.4
Credit to the private sector	0.0	2.8	2.3	4.5	6.6	5.2	5.5	5.3	5.2
Liabilities to the private sector	6.3	3.1	5.5	4.5	6.5	11.9	9.3	16.4	10.0
	(Percent of GDP)								
Credit to the private sector	47.5	45.3	44.8	47.1	48.9	50.1	51.1	51.7	51.9
Liabilities to the private sector	85.9	80.5	80.5	81.9	82.8	86.1	87.8	92.3	93.1
Excluding pension contributions	54.8	49.7	48.1	47.9	46.8	48.5	48.5	51.7	51.7
	(Annual percentage change, unless otherwise noted)								
Credit to the private sector	0.0	5.1	4.1	8.2	6.7	5.0	5.3	5.0	5.2
Private sector deposits in depository corporations	4.8	-0.6	2.4	2.8	-0.4	6.4	3.4	10.5	4.7
Depository corporations liquid deposits at central bank									
(In percent of total deposits)	24.8	24.1	23.1	25.0	25.0	24.4	24.9	25.1	25.1
(In percent of NIR)	81.5	90.7	70.1	91.0	92.8	96.1	92.3	91.8	92.5

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

1/ The data reflects the discussions during the mission on February, 2018, with the exception of the national accounts numbers, which were updated with the revised statistics published on March 23, 2018

2/ 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).

3/ Includes private pension funds, insurance corporations, and the state Development Bank.

Table 7. El Salvador: Selected Vulnerability Indicators 1/

(In percent of GDP; unless otherwise indicated)

								Act.	Proj.
	2010	2011	2012	2013	2014	2015	2016	2017	2018
Fiscal Indicators									
Overall balance of the nonfinancial public sector	-5.0	-4.5	-4.3	-4.5	-3.9	-3.8	-3.4	-2.5	-2.2
Primary balance of the nonfinancial public sector	-2.2	-1.9	-1.8	-1.8	-1.2	-1.0	-0.3	0.9	1.4
Gross public sector financing requirement	9.3	10.3	8.8	9.9	9.9	6.7	8.5	8.8	6.7
Public sector debt (gross) 2/	60.6	59.5	63.8	63.8	65.6	67.6	69.5	70.6	70.1
Public sector external debt	34.4	31.6	34.5	34.2	37.3	35.9	37.2	38.3	39.6
External interest payments to total fiscal revenue (percent)	8.5	7.8	7.2	7.7	7.6	8.1	8.1	8.4	9.0
External amortization payments to total fiscal revenue (percent) 3/	8.1	22.4	6.4	5.5	5.7	5.3	5.8	5.8	6.0
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	4.6
Private sector credit (percent change, end-of-period)	0.0	5.1	4.1	8.2	6.7	5.0	5.3	5.0	5.2
Ratio of capital to risk-weighted assets	17.6	17.1	17.3	17.3	16.6	16.8	16.9	…	…
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	…	…
Ratio of provisions to total loans	4.3	3.8	3.3	2.9	2.8	2.7	2.4	…	…
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	…	…
Return on average equity	7.3	12.2	12.4	12.4	10.0	7.9	6.9	…	…
Return on average total assets	0.9	1.5	1.6	1.6	1.3	1.0	0.9	…	…
Loans as percent of deposits	84.5	88.9	93.7	97.2	103.2	102.1	…	…	…
Ratio of liquid assets to total deposits	42.0	37.0	31.9	30.7	28.1	32.3	30.9	…	…
External Indicators									
Exports of goods and services (percent change, 12-month basis)	17.9	18.3	3.8	5.2	1.3	3.3	-0.8	5.1	5.1
Imports of goods and services (percent change, 12-month basis)	15.9	18.7	2.9	5.7	-1.6	0.0	-3.4	6.3	6.7
Current account balance	-2.9	-5.5	-6.0	-7.2	-5.4	-4.0	-2.2	-2.5	-3.5
Capital and financial account balance	1.1	4.5	10.4	5.1	3.0	4.6	5.3	4.3	4.0
Gross international reserves (millions of U.S. dollars)	2,882	2,503	3,175	2,745	2,693	2,787	3,238	3,671	3,799
Months of imports of goods and services, excluding maquila	3.6	3.1	3.7	3.2	3.2	3.4	3.7	3.9	3.9
Percent of short-term debt	345	217	209	151	138	146	126	137	137
Percent of gross external financing requirements	127	73	97	70	70	78	101	103	95
Percent of broad money	28.5	24.8	30.8	26.1	25.5	24.8	27.9	28.6	28.3
Public external debt service 3/	3.0	6.1	2.7	2.6	2.6	3.0	3.1	3.1	3.5
External debt to exports of goods and services (percent)	229	202	206	219	228	227	244	244	244
External interest payments to exports of goods and services (percent)	11.5	11.1	15.3	16.1	17.2	17.6	19.9	22.1	22.5
External amortization to exports of goods and services (percent) 3/	34.9	39.2	32.4	36.2	40.8	39.5	39.9	42.0	41.7
REER, depreciation is negative (percent change, end-of-period)	-0.7	1.7	-1.5	-0.9	2.8	5.5	-1.2	-0.5	0.0

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

1/ The data reflects the discussions during the mission on February, 2018, with the exception of the national accounts numbers, which were updated with the revised statistics published on March 23, 2018.
2/ Includes gross debt of the nonfinancial public sector and external debt of the central bank.
3/ In 2011, includes rollover of a maturing external bond.

Table 8. El Salvador: Public Sector Financing Requirements and Sources 1/

			Projections					
	2016	2017	2018	2019	2020	2021	2022	2023
	(Millions of U.S. dollars)							
Gross financing requirements	**2,041**	**2,184**	**1,743**	**2,622**	**1,750**	**2,004**	**2,145**	**2,912**
Overall deficit	806	611	584	740	794	846	933	1,047
Public debt amortizations	1,235	1,573	1,159	1,882	955	1,158	1,212	1,865
External	305	323	355	1147	355	356	376	1158
Multilaterals and bilaterals	305	323	355	347	355	356	376	358
Bonds	0	0	0	800	0	0	0	800
Domestic	930	1250	804	735	600	802	836	707
o.w. short-term debt (letes) 1/	772	1015	700	700	550	550	550	550
Sources of financing	**2,041**	**2,184**	**1,743**	**2,622**	**1,750**	**2,004**	**2,145**	**2,912**
External	236	942	755	242	300	340	340	340
Multilaterals and bilaterals	236	341	237	242	300	340	340	340
Bonds	0	601	518	0	0	0	0	0
Domestic	1,806	1,242	988	921	918	913	913	925
Pension funds	520	560	403	401	398	393	393	405
Use of BCR deposits	-116	15	15	-30	-30	-30	-30	-30
Short-term debt (letes)	1,015	700	700	550	550	550	550	550
Others, including floating debt	387	-33	-130	0	0	0	0	0
Unidentified financing	0	0	0	1,459	532	751	892	1,647
Memorandum items:								
Nominal GDP	23,912	24,805	25,970	27,152	28,351	29,532	30,771	32,050
	(Percent of GDP)							
Gross financing requirements	**8.5**	**8.8**	**6.7**	**9.7**	**6.2**	**6.8**	**7.0**	**9.1**
Overall deficit	3.4	2.5	2.2	2.7	2.8	2.9	3.0	3.3
Public debt amortizations	5.2	6.3	4.5	6.9	3.4	3.9	3.9	5.8
External	1.3	1.3	1.4	4.2	1.3	1.2	1.2	3.6
Multilaterals and bilaterals	1.3	1.3	1.4	1.3	1.3	1.2	1.2	1.1
Bonds	0.0	0.0	0.0	2.9	0.0	0.0	0.0	2.5
Domestic	3.9	5.0	3.1	2.7	2.1	2.7	2.7	2.2
o.w. short-term debt (letes)	3.2	4.1	2.7	2.6	1.9	1.9	1.8	1.7
Sources of financing	**8.5**	**8.8**	**6.7**	**9.7**	**6.2**	**6.8**	**7.0**	**9.1**
External	1.0	3.8	2.9	0.9	1.1	1.2	1.1	1.1
Multilaterals and bilaterals	1.0	1.4	0.9	0.9	1.1	1.2	1.1	1.1
Bonds	0.0	2.4	2.0	0.0	0.0	0.0	0.0	0.0
Domestic	7.6	5.0	3.8	3.4	3.2	3.1	3.0	2.9
Pension funds	2.2	2.3	1.6	1.5	1.4	1.3	1.3	1.3
Use of BCR deposits	-0.5	0.1	0.1	-0.1	-0.1	-0.1	-0.1	-0.1
Short-term debt (letes) 2/	4.2	2.8	2.7	2.0	1.9	1.9	1.8	1.7
Others	1.6	-0.1	-0.5	0.0	0.0	0.0	0.0	0.0
Unidentified financing	0.0	0.0	0.0	5.4	1.9	2.5	2.9	5.1

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

1/ The data reflects the discussions during the mission on February, 2018, with the exception of the national accounts numbers, which were updated with the revised statistics published on March 23, 2018.

2/ 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.

Annex I. Debt Sustainability Analysis

The debt stock was 71 percent of GDP at end-2017, well above prudent levels for El Salvador.[1] The debt ratio is higher by about 7 percentage points due to the recent one-off downward revision in nominal GDP. Some liabilities (notably pension recognition bonds) are not included in the estimated stock. Reflecting deficit reduction in 2016-17 and a recent pension reform, the debt ratio is projected to almost stabilize over the medium term, in contrast to the pronounced upward debt dynamics projected during the 2016 Article IV Consultation. The gross public financing needs do not look high compared to other emerging markets, but are elevated for a fully dollarized economy.[2] Eurobond repayments in 2019, 2023, and beyond need to be carefully managed. Susceptibility to growth and financing shocks are key risks. Vulnerabilities are moderated by a long maturity of existing debt, a stable investor base, and low implicit pension debt due to the ongoing transition to a defined-contribution system.

A. Key Assumptions

1. Debt definition. As in previous consultations, El Salvador's public debt is defined as the sum of gross debt of the nonfinancial public sector (NFPS) and the external debt of the central bank. The data on NFPS is reported by the Ministry of Finance. In staff's definition, the NFPS includes pension-related debt (formerly called *CIP-A* bonds that were issued to finance current public pension payments). This broad definition better captures quasi-fiscal liabilities related to public enterprises and the public financial sector. However, the debt definition excludes pension system's recognition bonds (e.g., *CIP-B* bonds, amounting to about 7 percent of GDP),[3] municipal debt (1½ percent of GDP), and some public enterprise debt.[4]

2. Macroeconomic outlook. The **baseline scenario** reflects the estimated growth potential of 2.2 percent, with somewhat higher growth in 2018-2019 due to expected U.S. economy's recovery. The fiscal projection incorporates the estimated structural component of the deficit reduction observed in 2016-17 and the effects of the 2018 budget, including the September 2017 pension reform. It is assumed that there is no further fiscal adjustment, with the primary balance gradually improving reflecting continued favorable fiscal effects from the pension reform. Reflecting higher interest bill from rising interest rates, the headline overall deficit would increase mildly over the medium term, exceeding 3 percent of GDP by 2023. The growth/interest differential would remain negative. The scenario assumes that financing gaps are filled with long-term loans from private creditors. Inflation is expected to remain anchored by the fully dollarized regime.

