INTERNATIONAL MONETARY FUND

IMF Country Report No. 25/67

EL SALVADOR

March 2025

2023 ARTICLE IV CONSULTATION—PRESS RELEASE; STAFF REPORT; AND STATEMENT BY THE EXECUTIVE DIRECTOR FOR EL SALVADOR

Under Article IV of the IMF's Articles of Agreement, the IMF holds bilateral discussions with members, usually every year. In the context of the 2023 Article IV consultation with El Salvador, the following documents have been released and are included in this package:

- A **Press Release** summarizing the views of the Executive Board as expressed during its March 20, 2023, consideration of the staff report that concluded the Article IV consultation with El Salvador.
- The **Staff Report** prepared by a staff team of the IMF for the Executive Board's consideration on March 20, 2023, following discussions that ended on February 9, 2023 with the officials of El Salvador on economic developments and policies. Based on information available at the time of these discussions, the staff report was completed on March 2, 2023.
- An **Informational Annex** prepared by the IMF staff.
- A **Statement by the Executive Director** for El Salvador.

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

- Selected Issues

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

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Washington, D.C.

PRESS RELEASE

PR25/069

IMF Executive Board Concludes 2023 Article IV Consultation with El Salvador

FOR IMMEDIATE RELEASE

Washington, DC – March 19, 2025: On March 20, 2023, the Executive Board of the International Monetary Fund (IMF) concluded the Article IV consultation[1] with El Salvador.

Despite a series of adverse external shocks, the Salvadoran economy has fared relatively well to date, and is estimated to have grown by 2.8 percent in 2022. Annual inflation jumped to 7¼ percent, mainly due to high global food prices while fuel price inflation was moderated by large subsidies. Vulnerabilities mounted, with international reserves falling below 2 months of imports. In the context of limited financing options, the fiscal deficit narrowed to 2½ percent of GDP, but fiscal policy is expected to turn expansionary in 2023. Under current policies, public debt is on an unsustainable path.

The economy is expected to grow by 2.4 percent in 2023, but the outlook is fragile, given the macroeconomic imbalances and a less favorable international environment. A comprehensive and credible policy package is urgently needed to put public debt on a firmly declining path and strengthen macroeconomic and financial stability.

Over a year after the adoption of Bitcoin as legal tender, its use has been minimal but risks for financial and market integrity, financial stability, and consumer protection remain and need to be addressed.

Executive Board Assessment[2]

Executive Directors noted the strong post-pandemic recovery supported by the authorities' timely responses to shocks and the improved security situation. Pointing to the fragile outlook amid rising risks and vulnerabilities, Directors urged the authorities to adopt a comprehensive plan to address macroeconomic imbalances, including

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

unsustainable public debt and limited reserve coverage, along with structural reforms to support stronger, inclusive growth.

Directors welcomed recent fiscal efforts but underscored the urgent need for an ambitious fiscal consolidation plan, based on greater revenue mobilization and efficiency of spending, including better targeting energy subsidies and social safety nets and rightsizing the wage bill. This is critical to put public debt on a firm downward trajectory and allow a gradual return to international capital markets. Restoring and upgrading the Fiscal Responsibility Law would also improve the transparency and credibility of fiscal policy. Directors stressed the importance of ensuring the sustainability of the pension system to limit contingent liabilities.

Directors noted that the banking system remains healthy but cautioned against rising exposures to the sovereign and the erosion of liquidity buffers. They called for raising banks' reserve requirements, enacting promptly the Financial Stability Bill, closing regulatory gaps, and continuing to implement the 2020 Safeguards Assessment recommendations.

Directors underscored the importance of narrowing the scope of the Bitcoin law and removing Bitcoin's legal tender status. They noted that while Bitcoin has had a minimal impact on financial inclusion, high risks to financial integrity and stability, fiscal sustainability, and consumer protection persist. Directors urged that Bitcoin transactions be transparently disclosed, together with the financial statements of public companies operating in the Bitcoin ecosystem. They also called on the authorities to carefully weigh the implications of the new crypto assets legislation and avoid expanding government exposure to Bitcoin.

Directors stressed the importance of structural reforms to strengthen governance, the investment climate and productivity. They called for continued efforts to strengthen fiscal transparency, public procurement, AML/CFT legislation, and the independence of the judicial system. Directors also stressed the importance of enhancing human capital, infrastructure, and climate resilience, as well as continuing to upgrade the statistical framework.

El Salvador: Selected Economic Indicators

I. Social Indicators

Per capita income (U.S. dollars, 2021)	4,408	Population (million, 2021)	6.5
Percent of pop. below poverty line (2021)	24.6	Gini index (2019)	39

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

						Proj.	
	2018	2019	2020	2021	2022	2023	2024
Income and Prices							
Real GDP growth (percent)	2.4	2.4	-8.2	10.3	2.8	2.4	1.9
Consumer price inflation (average, percent)	1.1	0.1	-0.4	3.5	7.2	4.1	2.1
Terms of trade (percent change)	-3.9	1.7	4.8	-7.6	-1.6	5.0	0.7
Sovereign bond spread (basis points)	424	453	760	837	1,485	…	…
Money and Credit							
Credit to the private sector	57.3	59.1	66.3	61.8	63.1	61.2	60.0
Broad money	54.8	59.1	70.4	61.5	58.5	58.5	60.5
Interest rate (time deposits, percent)	4.2	4.3	4.1	3.9	…	…	…
External Sector							
Current account balance	-3.3	-0.4	0.8	-5.1	-8.3	-5.4	-5.3
Trade balance	-21.7	-21.2	-21.0	-28.6	-31.4	-27.5	-27.4
Transfers (net)	20.6	21.0	24.4	25.9	24.0	22.9	22.4
Foreign direct investment	-3.2	-2.4	-1.1	-1.1	-0.2	-1.6	-2.2
Gross international reserves (mill. of US$)	3,569	4,446	3,083	3,426	2,440	2,798	3,382
Nonfinancial Public Sector							
Overall balance	-2.7	-3.1	-8.2	-5.6	-2.5	-3.4	-3.4
Primary balance	0.9	0.6	-3.8	-1.1	2.2	0.3	0.4
Of which: tax revenue	18.0	17.7	18.5	20.1	20.3	19.0	19.0
Public sector debt 1/	70.4	71.3	89.4	82.4	77.2	76.1	78.3
National Savings and Investment							
Gross domestic investment	18.4	18.3	18.9	22.2	20.7	19.8	19.4
Private sector 2/	15.7	15.9	16.9	19.6	18.8	17.4	17.1
National savings	15.1	17.9	19.8	17.1	12.4	14.5	14.2
Private sector	14.7	18.0	25.4	19.5	12.8	14.9	14.9
Net Foreign Assets of the Financial System							
Millions of U.S. dollars	2,655	3,372	3,618	3,022	1,114	1,227	1,400
Memorandum Items							
Nominal GDP (billions of US$)	26.0	26.9	24.6	28.7	31.6	33.7	35.1

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

1/ Gross debt of the nonfinancial public sector.

2/ Includes inventories.

INTERNATIONAL MONETARY FUND

EL SALVADOR

STAFF REPORT FOR THE 2023 ARTICLE IV CONSULTATION

March 2, 2023

EXECUTIVE SUMMARY

Political Context. President Bukele has been in office since June 2019. His party gained a supermajority in Congress in 2021. A regime of exception has been in place since March 2022 as part of an effort to crackdown on gang violence.

Economic Context. Following a strong rebound in economic activity in 2021, real GDP is estimated to have expanded by 2.8 percent last year. Meanwhile, inflation jumped to 7¼ percent, and the current account deficit rose sharply partly reflecting higher commodity prices and despite a narrowing of the fiscal deficit. Reserve coverage has fallen further, sovereign spreads remain high, and financing options are limited, with continued reliance on expensive short-term borrowing. A pension reform was recently enacted aimed at increasing the generosity of benefits and mobilizing near-term financing but adding to the system's structural weaknesses.

Outlook and Risks. Under a baseline of unchanged policies, the outlook is fragile given large macroeconomic imbalances and less favorable external backdrop. Risks are also high and tilted to the downside. A faster-than-anticipated slowdown in the United States, tighter global financial conditions and climate shocks would add to challenges, especially given limited policy space.

Policy Discussions. A comprehensive and credible policy package is urgently needed to strengthen macroeconomic and financial stability, put public debt on a firmly declining path, and improve conditions for stronger and more inclusive growth.

- ***Fiscal.*** A growth-friendly and inclusive fiscal consolidation of 3½ percent of GDP over the next three years is required to put the debt trajectory on a sustained downward path. This will need to be underpinned by structural efforts to mobilize revenues, improve the targeting of energy subsidies, and rationalize the wage bill, which would provide space to address social and infrastructure gaps.

- ***Financial Sector.*** Buffers need to be restored to preserve financial stability. To this end, reserve requirements should be raised as soon as possible, to 15 percent, and brought to pre-pandemic levels over time. The strategy of using Bitcoin to promote financial inclusion has not delivered results to date, and alternative options should be explored. Bitcoin risks should be mitigated, and its legal tender status removed.

- ***Governance.*** Improving economic governance is essential to boosting confidence and investment. Strengthening AML/CFT frameworks, the public procurement process, and fiscal transparency remain top priorities. It will be critical to align macroeconomic statistics with international standards and to disclose information from public companies like *Chivo*.

- ***Growth and Resilience.*** Boosting productivity and resilience will require well-planned and tailored investments in human capital and infrastructure, including to mitigate and adapt to the impacts of climate change. Efforts to reduce the cost of doing business and trade should continue. Meanwhile, durable improvements in security will require measures aimed at improving employment opportunities, especially of the young.

Approved By
Luis Cubeddu (WHD) and Geremia Palomba (SPR)

Discussions took place virtually on February 26-27 and in San Salvador during January 30–February 8, 2023. The staff team comprised Raphael Espinoza (Head), Javier Kapsoli, (WHD), Tristan Hennig (SPR), Jaime Ponce (MCM), and Germán Villegas Bauer (RES). Metodij Hadzi-Vaskov, Regional Resident Representative, and Saúl Chicas (OED) joined the mission. The concluding meetings were attended by Luis Cubeddu (WHD) and Executive Director Alfonso Guerra. Yorbol Yakhshilikov (SPR) contributed to the report. Justin Lesniak, Heidi Canelas, and Eliana Porras (all WHD) supported the team.

CONTENTS

TABLES

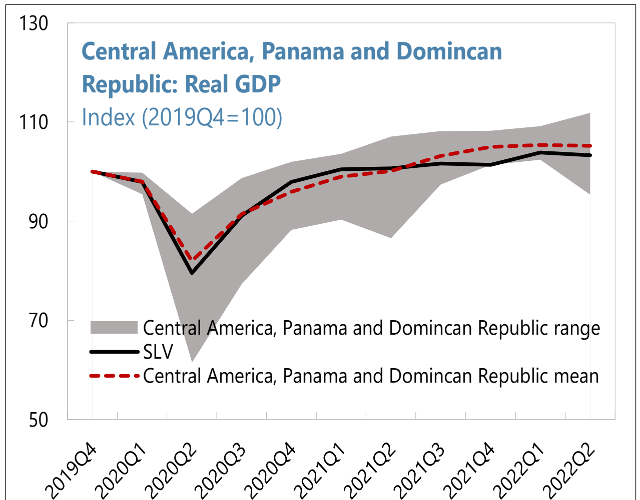
ANNEXES

Acronyms

AFPs	Private Pension Funds
ARA	Assessing Reserve Adequacy
CFT	*Certificados de Financiamiento Temporal*
CIP	*Certificados de Inversión Previsional*
Covid-19	Coronavirus Disease 2019
CPI	Consumer Price Index
DSA	Debt Sustainability Analysis
EBA	External Balance Assessment
ELA	Emergency Liquidity Assistance
FATF	Financial Action Task Force
FDI	Foreign Direct Investment
FIU	Financial Intelligence Unit
FOP	*Fideicomiso de Obligaciones Provisionales*
FRL	Fiscal Responsibility Law
GDP	Gross Domestic Product
GFSM	Government Finance Statistical Manual
MPG	Minimum Pension Guarantee
RAM	Risk Assessment Matrix
REER	Real Effective Exchange Rate
UNCAC	UN Convention Against Corruption
UNDP	United Nations Development Programme

CONTEXT

1. Despite a series of adverse shocks, the Salvadoran economy has fared relatively well to date. The economic expansion has continued, and real GDP is now close to 4 percent above pre-pandemic levels. The strong rebound from the COVID-19 crisis reflects the authorities' response to the health emergency, as well as tailwinds from strong remittances and tourism receipts, which have also helped support the labor market. Most social indicators have improved since the pandemic, and poverty rates remain below the levels observed a decade ago (24.6 percent in 2021 vis-à-vis 34.5 percent in 2012).



Source: National authorities and IMF staff calculations.

2. However, vulnerabilities have mounted, and the external environment is turning less favorable. The exceptional government responses to the pandemic and recent energy price shocks came at high costs. Rising public debt, declining liquidity buffers, and policy uncertainties have led to an erosion of investors' confidence. Credit rating agencies have downgraded the sovereign, and El Salvador has lost access to the international bond market. Slower U.S. growth and tighter global financial conditions will challenge the outlook, especially given the country's weaker fundamentals and uncertainties ahead of the 2024 Presidential election.

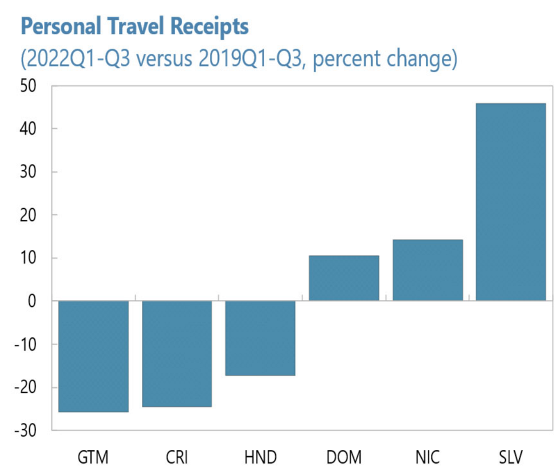
3. Meanwhile, bottlenecks to medium-term growth remain in place, with mixed progress in recent years. The government has emphasized the need to diversify the economy, widen financial inclusion, strengthen access to education and health, reduce trade costs, and encourage investment by cutting red tape and improving security. The ongoing crackdown on gangs implemented under the regime of exception has delivered a sharp reduction in crime but has raised concerns from several civil society groups and international agencies over the extended suspension of rights and guarantees.

RECENT DEVELOPMENTS

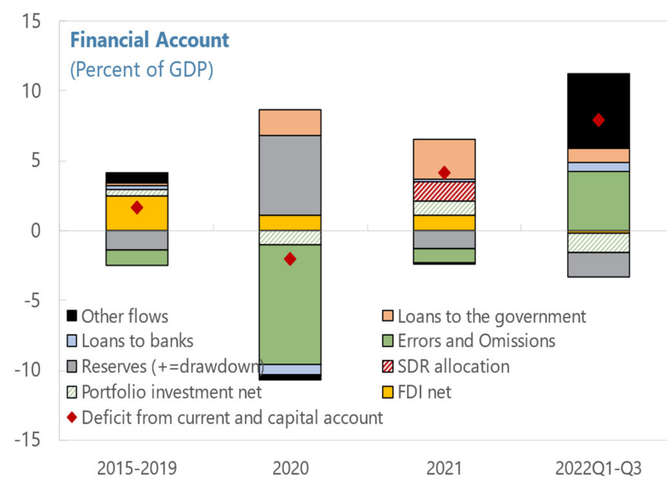
4. After a strong post-pandemic rebound, growth is slowing, although it remains above historical average. Real GDP growth is estimated at 2.8 percent y/y in 2022, driven mainly by private consumption, supported by strong remittances and a robust labor market, despite a tightening of fiscal policy. On the supply side, tourism and call center activity expanded sharply, while growth in the manufacturing sector has remained weak (Figure 1).

5. Inflation has risen against a backdrop of higher global commodity prices. Headline inflation reached 7.3 percent y/y in 2022, a high level for El Salvador, but lower than in the rest of the Central America region, driven by high food inflation (12.2 percent y/y). Transport inflation was contained (5.2 percent y/y) owing to energy price subsidies (Figure 2).[1] Second-round effects have also played a role, as inflation excluding food, housing, and transportation reached 4.8 percent y/y, with formal sector employment and real wages growth reaching 8.2 percent and 1.2 percent y/y in November 2022, respectively.

6. In addition, the external position has deteriorated markedly. The current account deficit widened to 8.3 percent of GDP over the four quarters ending in 2022Q3—from 3 percent of GDP in the preceding four quarters (Figure 3). The deterioration was driven by higher import prices (12.2 percent y/y) and import volume growth (4.2 percent y/y), which more than offset the expansion of tourism and remittances. Tourism inflows in the first three quarters of 2022 were 46 percent higher than in the same period in 2019, and remittance receipts also continued rising



Source: National authorities and IMF staff calculations.



Source: National authorities and IMF staff calculations.

(3.7 percent y/y), and now stand at about 25 percent of GDP. The current account was financed by an increase in other investment (mostly loans from multilaterals, for both public and private projects) as well as unexplained inflows (errors and omissions exceeded 4 percent of GDP over the first three quarters of 2022).[2] Reserves declined to around 2 months of imports, well below the ARA metric. Although sovereign spreads have fallen somewhat, they remain distressed. El Salvador's external position in 2022 is assessed to be weaker than the level implied by fundamentals and desirable policies (Annex III).

[1] Food represents 26 percent of the CPI basket, of which 40 percent is imported. Staff estimate the cost of the food-related terms-of-trade shock of the war in Ukraine at around 0.25 percent of GDP.

[2] FDI inflows, which averaged 2.3 percent of GDP over 2014-2019, declined to -0.2 percent of GDP in the four quarters ending 2022Q3, driven by negative reinvestment of earnings.

7. After a period of easing, the fiscal stance turned contractionary in 2022 (Figure 4). Overall, the primary balance posted a surplus of 2¼ percent of GDP (compared to a deficit of about 1 percent of GDP in 2021), on the back of transitory factors (windfall profits stemming from record GDP growth in 2021, large investment under-execution), a reduction in municipal transfers, and some improvements in expenditure control.

- **On the revenue side,** sustained efforts to boost tax collection have provided a remarkable outcome. Tax revenues increased from 15¾ percent of GDP in 2011 to 20.3 percent of GDP in 2022. Early efforts—such as the reform implemented in 2012—were based on increases in income tax rates, removing exemptions, and introducing excises on new products. The current strategy relies on strengthening the enforcement power of the tax authority (*Plan anti-evasión*). The Plan collected about 2 percent of GDP since its inception in 2019, based on a combination of strict audits, repeated short-timed tax amnesties, and close collaboration with the Attorney General Office.

Operations of the Nonfinancial Public Sector
(Percent of GDP)

	2020	2021	2022
Revenue	24.9	26.4	26.5
o/w Taxes	18.5	20.1	20.3
Expenditure	33.1	32.0	29.0
Wages	12.5	11.8	11.0
Goods and services	5.6	5.3	5.0
Interest	4.4	4.5	4.7
Investment	2.6	3.2	2.2
Other	8.0	7.2	6.1
Net lending	-8.2	-5.6	-2.5
Memo			
Primary balance	-3.8	-1.1	2.2
Energy subsidies	0.6	0.6	1.9
Municipalities' development fund (FODES)	2.0	0.8	0.6

Note: FODES 2022 is preliminary. Estimated by staff.
Source: Salvadorian authorities and Fund staff estimates.

- **On the spending side,** despite large increases in untargeted energy subsidies, efforts were made to contain spending. To protect consumers and limit the pass-through from global oil prices to local prices, the authorities introduced a universal LPG subsidy via a price stabilization fund (covering about 80 percent of the market price for consumers receiving both the fund and the vouchers subsidy);[3] and stabilized gasoline and diesel prices through the suspension of excise and VAT taxes and a price freeze (fuel prices during April-December 2022 were on average 18 percent below market prices). The higher subsidy bill was largely offset by (i) an under-execution of public investment (of around 1 percent of GDP); and (ii) cuts in local government spending, to adjust to the reduction in central government transfers. After allocating 0.7 percent of GDP to the Bitcoin project (including the *Fidebitcoin* trust) in 2021, no additional funds were allocated last year.

8. With spreads at distressed levels, financing has remained challenging. Given lack of access to the international bond market, El Salvador has increased its reliance on domestic and

[3] LPG consumption receives two subsidies. The stabilization fund which is universal and a targeted voucher-based system (*Tarjeta solidaria*). The latter is targeted based on electricity consumption. Currently, 54 percent of households receive both subsidies, 36½ percent receive only the stabilization fund subsidy and 9½ percent of households do not consume LPG (Oliva, José, 2022, "*Consideraciones en torno al subisido al gas licuado*". *Análisis económico* 65, FUSADES).

official financing sources (Table 6 and text table in ¶5). The gross financing needs of 15¾ percent of GDP in 2022 were met by:

- **Domestic sources.** The issuance of short-term securities to local banks and domestic institutional investors rose to 8¾ percent of GDP, supported by a reduction in bank reserve requirements (from 14 to 11.4 percent of liabilities, Boxes 1 and 2), as demand for government securities fell at the interest rate typically offered by the Treasury (about 7 percent).[4]

- **External sources.** Regional development banks CABEI (Central American Bank for Economic Integration) and CAF (*Corporación Andina de Fomento*) provided the bulk of gross official financing (2 percent of GDP). Meanwhile, amortization of private external debt was accelerated with two cash buybacks of 2023 and 2025 Eurobonds (Annex II), resulting in a negative net private external financing of around 2 percent of GDP (US$648 million). These buybacks were financed mostly by drawing down central bank reserves (US$365 million) obtained from the 2021 general SDR allocation. The operation resulted in gross savings of US$289 million, although the direct Treasury savings is projected to be smaller, given debt service obligations on a 10-year bond given to the central bank in exchange of its reserves. Payment of the remaining US$604 million of amortization due for the 2023 Eurobond was made in January 2023.

9. Banks remain relatively healthy, although underlying vulnerabilities are amplified by a deeper bank-sovereign nexus and thinner liquidity buffers (Figure 5). In 2020, the authorities adopted forbearance measures to cushion the impact of the pandemic. As the measures have been unwound, banks' solvency and asset quality have proved resilient. The capital adequacy ratio stands at 15.4 percent, above the legal minimum of 12 percent, and the overall stock of NPLs remains low, at 1.8 percent of total assets.[5] Banks' profitability has recently risen, fueled by widening financial margins and lower provisions. Nevertheless, the underlining vulnerabilities associated with dollarization persist, and have increased on account of growing banks' exposures to public debt instruments and shrinking liquidity buffers. Since 2019, the ratio of banks' liquid assets to short-term liabilities has fallen by a fifth, the legal requirement to hold reserves in the central bank has been halved, and international reserves have fallen by a quarter (Box 1). In addition, significant regulatory gaps remain with respect to international standards in key areas such as the financial safety net, risk-based supervision, and IFRS accounting rules.

10. While adoption of Bitcoin as official currency has been limited, associated risks persist (Selected Issues Paper). Public funding in the Bitcoin project has been about ¾ percent of GDP, comprising: (i) the "Bono Bitcoin" (a US$30 one-off endowment paid to every *Chivo* subscriber); (ii) the operational costs of the *Chivo* e-wallet; and the trust fund guaranteeing the dollar-Bitcoin convertibility (*Fidebitcoin)*. Meanwhile, as of end-2022, it is estimated that roughly 2,400 Bitcoins

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[4] In January 2023, LETES were placed at an interest rate of 8¼ percent.

[5] To cushion capital erosion, the authorities have allowed some banks to provision gradually the remaining share of loans impaired by the COVID-19 crisis. The loan portfolio affected by the pandemic is highly concentrated in five small-medium size institutions and has been declining significantly from 30.8 in 2020 to 5 percent over gross loans in 2022.

have been purchased, although a detailed assessment of the government's portfolio value is not possible given the absence of publicly available information. Against this backdrop, the use of Bitcoin appears to have been minimal. Most registered users downloaded *Chivo* only to cash the $30 allowance and 60 percent of them did not make any other transaction. In the same vein 98 percent of businesses have not made any sale in Bitcoin and less than 2 percent of remittances have been processed through Bitcoin providers. With such low adoption, the real effects from the collapse of several crypto firms and sharp declines in the price of Bitcoin (currently at 60 percent below its 2022 peak) have been limited, but risks persist. Although banks have no direct exposure to Bitcoin, this could change given Bitcoin's legal tender status, including if use of the *Chivo* accounts is expanded and substitutes for deposits or bank payments accounts. Risks are magnified by the limited oversight of Bitcoin services providers and absence of stricter regulatory safeguards.

OUTLOOK AND RISKS

11. Under the baseline, El Salvador's outlook will remain vulnerable, given unattended imbalances and a less favorable international environment. Despite an expansionary fiscal stance expected in 2023, growth is projected to slow on account of external headwinds, with persistent macroeconomic imbalances holding back investment and increasing the risk of a disorderly adjustment.

- **Real GDP** is expected to grow by 2.4 percent in 2023, supported by private consumption, public investment, and a continued strength in tourism. The moderation relative to 2022 reflects somewhat weaker exports and remittances growth as the U.S. economy and labor market cools (Box 3).[6] The economy is projected to expand by 2.1 percent over the medium term, below its historical average, as investment is forecast to remain subdued on account of projected persistent imbalances.

- **Inflation** is projected to moderate to an average of around 4 percent in 2023 due to a fall in imported prices, supported by tight monetary policy at the global level. In the medium term, when U.S. inflation returns to the Fed target, El Salvador's inflation should converge to about 2 percent, driven by the nominal anchor imported via dollarization.

- **The current account deficit** is projected to narrow to 5.4 percent of GDP in 2023, mainly on account of more favorable terms of trade. However, in the context of limited FDI and ongoing constraints to external financing, reserves are projected to remain at about 2 months of imports.

- **The primary fiscal balance** is projected to deteriorate from a surplus of 2.2 percent of GDP last year to a surplus of around ½ percent of GDP in 2023, driven by a moderation in tax revenues and increased spending, including in infrastructure as earlier delays are unwound.[7] The baseline

[6] Remittances, which amount to more than 25 percent of GDP, fuel private consumption, 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).

[7] This projection is based on the 2023 budget and considers public investment that was delayed in 2022.

primary balance is projected to remain unchanged over the medium term, with some improvement in the overall balance during 2023-26 on account of the pension reform (Box 4).

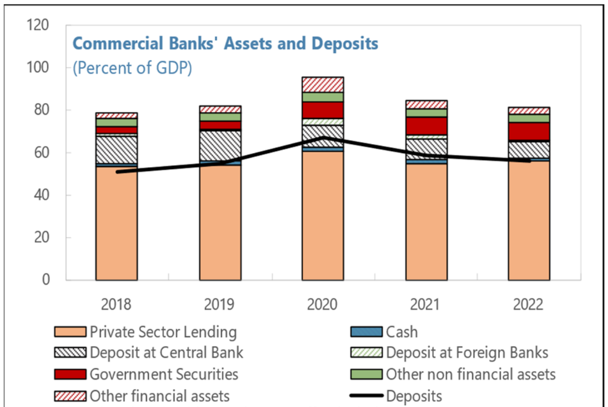
12. **Under baseline (unchanged) policies, public debt is on an unsustainable path.** Public debt is projected to rise to about 82 percent of GDP under current policies—including the pension reform and its associated debt exchange (Annex IV). Public gross financing needs are expected to remain elevated (18 percent of GDP on average), crowding out credit to the private sector (Box 2). While the path projected for debt has improved compared to the 2021 Article IV report, the fiscal outlook has not, given the lack of market access, increases in short-term debt, and exhausted liquidity buffers. In the baseline, to fulfill its high near-term financing needs, the public sector will need to further rely on domestic banks and institutional investors. In the absence of international market access and reduced banking system liquidity, this strategy is unsustainable, even if additional financing can be mobilized in the near term.

13. **Risks to the outlook are high and tilted to the downside (see also Table 11).**

- **On the domestic side, the difficult fiscal situation could worsen if policies are not appropriately and timely tightened.** In the absence of a credible fiscal and financing strategy, the Treasury's cashflow could deteriorate further. Meanwhile, reliance on financial repression, expenditure arrears, or reprofiling of domestic liabilities could hit investors and consumers' confidence.

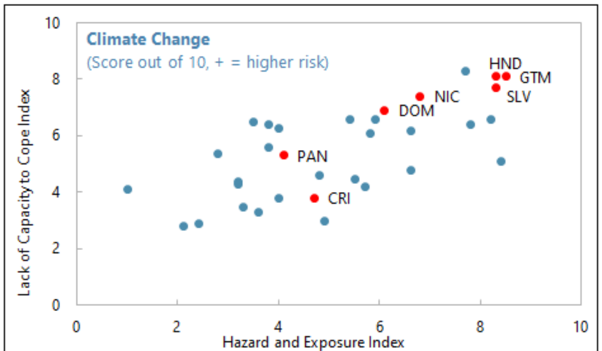
- **On the external side, a pronounced slowdown in the United States and tighter financial conditions could complicate the already fragile outlook.** El Salvador is highly susceptible to economic conditions in advanced economies, as it relies heavily on exports to and remittances from the United States. (Box 3), with around 20 percent of households receiving remittances. In addition, tighter global financial conditions could reduce external inflows and complicate financing of banks and nonfinancial corporations. While the pass-through of U.S. monetary policy rates to deposit and lending rates has been low in recent years (Annex I), a slowdown in external inflows, including remittances, could complicate the banking system's funding in the years ahead (Box 3). A drop in inflows could also force a correction of the current account deficit and reduce the liquidity of the banking system, triggering an even sharper deterioration in economic activity. The low level of international reserves impairs the country's ability to react to external shocks, including the central bank's ability to support banks in a stress scenario.

- **In this context, bank liquidity stress could increase further.** This would be especially concerning for smaller banks as flight to quality tends to favor foreign or larger institutions. Increases in banks' holdings of sovereign debt would amplify the spillovers from a credit event (Box 2), and increased liquidity strains could force banks to curtail credit to the private sector, hampering growth. The mitigation of such spillovers is constrained by dollarization, gaps in the crisis management framework, and lack of fiscal space.



Source: National authorities and IMF staff calculations.

- **Natural disasters, including those due to climate change, remain a key risk.** El Salvador is susceptible to earthquakes, volcanic activity, and has a long history of hurricanes, tropical storms, and their secondary effects such as floods and landslides. The UNDP estimates that 89 percent of the territory and 96 percent of the population are exposed to natural hazards. Relative to peers, El Salvador has low capacity to cope with natural disasters. The median cost of damages from floods and storms stands near 4 percent of GDP per event, underscoring the potential macroeconomic benefits of improving resilience to climate change-related events.[8]



Source: European Commission INFORM regional model of Latin America and Caribbean.

- **On the upside,** a durable improvement in the security situation could boost private investment and growth, reduce emigration, and encourage the return of migrants.

Authorities' Views

14. The authorities have a more positive view of the outlook, mainly driven by higher private and public investment and tourism. They expect real GDP to grow by 2.9 percent in 2023 on the back of a continued strength of tourism and private and public investment, including thanks to the unprecedented reduction in crime. In line with staff projections, the authorities expect a moderation of inflation, of the current account deficit, and of economic growth over the medium term. However, the authorities assess the risks surrounding the baseline as moderate, since the risk

[8] Kim, H.S., Chaverri, C., Fernandez-Corugedo E., and P. Juarros, 2022. On the Macro Impact of Extreme Climate Events in Central America: A Higher Frequency Investigation. IMF Working Paper 22/237. Washington DC: International Monetary Fund.

of remittances from the U.S. falling should be mitigated by the strength of the U.S. labor market and the boost in investment driven by the Salvadoran diaspora.

POLICY DISCUSSIONS

A. Restoring Macroeconomic Sustainability While Protecting the Vulnerable

15. Developing a comprehensive and ambitious fiscal and financing plan, aimed at bringing public debt back to a sustainable path and gradually restoring external market access, is the main priority. Under baseline policies, El Salvador's public debt is on an unsustainable path. In the absence of international market access, the domestic financial system and regional development banks have helped cover large financing needs, but this strategy is unsustainable. Local investors already have a large exposure to public debt and local banks will not be able to absorb the residual financing needs for long, eventually leading to a sharp adjustment and a disorderly allocation of losses. To prevent this scenario, a comprehensive and ambitious fiscal and financing plan is urgently needed, even if additional near-term financing can be mobilized.

16. The ambitious and comprehensive plan should be based on a combination of:

- **A growth-friendly fiscal adjustment, backed by structurally sound measures amounting to around 3½ percent of GDP over the next three years, to put public debt on a credible downward path.** Given the financing difficulties of the Treasury, and the economy's cyclical position, the proposed consolidation should start in 2023 as the authorities' expansionary policy stance seems inappropriate at the current juncture. The proposed fiscal adjustment, embedded within a medium-term fiscal and financing framework, is necessary to bring debt down, boost market confidence and regain market access. Although the recommended adjustment is ambitious, its size would be in line with the efforts made by other countries in the region.[9] The main fiscal measures recommended would seek to increase revenues permanently by aligning indirect taxes with comparators in Latin America, and rightsizing expenditure, including by addressing spending inefficiencies.[10]

- **A comprehensive financing strategy to restore debt sustainability, reduce rollover risks, and gradually recover external market access.** Even with the recommended adjustment, returning progressively to the external bond market is indispensable to finance future debt amortizations. A comprehensive financing strategy is required, that encompasses all liabilities, based on an appropriate mix of official and private domestic and external sources, to avoid excessive reliance on sources that are already stretched and reduce concerns over financing. To

[9] In the last 15 years, Costa Rica, the Dominican Republic, Honduras, Panama, have achieved similar adjustment, and El Salvador's fiscal adjustment in the early 1990s was also of a similar magnitude.

[10] IADB (2018) measures the technical inefficiency of public spending at 6½ percent of GDP, the second largest in Latin-America after Argentina. Even a small improvement would imply substantial savings at little cost.

recover market confidence, the strategy should also rebuild liquidity buffers by reducing banks' exposure to short term public debt, increasing international reserves, and lowering rollover risks for the Treasury and liquidity risks for the financial system (Box 1). The approach of completing cash buybacks to repay specific Eurobonds and relying on local investors to close potentially large financing gaps is not sustainable and cannot rebuild market confidence (Annex II).

17. Starting this year, efforts are needed in developing a balanced and well-articulated set of high-quality revenue and spending measures.

- **Revenue mobilization.** Achievements of the anti-evasion plan should be preserved, and complemented by a package of reforms which can consider: (i) an increase in the VAT rate by 2 percentage points—the current rate is below the average in Latin America—and the repeal of some exemptions; (ii) a surcharge in the CIT and including foreign income in the tax basis for the income tax; (iii) an increase in excise tax rates, particularly to address the negative environment and health externalities of the consumption of certain goods;[11] and (iv) a modernization of tax collection procedures, such as e-invoicing and transfer pricing. Alternative measures to consider are introducing a BEPS-compliant qualifying domestic minimum top-up tax, a carbon tax, or a property tax. Some of the taxes that were repealed in 2020 could also be restored (e.g., excise on mobile phones).

