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London

Economist Intelligence Unit
20 Cabot Square
London
E14 4QW
United Kingdom
Tel: (44.20) 7576 8000
Fax: (44.20) 7576 8500
E-mail: london@eiu.com

New York

Economist Intelligence Unit
The Economist Group
750 Third Avenue
5th Floor
New York, NY 10017, US
Tel: (1.212) 554 0600
Fax: (1.212) 586 0248
E-mail: newyork@eiu.com

Hong Kong

Economist Intelligence Unit
60/F, Central Plaza
18 Harbour Road
Wanchai
Hong Kong
Tel: (852) 2585 3888
Fax: (852) 2802 7638
E-mail: hongkong@eiu.com

Geneva

Economist Intelligence Unit
Rue de l’Athénée 32
1206 Geneva
Switzerland

Tel: (41) 22 566 2470
Fax: (41) 22 346 93 47
E-mail: geneva@eiu.com

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Highlights

Editor: **Rodrigo Aguilera**

Forecast Closing Date: **January 13, 2015**

Outlook for 2015-19

- The left-wing government of the ruling Frente Farabundo Martí para la Liberación Nacional (FMLN), led by Salvador Sánchez Cerén, will guarantee some degree of policy continuity despite the president's hardline credentials.
- The move towards a multiparty system will raise an element of risk to political effectiveness throughout the forecast period, and the FMLN is unlikely to gain a majority in legislative elections to be held in March.
- After estimated growth of 2% in 2014, the economy will expand by an average of just 2.2% in 2015-19 as a result of a very weak business environment and a fragile domestic production base, both of which constrain investment.
- The new government will be forced to impose fiscal-consolidation measures in order to bring down the deficit, which reached an estimated 3.5% of GDP in 2014, and to renew an expired IMF agreement.
- After averaging 1.1% in 2014, inflation will rise to an annual average of 1.9% in 2015-19. Despite weak domestic demand, continued dependence on costly imports will exert upward pressure on the consumer price index.
- Despite a moderate strengthening of the real effective exchange rate in 2015–19, dollarisation will not come under threat in the outlook period, reflecting its broad acceptance across the political spectrum.
- The current-account deficit is forecast to narrow to 4.5% by 2015-16, driven by low oil prices, but will then widen to 4.9% by 2019. The government will make efforts to increase the country's export potential.

Review

- A new poll has suggested that the FMLN will fail to win an absolute majority in legislative elections to be held in March.
- On January 6th the US Department of Homeland Security announced an extension to its existing Temporary Protection Status (TPS) programme for more than 200,000 illegal Salvadoran migrants.
- The constitutional chamber of the Corte Suprema de Justicia (the Supreme Court) has struck down the current system of limiting voters to a choice between pre-defined party lists of candidates in elections for Congress.
- GDP grew by 2% year on year in the third quarter of 2014, according to the Banco Central de Reserva de El Salvador (the Central Bank), following growth of 2% in the first half of the year.
- The current-account deficit narrowed to 2.3% of GDP in January-September, but foreign direct investment fell to just US$183.3m during the same period.

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Outlook for 2015-19

Political stability

The government of the left-wing Frente Farabundo Martí para la Liberación Nacional (FMLN)—led by Salvador Sánchez Cerén—which took office on June 1st 2014, will guarantee some degree of continuity with the policies of the former president, Mauricio Funes (2009-14), but will face significant challenges in the form of a chronically weak economy, low levels of socio-economic development, and high crime. To his benefit, Mr Sánchez Cerén has taken a more moderate stance than his history as a former left-wing guerrilla suggested he might, and this is unlikely to change given the need to appeal beyond the FMLN's traditional support base. The president's moderate stance should also help to maintain a higher degree of intra-party unity than was the case during the term of Mr Funes, who was an outsider within the party. Obtaining the support of the business community will be particularly crucial in a country where entrenched groups have traditionally held enormous political clout.

The political scene will now shift its focus to the upcoming legislative elections, which are scheduled for March 1st (these are not held in the same year as the presidential poll). The political environment has been complicated in recent years by the emergence of a third major political force, the Gran Alianza por la Unidad Nacional (GANA). GANA’s animosity towards the opposition Alianza Republicana Nacionalista (Arena; GANA was founded by former Arena members) could make it a potentially reliable government ally, but ideological differences may preclude a robust collaboration. In the meantime, the FMLN has been struggling with flagging support after its first few months in office. Although an early slump of this kind is common as post-election euphoria dies out, it risks putting the FMLN in a difficult position ahead of the legislative elections, which are now less than three months away. Given the improbability of the FMLN securing a legislative majority in 2015, much will depend on the party's ability to negotiate successfully with the opposition in order to pass its agenda.

In the long term, there remains a risk of tension between the different branches of government, especially the increasingly independent-minded Supreme Court (this led to a constitutional crisis in mid-2012). Another ongoing issue is the lethargic state of the economy—the slowest-growing in Central America—which has made it impossible to adequately address socio-economic needs such as high levels of poverty and inequality, as well as low educational standards. El Salvador’s precarious security situation, exacerbated by the breakdown of a truce between the two main urban gangs (known locally as maras), will also remain a major cause for concern for individuals and businesses in 2015-19, and will pose a threat to institutional stability. Although the homicide rate has fallen in recent years compared with highs in the previous decade, the frequency of other high-impact crimes such as kidnapping and extortion, as well as the presence of drug-trafficking gangs (many of which are affiliated with Mexican cartels) present a formidable institutional challenge in a country that has struggled to properly uphold the rule of law.

Election watch

The next presidential election is not due until 2019. However, legislative elections will be held in early 2015. The rise of GANA makes it likely that the legislature will remain highly factionalised, which will prevent the FMLN from gaining a majority. It is too soon to suggest potential candidates for the next presidential election (re-election is allowed, but not consecutively). Both the FMLN and Arena may look to a new generation of leaders, whereas GANA is likely to keep Antonio "Tony" Saca, a former president (2004-09), at the helm.

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International relations

Mr Sánchez Cerén's foreign policy, like that of his predecessor, will prioritise maintaining close relations with other Central American countries and the US, El Salvador's key trade and investment partner, and home to over 2.3m Salvadorans. Relations with the US will be focused primarily on trade, security and immigration; the latter has been given extra urgency due to the rise in child migration into the US. In the short-term, El Salvador will benefit from an extension of the US Temporary Protection Status (TPS) scheme, through which Salvadorans who have entered the country illegally can apply for protection against deportation. Although the FMLN maintains historical links with radical leftist regimes in the region (including in Venezuela and Cuba), the government has avoided a marked anti-US stance, and Mr Sánchez Cerén is unlikely to deepen ties with these governments, despite recently having joined Venezuela's PetroCaribe initiative (which provides subsidised oil). El Salvador will continue to develop political and economic ties with Latin American peers, and increase trade links with Asia and the EU. In the case of the EU, links have been boosted by an association agreement—which includes a free-trade component—signed in June 2012. Co-operation with other Central American governments on security-related issues will also be a priority, and will include discussions (and possibly partial legalisation) on decriminalisation of drug use.

Policy trends

The Salvadoran economy has consistently underperformed over the past two decades compared with its Central American peers, with GDP growth averaging less than 2% since 2008. The main reason for this sluggishness is weak levels of investment (on the public, private and foreign fronts), which have averaged less than 15% of GDP during this period. As a consequence, there has been only moderate progress in addressing the country's significant development needs. Mr Sánchez Cerén has pledged to continue many of Mr Funes's social programmes, focused mainly on healthcare, education and rural development. A 2013 law on public-private partnerships (PPPs) should also help to foster private investment in infrastructure, which could fill part of the financing gap resulting from spending constraints as the government seeks to consolidate its fiscal accounts. Further budgetary support (US$277m) will come from the Millennium Challenge Corporation (MCC) scheme, financed by the US. Despite his credentials as a former guerrilla leader, Mr Sánchez Cerén has begun his term with a conciliatory tone towards the business sector, in contrast with the combative stance of his predecessor. However, despite these first steps, the government will find it hard to ameliorate existing weak economic conditions and improve investment prospects, given the country's structural deficiencies and poor business environment.

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Fiscal policy

El Salvador's short-term fiscal outlook will remain somewhat fragile, although the provision of MCC funds will help to compensate for the lack of a renewed IMF stand-by arrangement (the last agreement expired in 2013). There was some improvement in the public-sector balance in 2014, with the deficit narrowing to 2.3% of estimated GDP in January-September, compared with 2.7% in the same period of 2013. The enfeebled state of the economy will continue to complicate efforts to raise revenue at a faster pace. A recent tax reform (focused on a new minimum corporate tax rate as well as closing loopholes) will help, but we nonetheless expect revenue to rise by less than 1% of GDP over the forecast period. However, further fiscal consolidation over the next few years will gradually reduce the public-sector deficit to 2.4% of GDP by 2019, although Mr Sánchez Cerén's government is likely to promote a less brisk pace of deficit reduction than would have been the case under a right-wing Arena administration. In terms of the country's broader debt profile, the government will continue to swap expensive short-term domestic debt for less onerous long-term multilateral debt, while occasionally tapping international markets to roll over its modest existing commitments (US$800m was issued in September 2014). Programmes such as the MCC will also help to alleviate some budgetary pressure. However, the increased borrowing will contribute to lifting the public debt/GDP ratio to 63.9% by 2019, from a year-end level of 58.1% in 2013.

Monetary policy

Because of El Salvador's fully dollarised economy, the government and the Banco Central de Reserva de El Salvador (the Central Bank) can only influence monetary policy through regulation of the banking system. Interest rates and the money supply are in the hands of commercial banks (most of which are foreign-owned). Domestic interest rates will remain relatively stable in 2014, before rising in 2015-19 in line with our expectations of tighter monetary policy in the OECD in the medium term. Volatile global conditions and the cautious lending practices of Salvadoran banks will hinder fast credit expansion, which, although gradually improving over the past few years, remains in single digits (6.3% year on year in October). This should accelerate further throughout the forecast period, and will be accompanied by modest efforts by the government to encourage lending to small and medium-sized enterprises.

International assumptions

	2014	2015	2016	2017	2018	2019
Economic growth (%)						
US GDP	2.3	3.3	2.5	2.4	2.6	1.4
OECD GDP	1.8	2.4	2.3	2.3	2.4	2.0
World GDP	2.3	2.9	2.9	2.8	2.9	3.0
World trade	3.4	5.1	5.3	5.4	5.5	5.6
Inflation indicators (% unless otherwise indicated)						
US CPI	1.7	1.7	2.1	2.3	2.5	2.0
OECD CPI	1.6	1.5	1.9	2.0	2.0	1.8
Manufactures (measured in US$)	-0.3	0.4	1.5	1.8	1.0	1.3
Oil (Brent; US$/b)	99.4	80.3	84.0	88.1	93.8	92.4
Non-oil commodities (measured in US$)	-5.4	-2.5	2.7	3.0	3.3	3.0
Financial variables						
US$ 3-month commercial paper rate (av; %)	0.1	0.3	1.4	2.4	2.9	3.0
Exchange rate US$:€ (av)	1.33	1.22	1.18	1.20	1.21	1.24

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Economic growth

El Salvador will continue to post the slowest rate of GDP growth in Central America in 2015-19, reflecting a weak local production and investment base, which limits domestic demand. In the first three quarters of 2014 GDP expanded by 2.1%—a noticeable improvement on the full-year rate of 1.7% in 2013—and we now expect more robust growth of 2% for the full year. Going forwards, growth will remain sluggish, at an average rate of 2.2% in 2015-19, despite improved investment conditions and a more conducive external environment. Such a weak pace of growth will be insufficient to raise productivity or address the country's development needs, resulting in continued poverty and inequality, as well as poor employment prospects, which will continue to fuel migration and crime.

Private consumption growth will gather strength after 2015 on the back of marginally better credit conditions and continued recovery in remittances. Most of the previous government's social development plans will remain in place and will be necessary to keep poverty levels from worsening. A precarious security situation following the unravelling of the truce between mara street gangs will affect private investment, but spending on public reconstruction projects and a bigger role for PPPs will support modest investment growth in the short term. This will accelerate slightly in the medium term, once global conditions improve and companies increasingly take advantage of the Dominican Republic-Central America Free-Trade Agreement (DR-CAFTA) with the US, as well as a recent association agreement with the EU. Furthermore, exporters will develop stronger ties with the EU and South American markets, bringing momentum to real exports over the forecast period. Import growth will accelerate as private consumption gradually strengthens, and will rise at a faster pace than exports in 2015-19, with the real external balance therefore acting as a drag on GDP.

On the supply side, output from the agricultural sector will be prone to volatility, owing to the country's vulnerability to natural phenomena, such as floods and tropical storms, as well as other temporary shocks such as the roya fungus, which has affected coffee production across Central America. Services growth will continue to gather pace in 2015-19, led by commerce, transport and communications. The manufacturing sector, which is dominated by the maquila (offshore assembly for re-export) industry, will also expand, but high input costs will limit growth. Construction will remain weak in the short term, but should pick up as new infrastructure projects are drawn up under the new administration. We expect the performance of most other sectors to improve in 2015-19, in line with more robust private-sector growth and stable international conditions. However, competition with other Central American economies that produce similar goods (such as textiles) will be intense, particularly as El Salvador's main competitive advantage, low labour costs, will be offset by its smaller productive base and a difficult security situation.