[1] Staff estimates public debt threshold for El Salvador within the 40–50 percent range (see IMF Country report No 15/13).

[2] In the absence of a fully-fledged LOLR role of the central bank, fiscal gross financing requirements in dollarized economies have been significantly lower than in other economies.

[3] The recognition bonds have been issued to validate the rights of pensioners who had contributed to the defined benefit system but would be receiving pension benefits from the defined contribution system.

[4] The exact amount of under-recorded debt would be determined as part of the ongoing reconciliation exercise between BCR and MoF.

An alternative fiscal **adjustment scenario** envisions a cumulative fiscal consolidation of 2 percent of GDP by 2020. Under plausible multiplier assumptions (0.7 on impact and 0.3 in the longer-term), this effort would bend the public debt curve and contribute to a sustained reduction in the debt ratio below 60 percent of GDP by 2024-25 and below a more comfortable level of 50 percent of GDP by 2030.

Fiscal Indicators in an Adjustment Scenario (percent of GDP) 1/

	2018	2019	2020	2021	2022	2023	2024	2025
GDP growth (percent)	2.3	1.6	1.4	2.4	2.4	2.4	2.3	2.3
Overall balance	-2.2	-1.8	-0.7	-0.6	-0.6	-0.6	-0.7	-0.7
Primary balance	1.4	2.0	3.2	3.4	3.5	3.5	3.5	3.5
Gross financing need	6.7	8.8	4.1	4.5	4.5	6.4	n.a.	n.a.
Public debt	70.1	69.5	67.9	65.8	63.6	61.7	59.8	58.0

Source: Fund staff estimates.

1/ Consolidation measures of 1 percent of GDP in 2019 and 1.3 percent of GDP in 2020, with multipliers of 0.7 short term and 0.3 long-term, followed by an increase in capital spending by 0.2 percentage point starting from 2021.

B. Results and Assessment

3. Baseline scenario results. The public debt ratio would remain around 70 percent of GDP in 2023, being on a mildly upward trajectory thereafter. The gross financing needs would average 7½ percent of GDP over 2018-23, increasing to 9¾ percent of GDP in 2019 due to a Eurobond repayment that year. There is clearly **no fiscal space** with the debt dynamics rising and output gap near zero.

4. Drivers. The debt dynamics are primarily driven by real interest rates, contributing about 3 percent of GDP to growth in the ratio on an annual basis, while primary surpluses and real GDP growth would reduce the ratio by about 1½ percent of GDP annually each.

5. Stress tests. Mostly standard shock scenarios have been considered for comparability, except the natural disaster impact, which assumes a decline of GDP growth by 3 percentage points the first year and 2 percentage point the following year. Real GDP and contingent liability shocks have a relatively significant impact, with the latter particularly costly since it significantly increases financing needs. A combined macro-fiscal shock and a natural disaster shock would be also challenging.

6. Assessment. Standard debt profile characteristics are mixed (see heat-map). The heat-map may understate some risks, including because: (i) the gross financing threshold of the heat map (15 percent of GDP) does not account for funding constraints of fully dollarized economies (their gross financing requirements tend to be substantially smaller than in other emerging economies); and (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. Mitigating factors. Unlike many countries, El Salvador on current policies has effectively pre-funded some of its future pension liabilities due to its ongoing transition toward a fully selffinanced defined-contribution system. Existing debt has a relatively long average debt maturity and a stable investor base (over one-half of the debt is held by domestic pension funds and official creditors) – in the latter aspect, the heat-map may overstate risks from "nonresident holdings."

8. El Salvador's **pension system** would be an additional driver of long-term debt. The September 2017 pension reform has a substantial favorable effect on the medium-term public debt dynamics, but creates a long-term liability that could become significant after 2040. While, the main actuarial study commissioned by the government projects the latter effect to be moderate and not altering the declining pension spending to GDP ratio through 2100, it hinges on assumptions that may not fully account for long-term population aging.[5] Furthermore, without parametric reforms, "social sustainability" of pensions is a chronic problem as replacement rates and coverage would remain very low.[6]

9. **Idiosyncratic risks and issues.** These include: (i) risks of potential reversal of the recent deficit reduction, particularly due to potential political pressures for higher spending in the 2018-19 electoral season; (ii) risks of potentially fiscally-costly adjustments to the pension system in response to a possible fall-out from the system's social sustainability problems, although these risks have been mitigated with the recent reform; (iii) potential assumption of enterprise debt; (iv) financing challenges due to potential difficulties in assembling a two-thirds majority in Congress that is required to authorize long-term borrowing. This would be important to address in the context of 2019 Eurobond repayment and similar payments in 2023-24.

[5] El Salvador is so far in a demographic "sweet spot," but the share of population over 64 is projected to increase from 7 percent now to 16 percent in 2050 and 29 percent in 2100 (ECLAC estimates).

[6] See IMF Country report 16/209.

Figure 1. El Salvador: Public Sector Debt Sustainability Analysis Baseline Scenario

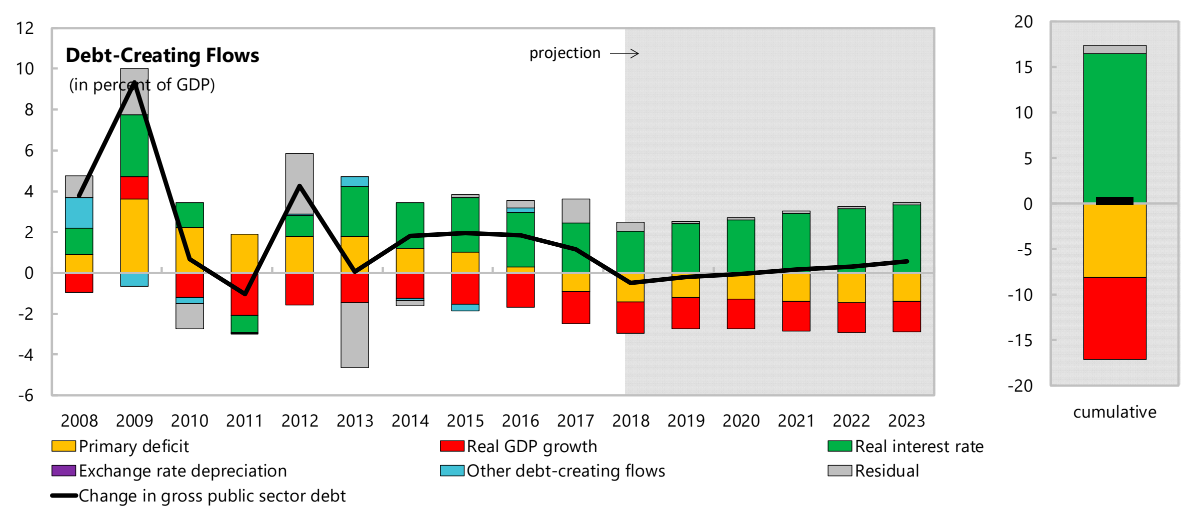
(In percent of GDP unless otherwise indicated)

Debt, Economic and Market Indicators [1]

	Actual			Projections						As of April 05, 2018		
	2008-2015 [2]	2016	2017	2018	2019	2020	2021	2022	2023	Sovereign Spreads		
Nominal gross public debt	59.8	69.5	70.6	70.1	69.9	69.9	70.0	70.3	70.9	EMBIG (bp) 3/		369
Public gross financing needs	8.9	8.5	8.8	6.7	9.7	6.2	6.8	7.0	9.1	5Y CDS (bp)		n.a.
Real GDP growth (in percent)	1.9	2.6	2.3	2.3	2.3	2.2	2.2	2.2	2.2	Ratings	Foreign	Local
Inflation (GDP deflator, in percent)	2.0	0.6	1.4	2.3	2.2	2.2	1.9	2.0	1.9	Moody's	B3	B3
Nominal GDP growth (in percent)	4.0	3.2	3.7	4.7	4.6	4.4	4.2	4.2	4.2	S&Ps	CCC	CCC
Effective interest rate (in percent) [4]	4.9	4.7	5.1	5.4	5.8	6.1	6.3	6.7	6.9	Fitch	B-	B-

Contribution to Changes in Public Debt

	Actual			Projections							
	2008-2015	2016	2017	2018	2019	2020	2021	2022	2023	cumulative	debt-stabilizing
Change in gross public sector debt	2.6	1.9	1.1	-0.5	-0.2	0.0	0.2	0.3	0.6	0.3	primary
Identified debt-creating flows	2.4	1.5	0.0	-0.9	-0.3	-0.2	0.1	0.2	0.5	-0.7	balance [9]
Primary deficit	1.8	0.3	-0.9	-1.4	-1.2	-1.3	-1.4	-1.4	-1.4	-8.1	1.8
Primary (noninterest) revenue and grants	20.8	22.0	22.6	22.9	22.7	22.4	22.3	22.3	22.2	134.9	
Primary (noninterest) expenditure	22.6	22.3	21.7	21.5	21.5	21.1	20.9	20.9	20.9	126.8	
Automatic debt dynamics [5]	0.5	1.0	0.9	0.5	0.9	1.1	1.5	1.7	1.8	7.4	
Interest rate/growth differential [6]	0.5	1.0	0.9	0.5	0.9	1.1	1.5	1.7	1.8	7.4	
Of which: real interest rate	1.6	2.7	2.4	2.0	2.4	2.6	2.9	3.1	3.3	16.5	
Of which: real GDP growth	-1.1	-1.7	-1.6	-1.6	-1.5	-1.5	-1.5	-1.5	-1.5	-9.0	
Exchange rate depreciation [7]	0.0	0.0	0.0	…	…	…	…	…	…	…	
Other identified debt-creating flows	0.0	0.2	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	
Privatization/Drawdown of Deposits	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	
Increase BCR's external debt	0.0	0.2	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	
Residual, including asset changes [8]	0.2	0.4	1.2	0.4	0.1	0.1	0.1	0.1	0.1	1.0	



Source: Fund staff estimates and projections.

1/ Public sector is defined as non-financial public sector, including external central bank debt.

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 - π(1+g) - g + ae(1+r)]/(1+g+π+gπ)) 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 - π (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.

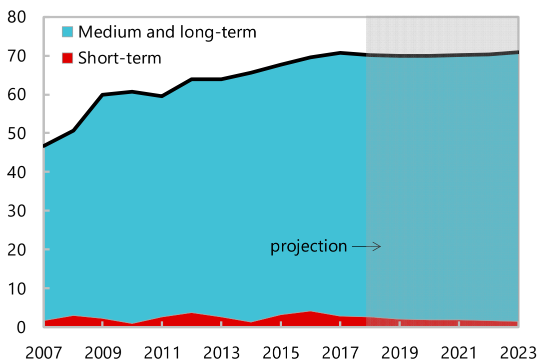
9/ Assumes that key variables (real GDP growth, real interest rate, and other identified debt-creating flows) remain at the level of the last projection year.