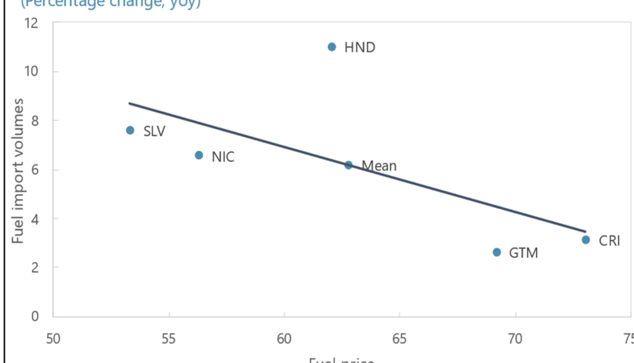
Revenue and Expenditure Reform Options
(In percent of GDP)

Estimated revenue impact	4.1
VAT	2.3
Increase in rate	1.4
Remove exemptions	0.8
CIT	0.4
Surcharge for large taxpayers	0.3
Pay CIT on worldwide income	0.1
Excises	0.4
Increase rates	0.2
Cell phones	0.2
Other	1.0
Estimated expenditure impact	1.8
Compensation of employees	1.4
Transfers	0.4
Total impact	6.0

Source: Salvadorian authorities and Fund staff estimates.

- **Spending rationalization.** Primary spending is projected to increase in 2023, reflecting in part the execution of investment delayed in 2022 and the impact of the pension reform.[12] Instead, efforts should continue to rationalize spending, while protecting investment and supporting the vulnerable. Given its size in the budget, any consolidation effort requires rightsizing the wage bill

Fuel Prices and Fuel Import Volumes
(Percentage change, yoy)



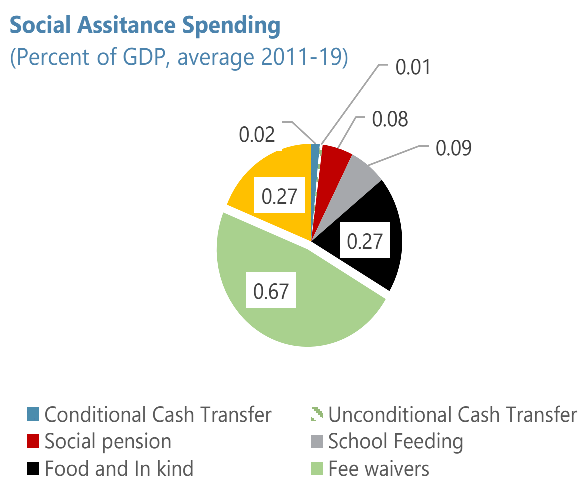
Source: Central America Monetary Council (CMCA) and Fund staff calculations.
Notes: Data covers the period April to September 2022.

[11] Cigarettes, energy drinks, carbonated soft drinks, liquors, and beer.

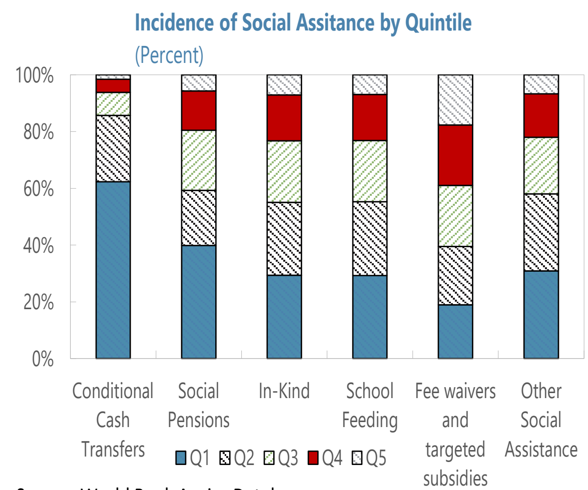
[12] Higher pensions for AFP pensioners will be financed by depleting individual savings accounts, but for public sector pensioners from the closed PAYG, higher pensions entail a direct liability for the Treasury estimated at 0.3 percent of GDP annually.

through a comprehensive reform, yielding at least ½ percent of GDP, that (i) eliminates special indexation rules for some civil servants; and (ii) harmonizes the compensation system to ensure public wages are related to civil servants' productivity and qualifications. In addition, savings could arise through improvements in the public procurement system—for example by standardizing purchases—and strengthening public spending controls (see also footnote 10).

- **Better targeting of energy subsidies.** A well-designed reduction in energy subsidies will be critical to improve spending efficiency, support consolidation, and reduce external imbalances, which were also adversely affected by increased smuggling activity to neighboring countries given large price differentials.[13] While the 2023 budget does not include funding for the diesel/gasoline subsidy, the LPG stabilization fund was recently extended until May 2023.[14] Repealing the diesel/gasoline subsidy was a step in the right direction, but more needs to be done. In particular, the stabilization fund—an across-the-board subsidy—should be eliminated and the LPG vouchers better targeted to benefit only poor households based on a means-tested mechanism.[15]



Source: World Bank Aspire



Source: World Bank Aspire Database.

18. Fiscal consolidation should also be coupled by efforts to improve the social safety net. While El Salvador's social safety net is large in terms of magnitude and coverage—vis-à-vis regional and comparators in Latin America—it remains largely unstructured and inefficient in its targeting. Ensuring an inclusive consolidation process will require a sizeable increase in interventions with the

[13] While rising oil prices might have started to restrain oil demand in early 2022, the fuel subsidies moderated this effect: since April, fuel import growth in El Salvador has been 4.5 percentage points higher than in Costa Rica, where no fuel subsidies were implemented, thus adding around 0.25 percent of GDP of oil imports between April and September.

[14] The annual cost of this subsidy is estimated at 0.2 percent of GDP.

[15] According to the 2021 household survey about half a million households live under the poverty line while 1.2 million of households receive the LPG vouchers.

largest impact on poverty and human capital, such as the targeted conditional cash transfers program and early childhood support programs. Consideration should be given to also enhancing gender equality by supporting female labor participation and women entrepreneurship. In the medium term, a robust household targeting system should be built, drawing from strong support from development partners and stakeholders.

19. Guaranteeing the sustainability of the pension system remains critical. The recently approved reform changed some elements of the pension scheme but did not address the system's structural weaknesses, and instead added to its vulnerabilities (Box 4). Specifically, the reform, which maintains the system based on Private Pension Funds (AFPs): (i) increased the minimum pension guarantee by 30 percent; and (ii) raised pensions by 30 percent for all current pensioners, while keeping the retirement age unchanged, with only a small increase in employer contributions (one percentage point) and a reduction in AFPs' charges to affiliates. Since pensions are primarily funded by affiliates' individual savings accounts, mandating pensions above the amount determined by the 20-year withdrawal formula will only accelerate the depletion of savings accounts, likely increasing Treasury liabilities over the medium term.[16] The reform could also lead to large contingent liabilities as the new law grants a blanket public guarantee for all pension-related claims. The new features of the pension system should be assessed regularly based on new independent actuarial studies.

20. While the pension reform may provide room for the stressed Treasury cash flow, it carries important costs. The reform repealed the limit on the AFP's portfolio that can be invested in the securities issued by the new *Instituto Salvadoreño de Pensiones (ISP)*. [17] It also includes a debt exchange between bonds issued by the *Fideicomiso de Obligaciones Previsionales* (FOP) with the new CFT (*Certificados de financiamiento temporal)*. This will likely reduce the liquidity of pension funds, weaken portfolio diversification, and crowd out private investment.

21. Restoring and upgrading the Fiscal Responsibility Law is crucial for the transparency and credibility of fiscal policy. The experience with the 2016 Fiscal Responsibility Law (FRL), which was suspended in 2020 to accommodate large pandemic-related spending, was mixed. It failed to provide an anchor for fiscal policy but contained a strong mandate to enhance fiscal transparency and accountability. The authorities should institutionalize fiscal prudence through an enhanced framework overcoming the suspension of the FRL. It should be based on a medium-term target—a debt anchor—coupled with operational rules to secure a rapid reduction in deficit and debt. Regional experience shows that a combination of an overall deficit target and an expenditure rule can deliver debt reduction,

Changes to the Approved Budget

	2021		2022 1/	
Reason to change	Cases	Mill. US$	Cases	Mill. US$
Debt not included in the budget	22	838	6	683
Tax collection higher than expected	11	198	23	387
Other	16	78	8	19

Source: Salvadorian authorities and Fund staff estimates.

1/ Until September.

[16] An increasing share of people is retiring without sufficient funds in their savings accounts to reach the minimum pension, in part reflecting the fact that a large proportion of workers (close to 70 percent) are in the informal sector.

[17] Under the Government Finance Statistical Manual (GFSM) standards the ISP will be classified as a general government entity.

while avoiding the pro-cyclicality of standalone deficit rules. Budget reforms should include updating the budget preparation towards some form of results-based framework. Improving budget processes is also needed to reduce the frequency of amendments to the budget.

22. Improving transparency and the efficiency of spending is essential. The FRL mandated the publication of the medium-term fiscal framework, debt sustainability and risks assessments, a distributional analysis of subsidies, and an actuarial balance of the pension system. After the suspension of the FRL, the publication of these analyses stopped. They should be restored and expanded.[18] Consistently disclosing information on public finances, strictly based on internationally accepted statistical standards, remains a priority. Guaranteeing the efficiency of public spending requires a strong public procurement framework. However, the current one has been eroded by exemptions, including for the new entity created to re-centralize investment projects from municipalities (DOM) and for crypto projects under the Digital Assets Law. Against this backdrop, a new public procurement law has been approved, seeking to incorporate international standards such as the obligation to provide information on the beneficial owners of bidding entities. The new law relies on e-procurement and centralization of procurement data, increasing transparency and competition, with the potential to reduce corruption risks and to improve the efficiency of spending. The conditions under which special procurement frameworks can be approved under the new law should be tightened.

Authorities' Views

23. The authorities highlighted the fiscal consolidation achieved since 2020, with tax collection increases based on tax administrative measures equivalent to a substantial tax reform. They argued that the anti-evasion and anti-smuggling plans, as well as various administration initiatives, boosted tax revenues by 6 percent of GDP during 2020-22. In addition, cuts in transfers to municipalities, among other measures, generated savings of about 1 percent of GDP. In line with the above, they consider that efforts should continue to be made, without changes in consumption tax rates, while highlighting the potential benefits of the digitalization of some tax procedures. The authorities viewed the rise in energy subsidies as a temporary and essential to limit the passthrough from international to consumer prices and mitigate the impact on the economy. The newly created Treasury subsidy unit is expected to develop options to reduce spending inefficiencies and strengthen compliance with the subsidy framework.

24. The authorities highlighted the social and financial benefits of the pension reform for the Treasury and recognized the importance of returning to the international bond market. They argued that the cap on pensions (US$3,000), the elimination of the maximum wage for contributions, and the obligation to pay contributions for pensioners that are still working, improved the equity and sustainability of the system. They consider that cash relief stemming from the pension debt exchange would give the Treasury room to maneuver and to focus on reforms options

[18] The authorities should consider publishing more information on Treasury cash flow, unpaid bills, and uses and sources of tax credits. Basic rules for reporting, transparency, and accountability of all trust funds should be established by amending the Financial Management Law (Ley AFI).

that could be implemented in the future if necessary. They agreed that the government strategy should be geared towards returning to the international bond market, and to that end they committed to strengthen their transparency portal and ensure fiscal statistics are in adherence with international standards.

B. Strengthening Financial Stability

25. Systemic risks have risen in the absence of a credible fiscal and financing strategy, the erosion of financial system buffers, and tighter bank-sovereign nexus. The financial system's vulnerability to shocks, already highly under a dollarized system, has been amplified on account of increased banks' exposure to public debt (doubling to over 11 percent of assets), falling international reserves and limited deposit insurance coverage.[19] In addition, less favorable external conditions could result in lower remittances and, with it, banks' deposits (Box 3), as well as tighter external funding conditions—although this latter channel is mitigated by banks' low reliance on wholesale funding markets and possible support from foreign shareholders.

26. Timely measures are required to safeguard financial stability from system-wide risks. Public intervention to mitigate the risk of systemic shocks and buttress the financial safety net is critical, including by:

- Restoring the 15 percent requirement for banks' reserves at the central bank as soon as possible (see Box 1), as well as monitoring the circumstances to eventually raise them further (towards pre-pandemic levels) to achieve desirable buffers.[20] A liquidity fund mutualizing liquidity risks across entities, managed by the central bank and funded with banks' contributions, should also be explored.
- Adopting a roadmap to increase international reserves and extend emergency contingent lines.[21]
- Improving the operational arrangements and funding sources for Emergency Liquidity Assistance (ELA) in line with IMF technical assistance.
- Strengthening the crisis management and deposit protection framework by adopting the Financial Stability Bill and improving crisis preparedness mechanisms.
- Accelerating the ongoing work to adopt Leverage Coverage Ratio and Net Stable Funding Ratio regulations according to Basel standards.

[19] El Salvador's Deposit Guarantee Institute covers deposits up to US$10,832, representing a coverage ratio—share of insured deposits over total deposits—of 26 percent, below its regional peers (around 39 percent). It has US$228.4 million of prefunded resources, i. e., 5.3 percent of insured deposits.

[20] The IMF Technical Assistance Handbook "Reserve requirements" (Della Valle and others, 2022) provides useful advice and good practices on this topic.

[21] The BCR currently holds a CABEI contingency line of US$200 million.

27. Ongoing efforts to close regulatory gaps should be intensified. Transition to IFRS, including the expected loss models, should keep its momentum.[22] Convergence towards Basel standards and supervisory practices would allow the authorities to use more qualitative judgement, forward-looking risk assessments and *ad-hoc* coercive powers to respond to emerging risks, such as capital add-ons or limits on dividend and bonus distributions. The scrutiny of public banks should be reinforced, including for the development bank—*Bandesal*—which should curb its direct lending activities. Consideration should be given to lower the threshold at which cooperatives fall under the full prudential supervision of the banks' superintendency.[23] Ongoing plans to reduce this threshold (from US$98 million to US$30 million of assets) go in the right direction, but the new regulatory framework will need to strike a balance between effective prudential oversight, proportionality for less significant entities, and adequate anti-money laundering/combating the financing of terrorism (AML/CFT) compliance.

28. Addressing the recommendations of the 2020 Safeguards Assessment remains a priority, though progress has been slow. Implementing the outstanding recommendations is essential to strengthening BCR governance, but progress has been limited so far to the external quality review of the internal audit function and improving the capital position of the BCR. Measures to increase revenue and reduce expenditure will be required. A formal agreement is also needed between the Ministry of Finance and the BCR to set the course for the bank's recapitalization.[24] This strategy must be complemented by the adoption of IFRS to enhance transparency and appropriately estimate capital needs. These actions should be supported by amendments to the central bank law to strengthen the central bank's autonomy and governance.

Authorities' Views

29. The authorities acknowledged the need to strengthen the financial safety net. In their view, increases in reserve requirements going forward will need to be carefully calibrated to accommodate the needs of the economy. They pointed to the benefits of the current regulatory level of liquidity requirements for credit and economic growth. They also agreed on the need for a far-reaching reform of the cooperative sector and reported that they are already studying strengthening *Bandesal's* business model.

C. Improving Financial Inclusion Whilst Addressing Risks from Bitcoin

30. Risks stemming from the legal tender status given to Bitcoin should be addressed. Although the Bitcoin strategy has not advanced financial inclusion nor increased digital remittances to date (Selected Issues Paper), the promotion of Bitcoin, including through its status as official currency, could result in greater uptake and—amidst a weak regulatory framework—bring sizeable

[22] A new Accounting Code was approved in December 2022 to introduce the use of IFRS reporting standards. Entities belonging to international groups already file IFRS accounts.

[23] Despite representing around 10 percent of total assets and 337 institutions, much of the cooperative subsector (below the legal limit of US$98 million) is not subject to prudential regulation and oversight.

[24] The settlement of Treasury debt, and the phasing out of BCR's quasi-fiscal activities remain pending.

risks to financial and market integrity, financial stability, fiscal sustainability, and consumer protection. Addressing the recommendations of the 2021 Article IV remains critical. These include:

- Narrowing the Bitcoin law's scope by removing Bitcoin's legal tender status and making its use voluntary for all transactions.

- Strengthening the regulatory and supervisory frameworks, especially for *Chivo*. The authorities should pay particular attention to the following risks: (i) operational—by strengthening cybersecurity, AML/CFT, and antifraud policies; (ii) consumer protection—by segregating and safeguarding clients' funds and providing clear disclosure of risks and costs; and (iii) counterparty— by developing governance, financial transparency and solvency requirements as well as implementing rigorous oversight and operating restrictions (e.g., limits on transactions and holdings, no lending or paying interest services).

- Safeguarding financial stability and adapting the banking regulatory framework (¶50 in the 2021 Article IV Consultation). [25]

- Stopping the use of public funds and enhancing transparency on their use. *Fidebitcoin* should be liquidated and audited, and *Chivo* should explore options to become self-sufficient.

31. Greater transparency and accountability over the government's transactions in Bitcoin and the financial situation of the e-wallet *Chivo* remain essential. The authorities have not publicly disclosed data on the use of Bitcoin, the government's purchases/sales of Bitcoins, and *Chivo's* financial statements. This lack of information has prevented staff from assessing the full implications of the Bitcoin project, particularly the risks that *Chivo* is posing to consumers and public funds.[26] Oversight of the Bitcoin ecosystem is still incomplete: the financial supervisor is monitoring Bitcoin services providers, but has not yet drawn conclusions, and the Court of Auditors will audit *Fidebitcoin*, but only after its liquidation.[27] *Chivo's* combined roles as a retail e-wallet, manager of the government Bitcoins, and free currency exchange provider pose significant conflicts of interest. Its financial statements and liquidity management policies should be made public, allowing a proper assessment of the counterparty risk to which its clients are exposed.

32. The new Digital Assets Law raises legal uncertainty and public financial management concerns. The new Law (Box 5) departs from the traditional regulation on securities and its market conduct and market integrity rules are much less detailed and stringent. [28] Important prudential

[25] In December 2022 the Basel Committee on Banking Supervision adopted standards on Prudential treatment of crypto asset exposures that should be used to adopt the banking regulatory framework.

[26] As the recent failures of crypto firms have illustrated, strong transparency standards are particularly important for an industry where regulation and oversight are still underdeveloped.

[27] As of October 2022, 65 bitcoin service providers were registered with the central bank but only 16 were operating, most of them as payment platforms.

[28] In this regard, the recent IMF Board Paper, Elements of Effective Policies for Crypto Asset (February 2023), describes the core elements for an effective regulatory framework for crypto assets, which could provide valuable guidance for a future reform of the law.

safeguards remain absent. Although investors' rights and safeguards are so far ill-defined, the law could legitimize high-risk crypto investments. The new Digital Assets Commission—designated supervisor—and the Bitcoin Funds Management Agency lack appropriate independence and governance requisites (Annex VI). Given the limited international precedents,[29] the authorities should work in cooperation with experts, stakeholders, and the industry to develop sound by-laws and revise the law if needed. Basel standards regarding prudential treatment of banks' exposures to crypto assets should be adopted.

33. Plans to increase exposure to Bitcoin by issuing tokenized bonds should be abandoned. The Digital Assets Law sets the stage for the issuance of the "Volcano bonds", half of the proceeds of which would be spent in Bitcoin-related investments, with the other half used for infrastructure including the development of "Bitcoin city". While recent turmoil in crypto markets delayed this plan, issuance of such bonds would increase fiscal risks and further erode market sentiment. Given El Salvador's fiscal vulnerability, the largely speculative nature of crypto markets, and legal risks, the authorities should reconsider their plans to expand government exposures to Bitcoin. In particular, financing purchases of Bitcoin by issuing tokenized securities should be eschewed.

34. Efforts to promote financial education and encourage retail payments through BCR's payments infrastructure are progressing. The new payments infrastructure managed by the central bank—*Transfer365*—is successfully promoting free and fast retail payments by interconnecting financial institutions' platforms, and the central bank is exploring ways to stimulate the development of fintech payments providers. In line with the National Policy for Financial Inclusion approved in 2021, the authorities are also making progress in financial education. Other areas, such as microfinance and credit bureaus regulations, require further work.

Authorities' Views

35. The authorities emphasized that Bitcoin's potential benefits remain significant and noted that the risks highlighted in last year's Article IV have not materialized and are unlikely to do so. In their view, the adoption of Bitcoin as legal tender improved El Salvador's international visibility and increased revenue from tourism. They see potential in *Chivo* to promote financial inclusion and said that its financial statements will be available soon. In the authorities' views, the new Digital Assets Law has provided a strong, yet to be fully implemented, regulatory framework for crypto assets and stable coins, and has opened innovative funding sources through tokenization. A tokenized bond issuance, which will be linked to Bitcoin and Bitcoin-related infrastructures, is being prepared although the final terms have yet to be defined.

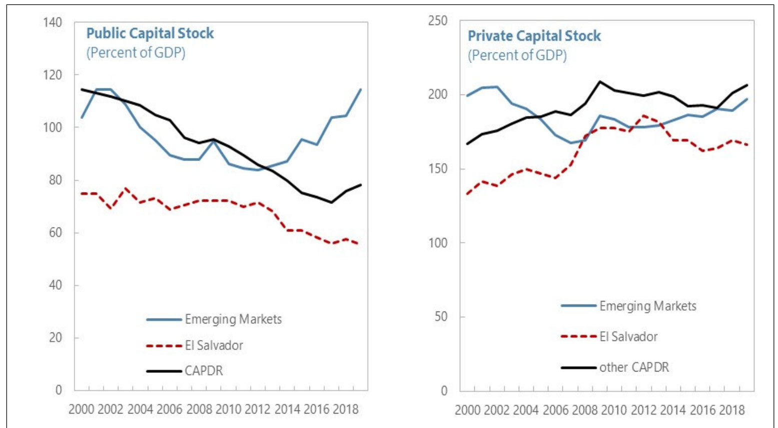
36. The BCR has expanded the comprehensive offer of digital financial services with *Transfer365*. It is achieving a significant level of customer satisfaction, becoming an inclusive, free,

[29] In June 2022, the EU authorities agreed on a new regulation on Markets in Crypto-Assets (MiCA). MICA is a comprehensive regulatory regime tailored for crypto-assets, covering stable coins, nonstable coins, and crypto-assets services.

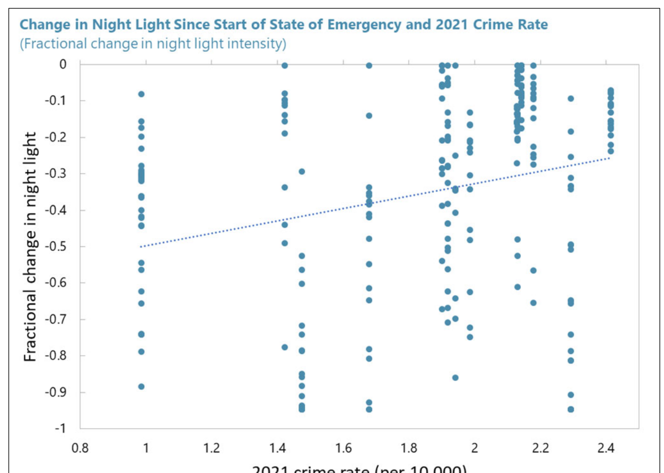
and preferred system for Salvadorans, thus fulfilling the presidential mandate to provide first class public services.

D. Strengthening Resilience and Growth Potential

37. Equitable growth will require sustainable increases in human capital and infrastructure, as well as improvements in the business climate. El Salvador's productivity growth has been below peers for decades. Boosting inclusive growth will require well-planned and tailored investments in human capital and infrastructure as well as continued efforts to improve security and reduce the cost of doing business. This will be critical to reduce informality, promote job creation, and limit emigration (El Salvador 2021 Article IV). These much-needed investments should take place in a responsible fashion while ensuring that the macroeconomic imbalances are addressed.



Source: IMF capital stock database.



Note: Crime rates are at the regional-level, while changes in night light are at the more granular district-level. Changes in night light intensity winsorized at the 5 percent-level.

38. A sustainable reduction in crime would help raise economic activity. Research by the BCR estimates the costs of violence at 16 percent of GDP,[30] as businesses and households spend time and resources to protect themselves, and crime reduces the returns to investment by making property rights less secure. Homicide rates dropped sharply after the implementation of the regime of exception and the imprisonment of 60,000 people since March 2022. Data on nightlight intensity, which can proxy for economic activity, show that regions with higher crime rates in 2021, which have a higher potential to benefit from crime reduction, saw larger improvements in nightlight intensity. Security measures will need to be complemented by social programs aimed at protecting the vulnerable and by

[30] Peñate Guerra, M. I.; Mendoza de Escobar, K.; Quintanilla Deras, J. A.; Alvarado Zepeda, C. A., "*Estimación del costo económico de la violencia en El Salvador 2014*" Banco Central de Reserva de El Salvador.

measures targeted at improving the economic opportunities of the young, to ensure a durable reduction in crime.[31]

39. Strong actions are needed to mitigate climate change and improve resilience to climate shocks. To further strengthen energy independence and climate change mitigation, efforts should continue to secure the construction of additional geothermal plants.[32] Meanwhile, concrete actions are needed to improve resilience to climate shocks, including by ensuring the fiscal consolidation protects much needed public investment in climate resilience and adaptation.

Authorities' Views

40. The authorities concurred with the staff on the importance of promoting long-term growth and underscored the multiple policies being implemented to that end. Policies include the improvement of security, which has been beyond expectations, the promotion of tourism, and the reduction of trade costs and red tape. The authorities underscored efforts to boost education spending and to promote the digital skills by partnering with fintech firms. Plans to improve financial inclusion are expected to have long-term benefits for poverty reduction and growth. Work is also ongoing with international financial institutions to mobilize financing and technical support to help mitigate the risks from natural disasters.

E. Strengthening Economic Governance, Anti-Money Laundering and Combating the Financing of Terrorism, and Anti-Corruption Efforts

41. Governance should be strengthened to improve resource management, lower borrowing costs, and build trust in the government (Annex V). The Court of Accounts is conducting audits of key programs that addressed the COVID-19 emergency, for a total amount of US$736 million, including the cash transfer program, food baskets, the purchase and distribution of vaccines, personnel hiring, and spending on *Hospital El Salvador*. In addition, the audits of the use of the 2020 IMF Rapid Financing Instrument (SDR$287.20 million) and of the IDB emergency loan (US$195 million) are in their final stages. A clear communication of these efforts to the general audience would improve the credibility of the economic governance framework. The Court should audit *Chivo* and *Fidebitcoin*.

42. Anti-corruption frameworks, government transparency, and impartial access to the judiciary are central in creating a favorable business environment. The authorities are working on strengthening the anti-corruption legal framework, including the Act of Illicit Enrichment of Public Officials and the Criminal Code, to align it with the UN Convention Against Corruption (UNCAC), the Financial Action Task Force (FATF) standards, and the G20 High-Level Principles on

[31] Systemic Country Diagnostic Update - El Salvador: Addressing Vulnerabilities to Sustain Poverty Reduction and Inclusive Growth. Washington DC: The World Bank.

[32] A new LNG plant was completed in October 2022 to eliminate the use of bunker fuel and diesel. Geothermal and hydroelectric power already provide climate-friendly electricity sources and allow El Salvador to export electricity (currently worth 0.1 percent of GDP).

asset disclosure by public officials. Plans are to cover all categories of corruption-related offences in line with UNCAC, removing the limitation period on bribery offences, making the requirement for filing asset declarations an annual requirement, releasing public reports based on the information on asset declarations, making provisions for non-conviction-based assets forfeiture, and strengthening the capacity of the department that will analyze asset declarations, including training in the use of specialized investigative techniques and the calculation of defendants' benefits for the purpose of confiscation. Efforts should continue in protecting judicial independence and in ensuring impartial access to the court system to attract investment and enhance the business climate.

43. Approving and implementing the revised AML/CFT legislation remains critical. The Special Law for the Prevention, Control, and Penalization of Money Laundering—which includes additional rules for Virtual Asset Service Providers (VASP)—was developed with the assistance of the United Nations Office on Drugs and Crime to meet the FATF standards and is being aligned with the country's national risk assessment, currently being finalized. It is critical that this law be enacted promptly and become fully operational well ahead of the mutual evaluation by the regional FATF-style regional body, GAFILAT (*Grupo de Acción Financiera de Latinoamérica*), scheduled for August 2024. The authorities have taken additional actions such as the establishment of coordination committees and the issuance of supervisory guidance and technical instruments with respect to Bitcoin activities. They have also taken initiatives to sensitize crypto asset service providers and other covered entities to their AML/CFT obligations, including the requirement to report suspicious transactions to the Financial Intelligence Unit, which is ramping up its institutional capacity in the crypto area. Additional measures are necessary to bring all designated non-financial businesses and professions under a risk-based system of supervision, ensure adequate, risk-based supervision of crypto asset service providers in full compliance with the FATF standards, and to implement measures to ensure that up-to-date and accurate beneficial ownership information is available to competent authorities on a timely basis.

Authorities' Views

44. The authorities broadly agreed with staff's recommendations and stressed that previous IMF recommendations are being implemented. They mentioned that the *Corte de Cuentas de la República* (Court of Accounts) is scheduled to audit *Fidebitcoin*. They highlighted that public reports based on the information on asset declarations by public officials will ensure that no information that may compromise the safety of public officials is released. They stressed that the alignment of the Act of Illicit Enrichment of Public Officials and the Criminal Code with international standards is nearly finished. The authorities also pointed out that the Special Law for the Prevention, Control, and Penalization of Money Laundering will be sent to the Legislative Body once the findings of the country's national risk assessment are incorporated. The Financial Intelligence Unit (FIU) is increasing the size of its workforce, hiring workers specialized in the crypto ecosystem, and developing tools to analyze the blockchain and track suspicious transactions. The FIU is increasing the operational capacity of its staff members by performing trainings with the U.S. Drug Enforcement Administration, the FBI, and fintech companies. It will further update its procedures once the Special Law for the Prevention, Control, and Penalization of Money Laundering is enacted.

STATISTICS

45. **The ongoing process to upgrade the statistical framework should continue.** Statistical responsibilities have been transferred from the Ministry of Economy's Directorate General of Statistics and Censuses (DIGESTYC) to the BCR, and it will be important that the potential of this reform, in terms of strengthening the quality and integrity of statistics, is achieved. Upgrading the recording framework of the fiscal statistics is critical. The upgrade should include not only progressing towards the GFSM 2014 standards, but also addressing under-reporting of public debt (Annex IV) and improving NFPS sectorizations in fiscal flows and public debt. STA and CAPTAC-DR are supporting the authorities' efforts, but progress so far has been slow (Annex VI). Macroeconomic statistics do not yet adequately record comprehensive Bitcoin operations.

STAFF APPRAISAL

46. **Despite adverse shocks, the Salvadoran economy continues to expand.** Real GDP growth is estimated at 2.8 percent in 2022 and the economy is already operating above pre-pandemic levels. Growth has been underpinned by strong domestic demand, supported by robust remittances and tourism, as well as a sharp improvement in the security situation.

47. **However, vulnerabilities have mounted.** While the fiscal deficit narrowed last year, gross financing needs and the stock of short-term domestic debt remained high, the current account widened sharply, and international reserves fell to around 2 months of imports. Sovereign spreads remain at distressed levels, despite the Eurobond payment, and the Treasury still lacks access to the international bond market.

48. **The outlook remains fragile with risks tilted to the downside.** The economy is projected to expand by 2.4 percent in 2023, driven by private consumption and supported by an easing of fiscal policy and more favorable terms of trade. The current account deficit is projected to narrow somewhat, but liquidity buffers will remain insufficient reflecting in part the continued absence of international market access. Risks to the outlook are elevated and tilted to the downside. On the external front, a pronounced slowdown in the United States could undermine exports and remittances, while tighter financial conditions could reduce capital inflows and force a sharper correction of external imbalances, with negative implications for growth. On the domestic side, expansionary policies and continued reliance on short-term bank debt could further weaken investor confidence, and liquidity shocks could dampen private sector credit and growth. Lingering macroeconomic imbalances would increase the likelihood of a disorderly adjustment.

49. **A comprehensive fiscal consolidation plan is urgently needed to bring debt back to a sustainable path and help gradually restore access to the international capital market.** Public debt remains high and is on an unsustainable path. Against this backdrop, a growth-friendly and inclusive fiscal consolidation is needed, backed by structurally sound revenue and spending measures amounting to around 3½ percent of GDP over the next three years. The adoption of such

a plan would boost market confidence, substantially reduce short-term debt, gradually rebuild buffers, and support El Salvador's return to the international capital market. The plan should seek to protect and improve the efficiency of social and infrastructure spending.

50. Strengthening the incentives and financial sustainability of the pension system remains necessary to limit contingent liabilities and encourage capital market development. In this regard, features of the pension system, following the recently enacted pension reform, should be assessed regularly based on new independent actuarial studies. While the reform may provide some temporary cash flow relief to the Treasury, it could also create large contingent liabilities given the proposed increases in pension entitlements and blanket guarantees on pension-related claims.

51. Although the banking sector remains healthy, systemic risks have risen in the absence of a credible fiscal and financing strategy, the erosion of financial system buffers, and tighter bank-sovereign nexus. With most COVID-based forbearance measures lifted, bank solvency and asset quality have proven resilient. Nonetheless, reserve requirements have been halved since the pandemic, system-wide liquidity buffers have fallen sharply, and banks' exposure to the government has risen. Against this backdrop, it will be critical to raise reserve requirements levels (to at least 15 percent of deposits) as soon as possible. These should be complemented by the enactment of the Financial Stability Bill, as well as efforts to recapitalize the central bank, and an overhaul of the legal framework for cooperative banks.

52. Bitcoin risks should be mitigated, and its legal tender status removed. While Bitcoin risks have not materialized due to low adoption, they remain present, and could grow if the use of Bitcoin increases given its legal tender status and recent legislative reforms. In this context, underlying risks to financial integrity and stability, fiscal sustainability, and consumer protection persist, and the recommendations of the 2021 Article IV remain valid, including removal of the Bitcoin's legal tender status. Greater transparency over the government's transactions in Bitcoin and the financial situation of the state-owned Bitcoin-wallet (*Chivo*) remains essential, especially to assess underlying fiscal contingencies and counterparty risks. Importantly, initiatives to expand government exposure to Bitcoin, including by issuing tokenized bonds, should be eschewed.

53. Boosting productivity and resilience remains a priority. Efforts should continue to strengthen security, diversify exports, improve education quality, reduce barriers to trade and investment, and promote financial inclusion, including by strengthening the central bank-led payment infrastructure (*Transfer365*). Investment in climate mitigation and adaptation are essential given El Salvador's exposure to climate shocks and high reliance on fossil fuel imports. Meanwhile, durable improvements in security will require targeted measures to improve employment opportunities for the young.

54. Strong governance, fiscal transparency, and accountability are critical to improve resource management, lower borrowing costs, and build trust. Audits on pandemic-related emergency spending should be finalized in 2023, and *Chivo* should be audited. Fiscal transparency standards need to be returned to the same level that existed prior to the start of the pandemic. The revised AML/CFT legislation should be promptly finalized. The proposed public procurement legislation has the potential to improve the efficiency of spending, but the conditions under which special procurement frameworks can be approved should be tightened. Efforts should continue in protecting judicial independence and in ensuring impartial access to the court system to attract investment and enhance the business climate.

