

**EXECUTIVE
BOARD
MEETING**

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To: Members of the Executive Board

From: The Secretary

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***At the time of circulation of this paper to the Board, the authorities have indicated that they need more time to consider whether they will consent to the Fund's publication of this paper. Publication will only proceed upon the receipt by the Fund of the member's explicit consent.**



EL SALVADOR

STAFF REPORT FOR THE 2021 ARTICLE IV CONSULTATION

January 3, 2022

KEY ISSUES

Political Context. President Bukele took office in June 2019 on an inclusive growth and anti-corruption agenda, and his party gained super-majority in the Legislative Assembly (LA) in May 2021.

Economic Context. The pandemic interrupted ten years of growth, but El Salvador is rebounding quickly. Robust external demand, resilient remittances, and a sound management of the pandemic—with the help of a disbursement under the Rapid Financing Instrument (RFI) (SDR287.2 million or US\$389 million) approved in April 2020—are supporting a strong recovery. Persistent fiscal deficits and high debt service are leading to large and increasing gross fiscal financing needs.

Policies. The discussions focused on the policies needed to secure inclusive growth, fiscal sustainability, and financial stability:

- *Inclusive growth:* Efforts to support growth should focus on continuing to reduce crime, reducing electricity costs, and fostering economic diversification. Better targeting social spending, and prioritizing infrastructure projects are critical to ensure inclusive growth by creating fiscal space without increasing risks.
- *Fiscal:* A well-articulated fiscal consolidation strategy should be anchored in a medium-term framework consisting of permanent measures to help restore fiscal sustainability.
- *Financial stability:* Continuing to closely monitor the unwinding of emergency pandemic measures, maintaining a strong liquidity management system, and advancing towards a risk-based financial supervision would maintain financial stability.
- *Governance:* Economic governance measures are critical to support public confidence and consolidation, and help contain borrowing costs. In this respect, fiscal transparency, and accountability, including on extrabudgetary funds, should be strengthened, and anti-corruption and AML/CFT frameworks should be aligned with international standards.

- *Bitcoin*: Efforts to improve financial inclusion are welcome, but Bitcoin use carries significant risks and Bitcoin should not be used as an official currency with legal tender status. Narrowing the scope of the Bitcoin law will contain some of the macroeconomic risks. Strict regulation and supervisory oversight are needed to mitigate remaining fiscal, financial integrity and financial stability risks.

Risks. The risks to the outlook are sizeable, stemming from high uncertainty regarding the course of the pandemic, and resulting global economic and financial conditions. On the domestic side, delays in addressing El Salvador's economic challenges, including with respect to fiscal policy, governance, and reforms to support inclusive growth, or closing the gaps in the oversight of Bitcoin could undermine fiscal sustainability and financial stability.

Approved By
**Julie Kozack (WHD) and
 Geremia Palomba (SPR)**

Discussions took place virtually during April 6-21, and November 10–22, 2021, and in person at IMF Headquarters in Washington D.C. during November 8-10, 2021. The staff team comprised Alina Carare (head), Javier Kapsoli, Yorbol Yakhshilikov (all WHD), Laura Doherty and Lorena Rivero del Paso (FAD), Jaime Ponce (MCM), Burcu Hacibedel and Juan Francisco Yépez (SPR). Metodij Hadzi-Vaskov, Regional Resident Representative, and Edgar Cartagena (OED) joined the missions. Julie Kozack (WHD) and Executive Director Pablo Moreno participated in some meetings. Justin Lesniak, Soungbe Coquillat, Heidi Canelas, Madina Toshmuhamedova and Sean Thomas (all WHD) supported the team. Given the virtual setting, TA experts from functional departments joined some of the technical meetings as warranted.

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Glossary

AML	Anti-Money Laundering
AFPs	Administradoras de Fondos de Pensiones
ARA	Assessing Reserve Adequacy
BCR	Central Bank (Banco Central de Reserva)
CABEI	Central American Bank for Economic Integration
CAF	Corporación Andina de Fomento
CAPTAC-DR	Central America, Panama, and Dominican Republic-Technical Assistance Center
CEL	Comisión Ejecutiva Hidroeléctrica de Río Lempa
CICIES	International Commission Against Impunity in El Salvador
CID	Interdisciplinary Development Consultants
CIP	Certificado de Inversión Previsional
CIT	Corporate Income Tax
CFT	Combating Terrorist Financing
CGS	Cuenta de Garantía Solidaria
CPMI-IOSCO	Committee on Payments and Market Infrastructure - International Organization of Securities Commissions
CoA	Court of Accounts
COVID	Coronavirus Disease
DOM	Dirección de Obras Municipales
DSA	Debt Sustainability Analysis
ELA	Emergency Liquidity Assistance
EMBI	Emerging Markets Bond Index
EMEs	Emerging Market Economies
ESA	External Sector Assessment
FATF	Financial Action Task Force
FDI	Foreign Direct Investment
FODES	Fondo para el Desarrollo Económico y Social de los Municipios de El Salvador
FOP	Fideicomiso de Obligaciones Previsionales
FOPROMID	Fondo de Protección Civil, Prevención y Mitigación de Desastres
FRL	Fiscal Responsibility Law
GAFILAT	Financial Action Task Force of Latin America
GDP	Gross domestic product
GFSR	Global Financial Stability Report
GFSM	Government Finance Statistics Manual
GIR	Gross International Reserves
GSMA	The Groupe Speciale Mobile Association
IADB	Inter-American Development Bank

ICU	Intensive Care Unit
IFC	International Finance Corporation
IFIs	International Financial Institutions
IFRS	International Financial Reporting Standards
IMF	International Monetary Fund
KYC	Know Your Customer
LA	Legislative Assembly
LAC	Latin America and the Caribbean
LCR	Liquidity Coverage Ratio
MoF	Ministry of Finance
MoU	Memorandum of Understanding
MPG	Minimum Pension Guarantee
MTEF	Medium-Term Expenditure Framework
MTFF	Medium-Term Fiscal Framework
NIIP	Net International Investment Position
NSFR	Net Stable Funding Ratio
NFPS	Non-Financial Public Sector
NPLs	Non-Performing Loans
OAS	Organization of American States
OGP	Open Government Partnership
PAYG	Pay-As-You-Go
PEPs	Publicly Exposed Persons
PFM	Public Financial Management
PPE	Personal Protective Equipment
PPPs	Public Private Partnerships
REER	Real Effective Exchange Rate
RFI	Rapid Financing Instrument
SAFI	Sistema de Administración Financiera Integrada
SDR	Special Drawing Rights
SMEs	Small and Mid-size Enterprises
SOEs	State-Owned Enterprises
TA	Technical Assistance
UN	United Nations
UNCAC	United Nations Convention Against Corruption
VAT	Value Added Tax
WB	World Bank

CONTEXT

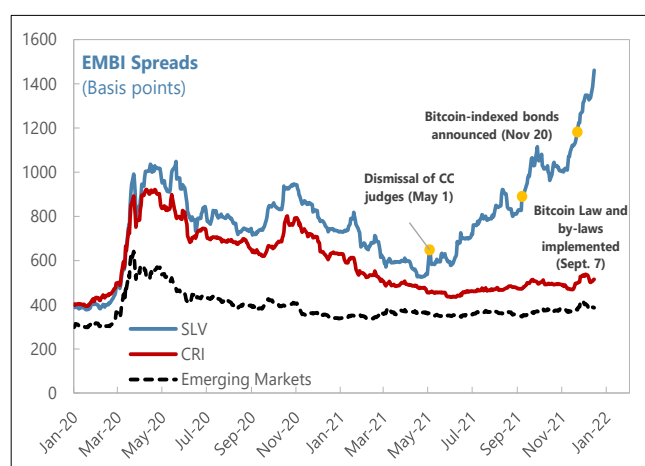
1. Pre-pandemic, the economy had a long stretch of inclusive growth that coincided with macroeconomic and financial stability. In the past two decades the economy grew on average 2¼ percent and inequality and poverty declined (the latter to 22.8 percent pre-pandemic, household survey) (Figure 1). However, growth remained below regional peers, primarily due to low investment rates, and it was insufficient to generate enough formal jobs. Banks maintained sound balance sheets and high liquidity buffers, but financial inclusion remained low.

2. Against this backdrop, public debt vulnerabilities emerged. Despite an improvement in the primary fiscal balance by 2¾ percent of GDP over 2013–18, public debt continued to rise due to unfavorable debt dynamics and unaddressed fiscal structural issues. Fiscal deficits were financed increasingly by Eurobonds, with average coupon rates double the nominal growth rate of the economy. Pension costs—stemming from the 1998 reform—increased, adding to the large stock of public debt (71 percent of GDP by end-2019, including pensions).

3. President Bukele was elected in 2019 on an inclusive growth and anti-corruption agenda, marking a break from the two-party system that has dominated El Salvador politics since the end of the civil war in 1992. In his first two years of a five-year mandate President Bukele enjoyed high approval ratings (over 85 percent, CID Gallup), while governing with limited support in the LA (11 out of 84 seats).

4. The authorities’ response to the COVID-19 pandemic was timely and effective, but public debt vulnerabilities increased, nonetheless. The immediate deterioration of the fiscal position at the onset of the pandemic created a sizable financing gap. Delays in the LA’s approval of the use of funds contracted from international financial institutions (IADB and CABEL)—and catalyzed by the disbursement of the RFI in April 2020—necessitated recourse to expensive market financing, which further elevated public debt by almost 20 percentage points of GDP in 2020.

5. More recently, concerns about the overall direction of policies led to a significant increase in El Salvador’s sovereign risk premium. In May 2021, President Bukele’s *Nuevas Ideas* party gained a supermajority in the LA, with an agenda focused on social issues and “building a free El Salvador”. The new Assembly swiftly overhauled the judicial system, and enacted legislation to adopt Bitcoin as legal tender. Reflecting high and rising gross fiscal financing needs starting in 2022, and

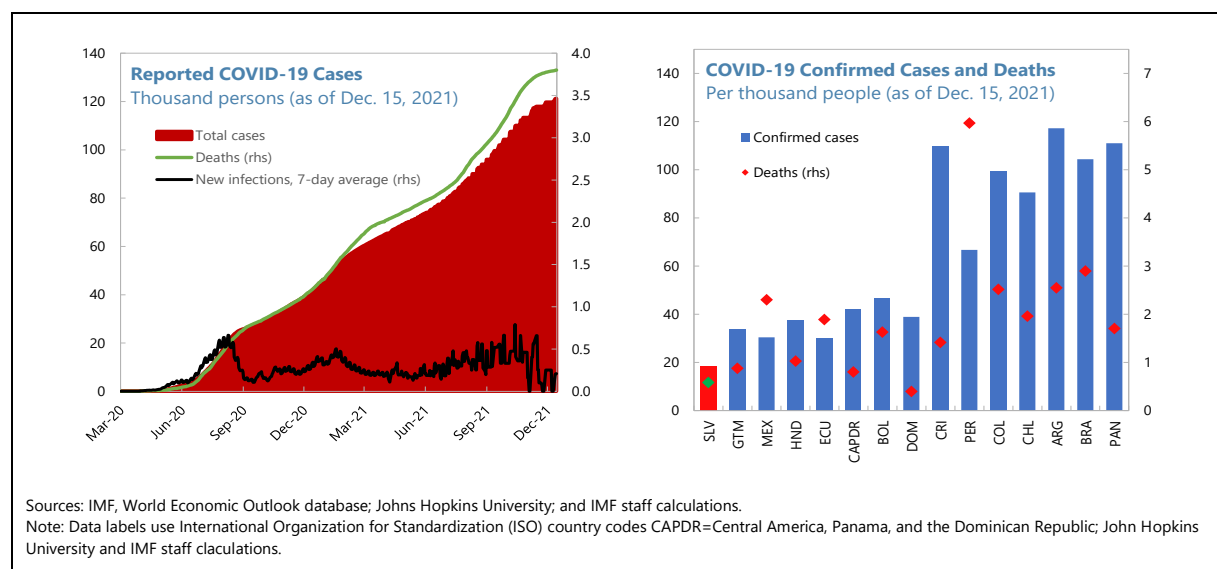


uncertainty of the course of policies, the EMBI spreads reached 1,400 basis points, by early-December 2021, with ten-year bond yields over 15 percent. The sovereign's credit rating was downgraded by Moody's from B3 (highly speculative) to Caa1 (substantial risk) in end-July 2021, with a negative outlook.

RECENT DEVELOPMENTS

A. The Pandemic

6. The authorities implemented timely and comprehensive measures to contain the COVID-19 pandemic. The economy fully reopened only at the end of September 2020, six months after the initial lockdown. During this period, testing and ICU capacity ramped up quickly, containing the spread of the pandemic. Due to the timely and effective public health response, El Salvador—one of the most densely populated countries in Latin America—had one of the lowest rates of recorded cases and fatalities in the region (1,860 and 58 respectively per 100,000 people as of December 15, 2021, text charts). Vaccinations started in February 2021 and advanced rapidly (with 69 percent of population full vaccinated by December 13, 2021).



7. The initial shock was large, but the recovery was swift, led by external demand. In 2020Q2 the economy suffered large shocks: the strict and lengthy lockdown, and two tropical storms, which adversely affected domestic demand, while exports and remittances plunged precipitously. Nominal exports recovered quickly, supported by external demand, and a rapid reorientation of the *maquila* towards demand from the health sector for personal protective equipment (PPE). For the year, the trade balance improved, as the import bill, twice as large as the export bill, suffered a large contraction. Overall, in 2020 the current account swung into a small surplus and real GDP contracted.

8. The implementation of two fiscal packages supported the fight against the pandemic and the economic recovery, but also led to a considerable increase in debt. The authorities approved and partially implemented two fiscal packages, amounting to US\$3 billion, about 12 percent of GDP (text table).¹ The large spending packages worsened the overall fiscal position by about 5 percent of GDP (to 8¼ percent of GDP). Public debt (including pensions) increased by 18 percentage points of GDP to 89 percent of GDP (Annex II).

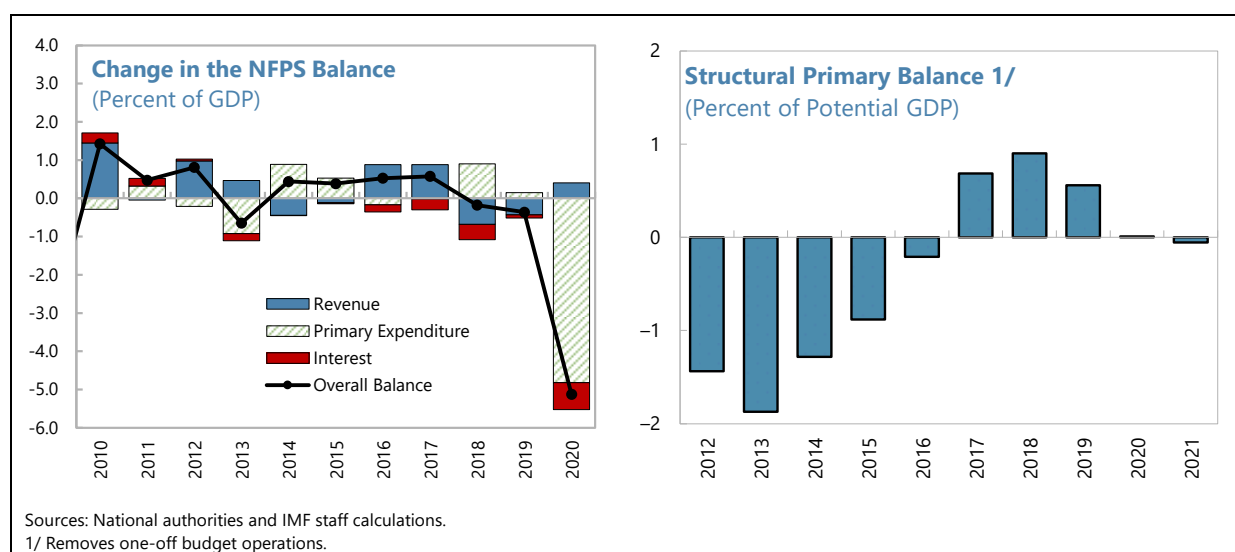
Text Table 1. El Salvador: COVID-19 Fiscal Measures 2020

(in percent of GDP)

By economic classification

Expenditure	3.4
<i>Expense</i>	3.3
o/w wage bill bonuses	0.1
o/w goods and services PPE	0.3
social benefits:	
Unconditional cash transfers	1.5
Food baskets	0.4
Other Paycheck protection program, etc.	0.9
Investment (hospital El Salvador)	0.1
Loans to SMEs and informal businesses	1.7

Source: IMF staff estimates



9. The authorities also introduced temporary financial measures, releasing substantial liquidity into the economy. In March 2020 the central bank (BCR) introduced debtor-relief measures (freeze in the credit ratings of borrowers and moratorium on debt service payments) and reduced banks' reserve requirements by about 12 percentage points of deposits (to about 9 percent). Liquidity—measured as excess reserve requirements of depository corporations held at BCR—increased by more than US\$2 billion, in equal parts due to the lower reserve requirements and a sustained increase in household deposits (5.9 percent year-over-year in October 2021, chart). Banks used the liquidity to increase credit to the government and the private sector, and to strengthen their external position (about US\$1 billion each).

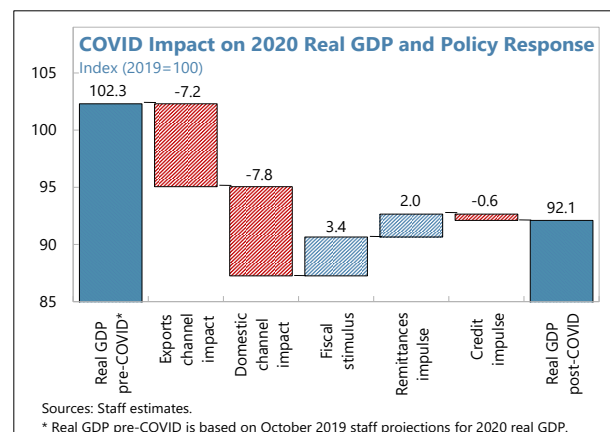
¹ Only about 5 percent of GDP was implemented, with the rest rescheduled to finance the 2021 budget.

10. The authorities' strong policy response and robust remittances helped cushion the economic contraction in 2020.

Staff estimates that in the absence of the fiscal support and resilient remittances, the economy could have contracted twice as much (text chart) as the recorded 7.9 percent.²

11. Gross international reserves declined, as expected.

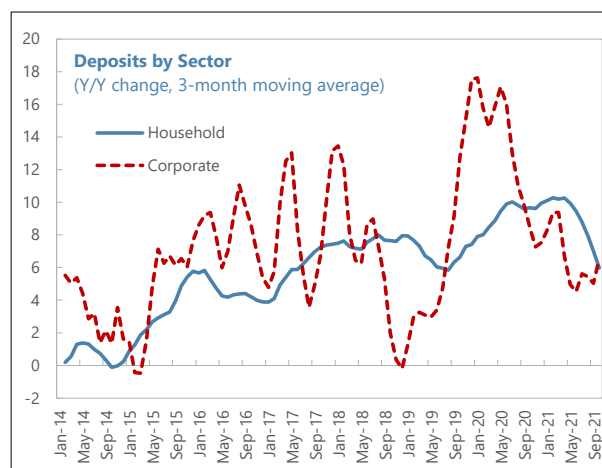
The reduction in banks' reserve requirements and resulting capital outflows by banks (as they paid down debt or increased their net foreign assets) led to a decline in gross international reserves of US\$1.4 billion (4¼ percent of GDP), to US\$3 billion at end-2020. While international reserves at end-2020 remained above 3 months of imports, they were inadequate according to the IMF metric (see Annexes III and IV).



B. The 2021 Recovery

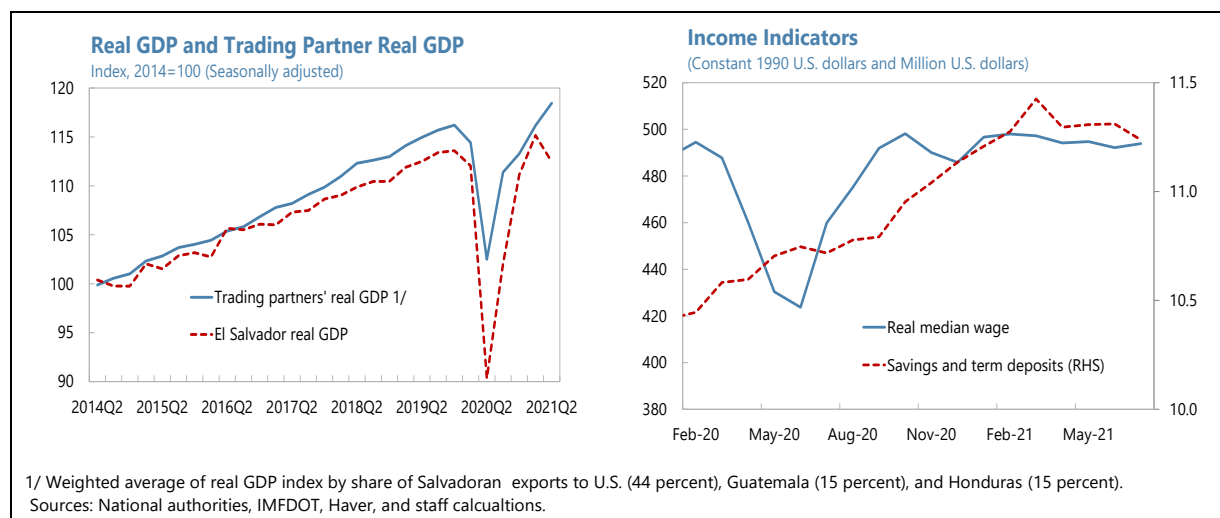
12. The recovery has been strong, but growth momentum waned in mid-2021.

Real GDP declined by 2.3 percent quarter-over-quarter in 2021Q2, after a strong growth in 2021Q1 (3.6 percent q-o-q, see chart), due to a deceleration in private consumption. Rising inflation (5½ percent by October) started eroding the gains in nominal wages in 2020 (chart). In 2021Q3 industrial production, total employment in the formal sector and private sector wages continued to grow, but at lower rates, and already reached their pre-pandemic levels. Real GDP is expected to reach pre-pandemic levels in 2021Q3, and annual 2021 growth is expected to reach 10 percent, in large part due to a carryover effect from 2020 (7 percent). The output gap remains negative, as some slack remains in the services sector. Cumulatively, in the first nine months of the year, nominal exports and remittances recorded growth rates above 30 percent compared to 2020, but a robust increase in imports is widening the trade deficit.³ The SDR allocation of about US\$390 million (SDR 275.3 million) is being used to bolster international reserves.



² The COVID-19 impact is measured as the difference between the 2020 real GDP projection done at end-2019, and the actual value. Contribution of real exports, remittances, and credit to GDP, were calculated as contributions to real GDP growth; contribution of fiscal policy was calculated using the regular multiplier to the fiscal impulse.

³ The import rally is likely to continue in the last quarter of 2021, as large energy and capital goods imports are needed for the launch of key electricity projects (see ¶22). The external position appears to be in line with the level implied by medium-term fundamentals and desirable policies (see Annex IV).



13. The fiscal outturn has improved in 2021 due to buoyant tax revenues and expenditure restraint. Although the 2021 budget targeted a 7½ percent of GDP nonfinancial public sector (NFPS) deficit, securing the needed financing has been challenging—except from CABEL. Consequently, the authorities postponed investment and transfers to local governments.⁴ Together with a strong tax collection (30 percent nominal increase y-o-y), a cash flow shortfall in 2021 was prevented. The NFPS deficit is projected to reach about 5¾ percent of GDP in 2021. Since the increase in nominal GDP is considerably higher than the increase in debt, the debt-to-GDP ratio is expected to decline to 85 percent of GDP.

14. Despite a gradual unwinding of emergency measures and a tapering of deposit growth, credit to the economy remained positive in 2021. Since March 2021, the BCR began to phase out the temporary pandemic-related measures. Financial institutions were required to restore the regular risk classification, gradually provision for the expected rise in non-performing loans (NPLs), and gradually increase reserve requirements (aiming to reach 15 percent of deposits by June 2022). Deposit growth slowed, as consumption increased, and real incomes leveled off. Private sector credit growth steadily increased and reached 4 percent by September.

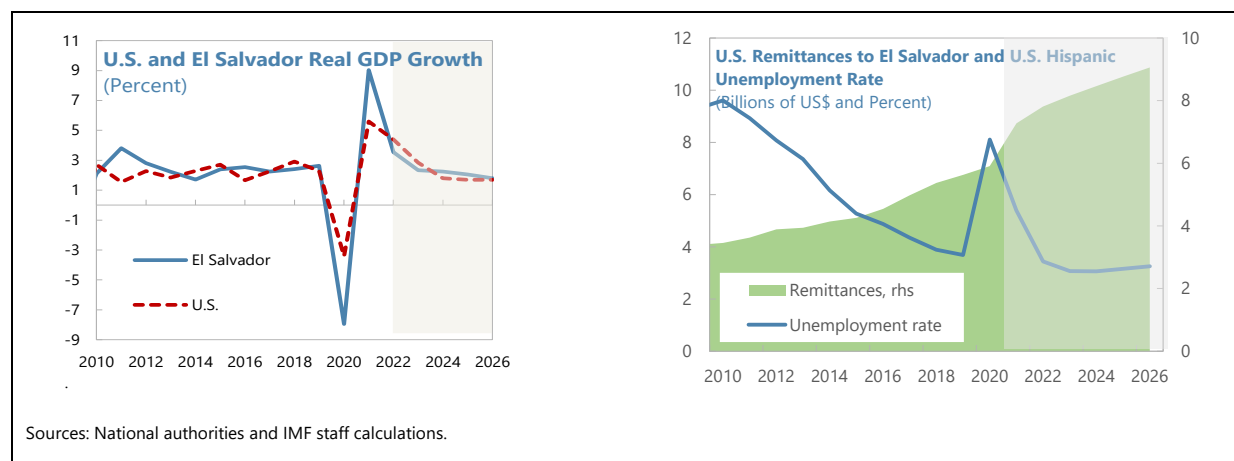
15. The banking system appears to remain resilient. While the overall capital position in the banking sector is well above the regulatory requirements, due to the phasing out of debtor-relief measures the recorded stock of NPLs increased from 1.7 percent of gross loans in February 2020 to 2.3 percent in September 2021. Banks remain liquid and continue to voluntarily increase provisions (up 23 percent from last year), in anticipation of rising NPLs.

⁴ The stock of short-term debt (LETES and CETES) placed in local banks has reached about 12 percent of GDP (tripling in two years).

OUTLOOK AND RISKS

16. The Salvadoran economy is expected to continue growing in line with the U.S. economy.⁵ Staff expects the economy to grow about 3.2 percent in 2022, on the back of buoyant exports, resilient remittances (Box 1), sound management of the pandemic and large increase in public investment (see ¶123).

17. Absent policy corrections, medium-term growth is expected to be constrained by high financing costs, rising public debt and thinning reserve buffers. As the effects of extraordinary policy measures are expected to wane in the U.S. in the medium-term, growth in El Salvador is also expected to converge towards potential. Absent frictions in trade, capital inflows, and remittances from the U.S., private consumption is expected to remain the main driver of growth. However, under current policies real GDP growth is expected to reach about 2 percent over the medium term—below its historical average—due to higher interest rates and lower private investment. Moreover, under current policies and assuming market access, public debt is expected to rise to about 96 percent of GDP (including pensions) by 2026, on an unsustainable path, and fiscal financing needs are expected to be large. Gross international reserves are expected to dip below 3 months of imports, as the increase in reserves will be slower than the expected increase in imports. Uncertainty surrounding the projections is unusually large due to the rapidly changing policy landscape.



18. Risks to the outlook are sizeable (see Table 10). Economic transformation in various countries following COVID-19 pandemic could affect global supply chain and hamper exports. *On the downside*, additional risks include:

- On the **health** side, a resurgence of the pandemic due to the vaccine-resistant variants, especially due to low vaccination rates in some countries, could affect external demand.

⁵ Remittances—more than 25 percent of GDP—fuel private consumption growth, the main growth driver of El Salvador. The U.S. is the main trading and financial partner (40 percent of exports and the main source of FDI).

- On the **financial** side, borrowing costs could increase further driven by investors' flight to safety and/or due to heightened domestic policy uncertainty,⁶ domestic policy slippages, or faster than- envisaged U.S. monetary policy normalization. Limited external financing or closed market access may induce a faster-than-planned adjustment, with negative impact on growth.

Gaps in the oversight of **Bitcoin**-based providers, Bitcoin trading and financial disintermediation pose significant macro-financial stability risks.

On the upside, gains from financial inclusion and improved payment system from the introduction of a public wallet—after addressing oversight gaps and vulnerabilities—could increase growth.

Authorities' Views

19. The authorities are slightly more optimistic on growth by about ¼ percent per year on the back of sustained dynamism in investment. The authorities expect investment to be more dynamic in the coming years driven by several projects in the energy and construction sectors. Business-friendly efforts, along with major public efforts in infrastructure will also support investment.

20. The authorities have a more benign view on the risks. The authorities stressed that the impact of a potential resurgence in the pandemic on the economy is likely to be limited, as the vaccination campaign already reached the global goal of vaccinating 70 percent of adult population, including booster shots and vaccines for children, and increased capacity in the public health sector. The authorities also noted their decision to start the fiscal consolidation. The authorities underscored their willingness to further tighten regulations and oversight of Bitcoin service providers to limit risks.

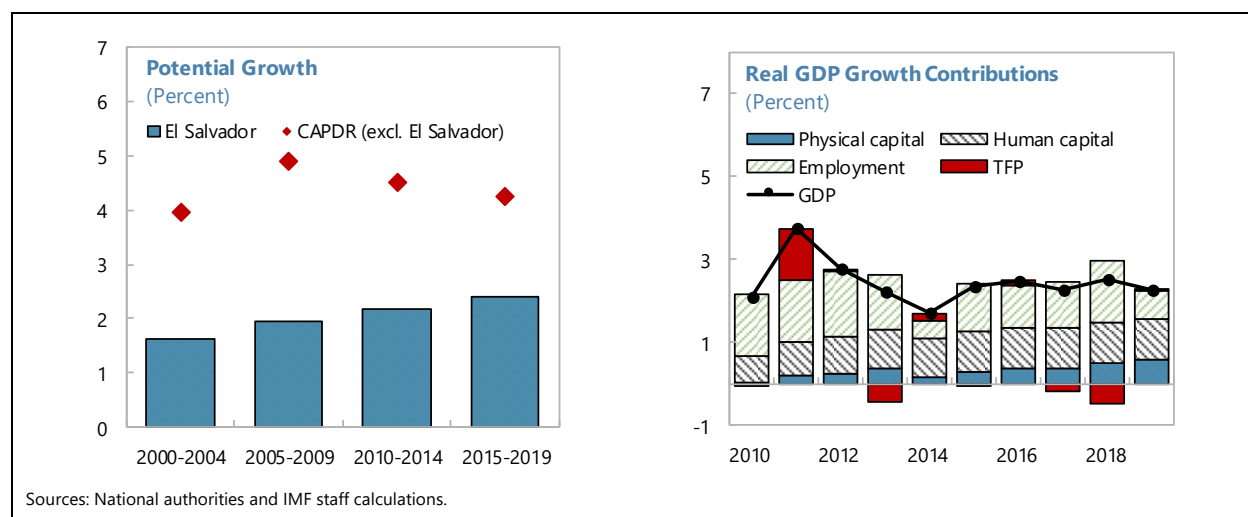
SUSTAINING THE RECOVERY AND BUILDING FORWARD BETTER

A. Raising Growth Potential

21. Higher investment is needed to raise potential output. Staff estimates that pre-pandemic potential output increased in the past two decades alongside the accumulation of physical capital (charts). Growth rates of 2¼ percent are attainable in the medium term by removing financing constraints, as higher investment rates will help accumulate more physical capital.⁷ A higher actual output growth rate is possible (2½ percent) if increases in productivity, human capital, and formal employment materialize (Annex I).

⁶ Access of private sector to international capital markets may also be affected.

⁷ See El Salvador: Selected Issues Paper, IMF 2016.



22. Higher investment to lift medium-term growth will hinge on further progress in reducing crime and corruption, implementing growth-enhancing reforms and restoring fiscal sustainability.

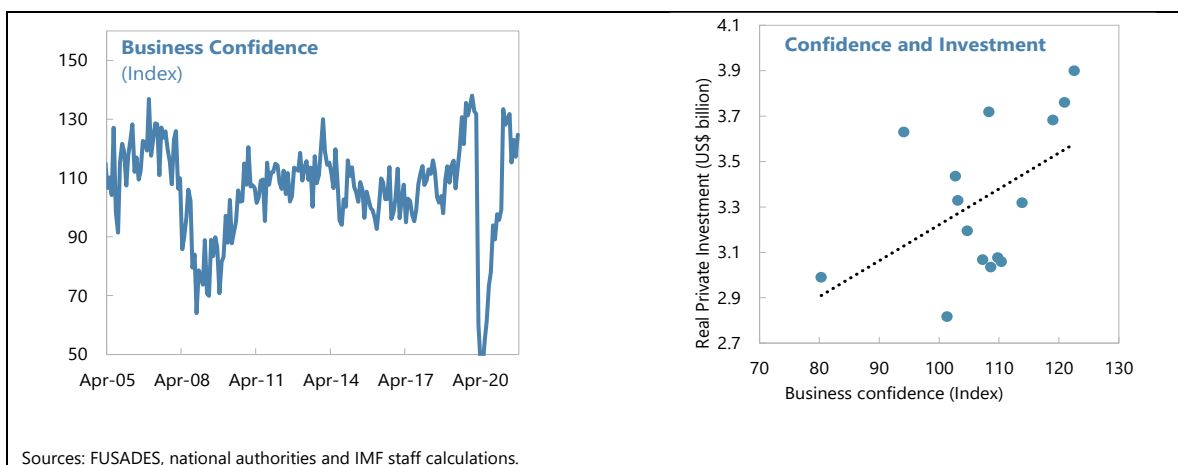
- *Reducing crime* will improve returns on investment, as it remains a primary constraint on growth.⁸ Despite a considerable reduction in homicides (see Annex I) extortion and organized crime remain widespread, adversely impacting the population and firms.⁹ The authorities' *Plan de Control Territorial*¹⁰ seeks to improve security and reduce crime, with a view to improving the environment for investment and growth.
- *Ensuring fiscal prudence and lowering risks.* Staff's analysis shows that business confidence contributes primarily to investment growth (charts), and FDI inflows (IMF WP 270/2020). The latter would also be supported by a lower level of public debt and political risk (Box 2).
- *Improving infrastructure* could increase physical capital and productivity. Strategically prioritized, properly planned and executed, and responsibly financed infrastructure projects¹¹ could help increase returns to capital and labor, and thereby catalyze private investment (Box 3).

⁸ See the 2011 constraints analysis by the U.S. Partnership for Growth based on Hausmann and others (2004).

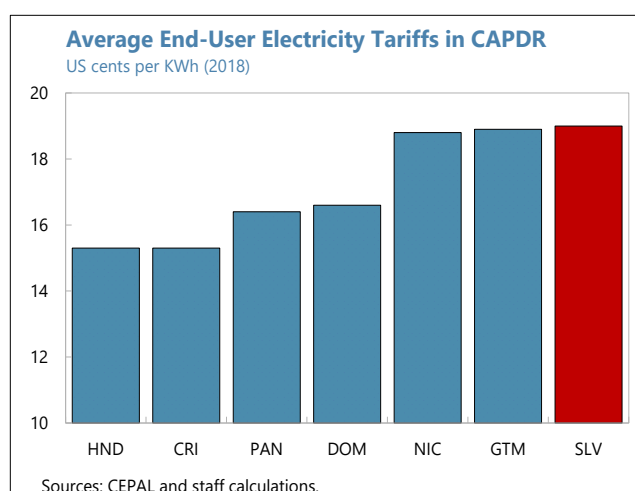
⁹ Large firms hire private security and purchase surveillance equipment while some smaller firms are forced to pay extortion fees. These costs represent, on average, 5–15 percent of revenues and 20 percent of operating costs.

¹⁰The plan aims to (i) strengthen the military and police to regain control over 17 high-crime municipalities and weaken financially gangs, (ii) provide youth with alternatives to joining gangs, and (iii) provide modern equipment and technology to the army and police to survey and control the territory.

¹¹ Identifying adequate and appropriate financing or revenue measures is needed to support infrastructure plans.



- **Reducing electricity costs.** El Salvador's electricity cost is high compared to peers due to limited production and expensive imports.¹² Limited access to electricity was listed regularly among the top 5 factors impeding business growth in surveys. The authorities are advancing in their plans to scale up investment and reduce costs. The public energy company launched several solar energy plants, and expects to complete the first wind energy farm, and *Energía del Pacífico*¹³ in 2022, which would diversify the energy matrix and therefore lead to lower electricity tariffs for end-users.



- **Facilitating economic diversification.** Promoting the reallocation of labor out of low-productivity sectors (such as agriculture and commerce) into higher productivity sectors (such as manufacturing, tourism, and communications) is critical to growth. In this respect, the authorities are developing and promoting a coastal tourism zone—*Surf City*.
- **Promoting safe digital financial inclusion** may support economic growth by providing financial services to the unbanked, increasing safe savings, and competition in the financial industry.¹⁴ Furthermore, a widely used e-wallet—with adequate safeguards—may increase the reach, and the speed with which cash benefits are distributed and facilitate payments in U.S. dollars.¹⁵

¹² High import component (20 percent of electricity is imported from Guatemala) is sensitive to oil price volatility.

¹³ IFC, DFC, IDB invest, Finish Export Credit Ltd, and KFW Ipelex bank led a US\$1 billion project to build the liquified natural gas power plant with production capacity of 378 megawatt, meeting 30 percent of the country demand.

¹⁴ See Khera P. and others, "Is Digital Financial Inclusion Unlocking Growth?" IMF WP/21/167, 2021.

¹⁵ See Prady D. and others, "Beyond the COVID-19 Crisis: A Framework for Sustainable Government-to-person Mobile Money Transfers" IMF WP/20/198 2020.

Authorities' Views

23. The authorities agreed with staff's assessment on drivers of growth and highlighted their continued efforts to support inclusive economic expansion. The authorities stressed that multi-year programs (*Plan de Control Territorial, Agenda Digital, Plan de Despegue Económico*) are critical in combating crime, closing the digital gap, building infrastructure and raising productivity. They emphasized the progress in launching the *Energía del Pacífico*, other renewable sources energy plants, lowering electricity costs and creating high productivity jobs. The authorities stressed accomplishments in cutting red tape (reducing waiting time for exporters/importers), and modernizing education (providing laptops to students). The authorities highlighted that infrastructure projects to improve roads and potable water access to *Surf City*, together with the organization of several global surf tournaments, and strong public health efforts are expected to boost tourism and contribute to the diversification of the economy and maintaining external balances.