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

Composition of Public Debt

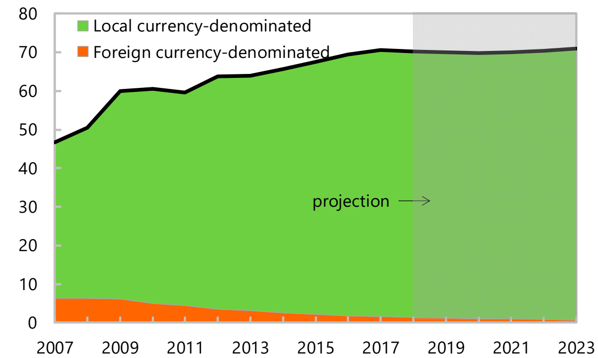
By Maturity

(in percent of GDP)



By Currency

(in percent of GDP)

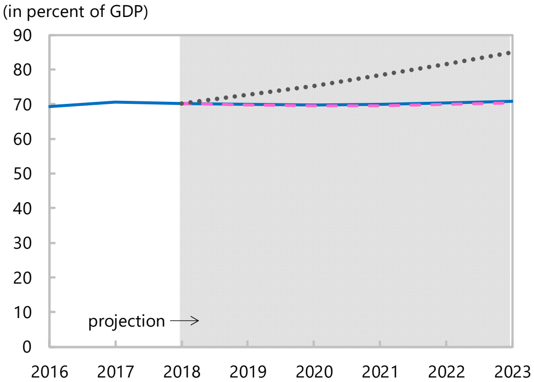


Alternative Scenarios

Historical   Constant Primary Balance

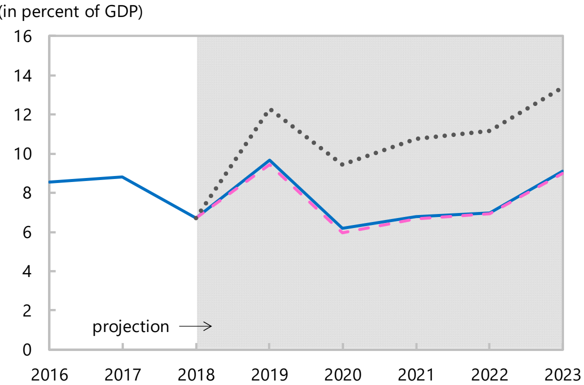
Gross Nominal Public Debt

(in percent of GDP)



Public Gross Financing Needs

(in percent of GDP)



Underlying Assumptions

(in percent)

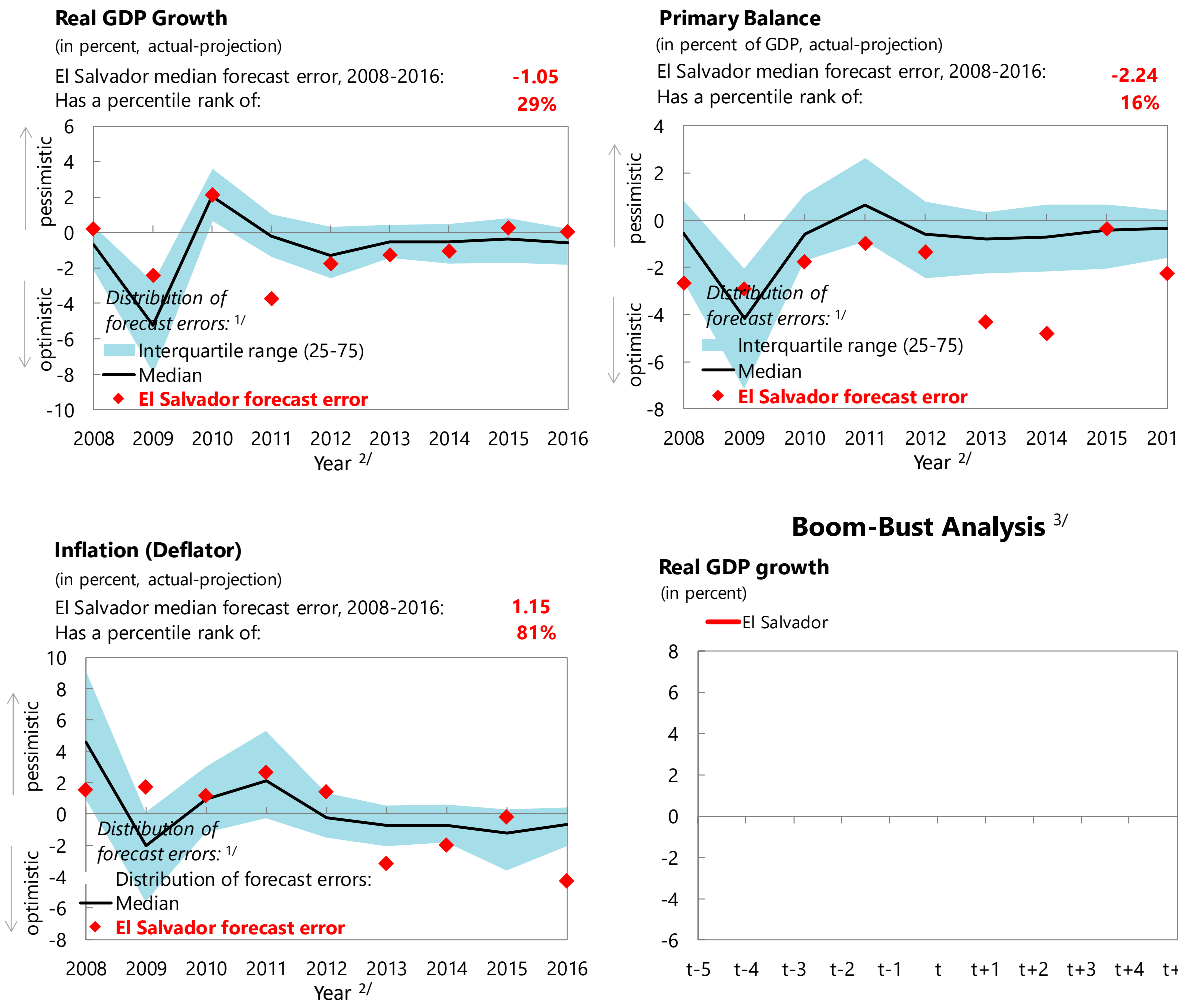
Baseline Scenario	2018	2019	2020	2021	2022	2023
Real GDP growth	2.3	2.3	2.2	2.2	2.2	2.2
Inflation	2.3	2.2	2.2	1.9	2.0	1.9
Primary Balance	1.4	1.2	1.3	1.4	1.4	1.4
Effective interest rate	5.4	5.8	6.1	6.3	6.7	6.9
Constant Primary Balance Scenario						
Real GDP growth	2.3	2.3	2.2	2.2	2.2	2.2
Inflation	2.3	2.2	2.2	1.9	2.0	1.9
Primary Balance	1.4	1.4	1.4	1.4	1.4	1.4
Effective interest rate	5.4	5.8	6.1	6.3	6.7	6.9

Historical Scenario	2018	2019	2020	2021	2022	2023
Real GDP growth	2.3	2.0	2.0	2.0	2.0	2.0
Inflation	2.3	2.2	2.2	1.9	2.0	1.9
Primary Balance	1.4	-1.4	-1.4	-1.4	-1.4	-1.4
Effective interest rate	5.4	5.8	6.0	6.1	6.4	6.5

Source: Fund staff estimates and projections.

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

Forecast Track Record, versus all countries



Source: Fund staff estimates and projections.
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

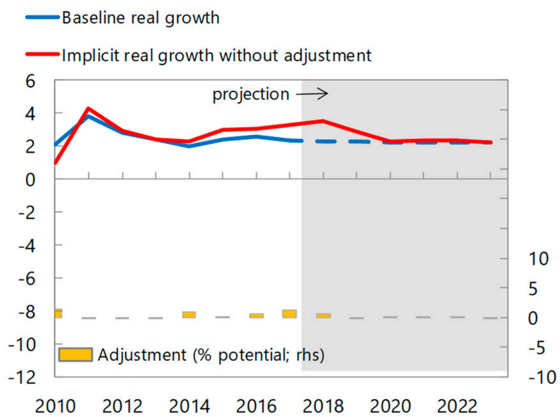
Figure 3. El Salvador: Public DSA – Realism of Baseline Assumptions (continued)

Growth and Level of Output in Absence of Fiscal Adjustment

Assumed multiplier of 0.7, persistence of 0.3

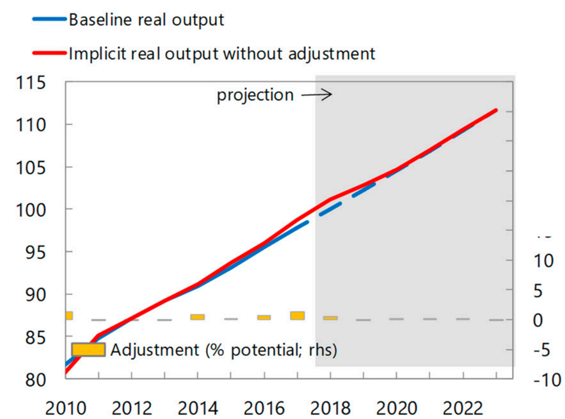
Real GDP Growth

(in percent)



Real Output Level

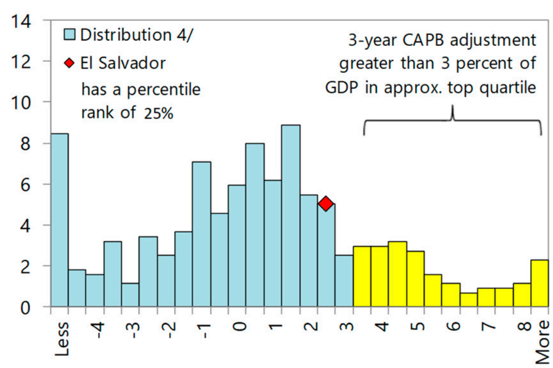
(Baseline real output in 2018=100)



Assessing the Realism of Projected Fiscal Adjustment

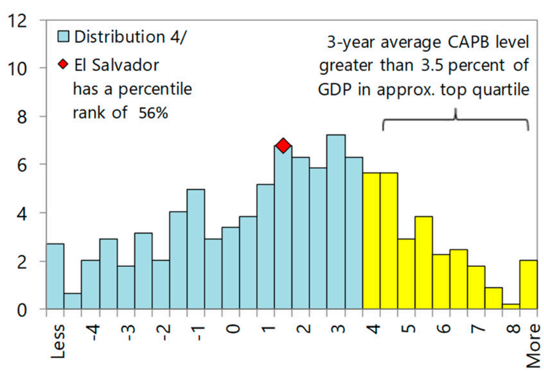
3-Year Adjustment in Cyclically-Adjusted Primary Balance (CAPB)

