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Offering Circular

The Republic of El Salvador

US$225,000,000 7.65% Notes due 2035

Issue Price: 96.71% plus accrued interest from June 15, 2006

Interest Payable June 15 and December 15

The Notes will mature on June 15, 2035. Interest will be payable semi-annually in arrears on June 15 and December 15 of each year commencing on December 15, 2006.

The Notes will be a further issuance of, and will be consolidated to form a single series with, the Republic of El Salvador's outstanding 7.65% Notes due 2035 issued on June 10, 2005 and April 26, 2006. The total aggregate principal amount of the previously issued Notes and the Notes now being issued will be US$1,000,000,000.

The Notes will contain provisions, commonly known as "collective action clauses," regarding acceleration and voting on future amendments, modifications and waivers that differ from those applicable to certain of the Republic of El Salvador's outstanding Public External Indebtedness (as defined herein). Under these provisions, which are described in the sections entitled "Terms and Conditions of the Notes — Events of Default" and "— Modifications, Amendments and Waivers," the Republic of El Salvador may amend the payment provisions of the Notes and certain other terms with the consent of the holders of 75% of the aggregate amount of the outstanding Notes.

Except as described herein, payments on the Notes will be made without deduction for or on account of withholding taxes imposed by the Republic of El Salvador. Application has been made to list the Notes on the Luxembourg Stock Exchange and to have the Notes admitted to trading on the Euro MTF Market, the alternative market of the Luxembourg Stock Exchange. Application will be made to list the Notes on the El Salvador Stock Exchange.

Delivery of the Notes will be made on or about July 20, 2006.

The Notes have not been and will not be registered under the Securities Act. The Notes may not be offered or sold within the United States or to U.S. persons except to qualified institutional buyers in reliance on the exemption from registration provided by Rule 144A and to certain persons in offshore transactions in reliance on Regulation S. You are hereby notified that sellers of the Notes may be relying on the exemption from the provisions of Section 5 of the Securities Act provided by Rule 144A.

Joint Lead Managers and Joint Bookrunners

Citigroup **JPMorgan**

July 13, 2006

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El Salvador

IN MAKING AN INVESTMENT DECISION, INVESTORS MUST RELY ON THEIR OWN EXAMINATION OF THE REPUBLIC AND THE TERMS OF THE OFFERING, INCLUDING THE MERITS OR THE RISKS INVOLVED.

You should rely only on the information contained in this document or to which we have referred you. We have not authorized anyone to provide you with information that is different. This document may only be used where it is legal to sell these securities. The information in this document may only be accurate on the date of this document.

This Offering Circular may only be used for the purposes for which it has been published.

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Because the Republic or its affiliates may purchase and resell the Notes in certain transactions exempt from registration under the U.S. Securities Act of 1933, as amended (the "Securities Act"), the ability of any subsequent holder of Notes to reoffer, resell, pledge or otherwise transfer the Notes pursuant to the exemption provided by Rule 144 under the Securities Act may be limited.

NOTICE TO NEW HAMPSHIRE RESIDENTS

NEITHER THE FACT THAT A REGISTRATION STATEMENT OR AN APPLICATION FOR A LICENSE HAS BEEN FILED UNDER CHAPTER 421-B OF THE NEW HAMPSHIRE REVISED STATUTES WITH THE STATE OF NEW HAMPSHIRE NOR THE FACT THAT A SECURITY IS EFFECTIVELY REGISTERED OR A PERSON IS LICENSED IN THE STATE OF NEW HAMPSHIRE CONSTITUTES A FINDING BY THE SECRETARY OF STATE THAT ANY DOCUMENT FILED UNDER RA 421-B IS TRUE, COMPLETE AND NOT MISLEADING. NEITHER ANY SUCH FACT NOR THE FACT THAT THE EXEMPTION OR EXCEPTION IS AVAILABLE FOR A SECURITY OR A TRANSACTION MEANS THAT THE SECRETARY OF STATE HAS PASSED IN ANY WAY UPON THE MERITS OR QUALIFICATIONS OF, OR RECOMMENDED OR GIVEN APPROVAL TO, ANY PERSON, SECURITY OR TRANSACTION. IT IS UNLAWFUL TO MAKE, OR CAUSE TO BE MADE, TO ANY PROSPECTIVE PURCHASER, CUSTOMER OR CLIENT, ANY REPRESENTATION INCONSISTENT WITH THE PROVISIONS OF THIS PARAGRAPH.

The Notes will be direct, general and unconditional obligations of the Republic. The Notes will, at all times, rank equally without any preference among themselves and at least *pari passu* with all other present and future unsecured and unsubordinated Public External Indebtedness (as defined herein) of the Republic.

The Notes will be issued in registered form only. Notes sold in offshore transactions in reliance on Regulation S under the Securities Act ("Regulation S") will be represented by a permanent global Note (which may be subdivided) in fully registered form without interest coupons (the "Regulation S Global Note") deposited with a custodian for, and registered in the name of a nominee of, The Depository Trust Company ("DTC") for the respective accounts at DTC as such subscribers may direct. Notes sold in the United States to qualified institutional buyers (each a "qualified institutional buyer") as defined in, and in reliance on, Rule 144A under the Securities Act ("Rule 144A") will be represented by a permanent global Note (which may be subdivided) in fully registered form without interest coupons (the "Restricted Global Note" and, together with the Regulation S Global Note, the "Global Notes") deposited with a custodian for, and registered in the name of a nominee of, DTC for the respective accounts at DTC as such subscribers may direct. Beneficial interests of DTC participants (as defined under "Book-Entry Settlement and Clearance") in the Global Notes will be shown on, and transfers thereof between DTC participants will be effected only through, records maintained by DTC and its direct and indirect participants, including Euroclear Bank S.A./N.V., as operator of the Euroclear System ("Euroclear") and Clearstream Banking, *société anonyme* ("Clearstream, Luxembourg"), if applicable. See "Book-Entry Settlement and Clearance." Except as described herein, definitive Notes will not be issued in exchange for beneficial interests in the Global Notes. See "Terms and Conditions of the Notes — Form, Denomination and Title." For restrictions on transfer applicable to the Notes, see "Transfer Restrictions" and "Subscription and Sale."

The Republic has taken reasonable care to ensure that the information contained in this Offering Circular is true and correct in all material respects and not misleading as of the date hereof, and that, to the best of the knowledge and belief of the Republic, there has been no omission of information which, in the context of the issue of the Notes, would make this document as a whole or any such information misleading in any material respect. The Republic accepts responsibility accordingly.

This Offering Circular does not constitute an offer by, or an invitation by or on behalf of, the Republic or the Joint Lead Managers to subscribe to or purchase any of the Notes. Each recipient shall be deemed to have made its own investigation and appraisal of the financial condition of the Republic. The distribution of this Offering Circular or any part of it and the offering, possession, sale and delivery of the Notes in certain jurisdictions may be restricted by law. Persons into whose possession this Offering Circular comes are required by the Republic and the Joint Lead Managers to inform themselves about and to observe any such restrictions. See "Subscription and Sale" and "Transfer Restrictions" for a description of further restrictions on the offer, sale and delivery of Notes and on distribution of this Offering Circular and other offering material relating to the Notes.

Each person purchasing Notes pursuant to Rule 144A will be deemed to:

- represent that it is purchasing the Notes for its own account or an account with respect to which it exercises sole investment discretion and that it or such account is a qualified institutional buyer (as defined in Rule 144A); and

- acknowledge that the Notes have not been and will not be registered under the Securities Act or any State securities laws and may not be reofferred, resold, pledged or otherwise transferred except as described under "Transfer Restrictions."

Each purchaser of Notes sold outside the United States in reliance on Regulation S will be deemed to have represented that it is not purchasing Notes with a view to distribution thereof in the United States. Each person purchasing Notes pursuant to Rule 144A also acknowledges that:

- it has been afforded an opportunity to request from the Republic and to review, and it has received, all additional information considered by it to be necessary to verify the accuracy of the information herein;

- it has not relied on the Joint Lead Managers or any person affiliated with the Joint Lead Managers in connection with its investigation of the accuracy of the information contained in this Offering Circular or its investment decision; and

- no person has been authorized to give any information or to make any representation concerning the Republic or the Notes other than those contained in this Offering Circular and, if given or made, such information or representation should not be relied upon as having been authorized by the Republic or the Joint Lead Managers.

IN CONNECTION WITH THIS ISSUE OF NOTES, THE JOINT LEAD MANAGERS MAY, THEMSELVES OR THROUGH THEIR AFFILIATES, OVERALLOT OR EFFECT TRANSACTIONS WHICH STABILIZE OR MAINTAIN THE MARKET PRICE OF THE NOTES AT A LEVEL WHICH MIGHT NOT OTHERWISE PREVAIL IN THE OPEN MARKET, TO THE EXTENT PERMITTED BY APPLICABLE LAWS. SUCH STABILIZING, IF COMMENCED, MAY BE DISCONTINUED AT ANY TIME.

PRESENTATION OF INFORMATION

Unless otherwise specified or the context requires, references to "US dollars" and "US$" are to United States dollars and references to the *"colón"* and *"colones"* and "¢" are to Salvadoran *colones.*

References to the "Republic" and "El Salvador" are to the Republic of El Salvador.

References to "FOB" are to exports free on board and to "CIF" are to imports including cost, insurance and freight charges.

Data identified as "preliminary" in the tables included in this Offering Circular reflect an interim calculation and is subject to change.

References to "*maquila"* are to the assembly of imported goods for re-export.

References to "Central America" and "Central American countries" are to El Salvador, Costa Rica, Guatemala, Honduras and Nicaragua.

Certain economic and financial data in this Offering Circular is derived from information previously published by *Banco Central de Reserva de El Salvador* (the "Central Bank") and other governmental entities of El Salvador. This data is subject to correction and change in subsequent publications.

Certain other information in this Offering Circular is derived from information made publicly available by the United Nations.

References to "net international reserves" are to foreign currency reserves. The term "current account surplus (deficit)" as applied to the balance of payments includes foreign aid, unless otherwise specified.

Certain amounts included in this Offering Circular have been subject to rounding adjustments; accordingly, figures shown as totals in certain tables may not be an arithmetic aggregation of the figures which precede them.

FORWARD-LOOKING STATEMENTS

This Offering Circular contains certain forward-looking statements (as such term is defined in the Securities Act) concerning the Republic. These statements are based upon beliefs of certain government officials and others as well as a number of assumptions and estimates which are inherently subject to significant uncertainties, many of which are beyond the control of the Republic. Future events may differ materially from those expressed or implied by such forward-looking statements. Such forward-looking statements are principally contained in the sections "Offering Circular Summary," "Recent Developments," "The Republic of El Salvador," "The Salvadoran Economy," "Foreign Trade and Balance of Payments," "Monetary System," "Public Sector Finances" and "Public Debt." In addition, in those and other portions of this Offering Circular, the words "anticipates," "believes," "estimates," "expects," "plans," "intends," "projections" and similar expressions, as they relate to the Republic, are intended to identify forward-looking statements. Such statements reflect the current views of the Republic with respect to future events and are subject to certain risks, uncertainties and assumptions. The Republic undertakes no obligation publicly to update or revise any forward-looking statements, whether as a result of new information, future events or otherwise. In light of these risks and uncertainties, there can be no assurances that the events described or implied in the forward-looking statements contained in this Offering Circular will in fact occur.

ENFORCEMENT OF CIVIL LIABILITIES

The Republic is a foreign sovereign state. Consequently, it may be difficult for investors to obtain or realize upon judgments in the courts of the United States. Under its Constitution, the Republic is not permitted to consent to jurisdiction of the courts of any foreign jurisdiction. The Republic has not consented to the jurisdiction of any court outside El Salvador in connection with actions arising out of or based on the Notes or in connection with the enforcement of any judgment arising out of such actions, nor has the Republic appointed an agent for service of process outside El Salvador. The Republic has agreed to the following arbitration provisions as part of the Terms and Conditions of the Notes.

Any dispute, controversy or claim arising out of or relating to the Notes (other than any action arising out of or based on the United States federal or state securities laws), including the performance, interpretation, construction, breach, termination or invalidity thereof shall be finally settled by arbitration in accordance with the Arbitration Rules of the United Nations Commission on International Trade Law (excluding Article 26 thereof) as in effect on the date of the Fiscal Agency Agreement (the "UNCITRAL Arbitration Rules"). The number of arbitrators shall be three, to be appointed in accordance with Section II of the UNCITRAL Arbitration Rules. The appointing authority shall be the Chairman of the International Court of Arbitration of the International Chamber of Commerce. The third arbitrator may be (but need not be) of the same nationality as any of the parties to the arbitration. The place of arbitration shall be New York, New York. The language to be used in the arbitration proceedings shall be English. Any arbitral tribunal constituted under this paragraph shall make its decisions entirely on the basis of the substantive law of the State of New York.

The decision of any arbitral tribunal shall be final to the fullest extent permitted by law, and a court judgment may be entered thereon by any Salvadoran court lawfully entitled to enter such judgment. In any arbitration or related legal proceedings for the conversion of an arbitral award into a judgment, the Republic will not raise any defense that it could not raise but for the fact that it is a sovereign state. The Republic has not consented to the jurisdiction of any court outside El Salvador, in connection with actions arising out of or based on the Notes or in connection with the enforcement of any judgment arising out of such actions, nor has the Republic appointed an agent for service of process outside El Salvador. The Republic waives any *forum non conveniens* defense in any proceeding in El Salvador.

No arbitration proceedings hereunder shall be binding upon or in any way affect the right or interest of any person other than the claimant or respondent with respect to such arbitration.

The Republic's consent to arbitration shall not preclude a holder of any Note from instituting legal proceedings against the Republic in the courts of El Salvador.

The Republic has represented that it has no right to immunity on the grounds of sovereignty or otherwise, from the execution of any judgment in El Salvador, or from the execution or enforcement in El Salvador of any arbitral award (except, in each case, for the limitation on alienation of public property) in respect of any proceeding or any other matter arising out of or relating to its obligations contained in the Notes. The enforcement by a Salvadoran court of a foreign arbitral award is subject to recognition by the *Corte Suprema de Justicia* (the "Supreme Court") of the Republic, which will recognize such award if all the required formalities are observed and the award does not contravene Salvadoran national sovereignty, public policy and "good morals." Under the laws of the Republic, public property *(bienes de uso público)* of the Republic located in El Salvador is not subject to execution or attachment, either prior to or after judgment. The execution of a judgment against the Republic in El Salvador is only available in accordance with the procedures set forth in Articles 450 et seq. of the Salvadoran Civil Procedure Code, which envisions registration of the judgment for inclusion in the budget for payment in a subsequent fiscal year of the Republic.

EXCHANGE RATE INFORMATION

From 1989 to December 31, 2000, although El Salvador set no official exchange controls on the *colón* and the exchange rate was permitted to float freely based on market forces, the Central Bank had a policy of purchasing and selling US dollars periodically for the purpose of limiting movement in the *colón/*US dollar exchange rate.

On November 30, 2000, the Legislative Assembly approved the *Ley de Integración Monetaria* (the "Monetary Integration Act"), which fixed the *colón* to the US dollar at ¢8.75 to US$1.00, effective January 1, 2001. Since January 1, 2001, the *colón*/US dollar exchange rate has been fixed at ¢8.75/US$1.00 pursuant to the Monetary Integration Act. The Monetary Integration Act allows free circulation of the US dollar in the Salvadoran economy and makes the US dollar the unit of account for the financial system in El Salvador. See "Foreign Trade and Balance of Payments — Exchange Rate Policy and Foreign Exchange Rates."