B. Continuing to Support the Recovery while Ensuring Fiscal Sustainability

24. The authorities plan to increase social spending to support growth. Support for the health sector will continue since the pandemic is not over. Non-pandemic support to the economy has already increased due to: (i) subsidies for a 20 percent increase in the minimum wage,¹⁶ and a large increase in the minimum pension guarantee, (ii) expansion of liquified gas subsidies for households' and companies, (iii) incentives for the use of *Chivo*, the government e-wallet, and (iv) support for the agricultural sector.

25. The implementation of the authorities' fiscal agenda in 2022 hinges critically on their financing capacity. The proposed 2022 total budget includes higher expenditures by 7¼ percent compared to the 2021 approved budget, driven mainly by an 18 percent increase in public investment. Aside from the measures listed above, the 2022 budget includes an increase in the wage bill due to the plan of doubling the size of the army by 2025. The budget forecasts the NFPS deficit at 4½ percent of GDP, including 1½ percent of GDP yields from tax administration measures. Some revenue measures and a cut in transfers to local governments (FODES)—both totaling about 1 percent of GDP—are planned to compensate for an eventual shortfall. In staff's view the 2022 budget needs to have a more prudent position, as expected yields from tax administration measures seem unlikely to materialize in the short-term. Factoring in all these elements, staff expects that the 2022 NFPS deficit would be about 5 percent of GDP—an improvement of about 1 percent of GDP in the primary balance compared to 2021, coming from lower Bitcoin budget support. In terms of financing this budget, in addition to the assumed rollover of domestic debt, and the multilateral project financing approved by the LA, the authorities are seeking additional multilateral support (e.g., they have signed a share subscription with the Development Bank of Latin America, CAF on December 7, 2021), and have announced plans to issue structured "Bitcoin bonds" (details below)

¹⁶ In 2019, the minimum wage in the formal sector in El Salvador was the lowest in the Northern Triangle region.

for US\$ 1 billion, and bonds collateralized with the future stream of revenues for two public companies for US\$1.6 billion (5½ percent of GDP).¹⁷ More consolidation measures are needed in 2022 to implement a more prudent fiscal position that also requires less financing.

26. Bold fiscal decisions are needed to restore public debt sustainability. Absent consolidation measures, the unidentified financing gap is large (cumulative 2022-26 about US\$8 billion or 28 percent of GDP).¹⁸ The large needs are explained, among others, by recurrent Eurobond amortization—about 2½ percent of GDP per year biannually, starting in January 2023. Assuming it can be filled with (expensive) market sources, public debt will rise to about 96 percent of GDP (including pensions) by end-2026 (Table 2).¹⁹ Under current policies, public debt is on an unsustainable path (Annex II).

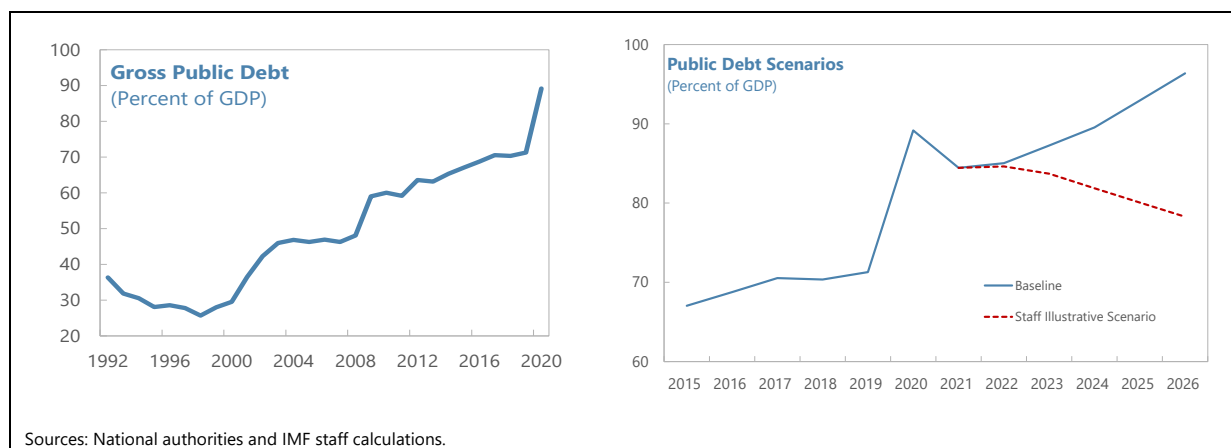
27. A prudent fiscal policy would support growth while restoring fiscal sustainability. A consolidation package of about 4 percent of GDP over 2022-24 would help restore fiscal sustainability. Such package—in line with the efforts done by other countries in the region—would lead to a decline in the public debt ratio below 80 percent by end-2026. Implementing consolidation measures in 2022 would bring the 2022 budget closer to the pre-pandemic NFPS deficit level and are needed given the financing constraints. Given the strong recovery, having the bulk of the adjustment occurring in 2022 and 2023 will help build confidence effects by lowering spreads, and help relieve those financing constraints.²⁰ Such consolidation effort would support external buffers too. Relying on leverage and thus increasing public debt to invest in Bitcoin with the expectations of its continuous rise in price, while also timing the market to acquire Bitcoin, is not a permanent solution to ease financing constraints. Measures should be designed to support the vulnerable, minimize adverse distributional effects, and ultimately achieving historical medium-term growth rates (see text table for an illustrative scenario).

¹⁷ The companies are ANDA, a water utility company, and FOVIAL a public fund responsible for roads maintenance. The securitization model follows the LaGEO experience (see box in Annex II).

¹⁸ The government has a small stock of deposits (about ¾ percent of GDP). These are for project financing in earmarked accounts and cannot be used as free disposal resources for discretionary budget financing.

¹⁹ Staff assumed that all short-term debt will be rolled over, pension system will remain unchanged (private pension funds absorbing pension bonds), and, to obtain the upper band of external credit costs, Eurobonds will be placed at about 12 percent spreads plus the coupon of same maturity US Treasury bonds. On November 20, the authorities announced that they will issue US\$1 billion in 10-year bond in tokenized U.S. dollars in 2022. The bond, first in a US\$ 5 billion series, will be issued under an upcoming electronic securities law, and it will offer a 6½ percent coupon and a “Bitcoin dividend”, starting with the sixth year, to be paid from disinvesting in Bitcoin (half of the proceeds from the bond sale will be invested in Bitcoin). The other half of the proceeds will be used for infrastructure including the development of “Bitcoin city”, a charter city located near the gulf of Fonseca where no taxes will be paid other than the VAT. Moreover, those estimated needs do not include those infrastructure plans. However, the bond may help release some financing constraints since it targets a different niche of investors (households which can buy US\$100 securities, investors which could receive permanent residence permits for US\$100,00, and institutional investors that are not allowed to invest directly in Bitcoin due to regulations and are searching for higher yield).

²⁰ Upfront comprehensive governance reforms, credible announcements of well-designed structural fiscal reforms along with measures to maintain financial stability and strengthen debt management (Annex VII) are also needed to bring down spreads.



28. Given the size and speed of the consolidation needed, the measures should be evenly distributed between revenue and spending measures. A menu of options is presented below, exceeding the required need of adjustment allowing the authorities the flexibility between the main package and contingency planning.

- On the *tax* front, consideration could be given to increasing outdated excise taxes on goods that generate negative externalities ($\frac{1}{2}$ percent of GDP), aligning the VAT rate with LAC and regional averages ($1\frac{1}{4}$ percent of GDP), introducing a surcharge on CIT for large companies ($\frac{1}{4}$ percent of GDP), introducing taxes on capital gains and streaming services (0.1 percent of GDP each), a carbon tax based on CO₂ emissions (0.3 percent of GDP), among others. Introducing a property tax and repealing VAT and income tax exemptions could also be considered.²¹
- On the *spending* side, measures on realigning the wage bill to make public sector wages consistent with private sector comparators, eliminating indexation rules (*escalafones*), and removing redundancies ($1\frac{1}{4}$ percent of GDP) are critical (Annex V). Better targeting subsidies—particularly on fossil fuels—is also an area that can deliver savings ($\frac{1}{4}$ percent of GDP). Savings from transfers to local governments ($\frac{1}{2}$ percent of GDP) and centralizing purchases of goods and large investment projects ($\frac{1}{4}$ percent of GDP) could also be considered.

²¹ Transfers to local governments (FODES) have been cut from 10 to $1\frac{1}{2}$ percent of tax revenues. “Up to” $4\frac{1}{2}$ percent of tax revenues will be transferred to a new centralized entity tasked to implement local investment projects.

Text Table 2: El Salvador: Baseline and Illustrative Scenarios

	Proj.					
	2021	2022	2023	2024	2025	2026
	Baseline					
GDP at constant prices (annual percent change)	10.0	3.2	2.3	2.2	2.0	2.0
	(Percent of GDP, unless otherwise specified)					
Nonfinancial Public Sector						
Overall balance	-5.8	-4.9	-5.1	-5.2	-6.2	-6.2
Primary balance	-1.1	0.0	0.7	0.5	0.4	0.5
Gross debt 1/	84.4	84.8	86.9	89.2	92.7	96.3
	Illustrative					
GDP at constant prices (annual percent change) 2/	10.0	2.7	1.6	2.1	2.2	2.3
	(Percent of GDP, unless otherwise specified)					
Nonfinancial Public Sector						
Overall balance	-5.8	-4.0	-1.8	-1.0	-1.0	-1.0
Primary balance	-1.1	0.6	3.1	3.8	3.9	3.9
Gross debt 1/	84.4	84.6	83.7	81.9	80.1	78.3

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

1/ Includes pension bonds (only CIP-A)

2/ Based on the estimates of fiscal multipliers for revenue measures at 0.3 and expenditure measures at 0.6, and the confidence effect of 0.7 percent of GDP.

29. Embedding policy decisions in a medium-term framework would instill additional discipline. El Salvador does not have yet a medium-term expenditure framework, and the Fiscal Responsibility Law (FRL) is suspended. Therefore, to instill fiscal discipline, staff recommends, modernizing the public financial management (PFM) framework. Specifically: (i) strengthening the execution control and quality of spending, including centralizing national planning to avoid the dispersion of planning instruments; (ii) improving the preparation and implementation of the Medium-Term Fiscal Framework (MTFF), and resuming its publication; (iii) developing a medium-term expenditure framework (MTEF), and (iv) implementing program budgeting aiming at (v) progressing towards results-based budgeting. Implementing the new Financial Management Information System (SAFI 2) is required to implement some of the PFM reforms. After significant delays, the authorities have advanced in the development of some modules of the SAFI 2. Staff also recommends that, in line with best practices, resume the FRL, while restricting the scope of its exception, and providing a clear path to a return to fiscal prudence. A comprehensive reform of the FRL could be considered as the current one has many targets.

30. Adjustments to the pension system aiming at limiting budget liabilities are also critical to restore fiscal sustainability. Despite the 1998 privatization of the pension system—that was implemented to contain the fiscal cost of the old PAYG system—large transfers from the budget were needed to sustain it (Annex VI). The 2017 reform temporarily reduced the budget burden by transferring liabilities to the *Cuenta de Garantía Solidaria* (CGS) funded by a 5 percent increase in contributions paid by employers.²² Against this backdrop, staff considers that deep analysis—from

²² Minimum pension guarantee, longevity payments triggered after individual capitalization accounts are depleted, among others. The impact of the 2021 MPG increase on public sector pensions is included in the macroframework. There is a risk that the CGS balance could turn into a deficit faster than assumed, therefore requiring budget support early (see box in Annex II).

an actuarial standpoint—should be conducted before embarking on more reforms. In the meantime, some elements that can be considered to alleviate the pressure on the budget are: (i) increase in the retirement age for women and further indexation to life expectancy for men and women, (ii) reduction in fees charged by private administrators (AFPs), and (iii) better connection between pensions and contributions.

31. Implementing measures to mitigate fiscal risks also helps ensuring medium-term fiscal sustainability. The Ministry of Finance (MoF) has recently established a Macroeconomic and Fiscal Impact Analysis Unit, which produced a comprehensive fiscal risks analysis, using IMF, WB and IADB tools for risk management. This analysis should be published, to enhance fiscal transparency. The capacity of the unit should be strengthened to identify, quantify, and design mitigation measures. In addition to the macroeconomic risks covered in ¶18, the government should also take steps to address the following fiscal risks:

- *Assets and liabilities.* It is critical to advance in the preparation of a public sector balance sheet, including the stock of debt and pension liabilities, as well as non-financial assets. Limiting the creation of trust funds and extrabudgetary funds and generating a centralized and public inventory of trusts including their balances and obligations will also be essential.
- *Investment and Public Private Partnerships (PPPs).* The investment portfolio needs to be unified to ensure the prioritization of projects based on pre-feasibility studies, regardless of the source of financing. With several PPPs in the pipeline, the authorities should ensure that they do not underestimate fiscal risks stemming from them.
- *Municipalities.* Since the newly created Municipal Works Directorate (DOM) is tasked with executing investment projects in local jurisdictions, DOM regulations should establish transparent criteria for the selection and prioritization of projects. As the MoF has assumed US\$629 million of municipal debt that will be paid from savings obtained from the cut in FODES, this entails a materialization of risk. Adjustments to the Municipal Debt Law are needed.
- *State-owned enterprises (SOEs).* Transfers to and from SOEs should be recorded by the MoF, along their quasi-fiscal activities and implicit and explicit guarantees granted to them. SOEs—including *Chivo*—should have a clear ownership policy, and financial statements based on international standards should be published in a transparent and timely manner.
- *Large exposure to climate/natural risks.* The IADB estimates the economic impact of climate change could reach 7.2 percent of GDP by 2030. Given El Salvador's exposure to natural disasters, an active policy to adapt to climate change is needed. The authorities started addressing these issues in the recently issued Financial Management Strategy for Disaster Risk and are working with international institutions to adopt parametric insurance, issue green bonds among other measures. Staff recommends that El Salvador integrates the different planning instruments related to climate change under the same framework and undertakes a Climate Macroeconomic Assessment in 2023, and work with the World Bank, UN agencies and IADB to increase resilience to natural disasters.

Authorities' Views

32. The authorities agreed on the need for the fiscal consolidation and the size of the proposed envelope. They highlighted that some measures were already approved by Congress—such as a reduction in transfers to local governments—and that they are also working on revenue measures. On the tax side, the authorities expressed their preference for measures to increase the progressivity of direct taxes, rather than increases in indirect taxes. The authorities also pointed to efforts on tax administration including on electronic invoicing and transfer pricing. Regarding expenditures, the authorities agreed on the importance of streamline across-the-board subsidies but underscored the need to develop proper targeting tools. They agreed that other measures could be considered but political consensus would be needed.

33. The authorities emphasized that they are undertaking reforms to strengthen the PFM framework. They emphasized the plan to adopt program budgeting in 2023. In this context, they will introduce pilot budget programs for the ministries of finance, health, and education, linked to national planning instruments, and prioritize expenditures, transparency of performance information and beneficiaries' targeting.

34. The authorities underscored the need for structural fiscal reforms over the medium term. They highlighted the need of a pension reform given that low pensions paid by AFPs are distorting the adjustment in the labor market by forcing workers to stay in their posts after surpassing retirement ages. They also pointed out that large and increasing pension obligations—that would be even higher once the CGS starts to run deficits since 2028—are constraining their capacity to develop infrastructure and spend on social assistance.

35. The authorities highlighted their progress in establishing an institutional framework to identify and quantify fiscal risks. They agreed on the publication of the risks report. Regarding DOM, they emphasized that it will soon start preparing all regulations related to transparency and selection of projects. Additionally, on managing risks stemming from natural disasters, the authorities mentioned that they are working on different instruments (contingent loans, parametric insurance, green bonds, and others) with the World Bank, UNDP and the IADB.

C. Maintaining Financial Stability

36. The authorities are phasing out debtor-relief measures aiming at preserving financial stability. The share of banks' loan portfolio affected by Covid-19 and benefiting from exceptional regulatory treatment declined to 10.8 percent of total loans at end-September 2021 (from a peak of 51.9 percent in June 2020). Although banks significantly upfronted provisions and the overall solvency is sound (average capital adequacy ratio is 15.8 percent), the banking system will have to cope with the further deterioration of asset quality. Accordingly, the BCR is allowing financial institutions to provision losses in the Covid-19 loans portfolio²³ within a flexible timeframe to

²³ According to the supervisory authorities, the provisioning shortfall of the banks that have requested gradual provisioning represents less than 10 percent of its equity.

cushion the termination of debtor-relief measures—debt payment moratoria and risk classification flexibility—and the expected increase on NPLs. A plan for finalizing the unwinding phase with tailored supervisory and regulatory actions should be prepared by the Financial superintendency and BCR and monitoring of asset quality on each bank must be intensified. To preserve the transparency of banks' financial situation, periods for provisioning should be as short as possible. If needed, flexibility could be granted to banks to implement medium-term plans to restore capital.

37. A gradual reversal of the reduction in reserve requirements is supporting financial stability. The temporary relaxation of reserve requirements halved banks' liquidity buffers, exacerbating vulnerabilities to liquidity shocks in the presence of dollarization and making the need to address limitations of the emergency liquidity assistance (ELA) framework critical. The new level of reserve requirements, approved in June 2021, is based on the authorities' stress-tests of banks' deposits. This level is broadly consistent with adequate coverage based on deposit withdrawal episodes in dollarized countries in the region (see Annex VIII), and sufficient if complemented with other elements suggested for strengthening the liquidity framework described below, but the authorities should regularly review if it remains sufficient.

38. Adoption of a banking crisis resolution framework is a crucial step to safeguard financial stability. Introducing a new banking resolution and deposit insurance law to the Legislative Assembly by end-2021, in line with IMF TA recommendations, is important to strengthen the financial safety net and support the liquidity management framework. To further strengthen the financial safety net, IMF technical assistance is being provided to improve the ELA framework.

39. Enhancing supervision and regulation over the medium-term is essential to further strengthen the banking system. Transition to IFRS standards, and forward-looking and risk-based supervision will gradually fill regulatory gaps with the international best practice. New liquidity requirements would provide sufficient liquidity buffers in banks, thereby alleviating the limitations of ELA under dollarization. Currently, the two largest banks, holding 40 percent of the assets in the system, already comply with Basel III, while four banks would require a two-year transition period to comply with the Liquidity Coverage Ratio (LCR) indicator. Staff recommends moving to Basel III standards for the Liquidity Coverage Ratio (LCR) and Net Stable Funding Ratio (NSFR) by end-2023. Consideration should be given to calibrating the regulatory boundaries to ensure adequate oversight of the overall financial sector, including customized supervisory strategies for public banks and cooperatives. Given the increase in sovereign risk and the overall deterioration in the outlook for debt sustainability, the exposure to government securities (9 percent of total assets) should be monitored and the authorities should carefully weigh the financial stability implications of increasingly relying on short-term debt purchased by banks.

Authorities' Views

40. The authorities broadly agreed with staff's views. They emphasized that the gradual exiting of the debtor-relief measures is being undertaken as recommended by staff, including the rules to gradually provision losses arising from COVID-19 portfolio. They consider that this gradual provisioning, tailored for each entity by the financial supervisor, will ensure an adequate withdrawal

of the forbearance measures without compromising financial stability. The authorities also emphasized that the COVID-19 portfolio represents only 10³/₄ percent of total loans and the provisioning shortfall for this portfolio are limited (US\$ 111.3 million). Therefore, the rising NPL ratio will not compromise the solvency of an adequately capitalized banking sector.

D. Strengthening Governance and Anti-Corruption Frameworks

41. To improve resource management, lower borrowing costs, and build public support for consolidation, economic governance should be strengthened. In November 2021, the MoF published the reports on the use of COVID-19 public funds with information until June 2021²⁴ and the Court of Accounts continues publishing the audit reports of the COVID-19 spending²⁵ (Annex IX). Major progress has been achieved in some high-profile anti-corruption cases against members of former administrations. To address anti-corruption weaknesses in the legislative framework, staff recommends aligning legislation to the UN Convention Against Corruption (UNCAC), by amending the Act of Illicit enrichment of Public officials (see Annex IX).²⁶ Along these lines, staff commends the authorities for amending the so-called “Pfizer” law in October 2021 to ensure that immunity for public health related issues is not granted to people that have abused public funds (e.g., fraud, corruption). To help lower borrowing costs and ensure public support for consolidation staff also recommends strengthening fiscal transparency and accountability in line with international standards: (i) improving the transparency of procurement processes—regardless of their funding sources—including the beneficial ownership of awarded contracts, (ii) strengthening the reporting and accountability structure of the Civil Protection Fund for Disaster Prevention and Mitigation (FOPROMID), (iii) strengthening fiscal transparency, including the use of COVID-19 funds,²⁷ and (iv) defining parameters to audit *Chivo* and FIDEBITCOIN.

42. Approving and implementing the revised anti-money laundering (AML) legislation is critical. El Salvador is strengthening its AML/CFT framework. The Special Law for the Prevention, Control, and Penalization of Money Laundering needs to be submitted to congress by end-2021 and implemented promptly within six months of approval, to ensure it incorporates 40 Financial Action Task Force (FATF) recommendations and receive a positive evaluation by the regional body (GAFILAT, see Annex IX). Warranting that the law captures all virtual asset providers in all provisions is important to lower risks.

²⁴ <https://www.mh.gob.sv/covid-19/>, latest report November 2021 <https://www.mh.gob.sv/wp-content/uploads/2021/11/700-DPEF-INF-2021-22581.pdf>

²⁵ <https://www.cortedecuentas.gob.sv/index.php/es/informacion-en-covid19/resultados-de-auditorias-covid19>

²⁶ Update definition of offences, require annual asset declarations with clear timelines and strong transparency provisions, enforce compliance, criminalize, and bring to trial all categories of corruption offences, and seize corruption proceeds in line with UNCAC requirements.

²⁷ (iii.a) strengthen the transparency of the debt, and (iii.b) codify the main requirements of the Fiscal Transparency Portal in the AFI Law, (iii.b) continue publishing spending audit reports (iii.c) publish an overall audit report of the of COVID-19 resources, summarizing the recommendations, and the government action plan to address any weaknesses, as well as (iii.d) follow up on the needed investigations and prosecutorial actions and informing the public on the actions taken in this respect.

43. Continuing to strengthen the safeguards of the central bank is critical to increase buffers. Following a Safeguards Assessment in 2020, the BCR has started to draft amendments to the central bank law to strengthen its autonomy and governance and adopted a policy to select and appoint external auditors. The BCR is taking initial steps to phasing out quasi fiscal activities and prepare the adoption of the International Financial Reporting Standards (IFRS) expected in 2024. Staff will engage with the authorities to speed up the adoption of IFRS and the settlement of the large debt from Treasury, which is not progressing as expected.

Authorities' Views

44. The authorities broadly agreed with the advice on economic governance, AML, and central bank safeguards. On fiscal transparency the authorities agreed with the need for a procurement reform, collecting beneficial ownership data, and publishing the report of all audit recommendations and the government response. The Ministry of Finance stated that they are already in the process of implementing a compilation and registration of the beneficial owners through COMPRASAL²⁸ and of reforming the FOPROMID manual. On anti-corruption the Attorney General mentioned that domestic legislation could be modernized, and due process is followed in pending investigations. On AML, the authorities indicated willingness to further refine the draft law in line with staff advice. On safeguards, the authorities noted that they are amending the central bank law and reiterated that without a settlement of the Treasury debt, it would be difficult for the central bank to migrate towards IFRS.

BITCOIN AS LEGAL TENDER, AND “CHIVO” A NEW MEANS OF PAYMENTS

45. El Salvador became the first country to adopt Bitcoin as an official currency with legal tender status²⁹ (alongside the U.S. dollar). On June 8, 2021, a law (the “Bitcoin law”) was adopted, establishing that the U.S. dollar will be used as a reference currency for accounting purposes, and mandating the acceptance of Bitcoin by economic agents in exchange for goods and services. The law also guarantees automatic conversion from Bitcoin to U.S. dollars, through a trust fund. In 90 days, the authorities adopted all Bitcoin regulations needed for the Bitcoin ecosystem³⁰ and introduced the e-wallet, *Chivo*, thereby fully implementing the law on September 7.

46. The government strongly supports its new digital means of payments. *Chivo* operates by default in U.S. dollars, but can accept Bitcoins, if offered, at the time of each transaction, and holds balances in U.S. dollars and Bitcoin.³¹ To foster the use of *Chivo* the government provides a one-time endowment of the equivalent to US\$30 in Bitcoins to every *Chivo* user, and assumes all

²⁸ The website of public purchases (COMPRASAL).

²⁹ Henceforth for brevity, we will use “Bitcoin as legal tender.”

³⁰ Other regulations: Bitcoin Law implementing Regulation, Bitcoin Trust Fund Law, and two BCR Technical Standards.

³¹ Prices are listed in stores in U.S. dollars. *Chivo* lists the customer’s balance in both currencies at any time.

transaction fees.³² Against this background, *Chivo* has amassed a sizeable number of clients, 3.8 million,³³ although it is unclear how many are using Bitcoin in their transactions or holding balances in Bitcoin.³⁴

47. The government guarantees the automatic conversion from Bitcoin to U.S. dollars in *Chivo*. As requested by the Bitcoin law, a trust fund, *FIDEBITCOIN*, endowed with US\$150 million has been established to guarantee the conversion. Its funds have been primarily used to finance the launch of *Chivo*, and now *Chivo* provides automatic and free convertibility services, by trading with the portfolio as needed. If a *Chivo* user receives Bitcoins in a transfer/payment, they will be automatically converted into U.S. dollars, unless the default setting in his wallet is changed by the user. If the user decides to hold Bitcoins, the user is responsible for capital losses/gains resulting from fluctuations in the Bitcoin-U.S. dollar exchange rate. At any point in time *Chivo's* users have a fixed value claim in U.S. dollars or Bitcoin against *Chivo*. When providing exchange services to its users, *Chivo* functions as an intermediary between users and wholesale Bitcoin exchange providers, and all costs and risks of exchanging and settling transactions are taken by *Chivo* at no cost to the user. *Chivo* also uses the valuation gains from Bitcoin to finance all its costs and discretionary projects chosen by the authorities.³⁵

48. In the near-term the actual costs of implementing *Chivo* and operationalizing the Bitcoin law exceed potential benefits. Staff estimates that the short-term budgetary costs are 1 percent of GDP for 2021-2022.³⁶ Staff's preliminary analysis shows that expected gains in near-term may measure up to ¼ percent of GDP per year, coming from an expected increase in tourism arrivals, and higher consumption, assuming that lower remittances fees than other traditional methods of transfers, through *Chivo* and other payment means that it challenges, would reach the recipients (Box 4). It is unclear at the moment how much the use of Bitcoin will be needed in this ecosystem to reduce costs and speed up *all* transactions. *Chivo* uses U.S. dollars for most transactions,³⁷ including remittances, and Bitcoin seems indispensable in the ecosystem for trading activities, and for the use of other Bitcoin wallets mostly by non-residents. Financial inclusion could improve if uptake in digital payments in U.S. dollars increases, technological impediments are overcome (notably download speeds, in which El Salvador significantly underperforms).

³² Uploading and withdrawing funds to and from the e-wallet, or for transfers within the e-wallet, are borne by *Chivo*.

³³ Including 16,300 companies.

³⁴ It seems that the vast majority was inactive by November 1st.

³⁵ As of October 28, 2021, *Chivo* spent an estimated US\$55 million (0.2 percent of GDP) for a total purchase of 1,120 Bitcoin, which at current market valuation is equivalent to US\$69 million (¼ percent of GDP). Considering the low uptake of Bitcoin, the impact of Bitcoin transactions on the macroframework and projections is expected to be small (see Box 4 and 5).

³⁶ Trust Fund (US\$150 million ½ percent of GDP), "bono Bitcoin" (0.4 percent of GDP); crypto friendly promotion (0.1 percent of GDP). All these costs are financed by a CABEL loan. Additional costs may come from replenishing the Trust Fund if it is depleted and investments required to mine Bitcoins based on geothermal energy.

³⁷ In September 2021 surveys indicated that at most 27 percent of the population were willing to use Bitcoin along the U.S. dollar, of which only 3.7 percent were willing to use solely Bitcoin in transactions (IUOP/ UCA survey). Data from remittances inflows show that by October 2021 about 4 percent of those transfers occurred in Bitcoin.

49. Bitcoin use carries significant risks and should not be used as an official currency with legal tender status (IMF, GFSR 2021). Crypto-technologies and digital payment systems like *Chivo* have the potential to make payments more efficient, thereby enhancing financial inclusion and supporting growth. However, its price volatility makes it inefficient as means of payments, unit of account or store of value. By adopting Bitcoin as legal tender considerable risks are introduced to financial stability, financial and market integrity, and consumer protection. In addition, a public backstop to ensure free convertibility from Bitcoin into U.S. dollars creates a contingent liability.³⁸ If the use of Bitcoin increases significantly, it can risk the dollarization regime that has proven to be successful nominal anchor for the economy.

50. The authorities need to address the risks from using Bitcoin as legal tender. To explore the opportunities of using crypto technologies as an alternate, not official means of payment and enhance financial inclusion without exposing the economy to unnecessary risks, staff recommends narrowing the Bitcoin law's scope, at the minimum by removing Bitcoin's legal tender status, and making explicit its strictly voluntary nature for all type of transactions. Three other areas require prompt corrective measures:

- *Developing strict Chivo's regulatory oversight.* *Chivo* is underregulated and not subject to the standards set by the central bank for financial institutions. Staff urges the implementation of stricter regulation and intrusive supervision to safeguard users' data and funds and to avoid indirect de-dollarization. In particular, to protect customers from the risk that *Chivo* may not have sufficient funds to repay claims, legal requirements to back users' holdings are needed. In staff's opinion, like other e-wallets, *Chivo* should be legally required to: (i) fully safeguard users' funds, both in U.S. dollars and Bitcoin, by segregating and ring-fencing from *Chivo's* own funds liquid and diversified reserve assets, such as bank or central bank deposits (for U.S. dollars) and cold wallets (offline) or third-party custodians (for Bitcoins); and (ii) provide only electronic payments and no other financial service such as lending or paying interest.
- *Containing the budgetary costs.* Staff recommends disentangling the initial push for financial inclusion from the need for a sound budgetary position, by making *Chivo* a self-funded company (charging fees for services provided). Staff also recommends ending US\$30 subsidy to every new *Chivo* user and liquidating *FIDEBITCOIN*—returning unused funds to the Treasury.
- *Safeguarding financial stability and adapting the banking regulatory frameworks.* If *Chivo* or other e-wallets would offer a close and subsidized alternative to bank deposits and bank-based means of payments, credit intermediation could rapidly shift from banks to non-deposit-taking institutions and markets. Therefore, staff recommends: (i) setting legal limits on transactions and holdings in e-wallets and (ii) adapting the banking regulation to strengthen Bitcoin risk

³⁸ In practice, the free convertibility service is being operated by *Chivo*. However, the Bitcoin law explicitly sets up a public blanket guarantee for free exchange services so that the State, through *FIDEBITCOIN*, would eventually support *Chivo's* if it run out of funds. The fiscal contingency may materialize if Bitcoin price evolution is unfavorable or, as would be advisable, *Chivo* ceases to trade Bitcoin. Against this backdrop, the central bank should not provide any sort of implicit State backstop for Bitcoin convertibility.

oversight and incorporate prudential safeguards, such as organizational segregation of Bitcoin services, banning deposits denominated in Bitcoin, and specific capital and liquidity requirements to fully back Bitcoin exposures.³⁹

51. Other vulnerabilities in the ecosystem also need to be addressed. Adopted regulations have addressed some of the identified financial risks, particularly for Bitcoin services provided by financial entities.⁴⁰ However, in staff's view additional regulations and stronger enforcement are needed to ensure the safe functioning of the new system, in both U.S. dollars and Bitcoins. Staff recommends:

- *Strengthening the legal requirements for all Bitcoin services providers—including Chivo.* The legal requirements for Bitcoin services providers, such as licensing, governance, capital requirements, AML/CFT, data protection, safeguards of funds or interoperability, require more intense and uniform regulation for all entities.⁴¹ The supporting regulations leave many items to the Bitcoin services provider's discretion (transaction caps, interpretation of international standards for AML/CFT, etc.). Particular attention should be paid to eliminating arbitrage and money laundering opportunities and ensuring adequate identification of e-wallet's users.
- *Better defining the regulatory perimeter and enforcement regime.* The authorities should clearly define the boundaries of Bitcoin regulation—especially the legal treatment for non-resident and cross border transactions. The sanctioning, inspection and enforcement regimes should also be developed, including measures to strengthen the supervisory capacity of authorities.
- *Minimizing risks on tax compliance.*⁴² Strategies to prevent the use of Bitcoin to hide taxable income and to enforce proper accounting and reporting rules to avoid tax evasion will need to be put in place.
- *Mitigating consumer protection and operational risks.* Given Bitcoin's price volatility and risks associated with cyber fraud, a stronger consumer protection framework with a higher

³⁹ For example, the latest consultation of the Basel Committee on Banking Supervision (2021) proposes that the capital requirements for crypto-asset exposures be based on a set of conditions that include (1) the regulatory and supervisory status of the entities performing key functions and (2) the effectiveness of the price stabilization mechanism. Bitcoins would be placed in the highest risk category, subject to a 1.250 percent risk weight.

⁴⁰ BCR rules require bank-run e-wallets to hold deposits at the central bank and Bitcoins in a custodian that back up every U.S. dollar and Bitcoin balances in its users' accounts.

⁴¹ The regulation should be equally applied to all type of e-wallets, regardless whether they are owned by financial institutions or not. Under the principle of same activity, same risks, same rules, all e-wallets should be subject to uniform regulation: operating in U.S. dollars and with Bitcoin. The Law to facilitate financial inclusion and the corresponding BCR Technical Standards for electronic money providers could be used as a reference to improve the legal framework for Bitcoin services providers. Also, CPMI-IOSCO Principles for financial market infrastructures, including payment systems, are international standards that should be considered to strengthen the regulatory framework.

⁴² There is no Bitcoin risk for Treasury revenues. As mandated by law, the Treasury only have accounts in US\$, therefore, any payment in Bitcoin is converted into US dollars before being deposited in the Treasury.

involvement of the authorities should be adopted.⁴³ Consumers should be informed of the risks involved in transacting and holding Bitcoins, including the speculative nature and unsuitability for non-sophisticated investors. Additionally, requirements for the Bitcoin service providers to adopt comprehensive risk management frameworks regarding operational resilience, reserve management and cybersecurity safeguards should be better regulated and supervised.

- *Managing and reporting of fiscal risks.* Risks and contingencies stemming from the crypto ecosystem should be reported in the fiscal risks statement mentioned above.

52. The government's use of funds and exposure to Bitcoin should be further monitored, reduced, and its accountability strengthened. As users of public funds, the *FIDEBITCOIN* and *Chivo* should transparently report their operations, governance arrangements, costs, and all necessary data to properly track its transactions in the fiscal accounts. Currently, *FIDEBITCOIN* can be audited by the Court of Accounts and in staff's view the same treatment should be applied to *Chivo*. Announced plans to use the proceeds of new sovereign bond issuances to invest in Bitcoin, and the implications of trading more broadly in Bitcoin, through *Chivo* or *FIDEBITCOIN*, are significantly exposing the government to Bitcoin's price volatility and risks. Staff recommends a very careful analysis of implications for, and potential risks to, financial stability and fiscal sustainability coming from these activities.

Authorities' Views

53. The authorities stressed their vision of Bitcoin's benefits to the economy. The authorities highlighted that using Bitcoin as legal tender is a strategy that seeks to promote financial inclusion, payments digitalization, and a rebrand of El Salvador to scale up gains from tourism and private investment. The authorities indicated that *Chivo* significantly increased financial inclusion, by allowing more than 3¾ million people to have access to the financial system in two months (60 percent of population), when after decades of unsuccessful initiatives only 23 percent of the population is banked. They expect broad reduction in remittances fees, due to the rapid uptake of *Chivo*, with the optional use of Bitcoin in the Lightning Network offering additional cost-reduction opportunities. The authorities noted the synergies between promoting tourism more broadly, and promoting Bitcoin, and highlighted the interest from Bitcoin mining investors in renewable energy opportunities in El Salvador.

54. The authorities noted that they observed limited risks arising from using Bitcoin as legal tender. The authorities do not see an immediate need to narrow the scope of Bitcoin law, given the limited observed risks arising from using Bitcoin as legal tender. The authorities see this as a safe ecosystem, especially when it comes to KYC and AML requirements, highlighting the average small size of operations, the limits on transactions and monitoring the use of Bitcoin.⁴⁴ The

⁴³ Requirements on transparent fees' disclosure, including exchange rates applied when converting U.S. dollars and Bitcoins, marketing practices, customer services and complaint mechanisms should be considered. Cross-selling of other services such as loans must be banned.

⁴⁴ While not legally required, *Chivo* limits transfers to 3,000 U.S. dollars per day and 24,000 U.S. dollars per month.

authorities agreed that regulation and oversight of *Chivo* and Bitcoin services can be strengthened. The authorities also stressed the commitment to continue monitoring the use of Bitcoin and its risks as the new ecosystem evolves and re-evaluating the need of introducing changes to the Bitcoin law if needed.

STATISTICS

55. Upgrading the statistical framework is needed, to capture well risks, and improve decision making process. The authorities are using the GFSM-1986 and should migrate to the GFSM-2014 with the IMF's Statistics Department and CAPTAC-DR support. The old GFSM poses severe limitations both in the recording of complex operations and in the valuation of financial assets and liabilities. A sectorization of the NFPS comprising all extra-budgetary entities and special purpose vehicles, including *Chivo* would be an important milestone. Revisiting the coverage and adequacy of public debt statistics should be part of this comprehensive effort. The collection, classification and clear separate reporting of Bitcoin related transactions are needed to understand how the economy is impacted, closely monitor risks, and reclassify items in the future as needed (Box 5), since the international statistical rules and accounting standards evolve as well.

STAFF APPRAISAL

56. El Salvador's response to the pandemic helped save many lives, cushioned the 2020 economic contraction and supported the recovery. The authorities' public health measures were deployed in a timely and effective manner, including advancing a successful vaccination campaign. As a result, El Salvador—one of the most densely populated countries in Latin America—recorded one of the lowest rates of COVID-19 infections and fatalities in the region. The authorities also swiftly responded to the two large shocks hitting the economy in spring 2020. Two large fiscal packages were implemented with the help of the RFI disbursement (US\$389 million) approved in April 2020, and temporary financial sector measures were introduced. The economy is projected to grow by about 10 percent in 2021 and 3.2 percent in 2022, with most economic indicators at, or exceeding, pre-pandemic levels in the third quarter of 2021. The banking system appears to remain resilient, liquid and solvent.