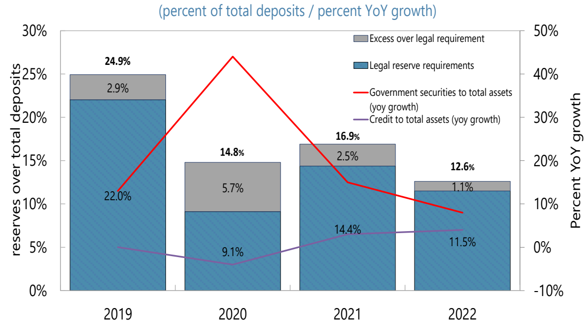
55. It is proposed that the next Article IV consultation with El Salvador take place on the standard 12-month cycle.

Box 1. El Salvador: Bank's Liquidity Framework

Before the COVID-19 emergency, conservative reserve requirements were in place. In the wake of dollarization (2001), the authorities imposed high reserve requirements to compensate for the BCR limited financial capacity as a lender of last resort. Banks held ¼ of total deposits in the central bank and 3 percent of highly liquid assets on their balance sheets. In line with international standards, risk governance requirements and sound supervisory practices such as periodic stress tests were in place. However, the Basel III liquidity ratios (Leverage Coverage Ratio and Net Stable Funding Ratio) were not implemented.

Liquidity Reserve Requirements and Credit Growth

(percent of total deposits / percent YoY growth)



Source: BCR and IMF staff calculations

To provide liquidity during the COVID-19 crisis, reserve requirements were significantly reduced. The reserve requirement fell from 22 percent to 9.1 percent of total deposits and the requirement to hold 3 percent of highly liquid assets was suspended. Banks allocated half of the liquidity surplus to high-quality liquid assets (including voluntary deposits at the central bank and highly rated foreign debt) and the other half was invested in domestic sovereign debt. As a result, holdings of government securities rose from 6.1 percent of assets in 2019 to 8.8 percent in 2020. Since private credit demand stagnated while deposit growth was strong, banks' liquidity was preserved.

Efforts to restore buffers in 2021 were reversed in 2022. In June 2021, the central bank began a gradual increase in reserve requirements, targeting 15 percent of deposits. This path was however reversed in 2022 to accommodate further lending, including to the Treasury. The new requirement has been set at 11.5 percent of deposits and will be revised or extended in March 2023. As a result, total reserves (mandatory and voluntary) have reached an historic low at the end of 2022, at 12.6 percent of total deposits.

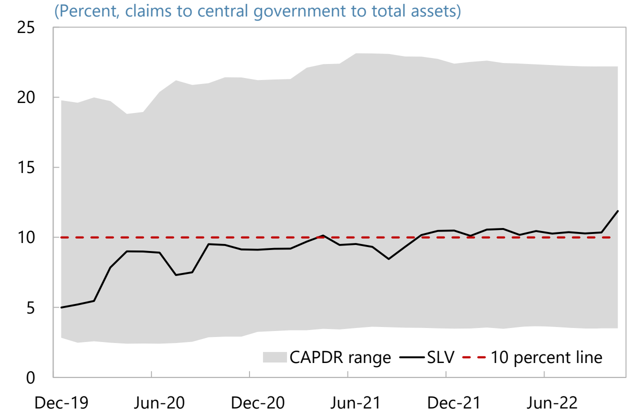
Alternative sources of systemic liquidity are scarce. Because dollarization prevents the central bank to issue money, the financial safety net has to rely on commercial banks' liquidity buffers, agile sources of central bank funding, or the government's fiscal capacity. However, El Salvador has low international reserves and no fiscal space. It also lacks the *ad-hoc* Liquidity Fund other dollarized economies have (e.g., Ecuador and Panama). The central bank has access to a US$200 million contingency credit line with CABEI.

Box 2. El Salvador: The Sovereign-Bank Nexus in El Salvador

The series of shocks that have buffeted El Salvador since 2019 has led to wider deficits and higher financing needs. With external borrowing prohibitively expensive, domestic financing increased, leading to a doubling of banks' holdings of public debt securities (mostly short-term instruments), from 4.4 percent of GDP in end-2019 to 9.2 percent of GDP in end-2021. As a result, banks' claims on the central government represent 11.1 percent of assets (October 2022). Although it has increased rapidly, Salvadoran banks' exposure to government debt is similar to that of banks in the CAPDR region.

Banks' Exposure to Government Debt

(Percent, claims to central government to total assets)

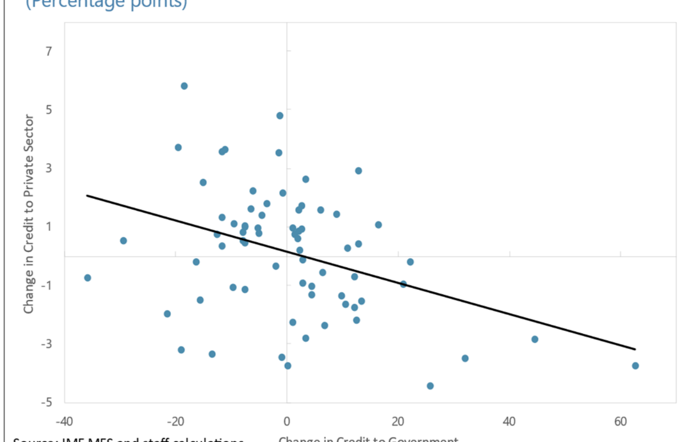


The increase in domestic debt has been accommodated with a reduction in the reserve requirement, at the cost of lowering the financial system's liquidity buffers. Reserve requirements fell from 22 percent of liabilities in December 2019 to 14 percent in December 2021 to limit the effect of higher banks' holdings of public debt on the provision of credit to the private sector. Further relaxations in 2022 effectively reduced the reserve requirements to 11.5 percent of liabilities by December 2022.

While credit growth has been resilient in 2022, staff analysis shows that higher banks' holdings of sovereign debt are negatively correlated with credit to the private sector, when controlling for changes in the reserve requirements, liabilities, and foreign assets. Crowding out of credit to the private sector is estimated to amount to 2.5 percent of GDP.

Change in Domestic Credit to Private Sector and Government

(Percentage points)



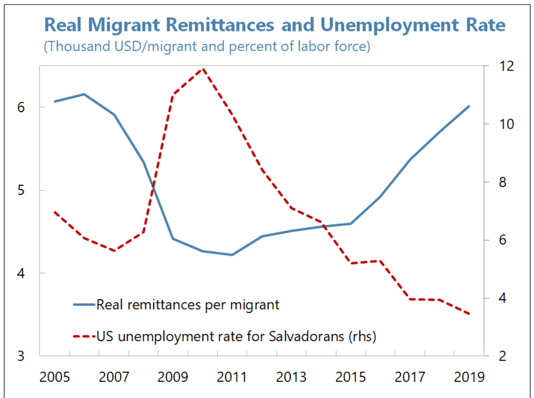
Source: IMF MFS and staff calculations.

Notes: The chart is based on an estimated regression for El Salvador of private credit against external liabilities, private liabilities, credit to the government, reserve requirements, and external assets. All variables expressed in natural log of percent of GDP, for a sample 2001Q4:2019Q4 with R-square of 0.77.

Banks' exposure to sovereign debt could also hurt their balance sheets and earning potential. While any scenario of domestic debt restructuring would lead to significant capital losses, this risk is not reflected in banks' financial and prudential ratios given the accommodative regulatory and accounting treatment of banks' sovereign exposures. Bank's holdings of government debt have zero risk weighting for capital purposes and there are no provisioning requirements to cover the inherent credit risk.

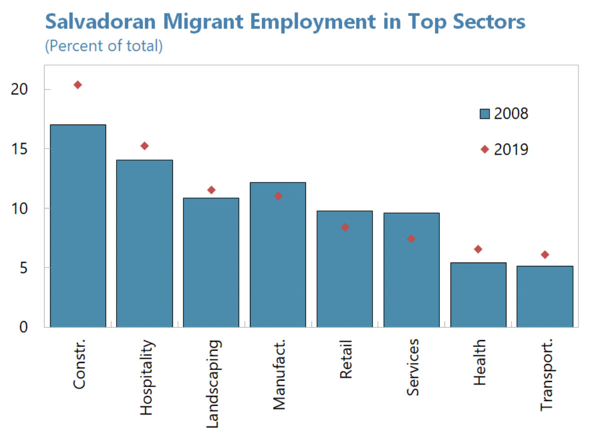
Box 3. El Salvador: Migrant Employment in the U.S., Remittances, and Financial System Liquidity

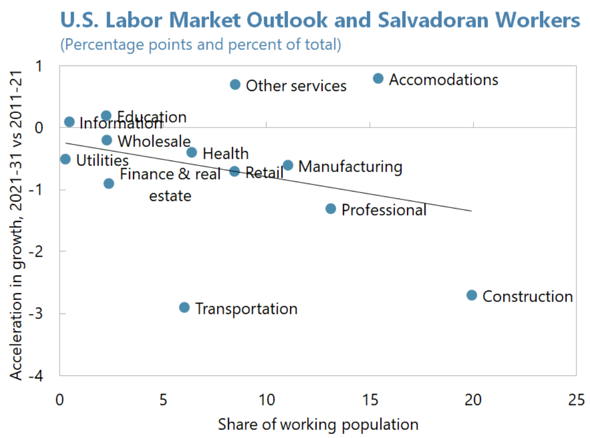
Remittances received by El Salvador reached historical heights in 2021, at 26 percent of GDP. This performance can be attributed to both structural factors and cyclical factors. The population of migrants working in the United States, the main destination for Salvadorians, increased substantially since 2005, driving a structural increase in remittance flows. In addition, migrants' financial capacity to support families back home is determined by wages and labor market conditions in the U.S., as confirmed by the negative relationship between remittances per migrant worker (adjusted for inflation) and the unemployment rate of Salvadorians in the United States. When this unemployment rate reached 12 percent in 2009, in the wake of the Global Financial Crisis, remittances per migrant fell by 17 percent in real terms.



Source: US ACS, BLS, and IMF staff calculations.

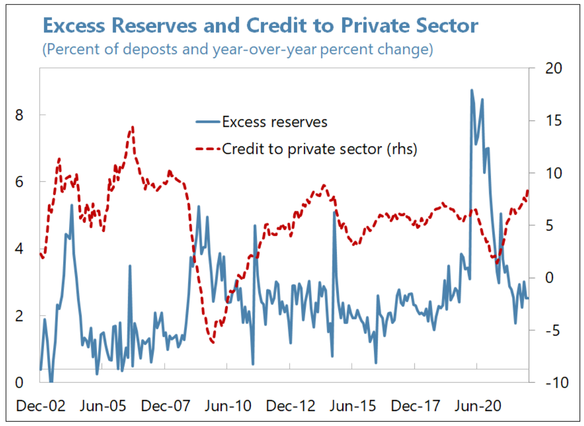
Although remittances have remained strong in 2022, a downturn in the United States labor market is one of the most significant downside risks for the economy of El Salvador. A doubling of the Salvadoran migrants' unemployment rate, to 7 percent (from 3.5 percent in 2019), is estimated to reduce real remittances per migrant by 11 percent, which would lead to a drop in remittances inflows by 6 percent of GDP. The structural composition of Salvadoran employment in the United States also points to an additional vulnerability. In the short and medium term, the Salvadoran migrant unemployment rate could be sensitive to the sectoral composition of a future slowdown in the United States. A large share of Salvadoran migrants work in construction, manufacturing, and transportation, sectors that the U.S. Bureau of Labor Statistics anticipates will be contracting. These arguments do not take into account a mitigating factor, however, which is the altruistic motive of remittances, as migrants can dip into their savings to support families in need in El Salvador.





Source: US ACS, BLS, and IMF staff calculations.

Box 3. El Salvador: Migrant Employment in the U.S., Remittances, and Financial System Liquidity (Concluded)



Remittances are critical to finance the balance of payments, increase dollars in circulation, and grow the banks' deposit base and lending capacity. As twenty percent of Salvadoran households rely on remittances for consumption expenditures, the private retail sector channels the remittances into their bank deposits, which in turn impacts money aggregates. In the aftermath of the GFC, a 9 percent fall in remittances was followed by a drop in private sector deposits and real money demand, pushing banks to preserve liquidity by curbing credit to the private sector. Staff estimates the remittances money multiplier to be 0.18, i.e. for a 10 percent decline in the remittances-to-GDP ratio (a decline by 2.5 percent of GDP), money in circulation and deposits would decline by 1.8 percent in real terms.[1/]

1/ Based on a regression of real money demand (M1) on remittances, controlling for the 90-day interest rate, and real GDP stripped of the effect of remittances on GDP.

Box 4. El Salvador: The Pension System: Implications of the Recent Reform

El Salvador has a mixed and cumbersome pension system. Following a privatization in 1996, it comprises private pension funds (AFPs, providing a defined-contribution pension based on the returns of individual accounts) and two public pension schemes (closed to new entrants). Additionally, the government provides a Minimum Pension Guarantee (MPG). To address pressure on the budget stemming from the need to finance the liabilities of the old PAYG, without revenues (as these are collected by the AFPs), a trust fund (FOP) was created in 2006, and the AFPs were mandated to purchase its securities (*Certificados de Inversión Previsional*—CIP). A 2017 reform partly addressed the budgetary cost of the MPG by increasing contributions from 13 to 15 percent and diverting 5 percentage points to a common fund (Solidarity account, CGS), mandated to pay the MPG. This created a mixed pension system, with the cost of the MPG paid by workers until the CGS reaches a deficit, when the Treasury needs to step in. The level of pensions provided by the system has however remained low given large informality rate—low contributions density—and low return of investments, because the bulk of the AFPs' portfolio comprised CIPs, with yields tied to the LIBOR until 2014.

A new reform was approved in December 2022 geared at increasing the generosity of the system. The reform does not change the structure of the pension system but adjusts a few parameters to increase its generosity, without changing the retirement age. Its main elements are (i) a one percent increase in contributions to the individual savings account; (ii) an across-the-board increase in pensions by 30 percent; (iii) the elimination of the insurance premium paid to AFPs, transferring the responsibility to pay disability pension to the CGS, offset by a one percent increase in contributions to the CGS; (iv) a 32 percent increase in the MPG (which was already raised by 47 percent in 2021); and (v) the elimination of the FOP and creation of a new institution (*Instituto Salvadoreño de Pensiones*—ISP). The ISP will issue securities that the AFPs will be obliged to purchase.

Pension Contributions

(Percentages)

	Pre-reform	Reform
Income	15.000	16.000
Employee	7.250	7.250
Employer	7.750	8.750
Distribution	15.000	16.000
Individual savings account	8.100	9.000
AFP	1.900	1.000
Fee	0.865	1.000
Insurance premium	1.035	...
Solidarity account (CGS)	5.000	6.000

Source: Pension reform bill

Although these adjustments may be approximately neutral in the near term, they will likely compromise the system's medium-term sustainability. Short-term revenue gains from the one-point increase in contribution and elimination of the insurance premium are estimated at 0.8 percent of GDP while the increase in pensions would cost 0.7 percent of GDP. However, the pension bill will increase steadily over time, reflecting the fact that most new pensioners will receive the MPG. This implies that the CGS would require transfers from the Treasury to honor its obligations.

AFPs Assets [1/]

	Mill. US$	(Percent of GDP)
Cash and equivalents	127	0.4
Accounts receivable	1,182	3.7
Investment portfolio	12,950	41.0
o/w Public sector	10,402	32.9
o/w domestic private assets	1,575	5.0
o/w foreign assets	977	3.1
Total assets	14,259	45.1

1/ As of November 2022

Source: Salvadorian authorities and Fund staff estimates

In the short term, the reform could provide some financing to the NFPS. The elimination of the limit on the AFP's exposure to ISP debt could provide such financing, although this would come at the cost of reduced liquidity, diversification and potentially profitability of the AFP's portfolio. With the elimination of the FOP, the stock of CIPs (28 percent of GDP) will be exchanged with CFT (*Certificados de Financiamiento Temporal*) issued by the ISP, although `the precise terms of these certificates have yet to be defined. The reform also suspended the right to withdraw from individual savings account, to protect the liquidity and sustainability of the pension system.

Box 5. El Salvador: The Digital Assets Law

In February 2023, a Digital Assets Law entered into force regulating the adoption of a broad range of crypto assets that would include sovereign and private tokenized instruments. The law is a preparatory step for the public issuance of tokenized bonds, such as the "Volcano bond"[1], and it also intends to provide a legal framework for private activities with crypto assets, including stable coins. It allows any public or private issuer to raise funding through public offerings of digital assets (*activos digitales*), which include any representation of value that can be digitally transferred, e.g., debt, property, or cash flows such as dividends. The Law exempts from taxation all digital asset transactions (including public offerings, interests, and capital gains) as well as the activities of all firms dealing with digital assets (including crypto services providers, issuers, and validators).[2] The authorities are working on secondary regulations to complete the new regime in areas such as digital asset providers and issuances, stable coins, and the governing rules for the new agencies. The Law does not apply to Central Bank Digital Currencies or to Bitcoin, whose official currency and monetary status is regulated by the Bitcoin Law and by specific regulations.

The new regulatory regime departs from the traditional regulation on securities, even for crypto assets that seem to function as typical securities. The Law also exempts crypto assets from the application of existing private laws (e.g., Code of Commerce), giving the new regulator the power to create applicable private law rules. This raises significant loopholes, legal uncertainty and legal hierarchy concerns that will be better understood once the legal framework is completed with the pending regulations. At this stage, the rules and requirements for digital assets issuers and service providers are incomplete in important prudential areas such as governance and capital, liquidity, and backup safeguards, as well as insolvency regime, AML/CFT, certifying and accounting standards, cybersecurity, secondary trading markets and market integrity. The Relevant Information Document (prospectus) is the key element to disclose risks and protect investors, however, investors' rights and safeguards are still ill-defined as securities market regulation is not applicable.

The Digital Assets Commission will be the supervisory and regulatory agency, but its governing body lacks the independence and governance requisites that typically pertain to similar authorities. It will cover both digital assets markets and services providers and enforce a set of requirements that include disclosure and record keeping provisions. The Commission will approve issuances of digital assets and receive fees by service providers. As a new regulator and given the complexity of the digital assets, a lack of appropriate resources and experienced staff could lead to significant regulatory risks, particularly during the early stages of operationalization.

The Bitcoin Funds Management Agency will administer the proceeds of any tokenized assets issued by public sector entities. The Law recognizes the issuance of digital assets by public entities, e.g., the state, central bank, ministries, and other autonomous entities, without clearly defining whether the issuance of these debt instruments will follow regular requirements for aggregated public sector issuances, such as Assembly approval. The rules for the management and investment of the proceeds, including the authorization to fund public investment projects, depart from public financial management and spending control rules.

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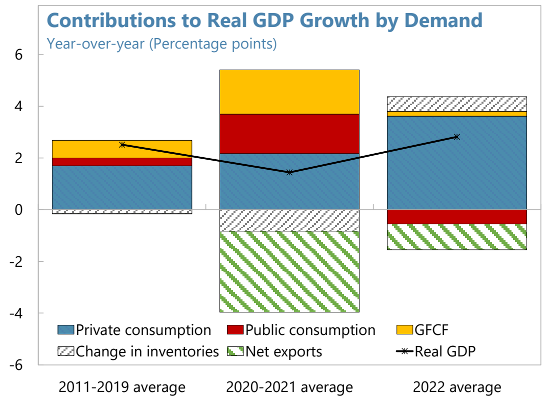
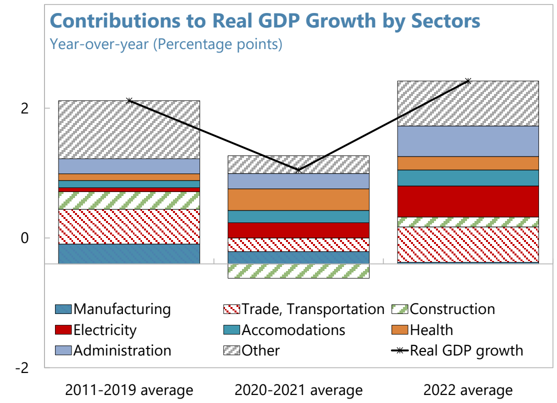
[1] The authorities are still exploring options for using tokenized bonds to finance Bitcoin investments, such as Bitcoin mining or the development of Bitcoin-infrastructures. In November 2021, they announced a 10-year US$1 billion bond, half of which would be spent on the purchase of Bitcoins and the other half for the development of "Bitcoin city".
[2] However, the use of digital assets—other than Bitcoin as an official currency—for payment of goods and services will be subject to taxation.

Figure 1. El Salvador: Real Sector Developments

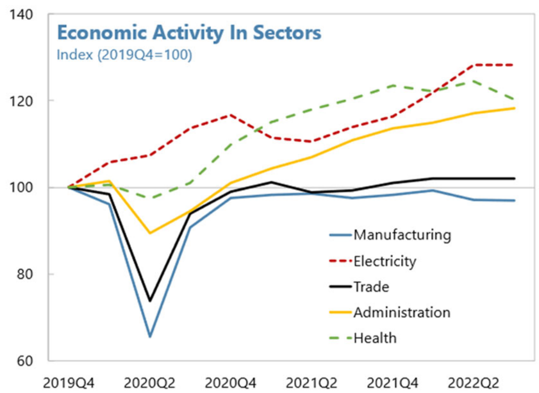
Strong real GDP growth in 2022H1 was supported by domestic demand.



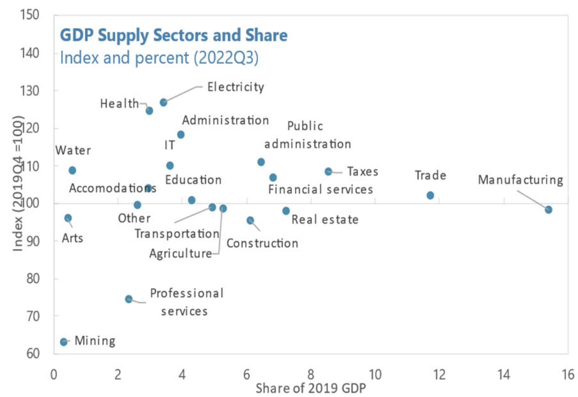
The engines of growth shifted from traditional sectors towards the electricity, administration, and health sectors.



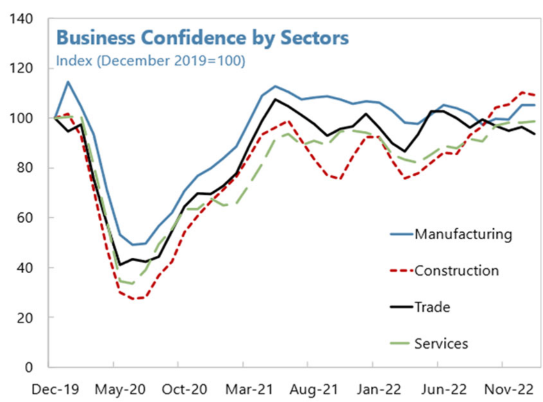
COVID-19 measures boosted the health sector, the launch of the LNG plant drove growth in electricity generation, and the administration sector saw growing call centers activity.



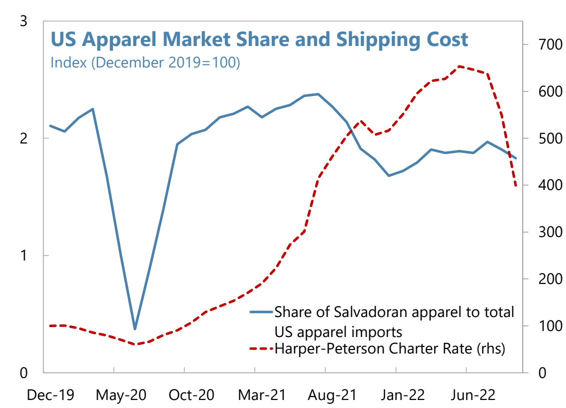
The traditionally large sectors merely recovered from the pandemic.



Business confidence in manufacturing and trade faltered...



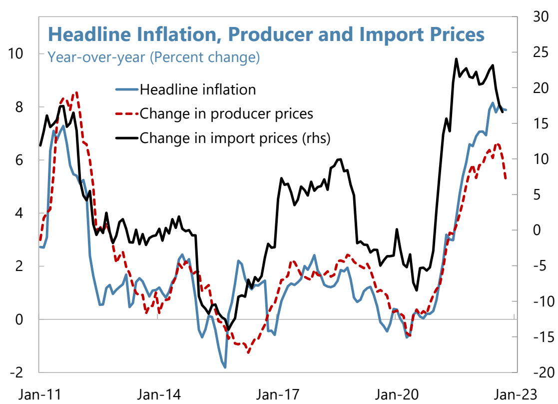
...amid a decline in apparel exports to the U.S., despite a drop in shipping costs.



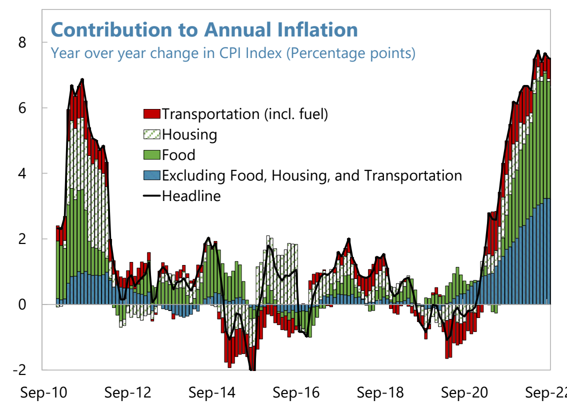
Source: Central Reserve Bank of El Salvador, Haver Analytics, FUSADES, and IMF staff calculations.

Figure 2. El Salvador: Inflation Developments

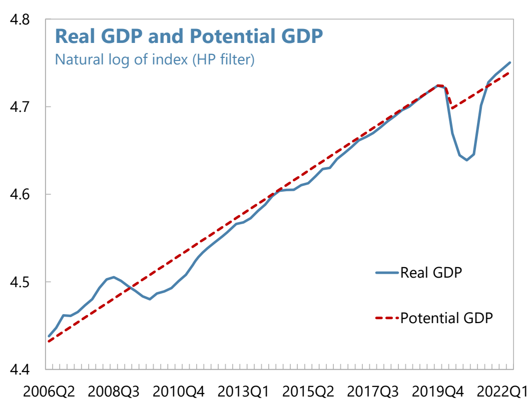
Import prices and producer prices increased sharply in 2022…



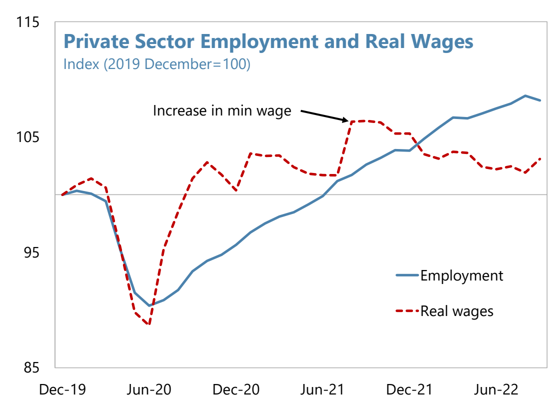
… which contributed to high headline inflation.



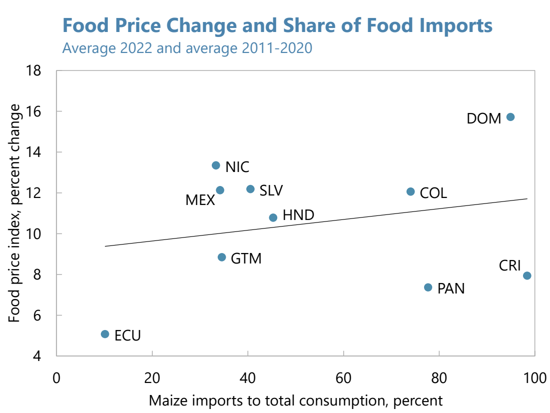
Demand was strong as the economy is running above potential…



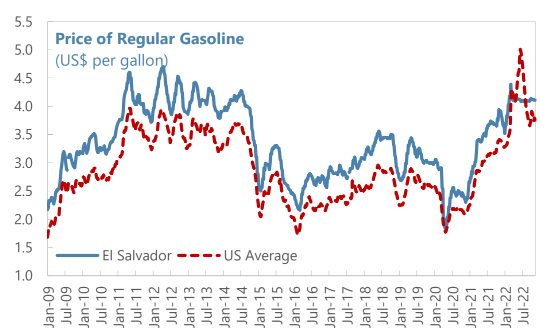
…with robust developments in labor and wages in the formal economy.



High food inflation owed to the high import component of food consumption in El Salvador…



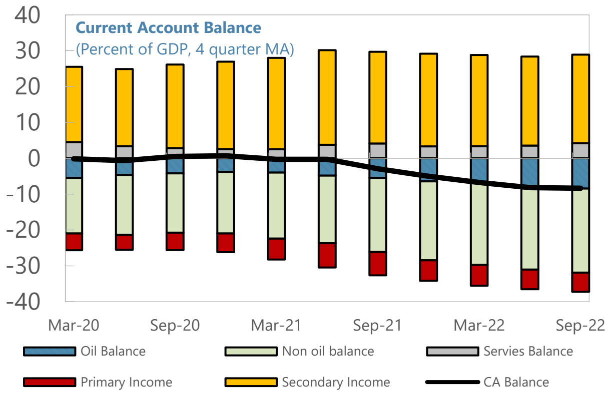
…while fuel inflation—which is 100 percent imported—was muted amidst a price freeze and subsidies.



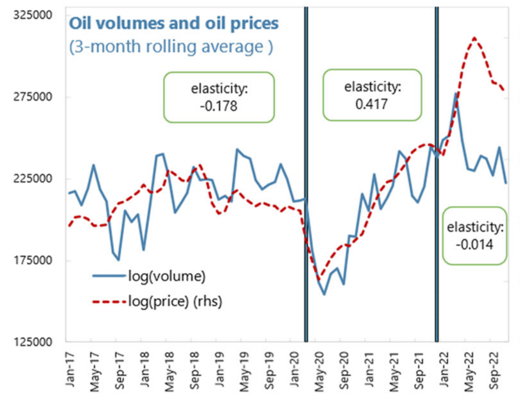
Source: Central Reserve Bank of El Salvador, Haver Analytics, and IMF staff calculations.
Notes: 2022 data is projected based on data for the first three quarters of the year.

Figure 3. El Salvador: Balance of Payments Developments

The current account deficit has widened substantially…

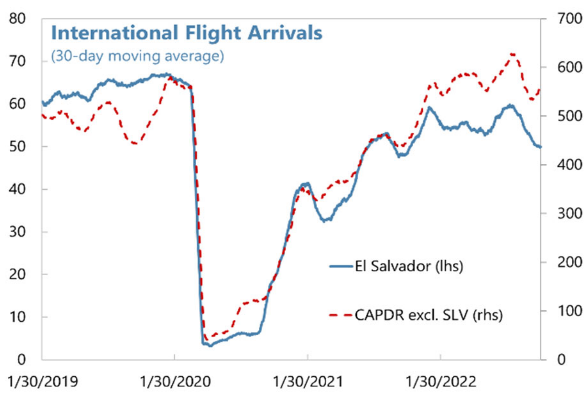


… fueled in part by rising oil prices and demand supported by universal energy subsidies.



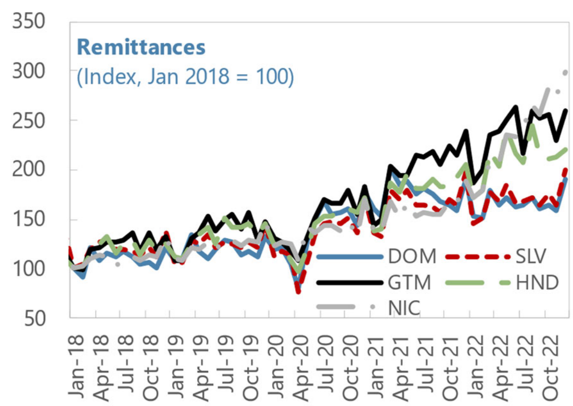
Note: Price elasticity of oil demand estimated by OLS. Similar patterns are visible for CRI, GTM, HND and DOM. The three subperiods are 2017m1-2020m2, 2020m3-2021m12, and 2022m1-2022m11.

Tourists have returned…

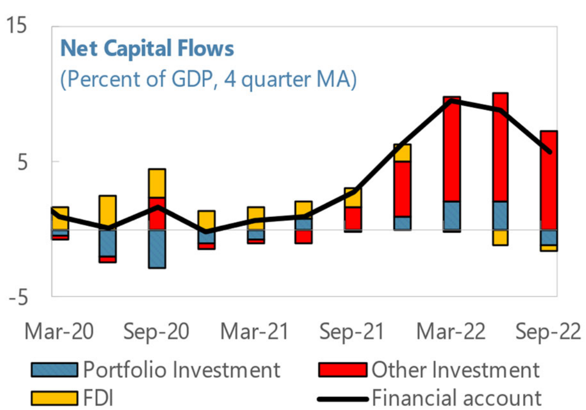


Sources: Flightradar

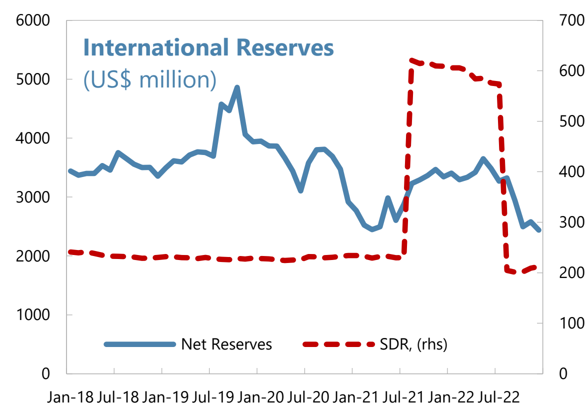
…but the pandemic surge in remittances slowed down.



FDI has been replaced by other borrowing as the biggest contributor to the financial account surplus…



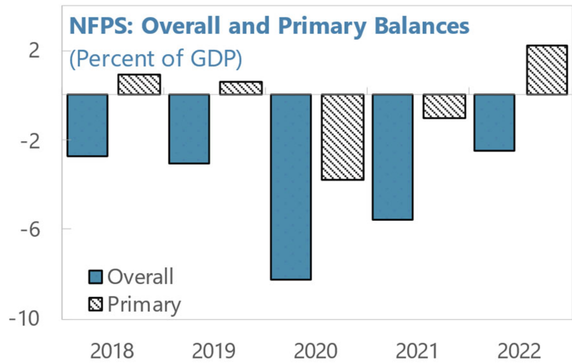
…and reserves have declined due to their use for the debt buyback.



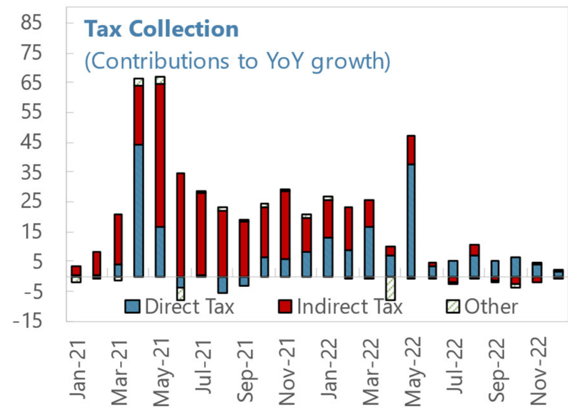
Source: Central Reserve Bank of El Salvador, Haver Analytics, and Fund staff calculations.