Currency conversions contained in this Offering Circular should not be construed as representations that *colones* have been, could have been or could be converted into US dollars at the indicated or any other rate of exchange.

OFFERING CIRCULAR SUMMARY

The following summary does not purport to be complete and is qualified in its entirety by, and is subject to, the detailed information appearing elsewhere in this Offering Circular.

The Republic of El Salvador

General

El Salvador is a republic and its form of government is a representative democracy. In March 2004, Elias Antonio Saca González of the *Alianza Republicana Nacionalista* ("ARENA") party was elected president of the Republic. His election marked the fourth consecutive term that a member of ARENA, a pro-market political party, was elected president. He took office on June 1, 2004, succeeding Francisco Flores, who was elected in 1999.

El Salvador is geographically the smallest and also the most densely populated of the five Central American countries. It is bounded on the south by the Pacific Ocean, on the northwest by Guatemala and on the northeast and east by Honduras.

In 2005, El Salvador had a nominal gross domestic product ("GDP") of approximately US$17.0 billion, an increase from US$15.8 billion in 2004, and real GDP grew at a rate of 2.8%, compared to 1.8% in 2004.

According to the United Nations Human Development Report 2005, per capita GDP based on 2003 figures and adjusted for purchasing power parity was US$4,781.

Economy

Beginning in late 1989, the government began to implement a number of measures designed to strengthen the private sector and to minimize the government's role in the economy. In the early 1990s, the government implemented reforms such as the privatization of the banking system and reorganization of the Central Bank as an independent institution, the introduction of a value added tax, the elimination of price controls, the simplification of the tax system and the liberalization of foreign trade policy through the reduction of tariffs and the establishment of free trade zones. Benefiting from these measures, as well as the signing of the Peace Accord (the "Peace Accord") in 1992 which ended 12 years of guerrilla war in the Republic, El Salvador's real GDP grew at an average annual rate of 5.1% from 1992 to 1999.

More recent steps taken by the government to stimulate the economy and strengthen macroeconomic stability include the following:

- Adopting the Monetary Integration Act, which went into effect on January 1, 2001 and fixes the *colón* to the US dollar at ¢8.75 to US$1.00, allows free circulation of the US dollar in the Salvadoran economy and makes the US dollar the unit of account for El Salvador's financial sector. These reforms were intended to stabilize permanently the value of the *colón* against the US dollar, reduce interest rates, increase the local savings rate, control inflation, encourage foreign investment, and simplify the management of the economy. The fixed exchange rate replaced the free floating exchange rate that had been in place since 1989. The Central Bank is not permitted to be a funding source for the central government. The power of the Central Bank to issue new *colones* or coins ceased as of January 1, 2001. All deposits, credits, pensions and other operations of the financial system were redenominated to US dollars on that date. Non-financial firms may use either *colones* or US dollars to express their financial records and accounting. Salaries and wages may be denominated in either *colones* or US dollars and prices can be specified in *colones* or US dollars. See "The Salvadoran Economy — Foreign Trade and Balance of Payments — Exchange Rate Policy and Foreign Exchange Rates."

- Promoting trade and foreign investment by eliminating certain tariffs and applying three tariff rates to approximately 90.0% of imported goods, adopting laws allowing unrestricted repatriation of earnings by foreign companies, providing for rebates of duties on certain exports and encouraging the establishment of free trade zones covering 1,421,072 square meters throughout the country as of December 31, 2005, which is more than double the area established as of December 31, 2001. These measures are intended to stimulate manufacturing, principally by *maquila* plants, which are exempt from import and export duties and enjoy certain income tax exemptions. In addition, the Republic has implemented the initiatives of the *Mercado Común Centroamericano* (the "Central American Common Market" or "CACM"), qualified for enhanced, preferential access to the United States market under the Caribbean Basin Initiative (the "CBI") and reached free trade agreements with Mexico, Chile, the Dominican Republic, Panama and the United States. El Salvador entered into the U.S.-Dominican Republic- Central America Free Trade Agreement (the "DR-CAFTA") with the United States, the five member countries of the Central America Economic Integration System and the Dominican Republic. On March 1,

2006, the DR-CAFTA entered into force between El Salvador and the United States. See "The Salvadoran Economy — Foreign Trade and Balance of Payments — Regional Integration and Free Trade."

- Modernizing the banking sector in El Salvador through the privatization of commercial banks and the savings and loan associations in order to promote competition and the development of a stronger financial system. The government also created the *Superintendencia del Sistema Financiero* (the "Superintendency of the Financial System") to regulate the banking industry. Further, the Legislative Assembly enacted legislation limiting loans to shareholders, increasing minimum capital requirements in light of the Basle Accord, regulating the supervisory powers and independence of the Superintendency of the Financial System and creating the *Instituto de Garantía de Depósitos* (the "Deposit Guaranty Agency"), which guarantees deposits up to US$7,890 and has the authority under certain circumstances to provide funding to banks with liquidity problems. See "Monetary System — Financial Sector." Subsequent legislation has provided additional protections to depositors by creating stricter capital and risk management requirements and granting broader authority to the Superintendency of the Financial System.

- Reforming the pension system with the creation of a new system pursuant to which a substantial portion of the public "pay-as-you-go" pension system was replaced by a private system based on individual contributions. Under the new system, participating workers make monthly contributions to private pension funds that invest in permitted Salvadoran securities. Subsequent reforms to the pension system law reduced the government's obligations by authorizing the government to make certain payments pursuant to a 15-year annuity rather than in one lump sum and eliminated employees' option to retire after 30 years of contributions to the system regardless of age. At December 31, 2005, over 1.2 million Salvadoran workers, or 47.2% of the Salvadoran workforce in 2004, were participating in the private system and US$2.9 billion in assets, equivalent to 17.1% of 2005 nominal GDP, were managed by the system's private pension fund administrators. See "The Salvadoran Economy — Employment and Wages — Pension Reform."

- Reducing the government's role in many sectors of the economy through a series of privatizations designed to encourage private investment and foster competition. Since 1998, the government has received net privatization revenues of approximately US$1,419.5 million, through the privatization of the country's electricity distribution companies and telecommunications providers. The government also granted private concessions for certain services and facilities at the international airport and plans to grant additional airport concessions at a future date. In addition, the government sold an alcohol factory and six state-owned sugar mills to private investors. In December 2004, the government sold most of its remaining interest (41.54% of the company's total shares) in the state-owned telecommunications company for approximately US$294.9 million. The Republic also announced that it plans to grant concessions at its port facilities at Acajutla and La Unión, which is currently under construction. See "The Salvadoran Economy — Privatizations and Concessions."

- Modifying the tax system, commencing with the introduction of a value added tax and subsequently increasing the value added tax rate from 10.0% to 13.0%. In addition, the government eliminated exemptions, closed loopholes, provided the tax administration with the tools to enforce tax compliance and to accelerate the imposition of fines and sanctions, increased excise taxes on tobacco products and alcoholic beverages, implemented measures to reduce tax evasion, introduced special contribution levies on gasoline, diesel fuel, guns, ammunition, fireworks, lodging and airport departures, and reformed the customs service. Reforms to the tax laws also included, among other things, clarifying the requirements for eligibility for tax credits, limiting deductions related to inter-company loans, disallowing deductions for expenses incurred in certain taxing jurisdictions, establishing a unified nondiscretionary period for taxpayers to pay delinquent tax liabilities, prohibiting settlement of cases involving customs smuggling, increasing the jail term that may be imposed on tax evaders and eliminating the possibility of tax evaders avoiding a prison sentence. The government has reformed a number of customs laws to permit the Republic to comply with its international commitments, such as those under the DR-CAFTA, the Central American Uniform Customs Code (the "CAUCA") and other international agreements concerning international trade of goods. See "Public Sector Finances — Taxation and Customs."

- Continuing its policy to modernize public sector institutions, the Republic has reduced the size of the central government by decreasing the number of employees and combining ministries. The number of government employees also decreased due to attrition and voluntary early retirement. The government has amended the *Ley del Servicio Civil* (the "Civil Service Law") to establish a more flexible public sector employment policy, which has reduced the government's payroll. The government enacted legislation in 2004 aimed at further decentralizing the government by increasing municipal allocations in the general budget from 6.0% to 7.0% of current revenues beginning in 2005. The Republic has also implemented measures designed to reduce government expenditures for subsidies in the areas of electricity and water consumption and public transportation and focus subsidies on those sectors of the population most in need of such assistance. In July 2004, the government mandated that all public sector entities apply strict measures aimed at increasing public savings and, in

May 2005, President Saca mandated a reduction of 5.0% in the budget of all public sector institutions. During 2006, the Republic expects to institute a new public savings policy aimed a reducing government expenditures that will set aside 5% of the budgeted funds for certain public institutions to cover unbudgeted expenses.

- Promoting tourism through, among other things, enacting laws and regulations designed to foster the development of the tourism sector, including the use of the proceeds from special contribution levies on lodging and airport departures toward developing the sector. See "The Salvadoran Economy — Promotion of Tourism."

- Investing in infrastructure projects, including the construction of a major port facility at La Unión and a 50 megawatt thermal power plant at Atéos. See "The Salvadoran Economy — Infrastructure Investment."

- Implementing a comprehensive education plan, known as *Plan Nacional de Educación 2021* (the "2021 National Education Plan"), which includes improving school facilities, providing greater access to computers and the Internet and establishing technological institutes, as well as implementing a program, known as *Programa Red Solidaria* (the "Solidarity Network"), which provides monetary assistance to rural families that enroll their children in school, among other things. See "The Salvadoran Economy — Education Initiatives (*Plan Nacional de Educación 2021*)."

Economic Performance

El Salvador's real GDP increased at an average annual rate of 2.2% from 2001 to 2005, compared to an average annual rate of growth of 4.7% between 1992 and 2000, primarily as a consequence of the rise in international oil prices, the effects of natural disasters in El Salvador, the decline in 2001 and 2002 of international coffee prices and the slow-down in the U.S. economy in 2001 and 2002. El Salvador's rate of inflation averaged 3.3% annually for the period from 2001 to 2005. Primarily as a result of the Monetary Integration Act, the average interest rate on short- and long-term loans fell to 7.0% and 7.9%, respectively, for the month of December 2005, compared to 12.2% and 13.7%, respectively, for the month of December 2000.

Worker remittances from Salvadorans abroad and a strong capital account resulted in the steady growth of foreign currency reserves at the Central Bank from 1992 through 1999. Net international reserves declined, as the Central Bank provided commercial banks with US dollars in connection with the implementation of the Monetary Integration Act. Net international reserves rose thereafter, reaching US$1,829.4 million at December 31, 2005. See "Foreign Trade and Balance of Payments — Foreign Currency Reserves."

The Republic's ratio of public external debt to GDP, which was 39.3% in 1992, decreased to 24.5% in 2001 and subsequently increased to 36.5% in 2005 primarily due to borrowings by the Republic to pay for reconstruction costs incurred as a result of the two 2001 earthquakes and to finance the Republic's pension obligations. The ratio of total public sector debt declined from 46.0% of GDP at December 31, 2004 to 45.2% of GDP at December 31, 2005.

In recent years, *maquila* (assembly for re-export) has been the most dynamic activity within the economy, contributing an average of 13.0% of total production in the manufacturing sector in real terms from 2001 to 2005. According to the *Ministerio de Economía* (the "Ministry of Economy"), as of December 31, 2005 there were 304 *maquila* plants, 140 of which are located in free trade zones, with the remaining 164 operating outside the free trade zones. Over half of the *maquila* plants established in the free trade zones produce apparel and linens, mainly for export to the United States. In 2005, *maquila* exports represented 53.6% of total exports of goods. While *Maquila* exports increased by 10.1% from 2001 to 2005, they decreased by 5.4% in 2005. In 2004 and 2005, *maquila* exports were negatively impacted by increased competition from China and Nicaragua as a result of lower labor costs in those countries, as well as the expiration of the Agreement on Textiles and Clothing. In addition, *maquila* exports declined sharply in the last quarter of 2005 due to the effects of Hurricanes Stan and Katrina, which temporarily discontinued the importation of inputs from the United States and negatively affected the production of exports. See "The Salvadoran Economy —Principal Sectors of the Economy — Manufacturing."

Traditionally, coffee has been the main agricultural product of the Republic and an important component of the overall Salvadoran economy. As the economy has increasingly come to rely on manufacturing production, particularly *maquila,* the importance of coffee to the economy has declined. Coffee accounted for 1.5% of real GDP and 12.6% of agricultural production in 2005 compared to 3.8% and 25.5%, respectively, in 1993. Coffee is nevertheless an important source of employment in El Salvador, generating approximately 63,173 jobs during the 2004/2005 harvest, which accounted for 2.3% of employment nationwide in 2004. Coffee is also an important source of foreign currency. In 2005, coffee accounted for 4.8% of total Salvadoran exports of goods.

The Peace Accord

In addition to the economic, monetary and fiscal reforms, the government has implemented a series of initiatives designed to promote social and democratic reforms. These social and democratic reforms flowed from the Peace Accord signed by the government and the *Frente Farabundo Martí para la Liberación Nacional* (the "FMLN"), ending 12 years of guerrilla war in the Republic. The three main objectives established by the Peace Accord were:

- the reintegration of former participants in the guerrilla war into the Salvadoran economy and society;
- the implementation of democratic reforms; and
- assistance to rural communities.

The development of programs to achieve these objectives was assisted and monitored by the United Nations. In December 1996, as a result of the implementation of many of these programs, the General Assembly of the United Nations adopted a resolution to withdraw its on-site observers and continue the United Nations verification responsibilities through periodic visits. The General Assembly of the United Nations noted the commitment of the Republic and other parties to the full implementation of the Peace Accord. On January 6, 2003, the United Nations declared that the objectives of the Peace Accord had been accomplished, thus ending the United Nations peace verification process.