57. At the same time, fiscal vulnerabilities were exacerbated by the pandemic. Public debt (including pensions) is projected to have increased by 14 percentage points of GDP, to about 85 percent of GDP by the end-2021. An increasingly high share of debt is short-term domestic debt (tripled since 2019, to 12 percent of total debt). Rising gross fiscal financing needs, alongside uncertainty about the direction of policies, pushed up sovereign spreads, considerably increasing borrowing costs.

58. Medium-term growth is expected to be constrained by high financing costs. Real GDP growth in El Salvador is expected to converge to 2 percent by 2026, as the effects of extraordinary policy measures will wane in the U.S., and the high Salvadoran sovereign spreads will limit private

investment. Gross fiscal financing needs are expected to be elevated as regular biannual Eurobond repayments start in January 2023. Absent strong policy measures to correct fiscal imbalances and ease constraints on growth, public debt will grow beyond 96 percent of GDP (including pensions) by 2026. Uncertainty about these medium-term projections is unusually high, given the evolving policy landscape. Risks to the economic outlook are sizeable.

59. A comprehensive economic strategy is needed to ease constraints on growth while lowering borrowing costs. Higher medium-term growth—around the historical average real GDP growth of 2¼ percent—is possible by removing financing constraints and sustaining investment. In addition, increasing productivity, private investment and improving human capital would allow for even higher medium-term growth (about 2½ percent). The authorities' efforts to reduce crime, cut red tape, lower energy costs, diversify the energy matrix, foster economic diversification, and enhance financial inclusion are welcome, and should continue. Efforts to increase investment in education, health, and infrastructure are commended, but in the context of fiscal sustainability concerns, additional efforts need to be made elsewhere, to create fiscal space without increasing risks. In this respect, better targeting social spending, prioritizing infrastructure projects, and strengthening economic governance are critical to ensure inclusive growth.

60. A well-articulated fiscal consolidation strategy, supported by high quality measures amidst a coherent medium-term framework, is critical to restore fiscal sustainability. Staff recommends implementing a fiscal consolidation package based on high quality measures amounting to about 4 percent of GDP over the next three years—starting in 2022. Such an effort would restore fiscal sustainability, by putting public debt (including pensions) on a downward path. Given the unsustainable debt path under current policies, additional consolidation measures should be incorporated in the 2022 budget. The measures should be fast-yielding and permanent. Measures supporting the sustainability of the pension scheme needs to be implemented, along modernizing the public financial management framework, and strengthening the capacity to design strategies to address fiscal risks.

61. Efforts to strengthen financial supervision and regulation are welcome. The unwinding of the exceptional financial sector interventions is appropriate. The increase of reserve requirements should be completed as projected, and monitored and changed if warranted, while complemented by other measures such as improving the Emergency Liquidity Assistance framework. The unwinding of regulatory forbearance measures—including debt payment moratoria and risk classification flexibility—is also welcome and should be accompanied by a plan with tailored supervisory actions aimed at monitoring bank's recovery strategies. Efforts to develop the banking crisis resolution framework should keep momentum as, once approved, it will be an effective tool to buttress the financial safety net. Over the medium-term efforts should be focused into transitioning to forward-looking and risk-based supervision.

62. Further progress in strengthening economic governance is critical in supporting growth. Staff commends the authorities for publishing the reports on the use of public funds for COVID-19, and many individual report audits by the Court of Accounts. Further progress in economic governance is critical in supporting growth. In this respect, staff supports the authorities'

plans to further strengthen fiscal transparency and accountability in line with international standards, by improving transparency of public procurement processes, limiting the use of extra budgetary funds, and aligning domestic legislation to the UNCAC. Staff urges the authorities to continue to strengthen the effectiveness of the AML framework, and welcomes the central bank's efforts to comply with the 2020 safeguards assessment.

63. Efforts to improve financial inclusion and raise growth are welcome, but risks arising from Bitcoin as a legal tender, the new payments ecosystem and trading in Bitcoin should be addressed. Crypto-technologies and digital payment systems like *Chivo* have the potential to make payments more efficient, thereby enhancing financial inclusion and supporting growth. Given Bitcoin's high price volatility, its use as a legal tender entail significant risk. Because of those risks, Bitcoin should not be used as a legal tender. Staff recommends narrowing the scope of the Bitcoin law and urges strengthening the regulation and supervision of the new payment ecosystem.

64. Upgrading the statistical and accounting frameworks are needed to better manage risks and enhance the decision-making process. Staff supports the implementation of IFRS standards for the entire banking system, migration to the 2014 Government Finance Statistics

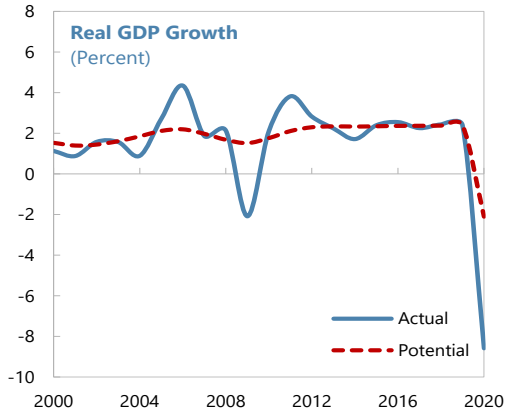
Manual (GFSM), and a sectorization of the nonfinancial public sector comprising all extra-budgetary entities and special purpose vehicles, including *Chivo*. Revisiting the coverage and adequacy of public debt statistics should be part of this comprehensive effort. Staff also recommends the appropriate reporting of Bitcoin related transactions to understand how the economy is impacted.

65. It is proposed that the next Article IV consultation with El Salvador takes place on a 12-month cycle in accordance with the Decision on Article IV Consultation Cycles.

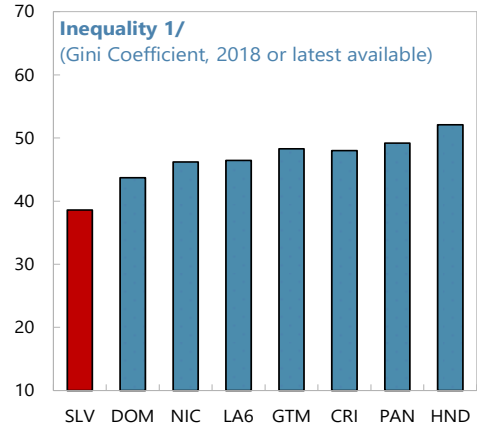
Figure 1. El Salvador: Long-Term Growth and Poverty

Structural bottlenecks have inhibited long-term growth

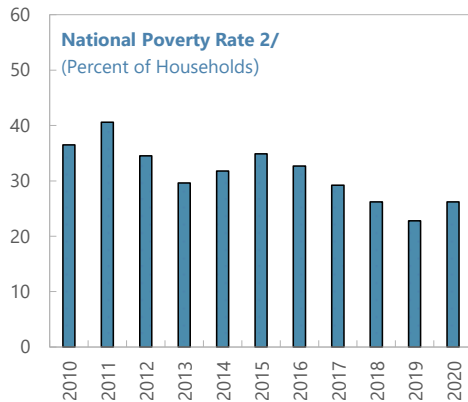
Pre-pandemic the country has experienced solid economic growth...



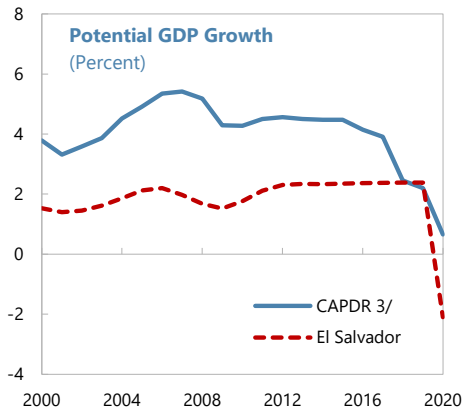
...with low inequality.



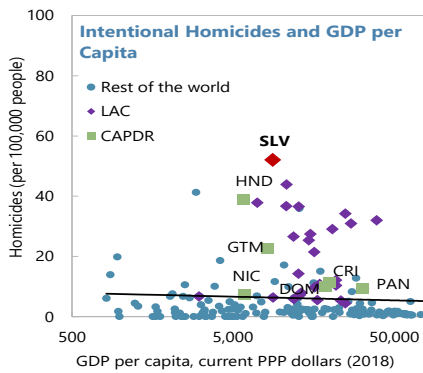
But poverty remained relatively high and expected to rise because of the pandemic...



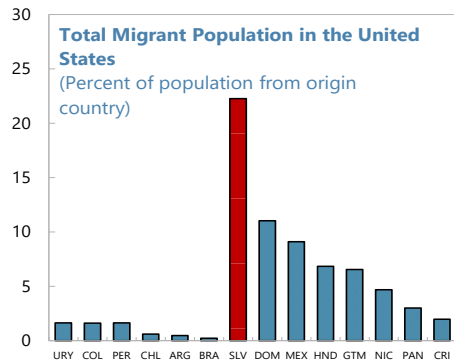
...and growth was below regional CAPDR rates.



Pre-pandemic crime declined, but remained high...



...contributed over time to outward migration, along other factors.



Sources: National authorities, IMF staff calculations, World Development Indicators and United Nations Population Division.

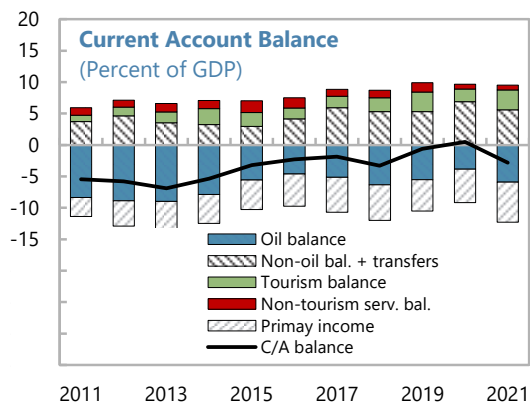
1/ Gini coefficient for GTM and NIC are as of 2014. Simple average of Brazil, Chile, Colombia, Mexico, Peru and Uruguay.

2/ El Salvador poverty line covers the percent of population lacking household income required to access a basket of goods and services needed to achieve adequate living conditions. Poverty numbers are as of 2014 for GTM and 2016 for PAN, NIC and DOM.

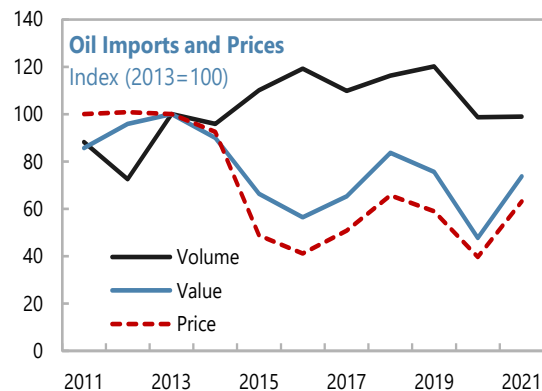
3/ Simple average of Costa Rica, Guatemala, Honduras, Nicaragua, Panama, and the Dominican Republic.

Figure 2. El Salvador: Balance of Payments Developments

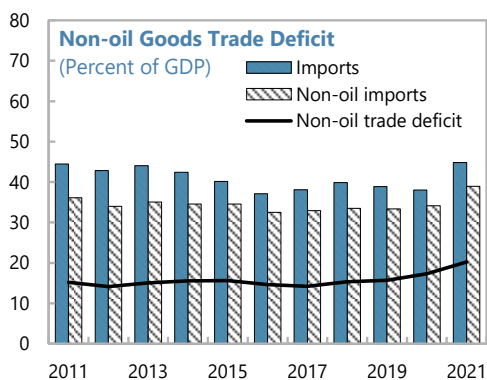
In 2021 current account balance is expected to turn to a deficit...



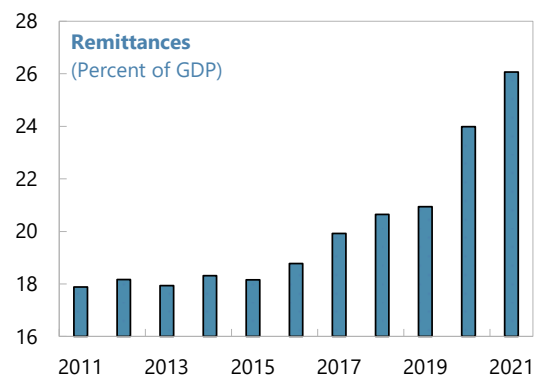
...amid rising oil imports, due to higher prices...



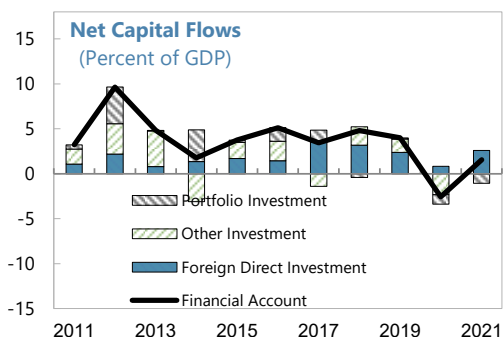
...and a widening of non-oil goods trade deficit due to rising imports.



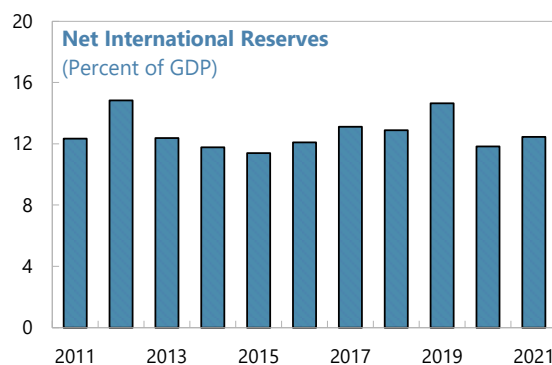
In 2021 remittances continued to surge...



...capital inflows have increased on the back of stronger foreign direct investment...



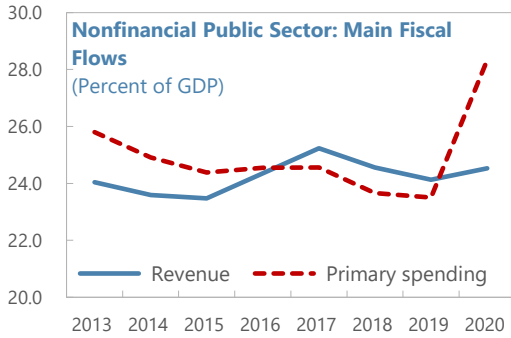
...and reserves remained broadly stable.



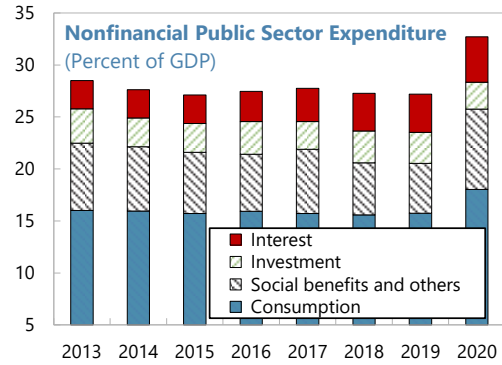
Sources: Central Reserve Bank of El Salvador, Haver Analytics, and IMF staff calculations. Note: 2021 data is preliminary and corresponds to the first half of the year only.

Figure 3. El Salvador: Fiscal Developments

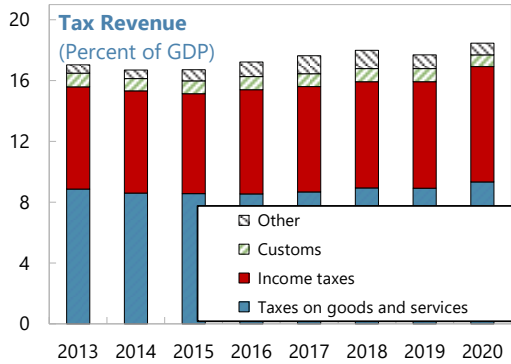
The COVID-19 response caused a large hike in spending...



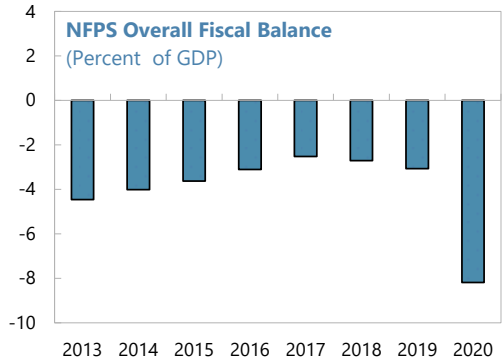
...mainly to strengthen the social safety net using unconditional transfers.



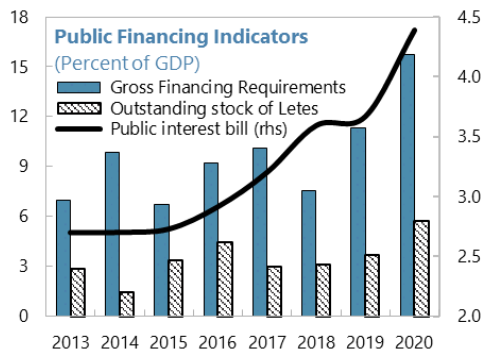
While taxes were remarkably resilient...



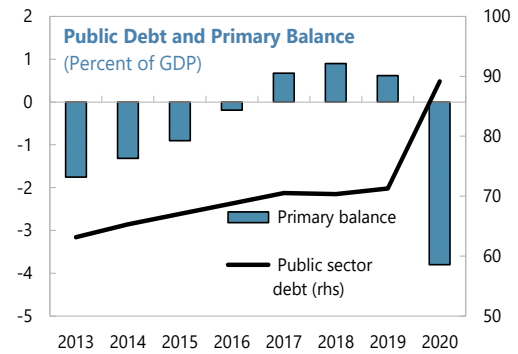
...large spending needs caused a significant deterioration in the fiscal balance



The interest bill continues to rise...



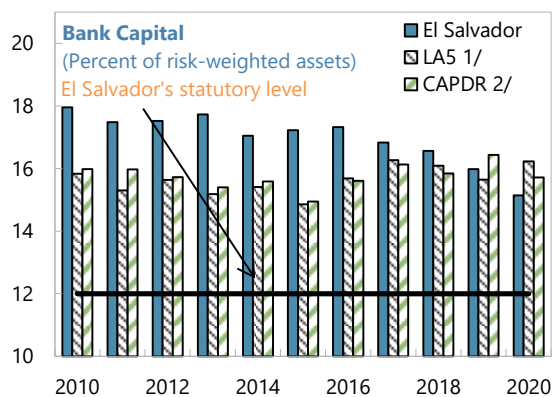
...amidst an unprecedented increase in public debt.



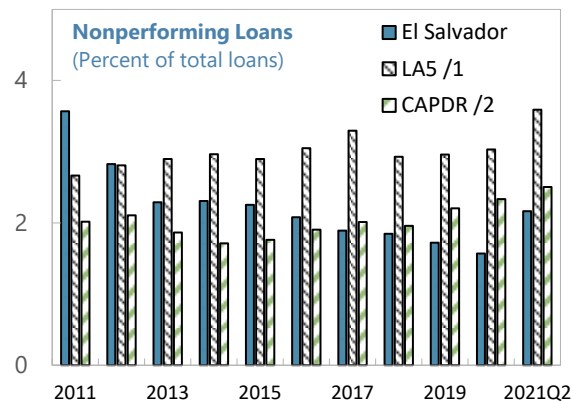
Sources: National authorities and IMF staff calculations.

Figure 4. El Salvador: Financial Sector Developments

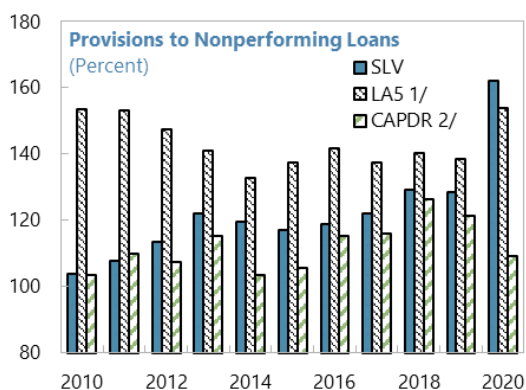
Banks' capital buffers remain high...



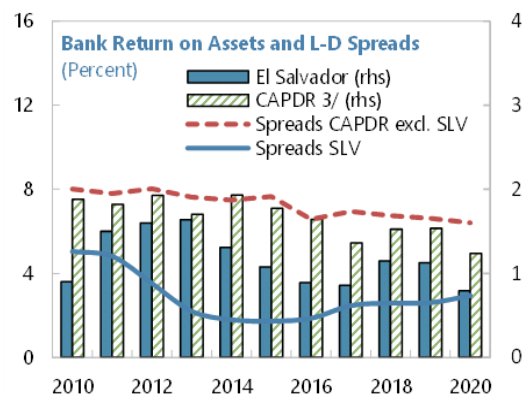
...amid the rise in non-performing loans caused by the unwinding of debtor-relief measures.



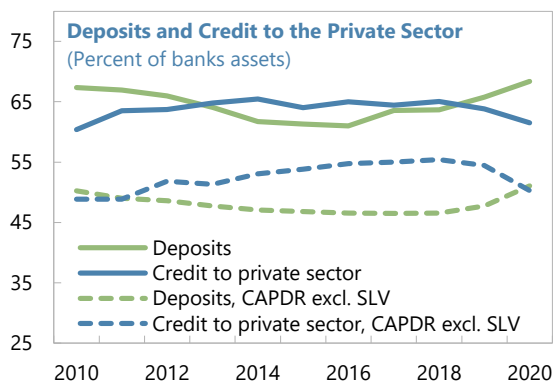
Amid increased provisioning...



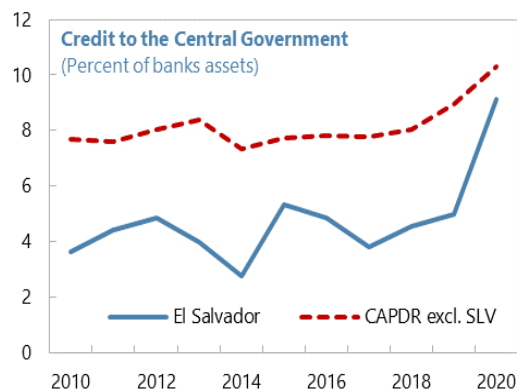
...strained banks' profitability despite widening of interest margin.



Deposit growth begins to slow and credit to private sector begins to recover...



...while credit to the central government increased.



Sources: National authorities, IMF Financial Soundness Indicators, and IMF 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 Indicators¹

I. Social Indicators									
Rank in UNDP Development Index 2019 (of 189)	124	Population (million, 2020)		6.5					
Per capita income (U.S. dollars, 2020)	3,799	Life expectancy at birth in years (2019)		73					
Percent of pop. below poverty line (2020)	26	Infant mortality (per 1,000 live births, 2019)		13					
Gini index (2019)	39	Adult literacy rate (% ages 15 and older, 2019)		89					
II. Economic Indicators (Percent of GDP, Unless Otherwise Indicated)									
	2014	2015	2016	2017	2018	2019	2020	Proj.	
								2021	2022
Income and Prices									
Real GDP growth (percent)	1.7	2.4	2.5	2.2	2.4	2.6	-7.9	10.0	3.2
Consumer price inflation (average, percent)	1.1	-0.7	0.6	1.0	1.1	0.1	-0.4	3.5	2.8
GDP deflator (percent)	1.0	1.3	0.7	1.0	1.7	0.7	-0.5	2.8	2.4
External Sector									
Current account balance	-5.4	-3.2	-2.3	-1.9	-3.3	-0.6	0.5	-3.9	-2.5
Trade balance	-23.4	-21.2	-19.2	-19.4	-21.7	-21.2	-21.1	-28.7	-28.4
Exports (f.o.b.)	19.0	18.9	17.9	18.7	18.2	17.7	16.9	18.4	18.6
Imports (f.o.b.)	42.4	40.1	37.1	38.1	39.9	38.9	38.0	47.1	47.0
Services and income (net)	-0.7	-0.6	-1.8	-2.6	-2.3	-0.4	-2.6	-1.3	-0.6
Transfers (net)	18.8	18.6	18.8	20.2	20.6	21.0	24.2	26.1	26.5
Foreign direct investment	-1.4	-1.7	-1.4	-3.6	-3.2	-2.4	-0.8	-2.8	-1.9
Gross international reserves (millions of U.S. dollars)	2,693	2,787	3,238	3,567	3,569	4,446	3,083	3,510	3,980
Nonfinancial Public Sector									
Overall balance	-4.0	-3.6	-3.1	-2.5	-2.7	-3.1	-8.2	-5.8	-4.9
Primary balance	-1.3	-0.9	-0.2	0.7	0.9	0.6	-3.8	-1.1	0.0
Of which: Tax burden	16.7	16.7	17.2	17.6	18.0	17.7	18.5	20.4	20.9
Gross debt 2/	65.3	67.0	68.8	70.5	70.4	71.3	89.2	84.4	84.8
National Savings and Investment									
Gross domestic investment	16.4	16.0	16.0	16.7	18.4	16.9	17.9	18.5	17.7
Private sector 3/	14.4	13.5	13.5	14.1	15.7	14.2	15.7	15.8	14.5
Public sector	2.0	2.5	2.5	2.6	2.7	2.6	2.2	2.6	3.2
National savings	11.0	12.8	13.7	14.8	15.1	16.3	18.4	14.5	15.2
Private sector	12.3	13.7	13.7	14.7	14.7	16.4	24.0	17.3	16.4
Public sector	-1.3	-0.9	0.0	0.1	0.4	-0.1	-5.6	-2.7	-1.2
Money and Credit									
Credit to the private sector	49.5	50.2	51.2	52.2	53.5	55.3	62.1	57.6	56.3
Broad money	48.6	50.1	50.0	53.8	54.8	59.0	70.2	65.7	65.1
Interest rate (time deposits, percent)	3.8	4.2	4.4	4.4	4.2	4.3	4.1	3.9	...
Net Foreign Assets of the Financial System									
Millions of U.S. dollars	2,189	1,904	1,995	2,645	2,714	3,424	3,046	3,303	3,836
Percent of deposits	21.2	17.4	17.7	21.2	20.5	23.2	18.6	19.2	21.3
Memorandum Items									
Nominal GDP (billions of U.S. dollars)	22.6	23.4	24.2	25.0	26.0	26.9	24.6	27.9	29.4
Terms of trade, percent change	-1.3	15.6	6.1	-4.3	-3.9	0.8	6.0	-5.4	3.4
Real effective exchange rate (+ = appreciation)	1.8	4.5	-1.0	-3.5	1.1	-2.6	-2.3	-0.7	...
External sovereign bond spread (basis points)	400	497	599	520	424	453	760	837	...

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

1/ Projections reflect unchanged policies scenario, including no additional spending on Bitcoin, and no large benefits to the economy from using Bitcoin as legal tender and Chivo wallet (see Box 4).

2/ Nonfinancial public sector, including CIP-A pension bonds. Does not include "Bitcoin" bonds.

3/ Includes inventories.

Table 2. El Salvador: Medium-Term Outlook¹

	2015	2016	2017	2018	2019	2020	Projections						
							2021	2022	2023	2024	2025	2026	
	(Percentage changes)												
Nominal GDP growth	3.7	3.2	3.3	4.2	3.4	-8.4	13.1	5.7	3.7	3.6	3.3	3.0	
GDP deflator	1.3	0.7	1.0	1.7	0.7	-0.5	2.8	2.4	1.4	1.3	1.2	1.0	
Real GDP growth	2.4	2.5	2.2	2.4	2.6	-7.9	10.0	3.2	2.3	2.2	2.0	2.0	
Output gap (percent of GDP)	-0.1	0.1	0.0	0.0	0.2	-9.3	-2.1	-0.9	-0.5	-0.3	-0.3	-0.3	
Inflation (average)	-0.7	0.6	1.0	1.1	0.1	-0.4	3.5	2.8	1.6	1.6	1.5	1.4	
	(Contribution to real GDP growth, percentage points)												
Private consumption	2.5	1.7	1.5	1.2	3.4	-9.1	9.5	2.8	2.2	1.9	1.9	1.9	
Public consumption	0.3	-0.2	0.0	0.2	0.1	0.9	0.5	0.9	0.1	0.4	0.4	0.3	
Private investment	0.7	0.5	0.5	1.1	1.1	-0.9	1.9	0.7	0.6	0.6	0.6	0.6	
Public investment	0.7	0.1	0.1	0.1	0.1	-0.6	0.7	0.7	0.1	0.2	0.1	0.1	
Change in inventories	-0.6	0.2	-0.1	0.6	-1.7	3.0	0.0	0.0	0.0	0.0	0.0	0.0	
Net exports	-1.2	0.2	0.2	-0.8	-0.4	-1.2	-2.6	-1.9	-0.7	-0.9	-1.0	-0.9	
	(Percentage changes)												
Exports of goods, f.o.b.	3.3	-2.6	8.0	1.5	0.3	-12.4	23.4	6.8	4.7	4.3	3.0	2.9	
Volume	3.1	-1.0	6.0	-1.7	1.7	-13.5	15.2	3.2	3.9	3.0	3.0	2.7	
Price	0.2	-1.6	1.9	3.2	-1.4	1.2	7.2	3.5	0.8	1.3	0.1	0.2	
Imports of goods, f.o.b.	-1.8	-4.6	6.0	9.1	0.8	-10.5	40.3	5.4	5.5	5.4	4.8	4.3	
Volume	13.2	2.9	-0.4	1.6	3.1	-6.2	23.9	5.3	5.3	5.3	4.7	4.3	
Price	-13.3	-7.2	6.4	7.4	-2.3	-4.5	13.2	0.1	0.2	0.1	0.1	0.0	
Terms of trade	15.6	6.1	-4.3	-3.9	0.8	6.0	-5.4	3.4	0.6	1.2	0.0	0.2	
	(Percent of GDP)												
Primary fiscal balance	-0.9	-0.2	0.7	0.9	0.6	-3.8	-1.1	0.0	0.7	0.5	0.4	0.5	
Overall fiscal balance	-3.6	-3.1	-2.5	-2.7	-3.1	-8.2	-5.8	-4.9	-5.1	-5.2	-6.2	-6.2	
Public sector gross debt 2/	67.0	68.8	70.5	70.4	71.3	89.2	84.4	84.8	86.9	89.2	92.7	96.3	
Cyclically adjusted primary balance	-0.9	-0.2	0.7	0.9	0.6	-1.5	-0.6	0.2	0.8	0.6	0.5	0.6	
Structural primary balance	-0.9	-0.2	0.7	0.9	0.6	0.0	-0.1	0.2	0.8	0.6	0.5	0.6	
Fiscal impulse (percentage points)	-0.4	-0.7	-0.9	-0.2	0.3	0.5	0.1	-0.3	-0.6	0.2	0.1	0.0	
Current account balance	-3.2	-2.3	-1.9	-3.3	-0.6	0.5	-3.9	-2.5	-2.7	-3.3	-4.0	-4.3	
Exports of goods, f.o.b.	18.9	17.9	18.7	18.2	17.7	16.9	18.4	18.6	18.8	18.9	18.9	18.9	
Imports of goods, f.o.b.	40.1	37.1	38.1	39.9	38.9	38.0	47.1	47.0	47.8	48.6	49.4	50.0	
Of which: Petroleum and products	5.6	4.6	5.2	6.4	5.6	3.8	5.4	5.6	5.4	5.3	5.5	5.6	
Current transfers	18.6	18.8	20.2	20.6	21.0	24.2	26.1	26.5	26.6	26.6	26.6	26.6	
Gross domestic investment	16.0	16.0	16.7	18.4	16.9	17.9	18.5	17.7	17.4	17.2	16.9	16.8	
Private sector 3/	13.5	13.5	14.1	15.7	14.2	15.7	15.8	14.5	14.1	13.8	13.6	13.4	
Public sector	2.5	2.5	2.6	2.7	2.6	2.2	2.6	3.2	3.3	3.4	3.4	3.4	
Gross national saving	12.8	13.7	14.8	15.1	16.3	18.4	14.5	15.2	14.7	13.9	12.9	12.4	
Private sector	13.7	13.7	14.7	14.7	16.4	24.0	17.3	16.4	16.1	15.2	15.2	14.7	
Public sector	-0.9	0.0	0.1	0.4	-0.1	-5.6	-2.7	-1.2	-1.3	-1.3	-2.3	-2.2	
External saving	3.2	2.3	1.9	3.3	0.6	-0.5	3.9	2.5	2.7	3.3	4.0	4.3	
Memorandum Items	(Percentage changes)												
Private consumption	2.8	2.0	1.7	1.4	4.0	-10.6	11.4	3.3	2.6	2.3	2.2	2.2	
Public consumption	2.1	-1.0	0.1	1.7	0.6	6.1	3.0	6.0	0.8	2.8	2.6	1.6	
Private investment	5.3	3.8	3.4	7.9	7.4	-5.6	12.0	4.0	3.5	3.4	3.4	3.4	
Public investment	34.1	2.9	4.9	3.4	2.8	-21.3	30.5	26.6	4.4	4.6	1.9	2.9	
Net exports	6.8	-1.6	-1.6	4.3	-2.2	8.6	15.3	8.4	2.9	3.8	3.8	3.8	

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

1/ Projections reflect unchanged policies scenario, including no additional spending on Bitcoin, and no large benefits to the economy from using Bitcoin as legal tender and Chivo wallet (see Box 4).

2/ Nonfinancial public sector, including CIP-A pension bonds. Does not include "Bitcoin" bonds.

3/ Includes inventories.

Table 3a. El Salvador: Balance of Payments¹
(In millions of U.S. dollars)

	2015	2016	2017	2018	2019	2020	Projections					
							2021	2022	2023	2024	2025	2026
Current Account	-754	-550	-465	-859	-165	121	-1,098	-727	-812	-1,039	-1,316	-1,454
Merchandise trade balance	-4,970	-4,654	-4,845	-5,640	-5,711	-5,204	-8,000	-8,355	-8,855	-9,394	-9,957	-10,464
Export of goods (f.o.b.)	4,437	4,322	4,667	4,736	4,748	4,158	5,131	5,481	5,739	5,986	6,168	6,348
Import of goods (f.o.b.)	9,407	8,976	9,512	10,376	10,458	9,363	13,132	13,837	14,594	15,380	16,126	16,812
Of which: Petroleum and products	1,312	1,114	1,290	1,654	1,494	944	1,517	1,641	1,635	1,687	1,795	1,881
Services, net	959	808	733	882	1,239	679	1,121	1,434	1,637	1,753	1,900	2,088
Of which: Travel receipts	817	829	873	1,014	1,306	636	954	1,241	1,348	1,469	1,604	1,757
Primary income, net	-1,092	-1,246	-1,388	-1,470	-1,337	-1,314	-1,495	-1,613	-1,730	-1,823	-1,956	-2,029
Of which: Interest	-351	-391	-443	-476	-449	-442	-662	-660	-752	-821	-930	-987
Secondary income, net	4,349	4,542	5,034	5,369	5,644	5,960	7,277	7,807	8,135	8,425	8,697	8,952
Of which: Workers' remittances (credits)	4,257	4,544	4,978	5,373	5,631	5,911	7,273	7,811	8,155	8,468	8,770	9,061
Capital Account, net	65	70	85	203	226	317	208	208	232	238	241	226
Financial Account												
(Net lending (+)/Net borrowing (-))	-878	-1,239	-860	-1,250	-1,075	1,024	-317	-990	-787	-1,124	-1,315	-1,371
Foreign direct investment, net	-396	-348	-889	-826	-636	-201	-774	-566	-582	-577	-494	-522
Net acquisition of financial assets	98	132	-385	-413	61	97	65	65	59	54	49	51
Net incurrence of liabilities	495	479	504	413	696	299	839	631	641	631	543	573
Of which: Reinvested earnings	280	301	575	513	110	186	210	166	160	155	149	145
Portfolio investment, net	-59	-365	-321	110	-38	261	181	-884	-784	-1,347	-1,617	-1,187
Net acquisition of financial assets	-58	-124	23	7	158	1,088	181	216	221	263	286	235
Net incurrence of liabilities	1	241	344	-103	195	827	0	1,100	1,005	1,610	1,903	1,422
Of which: Public sector	1	241	344	-82	201	839	0	1,000	900	1,400	1,687	1,200
Financial derivatives, net	0	0	0	0	0	0	0	0	0	0	0	0
Other investment, net	-423	-526	351	-533	-402	963	276	460	578	799	797	338
Net acquisition of financial assets	-131	323	361	-493	12	615	-172	-197	-10	-105	-7	0
Net incurrence of liabilities	293	849	10	40	413	-348	-448	-658	-589	-904	-803	-338
Errors and Omissions, net	-77	-307	-172	-592	-260	-1,193	0	0	0	0	0	0
Overall balance	113	452	308	2	876	-1,779	-573	470	207	323	240	142
Financing	-113	-452	-308	-2	-876	1,779	573	-470	-207	-323	-240	-142
Change in Reserve Assets (-=increase)	-113	-452	-308	-2	-876	1,387	-427	-470	-106	-121	-139	-142
Change in reserve requirements 2/	-95	-133	-309	-98	-549	1,265	-377	-357	-221	-121	-117	-109
Change in reserve position in the IMF	0	0	0	0	0	0	-392	0	0	0	0	0
Other changes in reserve assets	-18	-319	0	96	-327	122	341	-113	115	0	-22	-33
Exceptional Financing						392	1,000	0	-101	-202	-101	0
Of which: IMF						392	0	0	0	0	0	0
Repayments						0	0	0	-101	-202	-101	0
Of which: Other multilaterals						0	1,000	0	0	0	0	0
Unidentified financing	0	0	0	0	0	0	0	0	0	0	0	0
Memorandum Items												
Gross international reserves	2,787	3,238	3,567	3,569	4,446	3,083	3,510	3,980	4,087	4,208	4,346	4,488
In months of imports	3.1	3.6	3.8	3.5	4.3	3.4	2.8	3.0	2.9	2.9	2.8	2.8
In percent of total short-term external debt	138	128	175	172	201	165	182	177	191	174	166	177
External debt	15,493	16,297	16,474	16,661	17,410	18,349	19,094	20,711	21,856	23,593	25,349	25,257
Of which: Public sector debt	9,454	9,977	10,029	10,190	10,895	11,868	11,917	13,147	14,257	15,709	17,270	17,249
Of which: Private sector debt	6,040	6,320	6,445	6,471	6,515	6,481	7,178	7,564	7,600	7,884	8,079	8,009
International Investment Position, net	-14,689	-15,894	-16,479	-16,710	-17,508	-17,069	-17,591	-18,812	-19,876	-21,422	-23,753	-23,521

Sources: Central Reserve Bank of El Salvador and IMF staff estimates. Presented in BPM6 format.