Economic growth

%	2014[a]	2015[b]	2016[b]	2017[b]	2018[b]	2019[b]
GDP	2.0	2.1	2.2	2.2	2.3	2.3
Private consumption	2.5	2.7	2.8	2.9	3.0	3.0
Government consumption	3.0	2.8	2.8	2.7	2.7	3.0
Gross fixed investment	4.5	5.5	5.8	5.8	6.0	6.0
Exports of goods & services	3.3	3.2	3.5	3.8	3.9	3.9
Imports of goods & services	4.5	4.8	5.2	5.3	5.5	5.5
Domestic demand	2.8	3.1	3.3	3.3	3.5	3.5
Agriculture	1.6	1.6	2.0	2.0	2.4	2.8
Industry	2.2	2.2	2.4	2.4	2.6	2.8
Services	1.5	1.8	2.1	2.0	2.0	2.0

[a] Economist Intelligence Unit estimates. [b] Economist Intelligence Unit forecasts.

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Inflation

Consumer price inflation averaged 1.1% during 2014, but fell to 0.5% in December. Such weak levels are too low to signal a rebound in economic growth, and our baseline forecast sees inflation falling to an average of 0.9% in 2015, driven by lower oil prices (El Salvador imports nearly all of its oil). Dollarisation will help to keep inflation structurally low, at an annual average of 2.1% in 2015-19. This is lower than most countries in the region, giving a modest boost to El Salvador's terms of trade. Potential supply-side risks to our inflation forecasts stem from frequent weather-related disruptions, although these tend to have only temporary effects.

Exchange rates

The dollarisation policy adopted in 2001 will not come under threat in 2015-19, reflecting its broad acceptance across the political spectrum. As a result of weaker inflation throughout the forecast period (which will be largely similar to that of the US, its major trading partner), we expect the real effective exchange rate to weaken by 1.9% in 2019 from its 2013 level. This will aid the competitiveness of Salvadoran exporters, while the stability afforded by dollarisation should remain supportive of the country's overall macroeconomic and monetary environment.

External sector

A structural trade deficit will produce a persistent current-account deficit in the outlook period, but lower oil prices expected during this time have led us to revise our forecasts: we now anticipate that the deficit will average 4.8% of GDP per year in 2015-19 (versus 5.3% in our previous report). El Salvador's trade balance is heavily exposed to changes in international commodity prices and is subject to the country's strong structural dependence on imports, given its weak domestic manufacturing base. As a result, the trade deficit will average over 20% of GDP in the forecast period, notwithstanding higher exports in the long term, resulting from trade preferences under DR-CAFTA. The services and income balances—neither of which represent a particularly large share of the current account—will remain broadly stable in 2015-19, while the transfers surplus will rise steadily in real terms, boosted by higher remittances inflows, which have now recovered to their pre-crisis levels in absolute terms. However, in relative terms, the continued weakness of job creation in the US, as well as lower emigration rates, will prevent a return to 2006-08 levels, when remittances averaged a record 17.9% of GDP.

Continued access to multilateral support will help to finance the current-account deficit, but the country is struggling to attract foreign direct investment (FDI) in the context of a weak economy and a difficult security environment. FDI came in at just US$183.3m in the first three quarters of 2014, about one-third less than the inflows received in the same period of 2013. As a share of GDP, FDI will remain the lowest in Central America, averaging just 2% in the forecast period. Foreign reserves reached US$2.8bn in November (boosted by an US$800m Eurobond in September) and will provide an average of 2.7 months of import cover in 2015-19.

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Forecast summary

Forecast summary

(% unless otherwise indicated)

	2014[a]	2015[b]	2016[b]	2017[b]	2018[b]	2019[b]
Real GDP growth	2.0	2.1	2.2	2.2	2.3	2.3
Industrial production growth	2.2	2.2	2.4	2.4	2.6	2.8
Gross agricultural production growth	1.6	1.6	2.0	2.0	2.4	2.8
Unemployment rate (av)	6.2	6.1	6.1	6.1	6.0	6.0
Consumer price inflation (av)	1.1	0.9	1.9	2.1	2.4	2.4
Consumer price inflation (end-period)	0.5	1.8	2.0	2.1	2.4	2.4
Lending interest rate	6.0	6.1	6.1	6.3	6.3	6.3
NFPS balance (% of GDP)	-3.5	-3.2	-2.9	-2.7	-2.5	-2.4
Exports of goods fob (US$ bn)	4.5	4.7	5.2	5.7	6.3	6.9
Imports of goods fob (US$ bn)	9.9	10.3	11.3	12.3	13.3	14.4
Current-account balance (US$ bn)	-1.3	-1.1	-1.2	-1.4	-1.5	-1.5
Current-account balance (% of GDP)	-5.2	-4.3	-4.6	-4.8	-4.9	-4.9
External debt (end-period; US$ bn)	14.8	15.6	16.4	17.4	18.5	19.6
Exchange rate US$:¥100 (av)	0.94	0.81	0.79	0.81	0.82	0.83
Exchange rate US$:€ (av)	1.33	1.22	1.18	1.20	1.21	1.24
Exchange rate US$:€ (end-period)	1.25	1.19	1.17	1.21	1.22	1.25

[a] Economist Intelligence Unit estimates. [b] Economist Intelligence Unit forecasts.

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Data and charts

Annual data and forecast

	2010[a]	2011[a]	2012[a]	2013[a]	2014[b]	2015[c]	2016[c]
GDP							
Nominal GDP (m)	21,419	23,140	23,864	24,259	25,072	25,870	26,993
Real GDP at constant 1990 prices	9,076	9,277	9,452	9,610	9,806	10,012	10,228
Real GDP growth (%)	1.4	2.2	1.9	1.7	2.0	2.1	2.2
Expenditure on GDP (% real change)							
Private consumption	2.2	2.4	2.6	0.3	2.5	2.7	2.8
Government consumption	2.2	3.9	2.5	6.0	3.0	2.8	2.8
Gross fixed investment	2.4	13.8	-1.4	9.7	4.5	5.5	5.8
Exports of goods & services	11.6	9.3	-7.5	4.6	3.3	3.2	3.5
Imports of goods & services	10.4	10.8	-4.5	4.5	4.5	4.8	5.2
Origin of GDP (% real change)							
Agriculture	3.1	-2.5	2.5	1.2	1.6	1.6	2.0
Industry	0.9	3.4	1.2	1.8	2.2	2.2	2.4
Services	1.4	2.8	1.7	2.2	1.5	1.8	2.1
Population and income							
Population (m)	6.2	6.3	6.3	6.3[b]	6.4	6.4	6.4
GDP per head (US$ at PPP)	7,028	7,393	7,580[b]	7,814[b]	8,088	8,376	8,693
Recorded unemployment (av; %)	7.0	6.6	6.1	6.3[b]	6.2	6.1	6.1
Fiscal indicators (% of GDP)							
Public-sector balance[d]	-4.3	-3.9	-3.4	-4.0	-3.5	-3.2	-2.9
Public-sector debt interest payments	2.4	2.2	2.2	2.4	2.3	2.3	2.2
Public-sector primary balance	-1.9	-1.7	-1.2	-1.6	-1.2	-0.9	-0.7
Net public debt	53.0	53.4	57.9	58.1	60.5	61.7	62.3
Prices and financial indicators							
Consumer prices (end-period; %)	2.1	5.0	0.8	0.8	0.5	1.8	2.0
Stock of money M1 (% change)	14.2	5.3	0.6	3.4	3.5	4.8	5.5
Stock of money M2 (% change)	0.1	-2.3	1.0	2.2	3.1	4.4	4.9
Commercial prime interest rate (av; %)	7.6	6.0	5.6	5.7	6.0	6.1	6.1
Current account (US$ m)							
Trade balance	-4,022	-4,772	-4,927	-5,295	-5,414	-5,634	-6,137
Goods: exports fob	3,473	4,243	4,235	4,334	4,528	4,704	5,155
Goods: imports fob	-7,495	-9,015	-9,162	-9,629	-9,942	-10,338	-11,293
Services balance	398	449	508	584	697	754	821
Primary income balance	-538	-618	-890	-966	-928	-802	-729
Secondary income balance	3,629	3,830	4,021	4,100	4,334	4,563	4,802
Current-account balance	-533	-1,112	-1,288	-1,577	-1,311	-1,119	-1,243
External debt (US$ m)							
Debt stock	11,064	12,000	13,194	13,376	14,806	15,550	16,419
Debt service paid	1,082	1,284	1,148	1,110	863	877	1,004
Principal repayments	604	757	628	559	675	670	698
Interest	478	527	520	551	188	207	306
International reserves (US$ m)							
Total international reserves	2,883	2,504	3,176	2,745	3,008	2,714	2,958

[a] Actual. [b] Economist Intelligence Unit estimates. [c] Economist Intelligence Unit forecasts. [d] Receipts exclude proceeds from sales of state assets (privatisations).

Source: IMF, International Financial Statistics.

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Quarterly data

	2013				2014			
	1 Qtr	2 Qtr	3 Qtr	4 Qtr	1 Qtr	2 Qtr	3 Qtr	4 Qtr
Central government finance (US$ m)								
Revenue & grants	935	1,253	867	947	1,284	1,429	1,069	n/a
Expenditure & net lending	1,032	1,254	1,048	985	1,013	1,472	1,487	n/a
Balance	-97	-1	-182	-38	270	-43	-418	n/a
Output								
GDP at constant 1990 prices (US$ m)								
Agriculture	300	287	285	299	305	294	293	n/a
Industry	636	644	640	647	649	656	652	n/a
Commerce	1,241	1,247	1,254	1,261	1,272	1,273	1,279	n/a
Total	2,389	2,389	2,400	2,432	2,442	2,438	2,449	n/a
Total (% change, year on year)	1.3	1.7	1.9	1.8	2.2	2.1	2.0	n/a
Prices								
Consumer prices (2005=100)	108.0	107.6	107.7	107.8	108.6	108.6	109.7	109.1
Consumer prices (% change, year on year)	1.2	0.4	0.9	0.7	0.5	0.9	1.8	1.2
Producer prices (2005=100)	115.9	114.0	114.5	113.4	113.5	113.9	113.4	n/a
Producer prices (% change, year on year)	1.1	0.8	-0.7	-0.7	-2.1	-0.1	-1.0	n/a
Coffee price (US cents/lb)[a]	n/a	n/a	n/a	n/a	n/a	n/a	n/a	n/a
Financial indicators								
Deposit rate (av; %)	3.3	3.3	3.4	3.6	3.5	3.7	3.8	n/a
Lending rate (av; %)	5.7	5.7	5.9	5.7	6.0	5.9	6.1	n/a
M1 (end-period; US$ m)	2,931	2,987	2,979	2,892	3,126	3,121	3,069	n/a
M1 (% change, year on year)	2.5	0.3	7.4	3.4	6.6	4.5	3.0	n/a
M2 (end-period; US$ m)	10,775	10,884	10,892	10,872	10,969	10,892	11,001	n/a
M2 (% change, year on year)	1.3	1.4	2.8	2.2	1.8	0.1	1.0	n/a
Foreign trade (US$ m)								
Exports fob	1,362	1,460	1,394	1,275	1,289	1,379	1,354	n/a
Maquila[b]	275	291	295	297	239	279	276	n/a
Imports cif	2,542	2,866	2,731	2,634	2,615	2,756	2,534	n/a
Maquila[b]	195	197	173	188	172	204	160	n/a
Trade balance	-1,179	-1,406	-1,337	-1,359	-1,326	-1,377	-1,180	n/a
Foreign payments (US$ m)								
Merchandise trade balance fob-fob	-1,167	-1,395	-1,364	-1,369	-1,302	-1,354	-1,206	n/a
Services balance	87	115	175	207	153	157	242	n/a
Primary income balance[c]	-231	-210	-275	-250	-284	-235	-252	n/a
Current-account balance	-356	-429	-460	-332	-419	-294	-141	n/a
Reserves excl gold (end-period)	2,672	2,771	2,793	2,476	2,666	2,466	2,921	n/a

[a] ICO Indicator. [b] Offshore assembly for re-export. [c] Including Secondary income balance.
Sources: IMF, International Financial Statistics; Banco Central de Reserva de El Salvador.

