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El Salvador Strategy Flash

The fiscal position clocked in at -1.8% of GDP in August

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El Salvador's 12m- accumulated fiscal position came in at -1.8% of GDP in August, while the primary balance clocked in at +2.5p of GDP, improving relative to July. The fiscal deficit ended August just 0.1pp below Dec-22 levels, even after a marginal compression in January, which was then offset by slightly weaker monthly prints since. However, during August income sources rose by +0.3pp, marginally surpassing the growth pace of outlays, which experienced a similar +0.3pp increase relative to July, tightening the fiscal deficit relative to last month's figures. NFPS income totaled 24.8pp of GDP in August (+0.3pp vs. July). The variation in the segment was singlehandedly explained by a 0.3pp rise in tax revenues, with the rest of the sectors standing level with their July-23 figures. This slightly shuffled the composition of Income sources. Therefore, Tax revenues came in at 20% of GDP, accounting for 80.6% of Total Income, increasing relative to July's figures.

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Outlays totaled 26.6pp of GDP in August, increasing by +0.3pp relative to July. The rise in expenditure was driven by a variety of segments. Current outlays clocked in at 23.5pp of GDP, rising by 0.3pp relative to July. In turn, inside the segment, Consumption of goods and services exhibited a 0.2pp increase, which compounded with a 0.1pp hike in Interest payments. In this context, the government decided to maintain Capex levels constant, showcasing no variation relative to July. Public Investment now stands at 3.2pp of GDP, with gross investment accounting for 2.9pp of GDP. With primary NFPS Income increasing by +0.3pp and primary NFPS expenditures rising by +0.3pp of GDP, the primary surplus improved marginally relative to July. In this context, the balance continues to stand at the very healthy +2.5% level, well inside positive territory.

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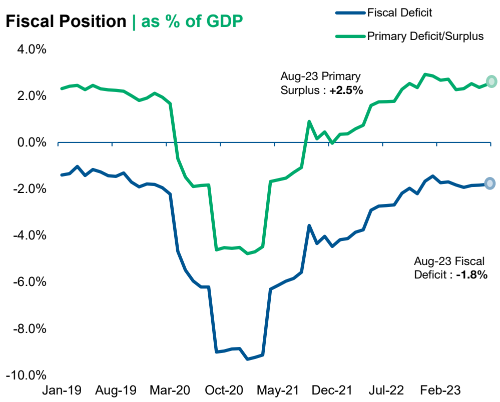
We find the recent fiscal prints to be credit-positive, as the administration is still conserving a hawkish fiscal bias. Going forward, we continue to believe it is unlikely the administration would commit to a large trim in government outlays, especially with dual elections dangling menacingly close in early 2024. However, it is also true that the administration's popularity does not seem to stem from fiscal impulse, as two consecutive years of massive consolidation did not even scratch Mr. Bukele's popularity ratings, which seem to be tied to the massive improvement in security metrics generated by the exception regime. With this in mind, it is not likely that the administration would increase expenditure massively to win the elections, as it does not need to, and most polls suggest so. Still, it is as unlikely as the government continuing to trim outlays in a context where their primary balance metrics exceed the historical average and stand close to its maximums. All in all, we expect the government to maintain relative order in the fiscal balance, not only due to its track record but also due to the fact that the administration pushed its financing sources to the limit during 2022 to pay the 2023 Eurobond, which should still leave the administration with financial constraints, tightening its spending possibilities.

Figure 1: August's fiscal figures



12m accumulated | % of GDP	dec-21	dec-22	jun-23	jul-23
Total Income	**24.1%**	**24.3%**	**24.5%**	**24.8%**
Current Income	24.1%	24.2%	24.4%	24.8%
Tax Revenues	19.6%	19.7%	19.7%	20.0%
Social System Contributions	2.2%	2.2%	2.3%	2.3%
Rest	2.3%	2.3%	2.5%	2.6%
Total Mandatory Outlays	**28.6%**	**25.9%**	**26.3%**	**26.6%**
Current Ouytlays	25.3%	23.3%	23.2%	23.5%
Consumption	15.6%	14.6%	15.0%	15.2%
Interest Payments	4.4%	4.6%	4.2%	4.3%
Current Transfers	5.3%	4.1%	4.0%	4.0%
Capital Expenditure	3.3%	2.7%	3.1%	3.2%
Net Loan Granting	0.0%	0.0%	0.0%	0.0%
Primary Balance	**0.0%**	**2.9%**	**2.4%**	**2.5%**
Pensions and Trusts	-1.0%	-1.0%	-0.5%	-0.4%
Net lending/borrowing	**-4.5%**	**-1.7%**	**-1.8%**	**-1.8%**