1/ Projections reflect unchanged policies scenario, including no additional spending on Bitcoin, and no large benefits to the economy from using Bitcoin as legal tender and Chivo wallet (see Box 4).

2/ Banks' reserve requirements are part of bilateral Emergency Liquidity Assistance (ELA) framework, and invested by the Central Bank in highly liquid external assets.

Table 3b. El Salvador: Balance of Payments¹
(Percent of GDP)

	2015	2016	2017	2018	2019	2020	Projections					
							2021	2022	2023	2024	2025	2026
Current Account	-3.2	-2.3	-1.9	-3.3	-0.6	0.5	-3.9	-2.5	-2.7	-3.3	-4.0	-4.3
Merchandise trade balance	-21.2	-19.2	-19.4	-21.7	-21.2	-21.1	-28.7	-28.4	-29.0	-29.7	-30.5	-31.1
Export of goods (f.o.b.)	18.9	17.9	18.7	18.2	17.7	16.9	18.4	18.6	18.8	18.9	18.9	18.9
Import of goods (f.o.b.)	40.1	37.1	38.1	39.9	38.9	38.0	47.1	47.0	47.8	48.6	49.4	50.0
Of which: Petroleum and products	5.6	4.6	5.2	6.4	5.6	3.8	5.4	5.6	5.4	5.3	5.5	5.6
Services, net	4.1	3.3	2.9	3.4	4.6	2.8	4.0	4.9	5.4	5.5	5.8	6.2
Of which: Travel receipts	3.5	3.4	3.5	3.9	4.9	2.6	3.4	4.2	4.4	4.6	4.9	5.2
Primary income, net	-4.7	-5.2	-5.6	-5.6	-5.0	-5.3	-5.4	-5.5	-5.7	-5.8	-6.0	-6.0
Of which: Interest	-1.5	-1.6	-1.8	-1.8	-1.7	-1.8	-2.4	-2.2	-2.5	-2.6	-2.8	-2.9
Secondary income, net	18.6	18.8	20.2	20.6	21.0	24.2	26.1	26.5	26.6	26.6	26.6	26.6
Of which: Workers' remittances (credits)	18.2	18.8	19.9	20.6	20.9	24.0	26.1	26.5	26.7	26.8	26.8	26.9
Capital Account, net	0.3	0.3	0.3	0.8	0.8	1.3	0.7	0.7	0.8	0.8	0.7	0.7
Financial Account												
(Net lending (+)/Net borrowing (-))	-3.7	-5.1	-3.4	-4.8	-4.0	4.2	-1.1	-3.4	-2.6	-3.6	-4.0	-4.1
Foreign direct investment, net	-1.7	-1.4	-3.6	-3.2	-2.4	-0.8	-2.8	-1.9	-1.9	-1.8	-1.5	-1.6
Net acquisition of financial assets	0.4	0.5	-1.5	-1.6	0.2	0.4	0.2	0.2	0.2	0.2	0.2	0.2
Net incurrence of liabilities	2.1	2.0	2.0	1.6	2.6	1.2	3.0	2.1	2.1	2.0	1.7	1.7
Of which: Reinvested earnings	1.2	1.2	2.3	2.0	0.4	0.8	0.8	0.6	0.5	0.5	0.5	0.4
Portfolio investment, net	-0.3	-1.5	-1.3	0.4	-0.1	1.1	0.6	-3.0	-2.6	-4.3	-4.9	-3.5
Net acquisition of financial assets	-0.2	-0.5	0.1	0.0	0.6	4.4	0.6	0.7	0.7	0.8	0.9	0.7
Net incurrence of liabilities	0.0	1.0	1.4	-0.4	0.7	3.4	0.0	3.7	3.3	5.1	5.8	4.2
Of which: Public sector	0.0	1.0	1.4	-0.3	0.7	3.4	0.0	3.4	2.9	4.4	5.2	3.6
Other investment, net	-1.8	-2.2	1.4	-2.0	-1.5	3.9	1.0	1.6	1.9	2.5	2.4	1.0
Net acquisition of financial assets	-0.6	1.3	1.4	-1.9	0.0	2.5	-0.6	-0.7	0.0	-0.3	0.0	0.0
Net incurrence of liabilities	1.2	3.5	0.0	0.2	1.5	-1.4	-1.6	-2.2	-1.9	-2.9	-2.5	-1.0
Errors and Omissions, net	-0.3	-1.3	-0.7	-2.3	-1.0	-4.8	0.0	0.0	0.0	0.0	0.0	0.0
Overall balance	0.5	1.9	1.2	0.0	3.3	-7.2	-2.1	1.6	0.7	1.0	0.7	0.4
Financing	-0.5	-1.9	-1.2	0.0	-3.3	7.2	2.1	-1.6	-0.7	-1.0	-0.7	-0.4
Change in Reserve Assets (-=increase)	-0.5	-1.9	-1.2	0.0	-3.3	5.6	-1.5	-1.6	-0.3	-0.4	-0.4	-0.4
Change in reserve requirements 2/	-0.4	-0.5	-1.2	-0.4	-2.0	5.1	-1.4	-1.2	-0.7	-0.4	-0.4	-0.3
Change in reserve position in the IMF	0.0	0.0	0.0	0.0	0.0	0.0	-1.4	0.0	0.0	0.0	0.0	0.0
Other changes in reserve assets	-0.1	-1.3	0.0	0.4	-1.2	0.5	1.2	-0.4	0.4	0.0	-0.1	-0.1
Exceptional Financing						1.6	3.6	0.0	-0.3	-0.6	-0.3	0.0
Of which: IMF						1.6	0.0	0.0	0.0	0.0	0.0	0.0
Repayments						0.0	0.0	0.0	-0.3	-0.6	-0.3	0.0
Of which: Other multilaterals						0.0	3.6	0.0	0.0	0.0	0.0	0.0
Unidentified Financing	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Memorandum Items												
Gross international reserves	11.9	13.4	14.3	13.7	16.5	12.5	12.6	13.5	13.4	13.3	13.3	13.3
In months of imports	3.1	3.6	3.8	3.5	4.3	3.4	2.8	3.0	2.9	2.9	2.8	2.8
In percent of total short-term external debt	138.1	127.8	174.6	172.4	200.8	164.7	182.4	177.3	191.1	173.7	166.3	177.2
External debt	66.1	67.4	66.0	64.0	64.7	74.5	68.6	70.3	71.6	74.6	77.6	75.0
Of which: Public sector debt	40.3	41.2	40.1	39.2	40.5	48.2	42.8	44.7	46.7	49.7	52.9	51.2
Of which: Private sector debt	25.8	26.1	25.8	24.9	24.2	26.3	25.8	25.7	24.9	24.9	24.7	23.8
International Investment Position, net	-62.7	-65.7	-66.0	-64.2	-65.1	-69.3	-63.2	-63.9	-65.1	-67.7	-72.7	-69.9

Sources: Central Reserve Bank of El Salvador and IMF staff estimates. Presented in BPM6 format.

1/ Projections reflect unchanged policies scenario, including no additional spending on Bitcoin, and no large benefits to the economy from using Bitcoin as legal tender and Chivo wallet (see Box 4).

2/ Banks' reserve requirements are part of bilateral Emergency Liquidity Assistance (ELA) framework, and invested by the Central Bank in highly liquid external assets.

Table 4. El Salvador: Gross External Financing Requirements and Sources¹
(In millions of U.S. dollars and percent of GDP)

	2015	2016	2017	2018	2019	2020	Proj.					
							2021	2022	2023	2024	2025	2026
	(Millions of U.S. dollars)											
Gross Financing Requirements (A)	4,139	4,133	5,317	5,499	6,476	5,119	5,863	5,822	7,445	6,970	8,209	7,712
Current account deficit	754	550	465	859	165	-121	1,098	727	812	1,039	1,316	1,454
Public debt amortization	319	320	604	458	1,031	296	312	309	1,386	789	1,357	435
Private debt amortization	3,067	3,263	4,249	4,182	5,280	4,944	4,454	4,786	5,247	5,142	5,537	5,823
Gross reserves accumulation (B)	113	452	308	2	876	-1,387	427	470	106	121	139	142
Gross Financing Sources (C)	4,253	4,585	5,626	5,501	7,352	3,732	6,291	6,292	7,551	7,091	8,348	7,854
FDI (net)	396	348	889	826	636	201	774	566	582	577	494	522
Public sector debt disbursements	332	671	1,024	646	1,301	1,635	1,406	1,702	2,538	2,050	3,300	2,041
Private sector debt disbursements	3,582	3,857	4,111	4,366	5,430	5,164	3,563	3,828	4,197	4,113	4,429	4,658
Other capital flows (net)	-58	-291	-398	-337	-14	-3,269	547	195	234	351	124	633
Unidentified Financing (A+B-C)	0	0	0	0	0	0	0	0	0	0	0	0
	(Percent of GDP)											
Gross Financing Requirements (A)	17.7	17.1	21.3	21.1	24.1	20.8	21.1	19.8	24.4	22.0	25.1	22.9
Current account deficit	3.2	2.3	1.9	3.3	0.6	-0.5	3.9	2.5	2.7	3.3	4.0	4.3
Public debt amortization	1.4	1.3	2.4	1.8	3.8	1.2	1.1	1.0	4.5	2.5	4.2	1.3
Private debt amortization	13.1	13.5	17.0	16.1	19.6	20.1	16.0	16.3	17.2	16.3	16.9	17.3
Gross reserves accumulation (B)	0.5	1.9	1.2	0.0	3.3	-5.6	1.5	1.6	0.3	0.4	0.4	0.4
Gross Financing Sources (C)	18.1	19.0	22.5	21.1	27.3	15.1	22.6	21.4	24.7	22.4	25.5	23.3
FDI (net)	1.7	1.4	3.6	3.2	2.4	0.8	2.8	1.9	1.9	1.8	1.5	1.6
Public sector debt disbursements	1.4	2.8	4.1	2.5	4.8	6.6	5.0	5.8	8.3	6.5	10.1	6.1
Private sector debt disbursements	15.3	15.9	16.5	16.8	20.2	21.0	12.8	13.0	13.7	13.0	13.6	13.8
Other capital flows (net)	-0.2	-1.2	-1.6	-1.3	-0.1	-13.3	2.0	0.7	0.8	1.1	0.4	1.9
Unidentified Financing (A+B-C)	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Memorandum Items												
External public debt servicing (US\$ million)	707	724	1,055	947	1,522	788	919	948	2,034	1,463	2,040	1,199
Percent of GDP	3.0	3.0	4.2	3.6	5.7	3.2	3.3	3.2	6.7	4.6	6.2	3.6
Percent of exports of goods and services	10.2	10.5	14.6	12.5	19.1	12.5	11.1	10.5	21.4	14.8	19.9	11.3

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

1/ Projections reflect unchanged policies scenario, including no additional spending on Bitcoin, and no large benefits to the economy from using Bitcoin as legal tender and Chivo wallet (see Box 4).

Table 5a. El Salvador: Statement of Operations of the Nonfinancial Public Sector¹
(Percent of GDP)

	2016	2017	2018	2019	2020	Proj.					
						2021	2022	2023	2024	2025	2026
Revenue	24.4	25.2	24.6	24.1	24.5	26.7	27.1	27.5	27.5	27.5	27.5
Taxes	17.2	17.6	18.0	17.7	18.5	20.4	20.9	21.3	21.3	21.3	21.3
Taxes on income	6.9	6.9	7.0	7.0	7.6	7.6	7.6	8.1	8.1	8.1	8.1
Taxes on property	0.1	0.1	0.1	0.1	0.1	0.1	0.1	0.1	0.1	0.1	0.1
Taxes on goods and services	8.6	8.7	8.9	8.9	9.3	11.0	11.2	11.2	11.2	11.2	11.2
Taxes on foreign trade	0.9	0.8	0.9	0.9	0.8	1.1	1.1	1.1	1.1	1.1	1.1
Other taxes	0.9	1.1	1.1	0.8	0.7	0.6	0.9	0.8	0.8	0.8	0.8
Social contributions	2.2	2.3	2.3	2.2	2.4	2.3	2.3	2.3	2.3	2.3	2.3
Other revenue	4.7	5.1	4.1	3.7	3.2	3.9	3.9	3.9	3.9	3.9	3.9
Grants	0.2	0.2	0.2	0.4	0.5	0.1	0.1	0.1	0.0	0.0	0.0
Expenditure	27.5	27.8	27.3	27.2	32.7	32.4	32.1	32.6	32.7	33.7	33.7
Expense	24.3	25.1	24.2	24.2	30.1	29.4	28.3	28.8	28.8	29.8	29.7
Compensation of employees	10.5	10.5	10.6	10.8	12.4	12.3	12.8	12.8	12.9	13.0	13.0
Purchases of goods and services	5.5	5.3	5.0	5.0	5.6	4.9	4.8	4.6	4.6	4.6	4.6
Interest	2.9	3.2	3.6	3.7	4.4	4.6	4.9	5.8	5.7	6.6	6.6
Subsidies	0.0	0.1	0.1	0.2	0.3	0.8	0.1	0.1	0.1	0.1	0.1
Social benefits	5.0	5.5	4.4	4.2	7.1	5.8	5.2	5.0	5.0	4.9	4.9
Other expense	0.5	0.6	0.5	0.5	0.4	1.0	0.4	0.4	0.4	0.4	0.4
Current	0.2	0.3	0.2	0.2	0.2	0.7	0.2	0.2	0.2	0.2	0.2
Capital	0.2	0.3	0.3	0.2	0.2	0.3	0.3	0.3	0.3	0.3	0.3
Net acquisition of nonfinancial assets	3.1	2.7	3.1	3.0	2.6	3.1	3.7	3.8	3.9	3.9	3.9
Net lending/borrowing	-3.1	-2.5	-2.7	-3.1	-8.2	-5.8	-4.9	-5.1	-5.2	-6.2	-6.2
Net financial transactions	-3.1	-2.5	-2.7	-3.1	-8.2	-5.8	-4.9	-5.1	-5.2	-6.2	-6.2
Net acquisition of financial assets	0.5	-0.1	0.1	0.0	2.0	-0.2	0.0	0.0	0.0	0.0	0.0
Foreign	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Domestic	0.5	-0.1	0.1	0.0	2.0	-0.2	0.0	0.0	0.0	0.0	0.0
Net incurrence of liabilities	3.6	2.5	2.8	3.1	10.2	5.5	4.9	5.1	5.2	6.2	6.2
Foreign	0.7	1.5	0.5	0.8	5.2	3.9	4.7	3.8	4.0	5.9	4.8
Loans	0.7	1.5	0.5	0.8	5.2	3.9	4.7	3.8	4.0	5.9	4.8
Disbursement	2.8	4.1	2.5	4.8	6.6	5.0	5.8	8.3	6.5	10.1	6.1
Amortizations	-2.0	-2.6	-2.0	-4.0	-1.4	-1.1	-1.0	-4.5	-2.5	-4.2	-1.3
Domestic	2.9	1.0	2.3	2.3	5.0	1.6	0.2	1.4	1.2	0.2	1.4
Loans	2.6	1.0	2.3	2.3	4.9	1.6	0.2	1.4	1.2	0.2	1.4
Other	0.3	0.0	0.0	0.0	0.1	0.0	0.0	0.0	0.0	0.0	0.0
Memorandum items (mill. of US\$ unless otherwise specified):											
Revenue	5,892	6,304	6,390	6,488	6,043	7,424	7,992	8,401	8,702	8,987	9,265
Taxes	4,166	4,407	4,680	4,760	4,549	5,674	6,144	6,493	6,730	6,959	7,173
Expenditure	6,643	6,935	7,094	7,314	8,061	9,034	9,440	9,970	10,345	11,011	11,336
Interest	705	800	938	991	1,081	1,290	1,446	1,776	1,810	2,170	2,227
Net lending	-751	-632	-704	-825	-2,018	-1,610	-1,447	-1,569	-1,643	-2,024	-2,071
Taxes (percent of revenue)	70.7	69.9	73.2	73.4	75.3	76.4	76.9	77.3	77.3	77.4	77.4
Compensation of employees (percent of expenditure)	38.1	37.7	38.9	39.6	38.0	37.9	40.0	39.1	39.4	38.6	38.6
Interest (percent of expenditure)	10.6	11.5	13.2	13.6	13.4	14.3	15.3	17.8	17.5	19.7	19.6
Primary balance (percent of GDP)	-0.2	0.7	0.9	0.6	-3.8	-1.1	0.0	0.7	0.5	0.4	0.5
Cyclically adjusted primary balance (percent of GDP)	-0.2	0.7	0.9	0.6	-1.5	-0.6	0.2	0.8	0.6	0.5	0.6
Structural primary balance (percent of GDP)	-0.2	0.7	0.9	0.6	0.0	-0.1	0.2	0.8	0.6	0.5	0.6
Fiscal impulse (percentage points)	-0.7	-0.9	-0.2	0.3	0.5	0.1	-0.3	-0.6	0.2	0.1	0.0
External disbursements	671	1,024	646	1,301	1,635	1,406	1,702	2,538	2,050	3,300	2,041
Nominal GDP	24,191	24,979	26,021	26,897	24,639	27,855	29,442	30,539	31,626	32,675	33,657

Sources: Department of the Treasury, Central Bank, and IMF staff estimates and projections.

1/ All budgetary costs incurred or committed in 2021-2021 related to the adoption of Bitcoin as a legal tender and the implementation of Chivo are included, but no further buying of Bitcoin is included.

Table 5b. El Salvador: Statement of Operations of the Central Government¹
(Percent of GDP)

	2016	2017	2018	2019	2020	Proj.					
						2021	2022	2023	2024	2025	2026
Revenue	18.1	19.1	19.3	19.0	19.9	21.3	21.9	22.3	22.3	22.3	22.3
Taxes	17.2	17.6	18.0	17.7	18.5	20.4	20.9	21.3	21.3	21.3	21.3
Taxes on income	6.9	6.9	7.0	7.0	7.6	7.6	7.6	8.1	8.1	8.1	8.1
Taxes on property	0.1	0.1	0.1	0.1	0.1	0.1	0.1	0.1	0.1	0.1	0.1
Taxes on goods and services	8.6	8.7	8.9	8.9	9.3	11.0	11.2	11.2	11.2	11.2	11.2
Taxes on foreign trade	0.9	0.8	0.9	0.9	0.8	1.1	1.1	1.1	1.1	1.1	1.1
Other taxes	0.9	1.1	1.1	0.8	0.7	0.6	0.9	0.8	0.8	0.8	0.8
Other revenue	0.8	1.4	1.0	0.9	0.9	0.8	0.9	0.9	0.9	0.9	0.9
Grants	0.1	0.2	0.2	0.4	0.5	0.1	0.1	0.1	0.0	0.0	0.0
Expenditure	21.1	21.5	21.8	21.9	28.3	27.9	29.5	30.0	30.1	31.0	31.1
Expense	19.9	20.5	20.4	20.6	26.5	25.8	26.7	27.1	27.1	28.0	28.1
Compensation of employees	6.6	6.5	6.5	6.7	7.8	7.6	8.2	8.3	8.5	8.6	8.6
Purchases of goods and services	2.5	2.1	2.3	2.3	2.5	1.9	1.9	1.9	1.9	1.9	1.9
Interest	2.8	3.1	3.4	3.5	4.2	4.4	4.6	5.5	5.4	6.2	6.2
Subsidies	0.0	0.0	0.0	0.0	0.1	0.0	0.0	0.0	0.0	0.0	0.0
Grants	6.4	6.4	5.9	5.8	7.1	6.9	6.9	6.9	6.9	6.8	6.8
Current	4.9	5.0	4.5	4.4	5.9	5.7	5.7	5.7	5.7	5.6	5.6
Capital	1.5	1.4	1.4	1.4	1.2	1.2	1.2	1.2	1.2	1.2	1.2
Social benefits	1.3	1.8	2.0	2.0	4.5	4.7	4.3	4.1	4.1	4.1	4.2
Other expense	0.3	0.5	0.3	0.3	0.3	0.3	0.8	0.3	0.3	0.3	0.3
Current	0.0	0.2	0.1	0.1	0.1	0.1	0.6	0.1	0.1	0.1	0.1
Capital	0.2	0.3	0.3	0.2	0.2	0.2	0.2	0.2	0.2	0.2	0.2
Net acquisition of nonfinancial assets	1.2	1.0	1.4	1.4	1.8	2.1	2.7	2.9	3.0	3.0	3.0
Net lending/borrowing	-3.0	-2.3	-2.5	-2.9	-8.4	-6.6	-7.6	-7.7	-7.9	-8.8	-8.8
Net financial transactions	-3.0	-2.3	-2.5	-2.9	-8.4	-6.6	-7.6	-7.7	-7.9	-8.8	-8.8
Net acquisition of financial assets	0.5	-0.1	0.1	0.0	2.0	-0.2	0.0	0.0	0.0	0.0	0.0
Foreign	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Domestic	0.5	-0.1	0.1	0.0	2.0	-0.2	0.0	0.0	0.0	0.0	0.0
Net incurrence of liabilities	3.5	2.2	2.6	2.9	10.4	6.3	7.6	7.7	7.9	8.8	8.8
Foreign	0.5	0.9	0.5	0.9	5.3	3.9	4.7	3.8	4.0	5.9	4.8
Loans	0.5	0.9	0.5	0.9	5.3	3.9	4.7	3.8	4.0	5.9	4.8
Disbursement	2.5	3.4	2.3	4.7	6.5	5.0	5.8	8.3	6.5	10.1	6.1
Amortizations	-1.9	-2.4	-1.8	-3.8	-1.2	-1.1	-1.0	-4.5	-2.5	-4.2	-1.3
Domestic	3.0	1.3	2.1	2.0	5.2	2.4	2.8	3.9	3.9	2.8	4.0
Loans	2.7	1.5	2.2	2.2	5.0	2.4	2.8	3.9	3.9	2.8	4.0
Other	0.3	-0.2	-0.1	-0.2	0.2	0.0	0.0	0.0	0.0	0.0	0.0
Memorandum items (mill. of US\$ unless otherwise specified):											
Revenue	4,388	4,783	5,009	5,121	4,894	5,935	6,443	6,800	7,041	7,277	7,498
Taxes	4,166	4,407	4,680	4,760	4,549	5,674	6,144	6,493	6,730	6,959	7,173
Expenditure	5,115	5,369	5,667	5,903	6,975	7,762	8,671	9,156	9,524	10,139	10,456
Interest	667	768	881	933	1,034	1,214	1,361	1,671	1,703	2,042	2,096
Net lending	-728	-587	-658	-782	-2,080	-1,827	-2,228	-2,356	-2,483	-2,862	-2,958
Taxes (percent of revenue)	95.0	92.1	93.4	92.9	92.9	95.6	95.4	95.5	95.6	95.6	95.7
Compensation of employees (percent of expenditure)	31.3	30.3	30.1	30.6	27.4	27.3	27.9	27.8	28.2	27.8	27.7
Interest (percent of expenditure)	13.0	14.3	15.6	15.8	14.8	15.6	15.7	18.2	17.9	20.1	20.0
External disbursements	595	839	603	1,267	1,591	1,406	1,702	2,538	2,050	3,300	2,041
Primary balance (percent of GDP)	-0.3	0.7	0.9	0.6	-4.2	-2.2	-2.9	-2.2	-2.5	-2.5	-2.6
Nominal GDP	24,191	24,979	26,021	26,897	24,639	27,855	29,442	30,539	31,626	32,675	33,657

Sources: Department of the Treasury, Central Bank, and IMF staff estimates and projections.

1/ All budgetary costs incurred or committed in 2021-2021 related to the adoption of Bitcoin as a legal tender and the implementation of Chivo are included, but no further buying of Bitcoin is included.

Table 6. El Salvador: Public Sector Financing Requirements and Sources¹
(In millions of U.S. dollars and percent of GDP)

	2017	2018	2019	2020	Projections					
					2021	2022	2023	2024	2025	2026
	(Millions of U.S. dollars)									
Gross Financing Requirements	2,517	2,018	3,059	3,847	4,086	4,598	5,737	5,297	6,620	5,383
Overall deficit	632	704	825	2,018	1,610	1,447	1,569	1,643	2,024	2,071
Public debt amortizations	1,886	1,314	2,234	1,400	1,831	2,036	3,053	2,540	3,481	2,197
External	604	458	1,082	349	312	309	1,386	789	1,357	435
Multilateral and bilateral	604	458	282	349	312	309	586	789	557	435
Bonds	0	0	800	0	0	0	800	0	800	0
Domestic	1,282	856	1,152	1,051	1,519	1,727	1,667	1,751	2,124	1,762
Of which: Short-term debt (LETES) 2/	1,105	813	896	1,009	1,355	1,424	1,495	1,570	1,570	1,570
Other	0	0	0	429	646	1,115	1,115	1,115	1,115	1,115
Sources of Financing	2,517	2,017	3,060	3,847	4,086	4,598	5,737	5,298	6,621	5,384
Domestic	1,563	1,469	1,476	2,210	2,680	2,896	3,199	3,198	3,321	3,343
Pension bonds	-560	366	346	271	313	279	272	265	260	253
Drawdown of deposits	15	16	-3	-65	65	0	0	0	0	0
Short-term debt (LETES) 2/	732	833	991	1,427	1,424	1,495	1,570	1,570	1,570	1,570
Others	1,376	254	142	577	878	1,122	1,357	1,363	1,491	1,520
External	955	548	1,584	1,637	1,406	1,702	2,538	2,100	3,300	2,041
Multilateral and bilateral 3/	354	548	287	798	1,406	702	838	700	700	841
Bonds	601	0	1,297	839	0	1,000	1,700	1,400	2,600	1,200
Unidentified Financing	0	0	0	0	0	0	0	0	0	0
	(Percent of GDP)									
Gross Financing Requirements	10.1	7.8	11.4	15.6	14.7	15.6	18.8	16.7	20.3	16.0
Overall deficit	2.5	2.7	3.1	8.2	5.8	4.9	5.1	5.2	6.2	6.2
Public debt amortizations	7.5	5.0	8.3	5.7	6.6	6.9	10.0	8.0	10.7	6.5
External	2.4	1.8	4.0	1.4	1.1	1.0	4.5	2.5	4.2	1.3
Multilateral and bilateral	2.4	1.8	1.0	1.4	1.1	1.0	1.9	2.5	1.7	1.3
Bonds	0.0	0.0	3.0	0.0	0.0	0.0	2.6	0.0	2.4	0.0
Domestic	5.1	3.3	4.3	4.3	5.5	5.9	5.5	5.5	6.5	5.2
Of which: Short-term debt (LETES) 2/	4.4	3.1	3.3	4.1	4.9	4.8	4.9	5.0	4.8	4.7
Other	0.0	0.0	0.0	1.7	2.3	3.8	3.7	3.5	3.4	3.3
Sources of Financing	10.1	7.8	11.4	15.6	14.7	15.6	18.8	16.8	20.3	16.0
Domestic	6.3	5.6	5.5	9.0	9.6	9.8	10.5	10.1	10.2	9.9
Pension bonds (CIP-A)	-2.2	1.4	1.3	1.1	1.1	0.9	0.9	0.8	0.8	0.8
Drawdown of deposits	-1.1	0.0	0.0	-0.3	0.2	0.0	0.0	0.0	0.0	0.0
Short-term debt (LETES) 2/	2.9	3.2	3.7	5.8	5.1	5.1	5.1	5.0	4.8	4.7
Others	5.5	1.0	0.5	2.3	3.2	3.8	4.4	4.3	4.6	4.5
External	3.8	2.1	5.9	6.6	5.0	5.8	8.3	6.6	10.1	6.1
Multilateral and bilateral 3/	1.4	2.1	1.1	3.2	5.0	2.4	2.7	2.2	2.1	2.5
Bonds 4/	2.4	0.0	4.8	3.4	0.0	3.4	5.6	4.4	8.0	3.6
Unidentified Financing	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0

Sources: Central Bank; Department of the Treasury; and IMF staff estimates.

1/ All budgetary costs incurred or committed in 2021-2021 related to the adoption of Bitcoin as a legal tender and the implementation of Chivo are included, but no further buying of Bitcoin is included.

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.

3/ Per article 148 of the Constitution, all loans must have two votes in the Legislature. One authorizing the Treasury for negotiations and one approving the loan contract. The last one requires qualified majority. Additionally, decree 608/2020 states that the Legislature should also approve the budget incorporation of each loan after it is disbursed.

Table 7. El Salvador: Summary Accounts of the Financial System¹
(In millions of U.S. dollars)

	2015	2016	2017	2018	2019	2020	2021	2022	Proj.			
	(End of period stocks; in millions of U.S. dollars)											
I. Central Bank												
Net Foreign Assets	2,393	2,630	3,032	3,152	3,754	2,252	2,541	3,008	3,114	3,235	3,157	3,273
Of which: Gross international reserves 2/	2,787	3,238	3,567	3,569	4,446	3,083	3,510	3,980	4,087	4,208	4,346	4,488
Of which: Gross international reserves net of liabilities 3/	221	541	561	464	792	695	745	858	743	743	765	797
Net Domestic Assets	280	162	113	97	28	187	276	141	141	141	276	275
Nonfinancial public sector (net)	726	609	623	616	617	580	616	481	481	481	616	615
Claims	830	829	829	835	834	834	834	834	834	834	834	834
Liabilities	103	220	205	219	217	254	218	353	353	353	218	219
Rest of the financial system (net)	93	146	106	122	91	-115	-50	-50	-50	-50	-50	-50
Other items (net)	-539	-593	-617	-640	-680	-278	-290	-290	-290	-290	-290	-290
Liabilities	2,675	2,794	3,147	3,252	3,785	2,437	2,817	3,174	3,396	3,517	3,634	3,743
Base Money	2,569	2,701	3,009	3,107	3,655	2,390	2,770	3,127	3,348	3,469	3,586	3,696
Liabilities to depository corporations 4/	2,565	2,698	3,006	3,104	3,654	2,388	2,765	3,122	3,343	3,465	3,582	3,691
Other liabilities to the public	107	94	138	145	130	48	48	48	48	48	48	48
II. Depository Corporations												
Net Foreign Assets	-990	-1,021	-703	-749	-657	498	475	487	531	576	619	660
Net Domestic Assets	11,938	12,341	13,216	14,015	15,411	15,730	16,859	17,671	18,389	19,038	19,663	20,247
Nonfinancial public sector (net)	765	721	585	758	927	1,776	1,966	2,038	2,112	2,112	2,112	2,112
Claims	1,020	961	812	1,000	1,185	2,208	2,217	2,288	2,363	2,363	2,363	2,363
Of which: LETES, CETES, and securities	857	791	643	827	981	1,996	2,039	2,110	2,185	2,185	2,185	2,185
Liabilities	255	241	227	242	258	432	251	251	251	251	251	251
Rest of the financial system (net)	2,191	2,064	2,398	2,332	2,784	1,713	2,104	2,428	2,609	2,695	2,879	3,060
Of which: Reserve requirements	2,497	2,628	2,924	3,029	3,532	2,265	2,628	2,985	3,206	3,328	3,445	3,554
Credit to the private sector	11,193	11,790	12,438	13,280	14,063	14,370	14,968	15,486	15,948	16,510	16,952	17,355
Other items (net)	-2,211	-2,234	-2,205	-2,355	-2,363	-2,129	-2,180	-2,280	-2,280	-2,280	-2,280	-2,280
Liabilities to the Private Sector	10,949	11,319	12,513	13,266	14,755	16,228	17,334	18,158	18,920	19,613	20,282	20,908
Deposits	10,599	10,975	12,145	12,831	14,286	15,704	16,739	17,560	18,323	19,016	19,684	20,310
Securities	350	345	368	435	468	524	596	598	598	598	598	598
III. Other Financial Corporations 5/												
Net Foreign Assets	501	386	317	311	327	295	286	341	447	506	504	495
Net Domestic Assets	8,500	9,319	10,263	11,088	12,087	12,995	13,698	14,265	14,674	14,730	14,847	14,969
Nonfinancial public sector (net)	7,019	7,678	8,362	9,057	9,577	10,207	10,742	11,220	11,616	11,705	11,794	11,882
Rest of the financial system (net)	1,105	1,218	1,537	1,648	1,980	1,504	1,584	1,649	1,712	1,768	1,773	1,772
Credit to the private sector	569	584	592	645	811	934	1,077	1,083	1,022	920	933	957
Other items (net)	-277	-235	-295	-319	-330	307	247	262	271	281	290	299
Liabilities to the Private Sector	9,001	9,705	10,580	11,399	12,415	13,290	13,984	14,606	15,121	15,236	15,351	15,464
Pension fund contributions	8,729	9,395	10,260	11,074	12,087	12,951	13,601	14,201	14,701	14,801	14,901	15,001
IV. Financial System												
Net Foreign Assets	1,904	1,995	2,645	2,714	3,424	3,046	3,303	3,836	4,093	4,317	4,280	4,429
Net Domestic Assets	18,570	19,504	21,064	22,625	24,541	27,192	28,601	29,535	30,571	31,169	32,004	32,608
Net claims on nonfinancial public sector	8,510	9,008	9,570	10,431	11,122	12,562	13,325	13,739	14,209	14,299	14,522	14,609
Credit to private sector	11,762	12,374	13,030	13,924	14,874	15,304	16,045	16,569	16,970	17,431	17,885	18,312
Other	-1,702	-1,878	-1,536	-1,730	-1,454	-674	-768	-773	-609	-560	-404	-314
Liabilities to the Private Sector	20,474	21,498	23,709	25,339	27,965	30,238	31,904	33,371	34,663	35,486	36,284	37,036
Money	3,115	2,970	3,497	3,623	4,047	4,570	4,916	5,033	5,105	5,169	5,229	5,285
Quasi-money	8,631	9,133	9,952	10,643	11,831	12,717	13,387	14,136	14,857	15,516	16,154	16,750
Pension fund contributions	8,729	9,395	10,260	11,074	12,087	12,951	13,601	14,201	14,701	14,801	14,901	15,001
(Percent changes relative to previous year's liabilities to the private sector)												
Net domestic assets	14.9	8.0	12.9	11.6	13.4	16.7	8.2	5.1	5.4	3.0	4.0	2.8
Nonfinancial public sector	10.0	4.2	4.6	6.4	4.8	9.1	4.4	2.3	2.5	0.4	1.1	0.4
Credit to the private sector	5.3	5.2	5.4	6.6	6.7	2.7	4.3	2.9	2.1	2.3	2.2	2.0
Liabilities to the private sector	12.4	8.7	18.3	12.1	18.4	14.3	9.6	8.0	6.7	4.1	3.9	3.5
(Percent of GDP)												
Credit to the private sector	50.2	51.2	52.2	53.5	55.3	62.1	57.6	56.3	55.6	55.1	54.7	54.4
Liabilities to the private sector	87.4	88.9	94.9	97.4	104.0	122.7	114.5	113.3	113.5	112.2	111.0	110.0
Excluding pension contributions	50.1	50.0	53.8	54.8	59.0	70.2	65.7	65.1	65.4	65.4	65.4	65.5
(Annual percentage change)												
Credit to the private sector	5.2	5.2	5.3	6.9	6.8	2.9	4.8	3.3	2.4	2.7	2.6	2.4
Private sector deposits in depository corporations	6.8	3.5	10.7	5.7	11.3	9.9	6.6	4.9	4.3	3.8	3.5	3.2
Depository corporations liquid deposits at central bank (In percent of total deposits)	24.2	24.6	24.8	24.2	25.6	15.2	16.5	17.8	18.2	18.2	18.2	18.2

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

1/ Projections reflect unchanged policies scenario, including no additional spending on Bitcoin, and no large benefits to the economy from using Bitcoin as legal tender and Chivo wallet (see Box 4).

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). Gross international reserves of BCR include required and excess reserve requirements of depository corporations.

3/ Gross international reserves of the BCR excluding required and excess reserve requirements of depository corporations.

4/ Required and excess reserve requirements of depository corporations at the BCR.

5/ Includes private pension funds, insurance corporations, and the State Development Bank.

