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El Salvador Ratings Raised To 'B-/B' From 'CCC+/C' After Local Debt Reprofiling; Outlook Stable

Overview

- El Salvador is gradually reprofiling its short-term debt held by local banks (repaying outstanding short-term bills and then issuing new debt obligations at longer maturities), reducing the government's rollover risk.
- Despite the immediate fiscal relief from recent liability management exercises, the country remains vulnerable because of its high debt and interest burdens and its limited monetary flexibility.
- We raised our sovereign credit ratings on El Salvador to 'B-/B' from 'CCC+/C'.
- The stable outlook reflects the balance of risks between the short-term fiscal relief from the debt reprofiling and the still-high debt service payments due in the coming years.

Rating Action

On Nov. 7, 2023, S&P Global Ratings raised its long- and short-term sovereign credit ratings on El Salvador to 'B-/B' from 'CCC+/C'. The outlook on the long-term ratings is stable. We also raised our long-term issue ratings to 'B-'. The transfer and convertibility assessment remains 'AAA'.

Outlook

The stable outlook indicates our view of balanced risks between El Salvador's recently reduced rollover needs and its still-high debt service payments in the coming years, along with its fragile economic profile.

Downside scenario

We could lower the ratings over the next six to 12 months if we see a weakening of the government's ability to secure adequate funding for its fiscal deficits and rollover needs, or of its capacity to undertake the fiscal adjustment needed to stabilize its very high debt burden. Furthermore, higher refinancing risks or potential indications that the government is less willing to service its debt could also lead to a downgrade.

Upside scenario

We could raise the ratings in the next six to 12 months if comprehensive reforms lead to improved debt management, continued economic recovery, and greater clarity about fiscal policy, in turn reducing the financing gap and bolstering the country's debt payment culture.

Rationale

We raised our sovereign credit ratings on El Salvador to 'B-/B' because we consider that the government's recent program to gradually refinance its short-term debt with local banks will reduce rollover needs and mitigate the risk of a default over the next two years. This strategy is another step in the broad debt reprofiling process that began around a year ago, with two external debt repurchases and a pension debt exchange. (We deemed the pension debt exchange to be a distressed exchange.)

Although the debt reprofiling brings some fiscal relief to the government, it still faces considerable fiscal and debt risks as debt service payments remain high and financing alternatives are somewhat limited.

The short-term debt refinancing strategy targets around $1.4 billion of the $2.8 billion (around 8% of GDP) in short-term bills (LETES and CETES, for its Spanish acronyms). Under the reprofiling, the government repays in full every outstanding short-term bill at its current maturity date. The following day, it issues a new debt obligation--at longer maturities of two, three, five, or seven years--that could be taken by the same bank. To compensate for the longer maturities, the government will pay higher interest rates that range from 8.25% for the current one-year bills to 9.75% for the seven-year issuance.

Banks have already agreed how much of each bond will be held in their portfolios. Longer maturity bonds are being issued first. The program started in October this year, and given that the current short-term bills are being paid at maturity, it will take around one year for the government to complete the refinancing process, concluding in September 2024.

Once it's finished, rollover needs on the short-term debt will ease to around $1.7 billion-$2 billion annually, from the current $2.8 billion. Furthermore, the program contemplates a strategy to gradually reduce the stock of short-term debt--since both five-year and seven-year bonds will be amortizing (instead of the current bullet issuances of LETES and CETES)--to around $300 million in seven years. The

government has also lowered the short-term debt ceiling approved in its 2024 budget to 20% of its revenues (from 25%) as a commitment to mitigate this exposure.
This gradual refinancing follows:

- Two long-term debt repurchases in late 2022, which reduced the bullet bond amortizations due in 2023 and 2025, and
- A pension debt restructuring in the first half of the year, which granted relief of around four years of no interest and capital payments on its pension debt certificates.

Despite the fiscal relief coming from these measures, the country's public finances remain fragile, reflecting long-term structural vulnerabilities.