Source: TPCG Research based on BCR

BoP flows continue to turn supportive

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On positive news, BoP flows continue to align, as the 2Q23 Current Account deficit stood at -USD120mn, compressing by USD560mn vs. 2Q22 -USD679mn figure. In this context, the external sector proved much more supportive during the half of 2023. This mostly came on the back of twin improvements in the Trade and Services Balance, which accounted for the entirety of the improvement. The former posted a +USD426mn improvement over 2Q22 figures. This came mostly on the back of reduced Imports, which dropped by -607USDmn. Energy imports explained roughly one-fourth of the compression, being reduced by -USD134mn. Instead, food imports remained roughly level, as international prices continued at relatively high levels. The rest of the variation was explained by the Rest of Imports, which dropped by -USD494mn. Exports also suffered, albeit marginally, dropping by -181USDmn relative to 2Q22, mostly due to a fall in Maquila/Clothing exports. On the Services balance side, the latter clocked in with a +USD131mn additional surplus than in 2Q22. A deterioration of -USD108mn in Primary income was balanced out by a moderate improvement in remittances, which came in at USD2077mn, +USD122mn over 2Q22 figures. In this context, the 12m-accumulated current account deficit came in at -4.7% of GDP (-USD1.6bn), which is a significant improvement over 2Q22 figures (-8.5%; -2.6bn), and also over 4Q22 figures, which closed a very difficult year for the Salvadoran external sector, as the deficit clocked in at -7.9% of GDP (-USD2.5bn).

Figure 2: 2Q23 BoP flows

USD mn	2021	2022	2022 2Q	2023 2Q	Δ	1H22	1H23	Δ
Current Account	**-1485**	**-2570**	**-679**	**-120**	**560**	**-1477**	**-485**	**992**
Trade Balance	-8223	-9993	-2624	-2197	426	-4951	-4347	604
Imports	14617	17108	4455	3848	-607	8658	7786	-872
Energy Imports	1925	2824	768	634	-134	1412	1285	-127
Food Imports	1875	2244	546	566	20	1080	1146	66
Rest	10818	12040	3141	2647	-494	6166	5355	-811
Exports	6395	7115	1831	1650	-181	3707	3439	-268
Clothing/Maquila	2624	2746	697	593	-104	1409	1218	-191
Rest	3771	4369	1134	1057	-77	2298	2222	-77
Services balance	881	1628	386	517	131	686	1028	342
Primary Income	-1566	-1867	-382	-489	-108	-925	-1071	-146
Secondary Income	7422	7662	1940	2050	110	3713	3905	192
o/w Remmitances	7453	7670	1956	2077	122	3742	3967	226
Capital Account	**270**	**261**	**43**	**80**	**37**	**173**	**126**	**-47**
Financial Account (- indicates inflow)	**-1694**	**-384**	**-420**	**61**	**481**	**-870**	**-603**	**267**
FDI	-308	101	57	-123	-180	284	-263	-547
Portfolio Investment	-303	503	-48	128	177	-146	220	366
Derivatives	0	1	0	3	3	0	5	5
Other Investment	-1083	-989	-429	53	482	-1008	-566	443
Net Errors&Ommisions	**-113**	**1222**	**362**	**-47**	**-410**	**1023**	**-104**	**-1127**
Reserve Assets	**359**	**-702**	**146**	**-146**	**-292**	**589**	**145**	**-444**
GDP (USDmn)	**29451**	**32489**	**31200**	**33371**	**2171**	**31200**	**33371**	**2171**
Current Account (as % of GDP)	**-5.0%**	**-7.9%**	**-8.5%**	**-4.7%**	**-**	**-8.5%**	**-4.7%**	**-**

Source: TPCG Research based on BCR

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The external sector has shown a significant improvement since the start of the year, reducing the probability of a BoP crisis derailing the Salvadoran economy. Even with the already good 1H23 figures, we expect the external situation to continue improving, as normalizing food and energy prices should continue to result in a decrease in Imports, which in turn should tighten the economy's current account deficit even further, bringing it back to more sustainable levels. In our view, the main threat to the Salvadoran economy during 2023 came from the external sector. In a scenario where remittance flows towards the country are reduced, on the back of an unflattering international scenario or a recession in the US, the economy would not be able to sustain its Import rates and, in turn, its consumption. This scenario would strain tax revenues and force the administration to push for increased outlays to contain the massive drop in disposable income. This, in turn, should have limited the government's fiscal policies and, with reduced financing sources, should have raised questions about debt sustainability once again. However, the substantial improvement in external figures caused by the solid 1Q23 and 2Q23 prints reduced the probability of occurrence of said scenario, rendering the print credit positive, as we believe the external sector carried the greatest risk of derailing the administration's solid tenure. Now, even if we believe this threat has been significantly mitigated by the solid 1H23 external numbers, the external situation continues to be fragile.

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