(Percent of GDP)



3-Year Average Level of Cyclically-Adjusted Primary Balance (CAPB)

(Percent of GDP)

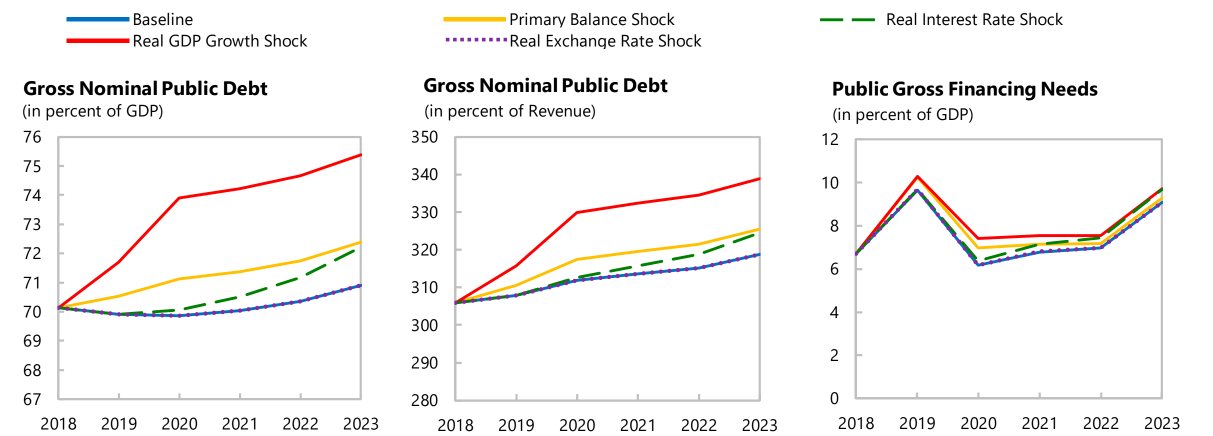


Source: Fund staff estimates and projections.

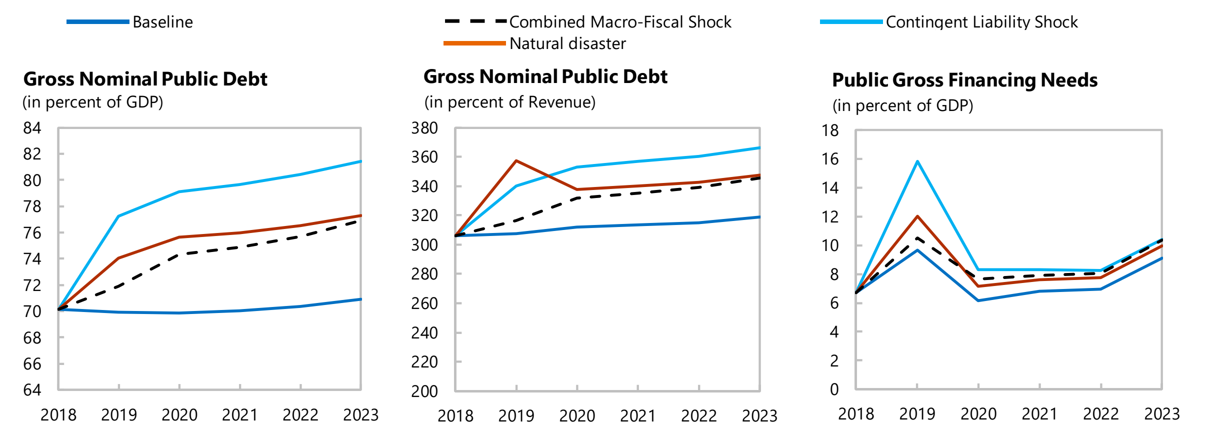
4/ Data cover annual obervations from 1990 to 2011 for advanced and emerging economies with debt greater than 60 percent of GDP. Percent of sample on vertical axis.

Figure 4. El Salvador: Public DSA – Stress Test

Macro-Fiscal Stress Tests



Additional Stress Tests



Underlying Assumptions

(in percent)

Primary Balance Shock	2018	2019	2020	2021	2022	2023
Real GDP growth	2.3	2.3	2.2	2.2	2.2	2.2
Inflation	2.3	2.2	2.2	1.9	2.0	1.9
Primary balance	1.4	0.6	0.7	1.4	1.4	1.4
Effective interest rate	5.4	5.8	6.1	6.4	6.7	7.0
Real Interest Rate Shock						
Real GDP growth	2.3	2.3	2.2	2.2	2.2	2.2
Inflation	2.3	2.2	2.2	1.9	2.0	1.9
Primary balance	1.4	1.2	1.3	1.4	1.4	1.4
Effective interest rate	5.4	5.8	6.4	6.7	7.2	7.6
Combined Shock						
Real GDP growth	2.3	0.8	0.7	2.2	2.2	2.2
Inflation	2.3	1.8	1.8	1.9	2.0	1.9
Primary balance	1.4	0.6	0.5	1.4	1.4	1.4
Effective interest rate	5.4	5.8	6.4	6.8	7.2	7.6

Real GDP Growth Shock	2018	2019	2020	2021	2022	2023
Real GDP growth	2.3	0.8	0.7	2.2	2.2	2.2
Inflation	2.3	1.8	1.8	1.9	2.0	1.9
Primary balance	1.4	0.8	0.5	1.4	1.4	1.4
Effective interest rate	5.4	5.8	6.1	6.4	6.7	6.9
Real Exchange Rate Shock						
Real GDP growth	2.3	2.3	2.2	2.2	2.2	2.2
Inflation	2.3	2.2	2.2	1.9	2.0	1.9
Primary balance	1.4	1.2	1.3	1.4	1.4	1.4
Effective interest rate	5.4	5.8	6.1	6.3	6.7	6.9
Contingent Liability Shock						
Real GDP growth	2.3	0.8	0.7	2.2	2.2	2.2
Inflation	2.3	1.8	1.8	1.9	2.0	1.9
Primary balance	1.4	-4.5	1.3	1.4	1.4	1.4
Effective interest rate	5.4	6.3	6.5	6.6	6.9	7.1

Source: Fund staff estimates and projections.

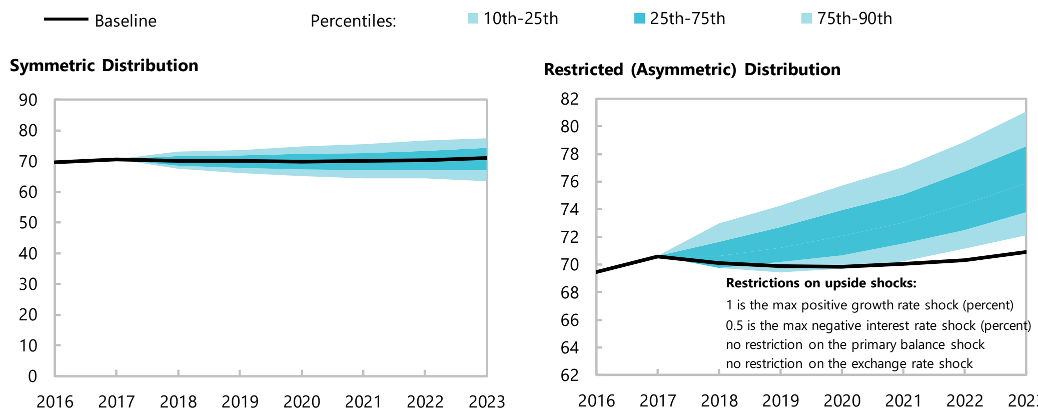
Figure 5. El Salvador Public DSA – Risk Assessment

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

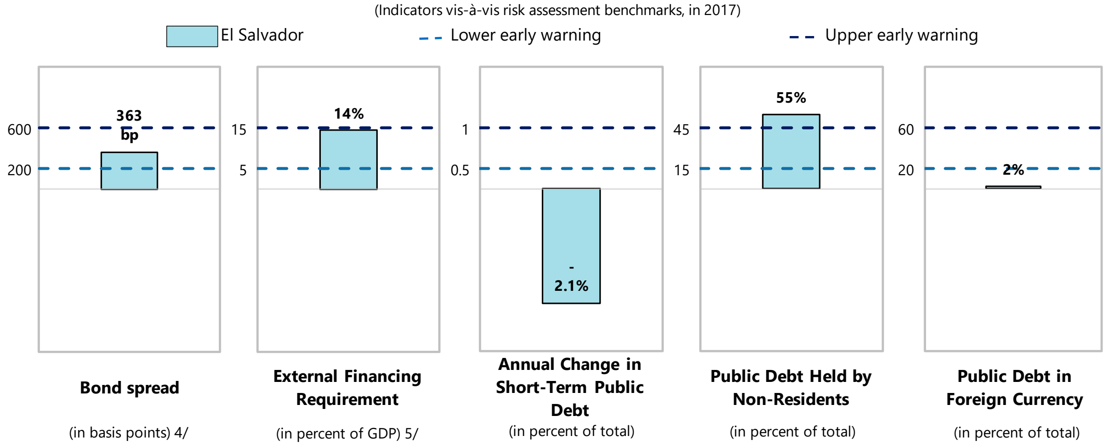
Evolution of Predictive Densities of Gross Nominal Public Debt

(in percent of GDP)



Debt Profile Vulnerabilities

(Indicators vis-à-vis risk assessment benchmarks, in 2017)



Source: Fund staff estimates and projections.

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.

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

4/ Long-term bond spread over U.S. bonds, an average over the last 3 months, 05-Jan-18 through 05-Apr-18.

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

10. The current account deficit shrunk considerably between 2013 and 2016, but has increased since then. The decline in current account deficit was driven by the fall in oil prices and a surge in remittances. The recent widening of the current account can be explained by rising merchandise imports in the second half of 2017, driven by intermediate goods and oil, and a worsening of the services and income balance.

11. The higher level of remittances and a spurt in investment is expected to contribute to a worsening of trade balance, even though exports will be helped initially by U.S. growth. While remittances stayed buoyant in 2017, they are expected to fall back to their trend level going forward. Additionally, the worsening income balance will contribute to the widening of the current account deficit in the medium term - the current account deficit is projected to increase from the 2.2 percent in 2016 to 4.5 percent in 2023. With modest growth, FDI and equity portfolio flows will also remain subdued in the medium term. The external debt is set to expand from its current level of 67 percent of GDP, driven largely by public sector borrowing.

12. The trajectory of the external debt does not show much sensitivity to shocks to interest rate and growth. In comparison, the non-interest current account shock and the combined shock have larger effects. The most adverse effect is observed in response to the real exchange rate depreciation shock causing the external debt to be higher by about 33 percentage points compared to the baseline by 2023.