Table 8. El Salvador: Financial Soundness Indicators Heatmap

El Salvador	2018Q4	2019Q1	2019Q2	2019Q3	2019Q4	2020Q1	2020Q2	2020Q3	2020Q4	2021Q1	2021Q2	Latest
Overall Financial Sector Rating	M	M	M	M	M	M	H	H	H	H	M	M
Credit cycle	L	L	L	L	L	L	H	H	H	H	M	M
Change in credit / GDP ratio (pp, annual)	1.3	1.2	1.1	1.0	1.3	2.1	5.0	6.3	6.0	6.0	4.9	4.9
Growth of credit / GDP (% , annual)	2.6	2.4	2.3	2.1	2.5	4.0	9.7	12.2	11.6	9.2	-0.6	-0.6
Credit-to-GDP gap (st. dev)	0.5	0.5	0.7	0.7	1.2	2.1	4.0	3.2	1.8	0.4	-2.3	-2.3
Balance Sheet Soundness	M	M	M	M	M	M	M	M	M	M	M	M
Balance Sheet Structural Risk	M	M	M	M	M	M	M	M	M	M	M	M
Deposit-to-loan ratio	95.2	96.1	96.5	98.2	100.4	102.8	103.8	106.0	110.5	111.2	110.6	110.6
FX liabilities % (of total liabilities)	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
FX loans % (of total loans)	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0
Balance Sheet Buffers	L	L	L	L	L	L	L	L	L	L	M	M
Leverage	L	L	L	L	L	L	L	L	L	L	L	L
Leverage ratio (%)	13.0	12.2	12.3	12.3	12.3	11.2	11.4	11.5	11.3	11.5	11.3	11.3
Profitability	L	L	L	L	L	L	L	L	L	L	L	L
ROA	1.1	1.1	1.2	1.1	1.1	1.1	0.8	0.9	0.8	1.2	1.2	1.2
ROE	8.7	9.0	9.3	9.1	9.1	9.4	7.3	7.5	6.9	10.6	10.9	10.9
Asset quality	L	L	L	L	L	L	L	L	L	M	H	H
NPL ratio	1.8	1.8	1.8	1.8	1.7	1.6	1.5	1.5	1.6	1.7	2.3	2.3
NPL ratio change (% , annual)	-2.5	-4.0	-6.3	-2.4	-6.8	-8.0	-14.1	-17.2	-8.7	6.1	47.2	47.2
Memo items:	2018Q4	2019Q1	2019Q2	2019Q3	2019Q4	2020Q1	2020Q2	2020Q3	2020Q4	2021Q1	2021Q2	Latest
Credit-to-GDP (%)	51.0	51.2	51.4	51.7	52.3	53.3	56.4	58.0	58.3	58.2	56.1	56.1
Credit-to-GDP gap (%; HP filter)	2.6	2.6	2.6	2.7	3.0	3.7	6.4	7.5	7.2	6.6	3.6	3.6
Credit growth (%; annual)	6.9	6.8	6.4	5.6	6.0	6.6	5.7	4.2	2.2	1.4	3.1	3.1
CAR (in %)	16.6	15.9	15.8	15.9	16.0	14.9	15.1	15.4	15.4	15.7	15.8	15.8
Tier 1 CAR (in %)	13.2	13.3	13.3	13.2	13.0	12.6	12.6	12.7	12.5	12.7	12.8	12.8

Table 9. El Salvador: Selected Vulnerability Indicators
(In percent of GDP, unless otherwise indicated)

	2012	2013	2014	2015	2016	2017	2018	2019	2020	Est. 2021
Fiscal Indicators										
Overall balance of the nonfinancial public sector	-3.8	-4.5	-4.0	-3.6	-3.1	-2.5	-2.7	-3.1	-8.2	-5.8
Primary balance of the nonfinancial public sector	-1.4	-1.8	-1.3	-0.9	-0.2	0.7	0.9	0.6	-3.8	-1.1
Gross public sector financing requirement	6.4	7.0	9.9	6.7	9.2	10.1	7.8	11.4	15.6	14.7
Public sector debt (gross) 1/	63.6	63.2	65.3	67.0	68.8	70.5	70.4	71.3	89.2	84.4
Public sector external debt	33.6	32.7	36.0	34.3	34.5	34.9	33.3	33.8	41.4	36.5
External interest payments to total fiscal revenue (percent)	6.4	6.8	6.7	7.2	7.0	7.2	8.3	8.5	11.5	9.1
External amortization payments to total fiscal revenue (percent)	5.7	4.9	5.1	6.3	8.4	10.3	8.0	16.7	5.8	4.2
Financial Indicators										
Broad money (percent change, end-of-period)	1.3	2.4	0.3	6.9	3.0	11.1	6.1	11.3	8.9	5.9
Private sector credit (percent change, end-of-period)	4.2	8.2	6.7	5.2	5.2	5.3	6.9	6.8	2.9	4.8
Ratio of capital to risk-weighted assets	17.3	17.3	16.6	16.8	17.3	16.8	16.6	16.0	14.7	...
Ratio of loans more than 90 days past due to total loans	2.9	2.3	2.4	2.3	2.1	1.9	1.8	1.7	1.4	...
Ratio of provisions to total loans	3.3	2.9	2.8	2.7	2.4	2.4	2.5	2.4	3.2	...
Ratio of provisions to loans more than 90 days past due	113.3	121.6	119.0	115.9	115.4	125.8	132.9	138.9	222.4	...
Return on average equity	12.4	12.4	10.0	7.9	6.6	7.4	8.7	9.1	6.9	...
Return on average total assets	1.6	1.6	1.3	1.0	0.9	1.0	1.1	1.1	0.7	...
Loans as percent of deposits	93.7	97.2	103.2	102.1	106.0	100.8	101.7	96.3	91.7	...
Ratio of liquid assets to total deposits	31.9	30.7	28.1	32.3	33.4	33.5	33.0	33.9	38.8	...
External Indicators										
Exports of goods and services (percent change, 12-month basis)	3.9	7.0	1.3	4.4	-0.6	5.1	4.7	5.5	-21.2	31.8
Imports of goods and services (percent change, 12-month basis)	2.9	6.3	-1.0	-1.0	-1.9	5.8	8.7	1.1	-13.2	40.3
Current account balance	-5.8	-6.9	-5.4	-3.2	-2.3	-1.9	-3.3	-0.6	0.5	-3.9
Capital and financial account balance	4.5	8.3	2.3	3.1	1.7	1.3	5.5	-1.7	10.0	2.6
Gross international reserves (millions of U.S. dollars)	3,175	2,745	2,693	2,787	3,238	3,567	3,569	4,446	3,083	3,510
Months of imports of goods and services, excluding maquila	-3.2	-2.8	-2.8	-3.0	-3.3	-3.3	-3.3	-4.7	-2.3	-2.5
Percent of short-term debt	209	150	134	138	128	175	172	201	165	182
Percent of gross external financing requirements	76	58	52	67	78	67	65	69	60	60
Percent of broad money	29.7	25.1	24.5	23.7	26.8	26.5	25.0	28.0	17.8	19.2
Public external debt service	2.7	2.6	2.6	3.0	3.0	4.3	3.7	5.7	3.5	3.2
External debt to exports of goods and services (percent)	205	215	225	224	237	228	220	218	292	230
External interest payments to exports of goods and services (percent)	-15.1	-15.9	-16.9	-17.1	-19.4	-20.9	-21.7	-19.1	-22.8	-19.5
External amortization to exports of goods and services (percent)	47.9	48.7	59.4	49.0	52.1	67.2	61.3	79.1	83.3	57.5
REER, depreciation is negative (percent change, end-of-period)	-1.8	-1.0	1.8	4.5	-1.0	-3.5	1.1	-2.6	-2.3	-0.7

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

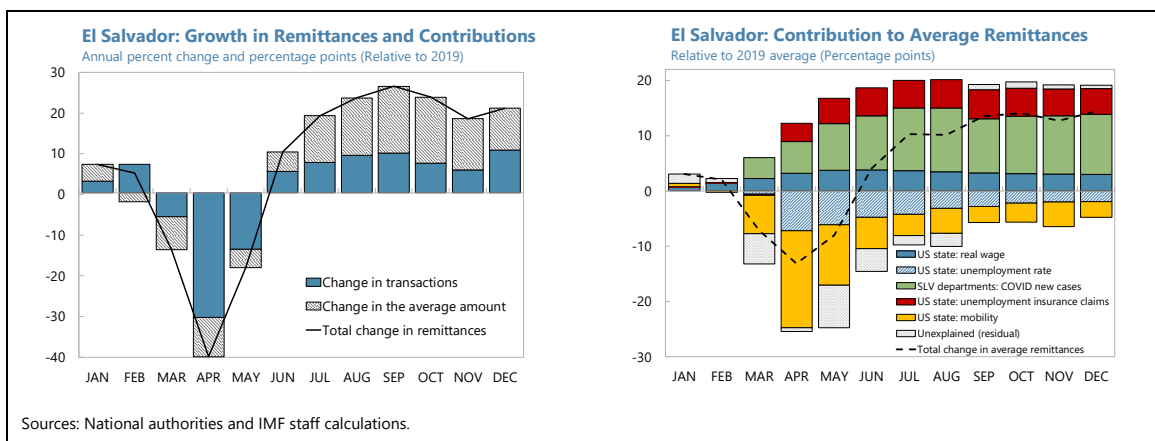
1/ Includes gross debt of the nonfinancial public sector and external debt of the central bank. Does not include "Bitcoin" bonds.

Table 10. Risk Assessment Matrix¹

Source of Risk	Likelihood/ Impact	Policy Response
Global Risks		
Subpar and volatile growth in countries prone to Covid-19 outbreaks. Uncontrolled outbreaks in slow-to-vaccinate countries force new lockdowns. For many, policy response to cushion the economic impact is constrained by lack of policy space.	Low Likelihood Medium Impact	Continue providing vaccination, testing and containment measures.
Disorderly transformations. Covid-19 triggers structural transformations, but the reallocation of resources is impeded by labor market rigidities, debt overhangs, and inadequate bankruptcy resolution frameworks. Adjustments in global value chains reduce trade and shift production activities across countries.	Medium Likelihood High Impact	Adopt bankruptcy resolution frameworks. Facilitate trade in the region and with the new markets. Ensure remaining membership in CAFTA.
De-anchoring of inflation expectations in the U.S. leads to rising core yields and risk premia. Sooner than expected tightening of the monetary policy in the U.S. could trigger a shift in market expectations, leading to a front-loaded tightening of financial conditions and higher risk premia, including for equities and emerging and frontier market currencies.	High Likelihood High Impact	Implement fiscal consolidation to reduce fiscal financing needs, improve debt dynamics and fiscal buffers. Improve financial sector liquidity buffers.
Domestic Risks		
Deterioration in the quality of political institutions. Concentration of political power without checks and balances could dampen investor confidence and hamper growth, especially if frictions with U.S. on trade and capital inflows emerge.	High Likelihood High Impact	The authorities should focus efforts and prioritize measures that will deliver growth, sustainability of public finances and financial stability. Increased transparency and accountability, allowing broader participation from society, and predictable policies will bring credibility to consolidation plans and therefore build investors' support.
Domestic policy slippages. Socio-political consensus around needed fiscal adjustment weakens.	High Likelihood High Impact	Forge consensus in the Legislative Assembly and with the private sector. Accelerate implementation of transparency and governance agenda.
Weakening social support for bold reforms. Public support for the envisaged bold and wide-ranging fiscal and governance reforms may erode, especially if the economic recovery falters.	Medium Likelihood Medium/High Impact	Ensure a broad-based policy dialogue to support macroeconomic stability. Stronger checks and balances among power branches could support reform implementation. Maintain the role of free press.
Natural disasters. El Salvador is exposed to earthquakes, floods, droughts, and hurricanes.	Medium Likelihood Medium/High Impact	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.
Bitcoin. Gaps in oversight and supervision of Bitcoin use, including from trading, and extreme volatility of price of Bitcoin, could impact balance sheets and thereby affect growth, if Bitcoin holding becomes widespread.	Medium Likelihood Medium/High Impact	Strengthen banks' Bitcoin risk oversight and incorporate prudential safeguards. Limit government's exposure to Bitcoin. Narrow the scope of the Bitcoin law and strengthen oversight of <i>Chivo</i> and ecosystem.
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.		

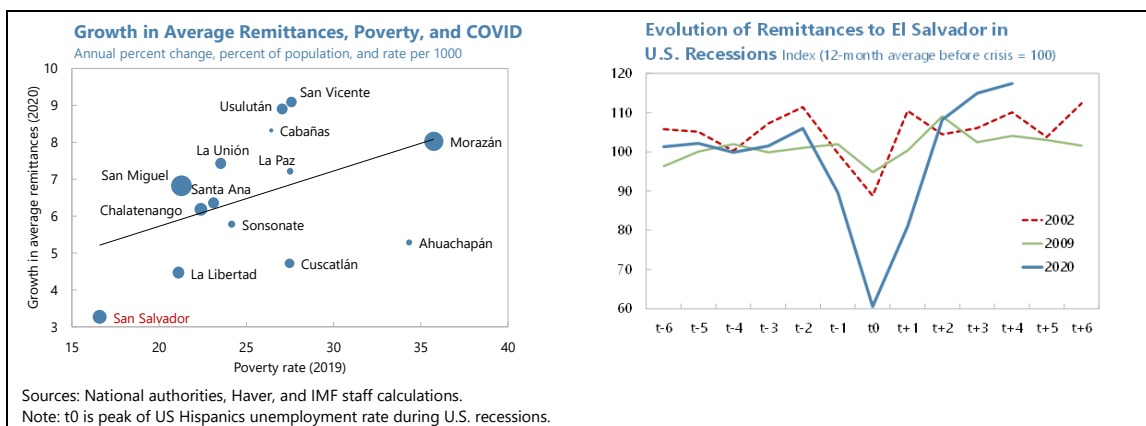
Box 1. Resilient Remittances

After an initial decline in 2020, remittances rebounded strongly. The collapse in remittances in April 2020 of 40 percent year-on-year mirrored the sharp increase in the US Hispanic unemployment rate. As the US Hispanic unemployment rate started recovering, so did remittances. However, remittances rebounded beyond what was expected from the U.S. Hispanic unemployment developments (reaching triple digits growth in 2021 Spring). The continuously elevated growth in remittances is due to an increase in the number of transactions as well as in the average value of remittances (charts).



Staff’s analysis¹ finds that both home and U.S. factors related to the pandemic explain the increase in average value of remittances:

- An increase in the *unemployment rate of Hispanics in the U.S.* predicted a decline in remittances in 2020. However, the U.S. COVID-19 unemployment relief offset the effect of lost jobs, allowing migrants to continue sending remittances, and at a higher average amount.
- The negative impact of *restricted mobility* in U.S. states reflected both the limited job opportunities for CAPDR migrants to earn an income and constraints these migrants faced to send remittances. As a result, lower mobility predicted a lower average value of remittances.
- Most importantly, the *altruism motive* was, and continues to be very strong. If the situation back home in El Salvador was difficult—represented by the new COVID-19 cases—Salvadorans in the U.S. continued to send higher remittances.



Box 1. Resilient Remittances (concluded)

Looking forward, strong growth in remittances is expected to be sustained, supported by the U.S. American Rescue Plan and recovery in the U.S. labor market. In particular, by the end of 2021 many jobs have been recovered in the U.S., in many of the sectors where Salvadoran-born migrants work. In historical terms, the recovery in remittances in 2020 was much stronger than in previous recessions. For example, following the 2008 recession, job recovery to the pre-recession level in the construction sector—the most affected sector, and where about 17 percent of Salvadoran migrants' work—took more than seven years, but in 2020 total remittances to El Salvador reached the pre-recession *level* in half that period.

^{1/}Based on the analysis of average remittances per transaction from 23 U.S. states and 14 Salvadoran departments, for the period from January 2017 to December 2020.

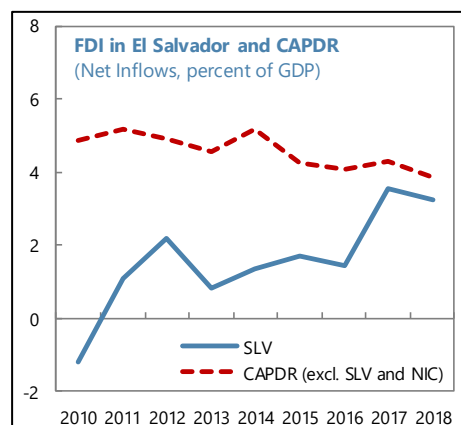
Box 2. Attracting More FDI to El Salvador

Although FDI inflows to El Salvador have been the lowest in the region, they picked up pre-pandemic.

Average net FDI inflows leaped in 2017—reaching more than 3 percent of GDP—close to the regional average. Inflows in manufacturing were particularly strong and were accompanied by an increase in exports and employment.

Using regional data and estimated coefficients from a cross-country panel regression staff finds that increasing competitiveness, reducing public debt and reducing political risk are key to attracting more FDI inflows:

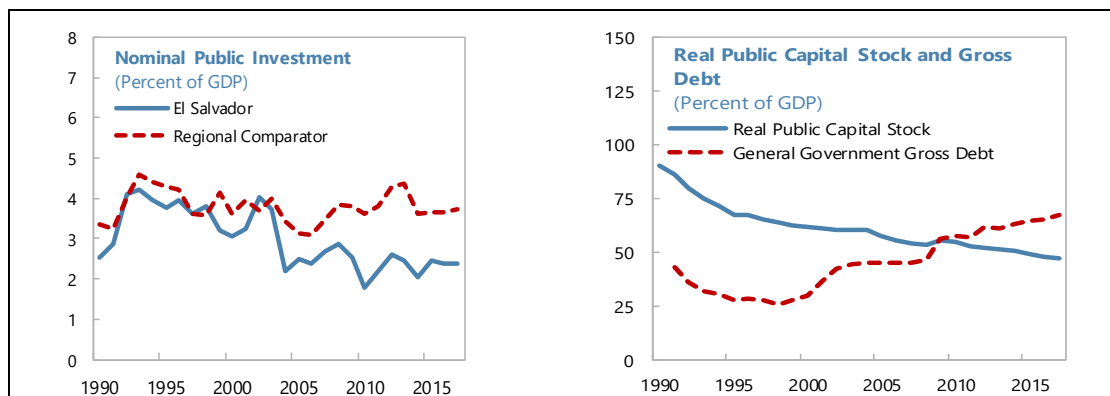
- *Increasing competitiveness* to the average regional level could raise FDI by 1.6 percentage points per year.
- *Reducing public debt* to 70 percent of GDP could raise FDI by 0.5 percentage point per year. A clearly articulated fiscal adjustment strategy could reduce uncertainty around future tax policy and lower borrowing costs also for private investors.
- *Reducing political risk* to the average regional level would raise FDI by 0.3 percentage point per year, all things equal. Political risk¹, a composite measure, captures aspects of government stability, corruption, military in politics, law and order, and democratic accountability, among others. This underscores the importance of continuing efforts to fight corruption, and more broadly upholding the rule of law, strengthening institutions, and avoiding political fragmentation.



^{1/} Political risk is a composite index that captures aspects of government stability, corruption, military in politics, law and order, and democratic accountability, among others (International Country Risk Guide).

Box 3. Ensuring Effectiveness and Efficiency of Public Spending and Reducing Risks

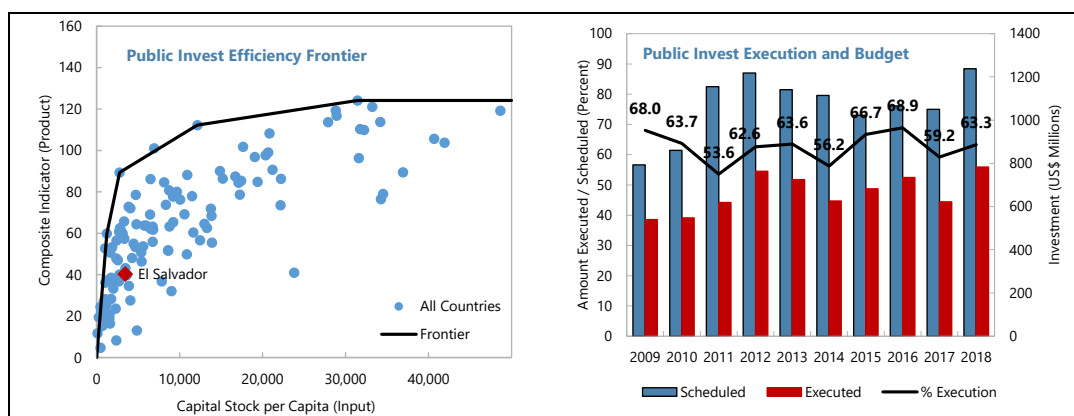
The efficiency of public investment spending continues to be low in El Salvador. Despite efforts to increase public investment, capital expenditure execution rates remain below 70 percent. Most difficulties originate from weaknesses in generating a pipeline of well-evaluated projects. Project design and environmental and social studies are prepared *after* the project has been budgeted, leading to significant delays and cost-overruns.



Proper project evaluation and design will be essential to improving the effectiveness of public investment. International evidence shows that cost overruns and implementation delays often originate from misdirected pressure for “accelerating” project preparation or implementation.

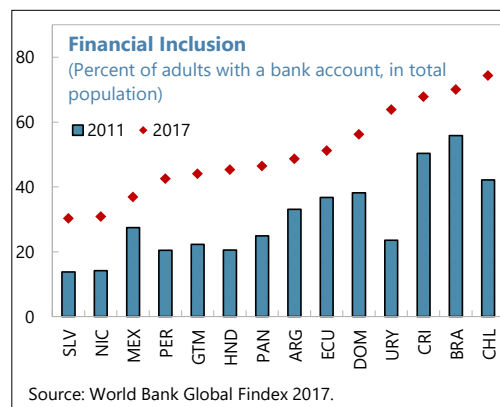
Concrete measures to improve the effectiveness and efficiency of public investment in El Salvador, as identified in Fund technical assistance on Public Investment Management Assessment and Public Financial Management, include:

- Moving from an annual to multi-year approach to preparing public investment projects aligned to the existing Medium-Term Fiscal Framework, and to a programmatic structure involving capital and current expenditure in joint programs. This would help plan and obtain proper financing.
- Including project evaluation for all investment projects at an early stage, regardless of the source of funding. This would help ensure that projects are ready to be implemented when they are funded.
- Allocating sufficient funds for project development, including evaluation and engineering design (prefeasibility stage), for approved projects to be ready for procurement when budgeted.
- Improving the quantification of fiscal risks related to the financial performance (including of municipalities, SOEs, and those associated with PPP contracts). This would help mitigate those risks.



Box 4. Financial Inclusion, Bitcoin and *Chivo*

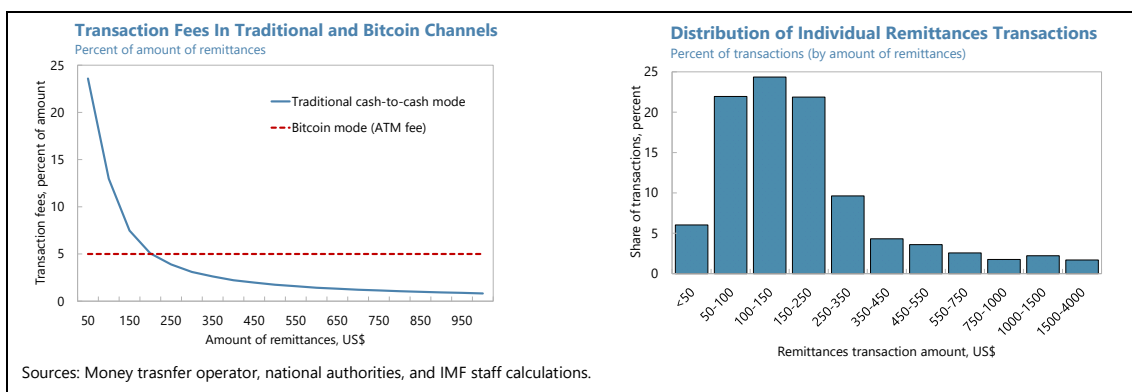
The introduction of Bitcoin as a legal tender in September 2021 was seen as needed on the relatively slow progress in improving financial inclusion. Based on the latest available data (2017, chart), only 30 percent of El Salvador’s adult population have a bank account, the lowest share in the region. This could be explained by the inability of the population to meet the requirements to open an account (notably, having a tax identification number and a minimum starting balance of USD 150). Simplified bank accounts introduced since 2017, and not having those requirements increased financial inclusion by a further estimated 5 percent of adult population. In 2019 the Financial Inclusion law allowed digital products and mobile money, but their use was limited due to, among other things, operational incompatibility of existing payment systems with these new products. The launch of Transfer365 payment system in June 2021 allowed for instantaneous online banking transactions for the banked. The launch of *Chivo* e-wallet with its 3.8 million customers (individuals and companies, overall population for the country is of 6.5 million) within two months is a breakthrough because it reached vast swath of unbanked, allowing them to transfer U.S. dollars or Bitcoin, and make electronic payments.¹



The authorities expect large economic gains from implementing *Chivo* and allowing Bitcoin transactions. The authorities emphasized that the *Chivo* wallet would improve financial inclusion and formalization of the economy—only 30 percent of the population have bank accounts and operates in the formal economy. Since a much larger share of population now has a *Chivo* account than a bank account, this previously unbanked population has access to digital payments (faster transactions), and most importantly, can show proof of income for vendors in the informal economy, which ultimately could improve financial inclusion. In addition, the authorities believe *Chivo*, and Bitcoin are lowering the transfer cost of remittances (either directly through the technology),² or indirectly (through absorbing the fees, or increasing competition). The government also expects to attract crypto-tourists, and investment from crypto-entrepreneurs.

The gains to the economy will depend on the extent of the use of *Chivo*.

Potential benefits in remittances could amount to US\$54 million (¼ percent of GDP) per year in savings in near term to Salvadoran migrants in the U.S. This benefit is estimated by adding the fees for small transactions (under US\$150, representing half of all transactions, see chart) that could be potentially saved by shifting from traditional cash-to-cash mode to Bitcoin mode to send remittances through *Chivo*.³



Box 4. Financial Inclusion, Bitcoin and *Chivo* (concluded)

Bitcoin tourism is estimated to attract an additional US\$5 million (0.03 percent of GDP) in travel receipts per year.

Prospects of Bitcoin-miners investment in harnessing renewable energy appear limited, as the average cost of geothermal-generated electricity of 9 cents/Kwh exceeds the highest price (affordable for Bitcoin mining) of 4 cents/Kwh. Staff estimates that mining at the current energy tariffs is not profitable for Bitcoin price above US\$45,000—since it is more energy-demanding and therefore costly to mine Bitcoin the higher the Bitcoin price is (Figure 5b). Public energy company CEL is conducting pilot project of mining Bitcoin on geothermal energy, with current capacity of 1 Mw/h, extendable to 15 Mw/h next year.

The *Chivo* wallet could speed up the use of digital payments. In the first month of operation, according to the authorities, 99 percent of peer-to-peer transactions on *Chivo* platform were conducted in U.S. dollars. Staff's estimation of these benefits requires data confirmation.

Against these potential benefits, the initial costs reached US\$180 million (including transfers to Bitcoin trust fund of US\$150 million, and cash transfers of US\$30 million). Additional costs could arise from direct and/or indirect subsidizing of Bitcoin mining (including the cost of Bitcoin mining machines of US\$1 million for each 1 Mw/h electricity use, the cost of electricity price differential—between tariff and mining breakeven cost—of US\$0.5 million for each 1Mw/h electricity use, and maintenance and connectivity costs).

To improve the ease of use, *Chivo* is linked with other payments networks, and the government is installing ATMs. *Chivo* has partnerships to connect its services to the credit/debit cards network worldwide, and to the domestic payments system—through a state-owned bank. Consequently, funds can be deposited in *Chivo* in U.S. dollars by credit/debit cards or from domestic bank accounts, and in Bitcoin through other e-wallets. Once funds are uploaded, remittances or any other payment can be sent and received through *Chivo* in U.S. dollars or Bitcoins. Cash can also be uploaded and withdrawn from *Chivo*, through ATMs. The authorities plan to install over 200 ATMs across El Salvador and 50 ATMs in the U.S. This will enable the unbanked population to deposit and withdraw cash in the system.

1/Bitcoin is used for economic transactions in El Salvador since 2019, in the small village El Zonte. Additionally, some migrants have also sent remittances in Bitcoin; in May 2021, Bitcoin remittances to El Salvador amounted to US\$1.7 million, equivalent to 0.2 percent of all remittances received during that month.

2/*Chivo* is providing its services in Bitcoins through second-layer payment protocols (Algorand) and agreements with other private providers.

3/Staff assume the same number of individuals remitting the same amounts as before. While the *Chivo* wallet offers an option of peer-to-peer transaction in U.S. dollars at zero fee, the scope of savings for unbanked migrants is limited by the lack of access to *Chivo* ATM infrastructure in the U.S. (50 machines). Banked migrants could upload funds in *Chivo* using debit/credit cards and bank accounts for zero-fee peer-to-peer transactions, similar to zero-fee offered by major remittances operators, such as Western Union. In the latter case, Bitcoin is not needed for transfers.

Box 5. Accounting for Bitcoin Transactions in Macro-Framework Tables

Currently Bitcoin transactions are not expected to have a significant impact on the macroeconomic projections, given the limited expected use and the way the Bitcoin system is implemented.

The IMF classifies Bitcoin currently as a nonfinancial asset, given the absence of counterparty liability,¹ and cannot be counted as international reserves. This classification has the following implications for the treatment of Bitcoin in macroeconomic statistics:

- *BoP*: For analytical purposes, transactions in Bitcoin are presented as an “of which” item of goods (exports/imports) with corresponding entry in net financial assets (inflows/outflows). Three examples can help clarify this treatment:
 - *Resident purchases of Bitcoin from non-residents* are recorded as an import of goods with a corresponding reduction in net financial assets (outflow). If the resident holds the Bitcoin, the BoP will register a deterioration of both the current account and the overall balance, and therefore a loss in international reserves.
 - *Resident exchanges of Bitcoin for U.S. dollars with a non-resident*, are recorded as an export of goods with a corresponding increase in net foreign assets (inflow), and improvement in the current account, and an increase in international reserves. Thus, in the case where Bitcoin purchases are exchanged into US dollars with non-residents, the net impact on the BoP and reserves would be zero.²
 - *Bitcoin remittances* are recorded as transfers in kind in the secondary income account, and as well as an imported good, but there is no corresponding increase in financial assets (in contrast to remittances sent in U.S. dollars). All things equal, receiving Bitcoin remittances does not have an impact on the BoP. However, as explained above, if a resident receives a remittance in Bitcoin and immediately converts into US dollars with a non-resident, this would improve the current account and international reserves.
- *Monetary statistics*. Bitcoin is recorded as nonfinancial asset (akin to physical gold) and captured in “other items net” line. Therefore, it is not recorded in net foreign assets.^{3/} If Bitcoin becomes more widely accepted as a medium of exchange, consideration could be given to its inclusion in a broader measure of liquidity. In this regard, it is paramount that the government and the financial sector keep Bitcoin transactions identifiable and traceable for transparency purposes and future reclassifications.
- *Fiscal accounts*. Bitcoin’s classification as a nonfinancial asset means that its acquisition is treated as (current) expenditure. The operations of the Trust Fund (exchanges from Bitcoin to U.S. dollars, or vice-versa) are not reflected in the fiscal accounts, since the Trust Fund is extrabudgetary. However, transfers to the Trust Fund are recorded as expenditure, implying an increase in the fiscal deficit by the size of the Trust Fund (½ percent of GDP) in 2021. Over time, if the government received tax payments in Bitcoin, they would be offset by a corresponding increase in spending (acquisition of Bitcoin as non-financial asset) and therefore have no impact on the net lending position. Moreover, since Bitcoin is classified as nonfinancial asset, in the case the Treasury holds Bitcoin positions, changes in its stock and in its valuation will change the net worth position of the public sector.

While El Salvador adopted Bitcoin as a legal tender it continues to designate the U.S. dollar as its currency in transactions with the Fund. The US dollar will therefore continue to be used as El Salvador’s local currency in financial transactions between El Salvador and the Fund. Specifically, on El Salvador’s purchase and repurchase transactions under the Fund’s General Resources Account. El Salvador would be required to provide and withdraw its local currency in US dollars (in form of cash or a promissory note) to and from IMF accounts (held with Central Reserve Bank of El Salvador) respectively. This would be the same for payments of any future quota increases.

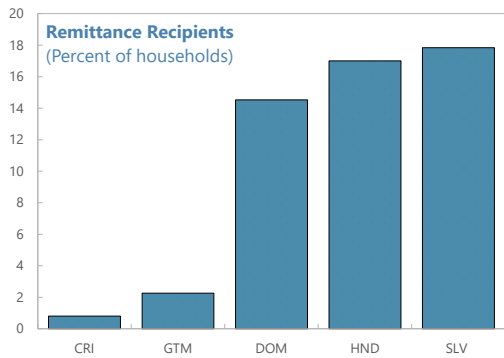
1/“Treatment of crypto assets in macroeconomic statistics”, IMF 2019.

2/Currently, the *Chivo* e-wallet by default, converts Bitcoin transactions into U.S. dollars in real time (and the user can change these default settings).

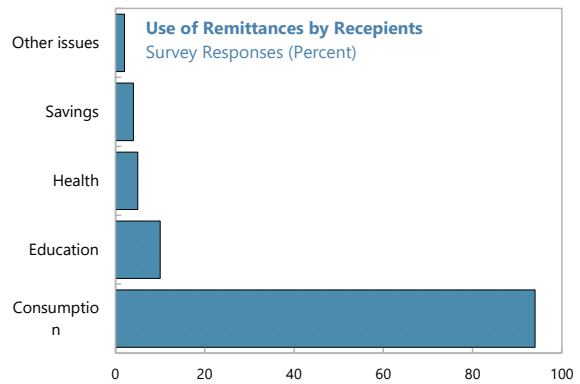
3/*Chivo* wallet and Bitcoin could potentially lead a reduction in deposits in banks, and impact money supply.

Figure 5a. El Salvador: Remittances, Fees, and Mobile Inclusion

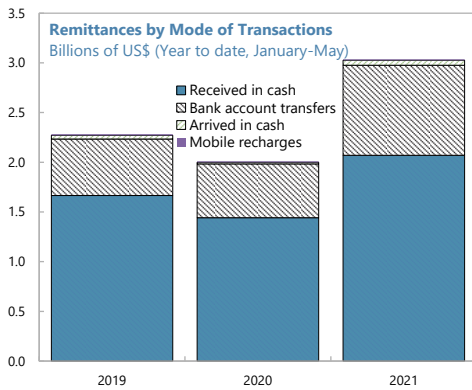
1/5 of Salvadoran families receive remittances...



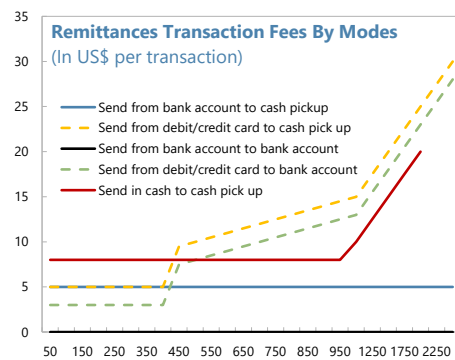
...and instantly spend them on consumption.



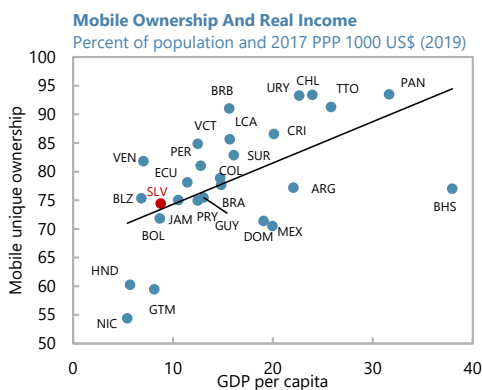
3/4 of remittances are sent and received in cash by predominantly unbanked population.



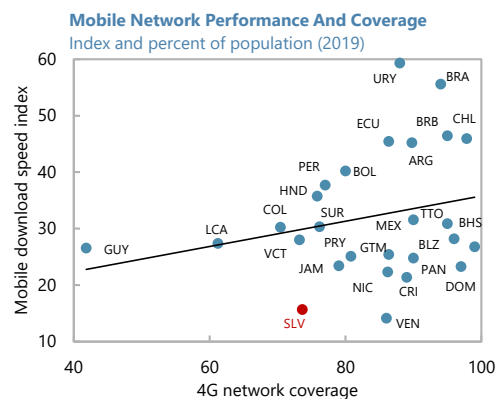
The cash-to-cash remittances for small amounts are costly, because of high KYC risks.



Mobile ownership in SLV is high in the region.



However, accessibility to digital services is limited by infrastructure and coverage bottlenecks.



Sources: IADB 2013 household survey, GSMA Mobile Connectivity Index, BCR, and IMF staff calculations.

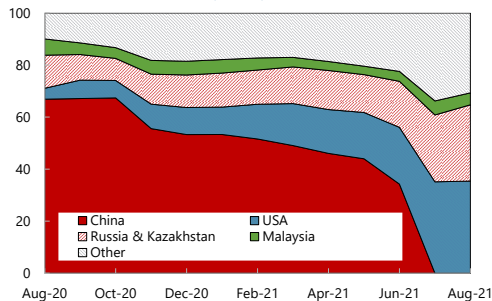
Figure 5b. El Salvador: Bitcoin Network, Mining, And Electricity Consumption

Tightening Bitcoin regulation in China, resulted in the shift in mining, with USA becoming the leader.

Majority of miners coop in pools; El Salvador mining was cited linked to Pooling (11 percent of market).

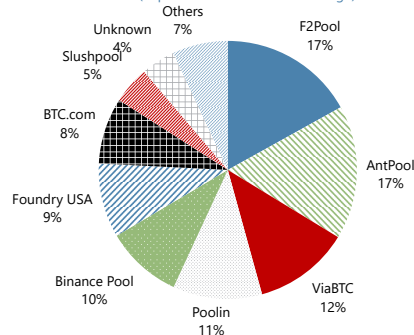
Bitcoin Mining By Country

Share of network hashrate (Percent)



Bitcoin Mining Pool Network

Percent of hashrate (September-October 2021 average)

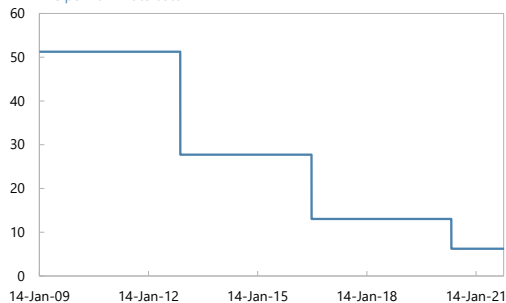


Bitcoin mining is limited and halved every four years.

On average prices are higher than in previous period.

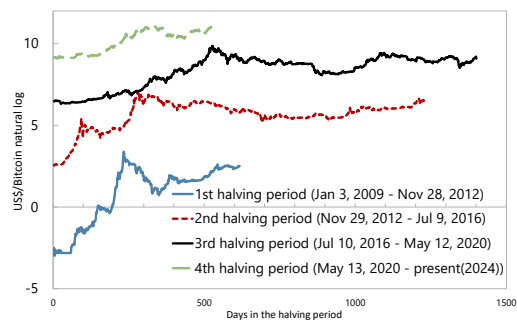
Bitcoin Mining

BTC per 10 minute batch



Bitcoin Price

US\$ per Bitcoin (natural log)

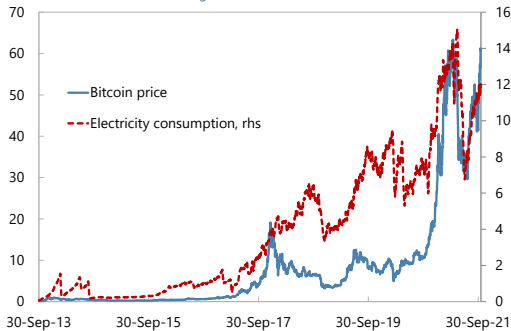


High Bitcoin prices lead to greater mining difficulty, which in turn drives up demand for electricity.

At current rate of difficulty, the required energy cost of mining Bitcoin (at zero profit) is below the average geothermal energy price.

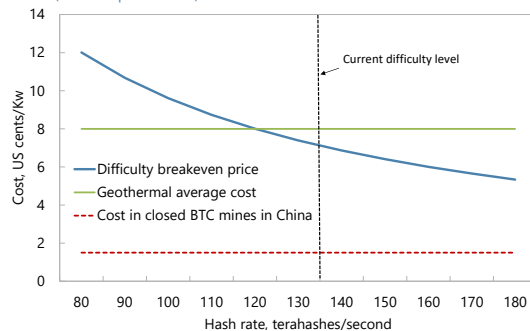
Bitcoin Price And Electricity Consumption

Thousand US\$/BTC and Gigawatts



Electricity Cost to Mine 1 BTC Across Difficulty Level

(US cents per Kilowatt)



Sources: University of Cambridge, Coindesk, BTC.com, and IMF staff calculations.