Figure 4. El Salvador: Fiscal Developments

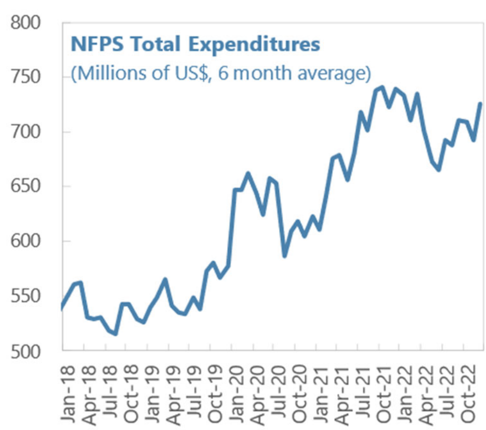
The fiscal position improved in 2022...



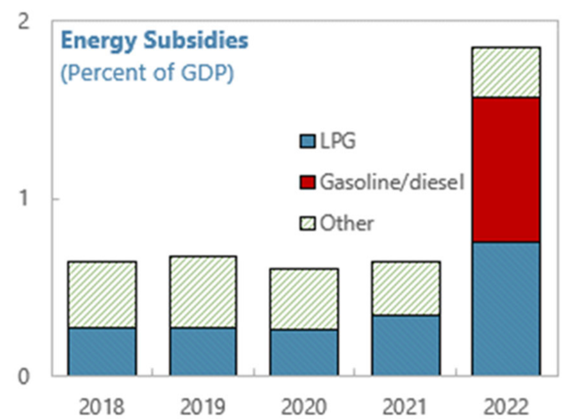
...mainly due to large CIT collection based on record 2021 growth...



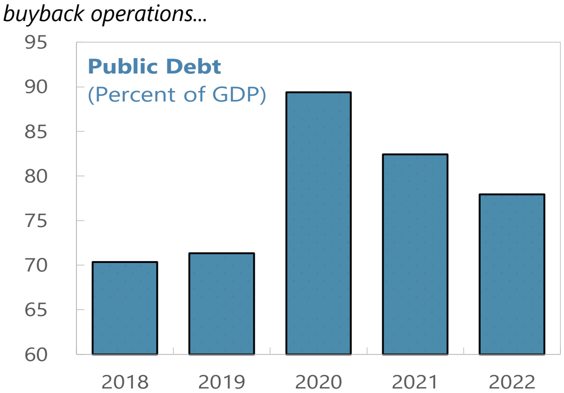
...and some spending control mostly due to delays in investment...



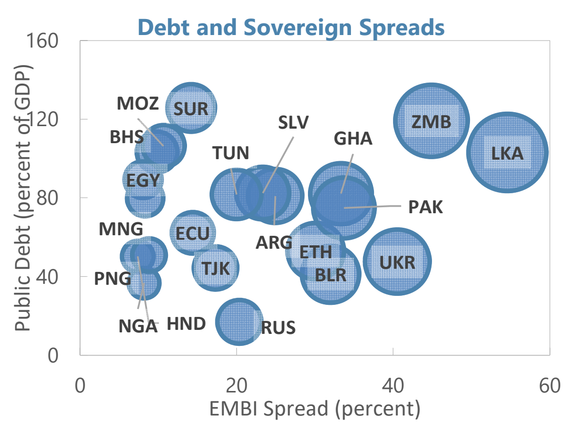
...while costly and untargeted energy subsidies were significantly increased.



While public debt has fallen due to inflation and the buyback operations...



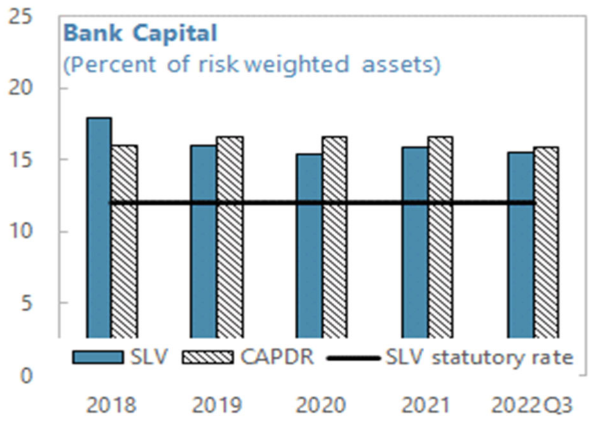
...financing still remains challenging



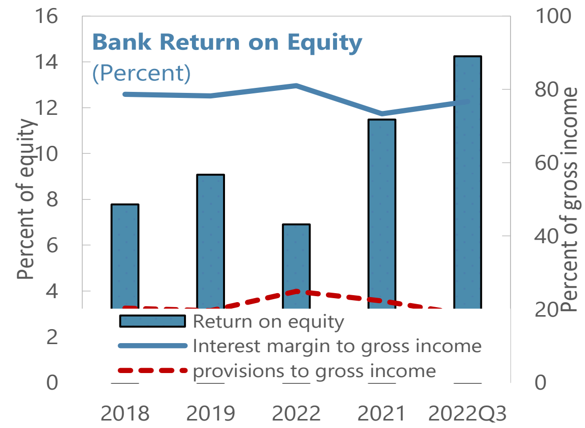
Source: National authorities and Fund staff calculations.
Notes: 2022 numbers are preliminary estimates.

Figure 5. El Salvador: Financial Sector Developments

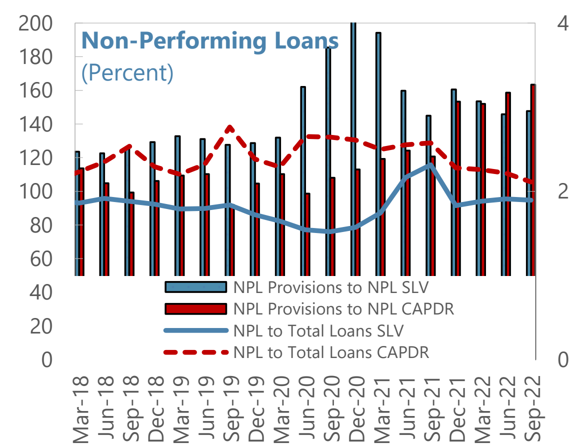
Bank's regulatory capital remained stable...



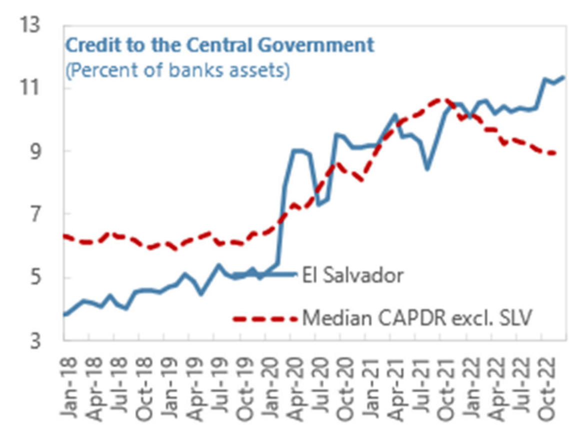
...and profitability improved as margins widened and provisions fell.



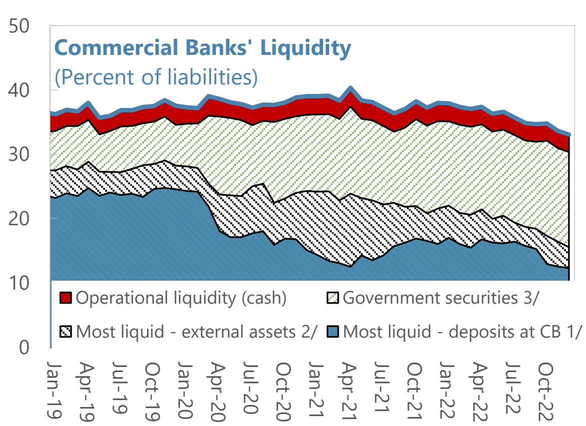
While non-performing loans remained subdued and well provisioned...



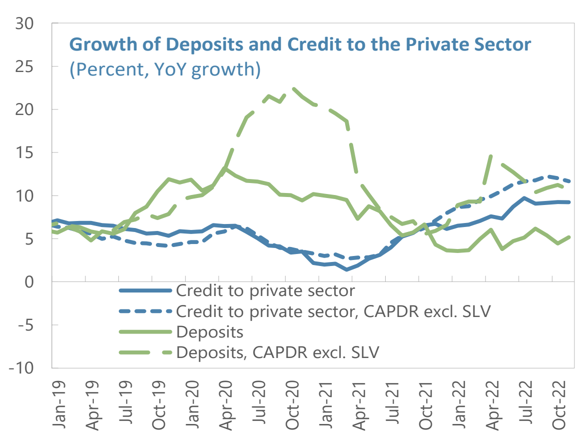
...rising exposures to domestic sovereign debt has deteriorated banks' asset quality.



Liquidity buffers have significantly declined, particularly, those deposited at the central bank...



...amid slowing deposit growth.



Source: IMF Financial Stability Indicators and staff calculations.
1/ Includes reserve requirements.
2/ Deposits and securities abroad.
3/ Holdings of central government treasuries and securities.

Table 1. El Salvador: Selected Economic Indicators

I. Social Indicators

Rank in UNDP Development Index 2021 (of 189)	125	Population (million, 2021)	6.5
Per capita income (U.S. dollars, 2021)	4,408	Life expectancy at birth in years (2021)	71
Percent of pop. below poverty line (2021)	24.6	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)

									Proj.	
	2015	2016	2017	2018	2019	2020	2021	2022	2023	2024
Income and Prices										
Real GDP growth (percent)	2.4	2.5	2.3	2.4	2.4	-8.2	10.3	2.8	2.4	1.9
Consumer price inflation (average, percent)	-0.7	0.6	1.0	1.1	0.1	-0.4	3.5	7.2	4.1	2.1
GDP deflator (percent)	1.3	0.7	1.0	1.7	0.9	-0.5	6.1	7.0	4.2	2.0
External Sector										
Exports of goods, volume	3.1	-1.0	6.0	-1.7	0.9	-12.6	20.3	0.7	2.4	0.8
Imports of goods, volume	13.2	-0.5	1.4	2.6	4.2	-10.6	26.6	4.0	3.7	2.0
External Sector										
Current account balance	-3.2	-2.3	-1.9	-3.3	-0.4	0.8	-5.1	-8.3	-5.4	-5.3
Oil prices (U.S. dollars per barrel)	50.9	43.3	53.0	68.5	61.4	41.8	69.2	96.4	81.9	77.1
Trade balance	-21.2	-19.2	-19.4	-21.7	-21.2	-21.0	-28.6	-31.4	-27.5	-27.4
Exports (f.o.b.)	18.9	17.9	18.7	18.2	17.7	16.9	18.7	18.9	18.1	17.9
Imports (f.o.b.)	40.1	37.1	38.1	39.9	38.9	37.8	47.3	50.3	45.6	45.3
Services and income (net)	-0.6	-1.8	-2.6	-2.3	-0.2	-2.6	-2.4	-1.0	-0.8	-0.2
Transfers (net)	18.6	18.8	20.2	20.6	21.0	24.4	25.9	24.0	22.9	22.4
Foreign direct investment	-1.7	-1.4	-3.6	-3.2	-2.4	-1.1	-1.1	-0.2	-1.6	-2.2
Gross international reserves (millions of U.S. dollars)	2,787	3,238	3,567	3,569	4,446	3,083	3,426	2,440	2,798	3,382
Nonfinancial Public Sector										
Overall balance	-3.6	-3.1	-2.5	-2.7	-3.1	-8.2	-5.6	-2.5	-3.4	-3.4
Primary balance	-0.9	-0.2	0.7	0.9	0.6	-3.8	-1.1	2.2	0.3	0.4
Of which: Tax burden	16.7	17.2	17.6	18.0	17.7	18.5	20.1	20.3	19.0	19.0
Gross debt 1/	67.0	68.8	70.5	70.4	71.3	89.4	82.4	77.2	76.1	78.3
National Savings and Investment										
Gross domestic investment	16.0	16.0	16.7	18.4	18.3	18.9	22.2	20.7	19.8	19.4
Private sector 2/	13.5	13.5	14.1	15.7	15.9	16.9	19.6	18.8	17.4	17.1
Public sector	2.5	2.5	2.6	2.7	2.4	2.1	2.6	2.0	2.4	2.3
National savings	12.8	13.7	14.8	15.1	17.9	19.8	17.1	12.4	14.5	14.2
Private sector	13.7	13.7	14.7	14.7	18.0	25.4	19.5	12.8	14.9	14.9
Public sector	-0.9	0.0	0.1	0.4	-0.1	-5.6	-2.4	-0.3	-0.4	-0.6
Money and Credit										
Credit to the private sector	54.1	55.1	56.0	57.3	59.1	66.3	61.8	63.1	61.2	60.0
Broad money	50.1	50.0	53.8	54.8	59.1	70.4	61.5	58.5	58.5	60.5
Interest rate (time deposits, percent)	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	1,904	1,995	2,609	2,655	3,372	3,618	3,022	1,114	1,227	1,400
Percent of deposits	17.4	17.7	20.9	20.1	22.9	22.1	18.0	6.4	6.7	7.2
Memorandum Items										
Nominal GDP (billions of U.S. dollars)	23.4	24.2	25.0	26.0	26.9	24.6	28.7	31.6	33.7	35.1
Terms of trade, percent change	15.6	6.1	-4.3	-3.9	1.7	4.8	-7.6	-1.6	5.0	0.7
Real effective exchange rate (+ = appreciation)	4.7	-0.8	-3.7	1.4	-2.6	-2.8	2.6	-0.8	…	…
External sovereign bond spread (basis points)	497	599	520	424	453	760	837	1,485	…	…

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

1/ Nonfinancial public sector, including CIP-A pension bonds

2/ Includes inventories.

Table 2. El Salvador: Medium-Term Outlook

	2018	2019	2020	2021	2022	Proj. 2023	2024	2025	2026	2027	2028
					(Percentage changes)						
Nominal GDP growth	4.2	3.3	-8.6	17.0	10.0	6.8	4.0	3.9	4.0	3.9	3.8
GDP deflator	1.7	0.9	-0.5	6.1	7.0	4.2	2.0	1.8	1.8	1.7	1.7
Real GDP growth	2.4	2.4	-8.2	10.3	2.8	2.4	1.9	2.0	2.1	2.1	2.1
Output gap (percent of GDP)	0.0	0.0	-7.7	0.0	0.5	0.6	0.3	0.0	-0.2	-0.3	-0.4
Inflation (average)	1.1	0.1	-0.4	3.5	7.2	4.1	2.1	1.7	1.7	1.7	1.7
					(Contribution to real GDP growth, percentage points)						
Private consumption	1.2	1.4	-9.1	12.7	3.6	1.8	1.6	2.0	1.9	2.0	2.0
Public consumption	0.2	0.1	1.5	1.3	-0.5	0.6	0.4	0.3	0.4	0.4	0.4
Private investment	1.1	1.3	-0.8	3.9	1.0	-0.2	0.4	0.4	0.4	0.4	0.4
Public investment	0.1	-0.2	-0.5	0.6	-0.4	0.5	-0.1	0.2	0.1	0.2	0.0
Change in inventories	0.6	-0.6	1.7	-2.9	-0.1	0.4	0.2	0.4	0.3	0.4	0.4
Net exports	-0.8	0.4	-1.0	-5.3	-0.8	-0.7	-0.6	-1.3	-1.0	-1.3	-1.1
					(Percentage changes)						
Exports of goods, f.o.b.	1.5	0.3	-12.8	30.0	11.2	2.1	2.8	3.9	4.1	4.8	5.2
Volume	-1.7	0.9	-12.6	20.3	0.7	2.4	0.8	2.2	2.9	3.5	3.8
Price	3.2	-0.6	-0.2	8.1	10.4	-0.3	2.0	1.7	1.2	1.2	1.3
Imports of goods, f.o.b.	9.1	0.8	-11.2	46.3	16.9	-3.1	3.2	5.0	5.3	5.3	4.7
Volume	1.6	3.1	-6.7	25.1	4.2	2.1	1.9	3.2	3.6	3.7	3.2
Price	7.4	-2.3	-4.7	16.9	12.2	-5.1	1.3	1.8	1.6	1.5	1.5
Terms of trade	-3.9	1.7	4.8	-7.6	-1.6	5.0	0.7	-0.1	-0.4	-0.2	-0.1
					(Percent of GDP)						
Primary fiscal balance	0.9	0.6	-3.8	-1.1	2.2	0.3	0.4	0.4	0.4	0.4	0.4
Overall fiscal balance	-2.7	-3.1	-8.2	-5.6	-2.5	-3.4	-3.4	-3.7	-3.7	-5.4	-5.4
Public sector gross debt 1/	70.4	71.3	89.4	82.4	77.2	76.1	78.3	78.6	80.7	82.7	84.0
Cyclicallly adjusted primary balance	0.9	0.6	-1.9	-1.1	2.1	0.1	0.4	0.4	0.5	0.5	0.4
Structural primary balance	0.9	0.6	0.0	-0.2	1.7	0.1	0.4	0.4	0.5	0.5	0.4
Fiscal impulse (percentage points)	-0.2	0.3	0.6	0.2	-1.9	1.5	-0.2	0.0	-0.1	0.0	0.1
Current account balance	-3.3	-0.4	0.8	-5.1	-8.3	-5.4	-5.3	-5.4	-5.5	-5.6	-5.6
Exports of goods, f.o.b.	18.2	17.7	16.9	18.7	18.9	18.1	17.9	17.9	17.9	18.1	18.3
Imports of goods, f.o.b.	39.9	38.9	37.8	47.3	50.3	45.6	45.3	45.8	46.3	47.0	47.4
Of which: Petroleum and products	6.4	5.6	3.9	6.4	8.5	6.7	6.1	5.7	5.3	5.0	4.7
Current transfers	20.6	21.0	24.4	25.9	24.0	22.9	22.4	22.2	22.2	22.3	22.4
Gross domestic investment	18.4	18.3	18.9	22.2	20.7	19.8	19.4	19.2	18.8	18.6	18.5
Private sector 2/	15.7	15.9	16.9	19.6	18.8	17.4	17.1	16.8	16.5	16.2	16.1
Public sector	2.7	2.4	2.1	2.6	2.0	2.4	2.3	2.4	2.4	2.5	2.4
Gross national saving	15.1	17.9	19.8	17.1	12.4	14.5	14.2	14.0	13.5	13.2	12.9
Private sector	14.7	18.0	25.4	19.5	12.8	14.9	14.9	14.8	14.3	15.7	15.4
Public sector	0.4	-0.1	-5.6	-2.4	-0.3	-0.4	-0.6	-0.8	-0.8	-2.5	-2.4
External saving	3.3	0.4	-0.8	5.1	8.3	5.3	5.1	5.2	5.3	5.4	5.6
Memorandum Items					(Percentage changes)						
Private consumption	1.3	1.7	-10.8	15.4	4.2	2.0	1.9	2.3	2.2	2.3	2.2
Public consumption	1.7	0.5	10.1	7.2	-3.2	3.9	2.2	1.8	2.7	2.4	2.3
Private investment	7.9	8.8	-5.1	23.9	5.5	-1.0	2.2	2.4	2.1	2.1	2.1
Public investment	3.4	-7.5	-18.8	29.5	-16.8	25.3	-3.8	6.4	3.4	7.2	1.6
Net exports	4.3	-2.5	7.5	27.2	1.5	3.0	2.3	5.3	4.3	4.9	3.9

Sources: Central Reserve Bank of El Salvador, Ministry of Finance, and IMF staff estimates.
1/ Nonfinancial public sector, including CIP-A pension bonds. Does not include "Bitcoin" bonds.
2/ Includes inventories.

Table 3a. El Salvador: Balance of Payments
(In millions of US Dollars)

					Proj.						
	2018	2019	2020	2021	2022	2023	2024	2025	2026	2027	2028
Current Account	**-859**	**-113**	**203**	**-1,457**	**-2,637**	**-1,816**	**-1,853**	**-1,962**	**-2,088**	**-2,223**	**-2,296**
Merchandise trade balance	-5,640	-5,709	-5,147	-8,208	-9,910	-9,292	-9,617	-10,174	-10,786	-11,385	-11,883
Export of goods (f.o.b.)	4,736	4,748	4,142	5,385	5,985	6,108	6,276	6,521	6,787	7,112	7,483
Import of goods (f.o.b.)	10,376	10,457	9,289	13,592	15,895	15,400	15,894	16,694	17,573	18,497	19,366
Of which: Petroleum and products	1,655	1,498	949	1,830	2,673	2,253	2,149	2,068	2,008	1,962	1,923
Services, net	882	1,297	678	945	1,528	1,833	2,017	2,156	2,278	2,395	2,489
Of which: Travel receipts	1,014	1,306	636	993	1,610	1,910	2,046	2,146	2,251	2,359	2,471
Primary income, net	-1,470	-1,341	-1,315	-1,624	-1,856	-2,097	-2,098	-2,049	-2,014	-2,021	-2,057
Of which: Interest	-476	-448	-464	-512	-660	-822	-810	-786	-758	-746	-751
Secondary income, net	5,369	5,640	5,987	7,431	7,601	7,740	7,845	8,105	8,434	8,789	9,155
Of which: Workers' remittances (credits)	5,373	5,631	5,911	7,465	7,741	7,914	8,058	8,358	8,734	9,144	9,573
Capital Account, net	**203**	**248**	**300**	**266**	**220**	**247**	**256**	**258**	**250**	**246**	**252**
Financial Account											
(Net lending (+)/Net borrowing (-))	**-1,250**	**-1,015**	**201**	**-1,859**	**-1,685**	**-2,022**	**-2,374**	**-1,747**	**-2,047**	**-2,187**	**-2,246**
Foreign direct investment, net	-826	-636	-281	-313	-66	-541	-773	-874	-879	-1,026	-1,015
Net acquisition of financial assets	-413	61	92	517	-3	46	138	154	166	96	120
Net incurence of labilities	413	696	373	831	62	588	911	1,027	1,045	1,121	1,135
Of which: Reinvested earnings	513	110	179	544	80	423	417	401	383	366	347
Portfolio investment, net	110	-17	251	-303	720	659	192	411	-26	847	42
Net acquisition of financial assets	7	178	1,078	-303	72	55	72	63	-26	47	42
Net incurence of labilities	-103	195	827	0	-648	-604	-120	-348	0	-800	0
Of which: Public sector	-82	201	839	0	-648	-604	-120	-348	0	-800	0
Other investment, net	-533	-361	231	-1,243	-2,339	-2,140	-1,793	-1,284	-1,142	-2,009	-1,273
Net acquisition of financial assets	-493	12	532	407	-185	3	-91	8	16	12	-3
Net incurence of labilities	40	373	301	1,650	2,154	2,143	1,701	1,293	1,158	2,021	1,270
Errors and Omissions, net	-592	-273	-2,102	-309	0	0	0	0	0	0	0
Overall balance	**2**	**876**	**-1,800**	**360**	**-731**	**454**	**777**	**43**	**208**	**211**	**202**
Financing	**-2**	**-876**	**1,800**	**-360**	**731**	**-454**	**-777**	**-43**	**-208**	**-211**	**-202**
Change in Reserve Assets (-=increase)	**-2**	**-876**	**1,387**	**-360**	**731**	**-357**	**-584**	**54**	**-208**	**-211**	**-202**
Change in reserve requirements 1/	-98	-549	1,265	-288	554	-288	-138	-145	-154	-161	-169
Change in reserve position in the IMF	0	0	0	-392	408	0	0	0	0	0	0
Other changes in reserve assets	96	-327	122	320	-230	-69	-446	199	-54	-50	-33
Exceptional Financing	**0**	**0**	**413**	**0**	**0**	**-97**	**-194**	**-97**	**0**	**0**	**0**
Of which: IMF	0	0	413	0	0	0	0	0	0	0	0
repayments	0	0	0	0	0	-97	-194	-97	0	0	0
Of which: Other multilaterals	0	0	0	0	0	0	0	0	0	0	0
Unidentified financing	**0**	**0**	**0**	**0**	**0**	**0**	**0**	**0**	**0**	**0**	**0**
Memorandum Items											
Gross international reserves	3,569	4,446	3,083	3,426	2,440	2,798	3,382	3,328	3,536	3,747	3,949
In months of imports	3.5	4.3	3.4	2.6	1.6	1.9	2.2	2.1	2.1	2.1	2.2
In percent of total short-term external debt	172	199	165	152	113	129	155	152	161	171	179
External debt	16,661	17,350	18,349	20,286	19,357	19,454	19,969	20,183	20,812	20,648	21,255
Of which: Public sector debt	10,190	10,838	11,868	12,980	11,597	11,240	11,310	11,097	11,279	10,668	10,825
Of which: Private sector debt	6,471	6,512	6,481	7,306	7,760	8,214	8,659	9,086	9,533	9,981	10,429
International Investment Position, net	-16,710	-17,457	-17,600	-16,674	-18,770	-20,152	-21,559	-23,209	-25,033	-26,935	-28,918

Sources: Central Reserve Bank of El Salvador and IMF staff estimates. Presented in BPM6 format.
1/ 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 Payments
(Percent of GDP)

	2018	2019	2020	2021	2022	2023	2024	Proj. 2025	2026	2027	2028
Current Account	**-3.3**	**-0.4**	**0.8**	**-5.1**	**-8.3**	**-5.4**	**-5.3**	**-5.4**	**-5.5**	**-5.6**	**-5.6**
Merchandise trade balance	-21.7	-21.2	-21.0	-28.6	-31.4	-27.5	-27.4	-27.9	-28.4	-28.9	-29.1
Export of goods (f.o.b.)	18.2	17.7	16.9	18.7	18.9	18.1	17.9	17.9	17.9	18.1	18.3
Import of goods (f.o.b.)	39.9	38.9	37.8	47.3	50.3	45.6	45.3	45.8	46.3	47.0	47.4
Of which: Petroleum and products	6.4	5.6	3.9	6.4	8.5	6.7	6.1	5.7	5.3	5.0	4.7
Services, net	3.4	4.8	2.8	3.3	4.8	5.4	5.7	5.9	6.0	6.1	6.1
Of which: Travel receipts	3.9	4.9	2.6	3.5	5.1	5.7	5.8	5.9	5.9	6.0	6.0
Primary income, net	-5.6	-5.0	-5.4	-5.7	-5.9	-6.2	-6.0	-5.6	-5.3	-5.1	-5.0
Of which: Interest	-1.8	-1.7	-1.9	-1.8	-2.1	-2.4	-2.3	-2.2	-2.0	-1.9	-1.8
Secondary income, net	20.6	21.0	24.4	25.9	24.0	22.9	22.4	22.2	22.2	22.3	22.4
Of which: Workers' remittances (credits)	20.6	20.9	24.1	26.0	24.5	23.5	23.0	22.9	23.0	23.2	23.4
Capital Account, net	**0.8**	**0.9**	**1.2**	**0.9**	**0.7**	**0.7**	**0.7**	**0.7**	**0.7**	**0.6**	**0.6**
Financial Account											
(Net lending (+)/Net borrowing (-))	**-4.8**	**-3.8**	**0.8**	**-6.5**	**-5.3**	**-6.0**	**-6.8**	**-4.8**	**-5.4**	**-5.6**	**-5.5**
Foreign direct investment, net	-3.2	-2.4	-1.1	-1.1	-0.2	-1.6	-2.2	-2.4	-2.3	-2.6	-2.5
Net acquisition of financial assets	-1.6	0.2	0.4	1.8	0.0	0.1	0.4	0.4	0.4	0.2	0.3
Net incurence of labilities	1.6	2.6	1.5	2.9	0.2	1.7	2.6	2.8	2.8	2.8	2.8
Of which: Reinvested earnings	2.0	0.4	0.7	1.9	0.3	1.3	1.2	1.1	1.0	0.9	0.8
Portfolio investment, net	0.4	-0.1	1.0	-1.1	2.3	2.0	0.5	1.1	-0.1	2.2	0.1
Net acquisition of financial assets	0.0	0.7	4.4	-1.1	0.2	0.2	0.2	0.2	-0.1	0.1	0.1
Net incurence of labilities	-0.4	0.7	3.4	0.0	-2.1	-1.8	-0.3	-1.0	0.0	-2.0	0.0
Of which: Public sector	-0.3	0.7	3.4	0.0	-2.1	-1.8	-0.3	-1.0	0.0	-2.0	0.0
Other investment, net	-2.0	-1.3	0.9	-4.3	-7.4	-6.3	-5.1	-3.5	-3.0	-5.1	-3.1
Net acquisition of financial assets	-1.9	0.0	2.2	1.4	-0.6	0.0	-0.3	0.0	0.0	0.0	0.0
Net incurence of labilities	0.2	1.4	1.2	5.7	6.8	6.4	4.8	3.5	3.1	5.1	3.1
Errors and Omissions, net	-2.3	-1.0	-8.6	-1.1	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Overall balance	**0.0**	**3.3**	**-7.3**	**1.3**	**-2.3**	**1.3**	**2.2**	**0.1**	**0.5**	**0.5**	**0.5**
Financing	**0.0**	**-3.3**	**7.3**	**-1.3**	**2.3**	**-1.3**	**-2.2**	**-0.1**	**-0.5**	**-0.5**	**-0.5**
Change in Reserve Assets (-=increase)	**0.0**	**-3.3**	**5.6**	**-1.3**	**2.3**	**-1.1**	**-1.7**	**0.1**	**-0.5**	**-0.5**	**-0.5**
Change in reserve requirements 1/	-0.4	-2.0	5.2	-1.0	1.8	-0.9	-0.4	-0.4	-0.4	-0.4	-0.4
Change in reserve position in the IMF	0.0	0.0	0.0	-1.4	1.3	0.0	0.0	0.0	0.0	0.0	0.0
Other changes in reserve assets	0.4	-1.2	0.5	1.1	-0.7	-0.2	-1.3	0.5	-0.1	-0.1	-0.1
Exceptional Financing	**0.0**	**0.0**	**1.7**	**0.0**	**0.0**	**-0.3**	**-0.6**	**-0.3**	**0.0**	**0.0**	**0.0**
Of which: IMF	0.0	0.0	1.7	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
repayments	0.0	0.0	0.0	0.0	0.0	-0.3	-0.6	-0.3	0.0	0.0	0.0
Of which: Other multilaterals	0.0	0.0	0.0	0.0	0.0	0.0	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**
Memorandum Items											
Gross international reserves	13.7	16.5	12.6	11.9	7.7	8.3	9.6	9.1	9.3	9.5	9.7
In months of imports	3.5	4.3	3.4	2.6	1.6	1.9	2.2	2.1	2.1	2.1	2.2
In percent of total short-term external debt	172.4	199.1	164.7	151.7	113.4	128.8	154.6	151.6	160.8	170.5	178.9
External debt	64.0	64.5	74.7	70.6	61.2	57.7	56.9	55.3	54.9	52.4	52.0
Of which: Public sector debt	39.2	40.3	48.3	45.2	36.7	33.3	32.2	30.4	29.7	27.1	26.5
Of which: Private sector debt	24.9	24.2	26.4	25.4	24.6	24.3	24.7	24.9	25.1	25.3	25.5
International Investment Position, net	-64.2	-64.9	-71.7	-58.0	-59.4	-59.7	-61.4	-63.6	-66.0	-68.4	-70.7

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

1/ 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 Sources

	2018	2019	2020	2021	2022 Proj.	2023 Proj.	2024 Proj.	2025 Proj.	2026 Proj.	2027 Proj.	2028 Proj.
	(Millions of U.S. dollars)										
Gross Financing Requirements (A)	**5,111**	**4,884**	**3,871**	**5,437**	**7,766**	**7,258**	**7,150**	**7,656**	**7,578**	**8,743**	**8,251**
Current account deficit	859	113	-203	1,457	2,637	1,816	1,853	1,962	2,088	2,223	2,296
Public debt amortization	511	1,082	349	312	983	1,040	640	781	321	1,094	272
Private debt amortization	3,742	3,689	3,725	3,668	4,146	4,402	4,657	4,913	5,169	5,426	5,683
Gross reserves accumulation (B)	**2**	**876**	**-1,387**	**360**	**-731**	**357**	**584**	**-54**	**208**	**211**	**202**
Gross Financing Sources (C)	**5,114**	**5,760**	**2,484**	**5,796**	**7,035**	**7,615**	**7,734**	**7,602**	**7,787**	**8,954**	**8,453**
FDI (net)	826	636	281	313	66	541	773	874	879	1,026	1,015
Public sector debt disbursements	646	1,301	1,635	1,107	769	1,503	944	944	1,044	1,044	1,044
Private sector debt disbursements	4,366	5,430	5,164	4,357	4,625	4,893	5,162	5,432	5,701	5,971	6,242
Other capital flows (net)	-724	-1,606	-4,596	19	1,575	677	855	353	163	913	152
Unidentified Financing (A+B-C)	**0**	**0**	**0**	**0**	**0**	**0**	**0**	**0**	**0**	**0**	**0**
	(Percent of GDP)										
Gross Financing Requirements (A)	**19.6**	**18.2**	**15.8**	**18.9**	**24.6**	**21.5**	**20.4**	**21.0**	**20.0**	**22.2**	**20.2**
Current account deficit	3.3	0.4	-0.8	5.1	8.3	5.4	5.3	5.4	5.5	5.6	5.6
Public debt amortization	2.0	4.0	1.4	1.1	3.1	3.1	1.8	2.1	0.8	2.8	0.7
Private debt amortization	14.4	13.7	15.2	12.8	13.1	13.0	13.3	13.5	13.6	13.8	13.9
Gross reserves accumulation (B)	**0.0**	**3.3**	**-5.6**	**1.3**	**-2.3**	**1.1**	**1.7**	**-0.1**	**0.5**	**0.5**	**0.5**
Gross Financing Sources (C)	**19.7**	**21.4**	**10.1**	**20.2**	**22.3**	**22.6**	**22.0**	**20.8**	**20.5**	**22.7**	**20.7**
FDI (net)	3.2	2.4	1.1	1.1	0.2	1.6	2.2	2.4	2.3	2.6	2.5
Public sector debt disbursements	2.5	4.8	6.7	3.9	2.4	4.5	2.7	2.6	2.8	2.7	2.6
Private sector debt disbursements	16.8	20.2	21.0	15.2	14.6	14.5	14.7	14.9	15.0	15.2	15.3
Other capital flows (net)	-2.8	-6.0	-18.7	0.1	5.0	2.0	2.4	1.0	0.4	2.3	0.4
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**
Memorandum Items											
External public debt servicing (US$ million	1,000	1,573	841	890	1,633	1,857	1,456	1,541	1,036	1,776	952
Percent of GDP	3.8	5.9	3.4	3.1	5.2	5.5	4.1	4.2	2.7	4.5	2.3
Percent of exports of goods and service	13.2	19.5	13.4	10.5	16.4	17.9	13.6	13.9	9.0	14.9	7.6

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

Table 5a. El Salvador: Statement of Operations of the Nonfinancial Public Sector [1/]