Selected Economic Indicators

	For the Year Ended December 31,				
	2001	2002	2003	2004	2005
	(in millions of US dollars, except percentages and where noted)				
The Economy					
Nominal GDP	$ 13,813	$ 14,307	$ 15,047	$ 15,822(2)	$ 16,974(2)
Real GDP (in millions of US dollars)(1)	$ 7,660	$ 7,839	$ 8,019	$ 8,166(2)	$ 8,391(2)
Real GDP growth(1)	1.7%	2.3%	2.3%	1.8%(2)	2.8%(2)
Annual inflation(3)	1.4%	2.8%	2.5%	5.4%	4.3%
Unemployment	7.0%	6.2%	6.9%	6.8%(2)	. . .
Balance of Payments					
Exports (FOB goods and services)	$ 3,595	$ 3,803	$ 4,101	$ 4,412(2)	$ 4,573(2)
Imports (FOB goods and services)	5,778	5,908	6,495	7,151(2)	7,652(2)
Trade and services balance	(2,183)	(2,105)	(2,393)	(2,739)(2)	(3,078)(2)
Current account surplus (deficit) of the balance of payments	(150)	(405)	(702)	(632)(2)	(787)(2)
As % of GDP(4)	(1.1)%	(2.8)%	(4.7)%	(4.0)%(2)	(4.6)%(2)
Net international reserves	$ 1,710	$ 1,589	$ 1,906	$ 1,888	$ 1,829
Non-Financial Public Sector					
Total revenues	$ 2,137	$ 2,308	$ 2,513	$ 2,677	$ 2,884(2)
Total expenditures	2,641	2,783	2,823	2,779	3,065(2)
Primary balance surplus (deficit)	(304)	(229)	(3)	232	209(2)
As % of GDP	(2.2)%	(1.6)%	(.02)%	1.5%(2)	1.2%(2)
Surplus (deficit)(4)	$ (504)	$ (475)	$ (310)	$ (103)	$ (181)(2)
As % of GDP	(3.6)%	(3.3)%	(2.1)%	(0.7)%(2)	(1.1)%(2)
Public Sector Debt(5)					
Total public debt	$ 5,517	$ 6,397	$ 7,119	$ 7,281	$ 7,674(2)
Internal debt	2,127	1,484	1,501	1,541	1,480(2)
External debt	3,390	4,913	5,618	5,741	6,194(2)
Total public debt (as % of GDP)	39.9%	44.7%	47.3%	46.0%(2)	45.2%(2)
Public internal debt (as % of GDP)	15.4%	10.4%	10.0%	9.7%(2)	8.7%(2)
Public external debt (as % of GDP)	24.5%	34.3%	37.3%	36.3%(2)	36.5%(2)
External debt service (as % of exports of goods and services)(6)	8.3%	9.3%	12.3%	17.0%(2)	15.9%(2)
Average Exchange Rate					
(*colones* per US dollar)(7)	¢ 8.75	¢ 8.75	¢ 8.75	¢ 8.75	¢ 8.75

. . . Not available.
(1) At constant 1990 prices.
(2) Preliminary.
(3) As measured by the variation in the *Índice de Precios al Consumidor* (Consumer Price Index or the “CPI”) published by the National Bureau of Statistics and Census.
(4) Including foreign aid.
(5) Including debt of the Central Bank.
(6) Exports (FOB goods and services). Calculation does not include Central Bank debt service.
(7) The average exchange rate is the average of the purchase and sale prices of US dollars stated in *colones*. Since January 1, 2001, the *colón*/US dollar has been fixed at ¢8.75/US$1.00 pursuant to the Monetary Integration Act.

Source: *Banco Central de Reserva de El Salvador.*

THE OFFERING

Issuer	The Republic of El Salvador.
Issue Amount	US$225,000,000 aggregate principal amount.
Issue Price	96.71% of the principal amount of the Notes, plus accrued interest from June 15, 2006, the last interest payment date under the Existing Notes (as defined below), to July 20, 2006, and additional interest, if any, from July 20, 2006.
Maturity Date	June 15, 2035.
Interest	The Notes will bear interest from June 15, 2006 at the rate of 7.65% per annum payable semi-annually in arrears on June 15 and December 15 of each year, commencing on December 15, 2006.
Single Series	The Notes will be a further issuance of, and will be consolidated to form a single series with, El Salvador's 7.65% Notes due 2035, US$375,000,000 of which were issued on June 10, 2005 and US$400,000,000 of which were issued on April 26, 2006 (the "Existing Notes"), and of which US$775,000,000 aggregate principal amount is outstanding.
Withholding Tax; Additional Amounts	Principal of and interest on the Notes are payable by the Republic without withholding or deduction for or on account of taxes imposed by El Salvador to the extent described herein. In the event that the Republic is required by law to deduct or withhold taxes, duties, assessments or governmental charges, the Republic will pay Additional Amounts (as defined herein) as necessary to enable holders of Notes to receive such amounts after such deduction or withholding as they would have received absent such deduction or withholding, subject to certain exceptions. See "Terms and Conditions of the Notes — Payment of Additional Amounts."
Status	The Notes will be direct, general, unsecured and unconditional obligations of the Republic. The Notes will at all times rank equally without any preference among themselves and at least equally with all other present and future unsecured and unsubordinated Public External Indebtedness of the Republic. See "Terms and Conditions of the Notes — General," "— Negative Pledge" and "— Covenants."
Negative Pledge and Certain Covenants	The Terms and Conditions of the Notes contain certain covenants and restrictions on the creation or subsistence of any Security (as defined herein) securing Public External Indebtedness, with certain exceptions. See "Terms and Conditions of the Notes — Negative Pledge" and "— Covenants."
Use of Proceeds	Net proceeds from the issuance and sale of the Notes will be used by the Republic to finance the payment of the Republic's pension liabilities, refinance indebtedness maturing in 2006 and finance investment projects and capital expenditures.
Collective Action Clauses	The Notes will contain provisions, commonly known as "collective action clauses," regarding acceleration and voting on future amendments, modifications and waivers that differ from those applicable to the Republic's outstanding Public External Indebtedness. Under these provisions, which are described in the sections entitled "Terms and Conditions of the Notes — Events of Default" and "— Modifications, Amendments and Waivers," the Republic may amend the payment provisions of the Notes and certain other terms with the consent of the holders of 75% of the aggregate amount of the outstanding Notes.
Form of Notes	Registered only, without coupons. No Notes will be issued in bearer form.

Denominations	Each Note will be issued in minimum denominations of US$10,000 and integral multiples of US$1,000 in excess thereof.
Further Issues	The Republic may, without the consent of the holders of the Notes, create and issue additional notes having the same ranking and the same interest rate, maturity and other terms as the Notes (or the same except for the amount of the first interest payment and the issue price), so that such further notes may be consolidated and form a single series with the Notes, provided that such additional notes do not have, for purposes of U.S. federal income taxation (regardless of whether any holders of such notes are subject to U.S. federal laws), a greater amount of original issue discount than the Notes have as of the date of issuance of such additional notes.
Listing	Application has been made to list the Notes on the Luxembourg Stock Exchange and to have the Notes admitted to trading on the Euro MTF Market, the alternative market of the Luxembourg Stock Exchange. Application will be made to list the Notes on the *Bolsa de Valores de El Salvador* (the "El Salvador Stock Exchange").
Governing Law	The Notes shall be governed by, and construed in accordance with, the laws of the State of New York, United States of America, except that all matters concerning authorization and execution by the Republic, as well as the bringing of any actions and the enforcement of any judgment against the Republic in the courts of the Republic will be governed by the laws of the Republic.
Arbitration	Any dispute, controversy or claim arising out of or relating to the Notes, including the performance, interpretation, construction, breach, termination or invalidity thereof, will be finally settled by arbitration in New York, New York, in accordance with the UNCITRAL Arbitration Rules. Any arbitral tribunal constituted under the terms of the Notes will be required to make its decisions entirely on the basis of the substantive law of the State of New York as provided above. The Republic's consent to arbitration will not preclude a holder of any Note from instituting legal proceedings against the Republic in the courts of El Salvador. The Republic has represented that it has no right to immunity on the grounds of sovereignty or otherwise from the execution of any judgment in El Salvador, or from the execution or enforcement in El Salvador of any arbitral award in El Salvador (except for the limitation on alienation of public property). The enforcement by a Salvadoran court of a foreign arbitral award is subject to recognition by the Supreme Court of Justice of the Republic and the execution of any judgment against the Republic in El Salvador is only available in accordance with the procedures set forth in Article 450 *et seq*. of the Salvadoran Civil Procedure Code.
Fiscal Agent, Principal Paying Agent, Registrar and Transfer Agent	Deutsche Bank Trust Company Americas.
Luxembourg Transfer and Paying Agent	Deutsche Bank Luxembourg SA.

USE OF PROCEEDS

The net proceeds from the issuance and sale of the Notes will be approximately US$216,952,500 after deduction of the underwriting commission and the net expenses payable by the Republic, estimated to be US$150,000. The net proceeds from the issuance and sale of the Notes will be used by the Republic to finance the payment of the Republic's pension liabilities, refinance indebtedness maturing in 2006 and finance investment projects and capital expenditures.

RECENT DEVELOPMENTS

Gross Domestic Product

The real GDP growth rate increased to 3.2% in the first quarter of 2006, compared to a real GDP growth rate of 1.7% in the first quarter of 2005. The rise in real GDP growth was attributable to real growth of 5.8% in the construction sector, 5.2% in the transportation, storage and communications sector, 4.6% in the real estate and business services sector and 4.8% in the finance and insurance sector, in each case compared to the first quarter of 2005. The agriculture and energy sectors also demonstrated positive growth in the first of quarter of 2006 compared to the first quarter of 2005.

Balance of Payments

In the first quarter of 2006, the current account registered a deficit of US$204.3 million, representing a 16.6% increase compared to a current account deficit of US$175.2 million in the first quarter of 2005, primarily due to an increase in merchandise and service imports. This increase in imports was offset in part by favorable prices for commodity exports and US$759.7 million of remittances from abroad during the first quarter of 2006, an increase of 13.3% compared to the first quarter of 2005.

Exports and Imports

From January 1, 2006 to May 31, 2006, total exports in dollar terms increased by 4.9% compared to the same period of 2005. This increase was due principally to an increase in dollar terms in exports of raw sugar, pharmaceutical drugs and ethyl alcohol. In addition, coffee exports increased 5.2% in dollar terms, despite an 11.0% decrease by volume compared to the same period of 2005. The increase in exports, however, was offset by a 10.1% decrease in *maquila* exports, particularly textiles, during the first five months of 2006 compared to the same period of 2005, primarily due to the expiration of the Agreement on Textile and Clothing and increased competition from China.

Imports rose in the first five months of 2006 by 11.1% in dollar terms compared to the same period of 2005, led by an increase in consumer, intermediate manufacturing and capital goods imports. Crude oil and oil byproducts imports also rose from US$328.4 million in the first five months of 2005 to US$445.0 million in the equivalent period of 2006, representing an increase of 35.5%.

Inflation

As of June 30, 2006, the year-over-year inflation rate was 4.4% primarily due to higher oil prices that affected the price of gasoline and food and beverages.

Non-Financial Public Sector Revenues and Expenditures

As of May 31, 2006, the non-financial public sector registered a surplus equal to US$94.6 million, equivalent to 0.5% of estimated nominal GDP for 2006. The non-financial public sector surplus as of May 31, 2006 reflects total revenues of US$133.2 over the 2006 budget projections for that period, which was partially offset by expenditures of US$229.0 over the 2006 budget projections for the same period.

Fiscal Policies

As part of its plan to reduce expenditures, the Government eliminated subsidies for public transportation and reduced subsidies for electricity. See “Public Sector Finances — Overview —Fiscal Policy.”

Public Debt

On April 26, 2006, El Salvador issued US$400 million aggregate principal amount of its 7.65% Notes due 2035, in a reopening of that issue. The net proceeds of the reopening were used to finance the payment of the El Salvador’s pension liabilities, refinance indebtedness maturing in 2006 and finance investment projects and capital expenditures.

As of May 31, 2006, public sector external debt was US$6,529.1 million or 35.8% of estimated nominal GDP for 2006 and public sector internal debt was US$1,558.5 million or 8.5% of estimated nominal GDP for 2006.

THE REPUBLIC OF EL SALVADOR

Territory, Population and Society

El Salvador is geographically the smallest as well as the most densely populated of the five Central American countries, encompassing 8,124 square miles (21,041 square kilometers). El Salvador is bounded on the south by 210 miles of Pacific Ocean coastline, on the northwest by Guatemala and on the northeast and east by Honduras. In the north, the Sierra Madre mountains rise to over 9,000 feet above sea level. Two major earthquakes struck El Salvador in January and February 2001. Prior to such earthquakes, the last significant earthquake occurred in 1986. Throughout the country, there are 25 distinct volcanoes, most of which are dormant. The most recent major volcanic eruption was in 1946. A minor volcanic eruption occurred in 2005.

El Salvador enjoys two seasons, rainy and dry. The rainy season lasts from early May through October, while the dry season lasts from November through April. Hurricanes in the Atlantic Ocean can exacerbate the rainy season in El Salvador. In 2005, Hurricane Stan produced floods and mudslides in El Salvador that required the central government to take emergency measures and provide temporary shelter to the affected population.

In September 1992, the International Court of Justice resolved a border dispute between El Salvador and Honduras and awarded most of the disputed territories in favor of Honduras. At present, both parties are involved in the process of border demarcation in accordance with the decision of the International Court of Justice.

El Salvador's population is currently estimated at 6.9 million people by the *Dirección General de Estadística y Censos* (the "National Bureau of Statistics and Census"), a division of the Ministry of Economy, with approximately 60.0% of the population in urban areas and 40.0% in rural areas. In addition, more than one million Salvadorans are believed to be living and working outside of the country, principally in the United States. Salvadorans abroad make a significant contribution to the Republic's economy through remittances to their families in El Salvador. Over 90.0% of the current population is *mestizo* (of mixed European and Indian descent). According to an estimate by the National Bureau of Statistics and Census, San Salvador, the capital and country's largest city, had a population of 507,665 in 2005 and the average annual population growth rate for the Republic is projected to be approximately 1.5% for the period between 2000 and 2025. Most of the population is Roman Catholic.

The following table sets forth information on per capita gross domestic product, average life expectancy, adult literacy rates and infant mortality rates in certain countries.

Selected Comparative Social Statistics

	El Salvador	Nicaragua	Honduras	Guatemala	Panama	Costa Rica	United States
Per Capita GDP(1)	$ 4,781	$ 3,262	$ 2,665	$ 4,148	$ 6,854	$ 9,606	$ 37,562
Average Life Expectancy(2)	70.9	69.7	67.8	67.3	74.8	78.2	77.4
Adult Literacy Rate(3)	79.7%	76.7%	80.0%	69.1%	91.9%	95.8%	99.0%
Infant Mortality(4)	32	30	32	35	18	8	7

(1) Based on 2003 figures, adjusted for purchasing power parity.
(2) In years, at 2003.
(3) At 2003.
(4) Per thousand live births in 2003.

Source: *Human Development Report 2005, United Nations.*

Historical Background

Prior to the Spanish conquest in the early 16th century, various Indian tribes occupied the area that is now El Salvador. The Spanish conquest began in 1524 with the arrival of an expedition from Guatemala led by Pedro de Alvarado. A Spanish settlement was permanently established in San Salvador in 1528 and became the agricultural center of the Captaincy General of Guatemala. Under the Spanish government, the area became a center for the production of several commercial crops including cocoa, indigo and balsam wood.

Following independence from Spain in 1821, El Salvador became a member of the Central American Federation, which was dissolved in 1838 after a military coup in Honduras. Thereafter, as an independent republic, El Salvador slowly shifted its economy from its earlier dependence on indigo, cocoa and balsam wood to one based on coffee.

During the end of the nineteenth and the first quarter of the twentieth century, coffee cultivation on extensive plantations contributed to the establishment of a wealthy landholding minority. Social tensions came to a head in 1932, when an uprising of the

landless peasantry led by the then recently formed Communist Party was quashed by General Maximiliano Hernández after the loss of 30,000 lives. From 1932 to 1979, El Salvador was governed by a succession of military leaders.

