Fitch Affirms El Salvador's Sovereign Ratings

3 de marzo de 2006

Fitch Ratings-New York-02 March 2006: Fitch Ratings today affirmed El Salvador's Foreign and Local Currency Default Issuer Ratings at 'BB+'. The Rating Outlook is Stable. El Salvador's ratings are supported by its macroeconomic stability, its relatively low public sector debt burden, and its good record for structural reforms. El Salvador's ratings are constrained by the country's weak social indicators, its fiscal deficits, which are relatively high for a dollarized economy, and the slow growth rate of recent years. President Saca remains highly popular and has made use of this to pass a tax-enhancing package and a modest pension reform. Public finances have remained stable thanks to the administration's commitment to reducing fiscal imbalances. Last year's tax package increased revenues by 1% of GDP (in line with expectations) even though tax rates were not increased. In 2005, the non-financial public sector deficit reached 3% of GDP, of which 2% of GDP corresponded to pension reform costs. In Fitch's view, the country needs to lower its fiscal deficit to increase the scope for counter-cyclical fiscal policies because, as a dollarized economy, fiscal policy is its only means of making adjustments to cope with external or domestic shocks. Similarly, El Salvador's government debt-to-GDP ratio, at 40%, is not unduly large compared with those of its peers, and is lower than the 'BB' median of 45%. However, Fitch believes the government's debt burden needs to be on a solid downward trajectory in order to increase its fiscal flexibility. An increase in the government's primary surplus and higher GDP growth would secure such an outcome. Currently, the Saca administration appears reluctant to raise tax rates further and is more inclined to increase revenue collection by fighting tax evasion. Fitch believes the authorities should be prepared to take additional action on taxes if administrative measures fail to yield the desired results. This is underscored by the fact that the tax base is still quite low, at 13% of GDP, while development needs are large. On the positive side, the government's financing needs continue to decline and are now in line with those of its rating peers. In 2005, they fell to 6.5% of GDP, and we estimate that they will decline to 5.6% in 2006. The government has reduced its reliance on short-term instruments (Letes) to finance its deficits, further reducing refinancing risks. The government has also started to diminish its reliance on the international capital markets by diversifying its sources of funding, including accessing the local markets and borrowing from the multilaterals. Fitch's concerns regarding El Salvador include its relatively poor rate of both GDP and export growth. Moreover, the agency believes the Salvadoran banking system needs to become stronger because of the dollarization of the economy, as there is no lender of last resort. Finally, in contrast to the situation a few years ago, El Salvador's external debt ratios are now above the 'BB' median. El Salvador's debt ratios have increased because current external receipts have grown only moderately, in part because of the decline in maquila exports, and both public and private sector external debt has increased. Even though El Salvador has one of the best records for structural reforms in Central America - including trade liberalization, privatization and pension reform - the country's GDP growth rate averaged less than 2% in the last five years. Although GDP growth increased to 2.8% last year, it is quite low compared to El Salvador's rating peers. Growth remains weak for numerous reasons, including low savings and investment rates, relatively weak business climate indicators due especially to high crime rates, which reduce the attractiveness of the country to foreign direct investment while increasing business costs. However, since the Saca administration has devised strategies to address the challenge of sluggish growth, Fitch expects the Salvadoran economy to grow at an average rate of just over 3% in the coming two years. The drivers for this growth should be the implementation of CAFTA, together with greater private and public investment in infrastructure, and the tourism and maquila sectors. Contact: Shelly Shetty +1-212-908-0324 or Theresa Paiz-Fredel +1-212-908-0534, New York. Media Relations: Christopher Kimble, New York, Tel: +1 212-908-0226. Fitch's rating definitions and the terms of use of such ratings

are available on the agency's public site, 'www.fitchratings.com'. Published ratings, criteria and methodologies are available from this site, at all times. Fitch's code of conduct, confidentiality, conflicts of interest, affiliate firewall, compliance and other relevant policies and procedures are also available from the 'Code of Conduct' section of this site.