Debtwire
An Acuris company

El Salvador president’s potential gains in legislative elections could lift market confidence

17 February 2021 | 10:18 EST

PROPRIETARY
Latin America

El Salvador

Issuer

Government Of El Salvador

A win for President Nayib Bukele’s party in the El Salvador (B-/B3/B-) legislative elections on 28 February would help boost the market’s confidence in the country’s debt sustainability and debt repayment capacity, according to three sovereign analysts. However, concerns persist about the controversial administration’s political willingness to pursue difficult fiscal consolidation measures rather than political reforms.

The president’s party, Nuevas Ideas (NI), needs a qualified two-thirds majority, or 56 out of 84 seats in the legislative assembly, in order to carry out planned fiscal adjustments aimed at increasing GDP growth.

Bukele’s party has performed well in recent polls, with 68.8% indicating they would vote for NI candidates, *El Mundo* reported 11 February, citing the Instituto de Opinion Publica at the Universidad Centroamericana Jose Simeon Canas. No other party registered more than 6% in the poll.

Moody’s senior sovereign analyst Ariane Ortiz-Bollin told *Debtwire* she expects the president’s party to gain seats in the legislative assembly, with the most likely scenario being one where the president has at least enough seats to have a simple majority, 43, but not enough for the qualified majority.

“A stronger presence in the assembly would provide the government clout to negotiate and carry out fiscal adjustment plans that will require changes to revenue and expenditure structures, possibly requiring law changes,” Ortiz-Bollin said. “If the government wins a qualified majority – not our baseline scenario – it would have an easier time approving reforms, including liability management operations to improve the government’s debt structure, reduce liquidity risks and retire expensive short-term debt, [including] enough votes to avoid having to reach agreements with the opposition in the unicameral Legislative Assembly to issue long-term debt.”

The main issue for El Salvador’s debt sustainability and repayment capacity is the Bukele administration’s ability to deliver the necessary fiscal and macro reforms that enhance economic growth in the medium-term, according to a second sovereign analyst.

Moody's expects the government to begin consolidating its finances in the second half of this year, which could catalyze access to multilateral debt financing.

In December the legislative assembly approved the 2021 budget, including USD 1.68bn in potential additional multilateral financing. The President later vetoed certain items in the budget, alleging they were "unconstitutional,” while permitting most of it. Congress later overrode a veto pertaining to certain multilateral financing.

The outlook on El Salvador's B3 ratings was revised to negative by Moody's earlier this month, considering implementation risks of the administration's forthcoming fiscal adjustments, high liquidity risks, and persistent debt sustainability concerns.

"A NI majority would increase our confidence in the government's capacity to deliver [the necessary fiscal adjustments]," the second analyst said. "[Potential] IMF funding would imply a set of reforms along these lines as part of the program."

However, if the legislative majority focused more on political reforms, it would be hard to give the benefit of the doubt to this credit, according to this analyst.

"For instance, market observers frequently discuss the possibility of President Bukele opening the door for his reelection as part of political reforms," the second analyst said. "Choosing this path would imply allocation time and political buffers rebuilt during the upcoming elections for projects that will not necessarily improve El Salvador's creditworthiness."

"While there is no guarantee the government goes to the IMF after the election, the limited alternative financing options do seem to point to that direction," Thomas Jackson, sovereign analyst at OPCO told *Debtwire*. "The easing of acute market pressure with the recent Eurobond performance could reduce the government's eagerness to pursue difficult fiscal consolidation measures. However, any deviation from this would likely result in a strong reaction from the market."

El Salvador's USD 800m 6.375% 2027 bond last traded 16 February at 96.01 to yield 7.22%, according to MarketAxess. Its USD 1bn 9.5% 2052 bond traded at 101.5 to yield 9.35%. The prices represent improvements from levels below 90 in October.

Prior to the coronavirus pandemic, the government reported a primary surplus of 1% of GDP between 2017 and 2019 and the large fiscal deficits of 2020-21 are mostly related to the fiscal response to address the impact of the pandemic. A return to primary balances closer to those posted prior to the pandemic should be attainable in the context of a gradual economic recovery and absent a resurgence of COVID-19 contagion spikes and lockdowns, according to Ortiz-Bollin.

"Regardless of the result of the legislative elections, political willingness from government officials to begin consolidating its finances and political support from the legislative assembly is required for the government to carry out any fiscal adjustment," Ortiz Bollin said. "We think the government of El Salvador has the ability to undertake fiscal adjustment if there is political willingness."

