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Strategy Flash – El Salvador

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El Salvador Strategy Flash

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El Salvador 12m- accumulated fiscal position came in at -1.5% of GDP in January, while the primary balance clocked in at +3.0p of GDP, improving since December. After overperforming the established target for 2022, the fiscal balance continues its compression, tightening by nearly -0.2pp relative to December. During January income dropped by 0.2pp relative to December, being offset by a -0.4pp fall in outlays, which was the main factor influencing the compression of the fiscal deficit. NFPS income totaled 25.1pp of GDP in January (-0.2pp vs December). The variation in the segment was singlehandedly explained by a 0.2pp drop in tax revenues, with the rest of the sectors coming in flat relative to December, with no significant variations in any subsections, as the composition of Income sources remained unchanged. Therefore, tax revenues came in at 20.4% of GDP, accounting for 81.2% of Total Income, decreasing marginally relative to December's figures.

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Outlays totaled 26.6pp of GDP in January, falling by -0.4pp relative to December. The drop in expenditure was driven by a fall in Current Expenditure, while public investment remained flat relative to December. The former came in at 23.8pp of GDP, decreasing by -0.4pp since December. In turn, inside the segment, Interest payments spearheaded the compression, falling by -0.3pp relative to December, which compounded with a 0.1pp fall in Current transfers. The rest of the sectors stood flat against last month's figures. Capex showed no variation relative to December, with Public Investment now standing at 2.7pp of GDP, with gross investment accounting for 2.2pp of GDP. With NFPS Income dropping by -0.2pp and NFPS expenditures falling by -0.4pp of GDP, the primary balance showed no variation relative to December, as the excess fall of NFPS outlays came mostly in line with a drop in interest expenses. Still, the balance continues to stand at the very healthy +3% level, well inside positive territory.

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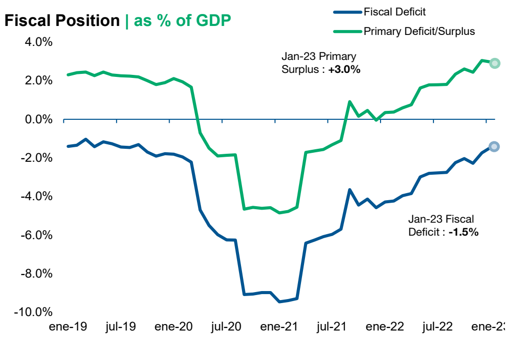
While the government is committed to improving the fiscal position, we believe a slowdown in economic activity is likely to dampen consolidation during 2023. During this year we expect income growth to become more sluggish, as its biggest contributor, tax revenues, is poised to slow down following the economic scenario. Already in January, monthly income fell by -4.2% yoy, hinting this trend could continue during the year. In addition, it is unlikely the administration would commit to a large trim in government outlays, especially with dual elections dangling menacingly close in early 2024. Still, 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. 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: January's fiscal figures



12m accumulated | % of GDP	dic-20	dic-21	dic-22	ene-23
Total Income	**23.4%**	**24.7%**	**25.3%**	**25.1%**
Current Income	22.9%	24.7%	25.2%	25.0%
Tax Revenues	18.5%	20.1%	20.6%	20.4%
Social System Contributions	2.4%	2.3%	2.3%	2.3%
Rest	2.5%	2.4%	2.4%	2.4%
Total Mandatory Outlays	**32.3%**	**29.3%**	**27.0%**	**26.6%**
Current Ouytlays	27.7%	25.9%	24.2%	23.8%
Consumption	17.0%	16.0%	15.2%	15.2%
Interest Payments	4.4%	4.5%	4.8%	4.4%
Current Transfers	6.2%	5.4%	4.3%	4.2%
Capital Expenditure	2.8%	3.4%	2.8%	2.7%
Net Loan Granting	1.9%	0.0%	0.0%	0.0%
Primary Balance	**-4.6%**	**0.0%**	**3.0%**	**3.0%**
Pensions and Trusts	-3.4%	-1.0%	-1.0%	-0.9%
Net lending/borrowing	**-9.0%**	**-4.6%**	**-1.7%**	**-1.5%**

Source: TPCG Research based on BCR

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