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Monthly data

	Jan	Feb	Mar	Apr	May	Jun	Jul	Aug	Sep	Oct	Nov	Dec
Economic activity (% change, year on year)												
2012	1.3	3.3	1.3	0.6	1.9	1.7	1.6	3.1	0.4	4.4	1.9	0.2
2013	-0.4	-2.0	-5.8	6.8	1.8	0.4	2.6	2.5	1.4	1.9	1.1	1.6
2014	1.8	2.8	7.2	-2.5	0.1	0.2	-0.3	-2.2	0.5	-2.1	n/a	n/a
M1 (% change, year on year)												
2012	12.1	10.1	5.8	5.7	10.7	14.1	-1.9	0.2	-0.8	-1.0	-0.5	0.6
2013	-0.2	0.5	2.5	2.7	0.3	0.3	0.3	5.8	7.4	9.7	2.1	3.4
2014	0.7	7.9	6.6	7.1	5.5	4.5	7.3	-0.7	3.0	0.7	4.6	n/a
M2 (% change, year on year)												
2012	-0.5	-0.1	-0.3	0.4	1.7	2.9	-0.8	-0.1	-0.3	0.7	0.7	1.0
2013	1.8	1.9	1.3	1.3	1.0	1.4	1.9	2.5	2.8	2.6	1.2	2.2
2014	0.8	0.9	1.8	1.0	0.0	0.1	0.4	-0.6	1.0	1.3	2.2	n/a
Consumer prices (av; % change, year on year)												
2012	4.7	4.9	4.4	2.0	1.2	0.6	0.0	0.1	0.8	0.9	0.7	0.8
2013	0.9	1.0	1.7	0.0	0.1	0.9	1.1	1.0	0.8	0.5	0.8	0.8
2014	0.8	0.6	0.0	0.6	0.9	1.1	1.8	2.0	1.7	1.9	1.3	n/a
Producer prices (av; % change, year on year)												
2012	6.9	7.8	4.7	1.3	0.6	-1.3	-1.0	3.1	4.9	3.1	1.2	2.3
2013	2.6	2.7	-2.0	-1.1	0.4	3.3	0.7	-0.9	-1.8	-1.3	-0.5	-0.2
2014	-2.2	-4.0	0.0	-0.8	0.5	-0.1	0.7	-1.5	-2.3	-2.1	n/a	n/a
Total exports fob (US$ m)												
2012	448.7	450.2	503.6	415.6	461.2	392.3	524.8	452.8	409.9	445.0	416.8	418.2
2013	478.0	436.5	447.6	489.4	519.6	451.1	490.7	478.3	424.8	449.9	400.0	425.2
2014	402.8	411.9	474.5	422.2	487.5	469.0	486.2	434.1	433.7	424.6	423.1	n/a
Total imports cif (US$ m)												
2012	820.7	819.5	896.8	816.5	989.7	686.4	1027.1	850.9	790.1	863.6	861.5	835.3
2013	914.8	801.7	825.0	946.8	957.4	961.4	966.7	933.6	830.7	942.0	895.5	796.5
2014	905.0	813.8	896.2	903.8	972.6	879.3	925.7	775.7	833.0	901.4	877.1	n/a
Trade balance fob-cif basis (US$ m)												
2012	-372.0	-369.3	-393.2	-400.9	-528.5	-294.1	-502.3	-398.1	-380.2	-418.6	-444.7	-417.1
2013	-436.8	-365.2	-377.4	-457.4	-437.8	-510.3	-476.0	-455.3	-405.9	-492.1	-495.5	-371.3
2014	-502.2	-401.9	-421.7	-481.6	-485.1	-410.3	-439.5	-341.6	-399.3	-476.8	-454.0	n/a
Foreign-exchange reserves excl gold (US$ m)												
2012	2,191	2,223	2,280	2,344	2,305	2,246	2,166	2,133	2,090	2,166	2,131	2,805
2013	2,746	2,830	2,672	2,852	2,910	2,771	2,675	2,647	2,793	2,692	2,539	2,476
2014	2,571	2,724	2,666	2,737	2,748	2,466	2,539	2,477	2,921	2,854	2,753	n/a

Sources: IMF, International Financial Statistics; Haver Analytics.

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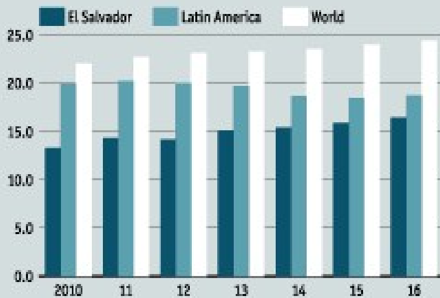
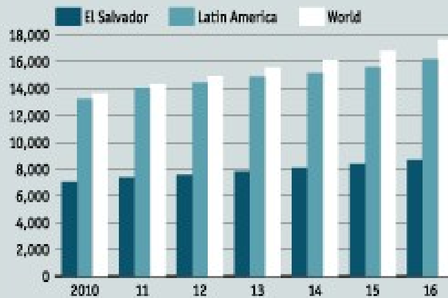
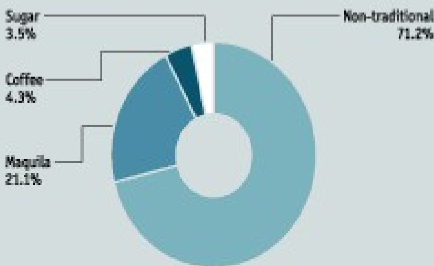
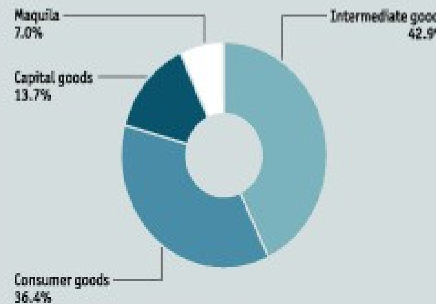
Annual trends charts

Annual trends charts









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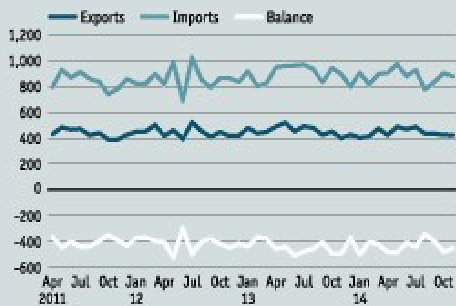
Monthly trends charts

Monthly trends charts

Price inflation
(% change, year on year)

Source: Economist Intelligence Unit.

Foreign trade
(US$ m; goods only)

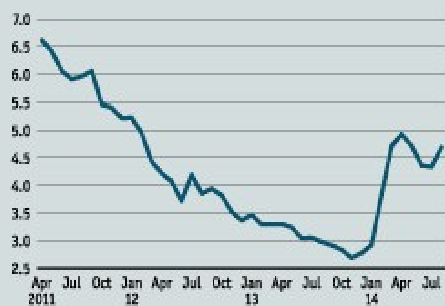


Source: Economist Intelligence Unit.

Foreign-exchange reserves
(US$ m)

Source: Economist Intelligence Unit.

Coffee: Arabica, ICO price
(US cents/kg; av)



Source: Economist Intelligence Unit.

Gold: London price
(US$/troy oz; av)

Source: Economist Intelligence Unit.

Oil: Brent crude price
(US$/b; av)

Source: Economist Intelligence Unit.

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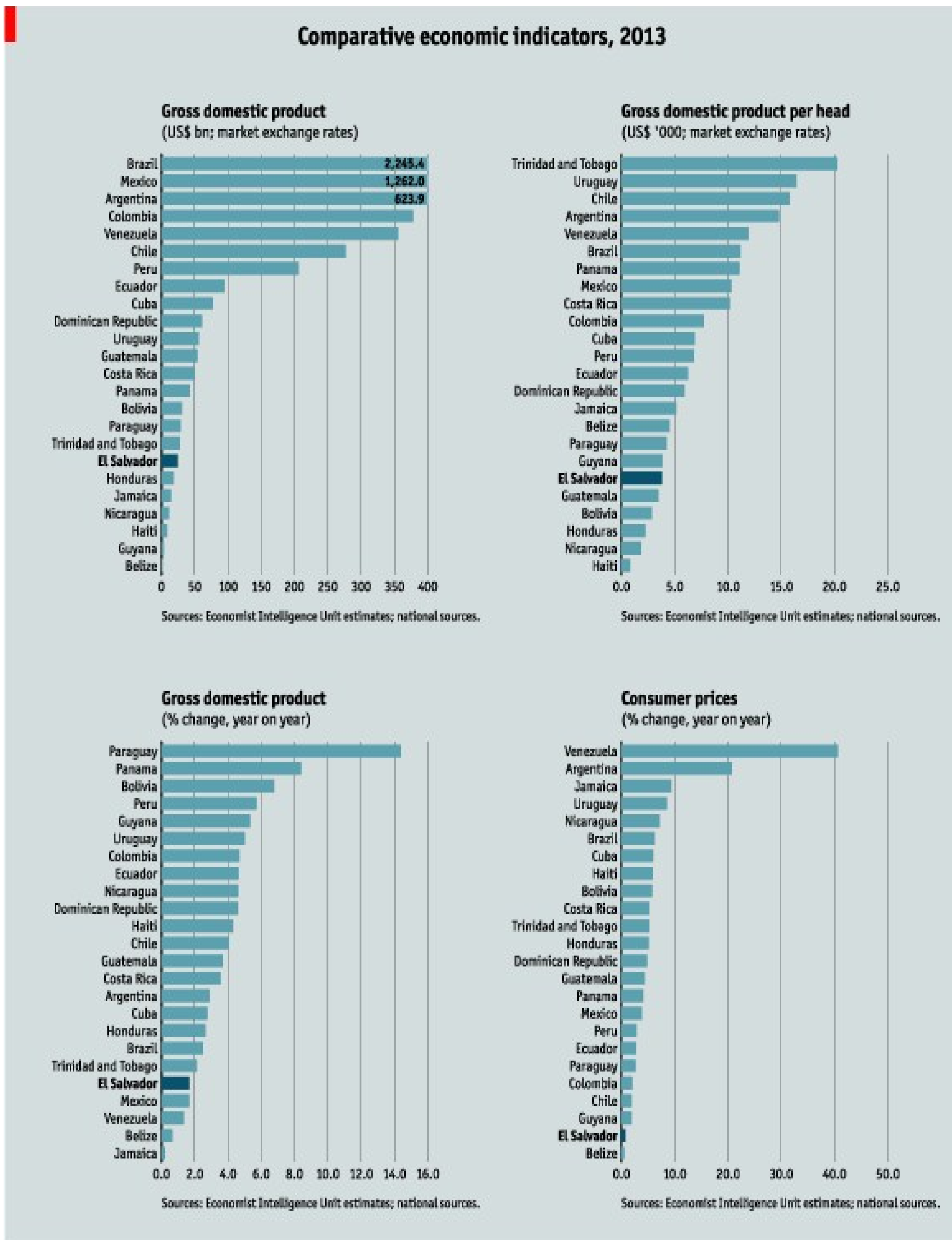
Comparative economic indicators



Basic data

Land area

20,720 sq km; volcanic upland and fertile coastal plains

Population

6.34m (2013 estimate)

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Main towns

Population in '000, 2007 census:

San Salvador (capital): 1,567 (Province) 316 (Municipality)

Santa Ana: 524 (Province) 245 (Municipality)

San Miguel: 434 (Province) 218 (Municipality)

Climate

Tropical on coast, sub-tropical on uplands

Weather in San Salvador (altitude 682 metres)

Hottest month, May, 19-33°C (average daily minimum and maximum); coldest month, December, 16-32°C; driest month, February, 5 mm average rainfall; wettest month, June, 328 mm average rainfall

Language

Spanish

Measures

Mixed: metric system and English measures; also old Spanish units

Currency

1 colón (c) = 100 centavos. On January 1st 2001 a fixed exchange rate of c8.75:US$1 was introduced by law and the US dollar became legal tender. The Monetary Integration Law provides for a dual-currency system; in practice, the US dollar is used almost exclusively, except in some small, rural areas

Time

6 hours behind GMT

Public holidays

January 1st; January 16th (Peace Day); Maundy Thursday; Good Friday; Easter Sunday; May 1st (Labour Day); early August (San Salvador Day); September 15th (Independence Day); October 12th (Columbus Day); November 2nd and 5th; December 24th and 25th

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Political structure

Official name

Republic of El Salvador

Form of state

Unitary republic

Legal system

US-style Supreme Court system

National legislature

Unicameral Legislative Assembly, comprising 64 locally and 20 nationally elected deputies, elected every three years

Electoral system

Universal adult suffrage

National elections

Next elections due in March 2015 (legislative), 2019 (presidential)

Head of state

President elected for a single term of five years

National government

The president, Salvador Sánchez Cerén, governs with the support of the FMLN,

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which holds 31 of 84 seats in the legislature; he appoints and presides over a Council of Ministers

Main political organisations

Government: left-wing Frente Farabundo Martí para la Liberación Nacional (FMLN)

Opposition: right-wing Alianza Republicana Nacionalista (Arena); Gran Alianza por la Unidad Nacional (GANA); Partido Demócrata Cristiano (PDC); Cambio Democrático (CD); Partido de la Esperanza (PES); Partido de Conciliación Nacional (PCN)

Key ministers

President: Salvador Sánchez Cerén

Vice-president: Oscar Ortíz Ascencio

Agriculture: Orestes Fredesman Ortez Andrade

Defence: David Munguía Payes

Economy: Tharsis Salomón López Guzmán

Education: Carlos Mauricio Canjura Linares

Environment & natural resources: Lina Dolores Pohl

Finance: Carlos Enrique Cáceres Chávez

Foreign relations: Hugo Martínez Bonilla

Health: Violeta Menjívar Escalante

Interior: Ramón Arístides Valencia Arana

Labour & social security: Sandra Guevara

Public security & justice: Benito Antonio Lara Fernández

Public works: Gerson Martínez

Tourism: José Napoleón Duarte Durán

Central Bank president

Marta Evelyn de Rivera

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Recent analysis

Generated on January 16th 2015

The following articles were published on our website in the period between our previous forecast and this one, and ser
a review of the developments that shaped our outlook.