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

(In percent of GDP, unless otherwise indicated)

	Actual							Projections						
	2013	2014	2015	2016	2017			2018	2019	2020	2021	2022	2023	Debt-stabilizing non-interest current account 7/
Baseline: External debt	63.4	65.5	65.4	67.5	67.9			**68.2**	**68.4**	**68.8**	**69.3**	**69.8**	**70.3**	**0.3**
Change in external debt	1.4	2.1	-0.1	2.2	0.4			0.3	0.2	0.3	0.5	0.5	0.5	
Identified external debt-creating flows (4+8+9)	5.1	3.3	1.1	-1.3	-1.4			0.9	0.7	0.7	1.0	1.3	1.8	
Current account deficit, excluding interest payments	4.4	2.4	0.7	-1.3	-1.3			-0.4	-0.6	-0.8	-0.5	-0.2	0.2	
Deficit in balance of goods and services	21.1	19.5	18.0	16.1	16.7			17.5	17.1	16.9	17.1	17.3	17.7	
Exports	29.0	28.8	28.9	27.7	27.9			28.0	28.2	28.4	28.4	28.1	27.7	
Imports	50.1	48.3	46.9	43.8	44.6			45.5	45.3	45.3	45.5	45.4	45.4	
Net non-debt creating capital inflows (negative)	-0.4	-0.8	-1.0	-1.4	-1.1			-1.1	-1.1	-1.1	-1.2	-1.2	-1.2	
Automatic debt dynamics 2/	1.1	1.8	1.3	1.3	0.9			2.4	2.5	2.6	2.6	2.7	2.8	
Contribution from nominal interest rate	2.8	3.0	3.2	3.5	3.8			3.9	4.0	4.0	4.1	4.2	4.3	
Contribution from real GDP growth	-1.5	-0.8	-1.8	-1.8	-1.6			-1.5	-1.5	-1.4	-1.5	-1.5	-1.5	
Contribution from price and exchange rate changes 3/	-0.2	-0.5	-0.1	-0.4	-1.3			...	...	...	...	...	...	
Residual, incl. change in gross foreign assets (2-3) 4/	-3.7	-1.2	-1.2	3.5	1.8			-0.6	-0.5	-0.3	-0.5	-0.9	-1.3	
External debt-to-exports ratio (in percent)	218.6	227.5	226.5	243.9	243.5			243.3	242.2	242.2	243.9	248.5	253.3	
Gross external financing need (in billions of US dollars) 5/	3.9	3.9	3.6	3.2	3.6			4.0	4.9	4.3	4.6	5.2	6.3	
in percent of GDP	17.7	17.1	15.4	13.3	14.2	10-Year	10-Year	15.2	17.7	14.8	15.2	16.6	19.5	
Scenario with key variables at their historical averages 6/								**68.2**	**70.1**	**72.1**	**73.8**	**75.2**	**76.1**	**-0.9**
Key Macroeconomic Assumptions Underlying Baseline						Historical Average	Standard Deviation							
Real GDP growth (in percent)	2.5	1.2	2.9	2.8	2.4	2.1	1.6	2.3	2.3	2.2	2.2	2.2	2.2	
GDP deflator in US dollars (change in percent)	0.4	0.8	0.2	0.6	1.9	1.8	1.9	2.3	2.3	2.2	2.0	2.0	2.0	
Nominal external interest rate (in percent)	4.6	4.8	5.1	5.5	5.8	4.6	0.8	6.1	6.1	6.1	6.2	6.3	6.4	
Growth of exports (US dollar terms, in percent)	5.2	1.3	3.3	-0.8	5.2	5.2	9.0	5.1	5.5	5.0	4.3	3.1	3.0	
Growth of imports (US dollar terms, in percent)	5.7	-1.6	0.0	-3.4	6.3	3.0	11.8	6.7	4.3	4.4	4.8	3.9	4.3	
Current account balance, excluding interest payments	-4.4	-2.4	-0.7	1.3	1.3	-1.8	2.6	0.4	0.6	0.8	0.5	0.2	-0.2	
Net non-debt creating capital inflows	0.4	0.8	1.0	1.4	1.1	1.3	0.7	1.1	1.1	1.1	1.2	1.2	1.2	

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

1/ The data reflects the discussions during the mission on February, 2018, with the exception of the national accounts numbers, which were updated with the revised statistics published on March 23, 2018.

2/ 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.

3/ 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).

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

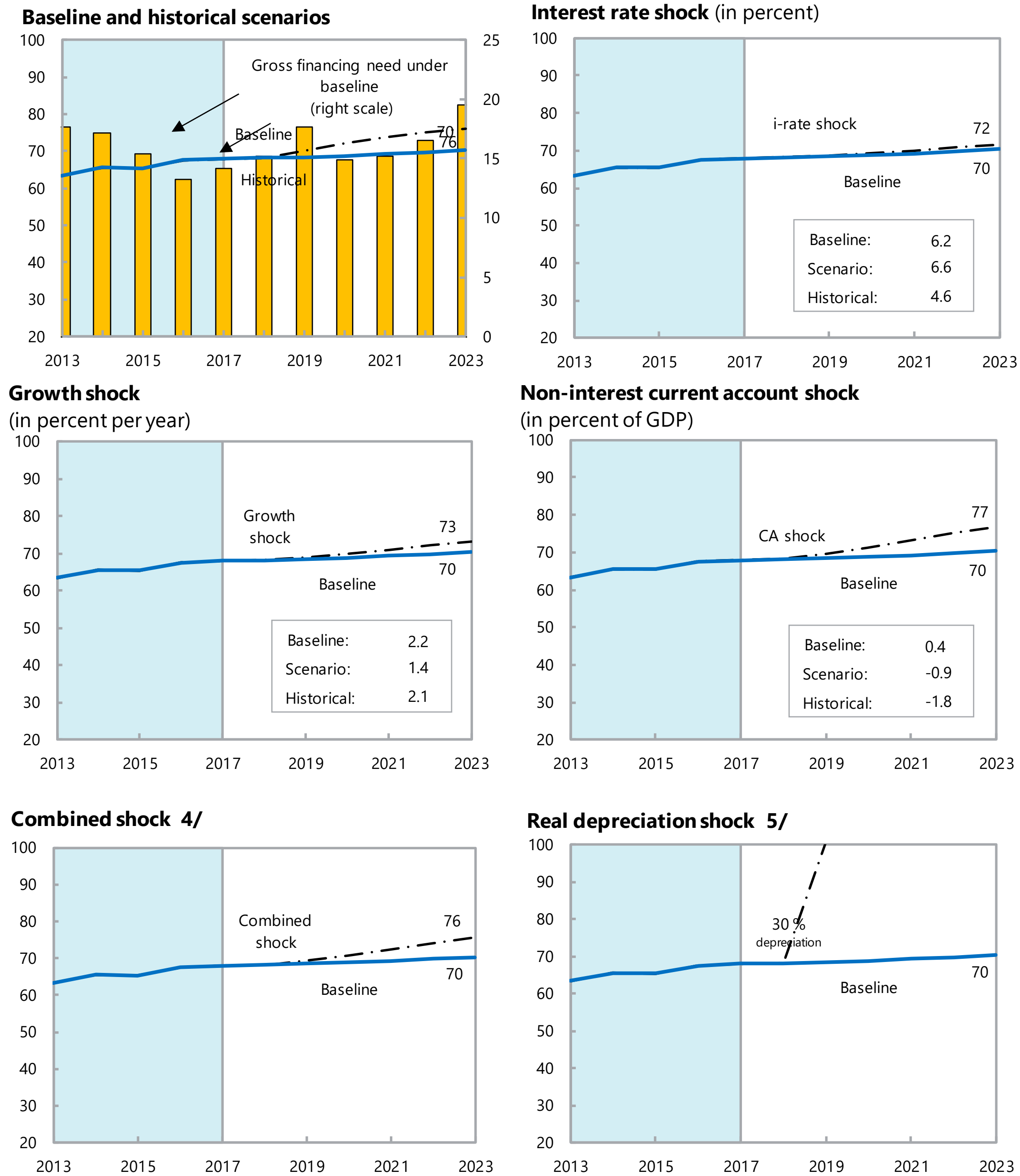
5/ Defined as current account deficit, plus amortization on medium- and long-term debt, plus short-term debt at end of previous period.

6/ 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.

7/ 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 6. El Salvador: External Debt Sustainability: Bound Test 1/ 2/ 3/

(External debt in percent of GDP)



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

1/ The data reflects the discussions during the mission on February, 2018, with the exception of the national accounts numbers, which were updated with the revised statistics published on March 23, 2018.

2/ 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.

3/ 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.

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

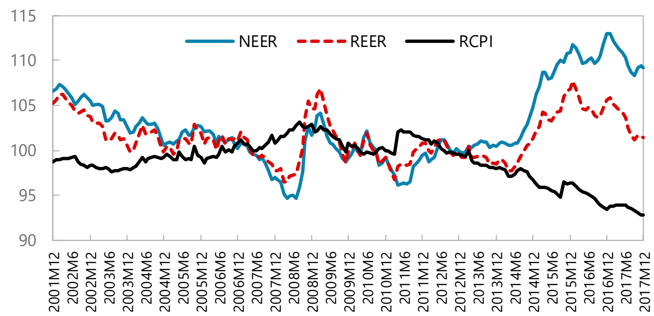
5/ One-time real depreciation of 30 percent occurs in 2019.

Annex II. External Stability Assessment

El Salvador has benefited from the decline in oil prices and the recent surge in remittances, resulting in a substantial improvement in the external sector balance. However, this is expected to be short-lived. The external position for 2017 is estimated to be moderately weaker than that implied by fundamentals and desirable policies, with a real effective exchange rate overvaluation in the range of 6 to 9 percent. Non-price indicators continue to point towards stagnating competitiveness, despite some improvements.

1. While the real effective exchange rate appreciated, the current account (CA) deficit has shrunk. After peaking in 2013, the current account deficit has been shrinking steadily, driven by savings due to fall in oil prices since 2014, and because of a surge in remittances in 2016. As a result, the CA deficit in 2016 stood at 2.2 percent of GDP compared with 7.2 percent in 2013. Having said that, the CA deficit is likely to be higher in 2017, (2.5 percent) despite the continued buoyancy in remittances. The real effective exchange rate (REER), on the other hand, has seen a strong appreciation since 2014, of about 7 percent (most of it between 2014 and 2015), owing to the strengthening of the U.S. dollar against currencies of the trading partners. Some of this appreciation has been reversed after 2016.[1]

REER, NEER, RCPI
(2005=100)



2. The external position for 2017 is estimated to be moderately weaker than that implied by fundamentals and desirable policies. The EBA-lite estimated CA norm deficit of 5.6 percent of GDP, determined by desirable policies and current fundamentals, is larger than the CA deficit of 2.5 percent, thereby resulting in a CA gap of 3.1 percent.[2] Almost all of the gap is attributable to the residual as the contribution of policy gaps has shrunk due to the improved fiscal position and the offsetting effects of reserve and credit policy gaps. While exports have shown a strong rebound in 2017, and are back to their long-run level of 18 percent of GDP, imports, at (estimated) 38 percent of GDP, are still lower than their long-run level of 40 percent. The dramatic surge in remittances should have translated into faster import growth. However, due to the uncertainty created by changes in the U.S. immigration policy, the higher remittances are more likely to be wealth transfers driven by precautionary savings motive. As uncertainty diminishes, and remittance growth falls to its

[1] While the appreciation hurt exports (maquila exports fell by 11.4 percent in 2014 compared to 2013), the large decline in oil import bill more than offset the decline in exports. In fact, given the sustained poor performance of exports after 2011, the trade balance would have worsened in the absence of this positive oil price shock.