Annex I. Increasing the Employment Contribution to Growth

1. To increase potential output in the medium term, the contribution of employment could be improved. Higher employment could be obtained through an increase in economically active population, labor force participation, and job creation. To widen economically active population base, sustained efforts are needed to continue reducing crime, and in turn diminish irregular migration. Generating formal employment is crucial to provide opportunities to young people and to support the pension system. Simplifying taxation, reducing administrative, regulatory, and financial barriers, as well as combatting corruption could incentivize firms to formalize, and generate more employment. The same conditions could also attract more FDI.

Reducing Crime

2. Homicide rates decreased significantly. Homicide rate declined from 52 per 100,00 inhabitants in 2018 to 19.7 per 100,00 inhabitants in 2020—a 62 percent drop. Once having the highest homicide rate in the world, El Salvador in 2020 ranked as eighth country in Latin America and the Caribbean region.^{1,2} In 2021, the homicide rate remained low.

3. Crime has high overall costs for the country.³ A recent IMF study (WP 20/02) estimates that the indirect costs of crime in El Salvador amount to 6.7 percent of GDP, consistent with a central bank (BCR) study (see table). Similarly, a 1 percent increase in output in El Salvador is associated with a decrease in crime by 2/3 percentage points. Other studies, which also include direct costs, find that the overall cost of crime in El Salvador is between 12 and 18 percent of GDP.

4. Crime, traditionally associated with gang activity, results in worse social and economic outcomes. Gangs restrict labor mobility through a system of checkpoints and tolls, forcing residents to work in their neighborhood. This impoverishes gang-controlled neighborhoods.

**Annex 1. Table 1. El-Salvador:
Estimates of the Cost of Violence**

	Year	Cost of violence (% GDP)
PNUD (2005)	2003	13.1
Acevedo (2008)	2007	12.9
USG-GOES Technical Team (2011)	2011	12.3
Peñate Guerra et al (BCR, 2016)	2014	17.7
IADB (2017)	2014	13.9
IMF WP 20/02 (only indirect)	2020	6.7

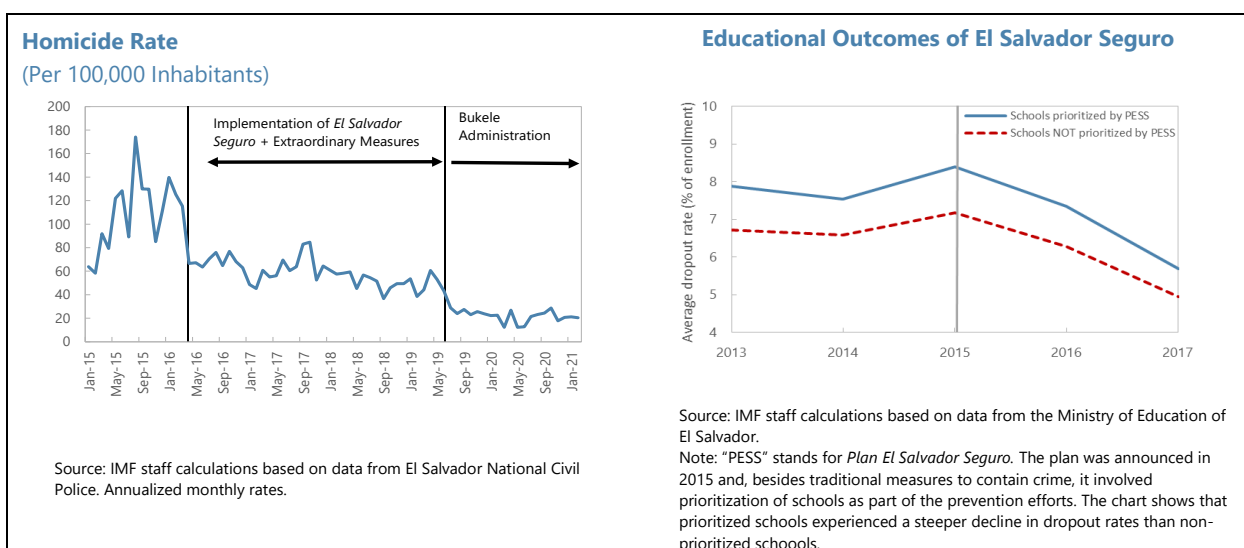
¹ Asmann, P. and E. O'Reilly. 2020 in *Crime's 2019 Homicide Round-Up*. InSight Crime, January 2020, and Asmann, P. and K. Jones. 2021 in *Crime's 2020 Homicide Round-Up*. InSight Crime, January 2021.

² There is a change in statistics methodology since July 2019. The current methodology considers only social violence, excluding deaths resulting from clashes between the police and gang members.

³ Indirect costs refer to the negative effect that crime has on economic activity and institutional quality. Direct costs include costs of prevention, of the crime itself (material losses, medical treatment of injuries, etc.), and of prosecuting criminals.

Using multiple sources of data, a recent study (Melnikov and others, 2019) finds that individuals living under gang control have fewer years of education, worse dwelling conditions, and lower income than individuals living in areas not controlled by gangs.

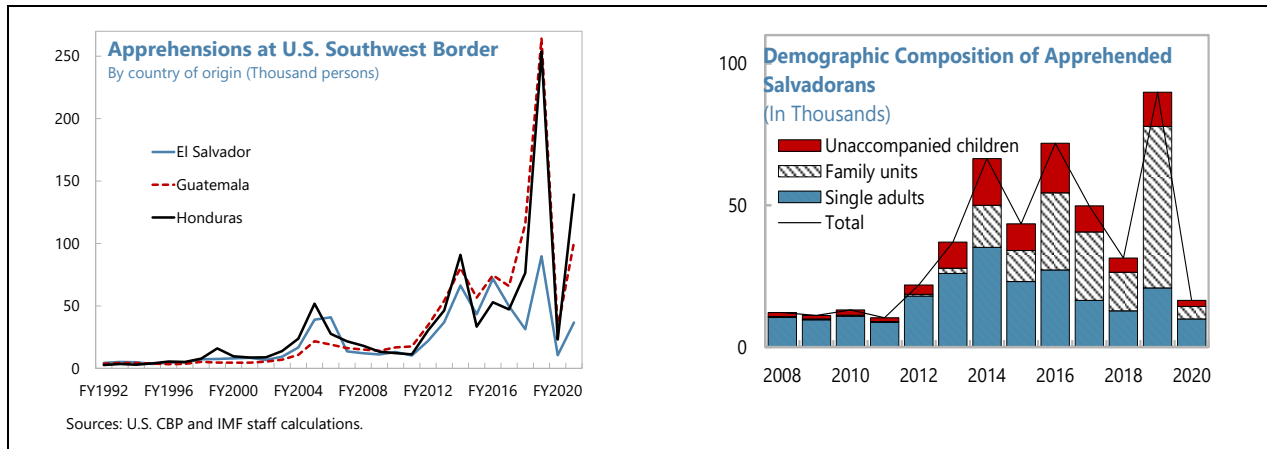
5. A comprehensive approach to combating crime needs to comprise prevention and rehabilitation efforts. IMF staff (WP/20/2) estimates that a 2.75 percent decline in crime, driven by better policing and stronger criminal justice, could increase output per capita by 1 percent, and that increasing the opportunity cost of crime by making leisure more valuable (e.g. through provision of recreational activities to at-risk youth) would reduce crime and improve output. Preliminary analysis by IMF staff on the effects of the *El Salvador Seguro* (previous administration's plan) indicates that prevention efforts had a positive effect in further reducing dropout rates (Figure 2).



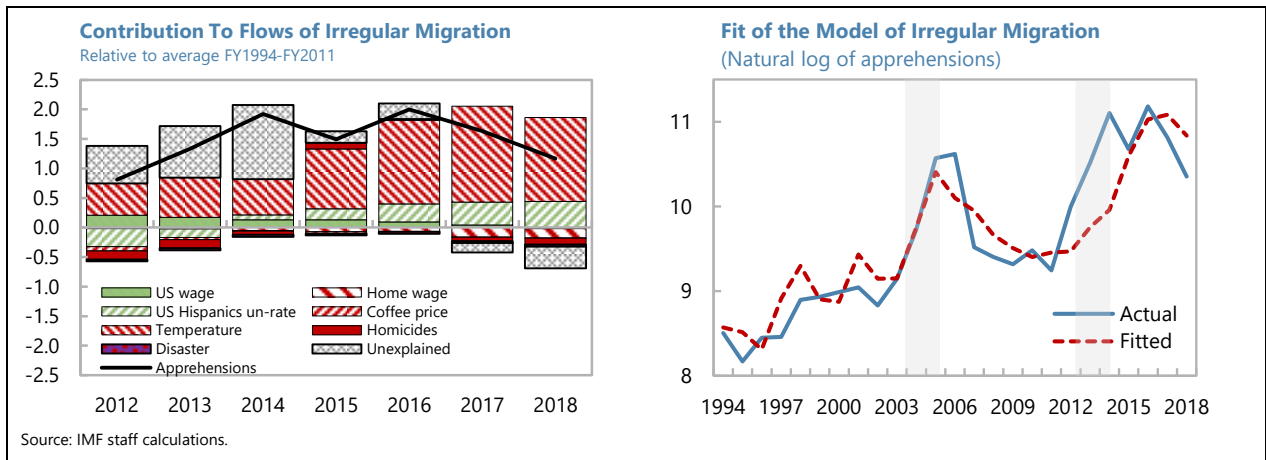
6. The *Plan de Control Territorial* implemented in 2019, has seven phases and aims at combatting crime and violence. The first three phases require US\$575.2 million through various sources over 2019-2021, out of which US\$192.8 million were executed in 2019. The plan aims to (i) strengthen the military and police to regain control over 17 high-crime municipalities and financially weaken gangs, (ii) provide youth with alternatives to joining gangs, and (iii) provide modern equipment and technology to the army and police. For (ii) the authorities have collaborated with EU and EU countries (Spain) to build the infrastructure for *Cubos*, recreation center for youth. UNICEF has collaborated to provide educational programs.

Understanding Undocumented Migration and Its Drivers

7. While the stock of undocumented migrants from El Salvador in the U.S. increased steadily over the past 30 years, the flows apprehended at the U.S. Southwest border have declined recently. Migrants of Salvadoran-origin in the U.S. increased from 0.5 million in 1990 (10 percent of Salvadoran population) to 1.4 million in 2019 (22 percent of Salvadoran population) of which about half are undocumented. In FY2019 (October 2018 to September 2019), apprehended migrants at the U.S. border reached historically high levels (over 1 percent of all Salvadorans). In 2021, the flows of Salvadoran migrants increased, but remained below 2019 levels.



8. Developments at home explain undocumented migration to the U.S. Using data from 1994–2018 for the Northern Triangle countries, staff’s analysis shows that traditional pull factors (higher wages and historic low unemployment rate for Hispanics in the U.S.) explain most of the migration since 1994. Since the early 2000s undocumented migration is increasingly explained by domestic push factors, including: (i) loss of livelihood from coffee due to a plunge in international coffee prices, and disruptive weather-related changes (see charts), (ii) a rise in homicides especially after 2011, and (iii) natural disasters. While dropping in 2020 irregular migration is increasing again, since February 2021.



Formal Employment Challenge

9. Pre-pandemic growth and investment have not necessarily translated into formal job creation. Despite average real GDP growth of 2½ percent over 2010-19, the share of informal employment declined only modestly, and remains high at 49 percent (2019). About 45,000 new jobs are needed annually to absorb entrants to the labor market; meanwhile only 14,055 formal jobs⁴ were created in 2019. Generating formal employment is crucial for providing opportunities to young

⁴ Defined as all workers who were reported to the Salvadoran Social Security Institute.

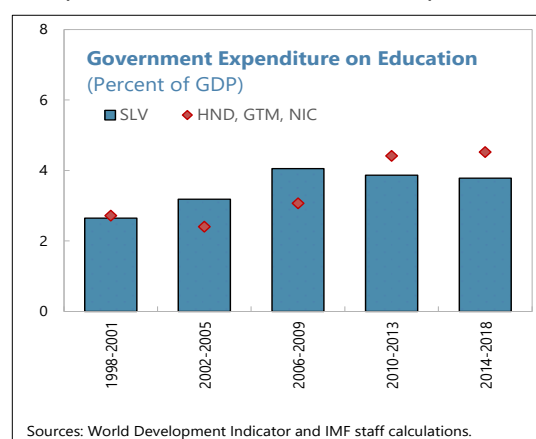
people and to support the pension system (the share of the working-age population is expected to peak at about 57 percent in 2040). Simplifying taxation, reducing administrative, regulatory, and financial barriers, as well as combatting corruption could incentivize firms to formalize.

10. International partnerships can help reduce informality. FDI can facilitate formal job creation both directly and indirectly by providing financing for infrastructure critical to improving the business environment and productivity. The presence of technologically advanced direct investment firms can also increase productivity and export competitiveness, and thereby stimulate employment generation. In 2018, FDI in El Salvador generated 14.3 percent of formal employment.

Authorities' Plans

Besides Reducing Crime, the Authorities' Agenda Covers Six Major Areas:

- Economic takeoff (infrastructure):** *Plan de Despegue Económico* is a 5-year plan comprising several large infrastructure projects, that has been unveiled in early 2020. These include the *Aeropuerto de Oriente* (a second airport for freight and passengers), the *Tren del Pacífico* (a train that connects the ports in Acajutla and La Unión), *Surf City* (the development of tourism sector network throughout El Salvador, including building infrastructure, such as a water treatment plan), and a ferry connection from El Salvador to Costa Rica that will modernize trade logistics. The economic takeoff plan is complemented by the *Agenda Digital*, a 10-year digital transformation plan, that aims at enhancing the country's ICT infrastructure, fostering innovation, and identifying needed changes in the legislation (e.g., for digital signature).
- International integration and cooperation:** The government has sought closer ties with its Northern Triangle neighbors, the U.S., and other allies, including China. The authorities have reached an integration agreement with Guatemala, covering many fronts, such as the construction of a Salvadoran port on Guatemala's Atlantic coast, the "open skies" program, and the free movement of people. China pledged financing for several large infrastructure projects with non-reimbursable funds. A revived U.S. plan for Central America is expected to bring increased grants.
- Investment in human capital:** The authorities have increased the allocation of resources to health by 14.2 percent in the 2020 budget¹ (new initiatives include, *Plan Nacional de Salud*, and the *Política Nacional de Primera Infancia*, an initiative supported by the World Bank, IADB, and UNICEF to support early childhood and education). The allocation to education has been raised by 2.1 percent (new initiatives have concentrated on the construction of schools and the provision of scholarships for tertiary education).



- **Cutting the red tape.** The authorities are determined to overhaul current cumbersome regulatory framework for business, by shortening time and reducing the number of steps required for obtaining permits (for accessing electricity), and by expediting registration process for new businesses. The authorities, with help from FOMILENIO II, recently launched a one-window services (CIEX and SFCE) for simplified electronic processing of export and import operations, facilitating the cross-border trade, especially with neighboring countries.
- **Diversification of economy.** PROESA, export and investment promotion agency of El Salvador, is actively seeking FDI investors in various sectors of the economy, ranging from pharmaceuticals to personal protective equipment (PPE) to high-value apparel to renewable energy. Together these investments expect to create 15 thousand new jobs.
- **Financial inclusion.** The law to facilitate financial inclusion signed in September 2019, promotes digital products, including mobile money. The *Agenda Digital* aims to help by introducing digital identity and fintech solutions⁵, and build on previous accomplishments (such as simplified bank accounts, digital signature, Transfer365, and *Chivo* wallet), increasingly used by consumers and firms.

⁵ The *Agenda Digital* 2020-2030 consists of four pillars: (1) digital identity; (2) innovation, education, and competitiveness; (3) modernization of the state; and (4) digital government.

Annex II. Public Debt Sustainability Analysis

The Public Debt Sustainability Assessment indicates that debt is on an unsustainable debt path under current policies. Absent strong consolidation measures public debt is projected to be above 85 percent of GDP (including pension liabilities) at end-2021 and on an upward trajectory over the medium term. The debt stock at end-2020 was about 7 percent of GDP higher than expected at the time of the RFI disbursement (April 2020), due to a larger economic contraction, resulting in larger financing needs. These adverse changes, relying on expensive market debt due to unfavorable developments in 2020 and uncertainty of policy direction in 2021, coupled with a lack of consolidation policies, explain the current assessment compared with the assessment of sustainable with high risks provided during the RFI request. Despite the better-than-expected economic recovery this year, the authorities have continued relaxing fiscal policy, relying largely on expensive short-term debt resulting on increased rollover risks. Fiscal consolidation and structural reforms, including on governance and the fiscal sector, are essential to restore debt sustainability.

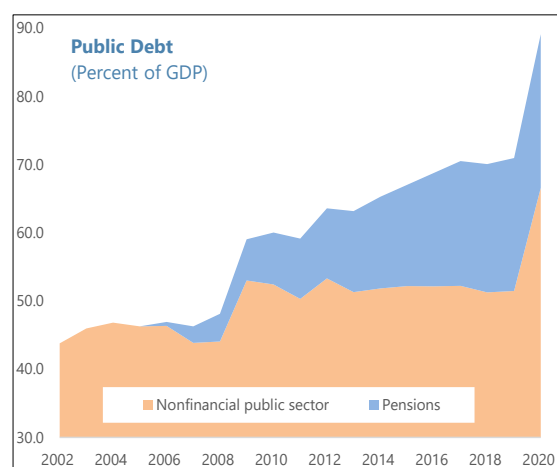
A. Background

1. Total public debt increased significantly in 2020 due to the impact of the pandemic.

This was the result of temporary spending measures implemented to mitigate the humanitarian and health crisis caused by the COVID-19 pandemic, including below-the-line operations to provide subsidized financing to companies impacted by the pandemic.¹

2. The coverage of public debt is comprehensive.

The DSA is based on the nonfinancial public sector (NFPS). Therefore, it includes general government and non-financial SOEs debt, both guaranteed and non-guaranteed. Decentralized autonomous agencies such as FOVIAL



are also included. As discussed in the report—the privatization of the public pension scheme in 1998 resulted in large and increasing transfers from the budget. To cope with this problem, in 2006 a trust fund—*Fideicomiso de obligaciones previsionales (FOP)*—was created. The role of FOP is issuing securities that the AFPs are obliged to purchase (see Annex VI).² Proceeds from these bonds are then transferred to the social security administration to pay entitlements for pensioners of the old public pension system. CAPTAC-DR is helping to strengthen the quality of debt statistics (see Box).

¹ A trust fund (FIREMPRESA) was created to support SMEs and informal business. As of February 22nd, US\$237 million from a total of US\$600 million has been disbursed to firms, which in addition to the overall deficit, has increased nonfinancial public sector debt in 2020.

² FOP issues two types of securities (*Certificados de inversión previsional-CIP*), CIP-A and CIP-B. See Annex VI for details on each of these securities.

Annex II. Box 1. Public Debt Statistics

IMF (2011) defines a debt instrument as any “financial claim that requires payment(s) of interest and/or principal by the debtor to the creditor at a date, or dates, in the future”. Against this backdrop, there are three types of liabilities that emerge when the pension system was privatized (Annex VI). Two of them are firm liabilities (the payment of current pensioners and the service of pension recognition bonds) while the third one (minimum pension guarantee) is contingent depending on how much savings workers accumulate in their individual accounts. The latter liability was transferred to workers through the creation of the “Cuenta de Garantía Solidaria—CGS” in 2017. However, according to the last actuarial assessment, the CGS would again require budget support as early as in 2028 (Superintendencia del Sistema Financiero, 2020).

Each of the above-mentioned firm liabilities is securitized through the Fideicomiso de Obligaciones Previsionales (FOP) by issuing bonds (Certificados de Inversión Previsional-CIP). Series A (CIP-A) are used to pay pensioners and series B (CIP-B) to refund the contributions paid to the old public pension system. Amortizations and interests for both series are paid from the budget and reported in the fiscal statistics.

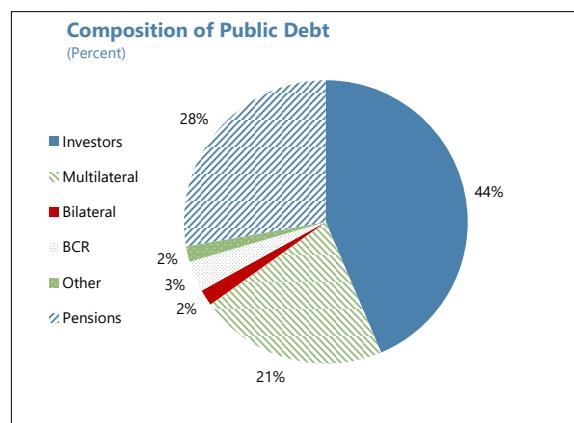
From the debt definition and considering that debt service for both series is being paid by the Treasury, they should be included in the stock of public debt. While the authorities do not report the stock of CIP-B, it can be obtained from the balances of the two existing AFPs reported by the Bank Superintendency.

Additionally, securitizations issued by subsidiaries of the Comisión Ejecutiva Hidroeléctrica de Río Lempa—CEL holding are also not included in the current stock of public debt. For example, in 2014 LaGEO—a CEL subsidiary—issued bonds backed by its future sales and their current stock can be obtained from LaGEO financial statements. Local governments’ debt is partially based on estimations—particularly for small municipalities. Part of the savings resulting from the reduction in FODES will be earmarked to pay local governments’ debt that has been assumed by the central government.

Producing comprehensive public debt figures is an ongoing work that the authorities are committed to finalize as part of their migration towards GFSM-2014. This effort is framed within the CAPTAC-DR regional project to improve the quality of the fiscal statistics.

Long-term debt	58.7
Investors	35.4
Multilateral	17.4
Bilateral	1.5
Central bank	2.9
Other	1.4
Short-term debt	8.0
Nonfinancial Public Sector	66.6
CIP series A	22.5
Reported debt	89.2
CIP series B	8.6
Bonds issued by Hencorp/LaGEO	1.2
Unreported debt	9.7

3. Public external debt is mostly held by international bondholders. The share of external debt stood at 59¼ percent of total public debt as of end-2020. The main creditors to El Salvador are bondholders (39¾ percent) and multilaterals (19 percent). Public domestic debt is held mainly by institutional investors (AFPs) and the central bank, the latter because of the recapitalization agreement subscribed in 2001. Short-term debt (LETES and CETES) is held by commercial banks (see Composition of Debt Table for details).



4. The scenario looks weakened *vis-à-vis* the one envisaged at the time of the RFI disbursement. The NFPS debt stock at end-2020 was higher than the one estimated at the time of the RFI, given the larger economic contraction as well as the larger COVID-19 response—including below-the-line operations (see ¶8 in the report), and higher borrowing costs. Due to a parliamentary gridlock, most of the multilateral funding was not timely available to finance the COVID-19 response, forcing the authorities to issue Eurobonds and short-term bonds, both at record-high interest rates. Additionally, the fiscal consolidation envisaged in the RFI report has not been implemented. On the contrary, additional permanent increases in expenditures (unrelated to the pandemic) have been introduced (see next paragraph). Finally, sovereign spreads have increased by about 300 basis points *vis-à-vis* April 2020, resulting in larger financing needs for the coming years.

5. Fiscal position has weakened and further risks emerged. The authorities have continue implementing expansionary fiscal policies. Specifically they have increased permanent spending by increasing the size of the armed forces, introducing and/or expanding across-the-board subsidies (not pandemic related), like liquified gas subsidies for households' and small companies, and an increasing in the minimum pension guarantee. They also have made Christmas bonuses exempted from the personal income tax. Along these lines, Congress has authorized contracting of additional debt for about US\$4 billion (13¼ percent of GDP) including funds for two new extra-budgetary trusts aiming at supporting agricultural projects. Subsidies to incentivize the use of *Chivo*, the government e-wallet, have also been introduced. The latter used a favorable CABEL loan but required the issuance of one-year CETES at expansive interest rate to fund the budget.³

B. Assumptions

6. The baseline scenario of the DSA reflects the authorities' current policies—including adjustment measures already announced—and staff projections based on them. Historically, economic activity had been driven by private consumption fueled by increasing remittances flows

³ The CABEL operation that was used to fund the Bitcoin implementation was a 20-year loan with 5 years of grace period. The interest rate was 6-month LIBOR plus 240 basis points.

from the Salvadoran diaspora living in the US. Following a sizable rebound in GDP growth in 2021, slow convergence towards potential is projected starting in 2022. After the implementation of certain tax measures—some of them administrative—and a sizeable curb in the resources transferred to local governments—already approved by Congress—a small NFPS primary surplus is expected. It, however, be insufficient to compensate for large and increasing interest payments resulting from the lack of a comprehensive fiscal adjustment. Fiscal projections include about 1 percent of GDP in measures—compared with 4 percent of GDP proposed by staff. Gains/costs from the pension reform are not included as the authorities have not yet made public their reform proposal. To close the financing, the scenario assumed that external financing would be obtained at current spreads. As a result, interest payments are expected to remain high amid high gross financing needs and an expected tightening of global financial conditions by the end of the projection period.

C. Analysis

7. Under current policies, the debt dynamics are highly unfavorable. After an initial decline expected in 2021 and explained entirely by the strong rebound in nominal GDP, the debt-to-GDP ratio is projected to increase until it reaches about 96 percent of GDP by the end of the projection period. This increase is driven by a primary deficit well above the debt-stabilizing primary balance. Gross financing needs would peak at 20 percent of GDP in 2025—well above the 15-percent threshold for emerging economies—and remain elevated due to regular biannual repayments of Eurobonds starting in January 2023.

8. Risks remain elevated. The heat map analysis indicates heightened risks given that debt exceeds the debt distress threshold of 70 percent of GDP in 2020 and is projected to stay above that level for the forecast horizon. Compared to the DSA prepared at the time of the RFI request (April 2020), the change in the stock of short-term debt now signals a risk (red signal), as the government has increased considerably the use of short-term debt. The macro-fiscal stress tests highlight risks stemming from adverse GDP shocks that would end with debt-to-GDP ratios above 96 percent. Gross financing needs, however, would breach the benchmark of 15 percent of GDP only under the adverse GDP shock.

Annex II. Table 1. El Salvador: Public Sector Debt Sustainability Analysis

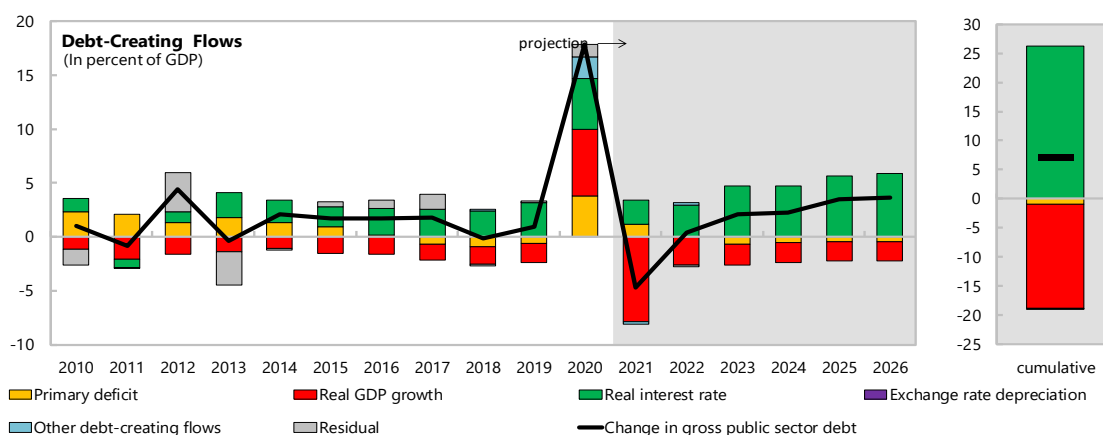
(in percent of GDP unless otherwise indicated)

Debt, Economic and Market Indicators 1/

	Actual			Projections						As of November 19, 2021		
	2010-2018 2/	2019	2020	2021	2022	2023	2024	2025	2026			
Nominal gross public debt	65.3	71.3	89.2	84.4	84.8	86.9	89.2	92.7	96.3	Sovereign Spreads EMBIG (bp) 3/	1,127	
Public gross financing needs	8.5	11.4	13.9	14.9	15.6	18.8	16.8	20.3	16.1	5Y CDS (bp)	n.a.	
Real GDP growth (in percent)	2.5	2.6	-7.9	10.0	3.2	2.3	2.2	2.0	2.0	Ratings	Foreign	Local
Inflation (GDP deflator, in percent)	1.9	0.7	-0.5	2.8	2.4	1.4	1.3	1.2	1.0	Moody's	Caa1	Caa1
Nominal GDP growth (in percent)	4.5	3.4	-8.4	13.1	5.7	3.7	3.6	3.3	3.0	S&P's	B-	B-
Effective interest rate (in percent) 4/	4.6	5.4	5.6	5.9	6.2	7.1	6.9	7.8	7.6	Fitch	B-	B-

Contribution to Changes in Public Debt

	Actual			Projections						cumulative	debt-stabilizing primary balance 9/
	2010-2018	2019	2020	2021	2022	2023	2024	2025	2026		
Change in gross public sector debt	1.3	0.9	17.9	-4.7	0.4	2.1	2.3	3.5	3.6	7.2	
Identified debt-creating flows	1.1	0.8	16.7	-4.7	0.6	2.1	2.3	3.5	3.6	7.4	
Primary deficit	0.9	-0.6	3.8	1.1	0.0	-0.7	-0.5	-0.4	-0.5	-1.0	4.1
Primary (noninterest) revenue and grants	23.8	24.1	24.5	26.7	27.1	27.5	27.5	27.5	27.5	163.9	
Primary (noninterest) expenditure	24.7	23.5	28.3	27.8	27.2	26.8	27.0	27.1	27.1	162.9	
Automatic debt dynamics 5/	0.2	1.4	10.9	-5.6	0.4	2.8	2.8	3.9	4.1	8.4	
Interest rate/growth differential 6/	0.2	1.4	10.9	-5.6	0.4	2.8	2.8	3.9	4.1	8.4	
Of which: real interest rate	1.7	3.2	4.7	2.3	3.0	4.7	4.7	5.7	5.9	26.2	
Of which: real GDP growth	-1.5	-1.8	6.2	-7.9	-2.6	-1.9	-1.9	-1.8	-1.8	-17.8	
Exchange rate depreciation 7/	0.0	0.0	0.0	...	...	...	...	...	...	...
Other identified debt-creating flows	0.0	0.0	2.0	-0.2	0.2	0.0	0.0	0.0	0.0	0.0	
Privatization/Drawdown of Deposits (negative)	0.0	0.0	2.0	-0.2	0.2	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	
Other debt-creating flows	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	
Residual, including asset changes 8/	0.1	0.1	1.2	0.0	-0.2	0.0	0.0	0.0	0.0	-0.2	



Source: IMF staff.

1/ Public sector is defined as non-financial public sector.

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.

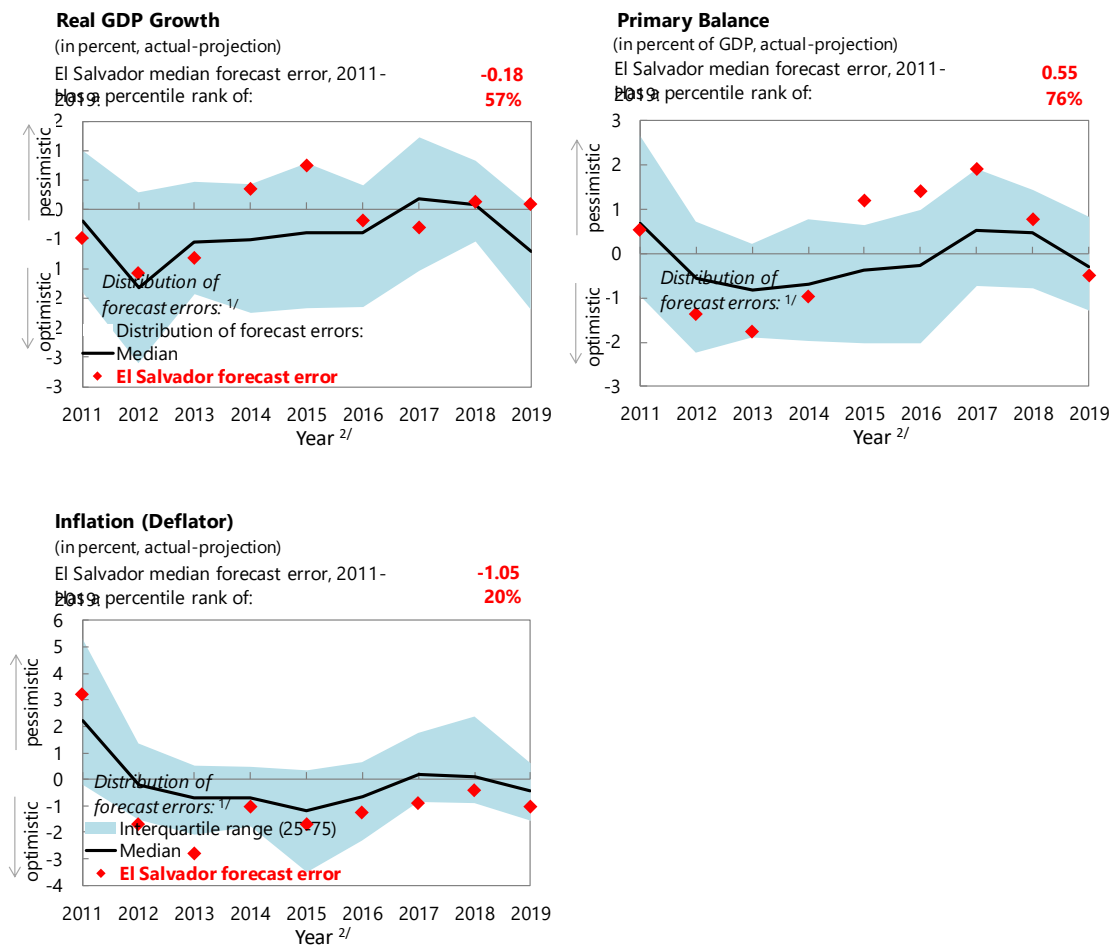
5/ Derived as $[(r - \pi(1+g) - g + ae(1+r))/(1+g+\pi+gr)]$ times previous period debt ratio, with r = interest rate; π = growth rate of GDP deflator; g = real GDP growth rate; a = share of foreign-currency denominated debt; and e = nominal exchange rate depreciation (measured by increase in local currency value of U.S. dollar).6/ The real interest rate contribution is derived from the numerator in footnote 5 as $r - \pi(1+g)$ 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.

Annex II. Figure 2. El Salvador: Public Debt Sustainability Analysis – Realism of Baseline Assumptions

Forecast Track Record, versus all countries



Source: IMF staff.

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, as it meets neither the positive output gap criterion nor the private credit growth criterion.

Annex II. Figure 3. El Salvador: Public Debt Sustainability Analysis - Realism of Baseline Assumptions (continued)

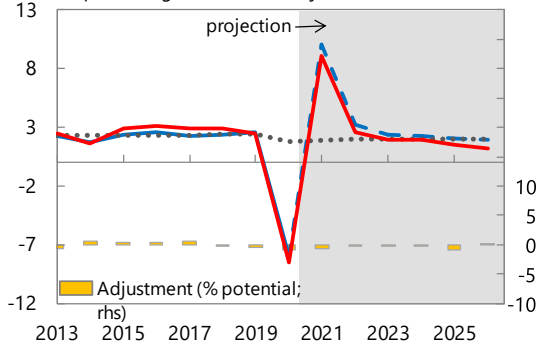
Growth and Level of Output in Absence of Fiscal Adjustment

Assumed multiplier of 0.7, persistence of 0.3

Real GDP Growth

(In percent)

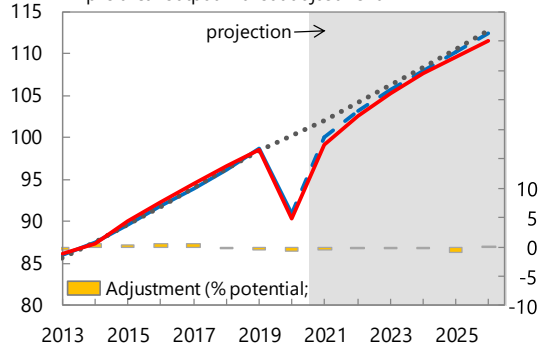
- Baseline real growth
- Baseline real potential growth
- Implicit real growth without adjustment



Real Output Level

(Baseline real output in 2021=100)

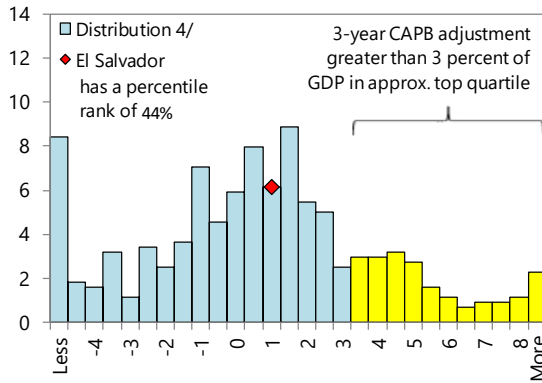
- Baseline real output
- Baseline real potential output
- Implicit real output without adjustment



Assessing the Realism of Projected Fiscal Adjustment

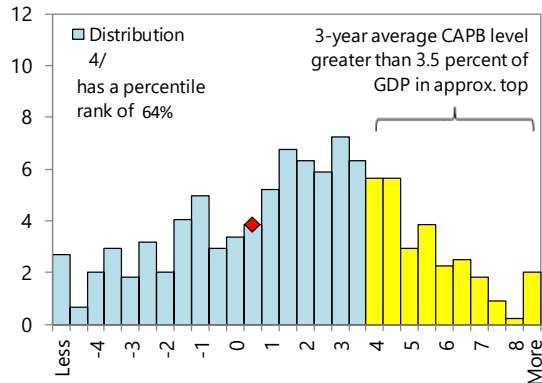
3-Year Adjustment in Cyclically-Adjusted Primary Balance (CAPB)

(Percent of GDP)



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

(Percent of GDP)

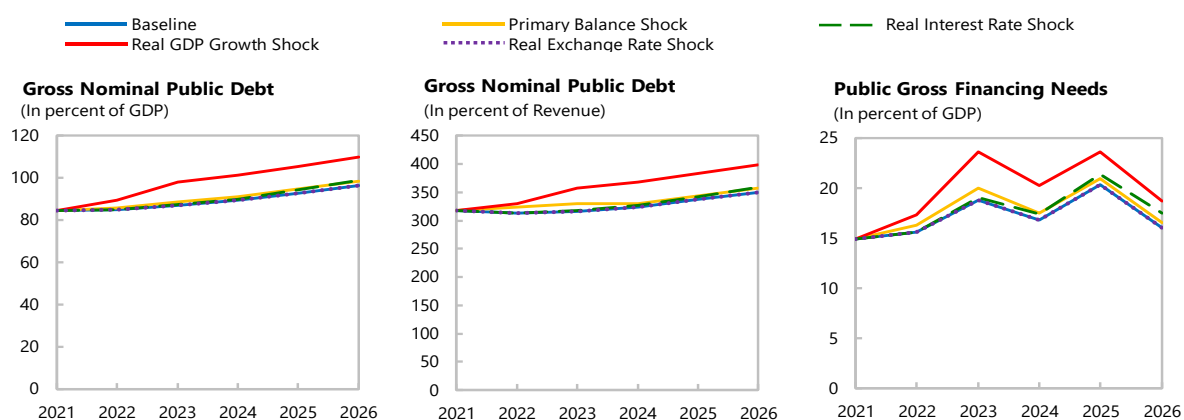


Source: IMF staff.