On October 15, 1979, a revolutionary *junta* composed of civilians and members of the military assumed control of the country. Early in 1980, the *Partido Demócrata Cristiano* (the "PDC") joined the *junta* and imposed a program of economic reforms that included the nationalization of the banking system, agrarian reform aimed at the re-distribution of land ownership and the granting of exclusive monopolies to state-owned entities for the international sale of coffee and sugar. In 1982, a popularly elected Constitutional Assembly began drafting a new constitution that became effective in 1983 and that, with amendments, is still in force. In 1984, in the first presidential election under the new Constitution, the PDC leader, José Napoleón Duarte, was elected president.

During this time, several guerrilla organizations unified to form the FMLN. From 1980 until the signing of the Peace Accord in 1992, the Republic faced internal political and military conflicts which caused the loss of approximately 75,000 lives, triggered extensive emigration, displaced hundreds of thousands of persons within the country and caused widespread destruction to the country's infrastructure and economy.

Mr. Duarte was replaced in the 1989 presidential election by Alfredo Cristiani of ARENA. The Cristiani administration implemented a number of changes designed to reinvigorate the economy. The benefits of these measures were evidenced by real GDP growth of 4.8% and 3.6% in 1990 and 1991, respectively, as compared to decreases or minimal growth in the period from 1985 through 1989. Nonetheless, the real benefits for the economy were limited due to the ongoing military conflict.

On January 16, 1992, after 12 years of conflict, the government and the FMLN signed the Peace Accord in Mexico City. The Peace Accord: (i) established the specific requirements for ending the armed conflict; (ii) addressed certain root causes of the conflict by instituting commitments from the parties to follow democratic principles; and (iii) placed specific emphasis on the process of reconstruction as part of the economic and social development of the Republic. Since the signing of the Peace Accord, the Republic has implemented a series of initiatives designed to promote social, economic and democratic reforms establishing a lasting foundation for peace. In December 1996, as a result of the implementation of many of these initiatives, the General Assembly of the United Nations adopted a resolution to withdraw its on-site observers and continue the United Nations verification responsibilities through periodic visits. The General Assembly noted the commitment of the Republic and other parties to the full implementation of the Peace Accord. On January 6, 2003, the United Nations declared that the objectives of the Peace Accord had been completed, thus ending the United Nations peace verification process.

The principal programs established pursuant to the Peace Accord were intended to meet the following goals:

- *Economic and social reintegration of former guerrillas and military personnel into the economy and society.* The immediate aim of the reintegration projects was to generate employment and income for the former combatants and military personnel. The projects included a program to transfer title to rural land to certain beneficiaries, United Nations agricultural training programs, agricultural credit access programs through the *Banco de Fomento Agropecuario,* vocational training and scholarship programs, and loan programs for the establishment of small business and scholarships.

- *Building public confidence in the government.* Through electoral reforms and voter identification and registration, changes in the judiciary including the evaluation and training of judges, the replacement of internal military police with a trained national civilian police force and the establishment of a human rights commission, the government has sought to restore and build confidence in the government.

- *Assistance to rural communities significantly affected by the conflict.* The Republic provided assistance to rural communities in the short-term through basic municipal services, food and housing and in the medium- and long-term through the promotion of production, infrastructure and capital investment projects in education, health, environmental protection, economic and social infrastructure and municipal development.

The aggregate cost of implementing these programs since 1992 has been approximately US$2.6 billion. In addition, the Republic benefited from the voluntary write-off by the United States of a portion of its external debt in 1993 and from the restructuring of the terms of much of its other external debt to finance the costs of such programs. See "Public Debt." The Republic believes that it has already incurred the costs of implementing the programs established pursuant to the Peace Accord.

Since the signing of the Peace Accord, the Republic has undertaken a number of economic, social, monetary and fiscal reforms designed to create stability and growth in the economy. For a discussion of these reforms, see "The Salvadoran Economy — Principal Reforms from 1979 to Present."

During the past decade, El Salvador's development has been affected by a series of natural disasters including Hurricane Mitch in 1998 and a series of devastating earthquakes in early 2001 that left nearly 2,000 people dead or missing and 8,000 injured, and caused severe dislocations across all sectors of Salvadoran society. The earthquake damage was severe, with the impact concentrated on housing, schools and other basic infrastructure in rural areas that are among the country's poorest regions. Since the occurrence of these natural disasters, however, the government of El Salvador has undertaken several efforts to rebuild the areas that were severely affected.

Form of Government

El Salvador is a republic and its form of government is a representative democracy, with powers divided among executive, legislative and judicial branches. Elections are held every five years for president and vice president and every three years for members of the single house of the legislative assembly (the "Legislative Assembly") and local governments. All Salvadoran citizens 18 years or older are entitled to vote. As part of the implementation of democratic reforms under the Peace Accord, there has been a major effort to improve voter identification and registration.

Executive authority is vested in the president and vice president and 13 cabinet ministers. Cabinet ministers are appointed, and may be removed at will, by the president. The president may propose legislation to the Legislative Assembly and has veto power over legislation, which may be overridden by a two-thirds vote of the Legislative Assembly. The president also appoints the regional governors for the 14 departments of El Salvador. The current president of El Salvador, Elias Antonio Saca González of ARENA, was elected in March 2004. President Saca took office on June 1, 2004, succeeding President Francisco Flores and becoming the fourth consecutive president from ARENA, a pro-market political party.

Legislative authority is vested in the Legislative Assembly, which is comprised of a single house of 84 elected members. The Legislative Assembly has the power to enact legislation, ratify treaties and approve the annual budget. A majority of the Legislative Assembly must approve a bill for it to become a law. Constitutional amendments require approval by the Legislative Assembly in two sessions, the first by a majority of the members of the Legislative Assembly and the second by a two-thirds vote.

In the recent legislative elections held on March 12, 2006, ARENA increased its representation in the Legislative Assembly from 27 to 34 seats, becoming the largest party in the Legislative Assembly, but falling short of a simple majority. As a result, no one party has control over the Legislative Assembly. FMLN won 32 seats, recovering the seats it had lost to defections over the past year and securing veto power over legislation that requires a two-thirds vote. Legislative matters must be resolved, as they were prior to the 2006 legislative elections, through the creation of coalitions by ARENA or FMLN with one or more of the other minority parties. The third largest party, *Partido de Conciliación Nacional* (the "PCN"), will hold 10 seats, compared to the 16 seats it held prior to the election.

The current composition of the Legislative Assembly is described in the following table.

Legislative Assembly
Composition by Political Party

Political Party	Number of Members
ARENA	34
FMLN	32
PCN	10
Partido Demócrata Cristiano ("PDC")	6
Cambio Democrático ("CD")	2
Total	84

Source: *La Prensa, El Diario de Hoy.*

The next presidential, legislative and municipal elections are scheduled to be held in March 2009.

National judicial authority is vested in the Supreme Court and several lower courts. The Supreme Court, the highest judicial authority in the Republic, is composed of 15 justices appointed by the Legislative Assembly from two different lists of nominees separately and independently prepared by the National Council of the Judiciary and the Salvadoran Bar Association. Each Supreme Court justice serves a nine-year term and may be re-appointed. The terms of the Supreme Court justices are staggered such that one-third of the justices are appointed every three years. Judges serving on courts of appeal, certain first-instance tribunals and justices of the peace are appointed by the Supreme Court, also from lists prepared by the National Council of the Judiciary. The Constitution

provides that the annual national budget must include appropriations for the judiciary totaling at least 6.0% of the central government's current revenues.

Memberships in International Organizations

El Salvador is a member of the United Nations and the Organization of American States and many of their respective specialized agencies, as well as the International Monetary Fund (the "IMF"), the International Bank for Reconstruction and Development ("World Bank"), the World Trade Organization (the "WTO"), the Inter-American Development Bank and the *Banco Centroamericano de Integración Económica.*

THE SALVADORAN ECONOMY

Principal Reforms from 1979 to Present

The economy of El Salvador has recovered from a series of negative developments during the period from 1979 through the inauguration of President Alfredo Cristiani in 1989, which included the nationalization of the banking system, failures in land reform, contraction of the manufacturing and agricultural sectors, the creation of state-owned monopolies in certain industries and extensive government spending related to the civil war. El Salvador experienced substantial flight of capital from the country and significant emigration of economically active segments of the population seeking to avoid the conflict and the depressed economy. The public sector recorded substantial fiscal deficits during that period, which were financed by the Central Bank. In addition, as a result of the depressed economy, the Republic fell behind on some of its external indebtedness, which was restructured after the implementation of the Peace Accord.

Principal Reforms

In 1989, the Republic began to implement a number of economic, monetary and fiscal reforms designed to create stability and growth in the economy. The benefits of these reforms were evidenced by average real GDP growth of 4.7% per year from 1992 to 2000 and average real GDP growth of 2.2% per year from 2001 to 2005. The reforms have focused on:

- fixing the exchange rate to the US dollar and introducing the US dollar into the Salvadoran economy as legal tender and the unit of account of the financial system through the Monetary Integration Act;
- reforming the pension system through the creation of a private pension system;
- privatizing and modernizing the banking sector;
- restructuring the Central Bank as an autonomous entity with a prohibition on financing of the central government;
- lowering tariff levels and liberalizing trade, including entering into free trade agreements with various trading partners;
- reforming the tax system, including expanding the tax base and improving the customs service; and
- privatizing certain state-owned companies and attracting private participation in infrastructure development through the granting of concessions.

In addition, continuing its policy to modernize public sector institutions, the Republic has reduced the size of government by decreasing the number of employees and combining ministries. Commencing in 2001, the Republic combined the Justice, Interior and Public Safety ministries into the Ministry of Governance and reduced the number of employees through outsourcing and the implementation of a hiring freeze. The number of government employees has also decreased due to attrition and voluntary early retirement. The government enacted legislation in 2004 aimed at further decentralizing the government by increasing municipal allocations in the general budget from 6.0% to 7.0% of current revenues beginning in 2005. The Republic has also implemented measures designed to reduce government expenditures for subsidies in the areas of electricity, water consumption and public transportation and to focus subsidies on those sectors of the population most in need of such assistance. In July 2004, the government mandated that all public sector entities apply strict measures aimed at increasing public savings and, in May 2005, President Saca mandated a reduction of 5.0% in the budget of all public sector institutions. During 2006, the Republic expects to institute a new public savings policy aimed at reducing government expenditures that will set aside 5% of the budgeted funds for certain public institutions to cover unbudgeted expenses.

Effects of Reforms

As a result of the implementation of these laws and programs, the economy experienced increases in consumer spending that caused real GDP to grow at an average annual rate of 6.9% from 1992 to 1995. The reforms that were implemented during the 1992 to 1995 period laid the foundation for stability in future periods. During the period from 1996 to 1999, the average rate of growth of real GDP was 3.3%, which slowed to 2.2% from 2001 to 2005, due in large part to natural phenomena, increases in international oil prices, decreases in coffee prices in the international market in 2001 and 2002 and the slow-down in the U.S. economy in 2001 and 2002. In 2005, real GDP grew at a rate of 2.8%, compared to 1.8% during 2004, primarily due to increased activity in the agriculture and manufacturing sectors and the recovery of the construction sector.

After reaching 19.9% in 1992, inflation in El Salvador fell to 7.4% for 1996 and to 4.3% for 2000. Average annual inflation for the period 2001 to 2005 was 3.3%. During 2004, inflation increased to 5.4% from 2.5% for 2003. This increase was primarily due to high international oil prices. For 2005, inflation declined to 4.3%. The decline in inflation in 2005 was the result of a deceleration in the prices for food products, private transportation and household furnishings and equipment, as well as the government policy of subsidizing public transportation for one year to lessen the impact of higher oil prices.

Between 1992 and 2005, El Salvador's trade and services deficit grew from US$1.1 billion to US$3.1 billion. The high volume of worker remittances from Salvadorans abroad, which first exceeded US$1.0 billion in 1995, has largely offset this trade and services deficit. Worker remittances from Salvadorans abroad totaled US$2.8 billion in 2005, an increase of 11.1% from 2004 and 34.4% from 2003. See "Foreign Trade and Balance of Payments."

Exports of goods and services increased from US$1.4 billion in 1993 to approximately US$4.6 billion in 2005, largely as a result of measures taken to eliminate trade barriers through tariff reductions and establish free trade zones (areas free from import or export duties and with an income tax exemption) and rebates for nontraditional exported goods manufactured outside of free trade zones.

Primarily as a result of the Monetary Integration Act, average interest rates on short-term and long-term loans fell to 7.0% and 7.9%, respectively, for the month of December 2005, compared to 12.2% and 13.7%, respectively, for the month of December 2000, the month prior to entry into force of the Monetary Integration Act. As of December 31, 2005, 95.2%, or US$677.9 million, of all cash in circulation was in US dollars. The domestic currency interest rate (passive basic rate — 180 days) decreased from 7.1% at December 31, 2000 to 4.0% at December 2005.

Foreign direct investment in the financial system in El Salvador was US$15.9 million in 2000. From January 1, 2001, the effective date of the Monetary Integration Act, to December 31, 2005, the investment level totaled US$174.0 million, due in part to the merger of Scotiabank and *Banco de Comercio de El Salvador* and the acquisition of *Banco Salvadoreño* by *Grupo Banistmo, S.A.* (Panama) by means of a public tender offer initiated in November 2005.

Economic and Social Policies

President Saca's economic and social plans include the following goals:

- attracting foreign direct investment;
- advancing free trade;
- promoting tourism in El Salvador;
- supporting the agricultural sector through technical assistance and training and providing microfinancing alternatives;
- improving the quality of health services and providing universal health coverage;
- modernizing and improving the educational system by, among other things, encouraging enrollment in the school system and investing in computers and other technology;
- achieving the "Millennium Development Goals" (which include eradicating hunger and poverty, achieving universal primary education and reducing child mortality, among others) that were established under the United Nations Millennium Declaration;
- encouraging the informal sector to register with the government so they can benefit from attractive financing alternatives;
- providing public access to government information, services and opportunities by establishing a technology infrastructure;
- creating an efficient government by eliminating, simplifying or redesigning processes that affect private enterprise;
- improving public security by addressing juvenile delinquency and implementing rehabilitation programs;
- improving infrastructure by building new roads and developing airport and port facilities;
- strengthening the financial system;

- advancing competition through regulation; and
- strengthening oversight over the telecommunications, electricity and securities industries.

Gross Domestic Product

The following tables set forth the Republic's real GDP growth and evolution by expenditure for the periods presented.

Real GDP and Real GDP Growth by Economic Sector

	For the Year Ended December 31,				
	2001	**2002**	**2003**	**2004[1]**	**2005[1]**
Real GDP (in millions of US dollars)[2]	$ 7,659.7	$ 7,839.0	$ 8,019.3	$ 8,166.4	$ 8,391.1
Real GDP growth[2]	1.7%	2.3%	2.3%	1.8%	2.8%
Real GDP growth by sector:					
Manufacturing	4.0	2.9	2.2	0.9	1.4
Trade, restaurants and hotels	1.9	1.5	2.7	2.4	1.6
Agriculture, livestock and fishing	(2.6)	0.4	0.9	3.0	5.8
Transportation, storage and communications	4.3	5.0	3.4	5.4	4.3
Residential leasing	(2.9)	3.8	3.3	1.3	1.9
Government services[3]	0.6	(2.8)	(0.1)	1.5	1.2
Community, social, personal, and domestic services[4]	(1.1)	1.8	1.1	2.1	2.1
Construction	9.6	6.7	3.2	(11.4)	3.4
Finance and insurance	1.6	0.6	1.9	5.4	4.0
Real estate and business services[5]	1.9	2.6	1.6	2.3	4.3
Electricity, gas and water	4.7	7.3	4.4	3.3	3.1
Mining	11.7	5.5	3.5	(16.0)	3.5

(1) Preliminary.
(2) Based on constant 1990 prices.
(3) Includes wages and fringe benefits paid by the government to its employees.
(4) Includes education and private health care services, entertainment (cinemas and television), and other services such as veterinary services, services provided by commercial, professional, labor and religious associations, and repair and maintenance services provided by electricians, technicians, etc.
(5) Includes leasing and use of non-residential real estate and professional, legal, accounting and similar services.