Politics

Forecast updates

November 4, 2014: International relations

Concerns raised over legal rights of child migrants

Event

Human rights organisations allege that unaccompanied minors from Central America are being pressured into agreeing to an abbreviated deportation process, in contravention to their rights.

Analysis

Human Rights Watch, an international non-governmental organisation (NGO), recently published a report alleging that human rights violations had been committed against Central American minors arriving unaccompanied at the US-Mexico border. The report, which is mainly based on interviews with Honduran child migrants, claims that although many of these faced serious threats in their home countries, less than half were referred by US Customs and Border Protection for a further assessment of whether they had a "credible" or "reasonable" fear of returning home. Human Rights Watch claims to have independently corroborated accounts of the specific dangers that its interviewees faced in Honduras, accounts which the group alleges should have led US authorities to give the cases sufficient scrutiny before the minors were returned to their home country. Should the allegations be proven, the US authorities would in effect be violating the principle of "non-refoulement" established by international law, which forbids the rendering of a true victim of persecution to their persecutor.

According to data from US Customs and Border Protection, 68,541 unaccompanied immigrant children were apprehended trying to cross the US–Mexico border illegally in fiscal year 2014 (October–September), a 77% increase from the almost 39,000 minors apprehended in 2013.The number of asylum seekers from El Salvador, Honduras and Guatemala has also skyrocketed. Recent data from the UN High Commission for Refugees (UNHCR) indicate that, although the US still receives most asylum claims from Central America, there was a combined 712% jump in the number of asylum applications from these three countries to Mexico, Panama, Nicaragua, Costa Rica and Belize in the 2008–13 period.

Impact on the forecast

We do not expect that the US will revise its deportation proceedings in the wake of the allegations made by Human Rights Watch. We do not foresee any impact on international relations between Guatemala and the US and, as a result, have made no changes to our forecasts at this time.

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November 13, 2014: Election watch

Supreme Court orders fundamental reform of voting rules

Event

In a controversial ruling published on November 5th, the constitutional chamber of the Corte Suprema de Justicia (the Supreme Court) has struck down the current system of limiting voters to a choice between pre-defined party lists of candidates in elections for Congress.

Analysis

This is a radical change to the current electoral code and would for the first time allow "cross voting" for candidates. This would end the current system under which the political parties can define the list of candidates in a given voting district, and therefore effectively oblige people to vote only for those lists. If the electoral code is reformed following the constitutional chamber's unanimous ruling, voters in a district represented by, for example, ten deputies, would in future be free to vote for any ten candidates, notwithstanding their party affiliations.

Critics of the change argue that this would further complicate an already complex voting process, and rightly point out that it could lead to people mistakenly voting for more candidates than are designated for a particular district, effectively invalidating their ballot paper. It is clear that any reform would need an extensive run-out period. The Tribunal Supremo Electoral (the supreme election tribunal) has already requested an extra US$4m in order to publicise the changes and pay staff extra for their increased workload. However, proponents of the reform say that it would ultimately benefit the democratic process. Unsurprisingly, politicians are split along party lines, with the governing left-wing Frente Farabundo Martí para la Liberación Nacional (FMLN) rejecting the reform and the main opposition right-wing Alianza Republicana Nacionalista (Arena) signalling its support. However, it is unclear whether the reform would secure the necessary majority support in the Asamblea Legislativa (the unicameral legislature), where it requires approval in order to be implemented.

Impact on the forecast

It is unlikely that the electoral code will be altered in time for the forthcoming mid-term elections in March 2015. However, these and other issues will continue to polarise opinion as the electoral period approaches. For the moment, our baseline forecasts remain unchanged.

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December 8, 2014: Election watch

Poll shows no clear winner in the 2015 legislative elections

Event

A new poll has revealed that the governing left-wing Frente Farabundo Martí para la Liberación Nacional (FMLN) will fail to win an absolute majority in next year's legislative elections, despite a rise in public support for the president, Salvador Sánchez Cerén.

Analysis

Voters look set to return another divided legislature at the elections next March, with neither of the two major political parties able to dominate. According to a survey carried out in mid-November by LPG Datos (the polling branch of a leading daily newspaper), the FMLN would win 29.2% of the votes, against 28.9% for the main right-wing opposition party, the Alianza Republicana Nacionalista (Arena). As is the case with the current unicameral legislature, the balance of power would be in the hands of the third-largest party, the Gran Alianza por la Unidad Nacional (Gana), a situation that benefits the FMLN more than Arena, given that Gana was formed by Arena dissidents. That said, the polling results also indicate that it is unlikely that there would be any sort of formal electoral alliance in March 2015 between the FMLN and Gana, as some commentators have suggested.

Another notable aspect of this polling is that the number of undecided voters has dropped significantly compared with three months ago—with all three major parties gaining a larger slice of the vote. That is quite a feat for FMLN, given constant criticism in the conservative media. Approval ratings for Mr Sánchez Cerén have also risen over the past three months, up from just 40% in August to 47% in November, although in comparative terms this still places him much lower than his two predecessors: six months into their terms in office, Antonio Saca (2004–09) and Mauricio Funes (2009–14) both enjoyed approval ratings of 70% or more. When questioned about Mr Sánchez Cerén's record so far, the vast majority of respondents pointed to failings on the economy and crime, although there was also praise for the government for the recent approval of the second phase of the US Millennium Challenge Corporation budgetary support programme—known in Spanish as Fomilenio II.

Impact on the forecast

The forthcoming legislative and municipal elections will dominate the political arena over the next three months, but we do not expect any major upheavals in terms of political stability in the long-term. Our baseline forecast assumes that neither the FMLN nor Arena will achieve a majority.

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January 9, 2015: International relations

US renews TPS scheme for Salvadoran migrants

Event

On January 6th the US Department of Homeland Security announced an extension to its existing Temporary Protection Status (TPS) programme for more than 200,000 illegal Salvadoran migrants.

Analysis

This is the tenth consecutive extension of the TPS programme, which was first established following two earthquakes suffered by El Salvador in January and February 2001. Eligible applicants must have entered the US, whether legally or otherwise, in the immediate aftermath of the disasters; successful applicants are then granted temporary protection from deportation and are allowed to work, and can even travel home to El Salvador and return to the US. However, the protected status only lasts for 18 months, after which time applicants must re-apply.

Such is the social and financial importance of the Salvadoran diaspora community in the US that securing a renewal of TPS for the more than 200,000 illegal ex-patriots who have successfully applied has become a permanent feature in government policy in El Salvador. The left-leaning administration of the president, Salvador Sáanchez Cerén, as its predecessors have done in the past, lobbied hard for the latest extension, which lasts until March 2016. In purely economic terms, remittances from the estimated 2.5m-strong Salvadoran migrant community in the US have become a major driving force behind consumer spending on everything from day-to-day household goods, to real estate, and even education and private healthcare bills. According to the Banco Central de Reserva de El Salvador (the Central Bank), those remittances amounted to US$3.8bn—a year on year rise of 7%—between January and November this year. The possibility of migration to the US (albeit involving a journey filled with dangers, particularly when crossing through Mexico) also provides a vital escape valve for a densely-populated country, where there are few real job opportunities for the young and the poor, especially in the countryside.

Given the contribution of migration and remittances towards maintaining stability in El Salvador, it is also unsurprising that successive US administrations have continually renewed the TPS programme. The number of beneficiaries is relatively small and the political risk for the US government is considerably less than would accompany, for example, a broader reform of the immigration laws (which would also need Congressional approval). Similar TPS programmes are also in place for Honduran and Nicaraguan ex-patriots.

Impact on the forecast

Our baseline forecast remains unchanged in its assumption that remittance levels and ongoing migration to the US will help to contribute to medium-term stability in El Salvador.

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Analysis

December 12, 2014

Ibero-American Summit: in search of a new identity

On December 8th-9th Latin American countries, Spain, and Portugal celebrated the 24th Ibero-American Summit in Veracruz in Mexico. The summit produced a number of bilateral agreements on the topics of education, innovation, culture and youth, in line with its proclaimed aim to boost its relevance for Ibero-American citizens by tackling concrete issues affecting the latter. The challenge for the summit will increasingly be maintaining its relevance amid a proliferation of regional and sub-regional forums and institutions in Latin America.

The event has been held annually since 1991 and has historically been attended by the heads of state of all the nations of the Iberian Peninsula, and Latin America and the Caribbean, to forge stronger political and economic ties. However, interest in the summit has waned in recent years.

This year 16 of the expected 22 leaders attended, with the presidents of Argentina, Bolivia, Brazil, Cuba, Nicaragua and Venezuela sending delegations in their place, indicating the increasing disengagement of left-leaning regimes in the region from this forum. Nonetheless, this was higher than the 11 who attended last year's summit in Panama, and the highest rate of participation since 2005. The summit this year was also the first presided over by the new Spanish king, Felipe VI, and the new Ibero-American secretary-general, Rebeca Grynspan.

Education and innovation as main topics

In a region increasingly divided by political and economic ideology, the conference steered clear of such topics, with an emphasis on topics such as education, innovation and culture. Among these, the summit agreed to: student exchanges of 200,000 students between Latin America and Iberia over the next five years; programmes to improve literacy; programmes to broaden intercultural exchange, particularly through digital media; science and technology transfers; programmes aimed at improving youth participation in civil society; and facilitated movement of talent between the regions. In a press statement, Spain's prime minister, Mariano Rajoy, also said that Spain and Portugal would continue to be "the greatest advocates" for Latin America within the EU.

Nonetheless, while the final declaration promised to strengthen the summit—with new proposals such as decentralising the Ibero-American secretariat, with a stronger positioning of the three offices in Latin America, and strengthening and integrating Ibero-American institutions such as the Ibero-American Social Security Organisation, the Ibero-American Youth Organisation and the International Ibero-American Judicial Network—members also agreed to hold the next summit in 2016 in Colombia rather than next year, probably in an acknowledgment that issues of bilateral concern are increasingly rare.

The above supports The Economist Intelligence Unit's view the EU (and Spain and Portugal) will not be among Latin America's areas of focus in 2015-19, compared with more dynamic non-traditional markets such as Asia and, to a lesser extent, Africa and the Middle-East. This comes amid weak growth prospects in the medium term and the well-established nature of bilateral relations.

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Economy

Forecast updates

October 2, 2014: Economic growth

GDP expands moderately in second quarter

Event

El Salvador's GDP grew by 2% in the second quarter of 2014, according to the Banco Central de Reserva de El Salvador (BCR, the Central Bank), following growth of 2.1% in the first quarter.

Analysis

These latest GDP figures show a more positive growth position for the economy than other indicators would suggest, and also differ from the more negative outlook that private-sector groups are reporting. Although export sales have continued to fall this year (down by 5.4% in the year to August), there has been a 3.2% reduction in the import bill, reflecting depressed demand in some parts of the economy rather than just a fall in the price of imported oil products. Consumer purchases abroad, for instance, rose by just 1% in the first eight months of the year, while capital purchases were down by almost 3% year on year. Moreover, growth in the first half, according to the Índice de Volumen de la Actividad Económica (IVAE, the monthly activity index) was just 1.6%—although as has been noted before, there is often a divergence between the GDP data of the IVAE and the BCR.

On a sectoral basis, the GDP figures show across the board growth in all but one sector (construction, which fell by 2.3%). On the supply side, farming and fisheries grew by 2% in the second quarter (although the contribution of agriculture to overall GDP has been falling steadily in recent years), while industrial manufacturing expanded by 2.4%, largely owing to sales of non-traditional products outside the region. In contrast, sales abroad from the *maquila* (domestic assembly for re-export) sector have fallen by almost 10% this year. The Asociación Salvadoreña de Industriales (ASI, the Salvadoran industrialist association) said on September 11th that 2,500 jobs had been lost between December 2013 and June this year, as a result of falling business confidence and rampant crime (the government has disputed these figures). Overall, the main thrust of growth still comes from the services sector (which makes up two-thirds of the economy), in particular financial and insurance services, retail, and restaurant and hotel services.

Looking ahead, the introduction of new taxes from September—including a charge on bank transactions—plus continued frustration over high levels of crime and insecurity could hamper growth in the second half of the year.

Impact on the forecast

Our estimate for growth of 1.7% in 2014 will be slightly raised in the light of the latest figures.

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October 8, 2014: External sector

Debt stock rises modestly in first half

Event

The external debt rose by 6.3% year on year in the second quarter of 2014 to reach US$14.5bn. This represents a modest 2.8% accumulation since the end of 2013, but does not yet incorporate the latest US$800m Eurobond issue.

Analysis

There continues to be a slow but steady pace to the rise in El Salvador's foreign debt. In the first quarter of this year, the country added US$200m to its total foreign debt stock, mainly in the form of extra long-term borrowing taken on by both the Banco Central de Reserva de El Salvador (BCR, the Central Bank) and the mostly foreign-owned commercial banks. In contrast, central government and corporate borrowing fell in the three months to March.