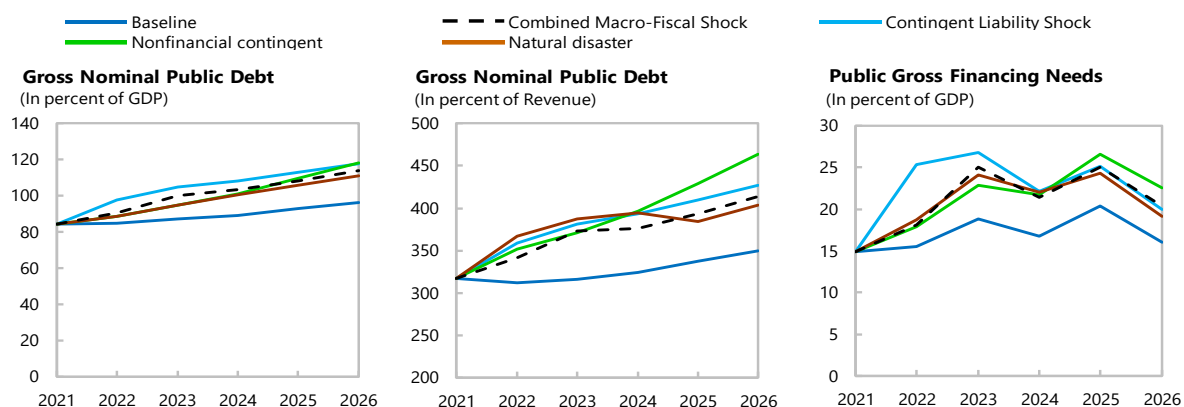
4/ Data cover annual observations from 1990 to 2011 for advanced and emerging economies with debt greater than 60 percent of GDP. Percent of sample on vertical axis.

Annex II. Figure 4. El Salvador: Public Debt Sustainability Analysis - Stress Tests

Macro-Fiscal Stress Tests



Additional Stress Tests



Underlying Assumptions

(In percent)

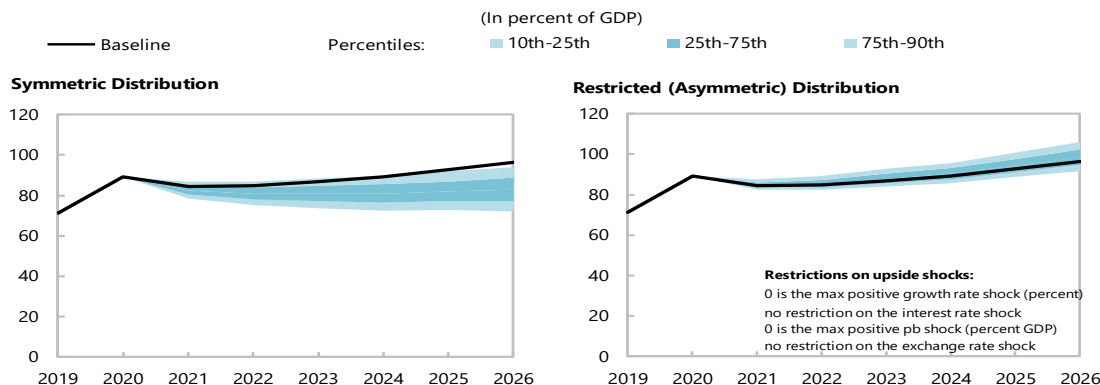
	2021	2022	2023	2024	2025	2026
Primary Balance Shock						
Real GDP growth	10.0	3.2	2.3	2.2	2.0	2.0
Inflation	2.8	2.4	1.4	1.3	1.2	1.0
Primary balance	-1.1	-0.7	-0.1	0.5	0.4	0.5
Effective interest rate	5.9	6.2	7.2	7.0	7.9	7.6
Real Interest Rate Shock						
Real GDP growth	10.0	3.2	2.3	2.2	2.0	2.0
Inflation	2.8	2.4	1.4	1.3	1.2	1.0
Primary balance	-1.1	0.0	0.7	0.5	0.4	0.5
Effective interest rate	5.9	6.2	7.5	7.5	8.6	8.5
Combined Shock						
Real GDP growth	10.0	-0.1	-1.0	2.2	2.0	2.0
Inflation	2.8	1.5	0.5	1.3	1.2	1.0
Primary balance	-1.1	-1.9	-2.4	0.5	0.4	0.5
Effective interest rate	5.9	6.2	7.6	7.6	8.7	8.7
Real GDP Growth Shock						
Real GDP growth	10.0	-0.1	-1.0	2.2	2.0	2.0
Inflation	2.8	1.5	0.5	1.3	1.2	1.0
Primary balance	-1.1	-1.1	-1.6	0.5	0.4	0.5
Effective interest rate	5.9	6.2	7.3	7.3	8.1	7.8
Real Exchange Rate Shock						
Real GDP growth	10.0	3.2	2.3	2.2	2.0	2.0
Inflation	2.8	2.4	1.4	1.3	1.2	1.0
Primary balance	-1.1	0.0	0.7	0.5	0.4	0.5
Effective interest rate	5.9	6.2	7.1	6.9	7.8	7.6
Contingent Liability Shock						
Real GDP growth	10.0	-0.1	-1.0	2.2	2.0	2.0
Inflation	2.8	1.5	0.5	1.3	1.2	1.0
Primary balance	-1.1	-8.7	0.7	0.5	0.4	0.5
Effective interest rate	5.9	6.7	7.8	7.2	8.1	7.9

Source: IMF staff.

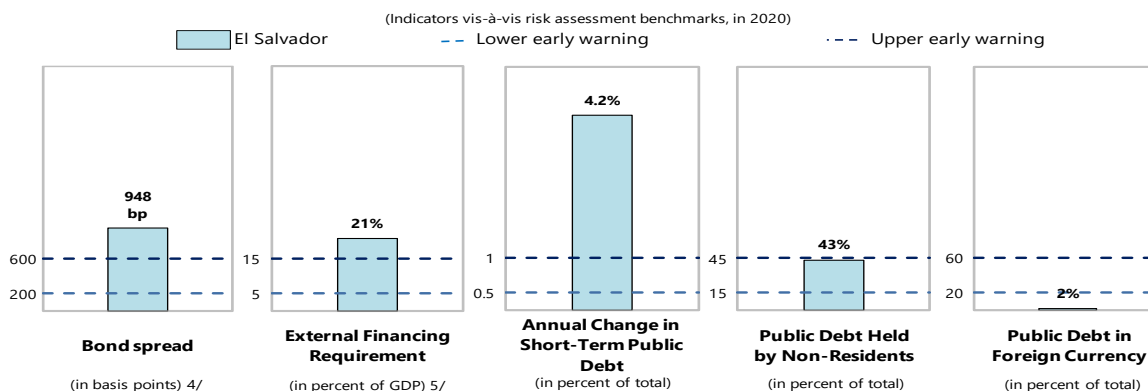
Annex II Figure 5. El Salvador: Public Debt Sustainability Analysis Risk Assessment

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



Debt Profile Vulnerabilities



Source: IMF staff.

1/ The cell is highlighted in green if debt burden benchmark of 70% is not exceeded under the specific shock or 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.

Lower and upper risk-assessment benchmarks are:

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 debt.

4/ Long-term bond spread over U.S. bonds, an average over the last 3 months, 21-Aug-21 through 19-Nov-21.

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.

Annex II. Table 2. El Salvador: Creditor Composition of Public Debt Stock 2020¹

	Percent of total Debt	Percent of GDP
Total	100.0	89.2
External	48.9	43.6
Multilateral creditors	19.6	17.4
IMF	1.9	1.7
IADB	10.1	9.0
World Bank	3.6	3.2
Other multilaterals	4.0	3.6
<i>o/w</i> : CABEI	1.6	1.4
<i>o/w</i> : IFAD	0.2	0.2
Bilateral creditors	1.7	1.5
Paris Club	0.0	0.0
Non-Paris Club	1.7	1.5
<i>o/w</i> : Japan	0.7	0.6
<i>o/w</i> : Germany	0.6	0.5
Eurobonds	27.6	24.6
Comercial lenders	0.0	0.0
Domestic	51.1	45.6
Held by residents, total	51.1	45.6
Held by non-residents, total	0.0	0.0
T-bills	8.9	8.0
Held by: central bank	0.0	0.0
local banks	8.9	8.0
local non-banks	0.0	0.0
non residents	0.0	0.0
Bonds	35.7	31.8
Held by: central bank	3.2	2.9
local banks	0.0	0.0
local non-banks	32.5	29.0
non residents	0.0	0.0
Loans	6.5	5.8
Held by: central bank	0.0	0.0
local banks	6.5	5.8
local non-banks	0.0	0.0
non residents	0.0	0.0
Memo items:		
Collateralized loans	...	...
Contingent liabilities	...	...

¹ Public debt includes publicly guaranteed debt.

Sources: Department of the Treasury, Central Bank, and IMF staff estimates.

Annex III. External Debt Sustainability Analysis

1. External debt is projected to increase in the near term and start to decline at the end of the forecast horizon. Gross external debt rose by about 10 percent of GDP to 74.5 percent of GDP in 2020, due to worsening debt dynamics in the face of the slowdown in economic activity, lower exports, and contraction in growth. Under the baseline scenario, external debt is projected to peak at 78 percent of GDP in 2025 and start to gradually decline thereafter. Under the historical scenario, external debt would rise above 80 percent of GDP after 2023, driven by public sector debt. The expansion in public sector debt will be somewhat offset by a reduction in private sector, mainly as a result of the passthrough of the elevated sovereign risk premium to the external borrowing costs of private firms and banks.

2. Gross external financing needs are projected to remain elevated. Debt service payments represent the bulk of the gross external financing needs. Driven by public sector needs, gross external financing needs are projected in the 20-23 percent of GDP range in the next five years, peaking in 2023 and 2025, as US\$800 million Eurobonds mature in each of these years. Under a scenario of significant deterioration in the non-interest current account deficit, the gross external financing needs could rise to about 28 percent of GDP. The implications of recently announced plans to use proceeds of a new sovereign bond issuance to purchase Bitcoin and fund infrastructure investment do not form part of this assessment.

Annex III. Table 1. El Salvador: External Debt Sustainability Framework, 2016–26
(In percent of GDP, unless otherwise indicated)

	Actual					Projections							Debt-stabilizing non-interest current account 6/ -0.8
	2016	2017	2018	2019	2020	2021	2022	2023	2024	2025	2026		
Baseline: External debt	67.4	66.0	64.0	64.7	74.5	68.6	70.3	71.6	74.6	77.6	75.0		
Change in external debt	1.3	-1.4	-1.9	0.7	9.7	-5.9	1.8	1.2	3.0	3.0	-2.5	0.0	
Identified external debt-creating flows (4+8+9)	-1.2	-3.8	-2.5	-3.8	4.6	-5.4	-1.9	-1.2	-0.4	0.7	0.9	0.0	
Current account deficit, excluding interest payments	0.2	-0.5	0.7	-1.8	-2.8	1.1	-0.3	-0.3	0.2	0.7	0.9	0.8	
Deficit in balance of goods and services	15.9	16.5	18.3	16.6	18.4	24.7	23.5	23.6	24.2	24.7	24.9		
Exports	28.4	28.9	29.1	29.7	25.5	29.8	30.6	31.1	31.3	31.4	31.7		
Imports	44.3	45.4	47.4	46.3	43.9	54.5	54.1	54.7	55.5	56.1	56.5		
Net non-debt creating capital inflows (negative)	-1.4	-3.6	-3.2	-2.4	-0.8	-2.8	-2.3	-2.2	-2.2	-1.9	-1.9	-1.9	
Automatic debt dynamics 1/	0.0	0.2	0.0	0.4	8.2	-3.7	0.6	1.3	1.5	1.8	1.9	1.1	
Contribution from nominal interest rate	2.1	2.3	2.6	2.5	2.3	2.9	2.7	2.9	3.1	3.3	3.4	3.3	
Contribution from real GDP growth	-1.6	-1.5	-1.5	-1.6	5.6	-6.6	-2.1	-1.6	-1.6	-1.5	-1.5	-1.4	
Contribution from price and exchange rate changes 2/	-0.4	-0.7	-1.1	-0.5	0.3	...	...	...	...	...	...	-0.8
Residual, incl. change in gross foreign assets (2-3) 3/	2.5	2.4	0.6	4.5	5.1	-0.5	3.7	2.4	3.5	2.3	-3.5	0.0	
External debt-to-exports ratio (in percent)	237.2	228.0	220.2	218.1	291.7	230.3	230.1	230.3	238.4	247.1	237.1		
Gross external financing need (in billions of US dollars) 4	4.1	5.3	5.5	6.5	5.1	5.9	5.8	7.4	7.0	8.2	7.7		
in percent of GDP	17.1	21.3	21.1	24.1	20.8	21.1	19.8	24.4	22.0	25.1	22.9		
Scenario with key variables at their historical averages 5/						68.6	73.7	76.9	81.2	84.3	81.3		
Key Macroeconomic Assumptions Underlying Baseline												For debt stabilization	
						Historical Average	Standard Deviation						
Real GDP growth (in percent)	2.5	2.3	2.4	2.6	-7.9	1.5	3.4	10.0	3.2	2.3	2.2	2.0	2.0
GDP deflator in US dollars (change in percent)	0.7	1.0	1.7	0.7	-0.5	1.5	1.7	2.7	2.4	1.4	1.3	1.2	1.0
Nominal external interest rate (in percent)	3.3	3.6	4.1	4.0	3.3	3.4	0.5	4.3	4.2	4.3	4.4	4.6	4.5
Growth of exports (US dollar terms, in percent)	-0.6	5.1	4.7	5.5	-21.2	2.8	9.8	31.8	8.6	5.4	4.3	3.7	3.9
Growth of imports (US dollar terms, in percent)	-1.9	5.8	8.7	1.1	-13.2	2.6	8.3	40.3	5.0	4.9	5.0	4.4	3.9
Current account balance, excluding interest payments	-0.2	0.5	-0.7	1.8	2.8	-1.3	2.7	-1.1	0.3	0.3	-0.2	-0.7	-0.9
Net non-debt creating capital inflows	1.4	3.6	3.2	2.4	0.8	1.8	1.0	2.8	2.3	2.2	1.9	1.9	1.9

1/ 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.

2/ 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).

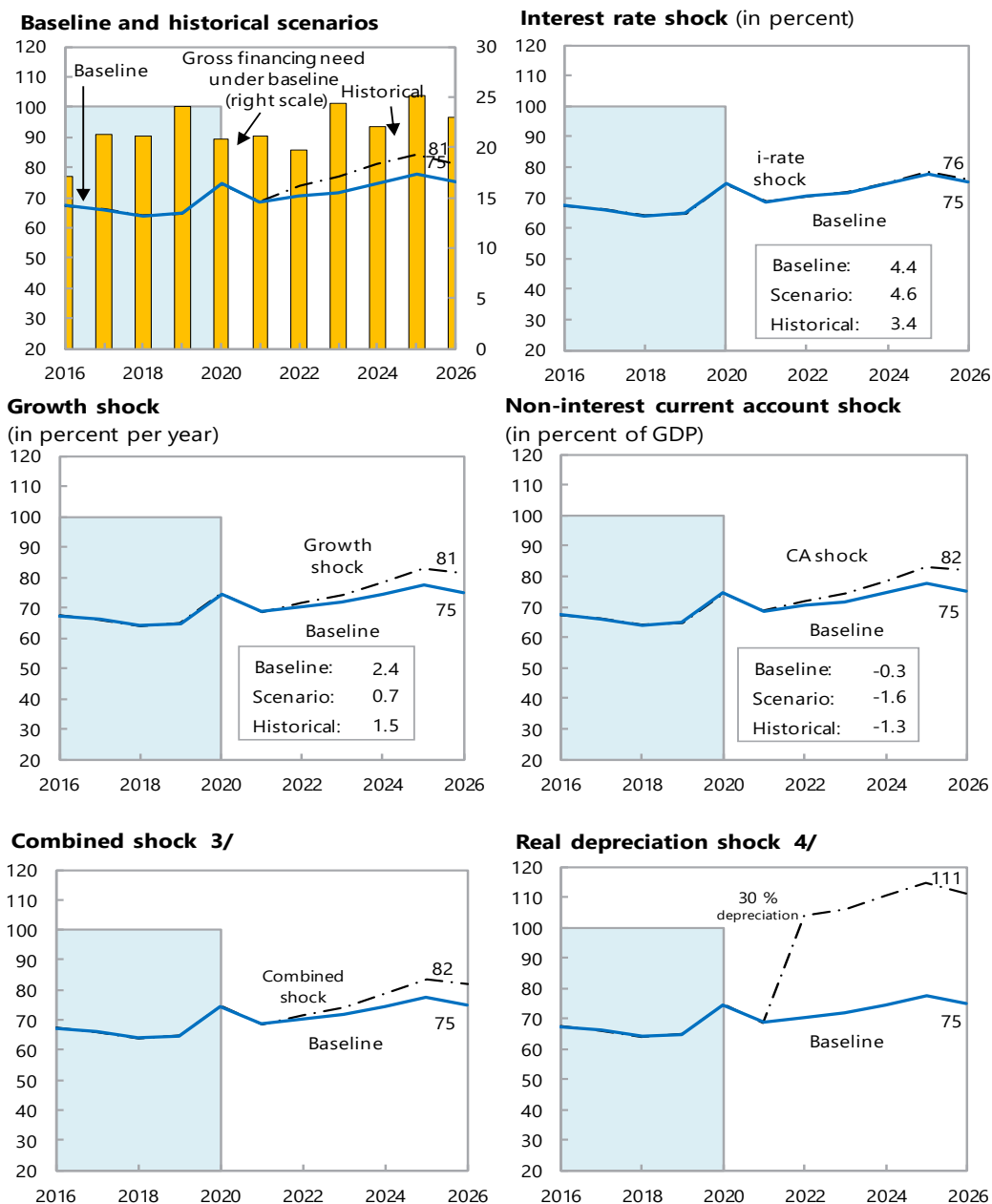
3/ For projection, line includes the impact of price and exchange rate changes.

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

5/ 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.

6/ 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.

Annex III. Figure 1. El Salvador: External Debt Sustainability: Bound Test ^{1, 2}
 (External debt in percent of GDP)



Sources: International Monetary Fund, Country desk data, and staff estimates.
 1/ 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.
 2/ 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.
 3/ Permanent 1/4 standard deviation shocks applied to real interest rate, growth rate, and current account balance.
 4/ One-time real depreciation of 30 percent occurs in 2022.

Annex IV. External Sector Assessment

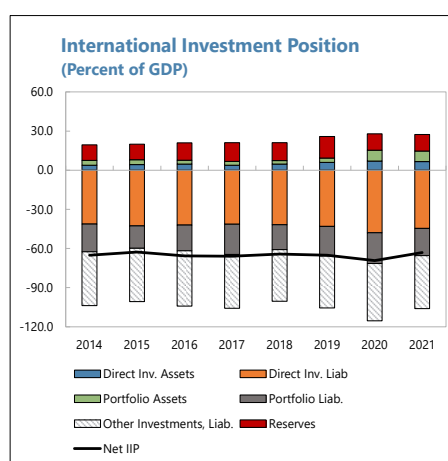
Overall Assessment: On a preliminary basis, the external position in 2021 is broadly in line with the level implied by fundamentals and desirable policies. While the quantitative model suggests a moderately stronger position, in staff's view, the sharp deterioration in foreign liabilities and relatively low foreign exchange reserves present an imminent risk to the country's external sustainability, thus the overall assessment is considered to be broadly in line. This assessment partly reflects a positive fiscal policy gap, owing to the relatively larger fiscal expansions in major economies. However, this assessment is highly uncertain given the lack of full-year data for 2021, the ongoing COVID-19 crisis, the introduction of a new payment system, and the recently announced plans to issue sovereign bonds to be partially invested in Bitcoin.

Potential Policy Responses: As the Covid -19 shock recedes domestically and globally, fiscal consolidation should resume immediately to ensure debt sustainability and prevent a deterioration in external sustainability. Maintaining macroeconomic stability is key to strengthening the country's competitiveness. Structural reforms aimed at improving the investment climate and raising productivity would further strengthen the economy's competitive position.

Foreign Assets and Liabilities: Position and Trajectory

Background. NIIP position has improved somewhat to pre-pandemic levels as the COVID-19 shock gradually dissipates. In 2021 it is expected that the NIIP will hover around 63 percent of GDP. The negative position is driven primarily by direct and other investment liabilities (-45 and -40 percent of GDP, respectively). Gross foreign assets are expected to remain at last year's levels (43 percent of GDP). Foreign assets consist mainly of reserves (13 percent of GDP) and other investment (15 percent of GDP). The total stock of external debt is expected to decrease by almost 6 percent of GDP to 69 percent of GDP by end 2021, as the economy recovers. The gradual increase in reserve requirements and the SDR allocation will further boost reserves by year end (see below).

Assessment. The projected trajectory in NIIP implies risks to external sustainability. The large gross foreign portfolio liabilities (21 percent of GDP) could be a source of vulnerability in case of global financial volatility.



2021 (% GDP)	NIIP: -63	Gross Assets: 43	Debt Assets: 21	Gross Liab.: 106	Debt Liab.: 68.6
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Current Account

Background. The current account is expected to turn to a deficit of -3.9 percent of GDP in 2021 from last year's surplus of 0.5 percent. This mainly reflects the widening of the merchandise-trade deficit, as imports have recovered, and are well above pre-pandemic levels. Cumulatively, in the first 10 months of the year, nominal exports and remittances recorded growth rates above 30 percent compared to 2020, mitigating somewhat the deterioration in the current account balance. The import rally is likely to continue in the last quarter of 2021, as large energy and capital goods imports are needed for the launch of key electricity projects (see ¶22). Over the medium term, the current account deficit is projected to widen to 4.3 percent of GDP, driven mostly by a wider deficit on the non-oil goods balance and on the primary income balance.

Assessment. Based on projections for 2021, the EBA current account (CA) model suggests a current account gap of 1.2 percent of GDP. This implies that the external position is moderately stronger than fundamentals and desirable policies in 2021. The relative policy gap in 2021—the difference between current and desirable policies— reflects mostly a relative fiscal policy gap and others (where health expenditure and reserves are being offset by credit gap). However, amid rising risks from the expected deterioration in the NIIP and the relatively low reserve coverage (see below), staff judges that the external position is broadly in line with the level implied by fundamentals and desirable policies.¹

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Annex IV. Table 1. El Salvador: EBA Current Account Model Estimates for 2021

(in percent of GDP, unless otherwise indicated)

	CA model	REER
CA-Actual	-3.9	
Cyclical contributions (from model) (-)	-0.2	
COVID-19 adjustor (+) 1/	0.5	
Adjusted CA	-3.1	
CA Norm (from model) 2/	-4.3	
Adjustments to the norm (+)	0.0	
Adjusted CA Norm	-4.3	
CA Gap	1.2	-0.3
o/w Relative policy gap	0.9	
Elasticity	-0.26	
REER Gap (in percent)	-4.5	1.1

1/ Additional cyclical adjustment to account for the temporary impact of the tourism (0.5 percent of GDP).

2/ Cyclically adjusted, including multilateral consistency adjustments. Cyclically adjusted CA does not include the remittances adjustor since the increase in remittance balance (in 2020 and 2021) is expected to be permanent.

Real Exchange Rate

Background. The exchange rate has been relatively stable over the last five years. The real effective exchange rate (REER) has marginally depreciated (by 0.7 percent) in 2021, owing mainly to higher oil prices. In 2020, the REER had depreciated by 2.3 percent, and in 2019 appreciated by 2.6 percent. The economy's competitiveness has potential to improve. At 93, real unit labor costs² in El Salvador are comparable to the levels of Panama, and less competitive than in Guatemala and Costa Rica. To improve competitiveness and to support economic growth, some structural gaps need to be closed. According to the 2016 World Bank enterprise surveys, crime, theft, and disorder was rated as the top constraint across firms, unfair competition from informal firms ranked second for small firms, lack of access to finance ranked third for medium sized firms, and cumbersome licensing and permits procedures ranked third for the largest firms. Additionally, maintaining macroeconomic stability—both fiscal and financial—is key to the economy's competitiveness.

Assessment. The EBA-lite current account model estimates an REER gap (undervaluation) of -4.5 percent using an elasticity of -0.26. This is based on the above-mentioned conclusion that the current account deficit is smaller than predicted by the model, given relative domestic and global developments. The EBA-lite IREER model estimates fitted REER of 4.6 (in natural log form), and a policy gap of -3 percent. This implies a REER gap of 1.1 percent, a modest overvaluation.

Capital and Financial Accounts: Flows and Policy Measures

Background. Despite the Eurobond issuance in 2020, net non-resident capital flows decreased by 2.5 percent of GDP (outflow) reversing the trend from average capital (in)flows in the last 5 years at 3 percent of GDP. The outflow in 2020 was mostly due to the deterioration in other investment liabilities at -7 percent of GDP in 2020 vs its 5-year average of 1.3 percent. Net FDI flows decreased to 0.8 percent of GDP, resting below the three-year average rate of 3.1 percent. Net resident capital flows (excluding errors and omissions) slightly increased to 0.5 percent of GDP. Net capital outflows have continued in 2021, with FDI inflows offset by portfolio and other investment net outflows.

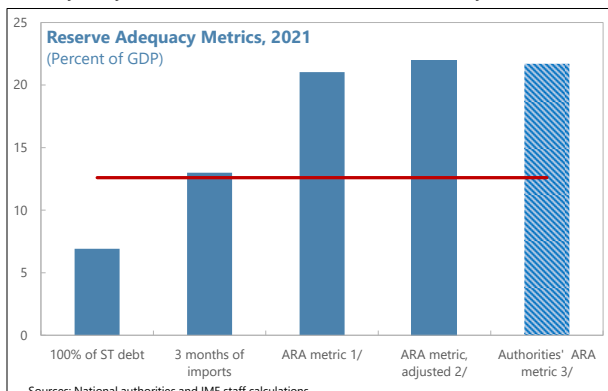
The relatively long average debt maturity (about 11 years) of existing debt and a diversified creditor base somewhat mitigate vulnerabilities. The banking sector is well capitalized and liquid. About half of the debt is owed to multilateral/bilateral creditors and private pension funds. Non-financial public sector (NFPS) interest bill reached 4½ percent of GDP in 2020 and is forecast to reach 5 percent of GDP by 2026 due to the issuance of expensive Eurobonds and the programmed increase in pension bonds’ interest. Besides the envisaged fiscal consolidation, the authorities should strengthen relations with investors by creating a specialized unit at the Treasury. Also, consideration could be given to smoothing the amortization profile through market-friendly liability management operations.

Assessment. Traditionally, El Salvador’s capital inflows have been dominated by FDI flows. Deterioration in global trade and the Covid-19 shock resulted in a large reversal in other investments. The gap was eventually covered by a drawdown in reserves and IFI financing. In the near-term, the BoP gap would deem IFI financing critical for El Salvador. The implications of recently announced plans to use proceeds of a new sovereign bond issuance to purchase Bitcoin and fund infrastructure investment have not been assessed by staff.

Reserves Level

Background. Gross international reserves (GIR) fell significantly—by about US\$ 1.4 billion—in 2020. At year-end, reserves amounted to US\$ 3. billion or 58.8 percent of the IMF’s metric for Assessing Reserve Adequacy (ARA metric) for countries with fixed exchange rates.

Among the traditional metrics—the 3-month import and broad money coverage of the end-2020 stock of international reserves—although diminished—are adequate. The metric on reserve coverage of short-term debt rests below the benchmark. In 2021, despite the recent SDR allocation, the ratio of reserves to GDP is expected to remain at 2020 levels, but with reserve coverage dipping below 3-months of imports by year end.



Assessment. It is expected that the level of international reserves by end-2021 (12.6 percent of GDP) continues to be below the adequate level implied by the adjusted risk-weighted adequacy (ARA) metric. Against the backdrop of the Covid-19 shock in 2020, reserves have fallen below the adjusted ARA benchmark for fixed exchange rate regimes (benchmark at 21 percent of GDP) and the level determined adequate by the authorities’ metric (benchmark at 22 percent of GDP).³

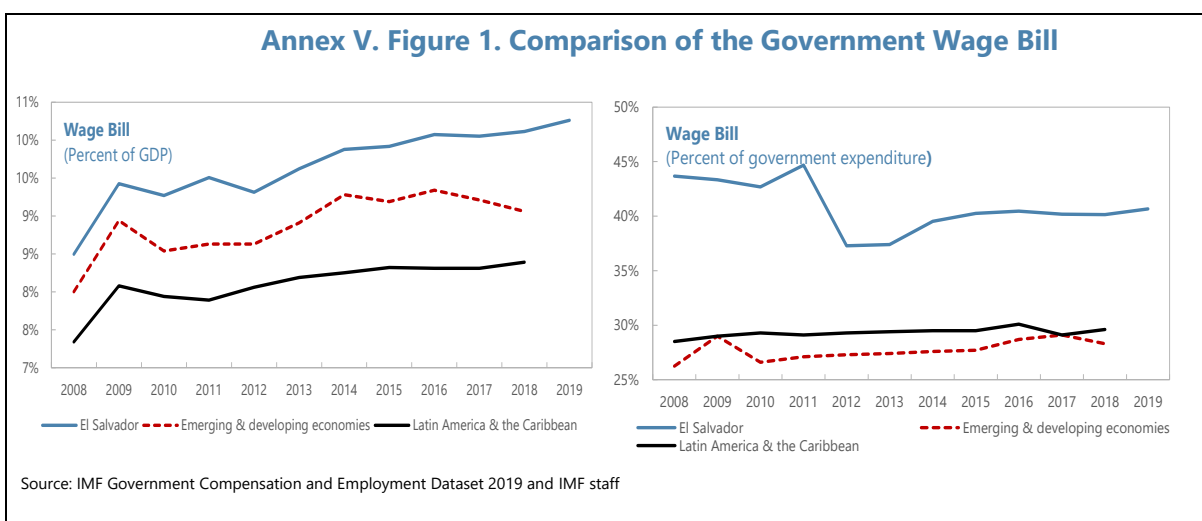
1/ ARA metric for fixed exchange rate regime	2/ ARA metric adjusted for dollarization	3/ Authorities ARA metric
= 10% of exports	= 10% (exports + remittances)	= 22% deposits (reserve requirements)
+ 10% of broad money	+ 20% deposits	+ 5% deposits (deposit insurance)
+ 30% short-term debt	+ 30% short-term debt	+ 8% deposits (medium-term target for LOLR and ELA purposes)
+ 20% other liabilities	+ 20% other liabilities	

1/Under the ES analysis (not presented here), results suggest that under the current baseline scenario, the NIIP does not deteriorate in net present value terms, that is, the NIIP is sustainable based on this definition.
 2/Real ULC is calculated as annual average real wages/ output per worker (GDP constant 2011 international \$ in PPP).
 3/The authorities’ metric = 22% Deposits (reserve requirements) + 5% Deposit Insurance + 8% Deposits (medium term target for LOLR and ELA purposes).

Annex V. Wage Bill Reform

1. Total general government expenditure has remained relatively high over the past decade, and the wage bill is a key determinant. Total general government expenditure in El Salvador remained stable at around 25 percent of GDP from 2012 to 2019. However, it was higher than regional comparators (average of 21.5 percent in Central America in 2019)¹. The government wage bill is a key driver of the high government expenditure, accounting for 36.9 percent of the total, or 12.4 percent of GDP in 2020 (and is budgeted to be 41 percent of total expenditure in 2021).

2. The wage bill in El Salvador exceeds international comparators (see Figure 1). It is especially high as a percentage of government expenditure (40.1 percent in 2018) compared to average of 29.6 percent in LAC countries and 28.3 percent in EMEs for the same year. It also exceeds that in comparators even in relation to GDP.



3. Education, health and justice and social security sectors represent the largest share in central government (together accounting for around 4.4 percent of GDP; Table 1). These are also the sectors where the wage bill increases have far exceeded the increases in employment levels from 2009 to 2020, thereby pointing to increases in wage levels and benefits. For example, in the nonfinancial public sector employment increased by 33 percent from 2009 to 2020, however, the total wage bill increased by 77 percent over the same period.

¹ IMF Expenditure Assessment Tool

Annex V. Table 1. El Salvador: Government Employment

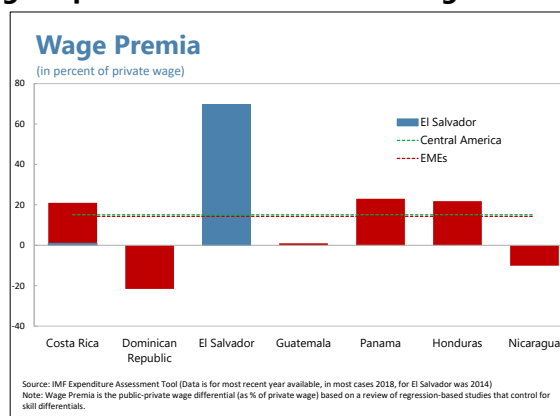
	Budget 2020 Wage Bill			Budget 2020 Employment		Percentage changes (2009-2020)		Proportion of change 2020 - 2009		
	\$US millions	% of total	% GDP	Employees ('000s)	% of total	Wage Bill	Employment	\$US millions	Employees	% change
Nonfinancial Public Sector	2059.28	100%	8.2%	184.197	100%	77%	33%	893.504	45.459	100%
Central Government	1600.097	78%	6.3%	144.686	79%	75%	30%	687.971	33.59	74%
Education	504.243	24%	2.0%	47.2	26%	82%	23%	227.698	8.829	19%
Health (including hospitals)	373.89	18%	1.5%	27.214	15%	108%	33%	194.102	6.735	15%
Justice and Social Security	226.334	11%	0.9%	36.798	20%	52%	40%	76.95	10.59	23%
Judiciary	174.81	8%	0.7%	10.715	6%	54%	15%	61.241	1.369	3%
Others	320.82	16%	1.3%	22.759	12%	66%	36%	127.98	6.067	13%
Decentralized institutions	364.4	18%	1.4%	31.618	17%	67%	34%	146.643	7.976	18%
Rest of NFPS	94.781	5%	0.4%	7.893	4%	164%	97%	58.889	3.893	9%

Source: Ministry of Finance. Note that this excludes municipalities.

4. A key issue for the wage level is the presence of a large public-private wage premium (defined as the public-private wage differential as a percent of private wage). El Salvador is an outlier with public sector wages 70 percent higher than the private sector (text chart). Such a premium is mainly explained by structural rigidities stemming from the different compensation frameworks. For example, the health sector pay scale exacerbates wage inequality both within the public sector and the wage gap vis-à-vis the private sector. It is the largest of the many compensation frameworks because it was designed in the early 1990s, in an inflationary context that no longer exists. The average annual wage increase is 8 percent, while inflation has averaged 0.4 percent since 2013.

Past FAD Recommendations

5. A 2016 IMF TA report on government wage expenditure found that in the general government sector, the wage bill increased by about 2 percentage points of GDP between 2008 and 2014. This increase is explained by marked job growth in all sectors, together with major discretionary increases in education and the impact of the generous health sector pay scale.² The mission identified various short-term options to control the wage bill that could have generated savings of more than 2 percentage points of GDP by 2020. These options remain valid and can be summarized into three key areas as below (and the potential fiscal savings of each are detailed at the end of this Annex).



- *Contain wage increases.* The high premium of government wages vis-à-vis private wages indicates that there is sufficient room for rationalizing wages without affecting the government's ability to attract and motivate employees. The first priority recommended was to suspend the

² IMF (2016) El Salvador: Government Wage Expenditure: Analysis and Challenges (English translation)

health sector pay scale until its parameters are revised. Another measure recommended was to rationalize payments other than the base wage, as they were proliferating, reducing transparency, and were not linked to performance.

- *Contain job growth.* Following the rapid increase in the number of jobs in the five years preceding the analysis, it seemed appropriate to limit further hiring, at least until the challenges related to the health sector pay scale had been addressed. One option proposed was to freeze the number of jobs (i.e., zero net growth). Such efforts could have been targeted – for example, by restricting job creation in all sectors except the security sector. Other measures to control the employment level included eliminating the positions of those who retire and introducing a mandatory retirement age in the public sector.
- *Strengthen budgetary processes.* Transfers between current expenditure budget items in favor of wages should be restricted. It is also essential to limit the use of contracts to create or convert jobs into permanent positions—the practice of converting employees subject to the Wage Law into contractuels in order to increase their pay should be prohibited, as its sole purpose is to evade the stricter controls imposed by the Wage Law.

Key Developments Since 2014

6. Since 2014 the increase in the wage bill is due to wage growth. From 2014 to 2020, the average annual increase of government positions was 1.4 percent, whereas the average annual increase in the wage bill was 4.1 percent (at a time when inflation was mostly less than 1 percent per annum), suggesting that the recent drive is primarily from wage growth. The key drivers of this continue to be the health sector pay scale, and also discretionary allowance increases allocated for the justice and social security sector. Therefore, efforts to contain the wage bill must include reform to the established pay scales (in particular, in the health sector). Most importantly, the wage bill was not cut during 2020, and bonuses were given to health workers, and policy (after in 2019 other bonuses were granted to policy and army). With a contracting nominal GDP, it shows an increase in compensation of employees by 2 percent of GDP.