Source: *Banco Central de Reserva de El Salvador.*

Real GDP Growth by Expenditure

	For the Year Ended December 31,				
	2001	**2002**	**2003**	**2004[1]**	**2005[1]**
	(percent change, based on constant 1990 prices)				
Consumption					
Public Sector Consumption	4.6%	0.1%	-0.3%	1.9%	1.7%
Private Consumption	3.1	1.6	2.1	2.8	2.6
Total Consumption	3.2	1.5	1.9	2.7	2.5
Gross Investment					
Public Sector	8.3	27.9	-4.9	-43.2	24.9
Private Sector	0.4	-0.9	4.1	2.6	3.6
Fixed Capital Formation	1.5	3.3	2.5	-5.0	5.7
Total Gross Investment	5.1	-2.7	7.8	-4.5	2.6
Exports of goods and services	-0.2	6.0	4.7	6.6	0.4
Imports of goods and services	4.2	1.5	4.8	4.3	0.8
Net exports/(imports)					
Real GDP	1.7%	2.3%	2.3%	1.8%	2.8%

(1) Preliminary.

Source: *Banco Central de Reserva de El Salvador.*

After centuries of dependence upon agricultural products, the Salvadoran economy has increasingly come to rely on manufacturing activity, which accounted for 21.4% of nominal GDP in 2005. In 2005, agricultural, livestock and fishing products

represented 9.5% of Salvadoran nominal GDP compared to 14.2% in 1992. Coffee, which traditionally has been the main agricultural product of the Republic, typically represents the largest agricultural component of GDP. See "— Principal Sectors of the Economy."

As measured by real growth in GDP, economic growth in El Salvador averaged 2.2% per year from 2001 to 2005. Private consumption grew in real terms by an average of 2.4% per year from 2001 to 2005. Increased private consumption has been satisfied largely with imports of goods (excluding *maquila*), which increased from US$3.9 billion in 2001 to US$5.4 billion in 2005, and has been fueled by an increase in lending by banks to the private sector, which totaled US$6.8 billion in 2005.

Real GDP grew at a rate of 1.7% in 2001 and 2.3% in 2002. The growth rate in 2001 was negatively affected by the impact of the earthquakes in January and February 2001, the decrease in the growth rate of the *maquila* sector primarily as a result of the slow-down of the U.S. economy in 2001, low international coffee prices and high international oil prices. These negative factors were offset by investment expenditures relating to the reconstruction after the earthquakes as well as the effect lower interest rates had on consumption and investment. In 2002, the primary sectors contributing to economic growth were the construction sector, including continued investment expenditures relating to the reconstruction effort, the manufacturing sector and the transportation, storage and communications sector. The increase in the real GDP growth rate in 2002 occurred despite low international coffee prices and a reduction of general external demand, particularly from the United States.

Real GDP growth was 2.3% in 2003, which represented no change from the real GDP growth rate in 2002. The decline in international demand for coffee and non-traditional exports and the decrease in public investment following the completion of certain reconstruction projects limited the real GDP growth rate in 2003. These factors had an impact on the manufacturing, construction, transportation, and trade sectors, which collectively contributed to 55.5% of nominal GDP.

Real GDP growth in 2004 was 1.8%, compared to 2.3% in 2003. The decrease in real GDP growth in 2004 was primarily attributable to a decline in public investment and construction activity. Investment declined due primarily to political uncertainty related to the 2004 presidential elections and the delay in the approval of the 2004 budget. Activity in the construction sector declined due primarily to the completion of certain reconstruction projects after the 2001 earthquakes.

Real GDP growth in 2005 was 2.8%, compared to 1.8% in 2004. The rise in real GDP growth in 2005 was primarily attributable to increased consumption, principally in the private sector, increased private investment and a significant rise in public investment.

Principal Sectors of the Economy

The following table sets forth El Salvador's nominal GDP by economic sector for the periods presented.

Nominal GDP by Economic Sector

	For the Year Ended December 31,									
	2001	% of GDP	2002	% of GDP	2003	% of GDP	2004[1]	% of GDP[1]	2005[1]	% of GDP[1]
	(in millions of US dollars, except for percentages)									
Manufacturing	$ 3,191	23.1%	$ 3,308	23.1%	$ 3,391	22.5%	$ 3,484	22.0%	$ 3,631	21.4%
Trade, restaurants and hotels	2,660	19.3	2,741	19.2	2,925	19.4	3,140	19.8	3,299	19.4
Transportation, storage and communications	1,202	8.7	1,281	9.0	1,334	8.9	1,450	9.2	1,569	9.2
Agriculture, livestock and fishing	1,301	9.4	1,219	8.5	1,249	8.3	1,402	8.9	1,611	9.5
Residential leasing	1,036	7.5	1,098	7.7	1,145	7.6	1,190	7.5	1,249	7.4
Community, social, personal, and domestic services	947	6.9	1,035	7.2	1,113	7.4	1,212	7.7	1,303	7.7
Government services	988	7.2	1,000	7.0	1,032	6.9	1,055	6.7	1,102	6.5
Finance and insurance	603	4.4	621	4.3	646	4.3	710	4.5	767	4.5
Construction	647	4.7	689	4.8	706	4.7	652	4.1	705	4.2
Real estate and business services	567	4.1	606	4.2	627	4.2	673	4.3	735	4.3
Electricity, gas and water	237	1.7	256	1.8	302	2.0	280	1.8	310	1.8
Mining	57	0.4	64	0.4	69	0.5	56	0.4	61	0.4
Plus: tariffs and value added tax	953	6.9	980	6.8	1,105	7.3	1,120	7.1	1,268	7.5
Less: imputed financial services[2]	577	-4.2	589	-4.1	598	-4.0	603	-3.8	636	-3.7
Total	$ 13,813	100.0%	$ 14,307	100.0%	$ 15,047	100.0%	$ 15,822	100.0%	$ 16,974	100.0%

(1) Preliminary.
(2) Imputed financial services include the difference between interest accrued and interest paid by the financial sector.

Source: *Banco Central de Reserva de El Salvador.*

Manufacturing

In recent years, manufacturing has become a key sector of the Salvadoran economy. Since 2001, the manufacturing sector has generated an annual average of 22.4% of the Republic's nominal GDP and increased from 2001 to 2005 by 7.7% in real terms. Manufacturing was one of the fastest growing sectors of the Salvadoran economy during the period from 2001 to 2005, increasing at an average annual rate of 2.3% in real terms. *Maquila* activity has been the most important component of the manufacturing sector.

The following table sets forth production (at constant 1990 prices) of El Salvador's principal manufacturing activities for the periods presented.

Principal Manufacturing Activities

	For the Year Ended December 31,				
	2001	2002	2003	2004[(1)]	2005[(1)]
	(in millions of US dollars)[(2)]				
Maquila (assembly for re-export)	$ 240.7	$ 246.3	$ 256.1	$ 247.7	$ 232.9
Baked goods	155.9	156.3	163.1	168.6	172.6
Chemicals	150.9	156.3	160.8	163.2	166.7
Beverages	159.4	160.6	156.2	158.2	160.9
Other processed foods	116.6	126.1	129.2	132.2	133.5
Sugar	126.9	124.5	132.1	139.4	142.4
Printing and related industries	87.7	96.7	100.2	104.9	109.2
Textiles	93.4	92.6	90.2	92.6	95.3
Non-metallic mineral products	80.5	89.0	90.1	81.2	84.0
Metallic mineral products	80.8	82.9	85.3	89.4	94.5
Refined oil products	91.6	93.5	92.7	87.9	92.2
Transport supplies and diverse manufacturing products	63.7	66.2	68.6	68.1	67.0
Leather and related products	67.8	67.1	68.9	70.1	71.4
Milk products	54.3	56.2	57.1	58.5	60.1
Paper and cardboard	46.4	52.2	54.5	55.4	57.0
Machinery and equipment	55.6	58.0	57.9	59.0	60.3
Plastic products	43.9	44.2	45.7	46.5	48.4
Meat packaging and related products	34.0	32.9	32.4	32.9	34.6
Apparel	32.9	33.3	34.6	35.7	36.1
Lumber and related products	21.0	21.8	22.4	23.2	23.4
Other	0.1	0.1	0.1	0.1	0.1
	$ 1,804.2	$ 1,856.9	$ 1,898.5	$ 1,914.8	$ 1,942.6

(1) Preliminary.
(2) In constant 1990 prices.

Source: *Banco Central de Reserva de El Salvador.*

Maquila (assembly for re-export) represented US$232.9 million (in 1990 constant prices) in 2005, compared to US$247.7 million (in 1990 constant prices) in 2004. *Maquila* production grew in real terms from 2001 to 2003, with growth rates of 2.3% in 2002 and 4.0% in 2003. However, the growth rate of *maquila* production in 2002 and 2003 represented a deceleration from the growth rate in 2000 and 2001, largely as a result of the slow-down in the U.S. economy. Nonetheless, the level of *maquila* production reached its highest historical level in 2003. *Maquila* production decreased by 3.3% in 2004 compared to 2003 due to increased competition from China and Nicaragua as a result of lower labor costs in those countries. In 2005, *maquila* production dropped 6.0% compared to 2004. While *maquila* production remained at 2004 levels through the first nine months of 2005, it declined sharply in the last quarter of 2005 due to Hurricanes Stan and Katrina, which temporarily discontinued the importation of inputs from the United States.

According to the Ministry of Economy, as of December 31, 2005, there were 304 *maquila* plants, 140 of which are located in free trade zones, with the remaining 164 operating outside the geographic boundaries of the free trade zones. Over half of the *maquila* plants established in the free trade zones produce apparel and linens, mainly for export to the United States. Companies that operate in a free trade zone are exempt from import and export duties and enjoy a ten-year exemption from income taxes, provided that the goods they manufacture are exported outside of Central America. Firms that operate outside of a free trade zone and that do not export 100.0% of their production are entitled to a 6.0% rebate on exports of non-traditional goods outside of Central America. See "Foreign Trade and Balance of Payments — Composition of Foreign Trade."

Trade, Restaurants and Hotels

Trade, restaurants and hotels accounted for 19.4% of the Republic's nominal GDP in 2005. In 2005, the trade, restaurants and hotels sector grew by 1.6% in real terms mainly due to the construction of new hotels intended to attract tourism and new restaurants located in commercial centers. In 2004, the trade, restaurants and hotels sector grew by 2.4% in real terms due mainly to growth in the trade sector. From 2001 to 2005, this sector grew by an average annual real rate of 2.0%. Growth in the trade sector slowed during the period from 2001 to 2005, compared to an average annual growth rate of 5.7% in the period from 1992 to 1999, due to higher private consumption in the earlier period. Growth in the restaurant and hotel industries largely follows patterns of tourism. Tourism to El Salvador increased after the signing of the Peace Accord in 1992, but has subsequently decreased and was particularly adversely affected by the September 11, 2001 terrorist attacks in the United States. Accordingly, the restaurant and hotel industries' rate of growth has slowed as well. In June 2004, the new government under President Saca created a new ministry within the executive branch, the Ministry of Tourism, which was charged with the task of promoting and revitalizing tourism in El Salvador.

Agriculture, Livestock and Fishing

Agriculture, livestock and fishing accounted for 9.5% of the Republic's nominal GDP during 2005. This sector grew at an average real annual rate of 1.4% during the 2001 to 2005 period. The decrease in the percentage of the Republic's GDP represented by agriculture between 2001 and 2003 was the result of several factors, including increases in activity in other sectors of the Salvadoran economy, particularly *maquila,* increasing urbanization of the population and the volatility of international coffee prices. Total land dedicated to the cultivation of traditional products (coffee, sugar, cotton, corn, beans, rice and sorghum) fell 16.6% from 1980 to 2003, but has increased 2.4% from 2003 to 2005.

In 2002, the agriculture, livestock and fishing sector grew by 0.4% in real terms primarily due to an increase in the production of basic grains and poultry. The decline in the international prices of coffee and sugar and the decrease in activity in the fishing sector affected growth in the sector. In 2003, the sector grew by 0.9% in real terms primarily due to an increase in the production of poultry and a rise in activity in the fishing sector. In 2003, the continued decline in the international price of sugar, a decrease in the volume of coffee produced and a decrease in activity in the basic grains sector contributed to the slow growth. In 2004, the agriculture, livestock and fishing sector grew by 3.0% in real terms primarily due to a 3.7% increase in the production of basic grains, a 11.7% rise in activity in the fishing sector and a 5.7% increase in the production of poultry. In 2005, the sector grew by 5.8% in real terms, primarily due to growth in the production of coffee, cotton, basic grains, poultry, eggs and fish.

Coffee is El Salvador's principal agricultural export. In 2005, coffee production totaled US$125.2 million in constant 1990 prices, an increase of 1.9% from 2004, primarily due to higher average international coffee prices, which rose from US$0.7032 per pound in 2004 to US$0.9830 per pound in 2005. In 2005, coffee accounted for 80.7% of agricultural exports and 4.8% of total exports of goods. Coffee is an important source of employment in El Salvador and generated approximately 63,173 jobs during the 2004/2005 harvest, accounting for 2.3% of employment nationwide in 2004.

In July 2000, the Legislative Assembly created the *Fondo de Emergencia para el Café* (the "Coffee Emergency Fund") to revitalize the coffee production industry and extend financing to coffee producers to enable them to repay debts related to their coffee production, thereby freeing funds for further investment in the coffee industry. The Coffee Emergency Fund obtained US$80 million of proceeds through a December 2000 issuance of zero coupon eurobonds that mature in six-month installments over a ten-year period and have an aggregate face amount at maturity of US$123,248,752. The Coffee Council, an autonomous public organization consisting of representatives from the government and private trade organizations, administers the Coffee Emergency Fund.

Projected coffee production from the 2005/2006 harvest is estimated to be 4.0% greater than the 2005/2004 harvest due primarily to rising international coffee prices. In January 2005, the Saca administration announced the government's intention to implement programs aimed at promoting Salvadoran coffee exports in foreign markets and the recultivation of Salvadoran coffee farms. Currently, there are an estimated 160,690 hectares devoted to the cultivation of coffee, representing approximately 7.6% of the country's land.

With the exception of coffee, most agricultural production is for domestic consumption. The Republic generally permits the importation of most agricultural products that meet established health standards, with the exception of poultry products. Since 1992, the *Ministerio de Salud* (the "Ministry of Health") has forbidden the importation of all poultry products in an effort to limit several common avian diseases such as salmonella.

The following table sets forth the production (at constant 1990 prices) of certain major agricultural, livestock and fishing products for the periods presented.