The second quarter of the year saw another US$200m added in borrowing. However, the spread was slightly different. The BCR's borrowing actually dropped by 1.7% year on year, largely owing to a sharp fall in new short-term debt. Meanwhile, its long-term debts, which make up the majority share of its overall stock, rose by a modest 8.3%. Central government borrowing reached US$7.3bn by June, an annual rise of 1.4%—all of it in long-term credit. In contrast, the commercial banks almost doubled their debt stock from US$826.3m in June 2013 to US$1.5bn by June 2014, with their short-term loan portfolios growing from US$383.4m to US$837.4m in the same period. Less dramatic was the rise in the corporate debt stock, by 2.2% by the end of June, following a 0.4% year-on-year fall in the first quarter. Although this appears to reflect some improvement in business confidence after the uncertainty of the electoral period, long-term borrowing by private firms (the major slice of the overall debt stock) was up by just 0.2%, and intra-company lending was down by 1.6%

In September, as expected, the incoming government of Salvador Sánchez Cerén moved to reduce its servicing liabilities, with the issue of US$800m in 12-year Eurobonds, part of which will go towards paying off onerous domestic bonds. Following the same strategy as previous administrations, we expect Mr Sánchez Cerén to return to the international markets again early next year, having secured legislative approval for up to US$1.16bn in bond issuance.

Impact on the forecast

Our forecast for the total foreign debt stock, currently at US$14.7bn for 2014, will be adjusted upwards in the light of the most recent bond issues.

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October 8, 2014: Fiscal policy outlook

Proposed 2015 budget sees higher social spending

Event

The government presented its US$4.8bn budget for 2015 on September 29th, based on 2.6% GDP growth, 1.3% inflation and a 4% fiscal deficit.

Analysis

As expected, the first budget of the president, Salvador Sánchez Cerén, clearly reflects the ongoing social priorities of the left-wing ruling Frente Farabundo Martí para la Liberación Nacional (FMLN), with education, healthcare and public security all receiving extra funds. According to the draft under discussion in the legislature, education will get an additional US$29m, healthcare an extra US$28m, and justice and public security—including the Supreme Court—an additional US$66m. Public-sector investment will be allocated 3% more than last year. Part of these funds will go towards the government's US$88.2m commitments for the second phase of the US Millennium Challenge Corporation budgetary support programme—known in Spanish as Fomilenio II—recently approved by the US government.

With the approval of a new stand-by arrangement with the IMF still pending, the 2015 draft budget also contemplates cuts across six ministries, ranging from a maximum of 13% (affecting the Ministry of Agriculture's budget) to a minimum of 1% (affecting the Ministry of Defence's budget). The budget of the Fiscalía General de la República (the attorney-general's office) will be slashed by 2%. Although the details of the cuts are not yet known, Mr Sánchez Cerén has pledged a 5% reduction in administrative costs across the public sector; such a move could provoke stiff opposition from the FMLN's allies in public-sector unions.

In the past, governments have traditionally underspent their projected budgets owing to poor administration. However, reflecting an overall increase of 3% from last year's budget, the 2015 draft is based on an optimistic 2.6% GDP growth next year, which The Economist Intelligence Unit does not expect the government to achieve. It also projects a fiscal deficit of around 4% by the end of next year, which depends partly on growth levels, but also, importantly, on the government's ability to raise extra revenue via taxation. Almost 90% of the budget is set to be financed via taxes. The expected increase in global interest rates over the next 12 months will also increase El Salvador's debt servicing costs.

Impact on the forecast

Our forecast for a 3.2% deficit in 2015 will be raised in consideration of the new budget.

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October 13, 2014: Inflation

Inflation falls slightly in September

Event

Annual inflation stood at 1.7% in September 2014, down from a high of 2% in August 2014, but almost double the annual rate of inflation registered in September 2013. In month-on-month terms, however, it fell slightly.

Analysis

Because of the combination of stronger growth coupled with higher prices for foods and imported oil, inflation has been creeping up this year after ending 2013 at just 0.8%. However, the 0.1% deflation in September is only the second time this year that prices have fallen in month-on-month terms (the other was back in April, with a decline of 0.5%).

Looking at the detailed data for the year to September, inflation is still being mainly driven by rising prices for food and non-alcoholic beverages (up by 5.5% year on year). Although the monthly prices in this sub-sector actually dropped by a slim 0.5%, the annual rate is still more than double that of last year, largely because of the difficult weather conditions that have interrupted the normal harvest periods. The regional shortage of red beans—part of the staple diet in Central America—has had a clear negative impact on supply and prices at a local level.

Meanwhile, the year-on-year prices of alcoholic beverages rose by 4.4%, hotels, cafes and restaurants by 2.3% and education by 1.8%. Transport costs increased by just 0.6% in September, compared with a yearly high of 2.9% in May, largely because of the decline in world oil prices; a slowdown in the rise in transport costs often helps to keep prices down elsewhere in the small economy, especially the price of basic foodstuffs. Elsewhere, there was a 0.7% year-on-year fall in prices for footwear and clothing, a 0.3% decline in housing costs, a 1.1% fall in communications prices and a 0.2% slip in the cost of medicines. The largest monthly fall in prices was in communications (0.7%) and the largest rise was for alcoholic beverages (0.5%).

Compared with its neighbours, El Salvador still has the lowest rate of inflation in the region, in part thanks to its dollarised economy. By way of comparison, annual inflation in September was 6.1% in Honduras, 3.5% in Guatemala and 6.5% in Nicaragua.

Impact on the forecast

Our forecast for annual inflation of 1.5% in 2014 remains unchanged.

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October 31, 2014: Economic growth

Growth continues to falter in August

Event

The Índice de Volumen Actividad Economica (IVAE, the monthly activity index) fell by 2.2% year on year in August, resulting in accumulated growth of just 0.9% in January-August.

Analysis

After a more positive growth pattern in the first half of the year—with GDP rising by 2.1% and 2% in the first and second quarters, respectively—these latest monthly activity figures suggest the Salvadoran economy has lost its earlier impetus (the IVAE fell 0.6% in July as well). Despite a strengthening US economy, overall exports fell by 2.9% in the third quarter, according to the Banco Central de Reserva (BCR, the Central Bank), while exports from *maquila* offshore assembly plants (mainly sold in the US market) were down further, by 6.7%, in the same period and 8% so far this year. Concerns over heightened insecurity and the impact of new taxes from September also appear to be impacting domestic-investment levels.

In detail, the supply side showed a mainly negative panorama in the January-August period, with output in mining down almost 8% and industrial manufacturing flatlining with the slowdown in output from the *maquilas.* The farming and fisheries sector was alone among the best-performing sectors, posting a yearly expansion of 3.3%, despite recent poor weather conditions that have been hampering this year's harvests; meanwhile the construction industry continued in decline, by 6.8%, due to poor investment in housing and large-scale works projects. The outlook for the building trade, in particular, should be improved in the medium term with the recent approval of the second phase of the US millennium funding (known as Fomilenio 2): US$277m disbursed over a five-year period starting in 2015, part of which will be destined for construction works in the coastal areas.

While the main thrust of growth continues to come from El Salvador's services industries, it was not a totally positive picture across the board. Retail, restaurants and hotels, which tend to rely on inward flows of family remittances, fell by 0.4% in the first eight months of the year, while, in contrast, the banking, insurance and financial services sector expanded by 4.2%. Real-estate and business services grew 4.5% and community and social services by 6.5%. Neither of these are, however, large contributors to the overall economy.

Impact on the forecast

GDP figures have been somewhat higher than the IVAE suggests, and, as such, our forecast for GDP growth of 1.8% for 2014 will remain unchanged.

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November 11, 2014: Policy trends

Costa Rica tops region in climate change adaptation survey

Event

The latest annual University of Notre Dame (US) Global Adaptation Index (ND-GAIN) shows Costa Rica overtaking Panama as the best prepared country in Central America for climate change.

Analysis

ND-GAIN ranks 178 countries based on their vulnerability to climate change and readiness to adapt to climate-related droughts, major storms and natural disasters. The leading country in the index this year is Norway, scoring 82.7 out of 100, while Chad is bottom, scoring 31.6. Costa Rica is in 69th place with a score of 58.2, followed by Panama, with 56.6. In general, Central American countries rank towards the middle of index. However, three of these are among the seven that have experienced the sharpest declines globally in the 2014 survey relative to 2013: Guatemala, El Salvador and Belize.

The founding chief executive of the University of Notre Dame's Global Adaptation Institute, a former Salvadoran finance minister, Juan José Daboub, has said that Central America is not as prepared as it could be because of a lack of public policies and an inability to attract sufficient local and foreign direct investment in areas that represent vulnerabilities. Mr Daboub has estimated that the region will need to spend around US$1bn over the next 25 years on adaptation, of a global annual total of between US$30bn and US$100bn. This does not include the costs of mitigating the effects of climate change over the longer term. He argues that private-sector investment will need to provide the bulk of this, as governments will be unable to do so.

Central America currently accounts for just 0.5% of greenhouse gas emissions globally. However, climate scientists believe that the region is a hotspot for future climate-related damage. Its seven countries already suffer disproportionately from flooding, hurricanes and other natural disasters. Indeed, Costa Rica, Honduras and Guatemala declared states of emergency earlier this year after drought severely affected agriculture. However, their ability to cope varies tremendously, and Costa Rica and Panama will continue to be the top countries in the region for climate change adaptation, increasingly pulling away from their neighbours.

Impact on the forecast

Our baseline forecast continues to assume that all countries in the region will suffer from occasional climate-related disruptions.

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November 21, 2014: Economic growth

Ageing Latin America

Event

A new report by the UN Economic Commission for Latin America and the Caribbean (ECLAC) highlights declining fertility rates and increasing life expectancy since 1950 as factors that will make ageing a key trend for Latin America in the 21st century, creating both opportunities and challenges for policymakers.

Analysis

The regional population will increase from 512m in 2000 to a peak of 734m by 2050, before falling to 687m by 2100, and will undergo major changes in structure. The percentage of people under 15 years old will decrease from 40% to 25% in the period spanning 1950–2100, with the percentage of people over 65 years old exceeding 25% from 2020. Meanwhile, the percentage of the population between 15 and 64 years old will increase from 55% to 67% in the 1950–2100 period.

Average life expectancy at birth has already increased from 55.7 years in 1950–55 to a projected 74.7 years in 2010–15, almost cutting the gap with the developed world in half in six decades. By 2070 all countries in the region will have a life expectancy of above 75 years, continuing the convergence process with the developed world. This trend has been made possible by a significant decline in early-age mortality, especially infant mortality—although widespread income (and regional) inequality and poverty result in very different performance in this indicator between rural and urban areas, and across countries (Bolivia and Haiti registered over 40 deaths per 1,000 infants in 2010, while Chile, Costa Rica and Cuba registered less than ten).

An important driver of population decrease will be falling fertility rates. The region total fertility rate (TFR) has declined from six children per woman in 1950–55 to an estimate of below 2.2 in 2010–15, slightly below the global median (2.3). By 2040, all countries in the region will have a TFR of below 3, while half will have a rate of between 1.8 and 2. Urbanisation helps to explain this trend, with 80% of the Latin American population living in cities in 2010 (up from 40% in 1950), among the highest rates globally. This will rise to 90% by 2050.

Impact on the forecast

The data are in line with our long-term forecast that ageing will put pressure on the region's pension systems and fiscal accounts. They also support our view that education levels will improve gradually in most countries, facilitated by a reduction in pupil numbers brought about by demographic changes.

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December 1, 2014: Economic growth

Slow growth continues in September

Event

The Índice de Volumen Actividad Económica (IVAE, the monthly activity index) recovered slightly in September, rising by 0.5% year on year. However, accumulated growth was still just 0.8% in January-September.

Analysis

Although a modest rise in growth year on year in September brought an end to two consecutive months of contraction (the IVAE fell by 0.3% and 2.2% in July and August respectively), the Salvadoran economy has clearly been faltering in the second half of the year. GDP rose by 2.1% and 2.2% in the first two quarters and, although GDP data can often differ from the IVAE figures, exports have consistently slackened this year (down by 4.7% between January and October), as has spending on imports (down by 3% year on year)—only partially, owing to a fall in the cost of imported oil. Domestic investment continues to be dampened as another election period approaches early next year.

On the supply side, farming and fisheries were alone in reporting expansion (by 2.8%), while mining fell by 6.6%, construction by 7% and activity in industrial manufacturing flatlined. Despite a strengthening US economy, demand from that country remains slow for the textiles produced by Salvadoran *maquilas* (local assembly factories for re-export), which appear to be losing their competitive edge against neighbouring exporters in Nicaragua and Guatemala. So far this year, Salvadoran *maquila* sales (most of which are sold in the US) have fallen by 9% compared with last year.

In contrast, there is a generally positive panorama in the services sector. Nonetheless, the retail, restaurants and hotels sector fell by 1.1% in the first nine months of the year, despite high inward flows of family remittances (totalling US$3.495bn by the end of October), which normally funds higher consumer spending. Resurgent violent crime is possibly having an increasing effect on consumer habits, restricting profit margins, especially in the tourism sector. However, the banking, insurance and financial services sector expanded by 4.4% year on year, real-estate and business services grew by 6.2%, and community and social services by 6.8%. Government services expanded by 1.2% and the utilities sector by 1.7%.

Impact on the forecast

With third-quarter GDP figures out next month and on the strength of the latest IVAE data, we continue to maintain our estimate for growth of 1.8% in 2014.

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December 31, 2014: Economic growth

GDP expands by 2% in third quarter

Event

GDP grew by 2% year on year in the third quarter of 2014, according to the Banco Central de Reserva (BCR, the Central Bank), following growth of 2% in the first half of the year.