Areas for Further Analysis and Consideration

7. The savings options developed in the 2016 TA report remain just as relevant for identifying current savings. Governments typically rely on quick fixes such as across-the-board freezes in wage and employment levels when seeking to reduce high wage bills. While these measures can be effective in reducing the wage bill in the short term, they tend to decrease morale, distort wage structures, and adversely affect service delivery. As a result, they tend to unravel over the medium term, resulting in recurring wage bill pressures. Undertaking functional reviews to inform structural reforms can help prevent the recurrence of wage bill pressures.³ Therefore, the fiscal impact of the measures recommended in the 2016 report should be reassessed with updated

³ IMF (2016) Managing Government Compensation and Employment.

data and follow up technical assistance could be provided on this topic, to inform a comprehensive review of the public sector and the standardization of compensation and benefits among different public entities (see below).

Potential Wage Bill Measures

8. A combination of measures addressing employment level and wage level could be used to reduce the impact of the government wage bill on total expenditure. Short-term measures can be useful; however, functional reviews are needed to identify the longer-term structural reforms that generate enduring savings.

Short-term Temporary Measures

- *Implement hiring freeze* whereby vacant posts are eliminated as employees retires, which could generate savings up to 0.4 percent of GDP in total over 2023-2025. This could be utilized until the authorities can undertake a comprehensive functional review and fully implement its findings.
- *Suspend the established pay scales in the health, education and justice sectors*, which could save up to 0.3 percent of GDP in total over 2023-2024. This could be utilized until a public sector employment law is enacted.

Longer-term Structural Measures

- *Comprehensive functional review of the public sector* to identify superfluous positions and overlapping functions within ministries and ensure reforms do not jeopardize access to, and quality of, government services. The review could propose consolidation of ministries and functions (and estimated reductions in employment) to be implemented from 2023.
- *Draft and enact a public sector employment law* to standardize compensation and benefits among different public entities. This would include review of the parameters of the established pay scales, as well as contractual wages and benefits. The new Law could then regulate wage increases and bonuses from 2024 (including for the existing established pay scales) and would have expanded coverage over temporary contractual positions which may be exempt from the current Wage Law.

Annex V. Table 2. El Salvador: Remuneration as a Percentage of GDP
(baseline scenario) ¹

	2016	2017	2018	2019	2020
	9.5	9.7	9.8	10	10.2
Tax savings associated with reforms (percentage points of GDP) 2/					
<i>Review parameters of the health scale</i>					
Suspend the escalafon	0.2	0.3	0.4	0.6	0.8
Modify it to be comparable to that of teachers	0	0.2	0.3	0.5	0.7
Lower the rank increase to 2%	0.1	0.2	0.4	0.5	0.7
Lower the rank increase to 5%	0.1	0.2	0.3	0.3	0.4
Freeze wages for those in the 75th percentile of their position 3/	0.2	0.3	0.3	0.4	0.6
Measure overall salary increases					
Zero overall increase	0.2	0.4	0.6	0.7	0.9
civil service	0.1	0.1	0.2	0.2	0.3
education and health	0.1	0.2	0.3	0.4	0.5
security	0	0.1	0.1	0.1	0.1
Reduce salary increases by one percentage point	0.1	0.2	0.2	0.3	0.4
Moderate the growth of places					
Zero increase in places (1 withdrawal = 1 hiring)	0.1	0.2	0.3	0.4	0.5
civil service	0.1	0.1	0.2	0.2	0.2
education and health	0.1	0.1	0.2	0.2	0.3
security	0.1	0.1	0.1	0.1	0.1
Eliminate places based on voluntary withdrawals	0.2	0.3	0.4	0.5	0.7
Maximum saving of total measures 4 /	0.5	1	1.4	1.9	2.3
<i>Measures to increase coverage and reduce disparities</i>					
Increase places in health, education, and safety by an additional 1 percent per year	0	0	-0.1	-0.2	-0.2
Raise wages to the median for each position	-0.7	-0.7	-0.7	-0.7	-0.7

Source: IMF 2015 El Salvador Government Wage Expenditure: Analysis and Challenges (English translation)

1/ The baseline scenario assumes that each year the number of positions increases by one percent and wages by two percent, in addition to the pay scales. Nominal GDP grows four percent per year (2 percent real growth and 2 percent inflation).

2/ The impact of the individual measures is calculated relative to the baseline; consequently, they are not additive.

3/ Based on a grouping of the civil service into 35 positions and on the level of the 75th percentile in 2015.

4/ The combined impact of suspending the health sector pay scale, freezing wages, and reducing the number of positions based on voluntary departures.

Annex VI. Pension System

1. The pension system in El Salvador is managed by private companies (*Administradoras de fondos de pensiones, AFPs*). In 1998 the public pay-as-you-go (PAYG) pension system was privatized to ease the burden on public finances. The reform created individual capitalization accounts comprising the amounts contributed by workers over their working lives plus profits coming from investing these funds until the retirement age is reached. However, while privatizing the pension system in principle eliminates the long-term fiscal cost as any entitlement is a liability for a private company instead of the Treasury, the transitional cost still needs to be paid (see below). At the time of privatization, the actuarial deficit of the PAYG was about US\$9 billion (Funde, 2014) but actuarial reserves were only US\$0.3 billion. Once reserves were depleted, the payment of the transitional cost was entirely shouldered by the Treasury and was done mainly by placing Eurobonds in the international market (Mesa-Lago and Rivera, 2020).

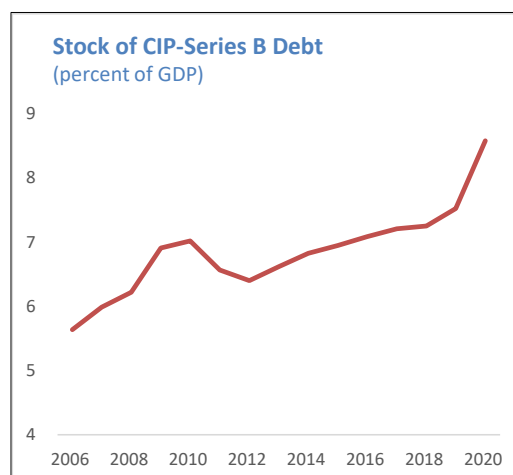
2. The newly privatized pension system created three types of liabilities.

- The cost of *paying entitlements* to the social security administration's pensioners and their survivors and workers that were too close to the retirement age at the time of the privatization.
- The cost of *pension recognition bonds*—issued to AFPs to reimburse the contributions paid to the old public PAYG of workers transferred to the private system, to finance their pensions once they retired.
- *Minimum pension guarantee (MPG)*. The state guarantees a minimum pension. If the amount accumulated on individual capitalization accounts is not enough to finance the MPG, the gap between the AFP pension and the minimum pension is paid by the Treasury.

Cuenta de Garantía Solidaria	34.1
Other liabilities	32.2
o/w entitlements	20.0
o/w pension recognition bonds	4.9
Actuarial deficit	66.3

3. The large pension burden on the budget triggered a series of financial reforms. In 2006 a trust fund—*Fideicomiso de obligaciones previsionales (FOP)*—was created to contain the drawdown of budget resources for pension transfers. The role of the FOP is issuing securities—*Certificados de inversión previsional (CIP)*—that the AFPs are mandated to purchase. Currently two types of securities are being issued: CIP-A to pay entitlements and CIP-B to pay pension recognition bonds (2a and 2b above). Proceeds from these bonds are transferred to the social security administration to pay obligations to beneficiaries of the old pension system. As the public system is closed, all liabilities stemming from it will be decreasing over time. However, obligations from the minimum pension guarantee (MPG) will increase over time as each year new pensioners do not reach the MPG with their own AFP funds, and over time MPG is increased.

4. The 2017 reform tried to address the increasing cost of liabilities stemming from the MPG. In 2017, the authorities created the *Cuenta de Garantía Solidaria (CGS)*. It is a common fund covering the financial burden of the MPG and other payments. It is funded by contribution rates of 15 percent (increased from 13 percent) and of which 5 percentage points are earmarked to the CGS. However, given the increasing nature of this liability—mainly explained by low returns from AFPs investments given their large exposure to sovereign risk—the last actuarial report from the Bank superintendency estimates that the CGS will be in deficit again in 2028.



5. As CIPs are held by private entities, their stock should be accounted as part of the nonfinancial public sector debt. The authorities include only the CIP-A bonds into the nonfinancial public sector debt. Those amount to 23 percent of GDP in 2020, doubling in size since 2013. As of end-2020, the stock of CIP-B, estimated based on the AFPs' balance sheets, was about 8½ percent of GDP. The presence of pension debt within the NFPS debt stock is a relevant metric when doing international comparisons with countries where the pension system is public. Other countries in Latin America with privatized pension system are also reporting debt owed to AFPs as part of public debt.

6. In the absence of structural reforms, pension obligations are expected to rise. Even though AFPs are paid relatively low interest rates on CIPs, the minimum pension guarantee effectively translates into a growing source of pension obligations for the government over the long-term, not only because of the increasing number of AFP pensioners but also because of the financial impact of a long period of subpar rates on fixed income securities. In addition, the Legislative Assembly approved an increase in the minimum pension guarantee from \$207 to \$304 in December 2020—47 percent increase. The pension infrastructure generates a cycle of low returns from AFPs investments—as they are concentrated on government securities with low rates—which in turn results in pensioners not reaching the MPG. This low pensions from AFP triggers higher obligations for the Treasury to pay the MPG.

7. Reform options range from parametric adjustments to an overhaul of the system. While the authorities have not decided on a pension reform strategy, they can already start to adjust some of the clear weaknesses of the current system, in particular retirement age—that is well below the recommended 65 years, especially for women. Additionally, the current design is largely regressive. El Salvador is a largely informal economy where two thirds of the labor force do not have access to any social security coverage. A progressive spending strategy would target this part of the population to guarantee some basic social safety net but currently a large part of the budget is appropriated to pay subsidies benefiting AFP's affiliates.

Annex VII. Fostering Domestic Market Development and Reducing Sovereign Risk

1. Elevated public debt poses significant risks. The stock of T-bills (LETES)—the only domestic market-based instrument—has increased to US\$1.5 billion by end-January 2021, which along with the 1-year CETES, of US\$ 0.7 billion, raise refinancing risks and, because the EMBI spread is elevated it considerably increases the interest bill. Eurobonds, dominating the external debt issuance, pose significant refinancing risk over the medium-term, and are also contributing to the high stock of debt, given their elevated yields. Non-marketable government liabilities held by pension funds pose future liquidity risks for the pension funds, given the non-tradability of the instrument.

2. A credible medium-term debt strategy could help lower borrowing costs. This would clearly define the government's debt management objective, raising the required amount of financing at minimum cost while giving due regard to risk, and supporting the development of the domestic debt market. A credible debt management strategy with clear targets and goals would strengthen credibility and communication with market participants. Proactive engagement with market participants through an investor relations program would enhance transparency and over time likely lower borrowing costs.

3. Sound debt management practices and efficient local capital markets would help mitigate risks. The development of the domestic government debt market is needed to increase its efficiency and liquidity to help mobilize capital to finance growth. This could be achieved in part through the development of a domestic bond yield curve that would help in diversifying the government's sources of financing, extending the average maturity of the domestic portfolio, and provide important pricing benchmarks for the introduction of private debt instruments to expand investment alternatives for pension funds and other investors. This would also improve financial institutions' asset valuation practices, enhancing trading and supporting the soundness of the financial system.

4. A strategy for domestic bond market development includes:

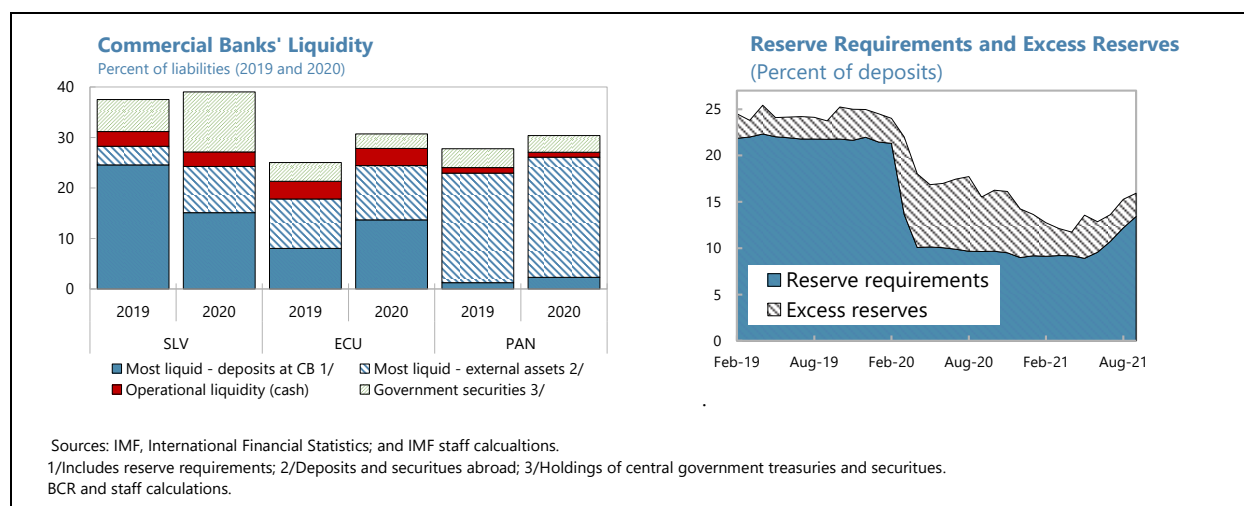
- Announcing an annual borrowing plan consistent with the goals outlined in the MTDS and adhering closely to the published quarterly calendar for LETES to enhance issuance predictability. Avoid frequent auction cancellations. Minimize large deviations from the published indicative amounts to improve predictability.
- Standardizing LETES and domestic government bonds to foster the construction of benchmark securities. Well-communicated regular issuance of standardized instruments—LETES, and 2- and 3-year bonds—would help to gradually create benchmark securities to build the domestic yield curve, which subsequently could serve as the reference rate for the private sector. LETES tenors should be standardized and issued according to a regular timetable across key maturities, such as 3, 6, 9 and 12 months, to enhance transparency and predictability and to build the short end of the domestic yield curve.

- Avoiding inter-year debt accumulation in LETES. Excessive inter-year debt accumulation in LETES should be avoided, given refinancing risks, and the debt management strategy could introduce some limits on the share of short-term borrowing. A feasible alternative could be to reduce the use of LETES by regularly issuing domestic bonds with longer tenors (e.g., 2–3 year), which would help the government to extend the average maturity of the domestic debt portfolio, reducing rollover risk. Decisions on issuance of longer-term bonds, however, should be based on analysis of cost and risk and availability of financing sources. The underlying cause for LETES accumulation should be addressed, such as overoptimistic budget forecasting, or inadequacy of other financing sources pre-pandemic, and large gross financing needs during the pandemic.
- Promoting small investors and corporate access to the domestic debt market, for example through investment funds. Development of funds to pool savings would help diversify the investor base and raise the demand for domestic government debt securities, increase activity in the primary and secondary markets, and subsequently lower debt costs.

Annex VIII. Liquidity Management and Emergency Liquidity Assistance

1. The liquidity buffers of commercial banks in El Salvador remain high, relative to the other two fully dollarized countries in the region.

- *Reserves in the Central Bank* declined from 25 percent of liabilities in end-2019 to 14 percent of liabilities in end-2020, like Ecuador (left chart). While the statutory requirements¹ declined to 9 percent of liabilities in 2020 the excess reserves remained elevated at 5 percent of liabilities (right chart). In 2021, after the central bank decision to gradually restore liquidity requirements, the reserves have increased up to 16 percent of liabilities.
- *External assets* increased from 3 percent of liabilities to 9 percent of liabilities, as banks used part of the liquidity released from the central bank to insure against tighter financing conditions.
- *Operational liquidity* such as cash, remained at 3 percent of liabilities, similar to Ecuador.
- *Liquid assets subject to funding constraints* doubled, from 6 percent of liabilities to 12 percent of liabilities by end-2020, as banks used freed liquidity to purchase government treasuries. The level of these liquid assets in Salvadoran commercial banks are the highest, when compared to banks in other dollarized countries in the region.



2. In case of liquidity needs, banks in El Salvador could borrow in the interbank market, or access their required reserves deposited at the BCR (against collateral), as a first line of defense. The latter could be done in three tranches, sequentially on tighter terms: (i) the first

¹ In El Salvador reserve requirements are averaged over 14-days. In Ecuador, reserve requirements are at 2–5 percent of liabilities (averaged over 7-days), and liquidity requirements are 18–32 percent of total assets. In Panama, there are no reserves requirements. Banks comply with Basel III liquidity requirements (the stock of high-quality liquid asset over total net cash outflows over the next 30 days should be more than 100 percent).

tranche (25 percent of total bank reserves) at no cost, (ii) the second tranche (25 percent) at LIBOR plus a penalty, and the third (50 percent), at no cost but subject to the approval by the Superintendence of Financial System (SSF), by submitting a regularization plan.

3. In addition, the central bank can provide bilateral emergency liquidity assistance to a solvent bank that has exhausted traditional facilities. When normal market functioning is disrupted, and a solvent bank's first and second tranche reserves are accessed, the central bank can provide emergency liquidity up to 100 percent value of the required capital of an individual bank under stress. The authorized ELA tools are: (i) repurchase agreements using appropriate capital, (ii) temporal acquisition of banks' investments portfolio, and (ii) liquidity credits to banks.

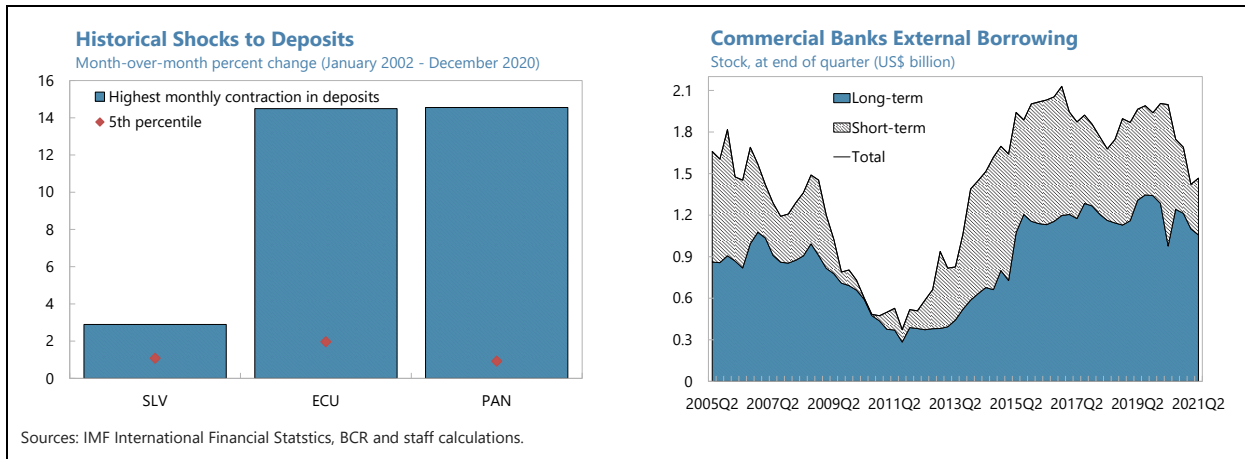
4. The gradual restoration of banks statutory reserves—15 percent of liabilities by June 2022—is adequate but vulnerabilities raised by potential liquidity shocks remain. While banks have excess reserves and strong external asset positions, the potential large liquidity shocks could come from deposits withdrawal or a sudden drop in the rollover of banks short-term debt (similar to 2008-09 episode). Authorities would face significant constraints in dealing with a run on the banking system given limited international reserves and the restrictions associated to a fully dollarized economy. The Salvadoran emergency liquidity framework is vulnerable to liquidity risks due to (i) absence of additional layers of liquidity buffers, for example the lack of a liquidity fund as it is in Ecuador;² (ii) delays in finalizing and approving the bank resolution law and framework; (iii) incomplete funding of deposit insurance fund, with a remaining two thirds expected to be filled;³ and (iv) absence of sufficient foreign reserves to be injected into banks in times of stress. Against this backdrop, the adequate reserve requirements level should be continuously reevaluated.

5. The authorities should strengthen the bilateral ELA framework and continue working towards a harmonized risk-based liquidity management framework. Increasing the capital of the central bank (BCR) (by removing central bank ownership of quasi-fiscal activities⁴) would allow for an augmentation of the ELA contingent credit line, as the central bank can borrow more than the currently possible US\$200 million, against its higher capital. Advancing on the banking resolution legal framework, including strengthening the deposit insurance fund, would reduce liquidity vulnerabilities. In the medium-term, some elements of the current system of prudential reserve requirements could be retained in the forward-looking liquidity risk-management framework of Basel III. To facilitate the transition process, the authorities could improve their communication tools, including by incorporating stress-tests in the financial stability reports and introduce early-warning system indicators.

² A liquidity fund is not needed in Basel III. However, at the moment, banks do not have incentives in pooling liquidity resources, since the largest banks have plenty liquidity, as they comply with Basel III.

³ The underfunded scheme of deposit insurance fund may provide less reassurance to depositors.

⁴ One of the main safeguard assessment recommendations was for BCR to exit from all quasi-fiscal activities—including participation in the state development bank and trust funds—to strengthen its governance and transparency. To be able to implement this recommendation, the government would need to pay for the central bank stakes in these institutions, about US\$400 million. This is in addition to the agreement with the government of recapitalization BCR needed to transition to IFRS, a safeguards assessment recommendation which is not progressing as expected.



Annex IX. Governance, Anti-Corruption, and AML/CFT Frameworks

1. **Strengthening economic governance should remain one of the authorities' top priorities.** The administration came in 2019 with an anti-corruption agenda based on preventing and prosecuting corruption offenses. In 2020 the government relied on the International Commission Against Impunity in El Salvador (CICIES) of the Organization of American States (OAS). to conduct audits of the July 2020 issue and placement of the Eurobonds, as well as any other COVID-19 spending. CICIES coordinated with the Court of Accounts (CoA) in conducting audits, and both institutions reported any findings requiring further investigation to the Attorney General in a timely manner.
2. **In particular, in early 2020, the CoA prepared a special plan to audit the funds for the COVID-19 response.** CoA has since published eight audit reports on specific spending programs of the pandemic response that cover approximately US\$596 million of the COVID-19 funds (69% of the resources assigned to the pandemic response; 2¼ percent of GDP) executed by six of the 12 implementing agencies up until September 2020. The CoA continued to audit COVID-19 funds and is publishing audit reports as they are finalized. Considering the wealth of this information, the authorities plan to publish the recommendations from the CoA audit reports, as well as the authorities' responses, and the summary of legal follow up actions. In addition, in 2020 the government invited CICIES to embed a team of 30 multidisciplinary professionals into each of the government's implementing agencies to track and audit in real time, the use of funds intended for the national COVID-19 emergency. At the government request CICIES prepared a report with recommendations to strengthen institutions and processes, however the cooperation agreement was terminated in June 2021, without the publication of the report.
3. **Further steps need to be taken to strengthen policies and procedures for avoiding corruption, illicit enrichment, including annual asset declarations.** The entities responsible for handling these measures are the Access to Public Information Units in every ministry, the Financial Intelligence Unit of the Attorney General's office and the CoA. Authorities have acknowledged the need to update the legal framework related to illicit enrichment. In this respect, the Act of Illicit enrichment of Public officials and civil servants needs to be amended to bring it in line with UNCAC, to which El Salvador is a signatory since 2010. The requirements related to public officials include: (i) updating the definition of offences and related penalties, (ii) protocols for prosecution of corrupt public officials, (iii) establishing annual asset declarations of public officials with clear timelines for compliance and transparency, (iv) establishing investigative techniques (eg. unexplained wealth orders) that can assist in investigating illicit enrichment cases, (v) debarring offenders from holding public office, (vi) typifying offences for trading of influence, obstruction of justice, role in preparation to commit a corruption offence, offence for interference in production of evidence, and lifting the corporate veil, related to third parties in bribery offences and the private sector, (viii) criminalizing all categories of corruption offences in line with UNCAC requirements, including criminal responsibility for legal persons and (ix) seizure of corruption proceeds.

4. Progress has been made in enhancing financial integrity. In 2019 the government rejoined the Egmont Group, a group of Financial Intelligence Units, supporting international efforts to combat money laundering. El Salvador has a relatively sound regulatory AML/CFT framework. The international standards have been applied for adequate risk management by the entities supervised by the Superintendency, which is applied by the Anti-Money Laundering and Combating Terrorist Financing Risk Management Standard (AML, CFT), including procedures aimed at complying with the Financial Action Task Force (FATF) Forty Recommendations. This Standard also includes controls applied to due diligence extended to publicly exposed persons (PEPs).

5. There are further plans to strengthen the AML/CFT framework through the Special Law for the Prevention, Control, and Penalization of Money Laundering. The Special Law, presented to the LA in 2019, incorporates 40 FATF recommendations. The authorities have submitted a draft for public consultation and in preparation for submission to the LA by the end 2021, and its implementation six months thereafter, to comply with FATF recommendations. The Authorities have, in the interim, issued a Financial intelligence Unit Directive of October 27, 2021, applicable to all AML/CFT obliged entities, including Designated Non-Financial Businesses and Professions (DNFBPs), to cover key preventative measures including the role and function of compliance officers, customer due diligence, record keeping, measures for politically exposed persons and for Non-Profit organizations.

6. The authorities should ensure that the AML framework meets the requirements of the international standards. El Salvador has applied to the Latin American (GAFILAT) for membership, leaving the Caribbean Financial Action Task Force (CFATF), therefore the next mutual evaluation will likely be carried out through GAFILAT. To prevent negative results from the GAFILAT mutual evaluation that could put pressure on correspondent banking relationships, effectiveness should be stepped-up across all the areas of the AML/CFT framework including risk-based supervision, compliance with AML/CFT preventive measures and availability of beneficial ownership, and overall enforcement against money laundering and confiscating ill-gotten proceeds. The authorities are actively building their capacity to address the AML/CFT risks from the increased VASPs activity in the country. As a matter of priority, additional pending AML/CFT measures include regulations to be issued to fully incorporate DNFBPs into the AML/CFT framework and the issue of reporting forms to implement threshold reporting on Bitcoin transactions. The definition of virtual asset providers needs to include persons exercising safekeeping and/or administration of instruments, and the law should contain powers for law enforcement agencies to investigate and sanction unlicensed Virtual Asset Service Providers (VASPs)

7. The fiscal and regulatory governance frameworks can be strengthened further¹, to help support growth as follows:

- Fiscal governance: The main weaknesses relate to revenue outcomes, due to the high informality and low compliance, although efforts have been made through Plan Anti-Evasion. On fiscal transparency, there is room to improve accountability, reporting and spending controls,

¹ See 2019 Article IV consultation staff report

including on procurement issues. With technical support from the IMF (provided in April 2021), the MoF is working to improve its existing reporting guidelines and mechanisms. Moreover, the authorities should publish on-line procurement contracts and beneficial ownership information in all government contracts, which will also require amendments to the law establishing the FOPROMID. These measures should cover budgetary and extra-budgetary funds, such as FOPROMID and other trust funds, and requires improving the legal framework and system enabling the use of the e-procurement system (CompraSal) for procuring and publishing purchases, including with extra-budgetary funds, and a change in the Civil Code.

- Regulatory framework: The ease of doing business has improved in recent years. To continue with this progress, staff recommends promptly implement electronic invoicing to make it easier to conduct business activities and improve tax collection through Anti-Evasion Plan, and other measures under the program, implement one-stop shop digital application for permits (including for government agencies to be able to share information).

8. Finally, to ensure access to external credit, especially through international cooperation from development partners, public access to information and open government need to be maintained. In 2010 the access to information law entered into force, granting controlled access to public information, including of asset declarations. However, in July 2021 a set of reforms to the Access to Information Law have been introduced in the LA, which would curtail access to public information by increasing the deadline to respond to information requests, reserving the right to not disclose public officials' asset declarations, and expanding the government's discretionary powers over the Institute for Access to Public Information. In addition, in November 2021, a Foreign Agents Law has also been introduced in the LA, which would tax 40 percent of revenues of organizations that receive funds from abroad, thereby affecting foreign funded civil society organizations.² While those laws have not passed, they have not been withdrawn from the consideration of the LA either, inviting reservations from international cooperation in El Salvador's quest for external credit. In addition, El Salvador would need to renew membership to the multilateral Open Government Partnership (OGP), after it has been placed under procedural review for falling below the minimum eligibility criteria, considering a lack of an active national action plan,³ and significant delays in implementation of its commitments.

² The 40 percent tax is proposed on revenue rather than operational profit, and it is punitive, since it is comparably higher than taxes levied for general income topped at 30 percent, with the possibility of applying deductions.

³ The last active national action plan for 2018-20.

Annex X. Implementing Fund's Policy Advice

Annex X. Table 1. El Salvador: Implementing Fund's Policy Advice from the 2019 Article IV Consultation and 2020 Rapid Financing Instrument	
Advice	Implementation
Fiscal Policy	
Implement a fiscal adjustment <ul style="list-style-type: none"> • allow the temporary 2020 crisis measures to lapse • 3 percent of GDP over 2021-24 	Partially implemented: the temporary 2020 measures are allowed to lapse, but a comprehensive fiscal adjustment has not been announced. ½ percent of GDP on fiscal savings are expected from cutting transfers to local governments. While the pandemic continues, most economic indicators reached the pre-pandemic levels by 2021Q3, and given that most measures implemented and planned will have permanent effects of increasing the deficit, a consolidation of 4 percent of GDP over 2022–24 is needed.
Comprehensive fiscal reform to eliminate distortions and to expand tax base	Not implemented. However, from the advice received in 2019 and 2020, the technical work on price transfers and electronic invoicing has finally been completed and the corresponding draft laws will be submitted to Congress. Authorities have received TA on tax policy in 2021, but advice has not implemented.
Any new public sector initiative should identify funding sources to avoid worsening public debt dynamics	Not implemented. New expenditure initiatives have been financed through additional debt.
Introduce additional reforms to strengthen the sustainability and fairness of the pension system that are budget neutral and fiscally sustainable in the long-term	Not implemented. The authorities have announced that they will propose a structural reform to Congress soon. The details of this proposal have not been provided, but the main target of the reform is to increase the replacement rate in the private pension scheme.
Strengthen the FRL	Not implemented. The FRL is currently suspended to implement COVID-19 relief measures.
Supporting financial market development and strengthening public debt management	Not implemented. The authorities have received technical assistance on this matter.
Financial Sector	
Temporary relaxation of the bank lending standards should be accompanied by close monitoring to ensure appropriate classification	Implemented: The BCR introduced the gradual phaseout of temporary relaxation of bank lending standards, with specific timeline and restored risk classification (to the pre-pandemic standards).
Establishing strict criteria for acceptable loan restructuring, and prudent credit extension to firms undergoing loan restructuring	Implemented: The SSF monitors bank-established loan restructuring practices and the appropriate risk classification according to the gradual phaseout rules.
Conduct impact assessment and develop individual banks' liquidity and recapitalization plans as needed	In course of implementation: The BCR issued requirement for depository corporations to report COVID-19 impacted loan portfolio to the SSF. In addition, the SSF conducts regular bank-level stress-tests on liquidity and capital buffers.

Annex X. Table 1. El Salvador: Implementing Fund's Policy Advice from the 2019 Article IV Consultation and 2020 Rapid Financing Instrument (continued)

Advice	Implementation
Continue building liquidity buffers for the financial system	Implemented: The BCR exited the temporary relaxation of liquidity buffers and introduced gradual increase in the reserve requirements to 15 percent of deposits by June 2022. Public ELA facility signed a credit-line agreement with CABEI. The authorities are working to improve the ELA framework, with the help of IMF technical assistance.
Adopt bank resolution and crisis management framework in line with international best practices	In course of implementation: Following the IMF technical assistance mission on the law, the BCR submitted the revised draft law to the Ministry of Economy for formal submission to the Legislative Assembly.
Enhance Financial inclusion	Implemented: The law to facilitate financial inclusion signed in September 2019, promotes digital products, including mobile money. In September 2021, the launch of <i>Chivo</i> e-wallet platform. Risks from the latter have to be mitigated.
Undergo Safeguards Assessment, sign MoU BCR and MoF, and provide external auditors reports	Implemented. The authorities will need to follow up on implementation of safeguards recommendations.
Governance and Anti-Corruption Frameworks	
Maintain sound AML/CFT standards	Implemented: The authorities have enhanced AML/CFT by establishing a high frequency monitoring system of capital flows and maintain international cooperation with the U.S. Department of Treasury.
Enhance governance and anti-corruption frameworks (ensuring harmonization of laws and considering their ultimate impact on the budget, align anti-corruption legislation with UNCAC)	Not implemented.
Increase fiscal transparency of the budget law	Not implemented. Fiscal transparency weakened. The publication of the 2022 budget bundle was delayed, it does not show properly the total unidentified financing.
Transparency and accountability of use of COVID-19 funds	Partially implemented: after significant delays, the publication of the use of COVID-19 funds has occurred, and 69 percent of COVID resources have been audited.
Implement electronic invoicing	In course of implementation (see above).
Strengthen audit of fiscal operations	Not implemented.
Establish better spending controls	Not implemented. The authorities have continued using trust funds to speed up spending execution at the cost of weakening transparency.
Improve Business Environment and Competitiveness	
Continue to improve security	Implemented. <i>Plan Control Territorial</i> brought down further organized crime in 2020 and 2021. Efforts need to continue to reduce kidnaping, extorsions.
Increase investment in public infrastructure	Partially implemented. <i>Plan de Despegue Económico</i> unveiled in 2020 which includes several public infrastructure projects such as <i>Aeropuerto de Oriente</i> , <i>Tren del Pacífico</i> , <i>Surf City</i> , and a ferry connection from El Salvador to Costa Rica. Financing is needed but delivering on infrastructure needed for <i>Surf City</i> started.

Annex X. Table 1. El Salvador: Implementing Fund's Policy Advice from the 2019 Article IV Consultation and 2020 Rapid Financing Instrument (concluded)	
Advice	Implementation
Investment in education	Partially implemented. The authorities supplied school-age children with computers and tablets. UNICEF and donor organizations assisted with teachers' digital training.
Enhance business environment	Implemented. See ¶23 and Annex I.
Reduce barriers to trade	Partially implemented: improvements in the logistics infrastructure, and launching the single window for export-import operations.
Advance regulatory simplification to reduce red tape	Implemented: The authorities optimized more than 200 procedures, halving the time for registering new businesses.



Appendix I. Draft Press Release

IMF Executive Board Concludes 2021 Article IV Consultation with El Salvador

FOR IMMEDIATE RELEASE

Washington, DC – January 24, 2022: The Executive Board of the International Monetary Fund (IMF) concluded the Article IV consultation¹ with El Salvador.

The pandemic interrupted ten years of growth, but El Salvador is rebounding quickly. Robust external demand, resilient remittances, and a sound management of the pandemic—with the help of a disbursement under the Rapid Financing Instrument (SDR287.2 million or US\$389 million) approved in April 2020—are supporting a strong recovery. The economy contracted by 7.9 percent in 2020 and is projected to grow by about 10 percent in 2021 and 3.2 percent in 2022.

Against this backdrop, public debt vulnerabilities emerged. Persistent fiscal deficits and high debt service are leading to large and increasing financing needs. The fiscal deficit is projected at 5¾ percent of GDP in 2021 and about 5 percent of GDP in 2022. Under current policies, public debt is expected to rise to about 96 percent of GDP in 2026 on an unsustainable path.

Since September 2021, the government has adopted Bitcoin as legal tender. The adoption of a cryptocurrency as legal tender, however, entails large risks for financial and market integrity, financial stability, and consumer protection. It also can create contingent liabilities.

Executive Board Assessment²

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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.

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 summings up can be found here: <http://www.IMF.org/external/np/sec/misc/qualifiers.htm>.

Table 1. El-Salvador: Selected Economic and Social Indicators

I. Social Indicators							
Per capita income (U.S. dollars, 2020)	3,799					Population (million, 2020)	6.5
Percent of pop. below poverty line (2020)	26					Gini index (2019)	39
II. Economic Indicators (Percent of GDP, Unless Otherwise Indicated)							
	2016	2017	2018	2019	2020	Proj.	
						2021	2022
Income and Prices							
Real GDP growth (percent)	2.5	2.2	2.4	2.6	-7.9	10.0	3.2
Consumer price inflation (average, percent)	0.6	1.0	1.1	0.1	-0.4	3.5	2.8
Terms of trade, percent change	6.1	-4.3	-3.9	0.8	6.0	-5.4	3.4
External sovereign bond spread (basis points)	599	520	424	453	760	837	...
Money and Credit							
Credit to the private sector	51.2	52.2	53.5	55.3	62.1	57.6	56.3
Broad money	50.0	53.8	54.8	59.0	70.2	65.7	65.1
Interest rate (time deposits, percent)	4.4	4.4	4.2	4.3	4.1	3.9	...
External Sector							
Current account balance	-2.3	-1.9	-3.3	-0.6	0.5	-3.9	-2.5
Trade balance	-19.2	-19.4	-21.7	-21.2	-21.1	-28.7	-28.4
Transfers (net)	18.8	20.2	20.6	21.0	24.2	26.1	26.5
Foreign direct investment	-1.4	-3.6	-3.2	-2.4	-0.8	-2.8	-1.9
Gross international reserves (millions of U.S. dollars)	3,238	3,567	3,569	4,446	3,083	3,510	3,980
Nonfinancial Public Sector							
Overall balance	-3.1	-2.5	-2.7	-3.1	-8.2	-5.8	-4.9
Primary balance	-0.2	0.7	0.9	0.6	-3.8	-1.1	0.0
<i>Of which:</i> tax revenue	17.2	17.6	18.0	17.7	18.5	20.4	20.9
Public sector debt 1/	68.8	70.5	70.4	71.3	89.2	84.4	84.8
National Savings and Investment							
Gross domestic investment	16.0	16.7	18.4	16.9	17.9	18.5	17.7
Private sector 2/	13.5	14.1	15.7	14.2	15.7	15.8	14.5
National savings	13.7	14.8	15.1	16.3	18.4	14.5	15.2
Private sector	13.7	14.7	14.7	16.4	24.0	17.3	16.4
Net Foreign Assets of the Financial System							
Millions of U.S. dollars	1,995	2,645	2,714	3,424	3,046	3,303	3,836
Memorandum Items							
Nominal GDP (billions of U.S. dollars)	24.2	25.0	26.0	26.9	24.6	27.9	29.4

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

1/ Includes gross debt of the nonfinancial public sector (including pension liabilities) and external debt of the central bank.

2/ Includes inventories.