	2019	2020	2021	2022	2023	2024	2025	2026	2027	2028
					Proj.					
Revenue	**24.1**	**24.9**	**26.4**	**26.5**	**25.0**	**25.0**	**25.0**	**25.0**	**25.0**	**25.0**
Taxes	17.7	18.5	20.1	20.3	19.0	19.0	19.0	19.0	19.0	19.0
Taxes on income	7.0	7.6	7.6	8.6	6.8	6.8	6.8	6.8	6.8	6.8
Taxes on property	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	8.9	9.4	10.8	10.4	10.6	10.6	10.6	10.6	10.6	10.6
Taxes on foreign trade	0.9	0.8	1.0	1.0	1.0	1.0	1.0	1.0	1.0	1.0
Other taxes	0.8	0.7	0.6	0.2	0.4	0.4	0.4	0.4	0.4	0.4
Social contributions	2.2	2.4	2.3	2.3	2.3	2.3	2.3	2.3	2.3	2.3
Other revenue	3.8	3.5	4.0	3.8	3.7	3.7	3.7	3.7	3.7	3.7
Grants	0.4	0.5	0.1	0.1	0.0	0.0	0.0	0.0	0.0	0.0
Expenditure	**27.2**	**33.1**	**32.0**	**29.0**	**28.4**	**28.4**	**28.7**	**28.7**	**30.4**	**30.4**
Expense	24.2	30.5	28.8	26.8	25.4	25.6	25.7	25.7	27.4	27.4
Compensation of employees	10.8	12.5	11.8	11.0	11.4	11.4	11.4	11.4	11.4	11.4
Purchases of goods and services	5.0	5.6	5.3	5.0	4.8	4.9	4.8	4.8	4.8	4.8
Interest	3.7	4.4	4.5	4.7	3.7	3.9	4.1	4.2	5.8	5.9
Subsidies	0.2	0.3	0.2	0.3	0.3	0.3	0.3	0.3	0.3	0.3
Social benefits	4.2	7.1	5.6	4.9	4.2	4.2	4.1	4.1	4.0	4.0
Other expense	0.5	0.7	1.4	1.0	1.0	1.0	1.0	1.0	1.0	1.0
Current	0.2	0.4	0.6	0.4	0.4	0.4	0.4	0.4	0.4	0.4
Capital	0.2	0.2	0.8	0.5	0.5	0.5	0.5	0.5	0.5	0.5
Net acquisition of nonfinancial assets	3.0	2.6	3.2	2.2	3.0	2.8	2.9	3.0	3.0	3.0
Net lending/borrowing	**-3.1**	**-8.2**	**-5.6**	**-2.5**	**-3.4**	**-3.4**	**-3.7**	**-3.7**	**-5.4**	**-5.4**
Net financial transactions	**-3.1**	**-8.2**	**-5.6**	**-2.5**	**-3.4**	**-3.4**	**-3.7**	**-3.7**	**-5.4**	**-5.4**
Net acquisition of financial assets	**0.0**	**2.0**	**-0.1**	**0.3**	**0.0**	**0.2**	**0.2**	**0.2**	**0.2**	**0.2**
Foreign	0.0	0.0	0.0	0.2	0.2	0.2	0.2	0.2	0.2	0.2
Domestic	0.0	2.0	-0.1	0.1	-0.2	0.0	0.0	0.0	0.0	0.0
Net incurrence of liabilities	**3.1**	**10.2**	**5.5**	**2.8**	**3.4**	**3.6**	**3.9**	**3.9**	**5.6**	**5.6**
Foreign	0.8	5.2	2.8	-0.7	1.4	0.9	0.4	1.9	-0.1	1.9
Loans	0.8	5.2	2.8	-0.7	1.4	0.9	0.4	1.9	-0.1	1.9
Disbursement	4.8	6.7	3.9	2.4	4.5	2.7	2.6	2.8	2.7	2.6
Amortizations	-4.0	-1.4	-1.1	-3.1	-3.1	-1.8	-2.1	-0.8	-2.8	-0.7
Domestic	2.3	5.0	2.7	3.5	2.0	2.7	3.4	2.0	5.7	3.7
Loans	2.3	4.9	2.9	3.0	2.0	2.7	3.4	2.0	5.7	3.7
Other	0.0	0.1	-0.2	0.5	0.0	0.0	0.0	0.0	0.0	0.0
Memorandum items (mill. of US$ unless otherwise specified):										
Revenue	6,488	6,110	7,594	8,372	8,443	8,777	9,104	9,471	9,832	10,215
Taxes	4,760	4,549	5,773	6,416	6,415	6,668	6,914	7,195	7,468	7,760
Expenditure	7,314	8,128	9,201	9,164	9,591	9,980	10,456	10,881	11,961	12,433
Interest	991	1,081	1,304	1,492	1,252	1,355	1,504	1,577	2,302	2,399
Net lending	-825	-2,018	-1,606	-792	-1,149	-1,203	-1,352	-1,410	-2,128	-2,219
Taxes (percent of revenue)	73.4	74.5	76.0	76.6	76.0	76.0	75.9	76.0	76.0	76.0
Compensation of employees (percent of expenditure)	39.6	37.7	36.8	37.9	40.1	40.1	39.8	39.7	37.6	37.5
Interest (percent of expenditure)	13.6	13.3	14.2	16.3	13.0	13.6	14.4	14.5	19.2	19.3
Primary balance (percent of GDP)	0.6	-3.8	-1.1	2.2	0.3	0.4	0.4	0.4	0.4	0.4
Cyclycally adjusted primary balance (percent of GDP)	0.6	-1.9	-1.1	2.1	0.1	0.4	0.4	0.5	0.5	0.4
Structural primary balance (percent of GDP)	0.6	0.0	-0.2	1.7	0.1	0.4	0.4	0.5	0.5	0.4
Fiscal impulse (percenteage points)	0.3	0.6	0.2	-1.9	1.5	-0.2	0.0	-0.1	0.0	0.1
External disbursements	1,301	1,635	1,107	769	1,503	944	944	1,044	1,044	1,044
Nominal GDP	26,881	24,563	28,737	31,606	33,744	35,090	36,467	37,917	39,383	40,893

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.

Table 5b. El Salvador: Statement of Operations of the Central Government [1/]

(Percent of GDP)

						Proj.					
	2018	2019	2020	2021	2022	2023	2024	2025	2026	2027	2028
Revenue	**19.3**	**19.1**	**19.9**	**21.0**	**21.0**	**19.8**	**19.8**	**19.8**	**19.8**	**19.7**	**19.8**
Taxes	18.0	17.7	18.5	20.1	20.3	19.0	19.0	19.0	19.0	19.0	19.0
Taxes on income	7.0	7.0	7.6	7.6	8.6	6.8	6.8	6.8	6.8	6.8	6.8
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	8.9	8.9	9.4	10.8	10.4	10.6	10.6	10.6	10.6	10.6	10.6
Taxes on foreign trade	0.9	0.9	0.8	1.0	1.0	1.0	1.0	1.0	1.0	1.0	1.0
Other taxes	1.1	0.8	0.7	0.6	0.2	0.4	0.4	0.4	0.4	0.4	0.4
Other revenue	1.0	0.9	0.9	0.9	0.7	0.7	0.7	0.8	0.8	0.8	0.8
Grants	0.2	0.4	0.5	0.1	0.1	0.0	0.0	0.0	0.0	0.0	0.0
Expenditure	**21.8**	**22.0**	**28.4**	**27.0**	**23.7**	**24.4**	**24.5**	**24.7**	**24.8**	**26.4**	**26.5**
Expense	20.4	20.6	26.6	25.0	22.2	22.1	22.3	22.4	22.4	24.1	24.1
Compensation of employees	6.5	6.7	7.8	7.3	7.0	7.4	7.4	7.4	7.4	7.4	7.4
Purchases of goods and services	2.3	2.3	2.5	2.3	2.2	2.2	2.3	2.3	2.3	2.3	2.3
Interest	3.4	3.5	4.2	4.3	4.4	3.5	3.6	3.9	3.9	5.5	5.5
Subsidies	0.0	0.0	0.1	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Grants	5.9	5.8	7.2	7.1	5.2	5.5	5.5	5.4	5.4	5.4	5.4
Current	4.5	4.4	6.0	5.4	5.2	5.5	5.5	5.3	5.3	5.3	5.3
Capital	1.4	1.4	1.2	1.7	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Social benefits	2.0	2.0	4.5	3.7	3.0	3.0	3.0	3.0	3.0	3.0	3.1
Other expense	0.3	0.3	0.3	0.3	0.4	0.4	0.4	0.4	0.4	0.4	0.4
Current	0.1	0.1	0.1	0.1	0.1	0.1	0.1	0.1	0.1	0.1	0.1
Capital	0.3	0.2	0.2	0.2	0.3	0.3	0.3	0.3	0.3	0.3	0.3
Net acquisition of nonfinancial assets	1.4	1.4	1.8	1.9	1.5	2.4	2.2	2.3	2.3	2.4	2.4
Net lending/borrowing	**-2.5**	**-2.9**	**-8.5**	**-5.9**	**-2.7**	**-4.7**	**-4.7**	**-4.9**	**-5.0**	**-6.7**	**-6.8**
Net financial transactions	**-2.5**	**-2.9**	**-8.5**	**-5.9**	**-2.7**	**-4.7**	**-4.7**	**-4.9**	**-5.0**	**-6.7**	**-6.8**
Net acquisition of financial assets	**0.1**	**0.0**	**2.0**	**-0.1**	**0.2**	**0.0**	**0.2**	**0.2**	**0.2**	**0.2**	**0.2**
Foreign	0.0	0.0	0.0	0.0	0.2	0.2	0.2	0.2	0.2	0.2	0.2
Domestic	0.1	0.0	2.0	-0.1	0.0	-0.2	0.0	0.0	0.0	0.0	0.0
Net incurrence of liabilities	**2.6**	**2.9**	**10.5**	**5.9**	**2.9**	**4.6**	**4.9**	**5.1**	**5.2**	**6.8**	**6.9**
Foreign	0.5	0.9	5.3	2.9	-0.7	1.2	0.9	0.4	1.8	-0.3	1.7
Loans	0.5	0.9	5.3	2.9	-0.7	1.2	0.9	0.4	1.8	-0.3	1.7
Disbursement	2.3	4.7	6.5	3.9	2.3	4.5	2.7	2.6	2.8	2.7	2.6
Amortizations	-1.8	-3.8	-1.2	-0.9	-3.0	-3.3	-1.8	-2.2	-0.9	-3.0	-0.8
Domestic	2.1	2.0	5.2	2.9	3.5	3.5	4.1	4.7	3.3	7.1	5.2
Loans	2.2	2.2	5.0	3.4	3.0	3.5	4.1	4.7	3.3	7.1	5.2
Other	-0.1	-0.2	0.2	-0.4	0.6	0.0	0.0	0.0	0.0	0.0	0.0
Memorandum items (mill. of US$ unless otherwise specified):											
Revenue	5,009	5,121	4,894	6,038	6,651	6,669	6,931	7,204	7,493	7,777	8,079
Taxes	4,680	4,760	4,549	5,773	6,416	6,415	6,668	6,914	7,195	7,468	7,760
Expenditure	5,667	5,903	6,975	7,745	7,489	8,242	8,598	9,004	9,395	10,402	10,840
Interest	881	933	1,034	1,246	1,375	1,178	1,275	1,415	1,484	2,166	2,258
Net lending	-658	-782	-2,080	-1,708	-838	-1,572	-1,666	-1,800	-1,902	-2,625	-2,761
Taxes (percent of revenue)	93.4	92.9	92.9	95.6	96.5	96.2	96.2	96.0	96.0	96.0	96.0
Compensation of employees (percent of expenditure)	30.1	30.6	27.4	27.1	29.6	30.4	30.3	30.1	30.0	28.1	28.0
Interest (percent of expenditure)	15.6	15.8	14.8	16.1	18.4	14.3	14.8	15.7	15.8	20.8	20.8
External disbursements	603	1,267	1,591	1,107	732	1,503	944	944	1,044	1,044	1,044
Primary balance (percent of GDP)	0.9	0.6	-4.3	-1.6	1.7	-1.2	-1.1	-1.1	-1.1	-1.2	-1.2
Nominal GDP	26,021	26,881	24,563	28,737	31,606	33,744	35,090	36,467	37,917	39,383	40,893

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.

Table 6. El Salvador: Public Sector Financing Requirements and Sources 1/

						Proj.					
	2018	2019	2020	2021	2022	2023	2024	2025	2026	2027	2028
					(Millions of U.S. dollars)						
Gross Financing Requirements	**1,979**	**3,059**	**3,847**	**4,237**	**4,974**	**5,519**	**6,053**	**6,607**	**7,205**	**8,746**	**7,868**
Overall deficit	704	825	2,018	1,606	792	1,149	1,203	1,352	1,410	2,128	2,219
Public debt amortizations	1,275	2,234	1,400	1,985	2,794	2,661	2,607	2,947	2,686	3,709	2,440
External	458	1,082	349	312	959	1,040	640	781	321	1,094	272
Multilateral and bilateral	458	282	349	312	311	436	520	433	321	294	272
Bonds	0	800	0	0	648	604	120	348	0	800	0
Domestic	817	1,152	1,051	1,673	1,835	1,621	1,967	2,166	2,365	2,615	2,168
Of which: Short-term debt (LETES) 2/	813	896	1,009	1,508	1,532	1,591	1,701	1,771	1,841	1,902	1,951
Other	0	0	429	646	1,388	1,709	2,244	2,309	3,109	2,909	3,209
Sources of Financing	**1,886**	**3,059**	**3,847**	**4,237**	**4,974**	**5,519**	**6,053**	**6,607**	**7,205**	**8,746**	**7,867**
Domestic	1,338	1,675	2,212	3,130	4,204	4,016	5,110	5,664	6,161	7,702	6,824
Pension bonds	366	346	271	291	318	319	313	307	301	293	285
Drawdown of deposits	16	89	-65	24	-21	75	0	0	0	0	0
Short-term debt (LETES) 2/	833	991	1,427	1,417	1,628	1,701	1,771	1,841	1,902	1,951	1,951
Others	123	249	578	1,398	2,279	1,921	3,025	3,516	3,958	5,458	4,588
External	548	1,384	1,635	1,107	769	1,503	944	944	1,044	1,044	1,044
Multilateral and bilateral 3/	548	287	635	1,107	769	1,503	944	944	1,044	1,044	1,044
Bonds	0	1,097	1,000	0	0	0	0	0	0	0	0
Unidentified Financing	**93**	**0**	**0**	**0**	**0**	**0**	**0**	**0**	**0**	**0**	**0**
					(Percent of GDP)						
Gross Financing Requirements	**7.6**	**11.4**	**15.7**	**14.7**	**15.7**	**16.4**	**17.3**	**18.1**	**19.0**	**22.2**	**19.2**
Overall deficit	2.7	3.1	8.2	5.6	2.5	3.4	3.4	3.7	3.7	5.4	5.4
Public debt amortizations	4.9	8.3	5.7	6.9	8.8	7.9	7.4	8.1	7.1	9.4	6.0
External	1.8	4.0	1.4	1.1	3.0	3.1	1.8	2.1	0.8	2.8	0.7
Multilateral and bilateral	1.8	1.0	1.4	1.1	1.0	1.3	1.5	1.2	0.8	0.7	0.7
Bonds	0.0	3.0	0.0	0.0	2.1	1.8	0.3	1.0	0.0	2.0	0.0
Domestic	3.1	4.3	4.3	5.8	5.8	4.8	5.6	5.9	6.2	6.6	5.3
Of which: Short-term debt (LETES) 2/	3.1	3.3	4.1	5.2	4.8	4.7	4.8	4.9	4.9	4.8	4.8
Other	0.0	0.0	1.7	2.2	4.4	5.1	6.4	6.3	8.2	7.4	7.8
Sources of Financing	**7.2**	**11.4**	**15.7**	**14.7**	**15.7**	**16.4**	**17.3**	**18.1**	**19.0**	**22.2**	**19.2**
Domestic	5.1	6.2	9.0	10.9	13.3	11.9	14.6	15.5	16.2	19.6	16.7
Pension bonds	1.4	1.3	1.1	1.0	1.0	0.9	0.9	0.8	0.8	0.7	0.7
Drawdown of deposits	0.4	0.3	-0.3	0.1	-0.1	0.2	0.0	0.0	0.0	0.0	0.0
Short-term debt (LETES) 2/	3.2	3.7	5.8	4.9	5.2	5.0	5.0	5.0	5.0	5.0	4.8
Others	0.5	0.9	2.4	4.9	7.2	5.7	8.6	9.6	10.4	13.9	11.2
External	2.1	5.1	6.7	3.9	2.4	4.5	2.7	2.6	2.8	2.7	2.6
Multilateral and bilateral	2.1	1.1	2.6	3.9	2.4	4.5	2.7	2.6	2.8	2.7	2.6
Bonds	0.0	4.1	4.1	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Unidentified Financing	**0.4**	**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.

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. Aditionally, 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 for Financial System

							Proj.				
	2018	2019	2020	2021	2022	2023	2024	2025	2026	2027	2028
	(End of period stocks; in millions of U.S. dollars)										
	I. Central Bank										
Net Foreign Assets	**3,152**	**3,754**	**2,252**	**2,336**	**1,167**	**1,410**	**1,547**	**1,632**	**1,791**	**1,951**	**2,120**
Of which: Gross international reserves 1/	3,569	4,446	3,083	3,426	2,440	2,798	3,382	3,328	3,536	3,747	3,949
Of which: Gross international reserves net of liabilities 2/	464	792	695	750	318	387	833	635	689	739	771
Net Domestic Assets	**97**	**28**	**187**	**373**	**960**	**856**	**856**	**856**	**856**	**856**	**855**
Nonfinancial public sector (net)	616	617	580	604	1,001	896	896	896	896	896	895
Claims	835	834	834	833	1,199	1,199	1,199	1,199	1,199	1,199	1,199
Liabilities	219	217	254	229	198	303	303	303	303	303	304
Rest of the financial system (net)	122	91	-115	56	-63	-63	-63	-63	-63	-63	-63
Other items (net)	-640	-680	-278	-287	22	22	22	22	22	22	22
Liabilities	**3,252**	**3,785**	**2,437**	**2,704**	**2,127**	**2,418**	**2,556**	**2,701**	**2,855**	**3,016**	**3,185**
Base Money	3,107	3,655	2,390	2,678	2,124	2,415	2,553	2,698	2,852	3,013	3,182
Liabilities to depositary corporations 3/	3,104	3,654	2,388	2,676	2,122	2,410	2,548	2,693	2,847	3,008	3,177
Other liabilities to the public	145	130	48	26	3	3	3	3	3	3	3
	II. Depository Corporations										
Net Foreign Assets	**-749**	**-657**	**498**	**-144**	**-577**	**-563**	**-609**	**-652**	**-694**	**-734**	**-773**
Net Domestic Assets	**14,015**	**15,411**	**15,730**	**17,040**	**18,210**	**19,381**	**20,512**	**21,695**	**22,953**	**24,259**	**25,630**
Nonfinancial public sector (net)	758	927	1,776	2,366	2,716	3,110	3,469	3,800	3,894	4,454	4,786
Claims	1,000	1,185	2,208	2,657	2,986	3,440	3,810	4,180	4,540	4,889	5,189
Of which: LETES, CETES, and securities	827	981	1,996	2,366	2,680	3,167	3,537	3,907	4,268	4,617	4,917
Liabilities	242	258	432	291	270	330	341	380	647	436	403
Rest of the financial system (net)	2,332	2,784	1,713	1,967	1,362	1,585	1,656	1,830	2,013	2,203	2,403
Of which: Reserve requirements	3,029	3,532	2,265	2,539	2,020	2,303	2,441	2,586	2,740	2,901	3,070
Credit to the private sector	13,280	14,063	14,370	15,254	16,898	17,452	18,154	18,776	19,646	20,285	21,016
Other items (net)	-2,355	-2,363	-2,129	-2,546	-2,766	-2,766	-2,766	-2,711	-2,600	-2,683	-2,575
Liabilities to the Private Sector	**13,266**	**14,755**	**16,228**	**16,911**	**17,669**	**18,817**	**19,904**	**21,043**	**22,259**	**23,525**	**24,858**
Deposits	12,831	14,286	15,704	16,298	16,986	18,135	19,221	20,360	21,576	22,842	24,175
Securities	435	468	524	613	683	683	683	683	683	683	683
	III. Other Financial Corporations 4/										
Net Foreign Assets	**252**	**275**	**867**	**830**	**524**	**381**	**461**	**427**	**431**	**441**	**451**
Net Domestic Assets	**11,162**	**12,153**	**12,437**	**13,320**	**14,209**	**14,619**	**14,895**	**15,402**	**16,057**	**17,193**	**18,315**
Nonfinancial public sector (net)	9,059	9,579	10,209	10,674	11,040	11,312	11,976	12,840	13,755	14,869	15,984
Rest of the financial system (net)	1,745	2,059	1,598	1,358	1,408	1,501	1,590	1,633	1,679	1,727	1,776
Credit to the private sector	1,624	1,817	1,911	2,503	3,057	3,190	2,914	2,744	2,701	2,974	3,273
Other items (net)	-1,323	-1,351	-1,324	-1,247	-1,318	-1,407	-1,610	-1,840	-2,105	-2,405	-2,747
Liabilities to the Private Sector	**11,415**	**12,428**	**13,305**	**14,150**	**14,733**	**14,999**	**15,356**	**15,829**	**16,489**	**17,634**	**18,766**
Pension fund contributions	11,074	12,087	12,951	13,801	14,380	14,623	14,769	14,914	15,062	15,412	15,766
	IV. Financial System										
Net Foreign Assets	**2,655**	**3,372**	**3,618**	**3,022**	**1,114**	**1,227**	**1,400**	**1,407**	**1,529**	**1,658**	**1,799**
Net Domestic Assets	**22,684**	**24,593**	**26,620**	**28,456**	**31,765**	**33,124**	**34,604**	**36,537**	**38,803**	**41,881**	**44,982**
Net claims on nonfinancial public sector	10,433	11,124	12,564	13,643	14,757	15,318	16,341	17,536	18,545	20,219	21,666
Credit to private sector	14,904	15,880	16,282	17,757	19,955	20,641	21,068	21,520	22,348	23,259	24,289
Other	-2,653	-2,410	-2,226	-2,944	-2,947	-2,836	-2,805	-2,519	-2,090	-1,598	-973
Liabilities to the Private Sector	**25,339**	**27,965**	**30,238**	**31,479**	**32,879**	**34,351**	**36,004**	**37,943**	**40,331**	**43,539**	**46,781**
Money	3,623	4,047	4,570	4,884	4,728	4,765	4,793	4,851	4,922	4,997	5,073
Quasi-money	10,643	11,831	12,717	12,793	13,771	14,962	16,441	18,178	20,347	23,130	25,941
Pension fund contributions	11,074	12,087	12,951	13,801	14,380	14,623	14,769	14,914	15,062	15,412	15,766
Memorandum Items	(Percent changes relative to previous year's liabilities to the private sector)										
Net domestic assets	11.8	13.4	12.8	10.6	18.7	7.3	7.5	9.1	9.8	12.2	11.0
Nonfinancial public sector	6.4	4.8	9.1	6.2	6.3	3.0	5.2	5.6	4.4	6.6	5.1
Credit to the private sector	6.7	6.8	2.5	8.5	12.4	3.7	2.2	2.1	3.6	3.6	3.7
Liabilities to the private sector	12.1	18.4	14.3	7.2	7.9	8.0	8.4	9.1	10.4	12.7	11.5
	(Percent of GDP)										
Credit to the private sector	57.3	59.1	66.3	61.8	63.1	61.2	60.0	59.0	58.9	59.1	59.4
Liabilities to the private sector	97.4	104.0	123.1	109.5	104.0	101.8	102.6	104.0	106.4	110.6	114.4
Excluding pension contributions	54.8	59.1	70.4	61.5	58.5	58.5	60.5	63.2	66.6	71.4	75.8
	(Annual percentage change)										
Credit to the private sector	6.5	6.5	2.5	9.1	12.4	3.4	2.1	2.1	3.8	4.1	4.4
Private sector deposits in depository corporations	5.7	11.3	9.9	3.8	4.2	6.8	6.0	5.9	6.0	5.9	5.8
Depository corporations liquid deposits at central bank (In percent of total deposits)	24.2	25.6	15.2	16.4	12.5	13.3	13.3	13.2	13.2	13.2	13.1

Sources: Central Reserve Bank of El Salvador and IMF staff estimates.
1/ 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.
2/ Gross international reserves of the BCR excluding required and excess reserve requirements of depository corporations.
3/ Required and excess reserve requirements of depository corporations at the BCR.
4/ Includes private pension funds, insurance corporations, and the State Development Bank.

Table 8. El Salvador: Selected Vulnerability Indicators
(In percent of GDP, unless otherwise indicated)

						Est.		
	2017	2018	2019	2020	2021	2022	2023	2024
Fiscal Indicators								
Overall balance of the nonfinancial public sector	-2.5	-2.7	-3.1	-8.2	-5.6	-2.5	-3.4	-3.4
Primary balance of the nonfinancial public sector	0.7	0.9	0.6	-3.8	-1.1	2.2	0.3	0.4
Gross public sector financing requirement	10.1	7.6	11.4	15.7	14.7	15.7	16.4	17.3
Public sector debt (gross)	70.5	70.4	71.3	89.4	82.4	77.2	76.1	78.3
Public sector external debt	34.9	33.3	33.8	41.6	38.2	31.4	28.0	27.0
External interest payments to total fiscal revenue (percent)	7.2	8.3	8.5	11.2	8.7	9.3	9.5	9.6
External amortization payments to total fiscal revenue (percent)	10.3	8.0	16.7	5.7	4.1	11.7	12.3	7.3
Financial Indicators								
Broad money (percent change, end-of-period)	11.1	6.1	11.3	8.9	2.3	4.6	6.6	7.6
Private sector credit (percent change, end-of-period)	5.1	6.5	6.5	2.5	9.1	12.4	3.4	2.1
Ratio of capital to risk-weighted assets	16.8	17.9	16.0	15.4	15.8	15.4	...	...
Ratio of loans more than 90 days past due to total loans	1.9	1.8	1.7	1.6	1.8	1.8	...	...
Ratio of provisions to total loans	2.3	2.4	2.2	3.2	2.9	2.8	...	...
Ratio of provisions to loans more than 90 days past due	122.1	129.2	128.7	205.2	160.5	145.8	...	...
Return on average equity	7.4	7.8	9.1	6.9	11.5	21.4	...	...
Return on average total assets	1.4	1.5	1.6	1.1	1.7	2.5	...	...
Loans as percent of deposits	104.8	105.0	99.6	90.5	94.1	95.9	...	...
Ratio of liquid assets to total assets	22.4	22.1	23.3	19.7	20.1	19.5	...	...
External Indicators								
Exports of goods and services (percent change, 12-month basis)	5.1	4.7	6.5	-21.9	34.9	17.6	4.0	3.1
Imports of goods and services (percent change, 12-month basis)	5.8	8.7	1.2	-13.7	46.4	17.5	-3.5	2.6
Current account balance	-1.9	-3.3	-0.4	0.8	-5.1	-8.3	-5.4	-5.3
Capital and financial account balance	1.3	5.5	-1.7	10.0	2.8	6.2	2.7	2.2
Gross international reserves (millions of U.S. dollars)	3,567	3,569	4,446	3,083	3,426	2,440	2,798	3,382
Months of imports of goods and services, excluding maquila	3.7	3.6	5.2	2.5	2.3	1.7	1.9	2.2
Percent of short-term debt	175	172	199	165	152	113	129	155
Percent of gross external financing requirements	75	70	91	80	63	31	39	47
Percent of broad money	26.5	25.0	28.0	17.8	19.4	13.2	14.2	15.9
Public external debt service	4.4	3.9	5.9	3.7	3.1	5.1	5.1	3.9
External debt to exports of goods and services (percent)	228	220	215	291	239	194	187	186
External interest payments to exports of goods and services (percent)	-20.9	-21.7	-18.9	-22.7	-20.2	-19.5	-21.1	-20.5
External amortization to exports of goods and services (percent)	59.1	56.2	59.2	64.7	46.9	51.4	52.4	49.5
REER, depreciation is negative (percent change, end-of-period)	-3.7	1.4	-2.6	-2.8	2.6	-0.8	0.1	-0.1

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

Table 9. El Salvador: Structure of the Financial System

	Number	Assets (million of USD)	Percent of total assets	Percent of GDP*
Commercial Banks	**14**	**21,942**	**51.8**	**76.4**
Of which				
Foreign-owned banks	10	18,721	44.2	**65.2**
Public sector-owned banks	2	2240	5.3	**7.8**
Domestic-owned banks	2	981	2.3	**3.4**
Nonbank intermediaries	**348**	**5,087**	**12.0**	**17.7**
Cooperatives including Federation	7	2,097	4.9	**7.3**
Cooperatives INSAFOCOOP	337	2,404	5.7	**8.4**
SAC-*Saving and credit companies*	4	587	1.4	**2.0**
Pension Funds/AFPs	**2**	**14,323**	**33.8**	**49.9**
Insurance companies	**24**	**1,009**	**2.4**	**3.5**
Financial services companies	**26**	**23**	**0.1**	**0.1**
Total financial system	**414**	**42,385**	**100**	**148**

Sources: Banco Central de la Reserva, INSAFOCOOP and IMF staff estimates and calculation.
*GDP is 2021

Source: Banco Central de la Reserva and IMF staff estimates and calculations.

Table 10. El Salvador: Financial Soundness Indicators
(In percent)

	2018	2019	2020	2021	2022
Capital adequacy					
Regulatory capital to risk-weighted assets	17.9	16.0	15.4	15.8	15.4
Tier 1 capital to risk-weighted assets	14.3	13.0	12.5	12.7	12.0
Asset quality					
Nonperforming loans to total gross loans	1.8	1.7	1.6	1.8	1.8
Nonperforming loans net of provisions to capital	-3.2	-3.0	-9.9	-6.7	-6.0
Credit growth to private sector	6.0	5.8	1.6	6.3	10.7
Domestic sovereign debt to total assets	5.4	6.1	8.8	10.2	11.1
Covid-19 loans to total gross loans			30.8	8.8	6.0
Profitability					
Return on assets	1.5	1.6	1.1	1.7	2.5
Return on equity	7.8	9.1	6.9	11.5	21.4
Interest margin to gross income	78.7	78.2	81.0	73.4	*77.5
Noninterest expenses to gross income	58.6	58.4	57.1	53.8	*54.2
Liquidity					
Liquid assets to total assets	22.1	23.3	19.7	20.1	*19.5
Liquid assets to short-term liabilities	32.9	34.2	27.7	28.2	*27.3
Customer deposits to total (noninterbank) loans	95.2	100.4	110.5	106.3	100.3
Legal liquidity reserves to total deposits	24.1	24.9	14.8	16.9	11.5

Sources: IMF Financial Soundness Indicators and BCR data
Note: No liquidity coverage or net stable funding ratio are in force.
* 2022Q2 data

Table 11. El Salvador: Risk Assessment Matrix[1]

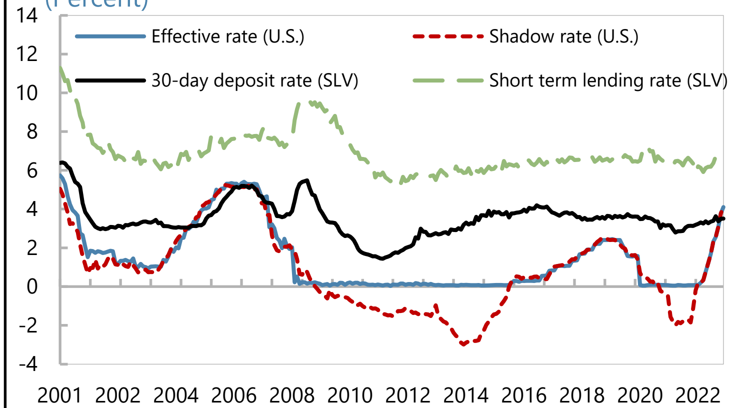
Source of Risk	Likelihood/ Impact	Policy Response
Global Risks		
Abrupt global slowdown or recession. Amid tight labor markets, supply disruptions and commodity price shocks, inflation remains elevated for longer, prompting the Fed to tighten policies further, or keep rates high for longer, and resulting in a "hard landing", housing market correction, and a stronger dollar.	Medium Likelihood High Impact	Implement fiscal consolidation to reduce financing needs and strengthen financial buffers. Improve financial sector liquidity buffers.
Debt and financial crises. Sharp increases in interest rates and risk premia amid growth downturns bring debt service burdens to unsustainable levels, causing defaults or distressed restructurings of private debts. This triggers a chain of insolvencies in banks or non-banks and capital outflows, stressing financial system, dominated by foreign banks in El Salvador.	Medium Likelihood High Impact	Implement fiscal consolidation. Adopt bankruptcy resolution frameworks. Strengthen the financial safety net. Facilitate trade in the region and with the new markets, and undertake reforms aimed at raising export competitiveness.
Extreme events caused by climate change. More frequent extreme climate events deal increasingly severe damage to infrastructure (especially in smaller vulnerable economies) and loss of human lives and livelihoods, amplifying supply chain disruptions and inflationary pressures, causing water and food shortages, and reducing medium-term growth.	Medium Likelihood High Impact	Improve resilience to negative climatic shocks by implementing appropriate adaptation and mitigation measures. 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.
Sharp balance of payments adjustment. A sudden stop could trigger sharp adjustment in the current account and heighten liquidity demand, including from banks. In the absence of sufficient backstop for ELA framework, depleted gross international reserves, and lack of a banking resolution framework, such liquidity crunch could result in a disorderly adjustment and assets sell-off.	Medium Likelihood High Impact	Increase reserve requirements to 15 percent of liabilities and eventually restore pre-pandemic liquidity buffers. Recapitalize the central bank, to prop up its ability to provide ELA. Advance to the liquidity risk-based Basel III regulatory and supervisory framework and adopt resolution framework.
Domestic Risks		
Domestic policy slippages. In the absence of a credible fiscal and financing strategy, the likelihood of expensive measures—e.g., price caps and untargeted subsidies—is high, which could deteriorate the fiscal position further and worsen financial stability risks.	High Likelihood High Impact	Forge consensus between the Executive, the Legislative Assembly, and the private sector to address the fiscal situation and financial stability risks. Accelerate implementation of transparency and governance agenda for predictable policies to foster credibility.
Deterioration in the quality of political institutions. The absence of checks and balances—including because of the regime of exception—could dampen investor confidence and hamper growth, especially if frictions with the U.S. on trade and capital inflows emerge.	Medium Likelihood High Impact	The authorities should prioritize measures that will deliver growth, sustainability of public finances and financial stability to prep up investors' confidence. Efforts should continue in protecting judicial independence and in ensuring impartial access to the court system to attract investment and enhance the business climate.
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 *Chivo* and the crypto 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.

Annex I. Global Financial Conditions and the Interest Rate Passthrough to El Salvador[1]

1. The passthrough of interest rates from the U.S. Federal Funds Rate to Salvadoran banks' rates has declined over time. The weighted average interest rates for short term deposits (30-day horizon) and for short-term lending (maturity less than one year) have not yet reacted to the recent increases in the Federal Funds Rate. In the early 2000s, interest rates in El Salvador clearly followed rates in the U.S., albeit with a small lag and lower volatility. Over time, however, this relationship has faded. After the Global Financial Crisis, unconventional monetary policy ensured that financial conditions in the U.S. kept easing (as captured by the Wu and Xia (2016) shadow rate), but deposit rates in El Salvador increased and lending rates stayed roughly constant. During the 2017-18 tightening cycle, deposit and lending rates in El Salvador barely responded to the actions of the Federal Reserve.