Main Agricultural, Livestock and Fishing Products

	For the Year Ended December 31,				
	2001	2002	2003	2004[(1)]	2005[(1)]
	(in millions of US dollars)[(2)]				
Basic grains	$ 170.4	$ 182.6	$ 181.1	$ 187.8	$ 202.1
Other agricultural	168.4	170.3	174.5	178.7	187.6
Livestock	164.5	166.7	166.9	170.0	176.3
Poultry	117.8	125.3	132.6	140.2	147.5
Coffee	150.0	131.6	124.6	122.8	125.2
Forestry	52.6	52.6	53.9	55.0	56.5
Sugar cane	53.7	52.6	53.3	55.3	56.5
Fishing	22.9	22.3	25.0	27.9	30.3
Cotton	0.5	0.5	0.5	2.1	12.0
	$ 900.8	$ 904.4	$ 912.5	$ 939.9	$ 993.9

(1) Preliminary.
(2) Based on constant 1990 prices.

Source: *Banco Central de Reserva de El Salvador.*

Transportation, Storage and Communications

From 2001 to 2005, the average annual real growth rate of 4.5% in the transportation, storage and communications sector was more than double the 2.2% average annual real growth rate for the economy as a whole during the same period. Prior to the privatization of the telecommunications company, ANTEL, in 1997, average annual real growth in the sector was similar to that of the entire economy. Prior to 2005, communications was the leading subsector due to the privatization program that introduced greater competition into the industry as the multinational corporations acquiring assets of ANTEL made investments in network expansion. In 2005, however, the transportation, storage and communications sector grew by 4.3% in real terms primarily due to growth in the transportation and storage subsectors resulting from the increased shipment of cargo and aerial transport activity. The communications subsector has continued to benefit from the rise in cellular phone usage.

Construction

In 2001, the construction sector grew by 9.6% primarily due to the reconstruction effort following the earthquakes in January and February 2001 and a rise in housing construction attributable in part to the decline in interest rates during 2001. Growth in the construction sector slowed to 6.7% in 2002 and 3.2% in 2003, due principally to lower levels of activity related to the earthquake reconstruction effort. The sector declined in 2004 by 11.4% compared to 2003 due primarily to decreased investment in public projects resulting from the delays in the approval of the 2004 budget and the completion of certain reconstruction projects relating to the 2001 earthquakes. In 2005, the construction sector grew by 3.4% due primarily to increased infrastructure development by the public and private sectors. See "— Infrastructure Investment."

Finance and Insurance

From 2001 to 2005, the financial services sector grew at an average annual real rate of 2.7%. In 2005, the financial services sector grew by 4.0%, compared to 5.4% in 2004. The growth rate in 2005 was primarily due to increases in the operational revenues of banks, other financial institutions and private pension companies. In addition, strategic alliances and mergers in this industry increased administrative efficiency and produced economies of scale that contributed to the sector's growth in 2005.

Currently, there are 11 private retail banks, two state-owned retail banks, one state-owned mezzanine bank *(Banco Multisectorial de Inversiones)*, which lends to commercial banks and financial institutions, and five non-bank financial institutions operating in El Salvador. At December 31, 2005, the Salvadoran commercial banks had total assets of US$10.7 billion, equivalent to approximately 63.0% of nominal GDP for 2005. The financial system also includes broker dealers, insurance companies and the El Salvador Stock Exchange. See "Monetary System — Financial Sector."

Employment and Wages

From 1992 to 2004, the labor force in El Salvador grew at an average annual rate of 2.7%, partly due to the greater participation of women in the labor force. Unemployment decreased from 7.0% in 2001 to 6.8% in 2004. The economic sectors with the greatest job generation during the 2001 to 2005 period were finance (annual average of 7.6%), services (annual average of 5.2%), commerce

(annual average of 5.1%) and agriculture (annual average of 4.6%). The percentage of workers in the informal sector of the economy appears to have remained constant during the same period, but the government has no official count of such workers.

El Salvador's labor law provides for a daily minimum wage. A council composed of representatives from the government, the private sector and labor organizations sets minimum wages. Minimum wages for each major sector of the economy are set taking into account the evolution of real wages and the overall economic situation. In 2003, the daily minimum wage in the industrial sector increased to US$5.16 from US$4.80, the previous daily minimum wage for that sector since 1997. In the commerce and services sector, the daily minimum wage increased to US$5.28 from US$4.80, also previously applicable since 1997. In 2005, the daily minimum wage in the construction sector increased to US$7.66 from US$7.36 in 2004. The daily minimum wage in the agricultural sector has been set at US$2.47 since 1997. The legal workday is eight hours and the legal workweek is 44 hours. The law prohibits employment of minors under the age of 14 unless such employment is necessary for family sustenance and does not interfere with schooling.

The law prohibits actions against workers seeking to organize. Unions and strikes are only legal in the private sector. Public sector workers may form associations but the law prohibits strikes in the public sector. Pursuant to an amendment to the Civil Service Law enacted December 19, 2001, the government has the ability to terminate the appointment of public sector employees.

A reform to the *Codigo de Trabajo* (the "Labor Act") enacted in March 2005 prohibits discrimination against individuals diagnosed with HIV or AIDS and bars employers from requiring an HIV or AIDS test as a condition for employment.

The following table sets forth daily minimum wages by economic activity in effect for the periods presented.

Daily Minimum Wages by Economic Sector

	Agriculture[1]	Industry	Commerce and Services	Construction [2]
	(in US dollars)			
2001	$ 2.47	$ 4.80	$ 4.80	$ 6.79
2002	2.47	4.80	4.80	6.94
2003	2.47	5.16	5.28	7.07
2004	2.47	5.16	5.28	7.36
2005	2.47	5.16	5.28	7.66

(1) Excluding seasonal workers who are guaranteed minimum wages at different levels for coffee, sugar and cotton.
(2) Daily wage based on *Laudo Arbitral* (Arbitral Award) among firms and construction unions.

Source: *Diario Oficial* (Official Gazette of El Salvador).

Poverty

Economic growth since 1992 has significantly decreased the level of poverty in El Salvador. From 1992 to 2004, the number of households living below the poverty line has decreased 24.1%. From 2001 to 2004, the percentage of households living in poverty decreased 10.8%. As of December 31, 2004, 29.2% of households in urban areas and 43.7% of households in rural areas lived below the poverty line. The percentage of households living in extreme poverty decreased to 12.6% in 2004 from 27.7% in 1992.

In March 2005, President Saca created the Solidarity Network, which seeks to improve the economic, social and health conditions for approximately 100,000 families living in conditions of extreme poverty. The program provides subsidies to families that agree to follow certain health and nutrition programs and send their 5 to 15-year old children to pre-school and primary school.

The following table sets forth the percentage of households in poverty by degree of poverty and location of the household for the periods presented.

Percentage of Households in Poverty

	Extreme Poverty			Poverty			Total Poverty		
	Urban	Rural	Total	Urban	Rural	Total	Urban	Rural	Total
1992	21.9	34.0	27.7	31.0	31.1	31.0	52.9	65.1	58.7
1993	20.8	33.8	27.0	29.6	31.5	30.5	50.5	65.3	57.5
1994	16.3	34.8	23.9	27.5	29.8	28.5	43.8	64.6	52.4
1995	12.4	26.5	18.2	27.6	31.7	29.3	40.0	58.2	47.5
1996	14.5	32.3	21.9	27.9	32.5	29.8	42.4	64.8	51.7
1997	12.0	27.9	18.5	26.7	33.7	29.5	38.7	61.6	48.0
1998	12.9	28.8	18.9	23.1	29.9	25.7	36.0	58.7	44.6
1999	10.3	27.4	16.7	22.5	28.0	24.6	32.8	55.4	41.3
2000	9.3	27.1	16.0	20.6	26.6	22.8	29.9	53.7	38.8
2001	10.3	26.1	16.1	21.0	25.5	22.7	31.3	51.6	38.8
2002	10.3	26.0	15.8	19.2	24.2	21.0	29.5	50.2	36.8
2003	9.7	22.1	14.4	20.3	24.1	21.7	30.0	46.2	36.1
2004	8.6	19.3	12.6	20.7	24.4	22.0	29.2	43.7	34.6

Source: *Encuesta de Hogares de Propósitos Múltiples, EHPM, DIGESTYC.*

Social Security

El Salvador's Constitution provides for the guarantee of social security benefits to workers and their families. Social security benefits provide assistance in case of accidents, illness, maternity, disability, retirement and death. Participation in the social security system for coverage for accident, illness, maternity and disability is mandatory for all individuals, except for teachers in the public sector and self-employed individuals. The *Instituto Salvadoreño del Seguro Social* (the "Salvadoran Social Security Institute") administers these benefits.

Retirement and death benefits for public and private sector workers who remained in the public pension system after the pension reform in 1998 are provided by the *Instituto Nacional de Pensiones de los Empleados Públicos* (the "National Public Pension Institute") and the Salvadoran Social Security Institute through a separate governmental system. The government provides medical services to the population not covered by the Salvadoran Social Security Institute or the National Public Pension Institute through a network of 30 hospitals and 579 health facilities across the country.

The social security system is financed by a combination of contributions from workers and employers. Since January 1, 2003, all employees, except for teachers in the public sector and self-employed individuals, contribute 3.0% of their salary and employers contribute 7.5% of their total payroll for accident, illness, maternity and disability benefits. Teachers in the public sector contribute the same percentage to the *Bienestar Magisterial* (the "Education Professionals Social Security") for the same benefits provided by the Salvadoran Social Security Institute. For retirement and death benefits, private sector employees contribute 7.0% of their salary and employers contribute 7.0% of their total payroll to the Salvadoran Social Security Institute. Public sector employees contribute 7.0% of their salary and their employers contribute 7.0% of their total payroll to the National Public Pension Institute.

In order to provide the government with the proceeds to improve social security benefits, the *Ley Especial para la Constitución del Fondo Solidario para la Salud* (the "Special Law for the Constitution of the Solidarity Fund" or "FOSALUD") was enacted in December 2004. FOSALUD aims to establish legal mechanisms to finance special programs designed to increase the availability of healthcare services and social assistance in rural and urban areas, as well as programs providing emergency assistance. During 2005, FOSALUD funds were used to modernize and expand services at 42 clinics throughout the country, which now operate on a 24-hour basis.

The following table sets forth the distribution of workers in the private sector by economic sector and as a percentage of the labor force in the private sector contributing to the Salvadoran Social Security Institute by number and percentage for the periods presented. No comparable information is available for workers in the informal sector of the economy.

Contributors by Sector

	As of December 31,									
	2001		2002		2003		2004		2005[(1)]	
	Number	%	Number	%	Number	%	Number	%	Number	%
Industry	169,462	37.1%	168,639	36.2%	168,334	35.1%	163,038	33.3%	159,652	30.9%
Commerce	96,433	21.1	98,019	21.1	104,639	21.8	111,928	22.9	121,908	23.6
Finance	74,049	16.2	78,665	16.9	85,877	17.9	89,066	18.2	98,334	19.1
Services	59,003	12.9	62,022	13.3	62,535	13.0	68,400	14.0	73,415	14.2
Construction	26,155	5.7	27,072	5.8	26,259	5.5	24,205	4.9	27,182	5.3
Transport and Communication	18,380	4.0	17,558	3.8	17,352	3.6	18,011	3.7	19,847	3.8
Agriculture	9,933	2.2	10,030	2.2	10,751	2.2	11,337	2.3	12,121	2.3
Electricity, Gas and Water	3,027	0.7	2,691	0.6	2,846	0.6	2,852	0.6	2,921	0.6
Mining	541	0.1	604	0.1	610	0.1	532	0.1	510	0.1
Total	456,983	100.0%	465,300	100.0%	479,203	100.0%	489,369	100.0%	515,890	100.0%

(1) Preliminary.

Source: *Instituto Salvadoreño del Seguro Social.*

Pension Reform

On December 20, 1996, the Legislative Assembly approved the creation of a private pension system for eligible workers (including both public sector employees and private sector employees) in El Salvador modeled on the then-existing Chilean system. The *Superintendencia de Pensiones* (the "Superintendency of Pensions") is responsible for overseeing both the public pension system and the private pension system. Private pension companies (the "*Administradoras de Fondos de Pensiones*" or "AFPs") were authorized to operate pursuant to the pension system law of April 15, 1998. All workers 35 years old or younger were required to affiliate with a private pension company by April 15, 1999. Men between the ages of 36 and 55 and women between the ages of 36 and 50 had the option of continuing with the prior public pension system, or switching to the new private pension system, while women over the age of 50 and men over the age of 55 were not eligible to participate in the new private pension system and were required to remain in the prior public pension system. All workers entering the work force since April 15, 1998 have been required to participate in the private pension system, regardless of age. At December 31, 2005, 1,279,714 workers, or 47.2% of the Salvadoran workforce in 2004, were covered by this private pension system. At December 31, 2005, there were 26,847 active workers registered in the public pension system.

Beginning January 1, 2002, employees participating in the private pension system were required to contribute 6.25% of their salary on a monthly basis to a private pension fund (a portion of such amount represented commissions to the AFPs). Employers are required to contribute an additional 6.75% of each worker's salary to each worker's private pension fund account on a monthly basis. On December 21, 2005, the Legislative Assembly approved an amendment to the pension system law, that became effective May 2006, which reduces the maximum commission that AFPs may charge from 3.0% to 2.7% and requires that such commissions be deducted from employer contributions rather than employee contributions. Under the new law, employees continue to contribute 6.25% of their salary on a monthly basis; however, commissions are not deducted from employee contributions, but instead are deducted from contributions by employers, who continue to contribute 6.75%. Only men who are 60 years old and women who are 55 years old, and who have contributed to the pension system for 25 years, are eligible to receive a monthly pension. As of January 2005, the option of retiring after contributing to the pension system for 30 years, regardless of age, is no longer available for those employees who did not meet the 30 years of service requirement by December 31, 2004.

When employees who transferred to the private pension system retire, the government issues *Certificados de Traspaso* ("Certificates of Transfer" or "CTs") to the relevant private pension fund in order to credit the employees for their prior contributions to the public pension system. Beginning in January 2002, CTs, due to reforms to the pension system law, are payable over a 15-year period commencing upon the date of the relevant employee's retirement. CTs were previously payable in one lump sum. In addition, since July 2003, persons who have the option of continuing with the prior public pension system or switching to the new private pension system are eligible to receive a *Certificado de Traspaso Complementario* (the "Complimentary Recognition Bond") that would compensate them for any difference between the value of the monthly pensions they would have received had they stayed in the prior public pensions system and the value of the monthly pensions if they shifted to the new private pension system.

The creation of the private pension system reduced the net present value of the government's obligations with respect to pensions by approximately 71.6%. The government currently estimates that the difference between contributions to the public pension system and benefits payable to retirees under the public pension system and partial benefits payable to retirees who switched to the private pension system for the time they were covered by the public pension system was 1.9% of GDP in 2005 and will increase thereafter to reach a projected peak deficit as a percentage of GDP of 2.3% in 2006. The accumulated deficit for the period from 2002-2006 could reach approximately US$1.4 billion.

Privatizations and Concessions

Telecommunications Privatization

Until 1998, *Administración Nacional de Telecomunicaciones* ("ANTEL") was the sole provider of basic telephone service in El Salvador and had sole power to license or grant concessions for related services. In September 1991, ANTEL granted a concession for cellular telecommunications to a company owned by Millicom International Cellular S.A. and local investors. Data transmission facilities have been leased to private operators. In addition, several paging service providers have obtained licenses to provide services.