Analysis

Compared with the same period a year ago, the economy is performing slightly better, although El Salvador is still lagging behind its Central American neighbours in terms of GDP growth. While the lower price of oil (the country is wholly dependent on imported oil for its energy needs) has helped reduce the overall import bill by almost 3% this year, export sales are still falling (down by 3.9%), in spite of improved growth in the US, El Salvador's main export market. This suggests that factors such as high crime and low private investment continue to hamper exporters' ability to expand output to take advantage of increased US demand. The 0.8% growth registered between January and September, according to the BCR's Indice de Volumen Actividad Económica (IVAE, the monthly activity index), also reflects a more sluggish pattern to overall output this year.

As in the second quarter, all sectors bar construction posted growth in June-September. Farming and fisheries expanded by 2.7% (against a 0.1% contraction a year ago). Industrial manufacturing and mining expanded by 2.3%, largely due to stronger demand for non-traditional industrial products outside Central America (with the exception of textiles). In contrast, exports from El Salvador's *maquila* (domestic-assembly) factories, which produce mainly textile items for the US market, are down 7.5% this year. The services sector continues to provide the main impetus for growth, although, in many areas, growth was lower or the same as a year earlier. Retail, restaurants and hotels expanded by 2.4% (similarly to a year ago), as family remittances from the US, which rose by 7% between January and November, continued to drive domestic consumer spending. The financial and insurance sectors grew by 3.6% (compared with 4.7% in the same period of 2013), while government services grew by 1.4% (down from last year's 3.2%).

Impact on the forecast

Given the third-quarter GDP results, we are likely to raise our current year-end growth estimate of 1.8% for 2014. Going forward, owing to the approaching elections in early 2015 and expected public-spending cuts, we retain our forecast for average GDP growth of just 2% in 2015-19.

Analysis

October 17, 2014

Latin American bond issuance cools in Q3

International bond activity by Latin American and Caribbean issuers slowed in the third quarter, amid a deterioration in global capital market conditions. Although the still-high levels of liquidity in global financial markets supported the region's bond activity, investor sentiment was impaired in the third quarter by rising—although still moderate—uncertainty about the international economy in general and Latin America in particular, as well as some adverse geopolitical events. The expectation that the Federal Reserve (the Fed, the US central bank) will begin to lift its Fed Funds policy interest rate sooner than anticipated weighed on the markets, particularly in September, when there was a shift into safer, long-term US-dollar

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assets, hitting Latin American currencies and securities.

According to data from Dealogic (a UK-based financial market information provider), the value of international bonds sold by the region's governments and corporations in July-September amounted to US$28.2bn, its lowest level for a third quarter since 2011. Despite the softer Q3 performance, the total value of international bonds issued by the region reached a record of US$117.7bn in the first nine months (19% more than in the same period in 2013), setting up 2014 to be another record year for this type of transaction.

Some risk-averse bondholders have been deterred from investing in the region by renewed fears of the impact that it may suffer from a higher than anticipated slowdown of the Chinese economy. In fact, Latin America's gloomier GDP growth outlook has dulled the investor exuberance that the region has enjoyed in recent years—The Economist Intelligence Unit now estimates regional growth of just 1.5% in 2014, with a moderate pick up in 2015, depending on a forecast upturn in the Mexican economy. Last, but not least, the fact that some Latin American issuers had already completed their external funding targets in the first half of the year also explains the region's slower bond activity in the third quarter.

Sovereign bonds take the lead

In terms of the profile of issuers, there was little diversification in the international bonds originated in Latin America in July-September. As in the previous quarter, more than 60% of total transaction volumes came from sovereigns, financial institutions, and oil and gas companies. At US$9.26bn, deals issued by sovereigns accounted for 33% of the total and rose by 3% on a quarter-on-quarter basis. This was partly driven by the US$3.55bn bond placed in late July by Brazil, with a 31-year maturity and 5% coupon. This transaction was the largest by any of the region's issuers in the quarter.

Investors retained their appetite for Brazilian assets, despite concerns about the outcome of the presidential election and the country's economic outlook. Investors are concerned that the re-election of the president, Dilma Rousseff (still the most likely result in what has become a very close race), will lead to another four years of poor economic performance. If Ms Rousseff is re-elected and fails to strengthen the public finances, low growth and fiscal laxity could well cost Brazil its investment grade rating. Even so, the Brazilian sovereign was able to retap the market in the midst of the electoral campaign by successfully placing a US$1.05bn bond in early September, maturing in 10.3 years and offering a 4.25% coupon.

Demand for the region's sovereign notes also extended to Panama, which in mid-September raised US$1.25bn, due in 2024 at a 4% coupon, in what constituted the country's largest bond in four years, despite revelations of the extent of fiscal slippage in the first half of the year by the outgoing government of Ricardo Martinelli (2010-14). Paraguay also tapped the market in early August with relative success, as it was able to sell US$1bn bonds maturing in 30 years with a 6.1% coupon, despite the country's "speculative-investment" risk category. In mid-September El Salvador issued US$800m in 12-year bonds with a yield of 6.375%.

Active issuers in Mexico and elsewhere

Deals originated in Mexico gained some dynamism on the back of the activity of Petróleos Mexicanos (Pemex, the state-owned oil company) among others. This company leveraged on the precedents set in the first half by other Mexican issuers, and in early September launched a peso-denominated deal equivalent to US$1.39bn, due in 2024 with a 7.19% coupon. Another large Mexican bond was launched around the same time by Cemex, a cement company, for US$1.63bn, of which US$1.1bn was denominated in US dollars (with 10.3-year maturity and 5.7% coupon) and the remainder in euros (due in 7.3 years and paying a 4.75% interest rate). Mexichem, a large petrochemical corporation, also tapped the market in mid-September through a US$750m deal due in 2044, and offered at a 5.875% coupon.

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Although Brazil and Mexico continued to account for the vast share of deals originated in the region, other issuers in Colombia, Chile and Peru were also active in Q3. This includes deals by Ecopetrol (the oil company controlled by the Colombian government), which sold US$1.2bn with a maturity of 10.3 years and a 4.125% coupon, Codelco (the government-controlled Chilean copper producer), issuing €600m due in 2024 with a 2.25% coupon, and Cofide (a Peruvian state-owned development bank) selling US$300m due in 2019 with a 3.25% coupon.

Reasons for cautious optimism

The Economist Intelligence Unit continues to expect that, barring a shock in world financial markets, Latin American borrowers will retain fairly good access to the international bond markets in the last quarter of 2014. This prospect is likely to make 2014 as a whole yet another record year for bonds issued by the region overseas. Nonetheless, market volatility will remain high as investors remain wary about geopolitical events (including the ongoing tensions in the Middle East and the Russia-Ukraine crisis), as well as developments in the world economy. Likewise, borrowing costs for the region (and other emerging markets for that matter) will continue rising as the Fed ends its third quantitative easing (QE3) programme in the short term, and it is likely to increase its main interest rate by mid-2015. However, global liquidity conditions will be supported by the monetary stimulus from the central banks in the EU and Asia in their efforts to boost economic growth and avoid deflation in their respective countries.

November 3, 2014

Trade performance decouples from US recovery

Despite a strengthening US economy, El Salvador's trade performance has been poor this year, with exports falling in year-on-year terms in each of the three quarters. In the crucial textiles sector, it appears that the country is losing market position to some of its Central American neighbours. This suggests that, in the absence of an effort to raise productivity and move into more value-added segments, the country will gradually lose out to its more competitive regional rivals.

In January-September export revenue fell by 4.6%, although the import bill also dropped by 2.9%, narrowing the trade gap for the first time in two years. This latest trade data confirms a downward trend despite improvements in the US economy (El Salvador's largest export destination). Hit by a combination of poor coffee output, depressed sales of non-traditional goods within the region and slackened demand for *maquila* products (local assembly for re-export), total sales had already fallen by 5.5% in the first half of 2014. That compares with a steady rise from US$4.5bn in 2010 to US$5.5bn in 2013.

Worrying stagnation of the non-traditional sector

On a sectoral basis, by the end of September 2014 traditional products (coffee, sugar, shrimp), continued their declining contribution to total exports, down from 9.5% a year ago to just 6%. Reflecting the impact of the Roya fungus on plantations, coffee export earnings are now 56% down on last year, with poor prospects for improved output into the next harvest. Meanwhile, sugar exports tumbled by 15% despite benefiting from quotas, and shrimp sales were down by 58% (although their contribution to total sales is very small).

More worrying, however, is the continuing poor performance of the non traditional products—mainly various types of textile garments, plastic accessories (boxes, bottles, covers) and paper products. Their share of total export revenue is currently around 74%, but sales grew by just 0.9% in January-September. This could be explained in part by the temporary closure of El Salvador's land borders with Honduras and Guatemala earlier in the year following a dispute with transport

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carriers that held up transfer and delivery around the region. Roughly half of non traditional produce is sold within Central America. By September these sales were down by 2.4%; however, in contrast, sales outside the region are still holding up, rising by 4.3% year on year in January-September, suggesting that long-term diversification of target markets could help. El Salvador is also struggling to increase its share of the US market for its *maquila* produce (total *maquila* exports fell by 7.9% in the year to September). According to figures from the US Office of Textiles and Apparel, although US imports of textile aggregations from the Dominican Republic-Central America Free-Trade Agreement (DR-CAFTA) trade area as a whole have risen this year, purchases from El Salvador and Honduras have dropped, while sales from Guatemala and Nicaragua have increased.

Falling imports not a good sign either

On the import side, the lower cost of imported fuel has meant that the purchase of intermediary goods fell by 6% year on year, while the farming sector spent 28% less on imported fertilisers, and imports of raw materials from the *maquila* sector were 5% lower year on year. Overall, there has been a 3% drop in spending on capital goods, with the retail sector's outlay 23% down on last year and industrial manufacturing down by 6.5%—signs of a lack of new investment spending. Consumer imports continued to rise, however, and were up by 1.6% as family remittances from abroad grew by 8%.

Overall, the fall in oil prices should help to buffer the trade balance from any significant deterioration, even in the event that exports were to fall further. Likewise, the milder year-on-year decline in exports during the third quarter compared with the first two quarters suggests some possible improvement going forwards. Nevertheless, the divergence between El Salvador's export sector and the US economy poses some key policy-making questions in the long run, particularly if the country's structurally weak growth and stagnant productivity make it lose further ground against its faster-growing neighbours.

November 20, 2014

Regional coffee sector facing greater risks

Climate-related extreme weather is making coffee growing increasingly risky in Central America. Moreover, a range of factors including volatile international coffee markets and widespread inefficient management mean that farmers are not able to reap increased rewards for taking on this risk. This creates pressure for farmers to diversify away from coffee production, although there is evidence that relatively simple changes to growing practices can be quite effective in countering coffee rust disease, which has decimated production in the region in recent years.

At the recent annual Sintercafé coffee trade conference there was a widespread view that climate change is already affecting coffee production in the region. Indeed, the seven Central American countries suffer disproportionately from flooding, hurricanes and other natural disasters. For example, Costa Rica, Honduras and Guatemala declared states of emergency earlier this year after drought had severely affected agriculture. Climate scientists believe that Central America is likely to experience warmer and drier conditions in future, meaning that more severe droughts are likely.

Coffee rust disease

Climate change has been blamed for the outbreak of coffee rust disease (*hemileia vastrix* or *roya* as it is known locally), which has been destroying plantations throughout Central America over the past three years. Rust fungus has been prevalent at low altitudes in the region since the 1970s, and farmers have learned to live with it. However, it has spread to higher altitudes where the main plantations are located, as warmer weather and greater humidity have helped it to grow.

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According to the UN Food and Agriculture Organisation (FAO), the disease has affected at least 505,000 ha of plantations, which is around 55% of the total area. As a result, coffee exports from Central America have dropped, from US$3.63bn in 2011-12 to US$2.4bn in 2012-13. In Guatemala 70% of coffee crops were destroyed last year, leading the government to declare a national state of emergency. In El Salvador, the infection rate was 74%, while in Costa Rica it was 64%, while Nicaragua and Honduras had lower rates of 37% and 25% respectively, according to International Coffee Organisation (ICO) data. The fungus has also hit coffee production in southern Mexico, particularly the state of Chiapas. In addition, there have been outbreaks in Colombia and Peru, but on a much smaller scale than in Central America.

In Central America, ageing coffee plants have exacerbated damage to the region's economy. For example, in El Salvador many coffee trees are 40-50 years old. In contrast, in Colombia, whose coffee sector has performed particularly strongly in recent years, some 65% of coffee trees are under five years old.

Price fluctuations

Coffee rust disease initially had a dramatic effect on coffee prices. The ICO annual average composite coffee price rose from US$1.47/lb in 2011 to US$2.10/lb in 2012 as the widespread nature of the outbreak became apparent. However, by the following year this had dropped back to US$1.56/lb, although prices remained higher for superior quality arabica varieties of coffee, which tend to be grown in Central America. The relatively brief spike in prices reflects a range of factors, including the volatility that typically characterises international coffee markets; production in South America, particularly Colombia and Brazil, replacing that from crops destroyed in Central America; and pressure from major purchasers of coffee which absorbed the rise in prices, rather than passing it on to customers.