The rating on El Salvador incorporates the country's institutional weaknesses, as indicated by long-standing difficulties in predicting policy responses amid poor checks and balances, modest per capita GDP at $5,200, and only moderate GDP growth prospects due to persistently low investment and productivity. In addition, the sovereign has a very high debt burden, around 70% of GDP, and hefty debt service payments over the next three to five years. It also lacks monetary flexibility because of full dollarization.

The government has been in talks with the IMF and could enter into a program in the coming year. Although, most likely this would happen after the presidential election in February 2024.

Key Statistics

Table 1

El Salvador--Selected indicators

	2016	2017	2018	2019	2020	2021	2022	2023F	202

ECONOMIC INDICATORS (%)									
Nominal GDP (bil. LC)	24.19	24.98	26.02	26.88	24.93	29.45	32.49	34.63	35.9
Nominal GDP (bil. $)	24.19	24.98	26.02	26.88	24.93	29.45	32.49	34.63	35.9
GDP per capita (000s $)	3.8	3.9	4.1	4.2	3.8	4.5	5.0	5.3	5.4
Real GDP growth	2.5	2.2	2.4	2.4	(7.8)	11.2	2.6	2.5	2.2
Real GDP per capita growth	2.0	1.7	1.9	1.9	(8.3)	10.6	2.1	2.0	1.7
Real investment growth	3.6	3.6	7.2	6.3	(7.8)	25.1	(21.1)	5.5	5.2
Investment/GDP	16.0	16.7	18.4	18.3	17.1	20.6	20.0	19.4	19.3
Savings/GDP	13.7	14.8	15.1	17.9	18.7	16.3	13.4	16.2	16.4
Exports/GDP	28.5	29.0	28.9	30.0	24.3	28.3	31.2	27.0	26.9
Real exports growth	0.2	3.4	1.6	8.5	(24.6)	29.4	10.2	(4)	3.0

Unemployment rate	4.4	4.4	4.0	4.0	7.0	6.3	5.0	4.8	4.5
EXTERNAL INDICATORS (%)									
Current account balance/GDP	(2.3)	(1.9)	(3.3)	(0.4)	1.6	(4.3)	(6.6)	(3.2)	(2.9
Current account balance/CARs	(4.7)	(3.7)	(6.4)	(0.8)	3.2	(7.8)	(11.6)	(6.2)	(5.7
CARs/GDP	48.6	50.6	51.5	52.8	50.2	55.3	56.8	52.2	51.8
Trade balance/GDP	(19.2)	(19.4)	(21.7)	(21.2)	(20.2)	(27.2)	(29.5)	(25.6)	(25.
Net FDI/GDP	1.4	3.6	3.2	2.4	1.1	1.0	(0.3)	1.0	1.0
Net portfolio equity inflow/GDP	(0.0)	(0.0)	(0.0)	(0.1)	(2.1)	(0.2)	0.2	0.0	0.0
Gross external financing needs/CARs plus usable reserves	126.7	121.3	127.6	122.0	112.2	122.4	124.6	123.4	121.

Narrow net external debt/CARs	91.3	89.9	78.9	78.4	93.8	69.9	65.8	71.1	72.7
Narrow net external debt/CAPs	87.2	86.7	74.1	77.8	96.9	64.8	59.0	67.0	68.8
Net external liabilities/CARs	135.3	130.3	124.7	122.9	127.2	92.7	86.9	94.6	97.3
Net external liabilities/CAPs	129.2	125.6	117.2	122.0	131.4	85.9	77.8	89.1	92.1
Short-term external debt by remaining maturity/CARs	21.6	21.0	23.8	22.7	19.8	16.1	16.1	18.4	16.4
Usable reserves/CAPs (months)	(0.0)	0.3	0.2	0.2	0.5	0.1	0.3	0.1	0.1
Usable reserves (mil. $)	349	277	185	488	211	461	184	83	41
FISCAL INDICATORS (GENERAL GOVERNMENT; %)									
Balance/GDP	(3.1)	(2.5)	(2.7)	(3.1)	(10.0)	(5.5)	(2.6)	(3.3)	(3.2)