[2] A positive CA gap implies that the CA balance is stronger (undervalued real exchange rate) than that implied by fundamentals, while a negative CA gap implies the CA position is weaker than that implied by fundamentals (overvalued real exchange rate).

normal level, the higher base level of remittances will translate into higher imports. Therefore, applying the imports gap to their long run level as a temporary adjustment would imply an adjusted CA deficit of 4.5 percent. Additionally, the CA norm suggested by EBA-lite CA approach is high; significantly higher than that of the EBA-lite External Sustainability (ES) approach. Even in the case of stabilizing net IIP at its current level of 67.4 percent the CA norm from ES is -3.7 percent. Given the large deterioration in net IIP due to the revision of the GDP data - from a pre-revision estimate of 60 percent to a post-revision estimate of 67.4 percent for 2017 -, staff puts greater weight on external sustainability at this juncture. Considering the worsened net IIP and the long-run average of CA deficits observed, staff assesses the CA norm for the EBA-lite CA approach to be -4.4 percent - between -3.7 percent based on ES and -5.6 percent suggested by CA approach. Thus, under the adjustment scenario the CA is line with fundamentals, with a CA gap of -0.1 percent. The REER approach estimates an overvaluation of 6 percent. Finally, the ES approach, with the objective of improving the net IIP position to -50 percent, yields a CA norm of -2.5 percent and a CA gap of - 2 percent. This implies a moderately weaker external balance with an exchange rate overvaluation of 9 percent. Therefore, overall, the staff assesses the external balance to be moderately weaker than that implied by fundamentals and desirable policies, with an overvaluation of the REER in the range of 6 to 9 percent.

Current Account and Exchange Rate Assessment

				With import and norm adjustment			
	CA norm (% of GDP) 1/	CA actual (% of GDP)	CA Gap	CA norm (% of GDP)	CA actual (% of GDP)	CA Gap	REER Gap 2/
EBA-lite CA methodology	-5.6	-2.5	3.1	-4.4	-4.5	-0.1%	0.5%
	ln(REER) norm	ln(REER) actual					REER Gap
EBA-lite REER methodology	4.58	4.64					6%
	CA norm (% of GDP)	Underlying CA (% of GDP)	CA Gap				REER Gap
EBA-lite ES methodology 3/	-2.5	-4.5	-2				9%

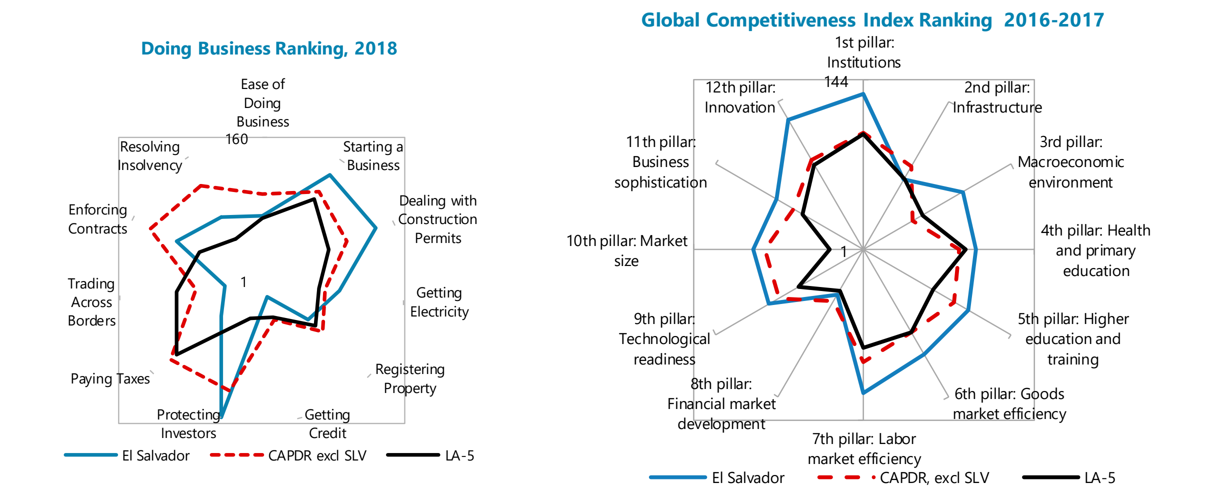
Source: Fund staff estimates and projections.

1/ Oil prices are assumed to affect the CA norm and underlying CA symmetrically

2/ Positive REER gap implies overvaluation. In the CA and ES methodologies, export elasticity: -0.44, import elasticity: 0.29.

3/ In the ES methodology the CA norm stabilizes the net IIP at the target level of -50% of GDP.

3. Non-price measures of competitiveness reveal continued stagnation on multiple fronts, despite some improvements. The Global Competitiveness ranking shows that El Salvador lags in almost every dimension compared to CAPDR and LA-5, and for institutions, human capital, innovation and labor market efficiency this gap is the widest. Though El Salvador's ranking jumped 22 notches in the 2018 Doing Business ranking produced by the World Bank, from 95 to 73, there is still substantial room for further work in reducing the difficulties in starting a business and getting construction permits.



Sources: ECLAC; and World Bank, World Development Indicators, Doing Business Indicators, and Global Competitiveness Indicators.

4. The level of export competition faced by El Salvador has increased, and in textiles, its largest export industry, El Salvador is now facing stiff competition from emerging Asian economies like Vietnam and Cambodia. Analysis of competition faced by El Salvador in exports show that during the period 2000-2014 competition with the traditional large exporters – U.S., Germany, and Japan – has declined, but competition with China has increased rapidly. Textile exports, which account for little less than half of all exports, not only face stiff competition from some of the big players like China, India and Bangladesh, but also more recently from emerging smaller Asian countries like Vietnam and Cambodia.

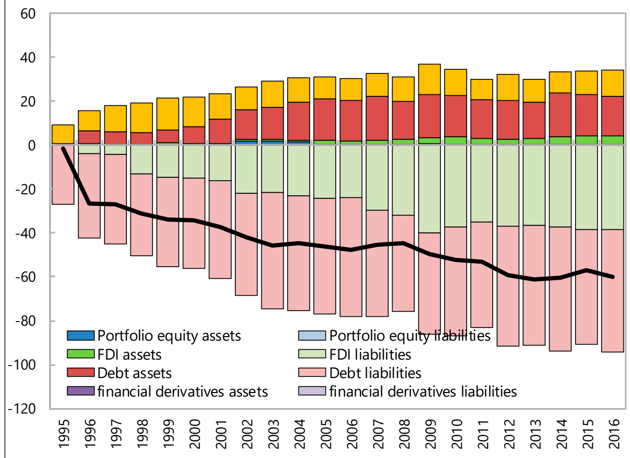
5. The increase in minimum wages could hurt competitiveness. Increases in minimum wages, by 20-80 percent, at the turn of 2016/17 could hurt competitiveness further, especially in highly competitive sectors such as maquila and non-maquila textile exporting firms.

6. The shrinking of the current account has resulted in a decline in the gross financing needs. The gross external financing requirement declined from 17.8 percent of GDP in 2013 to 13.3 percent in 2016. Going forward, it is expected to rise as the CA deficit is expected to worsen.

7. The net international investment position (IIP) continues to be at an elevated negative level - 67 percent of GDP in 2016 and 68 percent in 2017. The net IIP has deteriorated steadily since the 90s, and is projected to worsen further in the medium term as the current account deteriorates. The main components of financing in the past as well as in the medium term going forward are private and public sector debt liabilities (including the external bonds needed to finance the fiscal gap), and the capital inflows dominated by FDI liabilities.

IIP Composition, by Instrument

(In percent of GDP, based on IIP data from IMF BOPS)

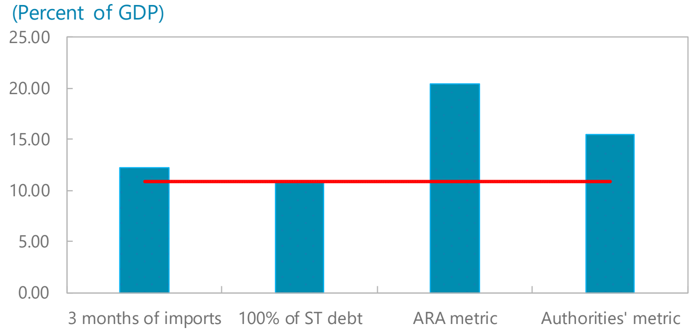


Source: IMF Balance of Payments Statistics, IMF World Economic Outlook

8. The level of international reserves is substantially lower than that implied by the risk weighted ARA metric. Reserves for El Salvador relative to the ARA benchmark peaked in 2009, in the immediate aftermath of the U.S. financial crisis. Since then they have fallen to 59 percent of the ARA benchmark level in 2017, which is lower than levels observed in 2007 and 2008. Against the traditional metrics - 3 months of import coverage and 100 percent of short term debt coverage – the level of reserves in 2017 appears to be adequate with respect to short term debt, but slightly inadequate to cover 3 months of imports. Due to dollarization, on the one hand reserves do not have the traditional role of being used for exchange rate stabilization, but on the other hand, they are going to be crucial for the central bank to credibly tackle a sudden liquidity crunch in the banking system.[3]

Reserve Adequacy Metrics, 2017

(Percent of GDP)



Sources: National authorities and Fund staff estimates.

Notes: The ARA metric for fixed exchange rate regimes is calculated as follows: 10% × Exports + 10% × Broad Money + 30% × Short-term Debt + 20% × Other Liabilities.

The Authorities' metric includes coverage of: (i) liquidity requirements and a liquidity fund, amounting to 22 percent of deposits, (ii) a newly created lender of last resort, with resources amounting to 8 percent of deposits over the medium term, and (iii) deposit insurance with 5 percent of deposits.

[3] The central bank does not have the traditional lender of last resort role in a dollarized economy since it cannot simply print money to address a sudden lack of liquidity in the banking system.

Annex III. National Accounts Revision

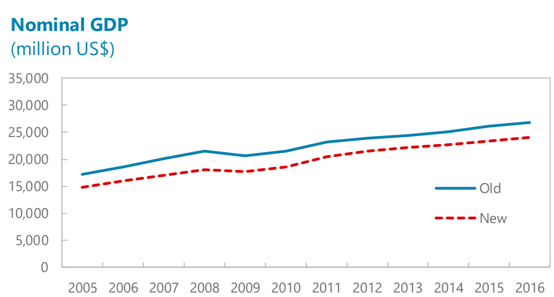
1. The revision of the national accounts represents a significant improvement over the previous series. The new series have been rebased, using 2005 as new base year. The previous 1990-based series presented several methodological deficiencies, such as (i) the use of outdated benchmark measures; (ii) poor sample coverage, (iii) outdated classifications; (iv) lack of detailed information; (v) deficient deflation methods; and (vi) biased manual imputed data. The new data revision improves both source data and methodology, including the adoption of the key recommendations of the *System of National Accounts 2008* (2008 SNA).