Coffee price volatility has also meant that Central American producers cannot be sure of being rewarded for the increased risk involved in growing coffee. Moreover, widespread inefficient management, as well as ageing crops, have eroded many of the potential financial gains that could have been enjoyed as a result of rising coffee prices. This has led to widespread diversification, both into other forms of agriculture such as maize and beans, small livestock, and fruit and vegetables, as well as illicit crops. Diversification is likely to continue, with many farmers in the region potentially moving out of coffee production altogether. Indeed, while most US coffee imports come from Asia, there is concern in the US that displaced coffee workers could either attempt to migrate illegally to that country, join organised criminal gangs or grow illicit crops instead of coffee.

Countering disease

As base temperatures in the region continue to rise, coffee rust disease and similar problems are likely to become even more serious. The FAO has already begun a programme to install an early warning system in every country in Central America; this will use mobile phones and the Internet to track the spread of the fungus in real time. In addition, the EU has pledged €750,000 (US$1m) to help those most affected, while the US government has offered to help to fund research into rust-resistant varieties of coffee.

However, Costa Rica offers evidence that attempts to mitigate the effects of disease can be relatively effective. Although the country has been badly affected, it has sought to make coffee production more sustainable and less vulnerable to climate-related disruption. For example, Nationally Appropriate Mitigation Actions (NAMA, or measures used to control greenhouse gas emissions) have led to a reduction in coffee's carbon footprint. The government has also funded environmental services that incentivise sustainable farming practices. Although coffee production fell by 26.7% between 2012 and 2013, the Instituto del Café de Costa Rica (the Costa Rican coffee institute) estimates that the harvest will grow by 4.5% in the 2014-15 season.

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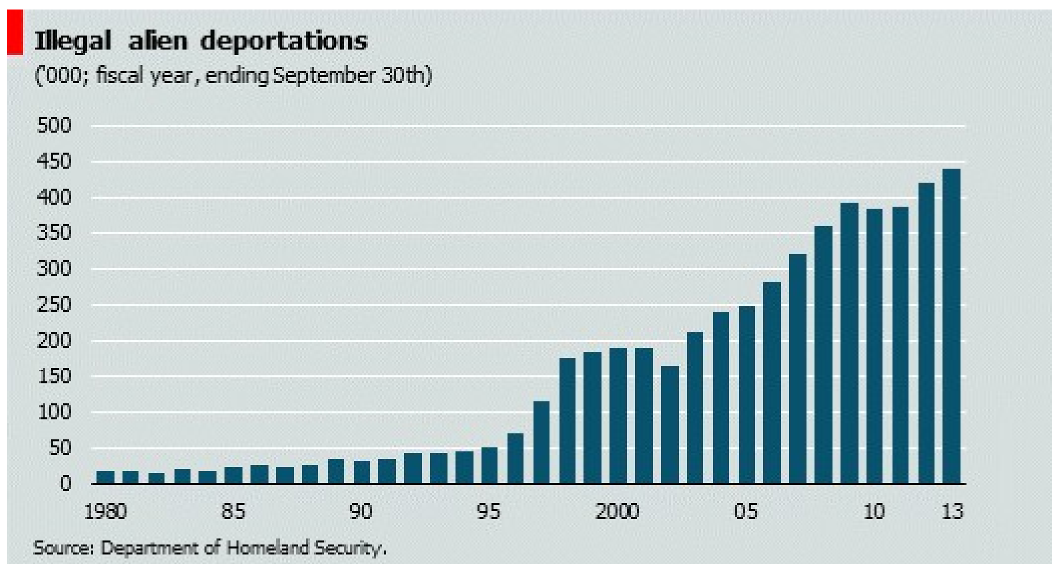
Nonetheless, farmers throughout the region need financial and technical assistance to enable them either to control the disease using chemicals or switch to producing other viable crops. There are also potentially sustainable ways to control the disease using inexpensive non-chemical techniques, such as pruning coffee plants and controlling the amount of shade that they receive. Indeed, major purchasers of coffee have been instrumental in working with key producers to ensure more sustainable production practices. These methods, if more widespread, could help to sustain the industry in the face of greater risks.

November 24, 2014

Obama sidesteps Congress in landmark immigration reform

The US president, Barack Obama, announced on November 20th a plan that will grant work papers to some 5m undocumented immigrants, slightly more than 40% of those in the country. It will allow them to participate in the formal economy and prevent them from being deported. However, it does not grant them permanent legal status or a path to citizenship, and it can be reversed by a future president. In the short term, the move ruins any hope that Congress will enact comprehensive immigration reform but, in the long term, it makes that reform inevitable. Most undocumented Latin American immigrants in the US, who make up the bulk of those who will be affected, along with their advocates, have cheered the executive decision, even if it does not represent a definitive solution to the dysfunctional immigration system.

There are around 11.4m people living illegally in the US. The number deported each year has reached its highest level ever under the presidency of Mr Obama, at just over 400,000. Most will stay in the country permanently, regardless of their legal status. Mr Obama's executive order is an overdue acknowledgment of the facts on the ground: that most undocumented immigrants are woven into the fabric of American life in a way that will be impossible to unwind. Millions have spouses or children who are citizens. Others arrived as children and have spent most of their lives in the US. Some have graduated from American universities but cannot legally get jobs using their diplomas.



Sweeping reform will change the lives of millions

The administration's new policy will legalise parents of US citizens who have lived in the country for at least five years. It will expand an existing programme granting legal status to those who arrived as children. It will scrap a law enforcement tool by which local police departments informed federal immigration authorities whenever

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they detained undocumented immigrants, even if they were only charged with minor traffic violations. It also expands programmes for students to work temporarily in the country after they graduate, allows spouses of legal permanent residents to work and gives more visas to entrepreneurs.

Rather than forcing immigrants to dodge the authorities at every turn, the executive action will make it possible for them to perform basic civic duties such as filing income tax returns, applying for a mortgage or getting a driving licence. Less than 40% of Americans, however, approve of Mr Obama using executive action to reform immigration, but most, by a two-to-one margin, agree that undocumented immigrants should be allowed to stay in the US. Roughly half say that they should eventually get full citizenship. Prominent Democrats and Republicans, including two possible Republican presidential contenders, Chris Christie and Jeb Bush, have embraced that position.

The economy will benefit

Allowing undocumented immigrants to live and work legally in the US will also be good for the economy. Underground workers will start paying income and payroll taxes. Knowing they are not about to be deported makes them more likely to open savings accounts and spend on big-ticket items. Business groups say relaxing visa requirements will encourage more talented students from around the world who study in the US to stay after graduation and, perhaps, launch successful new companies. By expanding the labour force and improving productivity, the executive action will raise GDP by 0.4% annually over the next ten years, according to White House estimates. Officials also expect an increase in worker wages and a reduction in the federal deficit by a cumulative US$25bn over the next ten years.

However, while the move gives hope to those who have been living in the shadows of the informal economy, it is not a panacea for undocumented immigrants. To start with, it applies to only around 40% of those living in the country illegally. Second, even for those who will benefit from the executive order, it does not set them on a path to citizenship. A future president could reverse the order, leaving them exposed once more. And it does nothing to expand the overall number of visas available to immigrant workers and their relatives. It's not uncommon today for people from Mexico, India or the Philippines to wait a decade or more for a visa. Fixing that backlog can only happen with an act of Congress.

Political repercussions

Immigration reform has been an elusive goal in Congress for several years, with efforts repeatedly breaking down under opposition from conservative Republicans. In 2013, supporters of immigration reform thought they had achieved a breakthrough when the Senate (the upper chamber of Congress) passed a carefully constructed bill that would have granted citizenship to millions of people while also beefing up border security. But rank-and-file members of the House of Representatives (the lower chamber) balked, saying the bill was going too far too fast, even though their leaders said they were sympathetic to the principle.

Incoming Republican leaders have erupted in fury at the breadth of Mr Obama's actions, accusing the president of behaving like a despot and vowing to use whatever means at their disposal to block the changes. His use of executive action is not unprecedented, although the magnitude of it is. He has passed an average of 34 executive orders in each year of his presidency, fewer than George W. Bush (36) and Bill Clinton (46), according to news website 538.com. Moreover, previous Republican presidents Dwight Eisenhower, Ronald Reagan and George H. W. Bush all used executive orders to loosen immigration policy. However, Mr Obama's action is far more sweeping in its scope and magnitude than that taken by his predecessors, and he has done it in defiance of Congress. It has set a dangerous presidential precedent.

Republicans are angry and they have promised to respond on several fronts. They

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started by suing the president on the morning of November 21st, arguing he had overstepped his constitutional authority (technically, the lawsuit is about the health care reform law but its filing was timed to coincide with the announcement). Republicans have also looked for ways to keep government funds from being used to carry out the presidential order. Some are even whispering about impeachment. It's clear that the goodwill that prevailed in 2013, when the Senate was writing the comprehensive immigration reform bill, has evaporated. It no longer appears possible for Congress to pass comprehensive reform in the final two years of Mr Obama's presidency.

The long run

But the dream of comprehensive reform is not dead. Pressure from well-organised Hispanic voters will only grow. And business groups ranging from farmers to Silicon Valley startups will keep pushing for more visas for farmhands, computer engineers and others. Someday, Congress will be forced to tackle immigration reform again.

On that day, lawmakers will have no choice but to assume that the 5m people granted legal status under Mr Obama are going to remain. The debate will focus over what to do about those who aren't covered by Mr Obama's announcement. For that reason, his edict will likely turn out to be one of the most significant acts of his presidency. By making his move, Mr Obama has managed to set the terms of the next immigration debate. When that debate comes, supporters of full amnesty will have a considerable head start. Sooner or later, millions more undocumented immigrants living in the US will become legal residents and, perhaps, full citizens. The only question is when.

December 30, 2014

Latin America — Key issues in 2015

The outlook for Latin America in 2015 appears fairly subdued as the region continues to struggle to emerge from a period of below-average growth against the backdrop of the continuously disappointing economic performances of Brazil and Mexico, outright contractions in Argentina and Venezuela, and the deceleration of previously very dynamic, commodities-driven economies, such as Peru and Chile. After growing at an average 2.7% in 2012-13, regional GDP decelerated to an estimated 1.5% in 2014, the worst performance since 2009 for Latin America. We expect growth to pick up slightly in 2015, to 2.6%, setting the scene for a more solid performance in 2016-19 (with annual average growth of 3.3%), amid resilient domestic demand, some progress in structural reforms and increased investment, as well as a more positive external outlook. However, this will be well below post-crisis highs of over 5% in 2010-11 and a host of external and domestic challenges will continue to test the resilience of the region in the short term.

Panama, the Dominican Republic and Peru will post Latin America's best performances in 2015 (with growth of 5.5%, 4.8% and 4.5%, respectively) while Venezuela, Argentina and Brazil will lag behind (a 1.8% contraction, and growth of only 0.3% and 0.8%, respectively), constraining regional growth. The outlook for Nicaragua, Bolivia, Paraguay and Costa Rica is also quite positive, with forecast growth rates above 4%. Mexico (3.3%) will post a better performance than Brazil and its medium-to-long-term prospects appear fairly solid, provided the ambitious growth-enhancing structural reforms adopted in 2013-14 are fully implemented, but risks abound for the country on the political front.

Despite a better performance expected by the region in 2015 and its increased resilience to external shocks than in the recent past, against the backdrop of better macroeconomic fundamentals and copious international reserves (an estimated US$882.9bn in 2014), a number of external and domestic factors weigh on the outlook, as follows.

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Monetary-policy normalisation in the US

After a painfully slow recovery, the US economy appears to be going from strength to strength, amid booming consumer demands, accelerating job creation, improving business confidence and increased public investment. We forecast growth to pick up to 3.3% in 2015, from 2.2% this year. As Japan and the euro zone introduce new stimulus measures to shore up their economies, the Federal Reserve (the Fed, the US central bank) is preparing to raise interest rates, after having completed the tapering of its massive bond-buying programme in October. This has the potential to draw some capital away from Latin America, stoking renewed volatility in international capital markets. Tighter global-financing conditions and increased attractiveness of the US and other OECD economies will make for a more challenging environment for attracting investment and financing, with the region's competitiveness shortcomings increasingly under scrutiny from potential investors.

Euro zone faces continuing economic woes

The Euro zone, one of Latin America's main trading and investment partners, remains mired in slow growth (with unemployment falling to an extent, but still high, at over 11%), amid continuously elevated debt levels, strained budgets and sour political mood. The Russia-Ukraine crisis has also damaged investor sentiment in Northern European economies, including Germany. Although economies in the periphery, like Spain, are doing better, they are too small to fully offset weaknesses in Italy, France and Germany. GDP expanded by an anaemic 0.8% this year and will remain subdued, at 1.1% in 2015, affecting Latin America via muted trade, credit, tourism and investment.