Deposit and Lending Rates in El Salvador
(Percent)



Source: BCR / Haver Analytics

2. On average over 2001-2022, a 100-basis point increase in the shadow rate has been associated with a 24-basis point increase in the deposit rate in El Salvador.[2] The estimated passthrough for deposit rates declined from 48 percent in the first half of the sample to just 6 percent in the second half of the sample. Lending rates generally responded by less to changes in the shadow rate, increasing by just 8 basis points for each 100-basis point increase in the US shadow rate (since the model is linear, the effect is symmetric for decreases in US interest rates).

3. The limited passthrough observed may be explained by the funding structure of Salvadoran banks. Although the interest rate banks pay on external debt does follow the U.S. shadow rate quite closely, external financing only represents a small proportion of banks' funding (8 percent). Given low passthrough to deposit and lending rates, banks in general do not pass on the variation in the cost of external debt to their depositors and debtors, accepting lower profits at the margin when the extension of credit is financed by international borrowing. A similar

[1] Prepared by Tristan Hennig.

[2] Estimates are obtained using a simple predictive passthrough model (following Swiston, 2011) of the form $\Delta r_t = \beta_1 + \beta_2 \Delta mpr_t + \beta_3 \Delta mpr_{t-1} + \beta_4 \Delta r_{t-1} + \epsilon_t$, where r_t is the local rate and mpr_t is the monetary policy rate. The model is specified in differences due to the non-stationarity of the series involved. Long-run passthrough is given by $(\beta_2 + \beta_3) / (1 - \beta_4)$.

phenomenon has been noted in Panama (Cerdeiro and Shi, 2015). Should local deposits become scarcer, however, bank competition would likely drive interest rates closer to international levels.

Annex I. Table 1. El Salvador: Regression Estimates

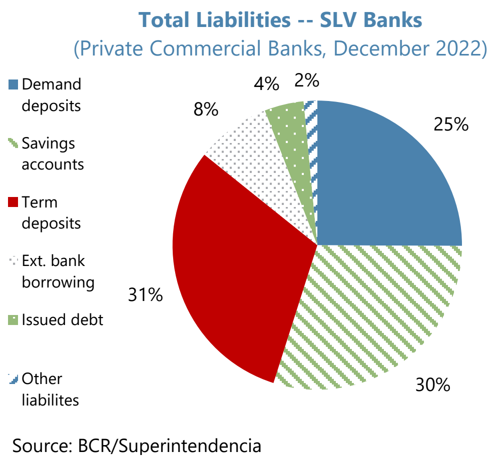
VARIABLES	(1) deposit rate (change)	(2) deposit rate (change)	(3) deposit rate (change)	(4) lending rate (change)	(5) lending rate (change)	(6) lending rate (change)
Timeframe	2001-2011	2012-2022	2001-2022	2001-2011	2012-2022	2001-2022
Shadow rate (change)	0.0385	0.0377	0.0611	0.0127	-0.0358	0.0109
	(0.0496)	(0.0512)	(0.0404)	(0.114)	(0.0787)	(0.0704)
Shadow rate (lagged change)	0.161***	0.0382	0.108***	0.132	-0.00578	0.0792
	(0.0502)	(0.0516)	(0.0410)	(0.113)	(0.0787)	(0.0703)
Deposit rate (lagged change)	0.588***	-0.340***	0.295***			
	(0.0663)	(0.0856)	(0.0587)			
Lending rate (lagged change)				-0.0101	-0.344***	-0.0947
				(0.0888)	(0.0854)	(0.0624)
Constant	-0.00517	0.0183*	-0.00568	-0.0360	0.0135	-0.0174
	(0.0116)	(0.0106)	(0.00877)	(0.0263)	(0.0162)	(0.0153)
Observations	130	129	259	130	129	259
R-squared	0.478	0.124	0.165	0.013	0.115	0.015

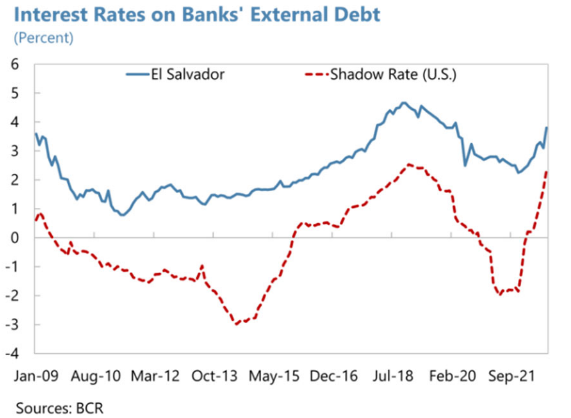
Standard errors in parentheses
*** p<0.01, ** p<0.05, * p<0.1

Annex I. Table 2. El Salvador: Pass-through Estimates

VARIABLES	(1) deposit rate	(2) deposit rate	(3) deposit rate	(4) lending rate	(5) lending rate	(6) lending rate
Timeframe	2001-2011	2012-2022	2001-2022	2001-2011	2012-2022	2001-2022
Estimated passthrough	0.4848***	0.0567	0.2405***	0.1429	-0.0310	0.0823
	(0.1425)	(0.0387)	(0.0612)	(0.1253)	(0.0593)	(0.0679)

Standard errors in parentheses.
*** p<0.01, ** p<0.05, * p<0.1

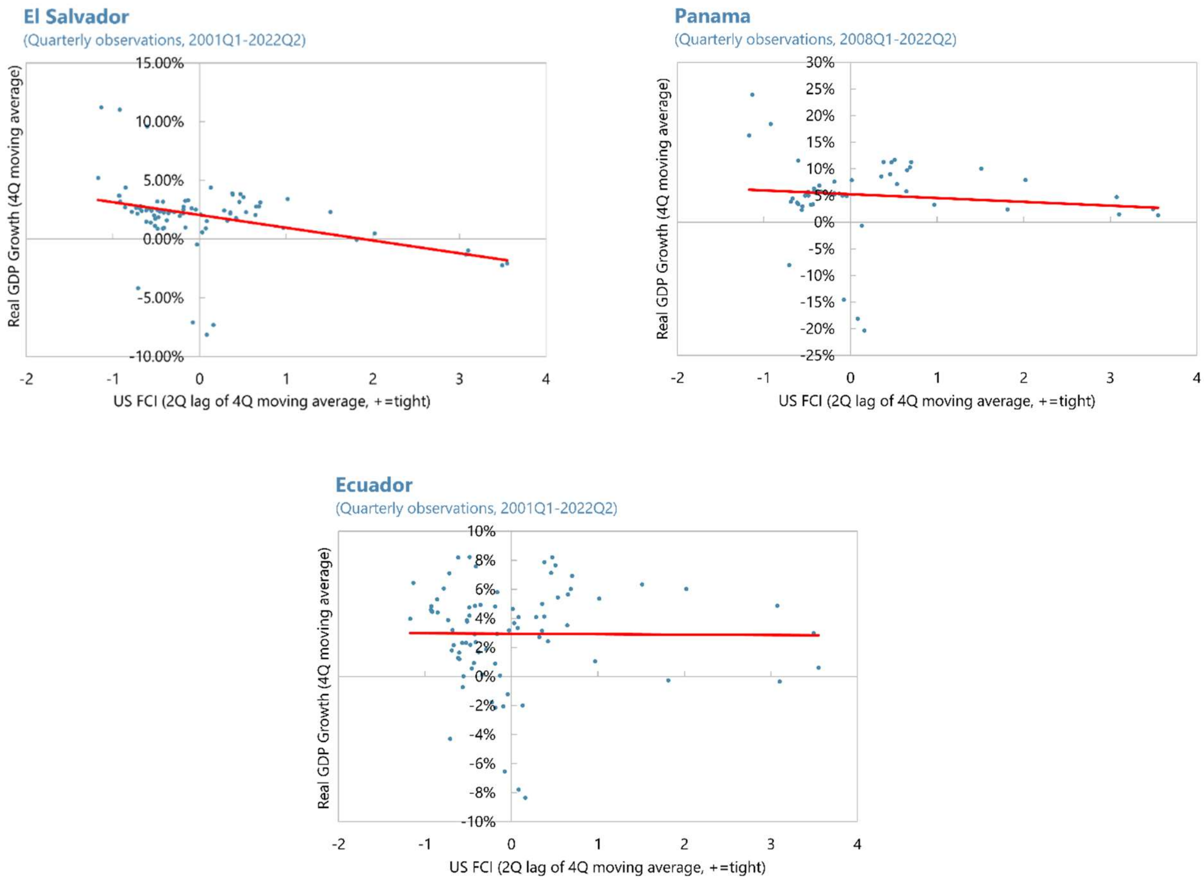




4. Notwithstanding limited recent passthrough of interest rates, the real economy of El Salvador is highly dependent on economic conditions in the United States. In 2021, almost 40 percent of Salvadoran exports went to the U.S. and US$7 billion of remittances (93 percent of remittances to El Salvador) originated from the United States. Because U.S. financial conditions have a strong effect on U.S. economic activity, a one-point increase (tightening) in the U.S. financial conditions index is associated with a fall in real GDP by 1.1 percentage point. This sensitivity appears stronger than in Panama and Ecuador, countries that also use the U.S. dollar as their national currency but that benefit from global sources of income (the Canal in the case of Panama and oil exports in the case of Ecuador).[3]

[3] References: Swiston, A. (2011), Official Dollarization as a Monetary Regime: Its Effects on El Salvador, IMF Working Paper 11/129; Cerdeiro, D. and Shi, W., 2018. Interest Rates in Panama: U.S. Pass-Through and its Effects on Local Economic Activity. IMF Country Report No. 15/238; Superintendencia de Bancos de Panamá, 2021. Análisis del Comportamiento de las Tasas de Interés en el Sistema Bancario Nacional; Wu, J.C., and Xia, F.D., 2016. Measuring the macroeconomic impact of monetary policy at the zero lower bound. *Journal of Money, Credit and Banking*, 48 (2-3), pp.253-291.

Financial Conditions and GDP Growth



Annex II. Should a Country Buy Back Its "Distressed" Debt?[1]

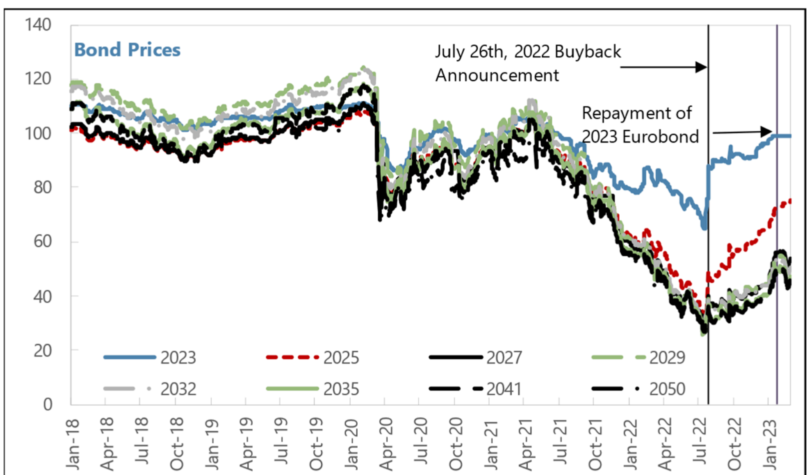
Financial Impact of the 2022 Debt Buybacks Million of US$	
Savings for the public sector	
Principal	222
Interest (accrued)	67
Financial cost of SDR bond 1/	-254
Net savings for NFPS	35

Source: Salvadorian authorities and Fund staff estimates

1/ Discounted at 12 percent interest rate

1. **In September and December 2022, El Salvador completed two buybacks of its Eurobonds in regular debt management operations.** It repurchased US$648 million in Eurobonds maturing in 2023 and 2025 at average prices of US$93 and US$58, respectively. These prepayments produced a cash flow savings for the country of US$289 million in interest and principal payments over the next several years, improving the debt service profile. From a sovereign balance sheet perspective, the net effect of reserves drawdown and debt reduction resulted in a positive net worth of US$205 million in nominal terms and US$159 million in present value terms (at a 12 percent discount rate).[2] Moreover, the internal rate of return of the combined transaction was 40 percent, much higher than any discount rate applicable for El Salvador. Following announcements of the buyback operations, El Salvador bonds rallied. The 2023 and 2025 bonds—the targets of the transactions—rallied the most, by around US$25 each. The 2027 and 2029 bonds went up in price by around US$5 to US$10. El Salvador bonds continued to perform well during the fall and winter, with the 2027 and 2029 bonds rising an additional US$20 by the time the remaining 2023 bonds matured and were fully repaid on January 24, 2023.

2. **A transaction that makes money for both creditors and debtors seem a win-win situation, but is that the case here?** A key feature is that the buyback occurred at prices well below par because the bond market assigned a high probability of default to El Salvador. One strand of the literature (Bulow and Rogoff, 1988) suggests that if a sovereign is indeed at risk of default, the benefits of a buyback always accrue to the creditors. That literature argues that the price of a buyback inevitably strays away from the fair market price; the low price seen prior to the announcement of the exchange



Source: Bloomberg.

[1] Prepared by Joe Kogan and Eriko Togo (both MCM).

[2] The operation does not generate savings for the Treasury, however. The SDRs used by the Treasury for the buyback were held by the central bank and exchanged for a Treasury bond, now held by the central bank. To protect the financial position of the central bank, this 10-year bond has a face value of SDR 275 million and a coupon of SOFR+8 percent, with present value cost to Treasury of US$252 million (at the 12 percent discount rate).

increases significantly once the exchange is announced and the exchange must occur at this higher price. Indeed, the post-announcement rally in El Salvador sovereign bonds is a measure of such benefits accruing to bondholders. Another way to see this point is to consider how the risk of default causes the savings calculation outlined above to fall apart. If sovereign default becomes inevitable, then there is no sense in calculating cost savings from the prepayment relative to a scenario where El Salvador pays all scheduled principal and interest on time and in full. Instead, the amount of the prepayment should be compared with the magnitude of expected future payments considering default and non-default scenarios. The amount of future payment reduction in that revised calculation would be significant. For example, according to Moody's historical analysis,[3] recovery rates in restructurings range from 17 to 95 percent, with an issuer-weighted average of 53 percent and a value-weighted average of 40 percent.

3. Another strand of the literature suggests that if informational asymmetries exist between creditors and debtors on the default probability, then a buyback is indeed a win-win strategy. Those asymmetries are more likely to occur in small countries for which investors have access to fewer analyses on policy space and policy priorities. If, for example, El Salvador knows it has higher buffers than the market is aware of, then the buyback can make sense for both sides. In other words, if the sovereign knows it will not default, then the savings are real. Meanwhile, the buyback provides a credible signal that El Salvador will not default to markets. Indeed, El Salvador bonds responded positively to the buyback because it was interpreted as a signal from the government that it has a strong willingness to pay. Nevertheless, even after the buyback and the January 24th payment on maturing bonds, long-dated bond prices have remained around US$50, implying that information asymmetry cannot be the only reason why bond prices were so low.

4. Sovereigns often buy back their own distressed debt when a new source of affordable funding was identified. Recent examples are the blue-bond issuances and debt-for-nature swaps. The Nature Conservancy, with the help of official donors, has successfully participated in three such buybacks for Seychelles, Belize, and Barbados (see Chamon and others 2022).[4] If such concessional funding is only available for a buyback, then the buyback may indeed provide net savings to the sovereign because of the grant component of the financing. This was not the case for El Salvador, as it used its own reserves to finance the buyback.

5. Generally, the gains to bondholders and the short-term cost savings for El Salvador need to be weighed against the broader costs to El Salvador and its remaining creditors. With no access to international bond markets, El Salvador has few sources of financing. By using its SDRs or budget support from regional development banks to prepay the Eurobonds, the country has used up the few buffers it has, leaving little cushion to handle further shocks. By prepaying debt, El Salvador has thus prioritized external debt service in the near-term over other expenses, including domestic expenditure and servicing remaining outstanding debt. One rating agency thus

[3] Moody's Investor Service, "Sovereign default and recovery rates, 1983-2021," April 14, 2022.

[4] Debt-for-Climate Swaps: Analysis, Design, and Implementation, IMF Working Paper 22/162.

downgraded El Salvador explaining that the buyback lowered expected future repayments to bondholders.

6. **Even if an informational asymmetry exists, using repeatedly this asymmetry is not a long-term strategy for a country that wishes to regain market access.** Although the buybacks were regular debt management operations, another rating agency classified the buyback as a distressed exchange (a selective default under its definition), under the justification that it implied losses to bondholders compared to the promise of full payment. Regaining market access would require a comprehensive fiscal and financial plan that mitigates credit risk and provides clarity to bondholders.

Annex III. External Sector Assessment

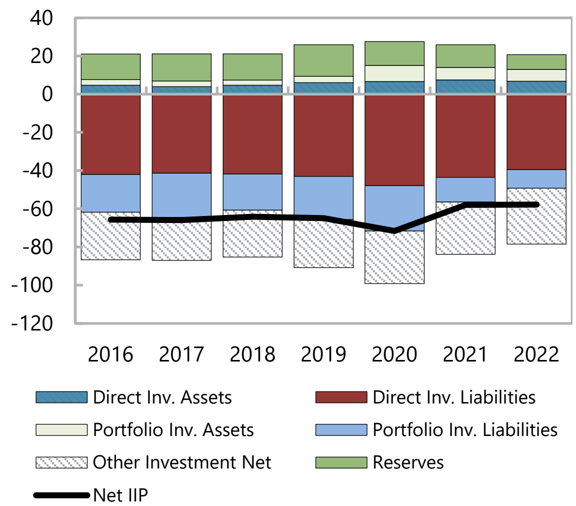
Overall Assessment. *The external position of El Salvador in 2022 is assessed to be weaker than the level implied by fundamentals and desirable policies. This assessment reflects the large current account deficit (estimated at -8.3 percent of GDP), the negative NIIP, the low level of reserves, and the loss of market access for the sovereign.*

Potential Policy Responses. *A substantial fiscal consolidation is urgently required to ensure medium-term debt sustainability. Immediate efforts are also needed to shore up the low level of international reserves to increase the resilience of the financial system to adverse external shocks. Over the medium term, structural reforms to raise productivity, increase resilience against climate change, and attract foreign direct investment would further strengthen the country's competitiveness.*

Foreign Assets and Liabilities: Position and Trajectory

Background. El Salvador's negative overall IIP position is driven by low levels of foreign assets and international reserves as well as accumulated FDI liabilities and other external borrowing. Besides reserves (7.5 percent of GDP), the country's foreign assets consist mainly of other investment (15 percent of GDP, mostly private sector currency deposits in foreign banks). Foreign liabilities are dominated by direct investment (40 percent of GDP) and other liabilities (44 percent of GDP) such as loans from multilaterals. With the sovereign lacking market access and Eurobond prices falling, portfolio investment liabilities were reduced from 22 percent of GDP in 2020 to about 10 percent in 2022.

International Investment Position
(Percent of GDP)



Source: BCR / Haver Analytics.

Assessment. The NIIP position, expressed in percent of GDP, is estimated to remain unchanged in 2022 as high nominal GDP growth and valuation effects counterbalance the drop in reserves and increased borrowing from multilaterals. The absence of FX risks and the fact that the FDI stock is the main driver of the negative IIP mitigate risks arising from the persistently negative IIP (such as sudden capital outflows). However, the low level of international reserves is a vulnerability, as liquid buffers may be too small to address negative shocks to the balance of payments.

2022 (% GDP)	NIIP: -58	Gross Assets: 36	Debt Assets: 20	Gross Liab.: 94	Debt Liab.: 60

Current Account

Background. The current account deficit is estimated at 8.3 percent of GDP in 2022, substantially higher than 2021's deficit of 5.1 percent of GDP. The main driver of this deterioration was the worsening of the merchandise trade balance. While the value of goods exports grew 11.3 percent, goods imports leapt 17 percent. The oil balance widened from -6.4 to -8.5 percent of GDP driven by the price increase as well as large energy subsidies. The services balance recovered to pre-pandemic levels of about 5 percent of GDP due to strong tourism revenues. Primary income is projected to worsen due to a higher interest bill. Continued high remittance flows ensured that the current account deficit did not reach double digits.

El Salvador: EBA-lite Model Results, 2022

	CA model 1/	REER model 1/
	(in percent of GDP)	
CA-Actual	**-8.3**	
Cyclical contributions (from model) (-)	-0.3	
COVID-19 adjustors (-) 2/	0.0	
Natural disasters and conflicts (-)	0.1	
Adjusted CA	**-8.1**	
CA Norm (from model) 3/	**-5.6**	
Adjusted CA Norm	**-5.6**	
CA Gap	**-2.5**	**-0.4**
o/w Relative policy gap	-0.7	
Elasticity	-0.3	
REER Gap (in percent)	**9.7**	**1.4**

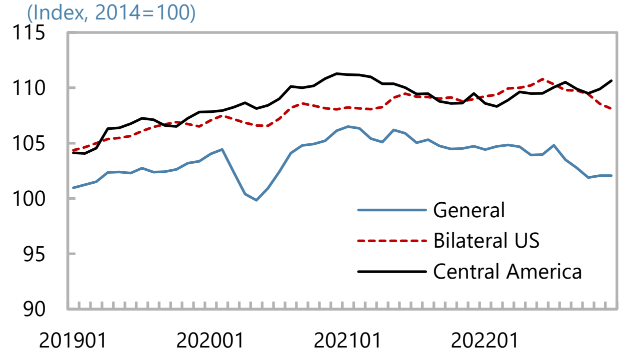
1/ Based on the EBA-lite 3.0 methodology
2/ Additional cyclical adjustment to account for the temporary impact of the pandemic on tourism. 0 percent of the shock to tourism is assumed temporary.
3/ Cyclically adjusted, including multilateral consistency adjustments.

Assessment. Using estimated data for 2022, the cyclically adjusted current account balance per the EBA-lite model is -8.1 percent of GDP. Given that tourism revenues have already surpassed pre-pandemic levels, no COVID-19 related adjustments for scarring were made. Evaluating the adjusted current account deficit of -8.1 percent of GDP against the model-based current account norm of -5.6 percent of GDP yields a gap of -2.5 percent of GDP. This implies that the external position is weaker than the level suggested by fundamentals and desirable policies.

Real Exchange Rate

Background. The Real Effective Exchange Rate (REER) has been stable in recent years. The REER depreciated by 2.5 percent in 2022 after depreciating by 1.3 percent in 2021. There is potential to improve the economy's competitiveness. The 2016 World Bank enterprise surveys highlighted crime, theft, and disorder as the top constraint across firms, as well as unfair competition, lack of access to finance, and cumbersome licensing and permits procedures. The Bukele administration has an ambitious agenda of reforms to reduce bureaucracy. While the authorities' stepped-up fight against gangs amid an extended regime of exception has reduced crime,

Real Effective Exchange Rate
(Index, 2014=100)

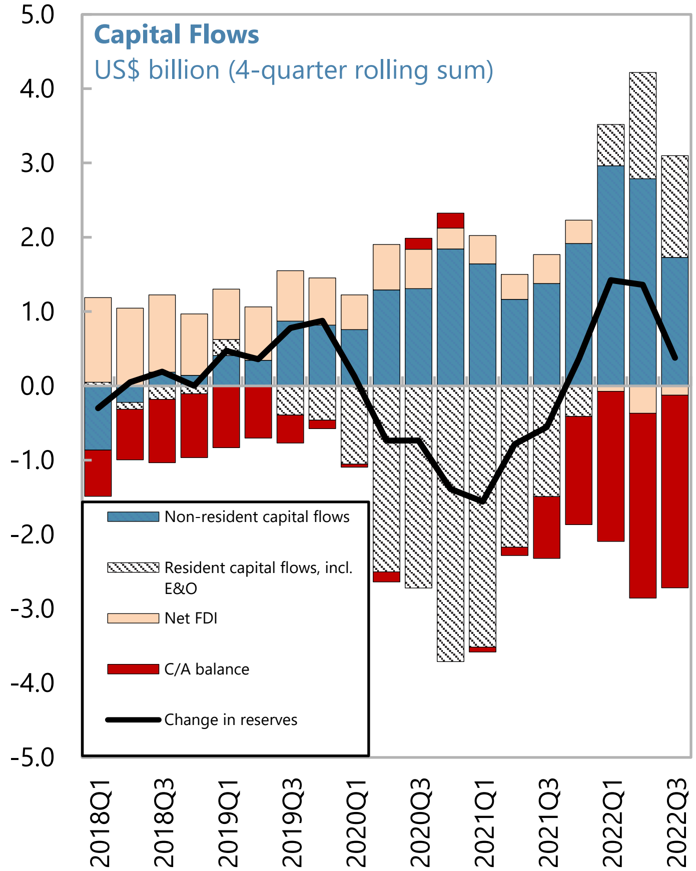


its impact on attracting foreign investment remains to be seen. Maintaining macroeconomic stability—both fiscal and financial—remains key to the economy's competitiveness.

Assessment. The REER gap based on the CA model suggests that a depreciation of around 10 percent would be needed to close the current account gap. The REER model suggests a much smaller overvaluation, which in turn implies an unrealistically small current account gap given historical data. On balance, the overall assessment is a moderate overvaluation.

Capital and Financial Accounts: Flows and Policy Measures

Background. The financing of El Salvador's current account deficit has traditionally been dominated by FDI flows. In 2020 and 2021, FDI flows averaged only 1.1 percent of GDP, substantially below the average over 2016-2019 (2.65 percent of GDP), with little signs of recovery in the first three quarters of 2022. Non-resident capital flows increased, driven by other investment liabilities (multilateral loans to banks and the government).[1] Errors and omissions turned positive in the first half of 2022 (i.e., leaving unexplained capital inflows to finance the large current account deficit) after having been negative in 2020.

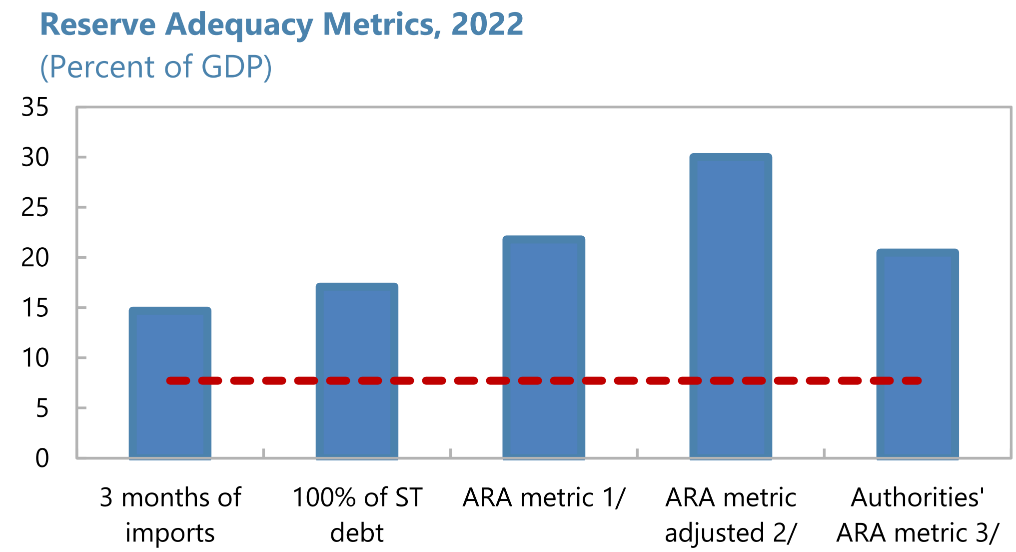


Source: BCR and IMF staff calculations.

Assessment. Given the large balance of payments gap, support from International Financial Institutions and a strategy to return to international capital market are critical for the country in order to avoid a forced correction of the current account deficit. A return to international capital markets will require the development of a credible medium-term fiscal and financing strategy involving a substantial fiscal adjustment. Efforts to attract more FDI should also be intensified.

[1] Sources include the World Bank (COVID-19 vaccines), IFC (green bank loans), CABEI and CAF (infrastructure). Due to country exposure caps, multilateral financing is unlikely to provide a sufficiently large financing source over the medium term, implying a high risk of a current account adjustment if other inflows do not materialize.

FX Intervention and Reserves Level



Sources: BCR, IMF Staff calculations

1/ ARA metric for fixed exchange rate regime
=10% of exports
+ 10% of broad money
+ 30% short-term debt
+ 20% other liabilities

2/ ARA metric adjusted for dollarization
= 10% of (exports + remittances)
+ 20% deposits
+ 30% short-term debt
+ 20% other liabilities

3/ Authorities' ARA metric
= 22% of deposits (reserve requirements)
+ 5% deposits (deposit insurance)
+ 8% deposits (medium-term target for LOLR and ELA purposes)

Background. El Salvador is fully dollarized and does not have its own currency. Net International Reserves (NIR) amounted to US$2.4 billion at year-end. This represents only 35 percent of the IMF's metric for Assessing Reserve Adequacy (ARA metric) for countries with fixed exchange rates. The decline in reserves in 2022 is explained by the buyback of external debt completed in September 2022, which was financed by drawing down SDRs that were allocated to the central bank of El Salvador under the 2021 general SDR allocation (US$365 million), as well as the reduction in banks' reserve requirements from 14 to 11.4 percent. Due to the strong increases in both imports and short-term debt in 2022, the traditional metrics—the 3-month import coverage and the broad money coverage — paint a substantially worse picture than before the pandemic.

Assessment. The level of international reserves is far below the adequate level implied by the adjusted risk-weighted adequacy ARA metric. As a fully dollarized economy, El Salvador does not face risks stemming from exchange rate fluctuations and currency mismatches. However, with fiscal space nearly exhausted, the low level of reserves presents a significant impairment to the central bank's capacity to act as lender of last resort in case of a banking crisis. The authorities should therefore work to increase the stock of reserves as soon as possible by restoring the 15 percent reserve requirement.

Annex IV. Application of the Sovereign Risk and Debt Sustainability Framework

A. Assessment

1. Under baseline (unchanged) policies, public debt is on an unsustainable path. Public debt is projected to rise to about 82 percent of GDP under current policies—including the pension reform and its associated debt exchange. With limited financing options, the baseline scenario leads to increasing financing costs and persistent financial repression. A sizable fiscal adjustment needs to be implemented, and a comprehensive financing strategy needs to be developed, that encompasses all liabilities, based on an equitable mix of official and private domestic and external sources, that permits a gradual improvement in reserve coverage and eventual return to the international bond market.

B. Background

2. After a sharp increase in 2020, the public debt ratio fell in 2021. Debt increased by 18 percentage points of GDP in 2020, because of the extensive, but effective, measures to contain the health and economic effects of the COVID-19 pandemic. The debt-to-GDP ratio then fell by 7 points of GDP in 2021, driven by a 17 percent increase in nominal GDP. Debt was also reduced in 2022 in particular because of two buybacks, at distressed prices, of Eurobonds due in 2023 and 2025 (see Annex II).

3. Public debt data still have gaps. This Annex' analysis is based on the Nonfinancial Public Sector (NFPS) coverage. While it is broadly adequate, staff has identified several data gaps that should be addressed. In particular, a large share of the debt owed to private pension funds is not reported—although its debt service is included in the fiscal flows. Similarly, several public corporations have securitized their future income flows. The data from municipalities is incomplete and imperfect—a common problem in the LAC region. The authorities have been working extensively with STA and CAPTAC-DR to improve their debt statistics, but progress has been limited so far (see ¶43 in the main report and Annex VI).

Nonfinancial Public Sector Debt 2021
(Percent of GDP)

Reported debt	82.4
o/w CIP-A	20.2
Unreported debt	9.4
CIP-B	7.7
Public corporations bonds	1.8
Total	**91.9**
Memo	
Pension-related debt	27.9

Source: Salvadorian authorities and Fund staff estimates.

4. Terms for some domestic creditors have been changed. Currently the BCR holds three series of Treasury bonds (A, B, and C) totaling US$704 million. Series B (US$200 million) matured in

2021 but its maturity was extended to 2041 by decree 232/2021. In the same vein, the pension reform includes a debt exchange between the old bonds (28 percent of GDP) issued by the FOP and new bonds issued by the *Instituto Salvadoreño de Pensiones* (ISP). The terms of this debt exchange are not issued yet. The assumptions needed to prepare this Annex's analysis are outlined in Box 1.

C. Risk Analysis

5. The GFN Financeability Module points to moderate risk of sovereign stress. Baseline GFNs average 18 percent of GDP over 2022-2027 in the baseline, about half of them coming from the need to rollover short term debt. It is expected that the government can place additional securities on the banking sector as its current exposure to the sovereign is still below regional and comparators in Latin America.[1] The GFN index is estimated at 14½, below the threshold to be considered high risk (17.9). The index is mainly driven by the increasing the pressure on domestic banks given the lack of access to the market and limited financing from multilaterals. The baseline scenario assumes that financing is closed with the issuance of short-term debt (see Box 1).

6. The debt fanchart module points to high risk of sovereign stress. Public debt is projected to increase from 82½ percent of GDP in 2021 to 82¾ percent of GDP by end-2027. The probability of debt stabilization under the baseline is very low. Projected institutions-adjusted median debt level in 2027 is around 56.4 percent of GDP, contributing highly to the overall index. Uncertainty proxied by the fanchart width is not very large as growth and inflation have not been very volatile historically, and dollar-denominated debt has not presented fiscal risks given official dollarization.

7. The overall Medium-Term Index (MTI) indicates high risks. The MTI index is 0.419 above the high-risk threshold (0.395). Thus, the mechanical signal points to high sovereign stress risk. However, the extraordinary level of uncertainty surrounding the baseline, in particular the capacity of the government to achieve its financing targets is an important risk to this assessment.

[1] Sovereign debt is 10½ percent of banks' assets, smaller than Costa Rica (13 percent), Guatemala (19 percent) and well below Argentina (26 percent) and Brazil (25 percent).

Annex IV. Box 1. SRDSF Main Assumptions

Macroeconomic Assumptions

- *Real GDP growth*, closely correlated with U.S. growth, is projected to moderate to 2.4 in 2023. Over the medium-term, growth is expected to reach about 2 percent (slightly below historical average), as persistent macroeconomic imbalances will weigh on investors' confidence and investment.
- *Inflation,* given dollarization, is expected to follow the path of U.S. inflation. In the medium term it is expected to converge to around the Fed's inflation target of 2 percent.
- *The REER* shows a small appreciation until external and domestic inflation converge.
- *The primary balance* is forecast to remain slightly positive, consistent with the financing constraint faced by the NFPS.

Financing Assumptions

- *External official financing* is expected to remain limited to two regional development banks for budget support. Project financing would be provided by all IFIs, and most of these projects have already been agreed and approved by Congress. In total about US$1 billion of external official financing is expected each year, except for 2023 as an additional US$0.5 billion has helped the government repay the 2023 Eurobond.
- *Domestic financing* assumes LETES issuances at 25 percent of revenue each year, the current legal limit, thus providing some small net financing. CETES are expected to increase by about US$1 billion by the end of the projection period. If additional placements of domestic securities are needed, they are expected to be purchased either by banks or institutional investors.
- *FOP debt exchange*. It is assumed that US$8 billion of outstanding CIPs will be exchanged by the same amount of CFTs, with staff assuming the terms of the CFTs based on the authorities' preliminary plan.