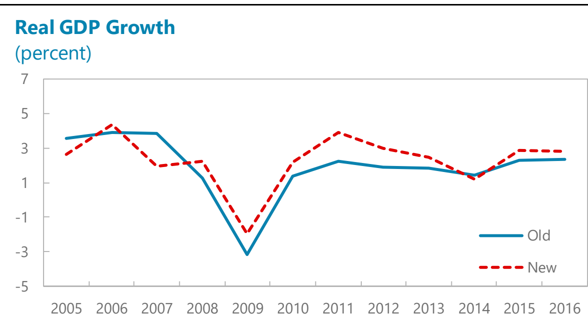
2. The national accounts update results in a downward revision to the 2016 GDP by 11 percent. The revision is explained by three key factors:

- *Overstatement of agriculture prices.* Some of the output data used for the 1990-based series were valued at market rather than at producer prices. This resulted in an overestimation of agricultural prices and value added.

- *Underestimation of intermediate consumption.* The lack of adequate information and the fixed weights methodology impeded an accurate quantification of intermediate consumption. As a result, the intermediate consumption of several activities was underestimated, inflating their value-added figures.

- *Overestimation of population*. Population data was overestimated, as revealed by the 2007 census. Therefore, some value-added estimates derived from population statistics, such as own production and imputed rents, were overstated.





Source: BCR.

3. The data revision affects key macroeconomic ratios to GDP, which are particularly important for fiscal policy. As a result of the GDP revision, the debt-to-GDP ratio rises from 63 to 71 percent, and the overall fiscal deficit deteriorates from 2.2 to 2.5 percent of GDP at end-2017. These changes would require an adjustment of the government's fiscal strategy, including the targets in the FRL.

Selected Economic Statistics

	2011	2012	2013	2014	2015	2016	2017
				Old National Accounts			
Real GDP growth (percent)	2.2	1.9	1.8	1.4	2.3	2.4	2.3
Current account balance	-4.8	-5.4	-6.5	-4.8	-3.6	-2.0	-2.3
Overall balance	-3.9	-3.9	-4.1	-3.5	-3.4	-3.0	-2.2
Public sector debt	52.2	57.3	57.6	59.2	60.1	62.0	63.0
				Revised National Accounts			
Real GDP growth (percent)	3.8	2.8	2.4	2.0	2.4	2.6	2.3
Current account balance	-5.5	-6.0	-7.2	-5.4	-4.0	-2.2	-2.5
Overall balance	-4.5	-4.3	-4.5	-3.9	-3.8	-3.4	-2.5
Public sector debt	59.5	63.8	63.8	65.6	67.6	69.5	70.6

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

INTERNATIONAL MONETARY FUND

EL SALVADOR

April 26, 2018

STAFF REPORT FOR THE 2018 ARTICLE IV CONSULTATION—INFORMATIONAL ANNEX

Prepared by: The Western Hemisphere Department

CONTENTS

FUND RELATIONS 2

RELATIONS WITH THE WORLD BANK 5

RELATIONS WITH THE INTER-AMERICAN DEVELOPMENT BANK (IADB) 8

STATISTICAL ISSUES 9

FUND RELATIONS

(As of April 10, 2018)

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	165.56	101.07

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 July 1, 2016 (Country Report No. 16/208).

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)	
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	Strengthening the taxpayer registry
	3/5/2018	Strengthening tax audits
	Customs Administration (FAD)	
FAD	4/24/2017	Risk Management in Customs
	9/28/2017	OAS program launch
	10/16/2017 4/30/2018	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
	Public Financial Management (FAD)	
FAD	10/17/2016 4/3/2017	Treasury Single Account
	4/9/2018 4/9/2018	Budget-PIMA
	3/22/2017	Workshop- Treasury Management

Department	Date Delivery	Purpose
Financial Supervision and Regulation (MCM)		
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	Insurance supervision
Central Banking (MCM)		
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)		
STA	9/18/2017	Economic Activity Volume Indicators
	2/26/2018	Monthly Activity Indicators
Government Finance Statistics (STA)		
STA	10/2/2017	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

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

RELATIONS WITH THE WORLD BANK

1. Collaboration. In the context of the joint management action plan (JMAP) for Bank-Fund collaboration, the IMF team met on several occasions with the World Bank team, comprising Mrs. Fritzi Koehler (Program Leader) and Mr. Fernando Im (Senior Country Economist), to discuss El Salvador's main macroeconomic challenges, identify macro-critical structural reforms, and coordinate the work of both teams.

2. Macroeconomic challenges. The teams have agreed that the challenges facing El Salvador are to safeguard fiscal sustainability, deepen financial reforms, and boost growth and shared prosperity. The priority is to place the public debt-to-GDP ratio on a declining path and reduce the government's financing needs. Improvements in competitiveness and the business climate are needed to unleash the growth potential of the dollarized economy and elevate standards of living.

3. Structural reforms. Based on this shared assessment, the teams have identified four macro-critical structural reform areas:

- **Fiscal sustainability.** The fiscal consolidation strategy should comprise expenditure and revenue reforms to lower the fiscal deficit, while raising infrastructure, security, and other social spending. In particular, the increase in current primary spending ratio recorded since the global crisis of 2008-09 should be reversed, including subsidies and wages, and the tax effort should be aligned with country peers. The pension system should also be put on a sound financial footing. A fiscal responsibility law, a modernized medium-term fiscal framework, and improved tax and customs administration could usefully underpin the fiscal adjustment strategy.

- **Public financial management.** The focus should be on: (i) adopting a medium-term expenditure framework; (ii) introducing a unified budget for the nonfinancial public sector; (iii) broadening coverage of autonomous and decentralized institutions; and (iv) improving cash and public debt management. By resolving these weaknesses, the authorities' ability to control public expenditure, and execute investment and other priority spending will improve.

- **Financial system.** The priority should be to strengthen its crisis preparedness and increase financial intermediation by: (i) making operational the central bank's lender-of-last-resort facility and setting up an additional liquidity fund; (ii) shifting to risk-based supervision and improving cross-border consolidated supervision; (iii) addressing deficiencies in bank resolution procedures and strengthening the deposit insurance scheme; (iv) improving the legal framework for El Salvador's capital markets; and (v) promoting broader financial deepening.

- **Competitiveness.** There is a need to boost domestic investment in El Salvador, which for many years has remained low in terms of GDP and compared to regional peers. Weaknesses in areas such as security, education, and innovation, and lack of private participation in large infrastructure projects weigh on investment and growth.

4. Division of labor. Based on this assessment, the IMF and the World Bank agreed to support the authorities' efforts in the following areas:

- **Fiscal sustainability**. The IMF (the Fund) will continue to provide advice on macro-fiscal issues, including fiscal consolidation, and technical assistance (TA) to strengthen tax collection and reduce evasion. Building upon previous TA on tax policy, the Fund support will focus on improving control of large taxpayers and enhancing auditing capacity, as well as strengthening customs control while facilitating trade through risk-management schemes.

- **Public financial management.** The Fund will further assist the authorities in implementing medium-term expenditure framework, setting up a treasury single account, and enhancing capabilities in debt sustainability analysis, and the analysis of fiscal implications of pension reforms. The World Bank is undertaking a public expenditure review. The two institutions will collaborate on improving budget procedures, including in the context of the fiscal responsibility law.

- **Financial system.** The Bank and the Fund will continue to cooperate as needed in assisting the authorities in implementing the 2010 FSAP Update and 2014 Financial Stability strategy advice. The Fund will provide assistance with norms and procedures to shift to risk-based supervision, cross-border consolidation supervision, and the liquidity policy of the central bank. The Bank completed a mission on the Developmental FSAP module in March 2016 and will continue to provide assistance in these areas, including financial sector infrastructure, public and development banks, capital markets, and insurance. The two institutions will collaborate on the financial sector aspects of the pension system and financial inclusion.

- **Competitiveness.** The Fund will also assist the authorities in strengthening the framework for public-private partnerships and managing potential fiscal risks through regional seminars. The World Bank has also been working to strengthen the legal framework for public-private partnerships and to improve the investment climate.

5. Information sharing. The teams have agreed to share information on progress in the above macro-critical structural reform areas.

6. Work programs. The following table lists the teams' work programs.

World Bank and Fund Planned Activities in Macro-Critical Structural Reform Areas			
Title	**Products**	**Provisional Timing of Missions**	**Expected Delivery Date**
World Bank Work Program	*Lending portfolio*		
	Strengthening public health care system	Ongoing	May 2018
	Education Quality Improvement Project	Ongoing	December 2018
	Advisory Services & Analytical Work		
	El Salvador Public Expenditure Review	Ongoing	June 2019
	Economic Impacts of Global Uncertainty on Central America	Ongoing	June 2018
	Migration and Remittances in the Northern Triangle	Ongoing	September 2018
	Regulation of Private Pension System	Ongoing	February 2019
	Development of Inclusive and Sound Financial Systems - Review Liquidity Framework and Financial Inclusion Strategy	Ongoing	December 2019
	Central America Support Implementation of Trade Facilitation Agreement	Ongoing	June 2019
	Central America PPP – Institutional and Regulatory Framework strengthening	Ongoing	June 2020 (expected)
IMF Work Program	Regional Conference	July 2018	July 2018
	Staff Visit	November 2018	November 2018
	Technical Assistance	2017-2018	2017-2018
	Enhancing tax auditing and strengthening custom controls	Ongoing	
	Adopting a medium-term expenditure framework; improving multi-year budgeting; and setting up a treasury single account	Ongoing	
	Following up on risk-based supervision for banks; initiating the shift to risk-based supervision for insurance and pension system; improving cross-border consolidated financial supervision	Ongoing	
	Building models for macroeconomic forecasting	Ongoing	
	Assistance on revision of national accounts	Ongoing	

RELATIONS WITH THE INTER-AMERICAN DEVELOPMENT BANK (IADB)

1. The IADB completed the last country strategy for El Salvador in 2015, for the 2015–19 period.

2. As of April 2018, the IADB has pending disbursements for US$ 327 million, which correspond to public-sector guaranteed loans that are concentrated in ten programs in seven sectors.

El Salvador: Relations with the Inter-American Development Bank

(As of April 3, 2018, in millions of U.S. dollars)

A. Operations

Sector	Commitments	Amount Disbursed	Amount Undisbursed
Human capital 1/	200.0	--	200.0
Logistics infrastructure	40.0	1.0	39.0
Public finances 1/	30.0	--	30.0
Public security	45.0	26.9	18.1
Productive development	155.0	129.2	25.8
Urban development	50.0	35.8	14.2
Other areas	45.0	44.6	0.4

1/ Loans pending of approval by the Legislative Assembly.