China's new growth paradigm and weaker commodities prices

Growth in China will continue to decelerate in 2015, to 7.1% from an estimated 7.3% this year, amid the government's efforts to clamp down on rising levels of debt and reckless bank lending and to shift to a more balanced growth model, based on household consumption, rather than exports and investment. GDP growth will slow further in the forecast period, falling to a record 5.5% low in 2019. China is an increasingly key market and source of foreign direct investment (FDI) and financing for Latin America, and its weaker pace of expansion will continue to reduce, in particular, tailwinds enjoyed by South American commodity exporters in 2003-11. Although we do not envisage a complete collapse in commodity prices—these will continue to be supported by infrastructure-related demand in many emerging markets—commodities exporters in the region and beyond will no longer enjoy the cumulative annual gains in terms of trade experienced in recent years. This will strengthen the case for domestic reforms to boost productivity as a way to ensure sustained growth going forward. Although a boost for oil importers, the recent slump in oil prices, if prolonged, will also pose significant challenges for oil exporters in the region, in particular Venezuela, which is already struggling with severe domestic macroeconomic distortions.

Only slow progress on structural reforms

Latin America has consistently underperformed in comparison with other emerging economies in the recent past, in terms of its growth rate and potential, and our forecasts are for it to continue to do so, especially given the end of the commodities boom. This partly reflects Latin America's reduced scope for catch-up with developed-country income levels, but also the region's entrenched structural-competitiveness flaws, which constrain productivity and growth rates.

Reforms to broaden the tax base, notably by tackling widespread informality, are needed to boost government revenue, and tax systems could do with some simplification. According to the OECD, tax revenue in Latin America totalled 20.7% of GDP in 2012, up from 13.9% in 1990, but this was still low compared with the

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OECD average of 34.6%. The region also remains over-reliant on indirect taxes—which are especially regressive and inimical to the strengthening of domestic markets in a region with high poverty rates—and on commodity exports, which leave the public finances exposed to external shocks. A further liberalisation of the factors markets (notably by improving competition in the goods and services markets and increasing the flexibility of labour markets) will also increase the region's attractiveness to foreign investors. Poor infrastructure also remains a crucial bottleneck for regional growth, with public investment in infrastructure never having recovered from the substantial cuts made under the stabilisation programmes of the 1990s, and public-private partnerships (PPPs) not completely making up for the resulting infrastructure-financing gap.

The quality of education also remains a concern, as highlighted by the OECD's most recent Programme for International Student Assessment (PISA) survey. Progress on competitiveness-enhancing reforms has been piecemeal so far, amid a lack of political appetite in fragmented legislatures and little incentive to improve fundamentals amid exceptionally favourable external conditions (high commodities prices and unprecedented international liquidity). While Mexico has adopted a comprehensive structural-reform package in 2013, most countries have lagged behind on competitiveness reforms. We expect advances in reinforcing competitiveness fundamentals to gather some momentum in the forecast period, driven by an increasingly pressing need to boost the region's attractiveness against the backdrop of increased competition for investment, and demands for better services and more efficient governments from an increasingly vocal civil society.

Social unrest to trouble political outlook

Social unrest will continue to simmer—and occasionally boil over—in the region, amid growing frustration over governance flaws and poor government effectiveness, as well as concerns around projects involving natural resources, particularly in the Andes and Central America. Widespread corruption, in particular, will remain a major grievance for citizens in the region. According to the Corruption Perceptions Index 2014, recently released by anti-corruption watchdog, Transparency International, 18 of the 29 Latin American countries covered in its sample of 175 economies are placed in the bottom half of the rankings, with only Barbados and Uruguay (tied at 17th) making the top 20. While the index highlights Venezuela, Haiti (tied at 161st) and Paraguay (150th) as the regional laggards, perceptions of high corruption also plague regional giants such as Mexico (103rd) and, to a lesser extent, Brazil (69th). Mexico, notably, is currently facing a major political crisis following the disappearance (and presumed murder) of 43 students on September 26th, in the city of Iguala, Guerrero state. Evidence that municipal police had kidnapped the students and handed them over to a local drug cartel, known as Guerreros Unidos, were met with widespread outrage and provoked some of the largest protests seen in generations in Mexico, demanding that the president, Enrique Peña Nieto, step down. The crisis has also been exacerbated by a major scandal involving the first lady, and a US$7m home transferred to her by a media giant, Televisa, in 2010 and registered under a company associated with a Chinese-led consortium that was awarded a now-cancelled tender to build a high-speed railway. The events have highlighted the severity of institutional flaws at local and state level in Mexico and the presentation of a new ten-point security policy by Mr Peña Nieto has failed to quell social unrest. It is unlikely that the crisis will be defused without a major shake-up of the cabinet and a credible strategy for combating corruption in 2015.

Other episodes of social mobilisation have taken place in Brazil, Venezuela, Peru and Argentina during the course of 2014, exposing a wider crisis of representation and decreasing trust in the political class. Social conflicts over control and use of natural resources, as well as a backlash against mining activities and foreign investors' involvement, have also continued across the region, amid concerns of the rural poor and indigenous communities over how extractive projects will affect their livelihoods and the environment.

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Levels of crime and violence to remain high

Latin America is likely to remain among the most violent regions in the world; it had an average of 25 murders per 100,000 population in 2012, compared with a global average of 6.2 per 100,000 according to the UN Office on Drugs and Crime's (UNODC) latest data. Crime will be particularly concerning in Mexico, Central America and the Caribbean, with drug-trafficking the central element. Given that hardline security policies have not always yielded the desired results, the debate on different or additional courses of action is likely to continue. This will include a focus on prevention, but also drug decriminalisation, following the lead of Uruguay. Persistently high crime rates will continue to discourage private investment, increase business-operating costs, and divert government expenditure from other social and economic needs. Inadequate domestic police forces and judicial institutions will struggle to contain the crime epidemic, and this will continue to fuel state corruption and undermine trust in democratic governance.

December 30, 2014

Falling oil prices: winners and losers in Latin America

In the short run, Latin America as a whole will benefit from the recent plunge in global oil prices, but some economies may be hit hard by the market rout. Lower energy costs will have a favourable impact, principally on net oil importers in the region, but falling oil exports and fiscal revenue will hurt the external and public accounts of net exporters, principally those with weaker macroeconomic fundamentals. The Economist Intelligence Unit assumes that the market will stabilise and international prices will rebound in the months to come, with the Brent crude price expected to average US$80/barrel in 2015, down from US$100/b in 2014.

Although world oil prices plummeted by nearly 50% in the second half of 2014, this decline is lower than that experienced in the second half of 2008—at the brink of the world financial crisis—when they plunged by 77%. The global economy is not in its best shape at present, but it is certainly not in the critical condition that marked the start of the recent great recession. This fact confirms our view that the ongoing oil-market rout chiefly responds to a global oversupply of crude, and, to a lesser extent, to demand factors.

Venezuela the most vulnerable

Lower oil prices will have a particularly negative effect on the ailing Venezuelan economy. The country's dependence on the oil industry is extremely high, as it accounts for about 95% of export revenue, nearly 40% of fiscal income and about one-third of total GDP. The government of the Venezuelan president, Nicolás Maduro, assumed a price of US$120/b in the 2015 budget, while it is estimated that prices below US$100/b will make Venezuela's huge government-subsidised programmes unsustainable. Prices close to US$50/b (the level that the Venezuelan crude basket reached at some point in December) severely increase the risk of sovereign default. This risk comes directly from the financial vulnerability of Petróleos de Venezuela (PDVSA, the state-controlled oil company).

In this context, Mr Maduro will probably have to take harsh measures to prevent balance-of-payments and fiscal crises. These measures will likely include devaluation of the currency and some budget cuts, but Mr Maduro will seek to avoid more drastic fiscal adjustment, a rise in petrol prices, or the floating of the exchange rate. Any measures taken will be unpopular and will further undermine Mr Maduro's popular and political standing, already damaged by an economic recession, high inflation and widespread goods scarcity.

Mixed impact on other economies

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Other net oil exporters affected by the current oil rout include Colombia, Ecuador and Mexico. Although the Colombian economy has traditionally been well managed and this reduces risks, oil dependence is high, with this commodity accounting for 55% of export revenue, around one-quarter of total fiscal income and more than one-third of foreign direct investment (FDI). Falling oil prices (in tandem with market jitters on account of expected changes in US monetary policy) have already sparked drastic currency depreciation, led to a significant depreciation of the stock value of Ecopetrol (the oil company owned in majority by the state, although with shares floating on the local stock exchange, held by more than 500,000 individuals) and forced the government to revise upwards its fiscal-deficit and public-debt goals for 2015.

Although lower oil prices, together with a recent hike in taxes, reduce the attractiveness of the oil industry to investors, Colombia's free-floating foreign-exchange regime will provide for an adequate adjustment of external imbalances, while a relatively strong fiscal position will enable the implementation of a pro-cyclical fiscal policy. Policy options are more limited in the case of Ecuador, which requires an oil price of around US$120/b to maintain fiscal stability and which already has a high fiscal deficit, of nearly 5% of GDP in 2014.

Mexico's economic vulnerability to falling oil prices principally comes from the fact that the industry provides about one-third of total fiscal income. However, the country has hedged part of its oil-price risks for 2015 and has saved a portion of the oil bonanza in a stabilisation fund, thereby reducing the need for drastic public-spending cuts. Further, it is expected that lower oil prices can help to reduce electricity costs, boosting the competitiveness of Mexico's manufacturing exports at a time of rising demand from a stronger US economy, their main destination. It remains to be seen, however, how lower world oil prices will affect expectations for an increased stream of foreign investment, following the comprehensive energy-sector reform currently being implemented.

Some short-term winners

Indeed, sustained lower crude prices will deter investment in the oil industry throughout the region, but mostly in high-cost shale and offshore projects. This could have particularly negative effects for the development of new key projects in Argentina and Brazil in the medium-to-long run. Nevertheless, in the short term, the impact of the ongoing oil rout will be beneficial to these and other net oil importers as energy costs fall. These include Chile, Peru, Panama and other Central American and Caribbean nations.

While this impact will most likely materialise in improved terms of trade and lower inflationary pressures, it may also help to boost domestic demand as households use their savings on petrol bills to increase consumption and governments (as in the case of Brazil) to reduce subsidies and, consequently, potentially adopt expansionary fiscal policies. In all, however, consumer and investor confidence in the region will benefit if the current uncertainty regarding the future of oil prices, as well as the movements in US monetary policy, subside sooner rather than later.

January 12, 2015

Chinese and Latin American leaders tighten ties in Beijing

Leaders from the 33 member states of the Comunidad de Estados Latinoamericanos y Caribeños (CELAC, a 33-member block of all independent nations of the Americas, excluding Canada and the US) met with Chinese leaders in Beijing on January 8th and 9th for the first CELAC-China Forum. The meeting confirmed a growing interest in closer ties between China and Latin America, and points to a deepening of bilateral trade and investment flows going forwards.

The two-day meeting was co-chaired by China's foreign minister, Wang Yi, and Costa Rica's foreign minister, Manuel González Sanz, as Costa Rica is pro tempore

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president of CELAC. Together, the two sides agreed on three major documents: regulations on the forum, a five-year co-operation plan and the Beijing Declaration. These agreements include various measures to boost co-operation among the group's governments and private sectors.

Boosting trade and investment

Over the next five years (2015-19), China will invite 1,000 leaders from CELAC member states to visit China. Similarly, both sides will aim to achieve US$500bn in bilateral trade (in 2013 bilateral trade totalled around half of this figure), while also increasing investment to around US$250bn. As part of this effort, China has vowed to invest in infrastructure projects in the region, and to provide 6,000 government scholarships for CELAC members, while also increasing Mandarin-language programmes in primary and secondary schools in member countries. Members also agreed to boost co-operation between civil authorities and that the next forum would be held in Chile in 2018.

Increased financing needs

Chinese influence in the region has grown tremendously in the past decade as the Asian giant has sought an ever greater share of the region's natural resources, with bilateral trade growing by a factor of 22 between 2000 and 2013. In many countries, China has eclipsed the US as the largest trading partner. Similarly, over the past decade Chinese state financial institutions have disbursed around US$100bn in trade credits and investment to Latin American countries. According to Inter-American Dialogue, a US-based think tank, 54.4% of this money was spent on infrastructure, 26.3% on energy, 12.6% on other and 5.1% on mining. Around half of the money (US$50.6bn) went towards Venezuela, with repayment partially financed through oil exports. Similar agreements were made with Ecuador. Other large recipients include Argentina (shut out of international capital markets since its default in 2001) and Brazil.

The forum comes at a time of slower growth amid declining commodity prices in Latin America, owing in part to reduced Chinese demand. Particularly hard-hit are China's largest clients, such as Ecuador and Venezuela, who have seen shortfalls as the price of oil has fallen by more than half since the middle of 2014. This makes the announcement of increased financing particularly welcome in these countries, which also announced that they had received billion-dollar investments from China during the forum.

Cementing ties

However, also important are the announced investments in infrastructure development and education, which could help to boost Latin America's competitiveness. The announced scholarships and increased meetings between China and CELAC governments are also good news, as they will increase connectedness and intercultural understanding, which are currently lacking but are necessary to build lasting ties. Although the announcement of improved diplomatic and trade ties between the CELAC countries and China is nothing new—and in the past has failed to materialise—the dedication to the meeting shows a commitment from both sides to nurturing an intra-regional relationship.

China's growing interest in Latin American markets, and its increased assertiveness in searching for market opportunities and natural resources in what has traditionally been seen as the US's backyard, coupled with Latin America's interest in diversifying its trade and investment ties to less traditional partners in a more complicated external environment, suggest that bilateral relations will continue to deepen moving forwards.

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