Annex IV. Box 2. El Salvador: Risk of Sovereign Stress

Horizon	Mechanical signal	Final assessment	Comments
Overall	…	High	The overall risk of sovereign stress continues to be high. It mainly reflects high and increasing reliance on short-term debt, limited financing options, and the lack of a medium-term consolidation plan.
Near term 1/	…	…	Not applicable.
Medium term	High	High	Staff's assesment on the medium-term risk is "high", which is aligned with the mechanical signal. The mechanical medium-term signal for the GFN indicates a "moderate" mainly because of the temporary impact of the pension bonds debt exchange.
Fanchart	High	…	
GFN	Moderate	…	
Stress test	…	…	
Long term	…	High	Given large susceptibility to exogenous shocks, including natural disasters, lack of access to the international debt market, and lack of a comprehensive medium-term consolidation plan, high risks of sovereign stress episodes could materialize.
Sustainability assessment 2/	…	…	Not required for surveillance-only countries.
Debt stabilization in the baseline			No

DSA summary assessment

Public debt does not stabilize in the baseline reflecting the exhaustion of tax administrative measures and recurrent nomarket financing policies. Tax administrative measures have been successful, but the authorities acknowledged that going beyond current revenue gains would involve tackling structural issues such as informality. Against this backdrop, the tools from the Sovereign Risk and Debt Sustainability Framework (SRDSF) indicate a high probability of sovereign stress. Such scenario calls for the implementation of a comprehensive fiscal consolidation effort based on a combination of permanent revenue and expenditure measures.

Risks in the baseline are exceptionally high, reflecting large exposure to shocks, including natural disasters, uncertainty about external conditions, and already stressed public finances with limited financing options.

Source: Fund staff.

Note: The risk of sovereign stress is a broader concept than debt sustainability. Unsustainable debt can only be resolved through exceptional measures (such as debt restructuring). In contrast, a sovereign can face stress without its debt necessarily being unsustainable, and there can be various measures—that do not involve a debt restructuring—to remedy such a situation, such as fiscal adjustment and new financing.

1/ The near-term assessment is not applicable in cases where there is a disbursing IMF arrangement. In surveillance-only cases or in cases with precautionary IMF arrangements, the near-term assessment is performed but not published.

2/ A debt sustainability assessment is optional for surveillance-only cases and mandatory in cases where there is a Fund arrangement. The mechanical signal of the debt sustainability assessment is deleted before publication. In surveillance-only cases or cases with IMF arrangements with normal access, the qualifier indicating probability of sustainable debt ("with high probability" or "but not with high probability") is deleted before publication.

Annex IV. Table 1. El Salvador: Debt Coverage and Disclosures

	CG	GG	NFPS	CPS	Other	Comments
1. Debt coverage in the DSA: 1/	CG	GG	NFPS	CPS	Other	
1a. If central government, are non-central government entities insignificant?					n.a.	

2. Subsectors included in the chosen coverage in (1) above:

Coverage groups		Subsectors captured in the baseline	Inclusion	Comments
CPS, NFPS, GG: expected, CG	1	Budgetary central government	Yes	Large unreported debt
CPS, NFPS, GG: expected, CG	2	Extra budgetary funds (EBFs)	Yes	
CPS, NFPS, GG: expected, CG	3	Social security funds (SSFs)	Yes	
CPS, NFPS, GG: expected	4	State governments	No	Not applicable
CPS, NFPS, GG: expected	5	Local governments	Yes	Incomplete coverage
CPS, NFPS	6	Public nonfinancial corporations	Yes	Incomplete coverage
CPS	7	Central bank	No	
CPS	8	Other public financial corporations	No	

3. Instrument coverage:	Currency & deposits	Loans	Debt securities	Oth acct. payable 2/	IPSGSs 3/

	Basis of recording		Valuation of debt stock		
4. Accounting principles:	Non-cash basis 4/	Cash basis	Nominal value 5/	Face value 6/	Market value 7/

5. Debt consolidation across sectors:	Consolidated	Non-consolidated

Color code: chosen coverage; Missing from recommended coverage; Not applicable

Reporting on intra-government debt holdings

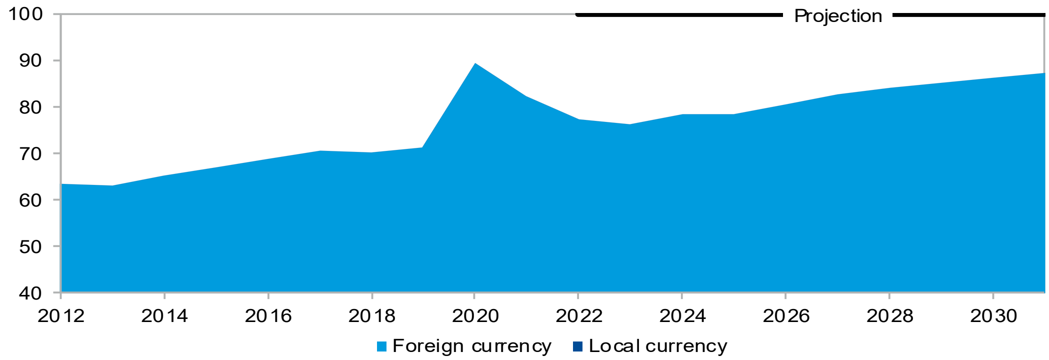
	Issuer \ Holder	Budget. central govt	Extra-budget. funds	Social security funds	State govt.	Local govt.	Nonfin. pub. corp.	Central bank	Oth. pub. fin corp	Total
1	Budget. central govt									0
2	Extra-budget. funds									0
3	Social security funds									0
4	State govt.									0
5	Local govt.									0
6	Nonfin pub. corp.									0
7	Central bank									0
8	Oth. pub. fin. corp									0
	Total	0	0	0	0	0	0	0	0	0

1/ CG=Central government; GG=General government; NFPS=Nonfinancial public sector; PS=Public sector.
2/ Stock of arrears could be used as a proxy in the absence of accrual data on other accounts payable.
3/ Insurance, Pension, and Standardized Guarantee Schemes, typically including government employee pension liabilities.
4/ Includes accrual recording, commitment basis, due for payment, etc.
5/ Nominal value at any moment in time is the amount the debtor owes to the creditor. It reflects the value of the instrument at creation and subsequent economic flows (such as transactions, exchange rate, and other valuation changes other than market price changes, and other volume changes).
6/ The face value of a debt instrument is the undiscounted amount of principal to be paid at (or before) maturity.
7/ Market value of debt instruments is the value as if they were acquired in market transactions on the balance sheet reporting date (reference date). Only traded debt securities have observed market values.

Commentary: While debt coverage is comprehensive, staff has identified some large under-reporting cases (see IMF, 2022, Annex II). STA and CAPTAC-DR have been assisting the authorities to improve their debt statistics, but progress so far has been limited. As the pension system is private, securities issued by public sector entities and held by private pension funds are accounted as public debt. This treatment is consistent alongside all countries that have privatized their public PAYG systems, many of them in the LAC region.

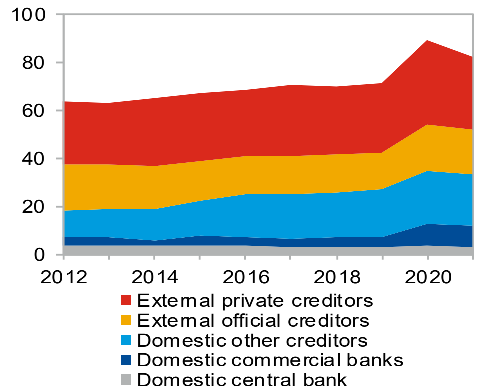
Annex IV. Figure 1. El Salvador: Public Debt Structure Indicators

Debt by Currency (Percent of GDP)



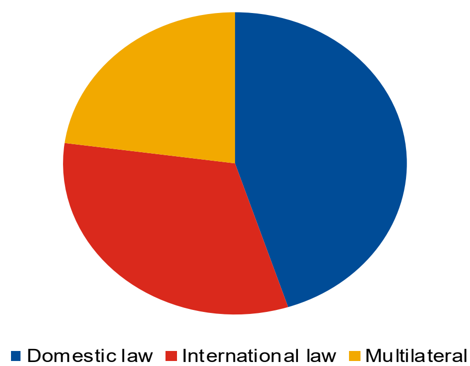
Note: The perimeter show n is nonfinancial public sector.

Public debt by holder (percent of GDP)



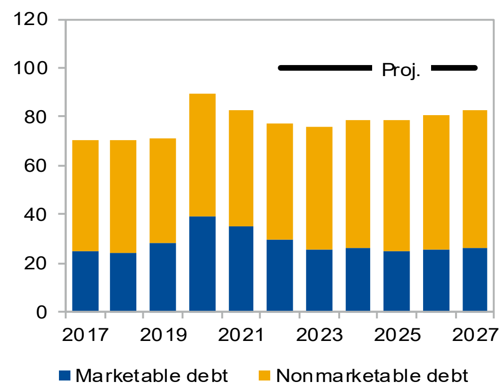
Note: The perimeter show n is nonfinancial public sector.

Public debt by governing law, 2021 (percent)



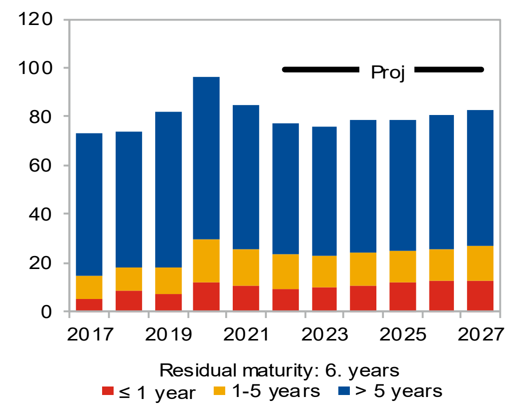
Note: The perimeter show n is nonfinancial public sector.

Debt by instruments (percent of GDP)



Note: The perimeter show n is nonfinancial public sector.

Public debt by maturity (percent of GDP)



Note: The perimeter show n is nonfinancial public sector.

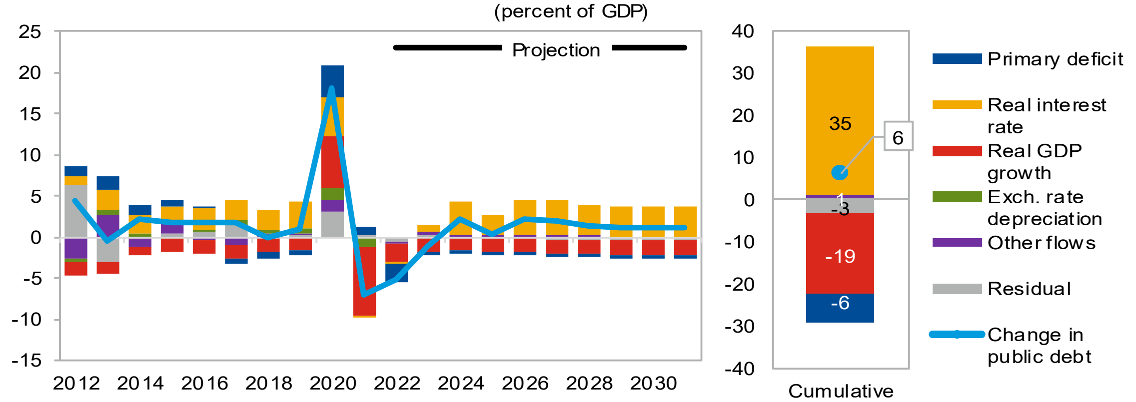
Commentary: The scenario assumes a continuous reliance on short-term debt and multilateral loans, w ith budget support from regional banks only and project financing from all multilaterals. Given the lack of access to the external bond market, a higher dependance on direct loans from domestic/external financial institutions and/or institutional investors is expected.

Annex IV. Table 2. El Salvador: Baseline Scenario
(Percent of GDP unless Indicated Otherwise)

	Actual	Medium-term projection						Extended projection			
	2021	2022	2023	2024	2025	2026	2027	2028	2029	2030	2031
Public debt	82.4	77.2	76.1	78.3	78.6	80.7	82.7	83.9	85.1	86.2	87.3
Change in public debt	-7.0	-5.2	-1.1	2.1	0.3	2.1	1.9	1.3	1.1	1.1	1.1
Contribution of identified flow s	-7.2	-4.7	-1.2	2.3	0.6	2.4	2.2	1.6	1.5	1.6	1.6
Primary deficit	1.1	-2.2	-0.3	-0.4	-0.4	-0.4	-0.4	-0.4	-0.4	-0.4	-0.4
Noninterest revenues	26.4	26.5	25.0	25.0	25.0	25.0	25.0	25.0	25.0	25.0	25.0
Noninterest expenditures	27.5	24.3	24.7	24.6	24.5	24.5	24.5	24.5	24.5	24.5	24.5
Automatic debt dynamics	-8.2	-2.5	-0.9	2.8	1.0	2.8	2.6	2.1	2.0	2.0	2.0
Int. rate-grow th differentia	-8.4	-2.5	-1.0	2.7	1.0	2.8	2.7	2.1	2.0	2.0	2.0
Real interest rate	-0.1	-0.2	0.9	4.2	2.5	4.4	4.3	3.8	3.7	3.8	3.8
Real grow th rate	-8.3	-2.2	-1.8	-1.4	-1.6	-1.6	-1.7	-1.7	-1.7	-1.8	-1.8
Real exchange rate	-1.2	…	…	…	…	…	…	…	…	…	…
Relative inflation	1.4	-0.1	0.5	-0.1	0.0	-0.1	-0.2	-0.2	-0.2	-0.2	-0.2
Other identified flow s	0.1	-0.3	0.4	0.2	0.2	0.2	0.2	0.2	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	0.0
Other transactions	0.1	-0.3	0.4	0.2	0.2	0.2	0.2	0.2	0.0	0.0	0.0
Contribution of residual	0.2	-0.5	0.2	-0.1	-0.2	-0.2	-0.3	-0.3	-0.4	-0.5	-0.5
Gross financing needs	12.5	15.6	16.3	17.3	18.1	19.0	22.1	20.8	21.7	19.4	20.3
of w hich: debt service	11.4	17.8	16.6	17.7	18.5	19.4	22.6	21.2	22.2	19.9	20.8
Local currency	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Foreign currency	11.4	17.8	16.6	17.7	18.5	19.4	22.6	21.2	22.2	19.9	20.8
Memo:											
Real GDP grow th (percent)	10.3	2.8	2.4	1.9	2.0	2.1	2.1	2.1	2.1	2.1	2.1
Inflation (GDP deflator; percent	6.1	7.0	4.2	2.0	1.8	1.8	1.7	1.7	1.7	1.7	1.7
Nominal GDP grow th (percent)	17.0	10.0	6.8	4.0	3.9	4.0	3.9	3.9	3.9	3.9	3.9
Effective interest rate (percent	5.9	6.7	5.4	7.8	5.2	7.8	7.5	6.6	6.5	6.5	6.5

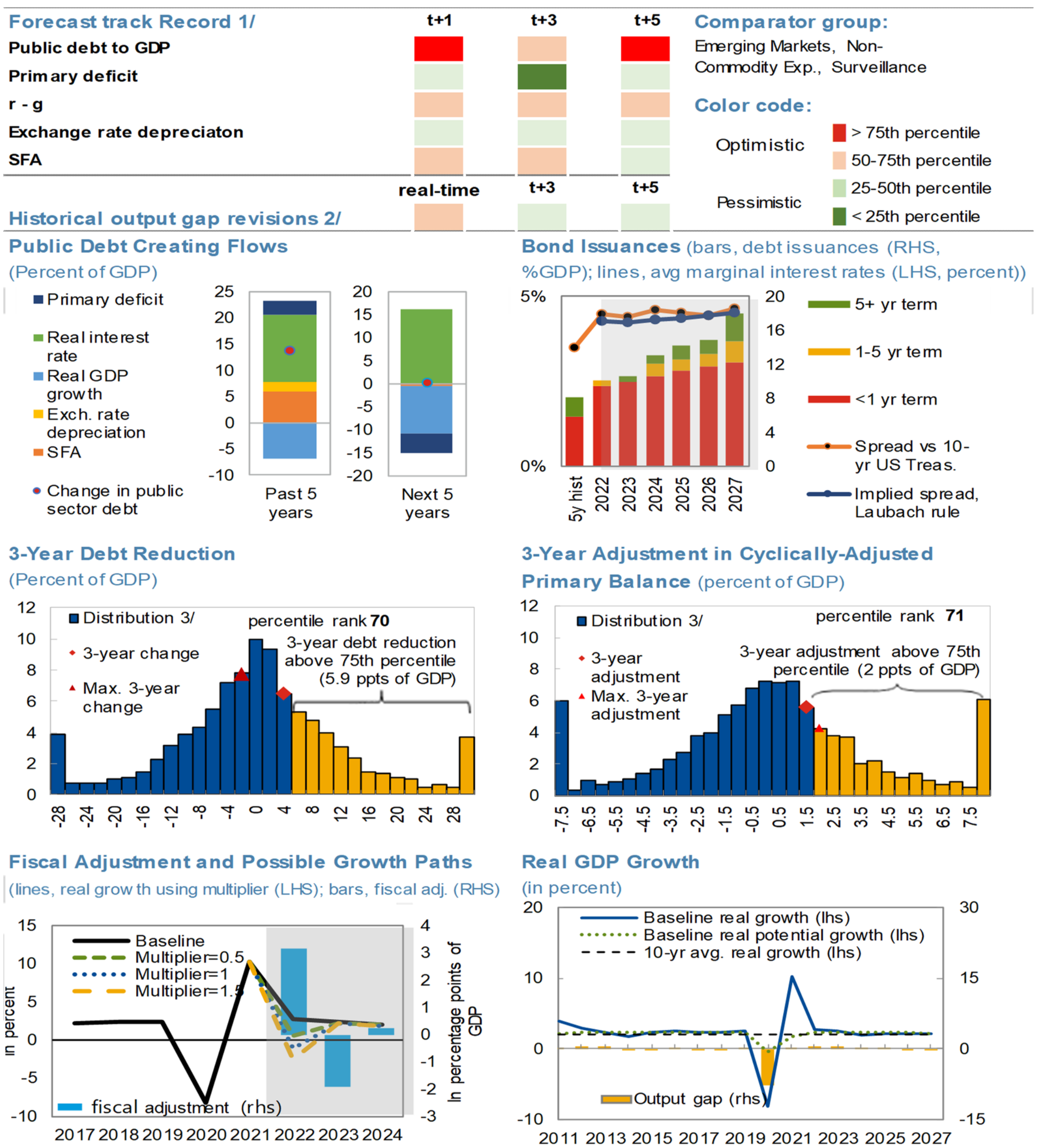
Contribution to change in public debt

(percent of GDP)



Commentary: Based on the authorities' expected policies, debt does not stabilize in the baseline. While expansionary fiscal policies w ere justified to address the COVID-19 emergency, a consolidation consistent w ith the lack of fiscal space w ould have been expected after that, particularly given large gains from strengthening tax compliance

Annex IV. Table 3. El Salvador: Realism of Baseline Assumptions



Commentary: Forecast track record analysis points towards some optimism particularly in the debt-to-GDP ratio. The key debt drivers will be high interest rates, absent fiscal consolidation, and sluggish growth given persistent imbalances and higher financing costs for investors and consumers. The baseline does not envisage any fiscal consolidation effort and growth projections are aligned with the historical averages.

Source : IMF Staff.

1/ Projections made in the October and April WEO vintage.

2/ Data cover annual obervations from 1990 to 2019 for MAC advanced and emerging economies. Percent of sample on vertical axis.

3/ Starting point reflects the team's assessment of the initial overvaluation from EBA (or EBA-Lite).

Annex IV. Table 4. El Salvador: Medium-Term Risk Analysis

Debt fanchart and GFN financeability indexes

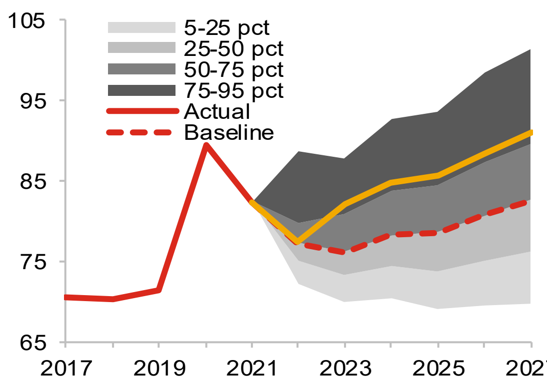
(percent of GDP unless otherwise indicated)

Module	Indicator	Value	Risk index	Risk signal
Debt fanchart module	Fanchart width	31.7	0.5	...
	Probability of debt not stabilizing (pct)	100.0	0.8	...
	Terminal debt level x institutions index	56.4	1.2	...
	Debt fanchart index	**...**	**2.5**	**High**
GFN finance-ability module	Average GFN in baseline	18.0	6.2	...
	Bank claims on government (pct bank assets)	10.2	3.3	...
	Chg. in claims on govt. in stress (pct bank assets)	14.9	5.0	...
	GFN financeability index	**...**	**14.4**	**Moderate**

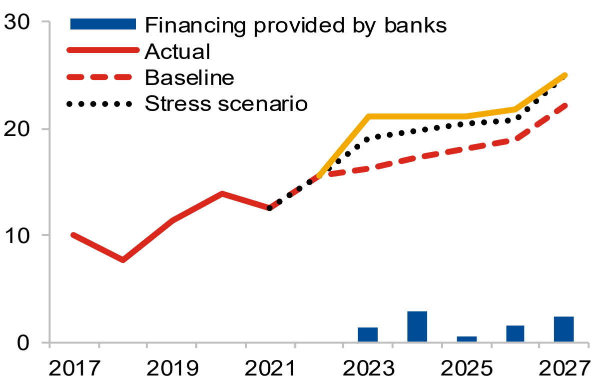
Adv. Econ., Non-Com. Exp, Program: 0, 25, 50, 75, 100

Legend: Interquartile range; El Salvador

Final fanchart (pct of GDP)



Gross Financing Needs (pct of GDP)

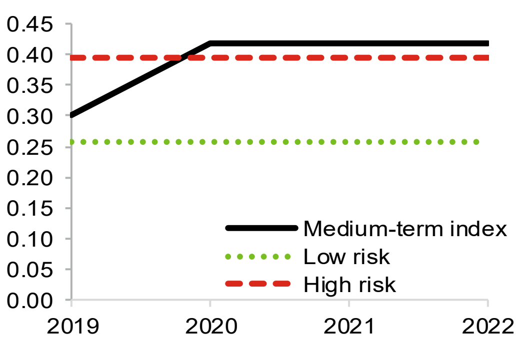


Triggered stress tests (stress tests not activated in gray)

Banking crisis | Commodity prices | Exchange rate | Contingent liab. | Natural disaster

Medium-term index

(index number)



Medium-term risk analysis

	Low risk threshold	High risk threshold	Weight in MTI	Normalized level
Debt fanchart index	1.1	2.1	0.5	0.6
GFN finaceability index	7.6	17.9	0.5	0.3
Medium-term index (MTI)	0.3	0.4	...	0.4, High

Prob. of missed crisis, 2022-2027 (if stress not predicted): 54.5 p

Prob. of false alarm, 2022-2027 (if stress predicted): 8.0 pct.

Commentary: The medium-term modules signal high sovereign stress risks. The high-risk signal for fanchart is driven by the low probability of debt stabilization during the projection period and high terminal debt level both suggesting that debt-carrying capacity is stretched. The GFN stress tests find moderate risks but this result is mainly the consequence of the temporary reduction in the debt service due to the pensions bonds debt exchange.

Annex V. Recent Economic Governance Issues

1. While the extended state of regime of exception has been important to improve indicators of violence, it has led to a deterioration in governance. In March 2022, after a sharp increase in crime, congress approved a regime of exception, suspending constitutional rights and leading to the arrest of around 65,000 people. Since then, the regime of exception has been continuously extended. Through a decree, security forces can now expedite procurement, and information on the purchases is reserved as national security. Civil society groups, the United Nations, and the Organization of American States have expressed concerns over the extended suspension of rights and guarantees.

2. Accountability in public resource management is necessary to strengthen accountability on the use of public resources. Civil servants' and elected officials' accountability and integrity systems need to be strengthened. The authorities are working on a revised anti-corruption legal framework, to align it to the UN Convention Against Corruption (UNCAC), the FATF standards, and the G-20 High Level Principles on asset disclosure by public officials. A robust asset declaration and conflict of interest system for civil servants and elected officials in line with international good practices and the laws regulating revolving doors procedures are needed.

3. It will be important that the application of the Digital Assets Law guarantees good public management and governance standards. The law creates two autonomous agencies: the National Commission of Digital Assets (NCDA) and the Bitcoin Funds Administrative Agency (BAA). This autonomy would allow the agencies to bypass some rules and controls applicable to Central Government entities. However, their autonomy will be limited, as the director's appointment is foreseen by the President, and there are inappropriate reporting requirements and no oversight from the Legislature. The budget of the NCDA will be approved by their board and added "as is" to the Ministry of Economy's budget. The BAA will have the authority to approve, develop, and administer public investment projects, including infrastructure. The law also entails financial integrity risks, as the introduction of new digital assets will create additional AML/CFT risks. On procurement, the BAA will be given the power to bypass the procurement procedures, performing all the direct procurement that they deem necessary. The BAA will also be given the attribution to audit and control the entities where it has made investments, and the role of the Comptroller General is not addressed by the Bill. Bitcoin purchases and handling by the government should be made more transparent.

Annex VI. IMF Capacity Development

1. Capacity Development (CD) has had moderate impact so far in El Salvador. On the positive side, the ability to implement reforms is strong given the ruling party majority in Congress, and some areas of CD have been successful. Two examples include CD on tax administration, which has been important to strengthening compliance from taxpayers as well as to fill in gaps in the tax legislation, and CD to improve national accounts, which has generated integrated economic accounts by institutional sectors and industries. On the other hand, intense CD efforts to improve the quality of the fiscal statistics have failed to produce comprehensive figures for stocks and flows. Going forward, CD assistance should be focused on tools that help the authorities assess the costs and benefits of different macroeconomic policies and that mitigate risks stemming from policies and shocks. Critical elements are fiscal reporting, budget transparency, revenue mobilization, and strengthening the financial safety net. Close relationship between the WHD team, functional departments, and the government's counterparts is critical to ensure CD is properly absorbed.

2. The authorities see as the main objective for CD the strengthening of technical capacity at the Ministry of Finance and the BCR, to help the government fulfill its key policy priorities. These include sustaining the ongoing revenue mobilization effort based on improving compliance and strengthening the financial safety net and the capacity to regulate new financial developments. On the statistical front, as the statistical office previously hosted in the Ministry of Economy was absorbed by the BCR, an important objective is to expand the BCR role as key provider of statistics, particularly by updating the base year of the national accounts (an IADB-funded project) and improving the consistency of statistics across the different institutional sectors.

A. Fiscal Area

3. CD has been focused on developing a medium-term fiscal framework, strengthening public investment management, implementing a framework to identify and quantify fiscal risks, strengthening fiscal prudence legislation, and fostering transparency on budget execution, particularly on COVID-19 spending. Additionally, the authorities have received extensive CD on tax administration. The authorities asked and received comprehensive tax policy CD aiming at identifying options to mobilize revenues including by removing some tax exemptions. Staff identifies the following CD priorities: (i) Developing and publishing a medium-term fiscal framework; (ii) Strengthening the quality of budget preparation aiming at minimizing recurrent supplementary budgets (iii) Strengthening the management of fiscal risks by preparing a risks statement as part of the annual budget cycle; (iv) Strengthening the risk management capacities of the customs administration; (v) Supporting the authorities' efforts to firm up their gains on reducing evasion and smuggling (vi) Supporting the implementation of measures designed to strengthening the audit function (vii) Rightsizing the wage bill under the framework of a comprehensive civil service reform; (viii) Improving the targeting of energy subsidies or replacing them with targeted financial support for the most vulnerable. CD on integrating climate considerations into public investment decisions (C-PIMA) would also be available.

B. Monetary and Financial

4. Some CD has been provided but institutional rigidities have precluded the implementation of recommendations. Because El Salvador is fully dollarized, the central bank has limited power and lacks financial resources to create a financial safety net. On financial regulation, CD should focus on developing analytical and supervisory capacities. Staff identifies the following CD priorities: (i) Strengthening the framework to implement macroprudential policies including by assessing and upgrading the stress testing and systemic risk analyses; (ii) Developing capacities to regulate financial innovations; (iii) Developing capacities, including on data collection, to assess the impact of climate change in the banking portfolio, including potential systemic risks (sustainable finance); (v) Supporting the effort to design a framework for emergency central bank liquidity assistance; (vi) Strengthening the BCR technical capacity particularly in short-term forecasting and structural modelling; and (vii) Supporting the transition of the BCR towards IFRS as recommended by the safeguards assessment .

C. Legal

5. LEG has provided advice under the IMF's Framework for Enhanced Fund Engagement on Governance Issues. Additionally, LEG has assisted on the drafting of the new BCR framework law as recommended by the safeguards assessment mission. LEG has also been providing technical assistance on bank resolution, deposit insurance and ELA legal frameworks. Staff identifies the following CD priorities: (i) Introducing a system of public asset declaration for public officials to prevent or combat corruption; (ii) Strengthening the reporting rules on beneficial ownership to cover the public procurement system; (iii) Implementing a risk-based framework for the supervision for Designated Non-Financial Businesses and Professions; (iv) Implementing a risk-based framework for the supervision of Virtual Asset Providers; and (v) Implementing structures and tools to improve the performance of the Financial Intelligence Unit.

D. Statistics

6. The key priorities are (i) rebasing the national accounts, as the current base (2005) is outdated; (ii) Improving the consistency among institutional sectors particularly with the general government sector; (iii) Disseminating fiscal operations consistent with the GFSM 2014 manual; and (iv) Preparing comprehensive and transparent public debt statistics, including subsidiaries of public corporations, all pension-related liabilities, and *Chivo*.

E. Financial Programing

7. ICD/CAPTAC-DR has an ongoing project with the Central Bank and the Treasury to build capacity to prepare macroeconomic projections and scenarios. This TA is expected to help assessing the impact of fiscal rules and could be enhanced to integrate the model with the Debt Dynamics Tool (DDT).

Annex VII. Implementing Fund's Policy Advice

Annex VII. Table 1. El Salvador: Implementing Fund's Policy Advice from the 2021 Article IV Consultation and 2010 Financial Sector Assessment Program

Advice	Implementation
Fiscal Policy	
Implement a fiscal adjustment of about 4 percent of GDP over 2022-24, while supporting the vulnerable	Partially implemented. The fiscal deficit was reduced substantially in 2022, based on cyclical revenues and a reduction of expenditure by around 3 percent of GDP. However, no structural measures were taken except the cut in transfer to municipalities (FODES).
Implement a medium-term expenditure framework and modernize the public financial management (PFM) framework	This is a medium-term objective. So far, there has been no progress.
Resume the fiscal responsibility law (FRL)	There has been no progress so far, but the authorities are committed to relaunch the transparency portal.
Perform an actuarial analysis of the pension system and introduce additional reforms to strengthen its sustainability and	The disclosure of the actuarial assessment of the pension system mandated by the FRL is currently suspended. A pension reform bill was enacted that does not address the issue of sustainability.
Financial Sector	
Monitor banks' asset quality during the phasing out of debtor relief measures implemented during Covid-19.	The authorities approved new rules to gradually provision loans affected by COVID-19. The SSF is closely monitoring compliance among entities benefiting from this relaxed provisioning schedule, including through on site inspections and monthly review of the portfolios. The share of loans affected by the pandemic has declined significantly from 30.8 in 2020 to 5 percent of gross loans in 2022.
Adopt a new banking crisis resolution framework and deposit insurance law in line with international best practices.	A new bank resolution and deposit insurance bill was drafted in 2021, in line with IMF TA recommendations. The bill is since January 2022 under the review of the Legal Secretary of Presidency and has yet to be submitted to the Assembly.
Enhancing banking system supervision and regulation: • Move to Basel III standards for the Liquidity Coverage Ratio (LCR) and Net Stable Funding Ratio (NSFR) • Calibrate regulatory boundaries to ensure adequate oversight of the overall financial sector • Monitor financial system's exposure to government securities.	Preparatory works to draft bills on Basel III liquidity ratios are ongoing, including discussions with the industry. Some banks, owned by international groups, already apply the Basel liquidity ratios at consolidated level. The authorities are making progress in adopting IFRS standards—a first phase of amendments to the Accounting Code (not including credit risks rules) were adopted in December. Three bills are under consideration of the Assembly to expand and strengthen the supervision of *Asociaciones Cooperativas de Credito y Ahorro* (cooperative banks). The BCR regularly monitors the composition of banks' trading book and the SSF oversees the market and counterparty risks of these investments.

Annex VII. Table 1. El Salvador: Implementing Fund's Policy Advice from the 2021 Article IV Consultation and 2010 Financial Sector Assessment Program (Continued)

Banking supervision (2012 FSAP): • Approve the proposed FSSRL, amending the draft to include adequate legal protection for supervisors, and broader preventive powers prior to regularization • Issue regulations for key risks and corporate governance • Bring qualitative assessments in line with international best practices and appoint dedicated relationship manager responsible for the overall supervision of each bank • Intensify supervision of credit concentration and debtor repayment capacity	The Financial System Supervision and Regulation Law was approved in 2011, and its secondary regulations and technical standards have improved risk management legal requirements. The approval of the Financial Estability and Protection bill would expand the legal protection for the staff of the financial agencies. The SSF is already working on recovery planning with supervised institutions. A large set of technical standards has been implemented or amended since 2012, covering key areas such as: risk management systems (for each type of financial institution), operational, liquidity and credit risks, corporate governance, cybersecurity, anti-money laundering and combating the financing of terrorism, etc. The SSF's risk-based supervisory handbook has recently been updated (February 2022). Inspection and supervision practices have improved over time, particularly with regard to credit risk control and mitigation. Further progress on convergence with regulatory and supervisory Basel core principles has yet to be made (Liquidity ratios, Capital Requirements, forward-looking supervision, etc.).
Safety nets (2012 FSAP): • Allow the BCR to lend to banks with its own or external funds in case of emergency • Eliminate 3-day notification period for resolution measures; require removal of a bank's board at judicial intervention; limit IGD to the least-cost solution; and increase IGD's funding options and target fund • Implement a comprehensive liquidity policy, which includes objectives and contingency plans • Issue regulations to implement BCR powers to provide liquidity • MOF allocates the entire SDR allocation granted in 2009 to the BCR for ELA • SSF, BCR, and IGD formalize procedures and manuals for banking resolution and crisis management • SSF, BCR, IGD and MOF undertake a comprehensive bank resolution simulation exercise	A new bank resolution and deposit insurance bill was drafted in 2021, in line with IMF TA recommendations. The bill is since January 2022 under the review of the Legal Secretary of Presidency and has yet to be submitted to the Assembly. Emergency liquidity assistance (ELA) arragenments were introduced in June 2012 and have recently been updated (2022). The central bank has a US$200 million credit line with CABEI to finance its lender of last resort function. The Deposit protection Institute could obtain extrarordinary funding from the central bank (technical standards approved in June 2022). The 2009 SDR distribution (US$138.7 million) was allocated entirely to the central bank. SDRs that were allocated to the BCR under the 2021 general SDR allocation (US$365 million) were used to provide a loan to the Treasury to perform a buyback operation of Eurobonds. Under the coordination of the Systemic Risk Committee (created in 2013), the authorities have conducted crisis simulation exercises and reviewed their operational manuals and crisis strategies (Financial Safety Net and Inter-agency coordination guidelines and Crisis comunication strategy and).

