EL SALVADOR

Table 1	2020
Population, million	6.5
GDP, current US$ billion	25.0
GDP per capita, current US$	3854.5
International poverty rate ($1.9)[a]	1.3
Lower middle-income poverty rate ($3.2)[a]	5.7
Upper middle-income poverty rate ($5.5)[a]	22.3
Gini index[a]	38.8
School enrollment, primary (% gross)[b]	94.8
Life expectancy at birth, years[b]	73.1

Source: WDI, Macro Poverty Outlook, and official data.
Notes:
(a) Most recent value (2019), 2011 PPPs.
(b) Most recent WDI value (2018).

El Salvador succeeded in containing the worst effects of the COVID-19 crisis, but at high macroeconomic and fiscal cost, due to fiscal vulnerabilities accrued before the crisis and the generosity of the government fiscal response, which was mostly financed by debt. A large fiscal consolidation is required and the challenge will be to manage it, while also fostering economic recovery and mitigating the continued social and poverty impact of COVID-19 pandemic.

Key conditions and challenges

El Salvador grew at a slow but steady pace – 2.4 percent – from 2015 to 2019. Declining productivity, which has contracted by 0.6 percent a year on average since 2000, was the main reason behind low growth. Poverty and inequality have been declining despite the slow growth. Poverty ($5.50 a day) declined from 32.6 percent in 2015 to 22.3 percent in 2019. Labor income, particularly labor earning, has been the main driver behind poverty reduction. Inequality measured by the Gini Index reached 0.388 percent in 2019, the lowest level in Latin America and the Caribbean (LAC). Moreover, the country has the highest rate of vulnerability in LAC with 48.2 percent of households vulnerable to poverty (daily income between 5.5 USD and 13 USD) in 2019.

The country succeeded in containing the impact of the first waves of the COVID-19 pandemic, but cases accelerated towards the end of 2020. Vaccination is at an early stage but should be deployed more widely in mid-2021. The pandemic has increased poverty by an estimated 4.5 percentage points and shrank GDP in 2020. Unlike other crises, remittances increased by 4.8 percent in 2020, boosted by the reopening of the US economy, and government transfers to Salvadorean households in US.

El Salvador entered the pandemic with a fragile fiscal situation – the largest debt (73.3 percent of GDP) and the third largest budget deficit (-3.0 percent of GDP) in Central America. The fiscal response to the COVID-19 crisis was the most generous in LAC (15.5 percent of GDP) and financed mostly by debt, but not necessarily well targeted, and therefore, with relatively limited poverty impact.

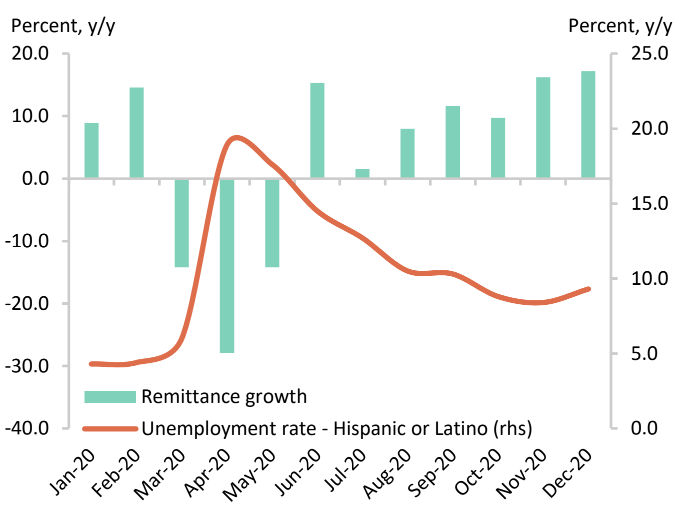
The greatest medium-term challenges El Salvador face are to meet its gross financing needs, put its finances back on a fiscally sustainable path; and mitigate social and poverty impacts of the COVID-19 pandemic in a tight fiscal environment.

Recent developments

The COVID-19 crisis reduced GDP by an estimated 8.6 percent in 2020 with construction and services taking the biggest hit. Reduced economic activity, lower commodity prices and resilient remittances lowered the current account deficit from 2.1 percent of GDP in 2019 to 1.4 in 2020.

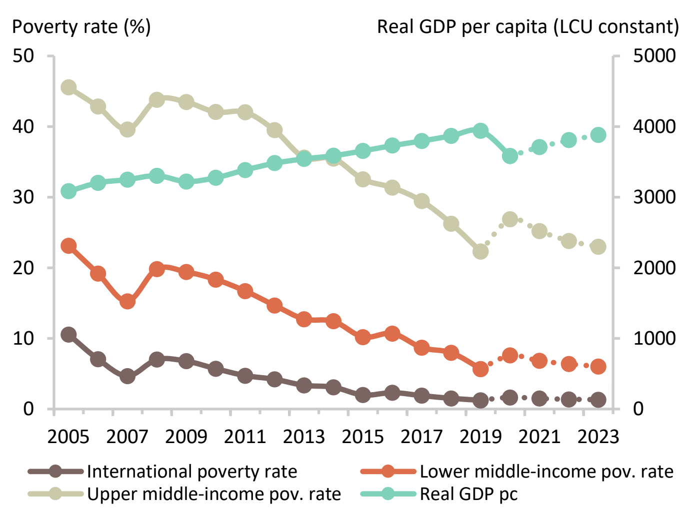
The approved 2021 budget failed to shift fiscal policy in the right direction, as the approved overall deficit is around five percent of GDP. It includes wage increases for teachers, police and health workers, and a 46 percent increase in the minimum pension, fueling pension system imbalances. In addition, it is unclear how the arrears built in 2020 will be cleared, including transfers to municipalities and VAT refunds. Once the new parliament is seated, the government is likely to propose a budget amendment, aiming at reducing refinancing risks and start a fiscal consolidation process.