In July 1998, ANTEL was privatized through a public auction in which France Telecom purchased 51.0% of the capital stock of the entity holding the fixed line telecommunications assets of ANTEL, *Compañía de Telecomunicaciones de El Salvador* ("CTE"), for US$275.0 million and *Telefónica de España* purchased 51.0% of the capital stock of the entity holding ANTEL's wireless telecommunications assets, *Internacional de Telecomunicaciones* ("INTEL"), which subsequently changed its name to *Telefónica El Salvador,* for US$41.0 million. The government sold its remaining interest in INTEL to the public on October 26, 1999 for US$43.5 million. The government sold approximately 6.0% of CTE's capital stock to the company's employees. In September 2003, France Telecom sold its interest in CTE to América Móvil, a Mexican company. In December 2004, the government sold most of its remaining interest (41.54% of the company's total shares) in CTE to Sercotel SA, a unit of América Móvil, for approximately US$294.5 million. Currently, the government maintains a 1.11% stake in CTE while public shareholders hold 3.69% of the company.

The government transferred the net proceeds from the privatization of ANTEL (US$706.8 million) to the ANTEL Privatization Fund. Interest generated by the ANTEL Privatization Fund is used for the promotion of employment by attracting foreign investment and increasing exports and tourism, for the promotion of handicraft industries and for forest development and protection, school food, scholarships and information technology projects. Since its inception in 1998 through December 2005, the ANTEL Privatization Fund has invested US$88.0 million in such projects and US$200 million of the capital in the ANTEL Privatization Fund has been used for reconstruction efforts related to the 2001 earthquakes as well as other public works. Proceeds from the December 2004 sale of CTE to Sercotel SA were used to cover government expenses for pensions.

Electricity Privatization

All planning, regulatory and executive functions concerning power generation, transmission and distribution were vested until 1998 in the *Comisión Ejecutiva Hidroélectrica del Río Lempa* ("CEL"), a state-owned monopoly. From 1986 to 1998, CEL transmitted and distributed all of the Republic's electricity. Currently, approximately 50.0% of the Republic's electricity is generated by CEL. A private company, *Compañía Nejapa Power,* owns and operates a power plant located in Nejapa in the northern region of San Salvador. The plant has a generating capacity of 151.2MW, which represents approximately 12.6% of the Republic's total approximate generation capacity of 1,200MW. In addition, many of the large manufacturing enterprises in El Salvador have their own generating capacity.

Privatization of Electricity Distribution Facilities

In 1996, the Legislative Assembly approved the *Plan de Gestión del Servicio Público de Distribución de Energía Eléctrica* (the "Electricity Distribution Act") to privatize the electricity distribution companies in El Salvador. Prior to the privatization, CEL controlled the four primary operating electricity distribution companies: *Compañía de Alumbrado Eléctrico de San Salvador* ("CAESS"), *Empresa Eléctrica de Oriente* ("EEO"), *Distribuidora de Electricidad del Sur* ("DELSUR") and *Compañía de Luz Eléctrica de Santa Ana* ("CLESA"). Ownership of a smaller fifth company, *Distribuidora Eléctrica de Usulután* ("DEUSEM"), was divided equally between CEL, local governments and private investors. Pursuant to an auction in January 1998, CEL sold controlling interests in: (i) CAESS and EEO to a joint venture between *C.A. La Electricidad de Caracas* (Venezuela) and Reliant Energy (United States); (ii) CLESA to AES El Salvador, an affiliate of AES Corporation (United States) ("AES") and (iii) DELSUR to Emel Group (Chile). Net proceeds (including a purchase price adjustment of US$12.5 million paid to AES) from the sale of the four companies were US$573.6 million. CEL retained less than 5.0% of the capital stock of each of the four electricity distribution companies and the remaining capital stock was sold to employees of the companies and the public. During 2002, CEL sold approximately 1.2% of the capital stock of the companies to the public for approximately US$3.0 million. In 2004, CEL sold additional shares to the public for US$2.5 million. The government may sell its remaining interests in the distribution companies at a future date.

From the net proceeds of the initial privatization (including sales to employees and the public), which amounted to US$581.4 million, US$320.0 million was used to repay short-term foreign currency debt and US$104.8 million was used to finance certain social and infrastructure projects. Subsequently, CAESS purchased DEUSEM from each one of its original owners in three stages during the second half of 1998. In June 2000, AES, the parent company of CLESA, acquired *C.A. Le Electricidad de Caracas* and,

thereby, its indirect interests in CAESS, EEO and DEUSEM, and in the fourth quarter of 2000, AES acquired Reliant Energy's interests in CAESS, EEO and DEUSEM.

Privatization of Electricity Generation Facilities

The Electricity Distribution Act also provided for the restructuring of CEL for the privatization of electricity generation facilities. On July 30, 1999, after a bidding process, Duke Energy International El Salvador acquired 80.0% of the capital stock of the companies holding the thermal assets of CEL for a purchase price of US$125.1 million. In August 1999, the remaining 20.0% of the capital stock was sold to employees. On June 3, 2002, Enel Green Power of Italy entered into an agreement with *Geotérmica de El Salvador,* a wholly owned subsidiary of CEL, for the exploration and testing of geothermal wells. Pursuant to the agreement, Enel Green Power acquired approximately 8.5% of *Geotérmica de El Salvador* and, based on the outcome of the exploration and testing, may acquire additional shares in exchange for an investment in *Geotérmica de El Salvador.* From 2002 to 2005, Enel Green Power acquired an additional 4% of *Geotérmica de El Salvador*, bringing its total ownership in *Geotérmica de El Salvador* to 12.5% as of December 31, 2005.

Transportation Infrastructure Concessions

The Republic has approximately 12,000 kilometers of roads. Two major highways cross the country: the Pan-American highway links the Republic with Guatemala in the west and Honduras in the east; and the *Carretera Litoral,* which runs south of the Pan-American highway, links Sonsonate to the west and Zacatecoluca and Usulután to the east and forms part of the Mexico-Central American region's plans under *Plan Puebla Panama* to link the Central American countries from Mexico to South America. The Republic has outsourced the maintenance of roads to private companies formed by former Ministry of Public Works employees who purchased the maintenance equipment from the government.

The Republic has one operating seaport, Puerto Acajutla, a cargo seaport to the west of San Salvador, and a second major seaport under construction at La Unión, to the east of San Salvador. The *Comisión Ejecutiva Portuaria Autónoma* (the "Autonomous Executive Ports Commission" or "CEPA") administers these ports and the international airport. The government has contracted with private companies owned by former port facilities employees for loading and unloading services at port facilities. In September 2002, the Legislative Assembly enacted the *Ley General Marítimo Portuaria* (the "General Sea Ports Law") establishing, among other matters, the regulation of the construction, rehabilitation, and operation of the national port facilities. In October 2002, the Legislative Assembly announced the terms of reference for the concession of the port facilities at Acajutla. The government expects the concession of these port facilities to be completed in 2006; however, no concessions have been awarded to date. In April 2005, the government entered into a contract with a Japanese and Belgian consortium to improve the port facilities and build a canal at La Unión. In addition, the government created the *Comisión de Desarrollo del Golfo de Fonseca* (the "Fonseca Gulf Development Commission") that is responsible for the planning and management of the development of the *Golfo de Fonseca* area.

The El Salvador International Airport is located 40 kilometers south of San Salvador and, as of December 31, 2004, was served by over eight international airlines. In March 1998, the government completed a US$14.5 million expansion program for the airport and concessions have been granted to private companies for a number of facilities and services at and near the airport. The government is currently evaluating a possible public tender for the privatization of other facilities at the airport, possibly through concessions.

Infrastructure Investment

Puerto La Unión

The government currently is undertaking plans to build a major port facility at La Unión. The project is estimated to cost a total of approximately US$170.0 million. Approximately US$90.0 million of the project costs are being financed through a credit facility provided by the Japan Bank for International Cooperation. Approximately US$45.0 million of the project costs will be financed through government funds and the balance is expected to be financed through additional credit facilities. The port facilities are expected to be operational in January 2008.

Planta Térmica Atéos

The government is also undertaking the installation of a 50MW thermal power plant at Atéos, to the west of San Salvador. The project is expected to cost a total of US$65.8 million, of which approximately US$46.0 million is expected to be financed through a loan from *Banco Centroamericano de Integración Económica.* The balance of the project costs will be financed by government funds. The power plant is expected to be operational in January 2007.

Promotion of Tourism

The government believes that tourism represents a potential growth area for the Salvadoran economy and has begun to implement measures designed to foster development of the country's tourism sector. On December 21, 2005, the Legislative Assembly enacted a new tourism law (the "*Ley de Turismo*" or "Tourism Law"), which sets forth a framework for the development of the tourism sector. The tourism law imposes a special contribution levy of US$7.00 for each person leaving the country through the international airport, as well as a special contribution levy of 5% on lodging. The tourism law also contemplates the implementation of economic incentives to companies that engage in certain tourism activities.

All of the proceeds generated by the special contribution levies will be allocated to *Corporación Salvadoreña de Turismo* ("CORSATUR"), a state-owned company established to develop the tourism sector. By law, these proceeds must be used by CORSATUR for the purpose of promoting the country's tourism sector.

Education Initiatives (*Plan Nacional de Educación 2021*)

The government has also begun to implement measures designed to improve the education system, promote greater access to educational opportunities and encourage greater participation in the education system, particularly in rural communities. These measures include:

- improving educational facilities throughout the country;
- increasing access to computers and the Internet;
- promoting English as a second language for all students; and
- implementing, a conditional cash transfer program, known as *Programa Red Solidaria* or the Solidarity Network, to encourage extremely poor families to send their 5 to 15-year old children to pre-school and primary school, fully immunize children younger than 5, and regularly monitor the health and nutrition status of pregnant mothers and infants.

For the year ended December 31, 2005, government expenditures in education increased to US$493.0 million from US$457.3 million for the year ended December 31, 2004, representing an increase of 7.8%. Under its *Plan Nacional de Educación 2021*, the government expects to increase expenditures in the area of education from 2.9% to 4.2% of GDP during the period from 2004 to 2009.

FOREIGN TRADE AND BALANCE OF PAYMENTS

General

During the 1960s, El Salvador imposed tariff and non-tariff barriers to foreign competition in an effort to encourage the development of a domestic industrial base. By 1970, due to the country's shortage of natural resources, El Salvador imported 74.0% of its raw materials and 95.0% of its capital goods from countries outside the CACM. In an effort to reduce this import dependency, El Salvador introduced incentives to foreign investment, and the *maquila* industry developed in free trade zones to take advantage of El Salvador's comparatively low labor costs.

With the reform programs begun in 1989 and the initiatives implemented after the signing of the Peace Accord, the export sector of the economy began to grow. By 2005, exports of goods and services accounted for 26.8% of nominal GDP. In 2005, imports accounted for 45.2% of nominal GDP, mostly in the form of intermediate goods (34.4% of total imports) and consumer goods (29.8% of total imports). Export earnings have grown 26.7% from 2001 to 2005 primarily due to *maquila*, coffee, manufacturing and food products exports. Based on preliminary information, the current account deficit of the balance of payments increased from 4.0% of nominal GDP in 2004 to 4.6% of nominal GDP in 2005 due to the increase in the trade and services deficit and current account transfers (excluding remittances). The trade and services deficit increased from 17.3% of nominal GDP during 2004 to 18.1% of nominal GDP during 2005.

Tariffs and Other Trade Restrictions

Until the late 1980s, El Salvador used tariff barriers to protect its domestic industry against foreign competition. Import duties ranged from zero to 290.0%, with up to 25 different rates. The government largely controlled exports, with the international commercialization of coffee and sugar in the hands of state-owned monopolies.

Since 1989, the Republic has significantly liberalized its foreign trade policy. The tariff structure has been simplified and currently consists of three principal rates: zero for capital goods, between 5.0% and 10.0% for intermediate goods and 15.0% for consumer goods. These three rates apply to approximately 90.0% of imports. There are some products with different rates, such as jewelry, fine arts, guns and ammunition. Import licenses have been eliminated for most goods and export license requirements have been replaced by reporting requirements primarily designed to ensure collection of data relating to foreign trade. The national coffee and sugar boards were dissolved, eliminating government involvement in these industries.

Regional Integration and Free Trade

El Salvador has benefited from regional trade initiatives that have opened up the markets of Central American nations to other nations in the region. Regional integration has been especially beneficial to the manufacturing sector. Increased access to international markets and liberalization of trade barriers are components of El Salvador's plan to increase international competitiveness, to improve export revenues and to encourage foreign investment. In recent years, the Republic has intensified its efforts to strengthen its trade arrangements with its primary trading partners including:

- entering into, along with several other Central American countries, a free trade agreement with the Dominican Republic that became effective on October 1, 2001;
- entering into, along with Guatemala and Honduras, a free trade agreement with Mexico that became effective on March 15, 2001;
- entering into, along with other Central American countries, a free trade agreement with Chile that became effective on June 1, 2002;
- entering into a free trade agreement with Panama that became effective on April 11, 2003;
- entering into, along with the other members of the Central America Economic Integration System, a free trade agreement with the United States on May 28, 2004, which the Dominican Republic also later signed on August 5, 2004 and which became effective between El Salvador and the United States on March 1, 2006.
- participating in the Free Trade Area of the Americas negotiations; and
- participating in free trade agreement negotiations with Canada.

Trade Initiatives Involving Central America

The opening of the markets of Central America began in 1960 when El Salvador, Guatemala, Honduras and Nicaragua (joined by Costa Rica in 1963) signed the General Treaty for Central American Economic Integration (the "General Treaty"), which provided the framework for the CACM. The CACM envisioned the creation of a customs union as a temporary step towards the creation of a common market similar to the European Union. In 1995, the five members of the CACM agreed to reduce gradually their external tariff structures for goods produced outside the Central American region. In January 2000, the Central American nations agreed to a tariff structure with, and Salvadoran tariffs are currently set at, three principal rates: zero for capital goods; between 5.0% and 10.0% for intermediate goods; and 15.0% for consumer goods.

In early 1998, El Salvador and several Central American countries signed a free trade agreement with the Dominican Republic intended to create a free trade zone in accordance with WTO regulations. This agreement became effective on October 1, 2001. In October 1999, El Salvador, along with other Central American countries, entered into a free trade agreement with Chile that became effective on June 1, 2002. El Salvador, Guatemala and Honduras reached a free trade agreement with Mexico, which became effective for El Salvador on March 15, 2001. This free trade agreement with Mexico does not apply to trade between El Salvador and Guatemala or Honduras. On March 6, 2002, El Salvador and Panama entered into a free trade agreement that became effective on April 11, 2003.

Trade Initiatives Involving the United States and Canada

El Salvador has been a beneficiary of the CBI since 1983, when the United States government established the CBI to aid Central American and Caribbean countries. The CBI provides duty-free access to the U.S. market for certain goods manufactured and processed in CBI member countries. Excluded from the original list of duty-free products were beef, textiles, clothing, oil and oil derivatives. Sugar remains subject to quotas. The CBI also contains rules of origin which require that products must have at least 35 percent CBI-country content in order to be eligible for duty-free treatment.

