El Salvador

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Last Updated: Jan 2016

First Citizens
Research & Analytics

COUNTRY

Real GDP growth (%) 2015	2.80%	Central Bank
Real GDP growth (%) 2016	2.50%	IMF
Exchange Rate (USD/SVC)	8.72	
FX Direction	fixed	

CREDIT RATING

S&P Foreign Currency	B+ (Stable)
Fitch Foreign Currency	B+ (Stable)
Moody's Foreign Currency Debt	Ba3 (Negative)

TRADE

Partners:	US 47.3%, Guatemala 13.8%, Honduras 9.6%, Nicaragua 5.4%
Exports	Offshore assembly exports, coffee, sugar, textiles and apparel, gold
Foreign Reserves	US 2,827.2 m
Reserve Direction	Appears to be stabalizing. Sold gold in April
Import Cover	3 months
Direction	stable to declining

INFLATION

Target Rate		
Current Month (y/y)	1.00%	Dec
Direction		
Forecast 2015	-0.80%	

POLICY INTEREST RATE

Target Rate	-
Current Rate	-
Direction	-
Last Year 2014	-

dollarized

FISCAL

Budget Deficit (%) 2014	3.6%
Deficit Trend	
Debt/GDP	59%
Debt Direction	

POLITICAL

Last Election	Jul-05
Next Election	
Term	
Other	Mid Term (Mar 2015)

ECONOMIC OUTLOOK

The economy of El Salvador expanded by 2.6% in the third quarter, following growth of 2.4% and 2.8% in the second and first quarters of 2015. Growth in the full year is forecast between 2.1% and 2.8% on stronger domestic demand, cheaper oil and more private investment (Fitch: 2.5%). In terms of structure, manufacturing (23% of GDP) and tourism (20% of GDP) are the two largest sectors of the economy, followed by agriculture/fishing (12%) and logistics (10%). Remittances from migrant workers (principally US) are a significant driver of growth in El Salvador, accounting for 17% of GDP and is an important source of foreign exchange and is acutally equivalent to export income. Remittances increased 6.1% (y/y) in Dec 2015. Crime is a major deterrent to development in the country with high levels of gang activity, murders and narcotics trading.

INFLATION
MONETARY POLICY

El Salvador's inflation rate has slowed substantially and is presently negative, indicative of weak internal demand. The most recent figures indicate inflation was 1.0% in Dec 2015.

Dollarization limits the central bank's monetary policy, resorting mainly to adjusting reserve requirements or issuing debt to manage liquidity.

According to S&P, the banking system is well capitalized with the top five banks accounting for 80% of total assets in the system. Consumer lending accounts for 31% of loans with household loans accounting for 23%. Nonperforming loans were reported at 2.5% of total loans in late 2014 with 40% of all NPLs originating in the housing sector.

TRADE BALANCE/ BOP

The United States is El Salvador's single largest market, accounting for just under half of all exports and is comprised mainly of textiles, coffee and agricultural products. El Salvador is expected to have operated a current account deficit of 5% of GDP in 2014 but the deficit should narrow in 2015 and 2016 as a stronger US economy bolsters remittances and export growth, while lower oil prices lower the country's import burden. El Salvador receives as much foreign currency from remittances as it does from exports (it accounts for 1/6th of GDP). The current account deficit is estimated at 3.7% of GDP in 2015 and 2.9% of GDP in 2016.

Capital account inflows are expected to exceed the deficit in 2014 and support foreign reserve growth. International reserves stood at USD2.8 billion in Sep 2015, providing an estimated 2.8 months of import coverage.

FISCAL ACCOUNTS

El Salvador is estimated to have operated a budget deficit of 3.6% of GDP in 2014. The government has introduced new corporate taxation measures which, when fully implemented in fiscal 2016, is expected to increase tax revenues by 0.4% of GDP.

General Government Debt is forecasted to end at 59% of GDP in 2015 (Fitch: 52%) and servicing costs are relatively high at 12% of revenue. S&P estimates that 70% of government debt is externally held. Fitch projects that the country's debt load will rise to 65% of GDP by 2017 unless economic growth can be stimulated and appropriate fiscal consolidation is undertaken.

A proposed fiscal responsibility framework (FRF) has not yet been approved by legislature but seeks to achieve primary balances, limit current expenditure and wages, and reducing nonfinancial public sector debt. The bill will increase tax revenue to 17% of GDP and cut public debt to less than 42% of GDP from about 60%.

Fitch Ratings downgraded its sovereign rating of El Salvador from BB- to B+ in July 2015 based on their rising debt burden and poor growth. In November 2015, Moody's changed it's rating outlook to negative.

POLITICAL

Following contentious midterm elections in March 2015, the ruling Farabundo Marti National Liberation Front (FMLN) attained the highest number of votes overall but, in terms of seats, lost the elections to the Nationalist Republican Alliance (ARENA). The loss of majority in the legislature will make it difficult to pass needed reforms.

KEY ISSUES

>Downgraded by Fitch in July 2015.
>Crime. Activity by the Mara Salvatrucha (MS-13) and Barrio18 gangs results in one of the highest homicide rates in the world.
>Remittances, principally from the US, are an important part of the El Salvador economy. Remittance outlook set to improve.
>Limited control of monetary environment.
>Proposed fiscal limits. If passed, ratings could benefit.

BUSINESS ENVIRONMENT

El Salvador continues to perform poorly in terms of social stability and external threats, reflecting high rates of underemployment, a substantial impoverished population and high incidence of drug-trafficking and gang-related violence. El Salvador's trade regulations and procedures and its transport network as superior to its regional counterparts, though this is partially due to the small size of the country which aids metrics like road density. As with the rest of the Northern Triangle (including El Salvador, Honduras and Guatemala), high levels of criminal violence remain a significant deterrent to investment.

OUTLOOK

Rated as it is on the threshold of a speculative grade credit rating, El Salvador's weak fiscal position and struggling economy places it in a precarious position. While the US recovery will aid in export and remittance growth, First Citizens Research & Analytics holds a cautious view on El Salvador.