Annex VII. Table 1. El Salvador: Implementing Fund's Policy Advice from the 2021 Article IV Consultation and 2010 Financial Sector Assessment Program (Continued)	
Capital markets (2012 FSAP): • Approve the proposed Investment Funds Law • Approve a comprehensive overhaul of the securities markets law • Amend the Pension Funds Law to increase the number and type of investments allowed • Rationalize the securities exchange's role in the market • Adopt an external yield curve (US yield curve) for valuation of portfolios • Implement the action plan to comply with IOSCO principles	The Investment Funds Law was approved in 2014. Although technical standards and other specific amendments to capital markets regulation have been frequently adopted, a complete revision of the regulatory framework had not been yet carried out. In March 2022, a draft reform of the Securities Market Law was sent to the Ministry of Economy. It aims to amend the capital markets legal regime in areas such as takeover bids and public offerings, securities lending, insider trading, foreign securities recording and retail investors. In 2012, El Salvador signed the Appendix A of the IOSCO MMoU. The technical rules approved since then have sought to align with the corresponding IOSCO standards. A new Pension Law was approved in December 2022 (see Box 4).
Access to finance (2012 FSAP): • Require federations to collect and report information to the SSF • Allow for the transfer of an invoice to a third party • Harmonize requirements for credit and registration of assets in exempting low-value transactions	The ongoing bills to regulate cooperative banks are supposed to expand the financial oversight over federations. Currently, FEDECREDITO submits information to the financial supervisor according to the Central Risk System Regulation and the Technical Standards on Liquidity Reserves. A draft Factoring Law has been prepared and is currently under review by the Legal Secretary in the President's Office. In 2020, the Special Law to Facilitate Access to Credit was passed to encourage small businesses credit. It incorporated simplified requirements for small loans (under ten minimum wages).
Public banks (2012 FSAP): • MOF creates coordination mechanisms among the three public banks • SSF implements schedule of on-site visits and off-site reviews of public banks' financial information • Public banks improve credit risk analysis and operative processes • Consolidate and redefine the guarantee funds and scale up the mutual guaranteed scheme (SGR)	No specific changes on public banks. They are subject to standard oversight and inspection practices by the SSF. The BANDESAL (public development bank) Law includes the Fondo Salvadoreño de Garantías (FSG), focused on guarantees to micro and small companies.
Financial infrastructure (2012 FSAP): • Allow the free circulation of credit information among all members of private bureaus • BCR implements its oversight functions of the payment systems • BCR introduces a liquidity scheme for the RTGS • BCR creates an alternate site for the RTGS • Implement linkage between RTGS system and CEDEVAL`	According to the Banking Law, credit information can only be shared among entities supervised by the SSF. In 2013, the Credit History Law was passed, requiring consumer's authorization to share creditworthiness information beyond supervised institutions. The BCR is not legally authorized to provide liquidity to RTGS. An alternative site that replicates RTGS information in real time is already operational. CEDEVAL has a deposit account with the BCR, allowing its access to the RTGS system. In March 2022, the project for the automatic transmission of operations from the CEDEVAL to the RTGS system was completed. In December 2018, the Payment Systems Oversight Unit was created at the BCR. Recently, the BCR has made significant progress promoting retail payments interoperability through a new platform, Transfer 365.

Annex VII. Table 1. El Salvador: Implementing Fund's Policy Advice from the 2021 Article IV Consultation and 2010 Financial Sector Assessment Program (Continued)	
Governance and Anti-Corruption Frameworks	
Align legislation to the UN Convention Against Corruption (UNCAC)	In progress. The authorities are working on aligning the anti-corruption legal framework, including the Act of Illicit Enrichment of Public Officials and the Criminal Code, with the UNCAC, the FATF standards, and the G20 High-Level Principles on asset disclosure by public officials.
Strengthen fiscal transparency and accountability in line with international standards: • Improve the transparency of procurement processes • Strengthen the reporting and accountability structure of the Civil Protection Fund for Disaster Prevention and Mitigation (*FOPROMID*) • Strengthen fiscal transparency, including the use of COVID-19 funds • Define parameters to audit *Chivo* and *Fidebitcoin*	• *Procurement*. The public procurement process has been weakened by using exemptions and *ad-hoc* frameworks. A new public procurement law has been enacted, which includes the obligation to provide information on the beneficial owners of bidding entities, and that relies on e-procurement. • *FOPROMID.* The authorities have prepared a revised framework, but the corresponding by-law was not issued. The new Procurement law has its own emergency procurement rules. • *COVID audits.* Some progress has been done by the Court of Accounts but audits for some entities are still pending. • *Chivo and Fidebitcoin.* No progress has been made.
Approve and implement the revised anti-money laundering (AML) legislation	The legislation is currently being drafted.
Continue to strengthen central bank's autonomy and governance • Phase out quasi fiscal activities • Adopt the International Financial Reporting Standards (IFRS)	• Quasi-fiscal operations: No progress so far. A law was issued to allow the central bank to provide a loan the Treasury authorizing the use of its SDR reserves to perform a buyback operation of distressed Eurobonds. • IFRS: No progress has been done.
Improve Business Environment and Competitiveness	
Continue to improve security	Partially implemented. A move away from exceptional regimes to a more systemic and comprehensive strategy is needed, while preserving independence of the judiciary system to protect property and contractual rights.
Increase investment in public infrastructure	Partially implemented. Plan de Despegue Ecónomico unveiled in 2020 which includes several public infrastructure projects such as Aeropuerto de Oriente, Tren del Pacífico, Surf City, and a ferry connection from El Salvador to Costa Rica. Financing is needed.
Scale up investments in energy production	Implemented.
Promote safe digital financial inclusion	Partially implemented. Notwithstanding uncertainty over the operations of the public e-wallet Chivo, elsewhere there are positive developments, including in promoting Transfer365 and a financial inclusion education campaign.

Annex VII. Table 1. El Salvador: Implementing Fund's Policy Advice from the 2021 Article IV Consultation and 2010 Financial Sector Assessment Program (Concluded)

Bitcoin and Chivo Wallet	
Narrow the Bitcoin law's scope by removing Bitcoin's legal tender status and making explicit it's strictly voluntary nature for all type of transactions: • Develop strict Chivo's regulatory oversight • Make Chivo a self-funded company and liquidate Fidebitcoin • Set limits on transactions and holdings in e-wallets and adapt the banking regulation to strengthen Bitcoin risk oversight and incorporate prudential safeguards	The Financial Supervisor is already conducting inspection work on Chivo and other Bitcoin services providers. The Financial Investigation Unit, at the Prosecutor General's Office, is also monitoring Bitcoin service providers' compliance with AML/CFT regulations. The authorities plan to liquidate Fidebitcoin shortly. There has been no progress so far in other areas.
Implement additional regulations and stronger enforcement: • Strengthen the legal requirements for Bitcoin services providers, including Chivo • Better define the regulatory perimeter and enforcement regime • Minimize risks on tax compliance • Mitigate consumer protection and operational risks • Manage and reporting fiscal risks	There has been no progress so far.
Monitor, reduce, and strengthen accountability of the government's use of funds and exposure to Bitcoin	No progress in terms of disclosure and accountability of the use of public funds to purchase crypto assets.

INTERNATIONAL MONETARY FUND

EL SALVADOR

March 2, 2023

STAFF REPORT FOR THE 2023 ARTICLE IV CONSULTATION—INFORMATIONAL ANNEX

Prepared by: The Western Hemisphere Department

CONTENTS

FUND RELATIONS

(As of January 31, 2023)

Membership Status: Joined: March 14, 1946; Article VIII

General Resources Account:	**SDR Million**	**% Quota**
Quota	287.20	100.00
Fund holdings of currency	574.40	200.00
Reserve Tranche Position	0.00	0.00

SDR Department:	**SDR Million**	**% Allocation**
Net cumulative allocation	439.08	100.00
Holdings	158.95	36.20

Outstanding Purchases and Loans:	**SDR Million**	**% Allocation**
Emergency assistance 1/	287.20	100.00

1/ Emergency Assistance may include ENDA, EPCA, and RFI.

Latest Financial Commitments:

Type	**Date of Arrangement**	**Expiration Date**	**Amount Approved (SDR Million)**	**Amount Drawn (SDR Million)**
Stand-By	03/17/2010	03/16/2013	513.90	0.00
Stand-By	01/16/2009	03/16/2010	513.90	0.00
Stand-By	09/23/1998	02/22/2000	37.68	0.00

Outright Loans:

Type	**Date of Commitment**	**Date Drawn**	**Amount Approved (SDR Million)**	**Amount Drawn (SDR Million)**
RFI	04/14/2020	04/16/2020	287.20	287.20

Projected Payments to Fund
(SDR Million; based on existing use of resources and present holdings of SDRs):

	Forthcoming				
	2023	2024	2025	2026	2027
Principal	71.80	143.60	71.80		
Charges/Interest	20.19	15.64	10.06	9.06	9.06
Total	**91.99**	**159.24**	**81.86**	**9.06**	**9.06**

Exchange Arrangements. Both the US dollar and the Colón are legal tender. All payments may be made in either dollars or *Colones* The dollar is used as a unit of account and a medium of exchange, with no limitations.. The BCR has the obligation to exchange *Colones* for dollars upon request from banks, at a fixed and unalterable exchange rate of C8.75 per U.S. dollar. El Salvador *de jure* and de *facto* arrangements are no separate legal tender. El Salvador has accepted the obligations under Article VIII, Sections 2(a), 3, and 4, and maintains an exchange system that is free of restrictions on the making of payments and transfers for current international transactions and multiple currency practices.

As of September 7, 2021, El Salvador uses Bitcoin as an official currency with legal tender status alongside the U.S. dollar.

Article IV Consultation. The last Article IV consultation was concluded on January 24, 2022 (Country Report No. 22/20).

FSAP Participation and ROSCs. An FSAP Update was conducted in 2010 and the report was considered by the Executive Board on September 15, 2010. A fiscal ROSC was conducted in 2011. A data module ROSC was conducted in 2004.

Technical Assistance

Department	**Delivery Date**	**Purpose**
Tax Administration		
FAD	8/8/2016 8/16/2016 11/7/2016	Improve services to taxpayers
	8/22/2016 11/21/2016 7/3/2017	Strengthening the management of the tax administration
	2/15/2017 1/29/2018 3/5/2018	Strengthening the control of VAT credit
	2/20/2017 10/26/2018 3/21/2019	Strengthening the taxpayer registry

Department	Delivery Date	Purpose
	05/24/2019 08/18/21 01/17/22	
	3/5/2018 11/1/2018 2/26/2019 3/15/2019 06/21/2019 11/15/2019 09/17/2021 03/07/22 08/22/22	Strengthening tax audits
	8/17/2018	Improve management of declarations
	10/17/2018	Tax Administration Diagnostic Administration Tool (TADAT)
	2/22/2019	Strengthen Voluntary Compliance
	8/10/2019	Improve management of declarations
	07/12/2019 08/13/2019 01/29/2021 04/30/2021 08/20/2021 08/09/21 02/14/22 09/19/22 11/07/22	Strengthening Risk Management
	07/17/2020	Strengthen Organizational Arrangements
	03/05/2021 05/14/2021	Strengthen Tax Audit in Large Taxpayers
	03/19/2021	VAT Collecting System
	08/31/2021	Strengthen the ability to identify potential taxpayers
	9/5/2022	Enhance Tax Compliance Obligations
	2/14/2022	Improve Tax Compliance Risk Management
Customs Administration		
FAD	4/24/2017 07/28/2020 4/21/2021	Risk Management in Customs
	9/28/2017	OAS program launch
	10/16/2017 4/30/2018 8/24/2018 12/14/2018 04/26/2019 09/06/2019	Integral cargo control
	11/20/2017 3/12/2018	Improvement of dispatch and registry process in Customs
	11/20/2017	Risk-based segmentation of traders
	2/8/2019 05/31/2019 12/11/2020 09/16/2021 03/24/22 4/21/2021	Post clearance audit

Department	Delivery Date	Purpose
	9/9/2021	Matrix of Customs Risks
Public Financial Management		
FAD	10/17/2016 4/3/2017	Treasury Single Account
	4/9/2018 11/11/2019	Budget-PIMA
	3/22/2017	Workshop- Treasury Management
	03/30/2021 04/28/2021	Accounting
	10/5/2028	Accounting Consolidation
	05/24/2019 01/22/2021	IPSAS & Consolidation
	09/09/2020	Diagnostic Mission –HQ
	04/18/2022 04/29/2022	Accounting-IPSAS
	12/01/2021 12/14/2021	Evaluación de herramienta de riesgos fiscales (FRAT)
Financial Supervision and Regulation		
MCM	11/21/2016 12/5/2016 3/13/2017 8/21/2017 3/27/2017 4/9/2018	Liquidity risk supervision
	7/10/2017 7/12/2017 3/19/2018	Credit risk supervision
	8/21/2017 3/19/2018 1/25/2019	Insurance supervision
	12/7/2018 4/26/2019	IT risk supervision
	10/19/2018 3/22/2019	Market risk supervision
	02/28/2020	Internal Capital Adequacy Assessment Process (ICAAP) regulation and supervision
	01/28/2021	Covid-19 exit strategies
	02/26/2021	International Financial Reporting Standards (IFRS) implementation
	01/10/2022	Cybersecurity Regulation and Supervision
Central Banking Operations		
MCM	7/18/2016 3/12/2018 3/26/2018	Strengthening projection and overall analysis
	10/16/2017 10/25/2017	Strengthening capacities for producing and evaluating systemic risk indicators
	08/01/2021	Transition to IFRS-Phase I: Gap Analysis and Project Planning
	08/08/2022	Emergency Liquidity Assistance Operationalization and Funding
	10/24/2022	Nowcasting Tools Development

Department	Delivery Date	Purpose
National Accounts and Price Statistics		
STA	9/18/2017	Economic Activity Volume Indicators
	2/26/2018	Monthly Activity Indicators
	3/21/2018	National accounts
	8/24/2018 3/1/2019 5/3/2019	National accounts
	5/14/2018	Input Matrix Product
	2/18/2019 4/22/2019 10/23/2019	National accounts
	8/17/2020	Employment Matrix and Informal Sector
	10/26/2020	Quarterly national accounts and seasonal adjustment
	4/12/2021 10/25/2021 10/25/2021 01/10/2022	Sectoral Accounts and flow of funds
	04/18/2022	Supply and Use Tables
	05/16/2022	Sectoral Accounts and Flow of Funds
External Sector Statistics		
STA	4/5/2019	Strengthening source data for the compilation of external sector statistics
Government Finance Statistics		
STA	10/2/2017	Diagnostic mission for Government Finance Statistics
	8/13/2018	GFS implementation
	3/5/2019	Regional GFS Harmonization
	4/12/2019	Quarterly Data Compilation
	11/4/2019	High Frequency GFS & PSDS Nonfinancial corporations
	1/11/2021	Advances in Fiscal Data Coverage
	8/16/2021 11/8/2021	Government Finance and Public Sector Debt Statistics
	08/16/2021	Government Finance and Public Sector Debt Statistics
	11/08/2021	Public Sector Debt Statistics
	04/18/2022	Government Finance and Public Sector Debt Statistics
	08/15/2022	Government Finance and Public Sector Debt Statistics – Compilation of General Government Assets and Liabilities
	11/28/2022	Government Finance and Public Sector Debt Statistics – Functional Classification of Public Expenditure
Multi-Sector Statistics		
STA	1/31/2022-2/11/2022	Compilation and Recording of Bitcoins in Macroeconomics Statistics

Resident Representative: Metodij Hadzi-Vaskov (based in Guatemala) is the Regional Resident Representative for Central America, Panama, and the Dominican Republic.

RELATIONS WITH OTHER FINANCIAL INSTITUTIONS

World Bank

http://www.worldbank.org/en/country/elsalvador

Inter-American Development Bank

https://www.iadb.org/en/countries/el-salvador/overview

STATISTICAL ISSUES

(As of December 31, 2022)

I. Assessment of Data Adequacy for Surveillance
General. Data provision has some shortcomings but is broadly adequate for surveillance.
National Accounts. The Central Reserve Bank of El Salvador disseminates annual and quarterly national accounts, following the *System of National Accounts 1993* (*1993 SNA*), and including key recommendations from the *2008 SNA*. The series, available for 2005-18, with benchmark year 2005, are disseminated by the production and expenditure approaches, and Supply and Use Tables are disseminated for 2014-16 and Input-Output Tables for 2005 and 2014. In addition, a monthly index of economic activity (IVAE), which is consistent with the quarterly and annual national accounts, is disseminated on a regular basis. The rebased national accounts and monthly index of economic activity series were published on March 23, 2018.
Price Statistics. Price statistics are disseminated at monthly frequency. Consumer Price Index weights are based on the 2005-06 Household Income and Expenditure Survey. A broad PPI, with base year 2009, is compiled and disseminated on the website of the Central Reserve Bank.
Government Finance Statistics. Public sector data is reported on a cash basis but is comprehensive and timely. Information on flow and stocks is published monthly for the different components of the nonfinancial public sector (NFPS). Public debt statistics is presented as NFPS but have large gaps, particularly not all government securities held by private pension funds are reported. Information from securities issued by subsidiaries of the *Comisión Ejecutiva Hidroeléctrica del Río Lempa*—CEL holding is also missed. Information is produced by the Treasury and disseminated by the Central Bank. The country participates in a regional capacity development program for the harmonization of GFS for Central America, Panama, and the Dominican Republic led by the IMF's Regional Center for Technical Assistance (CAPTAC-DR). As part of this projects the authorities plan to migrate their fiscal statistics towards GFSM-2104 but exact timelines are not available. Data on the use of Bitcoin is needed.
Monetary and Financial Statistics. The Central Reserve Bank of El Salvador (CRBS) compiles and disseminates monetary and financial statistics (MFS), with concepts, definitions, and classification that are broadly in line with the *Monetary and Financial Statistics Manual (MFSM) 2000*. The CRBS uses standardized report forms based on accounting data to report data to the Fund. The CRBS regularly reports monthly financial soundness indicators (FSIs) to the IMF for publication. Currently, the BCB reports all core and 5 encouraged FSIs. Plans are under way to compile the rest of the encouraged FSIs. Data on the use of Bitcoin is needed.

<table>
<tr><td colspan="2">Financial Sector Statistics. Data coverage is broadly adequate. However, comprehensive data on household and corporate balance sheets, as well as on housing prices, which are currently not available, would be useful for more effective surveillance. Data on the us of Bitcoin is needed.</td></tr>
<tr><td colspan="2">External Sector Statistics. The Central Bank of El Salvador compiles and reports all key ESS datasets, except for the Coordinated Portfolio Investment Survey (CPIS). Authorities expressed interest in disseminating CPIS in 2019. The Coordinated Direct Investment Survey (CDIS) is incomplete, with inward direct investment reported and limited coverage for outward direct investment. Further work on improving coverage of nonfinancial private sector transactions is needed as well as comprehensive granularity in the reporting of external debt statistics. Data on remittances in Bitcoin has started to be published.</td></tr>
<tr><td colspan="2" align="center">II. Data Standards and Quality</td></tr>
<tr><td>El Salvador is a subscriber to the Fund’s Special Data Dissemination Standard (SDDS) since 1998. El Salvador is taking a flexibility option for the periodicity of the labor market and wages/earnings data category and will continue at this time to publish annual data with a timeliness of one quarter after the end of the reference year.</td><td>A data ROSC was published in December 2004.</td></tr>
</table>

Table 1. El Salvador: Common Indicators Required for Surveillance
(As of December 31, 2022)

	Date of Latest Observation	Date Received	Frequency of Data[7]	Frequency of Reporting[7]	Frequency of Publication[7]
Exchange Rates	NA	NA	NA	NA	NA
International Reserve Assets and Reserve Liabilities of the Monetary Authorities[1]	Dec-2022	Jan-2023	M	M	M
Reserve/Base Money	Dec-2022	Jan-2023	M	M	M
Broad Money	Dec-2022	Jan-2023	M	M	M
Central Bank Balance Sheet	Dec-2022	Jan-2023	M	M	M
Consolidated Balance Sheet of the Banking System	Dec-2022	Jan-2023	M	M	M
Interest Rates[2]	Dec-2022	Jan-2023	W	W	W
Consumer Price Index	Jan-2023	Feb-2023	M	M	M
Revenue, Expenditure, Balance and Composition of Financing[3]—General Government[4]	Dec-2022	Jan-2023	M	M	M
Revenue, Expenditure, Balance and Composition of Financing[4]—Central Government	Dec-2022	Jan-2023	M	M	M
Stocks of Central Government and Central Government-Guaranteed Debt[5]	Dec-2022	Jan-2023	M	M	M
External Current Account Balance	Sep-2022	Oct-2022	Q	Q	Q
Exports and Imports of Goods	Dec-2022	Jan-2023	M	M	M
Exports and Imports of Services	Sept-2022	Oct-2022	Q	Q	Q
GDP/GNP	Sep-2022	Oct-2022	Q	Q	Q
Gross External Debt	Sep-2022	Oct-2022	Q	Q	Q
International Investment Position[6]	Sep-2022	Oct-2022	Q	Q	Q

[1] Any reserve assets that are pledged or otherwise encumbered should be specified separately. Also, data should comprise short-term liabilities linked to a foreign currency but settled by other means as well as the notional values of financial derivatives to pay and to receive foreign currency, including those linked to a foreign currency but settled by other means.
[2] Both market-based and officially determined, including discount rates, money market rates, rates on treasury bills, notes, and bonds.
[3] Foreign banks, domestic banks, and domestic nonbank financing.
[4] The general government consists of the central government (budgetary funds, extra budgetary funds, and social security funds) and state and local governments.
[5] Including currency and maturity composition.
[6] Includes external gross financial asset and liability positions vis-à-vis nonresidents.
[7] Daily (D); weekly (W); monthly (M); quarterly (Q); annually (A); irregular (I); and not available (NA).

Statement by Mr. Guerra, Executive Director for El Salvador and Mr. Chicas Cienfuegos, Senior Advisor to Executive Director March 20, 2023

On behalf of El Salvador's authorities, we convey their appreciation to the Mission Chief, Mr. Raphael Espinoza, and his team for the engagement and candid discussions during the Article IV consultation.

El Salvador has been a *de jure* dollarized economy since 2001, which reduces the policy options during a period of constant shocks. Before the pandemic, on average from 2015 to 2019, the economy grew 2.4 percent in a context of low inflation (0.4 percent), a moderate fiscal deficit of 3.0 percent of GDP, and a current account deficit of 2.2 percent of GDP. In terms of public debt, in 2019 the debt-to-GDP ratio registered 69.9 percent, which included around 20 percent of GDP from the pension system. The pandemic generated a drop in economic growth (-8.2 percent), but decisive efforts by President Nayib Bukele's government to support the economy, such as a successful COVID-19 vaccination campaign (as of December 2022, 85 percent of the population has been vaccinated), led to a faster than expected recovery.

Recent Developments

The economy of El Salvador is growing above its historical average, notwithstanding continuous external shocks. GDP grew 10.3 percent in 2021, exceeding expectations and surpassing the pre-pandemic level in that year. In 2022, the commodity price shocks and the tightening of global monetary conditions were headwinds for the economy, but decisive efforts by the authorities to reduce red tape, improvements in the business climate, and a historical reduction in crime supported an estimated economic real growth rate of 2.8 percent, above potential output growth. Private demand increased 4.4 percent, supported by strong job creation (5.8 percent in the formal sector) and a continuous remittance inflow (3.2 percent). Private investment grew at an estimated rate of 5.6 percent, and exports of goods and services rose 8.9 percent, while imports of goods and services increased 4.9 percent.

The external commodity shocks have pushed inflation above its historical average but have remained in single digits. El Salvador has registered low inflation levels in the last few years, averaging 0.4 percent in the period 2015-2019. The recovery from the pandemic and the oil shock in 2021 raised inflation to 6.1 percent in December 2021. The multiple commodity shocks and the spillovers from the war in Ukraine elevated inflation to an unseen rate of 7.8 percent in June 2022, driven mainly by food prices. The authorities established a temporary fuel subsidy (ending in December 2022), a subsidy for the consumption of liquefied petroleum gas (ending in May 2023), and some actions to monitor prices and the conditions under which sales of basic goods are made. The subsidies and administrative measures that were oriented to protect consumers have allowed the country to maintain an inflation rate in single digits, one of the lowest in the Latin American region. In February 2023, inflation continued to moderate, reaching 6.8 percent year-over-year, according to official statistics.

The risks associated with Bitcoin have not materialized. The legal tender status of Bitcoin has not negatively affected the economy or the stability of the financial system of El Salvador. In this vein, the risks stated in the previous Article IV consultation have not materialized. It is worth noting that banks do not have any exposure to Bitcoin on their balance sheets. Since the adoption of Bitcoin as legal tender, the authorities have issued different norms to create an effective regulatory framework. The Rules of Procedure of the Bitcoin Law determined that all Bitcoin service providers must be registered at the Central Bank, the Superintendency of the Financial System is in charge of supervision, and Bitcoin providers must follow the guidelines of the Anti-Money Laundering Law. Improving and adapting the regulatory framework is an ongoing process that the authorities will continue to support. The adoption of Bitcoin has helped El Salvador become known around the world, contributing to increase tourism. In 2022, international visitors reached 2.5 million, a 79 percent annual increase, contributing to a more dynamic economy.

The authorities are committed to honoring all the public debt. El Salvador has paid all its public debt on time, contrary to some speculations about a default in early 2023. The Eurobond 2023 was paid out in January 2023 as scheduled, as were all other debt obligations. This was a clear demonstration of the authorities' commitment to their obligations, and it will continue to be a priority in the coming years. Furthermore, the authorities are working to improve debt management and have taken actions to reduce the concentration of debt service obligations in a short period of time.

Economic Outlook

The economy will continue growing above its potential. According to the authorities´ estimates, the GDP will grow 2.9 percent in 2023, above the estimated potential growth of 2.2 percent; however, this performance is not expected to generate excessive pressures on prices due to the dollarization scheme of the economy and the high imported component of El Salvador's inflation. It is projected that inflation will be lower in 2023, in line with the trajectory of commodity prices, such as oil, and the inflation rate in the United States. The economic drivers will be private consumption, investment, and export of services in a context of an unprecedentedly improved security environment. Private consumption will be supported by higher employment levels and positive remittance inflows (projected at 23.6 percent of GDP given the strengthening of the labor market in the USA). Furthermore, the reduction in crime will favor an increase in leisure activities, which will boost production and employment in other activities such as trade and services in the formal and informal sectors. Investment will be boosted by both the public and private sectors. The government will increase the development of strategic infrastructure. The *Dirección de Obras Municipales (DOM)* will continue providing infrastructure to municipalities (despite its recent creation, the DOM has a budget execution rate of about 100 percent). The private sector's participation, the efforts to reduce red tape, and the dynamic domestic economic activity generated by the improvements in the security situation will continue bolstering investment. It is projected that the construction sector will continue to be one of the most dynamic sectors (in February 2023, the Directorate of Construction Procedures was launched to facilitate construction projects), supported by investments in real state by the diaspora (according to the BCR, around 45 percent of investments made in El Salvador by Salvadorans living in the USA are concentrated in real state). The effective policy of tourism promotion, such as *Surf City,* will generate an increase in international events in El Salvador, boosting exports of services.

Fiscal Policy

The authorities' efforts to reduce tax evasion have generated an important increase in tax revenues. The Ministry of Finance is committed to substantially reducing tax evasion through the implementation of the Anti-Evasion Plan and the Anti-Smuggling Plan, which have generated additional revenues of US$1.4 billion (around 4.4 percent of GDP) since their implementation. Modernization is one of the priorities for tax management. In this vein, with the support of the IDB, the Electronic Invoicing System was launched in December 2022 with the aim of strengthening tax administration and facilitating the compliance of tax obligations. The measures implemented have been reflected in tax receipts exceeding the pre-pandemic level, reaching 20.7 percent of GDP in 2022 from 18.3 percent registered in 2019. The authorities are exploring other revenue and expenditure measures to sustain improvements in fiscal performance but underscore that, at this stage, an increase in the VAT rate is not considered due to possible negative effects on household consumption and economic growth.

Fiscal prudence in 2022 allowed for improvements in public finances. The economic performance and the implementation of administrative measures by the Ministry of Finance generated an outstanding increase in fiscal revenues in 2022. According to the Ministry of Finance's statistics, tax collection increased 12.6 percent, mainly due to an increase in income tax of 25 percent and in the VAT of 8.4 percent. However, current expenditure increased only 2.7 percent due to expenditure growth restraints on public salaries. The primary balance, including pensions, registered a surplus of 2 percent of GDP, above pre-pandemic levels. The fiscal deficit decreased substantially to 2.7 percent of GDP, compared with the rates registered in 2020 (10.1 percent of GDP) and 2021 (5.6 percent of GDP).

Public debt has decreased in the last two years, notwithstanding multiple external shocks. The authorities' commitment to improve public finances has allowed a decline in public debt in the last two years. Relevant resources were necessary to protect the population during the pandemic, especially to finance health expenditures, resulting in an increase in public debt that reached 87.9 percent of GDP in 2020. However, revenue measures and expenditure constraints allowed a reduction in public debt to 81.0 percent of GDP in 2021, and it is estimated at 76.2 percent of GDP in 2022 (in 2019, the ratio accounted for 69.9 percent of GDP), despite the temporary subsidies implemented to cushion the pass-through of international commodity price shocks to domestic prices.

Reform Agenda

The authorities continue applying measures to reduce red tape in order to facilitate private investment. El Salvador is committed to boosting private investment to increase potential growth, the productivity of the economy, and generate better job opportunities for the population. In the last few years, the authorities have implemented different measures to eliminate red tape, which have contributed to improving business sentiment and favoring private investment expectations. Private investment is estimated to end 2022 at 20.3 percent above the pre-pandemic level in real terms. Recently, the National Strategy for Trade Facilitation 2023–2027 was launched with the aim of improving competitiveness, boosting private investment, and generating more inclusive economic growth. Despite the global context, the improvements at the national level will favor continued increases in private domestic investment in the coming years.

El Salvador has achieved an unprecedented reduction in crime, supporting better economic perspectives. Different studies have consistently highlighted that the elevated level of crime and violence was one of the main constraints to higher growth rates in El Salvador. Decisive efforts and the implementation of the *Plan Control Territorial* by President Nayib Bukele have reduced crime and violence to an unprecedented level. The homicide rate per 100,000 inhabitants was 18.1 in 2021, but in 2022 the rate declined to 7.8 (a 56.8 percent drop in terms of the number of homicides), which implied that 2022 was the safest year in recent history (as a reference, the homicide rate was 105 in 2015). The reduction in crime is a factual issue that all the economic players highlight, and it is generating more economic activity in the country, especially in areas previously dominated by gangs. In this regard, the authorities consider that the reduction in crime will generate higher private investment and consumption due to the reduction in security costs and extortion payments by enterprises and households, and at the same time will generate higher tax collection, contributing to better fiscal performance.

Financial Sector Policies

The financial system maintains a resilient position. One of the strengths of El Salvador is the healthy position of its financial system over the last decades, which has allowed it to withstand recent shocks without affecting the stability of the system. Institutions finance their lending operations predominantly with domestic deposits (loans as a percent of deposits accounted for 100.3 percent as of December 2022), which reduces the effects of the tightening of global monetary conditions on domestic interest rates. The NPL remained low at 1.8 percent with adequate provisions (around 2.8 percent of total loans and 152.7 percent of NPL). The solvency of financial institutions remained sound, accounting for 15.4 percent by December 2022, above the regulatory minimum of 12 percent. Bank exposures to public debt accounted for 11 percent of total assets at the end of December 2022, a ratio below the average exposure in the region.

El Salvador continues implementing measures to promote financial inclusion and facilitate transactions in the economy. In 2022, the National Financial Education Strategy was launched, which aims to develop the financial capabilities of the population through specific strategies for all the target segments. Furthermore, the BCR performed the National Survey on Access and Use of Financial Products and Services as well as the National Financial Capabilities Survey, which have provided updated information on the progress of financial inclusion in the country. The BCR continued boosting electronic transactions through a home-made automated clearing house called *Transfer 365,* which allows immediate transfers to all the financial institutions by e-banking at any time and at no cost. As of December 2022, *Transfer 365* has mobilized more than US$13.8 billion (around 48 percent of GDP) and generated financial savings for the population of around US$21.5 million. In June 2022, the BCR added two new services: *Transfers 365 Móvil,* which allows transactions using an associated phone number to a bank account, and *Transfer 365 Business,* which focuses on high-value transactions required by companies. The central bank is working on expanding the services of Transfer 365, which will increase the efficiency of the financial system to boost higher economic activity and reduce poverty, thus fulfilling the mandate of President Nayib Bukele that the "public must be better than private".

Governance

The authorities are committed to continuing to improve the governance and AML/CFT framework. Efforts to improve the alignment of the national legislation with the UN Convention Against Corruption, G-20 High-Level Principles on Asset Disclosure, and FATF standards are progressing. The alignment of the Criminal Code and the Act of Illicit Enrichment of Public Officials to international standards is almost finished. With the advisory of the United Nations Office on Drugs and Crime, a revised Anti-money Laundering legislation is being drafted in order to meet FATF standards and expand the scope of the AML/CFT framework. The draft includes additional guidelines for Virtual Asset Service Providers, and it is planned to be sent to the Assembly once the findings of the country's national risk assessment are incorporated. The Financial Intelligence Unit is building higher operational capacity through trainings with foreign institutions, such as the FBI, and hiring specialized personnel in technology to be able to analyze and track suspicious transactions, including operations in the crypto ecosystem.

A new Public Procurement Law was enacted by the Assembly that contains elements recommended by the IMF. In February 2023, a new Public Procurement Law (PPL) was approved, which will contribute to improving the operational management of government procurement and provide new tools to establish control and auditing measures. The PPL creates the Single Registry of State Suppliers, establishes the creation of a National Public Procurement System (SINAC), and puts in place the information requirement on the beneficial owners of the bidding entities as was recommended by the IMF. It is expected that the new law will generate savings for the public finances.

The Central Bank is progressing in implementing the recommendations of the Safeguard Assessment 2020. The BCR is strengthening its governance by implementing the recommendations of the safeguard assessment. The adoption of a policy for the selection and rotation of external auditors, the reconstitution of the Audit Committee, the development of a strategy to eliminate quasi-fiscal operations, and an external quality evaluation of the Department of Internal Audit were met. In February 2023, the internal audit of the BCR achieved quality certification by a European institution, which highlights that all the processes conform to the IIA's International Standards for the Professional Practice of Internal Auditing and the Code of Etic. Regarding the adoption of the IFRS, the BCR has continued implementing its Adoption Plan approved in 2021 through communications with the central banks of the region to know their IFRS implementation processes and building internal capacities.

Conclusion

The authorities are implementing decisive measures to improve internal conditions and generate a more positive macroeconomic framework. The external environment is generating headwinds, but the exceptional improvement in security is eliminating one of the most relevant growth restrictions of the last decades, which could produce a new starting point for El Salvador. Efforts to improve the business environment, the security, the regulatory framework, and reduce the red tape will continue, as well as the commitment to implement adequate macroeconomic policies that guarantee financial stability, sustainable public debt, financial inclusion, and inclusive economic growth.

The authorities of El Salvador appreciate the close and permanent dialogue with the Fund.