Loan Disbursements and Amortizations

(In millions of U.S. dollars)

	2011	2012	2013	2014	2015	2016	2017	2018p
A. Disbursements	202.8	266.1	97.3	71.8	72.4	80.7	70.1	192.4
of which PBL	*0*	*0*	*0*	*0*	*0*	*0*	*0*	*156.0*
B. Repayments	116.8	115.2	106.6	136.8	138.4	159.7	166.5	160.9
C. Net lending (A-B)	86.0	150.9	-9.3	-65.0	-66.0	-79.0	-96.4	31.5
D. Interest and charges	55.6	52.3	51.8	49.5	46.5	54.8	52.5	53.5
E. Subscriptions and contributions	1.5	2.7	1.7	1.7	15.1	0.2	2.1	2.3
F. Net cash flow (C-D-E)	28.9	95.9	-62.8	-116.2	-127.6	-134.0	-151.0	-24.3

STATISTICAL ISSUES

(As of April 2018)

I. Assessment of Data Adequacy for Surveillance
General: Data provision is adequate for surveillance.
National Accounts: The Central Reserve Bank of El Salvador disseminates rebased annual and quarterly national accounts, following the recommendations of the *System of National Accounts 1993* (*1993 SNA*), and including key recommendations from the *2008 SNA*. The series, available for 2005-17, were rebased to 2005. Quarterly national accounts compiled by the production and expenditure approaches are disseminated; in the previous system they were only compiled by the production approach. In addition, a monthly index of economic activity (IVAE), which is consistent with the quarterly and annual 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.

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.	
External Sector Statistics: Data provision is adequate.	
II. Data Standards and Quality	
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.	A data ROSC was published in December 2004.

El Salvador: Table of Common Indicators Required for Surveillance

(As of April 10, 2018)

	Date of Latest Observation (mm/yy)	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-2018	Mar-2018	M	M	M
Reserve/Base Money	Feb-2018	Mar-2018	M	M	M
Broad Money	Feb-2018	Mar-2018	M	M	M
Central Bank Balance Sheet	Feb-2018	Mar-2018	M	M	M
Consolidated Balance Sheet of the Banking System	Feb-2018	Mar-2018	M	M	M
Interest Rates[2]	Apr-2018	Apr-2018	W	W	W
Consumer Price Index	Mar-2018	Apr-2018	M	M	M
Revenue, Expenditure, Balance and Composition of Financing[3]—General Government[4]	Feb-2018	Mar-2018	M	M	M
Revenue, Expenditure, Balance and Composition of Financing[3]—Central Government	Feb-2018	Mar-2018	M	M	M
Stocks of Central Government and Central Government-Guaranteed Debt[5]	Feb-2018	Mar-2018	M	M	M
External Current Account Balance	Dec-2017	Mar-2018	Q	Q	Q
Exports and Imports of Goods and Services	Feb-2018	Mar-2018	M	M	M
GDP/GNP	Dec-2017	Mar-2018	Q	Q	Q
Gross External Debt	Dec-2017	Mar-2018	Q	Q	Q
International Investment Position[6]	Dec-2017	Mar-2018	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 Mr. Carlos Hurtado, Executive Director for El Salvador
May 11, 2018

On behalf of our Salvadoran authorities, we would like to thank staff for a candid and rich dialogue during the 2017 Article IV consultation. The authorities appreciate the rigorous analysis of the Salvadoran situation, and express their gratitude for the recommendations. However, they consider that stressing more the authorities' efforts and favorable results, without losing objectivity, would be more constructive and send a clearer message of confidence to markets and potential investors. While broadly agreeing with the thrust of the report, we would like to emphasize the following issues:

Recent Developments

The economy continued to grow in 2017, reaching a slightly higher rate than in 2016; while helped by low oil prices, higher external demand and a recent surge in remittances, it was also driven by internal factors such as household consumption and private investment dynamism. The sectors with more dynamic growth were manufacturing, transportation, commerce, financial services and construction. Inflation continued contained at 2.0 percent Corporate credit accelerated in 2017 and continue to grow faster than consumption credit (7.3 percent and 4.2 percent respectively). During the first quarter of 2018, credit to the private sector grew at a year-to year-rate of 7.6 percent. El Salvador´s exports increased 7.9 percent in 2017, after decreasing in 2016 (-1.4 percent). Net foreign direct investments almost doubled the accounted in 2016, with manufacturing industry as the main recipient. The current account deficit narrowed further to 2.0 percent. The authorities forecast an economic growth of about 2.5 percent this year, driven by a more dynamic internal demand and the higher economic growth expected for El Salvador´s main commercial partners (United States and Central American countries) which will stimulate the external demand.

New National Accounts

New accounts, updated with support from the IMF's Statistics Department and CAPTAC-DR, have been rebased, using 2005 as new base year, and represent a significant improvement over the previous series in both source data and methodology, including the adoption of the main recommendations of the System of National Accounts 2008. The updated accounts resulted in a downward revision to the 2016 GDP of around 11 percent which modified various macroeconomic ratios to GDP such as the fiscal deficit, financial deepening and debt. Therefore, it is very important to bear in mind that the new ratios do not respond to a macroeconomic deterioration but rather to the authorities' commitment to enhance the quality and transparency of statistics which will help to improve macroeconomic assessment and policy decision making. The new statistics were published in March 2018.

Political Agreements

Since the last article IV, the government has made considerable efforts to achieve political agreements that pave the way to advance in crucial topics for the country's development and growth: a) the pension system reform: this initiative got large consensus from different sectors and was approved by a qualified majority in Congress; b) the approval of the Fiscal Responsibility Law, which establishes the basis to maintain fiscal discipline; and c) the approval of the 2018 budget.

Fiscal Consolidation and Debt Sustainability

The authorities have made a considerable effort to improve the fiscal situation through both improving revenues and containing expenditures; these measures allowed for a fiscal deficit decline from 3.4 percent in 2016 to 2.5 percent in 2017 with the primary balance improving from -0.3 percent to a surplus of 0.9 percent. The pension reform approved in September last year will contribute to an additional reduction in the fiscal deficit to GDP ratio in the order of 0.8-1.0 percent per year and to debt service and principal payments relief. Moreover, debt has stabilized which has been a major achievement after several years of an increasing trend. The authorities are also working on a proposal to calibrate the Fiscal Responsibility Law (with support from the World Bank) in line with IMF's recommendations.

While the authorities acknowledge that additional adjustment is needed to gradually place debt on a declining path, they consider that the adjustment proposed by staff of 2 additional points in two years can negatively impact investment and growth and damage social expenditures. They believe the speed of the adjustment needs to be more carefully analyzed considering its impact in economic growth and social reality of El Salvador. Given the current political conjuncture, with presidential elections taking place early next year, efforts for fiscal consolidation in 2018 will concentrate on fighting fiscal evasion through continued strengthening of tax administration (including the introduction of electronic invoice for large taxpayers) and further rationalization of spending, particularly through the implementation of a programmatic and result-based budgeting approach. The authorities will also advance in the drafting of some additional revenue and expenditure proposals to be discussed with the new administration's team during the transition period.

The government has continued to work strongly to get the political consensus for a medium-term financing framework for 2019-2024 since Eurobond maturities are concentrated on these years; they intend to send the proposal to Congress shortly, looking for its approval early in the second semester. The agreement includes an IDB loan for the 2018-2019 financial gap, which would allow to reduce the cost of financing. Finally, given that remittances in El Salvador are a large and stable inflow, the authorities consider it would be more appropriate to assess debt sustainability by relating debt to disposable national income rather than to GDP.

Financial Stability

The banking system is sound and there is noticeable progress in risk-based supervision and financial inclusion with the normative for the Law to Facilitate Financial Inclusion completed in November 2016; the Financial Sector Superintendence (FSS) has also made substantial progress in consolidated and cross border supervision. The crisis management and bank resolution law is well advanced; the central bank and the FSS are working together in order to send the draft bill to the Legal and Legislative Affairs Secretariat of the Presidency during the third quarter of the present year.

About the AML/CFT, El Salvador carried out a continuous process of reforms to the regulatory framework between 2013- 2016 and issued the Instructions for the Financial Investigation Unit for the Prevention of Money Laundering. In addition, the Central Reserve Bank (BCR) approved the Technical Standards (TS) for Risk Management of Money Laundering and Terrorist Financing, which includes the application of a risk-based administration. With the issuance of this TS, the identification of the final beneficiary for companies was regulated, establishing the responsibility to identify a natural person with equity property greater than or equal to 10 percent. The BCR also approved the TS for the registration, obligations and -operation of entities that are dedicated to sending or receiving money transactions in which parameters and requirements were established for such entities, including requirements for compliance with AML /CFT and the minimum information that should be requested to identify clients or users.

Policies to Foster Higher Growth

Even though the economy has grown in a sustainable way in the past years and the country improved 22 notches in the 2017 Doing Business, the authorities recognize the important challenges ahead to grow at faster, more sustainable and inclusive rates; they are aware of the need to enhance investment in health, education and public infrastructure. To this end, the government's policy is based on a quinquennial plan centered on a productive transformation strategy which includes ongoing projects such as: a) transforming the energetic matrix towards renewable sources, with a large project of natural gas starting operations in 2019; b) supporting agroindustry and developing infrastructure which includes the expansion of the international airport to improve connectivity and the logistics platform; c) strengthening trade, through the well advanced adherence to the Guatemala-Honduras customs union and the trade agreement signed with South Korea. The custom union will facilitate trade, amplify gains from CAFTA and provide easier access to ports. The trade pillar of the EU-Central American Association Agreement will remain supportive to growth.

The authorities are aware of the need to expedite procedures and eliminate red tape to promote private investment. To this purpose, the government has created the regulatory improvement agency and a law to simplify administrative procedures was adopted in December last year; two projects are being implemented in private public partnership modality (PPP): a) upgrading the cargo terminal of the international airport, developed under Fomilenio II, and b) lighting and video surveillance equipment on 140km of highways in the metropolitan area of the capital San Salvador. A bill proposal was sent to Congress to reform the tax on financial transactions with the aim of increasing taxation efficiency.

The government launched last April the Plan 10, with the purpose to boost public and private investment and improve population's wellbeing; economic, fiscal, security, social protection and environment are the prioritized areas and a monitoring system of performance and execution to ensure compliance has been established with full involvement of the cabinet.

Policies to improve security and reduce crime

The government has adopted the plan "El Salvador Seguro", which comprises five pillars: (i) prevention of violence; (ii) control and criminal prosecution; (iii) reinsertion and rehabilitation; (iv) victims' attention and protection and (v) institutional strengthening. As of August 2017, more than 60 percent of the total contemplated actions have been achieved and, since January 2015, crime has declined 17 percent.

The authorities are committed to continue implementing a comprehensive strategy by promoting and adopting the necessary reforms to improve the country's competitiveness and growth potential, to consolidate public finance and debt sustainability, to tackle crime and corruption and to protect the most vulnerable population.