Change in net debt/GDP	3.4	2.8	2.5	3.2	10.6	6.4	3.0	3.3	3.2
Primary balance/GDP	(0.2)	0.7	0.9	0.6	(5.7)	(1.0)	1.9	1.2	1.3
Revenue/GDP	22.8	23.6	23.2	22.8	23.1	24.1	24.3	23.8	23.6
Expenditures/GDP	25.9	26.1	25.9	25.9	33.1	29.6	26.9	27.1	26.8
Interest/revenues	12.8	13.6	15.5	16.2	18.8	18.3	18.9	18.8	19.2
Debt/GDP	67.3	67.8	67.7	68.8	85.7	78.3	73.8	72.6	73.2
Debt/revenues	294.6	287.8	291.4	301.5	370.9	324.6	304.4	305.0	310
Net debt/GDP	65.4	66.1	66.0	67.1	83.0	76.6	72.4	71.3	71.9
Liquid assets/GDP	1.9	1.7	1.7	1.7	2.7	1.8	1.4	1.3	1.3
MONETARY INDICATORS (%)									
CPI growth	0.6	1.0	1.1	0.1	(0.4)	3.5	7.2	4.0	1.6
GDP deflator growth	0.7	1.0	1.7	0.8	0.6	6.3	7.5	4.0	1.6

Exchange rate, year-end (LC/$)	1.00	1.00	1.00	1.00	1.00	1.00	1.00	1.00	1.00
Banks' claims on resident non-gov't sector growth	5.3	5.1	8.5	6.8	9.5	9.1	12.4	5.6	2.8
Banks' claims on resident non-gov't sector/GDP	50.5	51.4	53.5	55.3	65.3	60.3	61.4	60.8	60.3
Foreign currency share of claims by banks on residents	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Foreign currency share of residents' bank deposits	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Real effective exchange rate growth	2.3	1.3	0.3	2.8	1.8	(0.7)	(1.8)	0.0	0.0

Adjustments: N/A

Definitions: Savings is defined as investment plus the current account surplus (deficit). Investment is defined as expenditure on capital goods, including plant, equipment, and housing, plus the change in inventories. Banks are other depository corporations other than the central bank, whose liabilities are included in the national definition of broad money. Gross external financing needs are defined as current account payments plus short-term external debt at the end of the prior year plus nonresident deposits at the end of the prior year plus long-term external debt maturing within the year. Narrow net external debt is defined as the stock of foreign and local currency public- and private- sector borrowings from nonresidents minus official reserves minus public-sector liquid claims on nonresidents minus financial-sector loans to, deposits with, or investments in nonresident entities. A negative number indicates net external lending. N/A--Not applicable. LC--Local currency. CARs--Current account receipts. FDI--Foreign direct investment. CAPs--Current account payments. The data and ratios above result from S&P Global Ratings' own calculations, drawing on national as well as international sources, reflecting S&P Global Ratings' independent view on the timeliness, coverage, accuracy, credibility, and usability of available information.

Ratings Score Snapshot

Table 2

El Salvador--Ratings score snapshot

KEY RATING FACTORS	SCORE	EXPLANATION

Institutional assessment	6	Reduced predictability of future policy responses because of moderate risk of challenges to political institutions. Relatively weak transparency and uncertain checks and balances between institutions.
		Debt payment culture is weak, demonstrated by distressed debt exchanges on pension debt.
Economic assessment	5	Based on GDP per capita ($) as per Selected Indicators in table 1.
External assessment	5	Based on narrow net external debt and gross external financing needs as per Selected Indicators in table 1.
		There is a risk of marked deterioration in the cost of or access to external financing, due to a potential significant reduction in the availability of official funding.
Fiscal assessment: flexibility and performance	6	Based on the change in net general government debt (% of GDP) as per Selected Indicators in table 1.
		The sovereign has a limited ability to raise general government revenue because of the large informal economy.