FIGURE 1 El Salvador / Growth in remittances to El Salvador and hispanic unemployment rate in the United States



Sources: Banco Central de Reserva de El Salvador, Bureau of Labor Statistics.

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



Sources: World Bank. Notes: see Table 2.

The COVID-19 crisis has brought substantial employment losses in El Salvador, but some recovery has been observed recently. About 16 percent of adults reported losing their employment since the beginning of the crisis in May 2020, compared to only 11.3 percent in October 2020. Job losses are concentrated in the service sector and among low-skilled individuals. Job recovery has been uneven, with men regaining employment faster than women. Remittances are not likely to compensate for income losses at the bottom, as only eight percent of the poor received remittances in 2018.
The COVID-19 crisis is estimated to have pushed between 0.25 and 0.5 million additional people into poverty in 2020. Simulations show that poverty (using the $5.5 poverty line) is expected to increase up to 4.5 percentage points, but reduced to 2.8 percentage points after government mitigation measures are considered. The most affected are expected to be informal and self-employed workers, mostly concentrated in services. Inequality is expected to increase (from a 0.388 Gini in 2019 to a 0.39 in 2020 without government measures).

Outlook

El Salvador's economy is expected to grow around four percent in 2021, helped by a base effect, vaccination campaign, and fewer mobility restrictions. The rebound in the US economy, together with a new round of fiscal stimulus in the US, is expected to support an increase in Salvadoran exports and remittances, which in turn is projected to underpin an increase in private consumption. Growth will then converge to its long-term rate of around 2.5 percent, while the current account deficit will increase, reflecting higher growth through higher imports and higher commodity prices. Inflation will remain controlled around 1 percent a year. Given the growth rebound, poverty in 2021 is expected to fall, but at a slower rate.

The fiscal deficit is expected to come down in 2021 as extraordinary expenditures triggered by the COVID-19 crisis will be phased out. However, without a fiscal policy correction, spending levels will steadily increase driven by automatic wage increases (escalafón) and higher debt service, while revenues are expected to remain stable around 20 percent of GDP. In this scenario, the fiscal deficit and debt ratio are expected to increase again starting in 2022, threatening fiscal sustainability.
The result of the recent legislative and municipal elections, in which government-aligned parties gained seats, might pave the way for fiscal consolidation and growth reforms and an eventual IMF program to anchor them. The main medium-term risks are a faltering commitment to fiscal consolidation, securing enough resources from markets and multilateral organizations to meet gross financing needs, and inability to stage economic recovery and poverty reduction.

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

	2018	2019	2020 e	2021 f	2022 f	2023 f
Real GDP growth, at constant market prices	2.4	2.4	-8.6	4.1	3.1	2.4
Private Consumption	3.1	2.6	-8.0	6.2	2.8	2.7
Government Consumption	0.2	-0.2	6.0	1.8	2.4	3.7
Gross Fixed Capital Investment	6.7	9.6	-19.2	2.4	9.4	2.1
Exports, Goods and Services	2.2	6.5	-18.3	6.6	4.2	3.1
Imports, Goods and Services	5.5	3.8	-10.2	7.8	5.0	3.4
Real GDP growth, at constant factor prices	2.3	2.6	-8.6	4.1	3.1	2.4
Agriculture	-3.3	3.0	-2.0	3.0	2.1	2.1
Industry	2.9	4.0	-9.0	4.0	3.2	2.3
Services	2.6	2.0	-9.1	4.3	3.2	2.5
Inflation (Consumer Price Index)	1.1	0.1	0.1	0.6	1.1	1.1
Current Account Balance (% of GDP)	-4.7	-2.1	-1.4	-2.1	-2.7	-3.1
Net Foreign Direct Investment (% of GDP)	3.2	2.4	0.6	2.2	2.4	2.6
Fiscal Balance (% of GDP)[a]	-2.6	-3.0	-9.1	-5.7	-6.3	-7.4
Debt (% of GDP)[b]	72.7	73.3	88.3	89.1	91.1	94.8
Primary Balance (% of GDP)[a]	1.0	0.7	-4.8	-1.7	-1.8	-2.3
International poverty rate ($1.9 in 2011 PPP)[c,d]	1.5	1.3	1.7	1.5	1.4	1.3
Lower middle-income poverty rate ($3.2 in 2011 PPP)[c,d]	8.0	5.7	7.6	6.8	6.4	6.0
Upper middle-income poverty rate ($5.5 in 2011 PPP)[c,d]	26.3	22.3	26.9	25.2	23.8	23.0

Source: World Bank, Poverty & Equity and Macroeconomics, Trade & Investment Global Practices.
Notes: e = estimate. f = forecast.
(a) Fiscal and Primary Balance correspond to the non-financial public sector.
(b) Debt is total public debt.
(c) Calculations based on SEDLAC harmonization, using 2019-EHPM .Actual data: 2019. Nowcast: 2019-2020. Forecast are from 2021to 2023.
(d) Projection using neutral distribution (2019) with pass-through = 1 based on GDP per capita in constant LCU.