Even though Moody's expects the government to adopt fiscal adjustment measures this year and next, concerns about debt sustainability persist.

"Given the higher interest burden, not even a larger-than-expected fiscal adjustment and a return to the primary surplus registered between 2017-19 would be sufficient to stabilize the debt metric, which we estimate will surpass 90% of GDP in 2022," Ortiz-Billon said. "Our calculations indicate that an overall fiscal adjustment of three to four

points of GDP between 2020 and 2022 is needed to reduce debt sustainability risks and assure continued access to multilateral funding."

No immediate need for market access

El Salvador will need market access next year, as a USD 800m bond matures in January 2023, but the financing gap for this year is manageable, according to the second analyst.

"Participation in a new issuance would be less tied to specific credit metrics and more to the outlook of reforms," the second analyst said. "Securing an IMF program and putting forward a legislative agenda complying with its targets (encompassing fiscal, labor, and microeconomic reforms) are the key points we're looking to have El Salvador issuing debt at lower yields than last year's 9.5% 2052 bonds."

In contrast, precisely because the 2021 financing situation is not too acute and the next bond maturity is only in 2023, the administration might not be hurrying to pass economic measures, preferring instead to focus on political reforms, according to the second analyst.

"In this scenario, of a status quo, tapping the bond markets would be very expensive for the credit for another year in a row, which in turn would put its repayment capacity in the spotlight," the second analyst said.

S&P sovereign analysts Livia Honsel, Joydeep Mukherji, and Patricio Vimberg noted institutional weakness including "low predictability of future policy responses as a result of a highly polarized political landscape and centralized decision-making," they told *Debtwire* in written comments. Though divisiveness complicated the 2021 budget approval, more concentration of policymaking in the hands of the executive would further damage the institutional environment and potentially weaken the commitment to make fiscal adjustments, they said.

Bukele has been criticized for his rhetoric, actions and disrespect for the rule of law. Last week, opposition lawmakers proposed initiating a process that could lead to his removal, on the grounds that he may be mentally unfit. The Biden administration declined to meet with him on a trip to Washington earlier this month.

El Salvador's gross financing needs are high, at around 17% of GDP. Fortunately, El Salvador does not have a major external bond maturity until January 2023, according to Jackson.

"There is the need to roll over the USD 1.4bn in Letes [short-term debt in the form of Letras del Tesoro (LETES)], which we assume the local market will continue to do as we have seen in recent auctions," Jackson said. "A NI election sweep that results in a qualified majority would allow the Bukele administration to amend the borrowing limits of this short-term debt if they were to pursue such a route. While it is possible to simply increase the limits, we do not think there would be sufficient demand to go much further than what is already outstanding."

El Salvador's ability to rely on domestic funding has narrowed, as a significant increase in short-term debt has driven the market's absorption capacity to its limit. Even though local banks may be willing

to increase their exposure to short-term debt, in the form of (LETES) or Certificados del Tesoro (CETES), Moody's thinks they will not be able to materially increase their holdings by much more.

Local banks would need approval from their parent companies to further increase their exposure to government debt and LETES have already reached a record level of USD 1.41bn, shy of the official limit approved in the 2021 budget, and substantially above the USD 800m-USD 900m observed pre-pandemic, according to the ratings agency.

"El Salvador has a relatively smooth debt amortization profile over the next 12 months, as well as access to official funding which eases short-term rollover risks, according to Honsel, Mukherji, and Vimberg. "We also consider El Salvador to have sufficient capacity to roll over its short-term debt (LETES)."

"Regardless of the result of the election, our base-case scenario assumes that the government will make only gradual progress over the long term in implementing its plans for boosting economic growth and strengthening public finances. And any potential program with the IMF would likely comprise significant revenue and spending adjustments and would therefore be politically costly," the S&P analysts said.

by Ero Partsakoulaki

© MERGERMARKET GROUP. ALL RIGHTS RESERVED.
To be used for the internal business of the assigned users only. Sharing, distributing or forwarding the entirety or any part of this article in any form to anyone that does not have access under your agreement is strictly prohibited and doing so violates your contract and is considered a breach of copyright. Any unauthorised recipient or distributor of this article is liable to Debtwire for unauthorised use and copyright breach.