		The sovereign faces shortfalls in basic services and infrastructure, as reflected in its low ranking on the UNDP's human development index.
Fiscal assessment: debt burden	6	Based on net general government debt (% of GDP) and general government interest expenditure (% of general government revenue) as per Selected Indicators in table 1.
		Nonresidents hold over 60% of government commercial debt.
Monetary assessment	6	El Salvador moved from a de facto pegged exchange rate with the U.S. dollar into full dollarization in 2001.
		We consider the operational independence of the central bank (BCR) to be limited by the full dollarization. Additionally, the BCR has a limited ability to act as a lender of last resort.
Indicative rating	b-	As per table 1 of "Sovereign Rating Methodology."
Notches of supplemental adjustments and flexibility	0	
Final rating		

Foreign currency	B-	
Notches of uplift	0	
Local currency	B-	

S&P Global Ratings' analysis of sovereign creditworthiness rests on its assessment and scoring of five key rating factors: (i) institutional assessment; (ii) economic assessment; (iii) external assessment; (iv) the average of fiscal flexibility and performance, and debt burden; and (v) monetary assessment. Each of the factors is assessed on a continuum spanning from 1 (strongest) to 6 (weakest). S&P Global Ratings' "Sovereign Rating Methodology," published on Dec. 18, 2017, details how we derive and combine the scores and then derive the sovereign foreign currency rating. In accordance with S&P Global Ratings' sovereign ratings methodology, a change in score does not in all cases lead to a change in the rating, nor is a change in the rating necessarily predicated on changes in one or more of the scores. In determining the final rating the committee can make use of the flexibility afforded by §15 and §§126-128 of the rating methodology.

Related Criteria

- General Criteria: Environmental, Social, And Governance Principles In Credit Ratings, Oct. 10, 2021
- Criteria | Governments | Sovereigns: Sovereign Rating Methodology, Dec. 18, 2017
- General Criteria: Methodology For Linking Long-Term And Short-Term Ratings, April 7, 2017
- General Criteria: Principles Of Credit Ratings, Feb. 16, 2011
- General Criteria: Methodology: Criteria For Determining Transfer And Convertibility Assessments, May 18, 2009

Related Research

- El Salvador, June 15, 2023
- El Salvador Upgraded To 'CCC+/C' On Cured Distressed Debt Exchange; Outlook Stable, May 10, 2023
- El Salvador Downgraded To 'SD' On Pension Debt Exchange; Distressed Exchange Subsequently Cured, May 9, 2023
- El Salvador 'CCC+' Long-Term Ratings Affirmed After Second Debt Repurchase Offer; Outlook Remains Negative, Dec. 5, 2022
- El Salvador 'CCC+' Ratings Affirmed After Debt Repurchase Offer; Outlook Remains Negative, Sept. 16, 2022

In accordance with our relevant policies and procedures, the Rating Committee was composed of analysts that are qualified to vote in the committee, with sufficient experience to convey the appropriate level of knowledge and understanding of the methodology applicable (see 'Related Criteria And Research'). At the onset of the committee, the chair confirmed that the information provided to the Rating Committee by the primary analyst had been distributed in a timely manner and was sufficient for Committee members to make an informed decision.

After the primary analyst gave opening remarks and explained the recommendation, the Committee discussed key rating factors and critical issues in accordance with the relevant criteria. Qualitative and quantitative risk factors were considered and discussed, looking at track-record and forecasts.

The committee's assessment of the key rating factors is reflected in the Ratings Score Snapshot above.

The chair ensured every voting member was given the opportunity to articulate his/her opinion. The chair or designee reviewed the draft report to ensure consistency with the Committee decision. The views and the decision of the rating committee are summarized in the above rationale and outlook. The weighting of all rating factors is described in the methodology used in this rating action (see 'Related Criteria And Research').

Ratings List

RATINGS AFFIRMED		
EL SALVADOR		
Transfer & Convertibility Assessment		
Local Currency	AAA	
UPGRADED		
	TO	**FROM**
EL SALVADOR		

Sovereign Credit Rating	B-/Stable/B	CCC+/Stable/C
EL SALVADOR		
Senior Unsecured	B-	CCC+

Certain terms used in this report, particularly certain adjectives used to express our view on rating relevant factors, have specific meanings ascribed to them in our criteria, and should therefore be read in conjunction with such criteria. Please see Ratings Criteria at www.spglobal.com/ratings for further information. Complete ratings information is available to RatingsDirect subscribers at www.capitaliq.com. All ratings affected by this rating action can be found on S&P Global Ratings' public website at www.spglobal.com/ratings.

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