On October 2, 2000, the United States declared El Salvador eligible for enhanced CBI benefits available under the Caribbean Basin Trade Partnership Act of 2000 (the "CBTPA"). The CBTPA significantly expands preferential treatment for apparel made in the Caribbean Basin region. Duty/quota-free treatment is provided for apparel made in the Caribbean Basin region from U.S. fabrics formed from U.S. yarns. Duty/quota-free treatment is also available for certain knit apparel made in CBTPA beneficiary countries from fabrics formed in the Caribbean Basin region, provided that U.S. yarns are used in forming the fabric. This "regional fabric" benefit for knit apparel is subject to an overall yearly limit, with a separate limit provided for t-shirts. Following the expiration in December 2004 of the Agreement on Textiles and Clothing, a multilateral transitional arrangement designed to progressively integrate the textile and clothing sector into the WTO regime, textile quotas have been eliminated. However, under the CBI, El Salvador will continue to benefit from preferential duty-free treatment up to the yearly limits for "regional fabric" and t-shirts until 2008.

Duty/quota-free treatment is also available for apparel made in the Caribbean Basin region from fabrics determined to be in "short supply" in the United States, and for designated "hand-loomed, handmade or folklore" articles. In addition to these apparel preferences, the CBTPA provides NAFTA-equivalent tariff treatment for certain items previously excluded from duty-free treatment under the CBI program (*e.g.*, footwear, canned tuna, oil products, watches and watch parts).

In December 1994, at the Summit of the Americas in Miami, the Presidents of the United States, El Salvador, Costa Rica, Guatemala, Honduras, Nicaragua, Belize and Panama signed the *Conjunto Centroamericano-USA,* a partnership for sustainable development that committed its signatories to achieving a Free Trade Area of the Americas by 2005. At the Summit of the Americas in Quebec City in April 2001, the parties reiterated their commitment to achieve a Free Trade Area of the Americas by 2005.

At the Canada-Central America Summit in Guatemala on September 28, 2000, the Prime Minister of Canada agreed to a request by the leaders of the Central American countries of El Salvador, Guatemala, Honduras and Nicaragua to pursue free trade negotiations. On November 21, 2001, the Canadian Minister for International Trade announced the launch of free trade negotiations. Canadian and Central American officials met for the tenth round of formal negotiations towards a bilateral free trade agreement in February 2004. Further rounds of negotiations may be held at a future date.

In addition, the Central American countries have established a dialogue with representatives of the European Union with a view to establishing an economic association, including a possible free trade agreement, between the two regions.

On August 1, 2002, the U.S. Congress passed the Trade Act of 2002, which granted Trade Promotion Authority to the President of the United States permitting him to have full authority to negotiate trade agreements. After several rounds of negotiations, the United States signed a free trade agreement with the five members of the Central America Economic Integration System on May 28, 2004.

Subsequently, the Dominican Republic became a party to the free trade agreement, now referred to as the U.S.-Dominican Republic-Central America Free Trade Agreement or the DR-CAFTA. The DR-CAFTA, which is subject to the ratification and implementation by the respective legislatures of the parties to the agreement, has been ratified and implemented by the United States and El Salvador. On March 1, 2006, the DR-CAFTA became effective between the United States and El Salvador.

Under the DR-CAFTA, El Salvador agreed to lower duties on U.S. products over a period of 20 years in the case of agricultural products and over a period of 10 years in the case of industrial products. Approximately 53.0% of U.S. farm exports, including high quality cuts of beef, cotton, wheat, soybeans, key fruits and vegetables, processed food products and wine, are now duty free. Approximately 78.0% of U.S. industrial products, including information technology, agricultural and construction equipment, paper, chemicals and medical and scientific equipment also now enjoy duty free access.

The United States, on the other hand, has granted immediate duty free access to approximately 89.0% of El Salvador's agricultural products, including natural honey, certain fruit juices, carbonated drinks, beer, and other ethnic products such as *ajonjoli, loroco, queso duro, quesadillas, tamales,* and *pupusas.* El Salvador's other agricultural products will be granted duty free access within 20 years. In addition, almost all (99.73%) of El Salvador's industrial products exported to the United States now receive duty free access under the DR-CAFTA. These products include canned tuna, jewelry, textiles, ready-to-wear clothing, footwear, crates, hooks and other products made of steel or iron.

With respect to sugar, El Salvador's present quota of 27,000 metric tons has been increased by an additional 24,000 metric tons. In succeeding years and until the year 2019, such additional quota will rise annually until it reaches 36,000 metric tons. From 2020 onwards, the additional quota will rise annually by 680 metric tons. With respect to coffee products, strict "rules of origin" will apply whereby only coffee cultivated in Central America, the Dominican Republic or the United States will enjoy duty free access under the agreement. In addition, the benefits under the Caribbean Basin Initiative and other trade preferences with the United States will be maintained.

Composition of Foreign Trade

The Republic's largest trading partners are the United States, Guatemala and Honduras. The following table sets forth the country of destination of the Republic's exports for the periods presented.

Merchandise Exports by Country of Destination

	For the Year Ended December 31,					Percentage of Total Exports	
	2001	2002	2003	2004[1]	2005[1]	2001	2005[1]
	(in millions of US dollars, except percentages)						
North America							
Canada	$ 5.0	$ 4.3	$ 6.1	$ 13.8	$ 19.0	0.2%	0.6%
Mexico	24.6	31.9	37.4	35.8	40.0	0.9	1.2
United States	1,873.6	2,006.0	2,113.0	2,163.7	2,057.7	65.4	60.7
Central America							
Belize	7.2	7.5	8.6	8.8	9.5	0.3	0.3
Costa Rica	94.6	106.6	102.0	100.4	109.0	3.3	3.2
Guatemala	323.4	344.0	361.3	386.8	409.4	11.3	12.1
Honduras	184.5	176.6	184.9	205.5	251.8	6.4	7.4
Nicaragua	120.3	113.2	98.1	128.6	143.4	4.2	4.2
South America and the Caribbean							
Chile	1.9	0.3	0.7	2.6	1.8	0.1	0.1
Dominican Republic	12.4	20.8	22.2	25.2	37.8	0.4	1.1
Panama	48.9	45.0	46.3	46.1	50.6	1.7	1.5
Puerto Rico	4.2	3.4	3.8	5.3	9.3	0.1	0.3
Venezuela	6.7	4.6	3.9	2.3	3.8	0.2	0.1
Europe							
Benelux[2]	5.8	7.9	9.7	13.5	26.3	0.2	0.8
Germany	48.8	36.4	31.3	34.2	44.5	1.7	1.3
Other	102.3	86.5	98.8	129.4	175.9	3.6	5.2
Total	$ 2,863.8	$ 2,995.0	$ 3,128.0	$ 3,302.2	$ 3,389.8	100.0%	100.0%

(1) Preliminary.
(2) Belgium, Netherlands and Luxembourg.

Source: *Banco Central de Reserva de El Salvador.*

In 2005, 27.2% of El Salvador's merchandise exports went to Belize and the Central American countries, compared to 25.5% in 2001. Primarily as a result of the free trade agreement with Mexico that became effective in 2001, exports to Mexico in 2005 increased by 62.6% compared to 2001, although they still represented only 1.2% of total exports in 2005. Exports to the United States decreased from 65.4% of the Republic's total exports in 2001 to 60.7% in 2005, primarily due to the decline in *maquila* production. Exports to the United States consist primarily of *maquila* products, coffee, sugar, shrimp, apparel and textiles.

The following table sets forth the composition of the Republic's major exports for the periods presented.

Merchandise Exports (FOB) by Groups of Products

	For the Year Ended December 31,					Percentage of Total Exports	
	2001	2002	2003	2004(1)	2005(1)	2001	2005(1)
	(in millions of US dollars, except percentages)						
Maquila	$ 1,650.3	$ 1,757.5	$ 1,873.0	$ 1,920.7	$ 1,817.7	57.6%	53.6%
Agricultural products							
Coffee	115.0	106.9	105.4	123.4	163.6	4.0	4.8
Other	35.9	36.0	34.9	44.3	39.2	1.3	1.2
Manufacturing							
Paper	100.0	128.2	122.9	128.8	142.5	3.5	4.2
Textiles	146.1	156.8	156.8	130.2	116.8	5.1	3.4
Shoes and footwear	19.3	17.7	19.2	19.3	19.5	0.7	0.6
Food, beverages and tobacco	227.5	223.0	239.9	270.9	368.2	7.9	10.9
Chemicals	154.6	157.6	149.8	159.2	170.4	5.4	5.0
Mineral products	85.7	68.6	67.2	71.3	58.0	3.0	1.7
Animal products							
Shrimp	19.6	9.5	10.8	5.0	2.9	0.7	0.1
Other	19.6	23.8	36.1	29.4	37.4	0.7	1.1
Other	290.2	309.5	312.0	399.6	453.6	10.1	13.4
Total	$ 2,863.8	$ 2,995.0	$ 3,128.0	$ 3,302.2	$ 3,389.8	100.0%	100.0%

(1) Preliminary.

Source: *Banco Central de Reserva de El Salvador.*

Maquila exports have increased by 10.1% from 2001 to 2005. However, *maquila* exports decreased by 5.4% in 2005 compared to 2004 due to increased competition from China and Nicaragua resulting from lower labor costs in those countries and the expiration of the Agreement on Textiles and Clothing in December 2004. While *maquila* exports remained at 2004 levels through the first nine months of 2005, they declined sharply in the last quarter of 2005 due to Hurricanes Stan and Katrina, which temporarily discontinued the importation of inputs from the United States and negatively affected the production of *maquila* exports.

Coffee exports have risen by 42.3% from 2001 to 2005. A decline in international coffee prices as well as a decrease in volume of coffee produced as a result of the earthquakes in the early part of 2001 contributed to decreased coffee exports from 2001 to 2003. However, in 2004 and 2005, coffee exports grew by US$18.0 million or 17.1% and US$40.2 million or 32.6%, respectively, due to improving international coffee prices.

In 2005, total exports grew 2.7% compared to 2004. Non-traditional exports grew by 10.1%, with tuna, other fish and crustaceans, fruit juices, baked goods and ethylic alcohol experiencing rates of growth greater than 50% compared to 2004. The growth rate of non-traditional exports, excluding exports to Central American countries, was 8.0% compared to 2004.

The following table describes the origin of the Republic's imports during the periods presented.

Merchandise Imports (CIF) by Country of Origin

	For the Year Ended December 31,					Percentage of Total Imports	
	2001	2002	2003	2004[1]	2005[1]	2001	2005[1]
	(in millions of US dollars, except percentages)						
North America							
Canada	$ 36.8	$ 34.2	$ 48.8	$ 46.5	$ 53.2	0.7%	0.8%
Mexico	313.8	294.6	315.6	374.1	530.7	6.2	7.8
United States	2,462.5	2,569.1	2,861.4	2,968.6	2,930.3	49.0	43.3
Central America							
Costa Rica	163.5	149.3	157.4	174.5	180.5	3.3	2.7
Guatemala	435.2	418.7	463.6	506.0	554.7	8.7	8.2
Honduras	133.8	155.3	134.9	153.1	153.4	2.7	2.3
Nicaragua	87.9	97.5	111.6	111.5	126.2	1.7	1.9
South America and the Caribbean							
Argentina	11.7	13.6	27.2	73.6	70.3	0.2	1.0
Brazil	52.6	82.2	116.7	168.4	261.0	1.0	3.9
Colombia	35.1	40.1	65.0	58.2	60.8	0.7	0.9
Chile	16.0	23.0	43.8	73.7	94.7	0.3	1.4
Ecuador	127.4	152.5	168.3	94.7	86.8	2.5	1.3
Panama	135.1	156.2	126.0	146.3	161.0	2.7	2.4
Peru	13.1	24.8	12.9	20.7	27.4	0.3	0.4
Venezuela	82.3	78.7	134.9	244.6	223.5	1.6	3.3
Europe							
Benelux[2]	33.5	30.1	45.4	43.8	51.0	0.7	0.8
Germany	89.0	81.0	91.6	92.7	117.0	1.8	1.7
Japan	124.7	136.3	132.3	134.1	125.2	2.5	1.9
Other	672.9	647.3	696.9	842.8	958.7	13.4	14.2
Total	$ 5,026.8	$ 5,184.5	$ 5,754.3	$ 6,327.9	$ 6,766.4	100.0%	100.0%

(1) Preliminary.
(2) Belgium, Netherlands and Luxembourg.

Source: *Banco Central de Reserva de El Salvador.*

From 2001 to 2005, El Salvador's trade deficit with the United States increased from US$588.9 million in 2001 to US$872.6 million in 2005. In 2001 and 2002, El Salvador's trade deficit with the United States declined due mainly to an increase in *maquila* exports that outpaced the increase in imports. However, from 2003 to 2005, El Salvador's trade deficit with the United States increased due primarily to a decline in *maquila* exports and an increase in the importation of consumer goods attributable in part to an increase in worker remittances from Salvadorans in the United States. In addition, the expiration of the Agreement on Textiles and Clothing in December 2004 resulted in a decline in *maquila* and non-*maquila* textile and clothing exports in 2005.

The United States is the principal source of El Salvador's imports. Imports from the United States consist primarily of raw materials for *maquila,* oil products, wheat, corn, automobiles, cotton and flour. Imports from the United States increased by 19.0% from 2001 to 2005, although they decreased from 49.0% of the Republic's total imports in 2001 to 43.3% in 2005. Imports from Brazil increased from US$52.6 million in 2001 to US$261.0 million in 2005, due primarily to the importation of iron, steel and gasoline, as well as Brazilian ethanol for dehydration and re-export.

The following table sets forth the composition of the Republic's imports for the periods presented.

Merchandise Imports (CIF) by Type of Goods

	For the Year Ended December 31,					Percentage of Total Imports	
	2001	2002	2003	2004[(1)]	2005[(1)]	2001	2005[(1)]
	(in millions of US dollars, except percentages)						
Consumer Goods	$ 1,275.5	$ 1,363.2	$ 1,589.5	$ 1,784.2	$ 2,019.2	25.4%	29.8%
Non-durable	1,100.8	1,179.4	1,317.1	1,448.0	1,687.1	21.9	24.9
Durable	174.7	183.8	272.4	336.2	332.1	3.5	4.9
Intermediate Goods	1,690.4	1,659.3	1,849.2	2,096.4	2,327.9	33.6	34.4
Manufacturing	1,275.3	1282.9	1,443.8	1,629.0	1,827.4	25.4	27.0
Agriculture	96.9	88.7	96.5	117.1	144.8	1.9	2.1
Construction	254.5	225.5	249.4	289.6	299.9	5.1	4.4
Other	63.7	62.2	59.5	60.8	55.8	1.3	0.8
Capital Goods	900.2	879.4	936.3	990.1	1,015.3	17.9	15.0
Manufacturing	280.9	252.2	269	257.8	281.8	5.6	4.2
Transport	354.5	348.9	387.7	437.0	418.0	7.1	6.2
Agriculture	13.9	13.7	12.5	45.0	15.6	0.3	0.2
Construction	50.6	81.9	79.9	59.6	64.1	1.0	0.9
Other	200.4	182.7	187.2	190.7	235.8	4.0	3.5
Maquila	1,160.6	1,282.6	1,379.2	1,457.1	1,403.9	23.1	20.7
Total	$ 5,026.8	$ 5,184.5	$ 5,754.3	$ 6,327.9	$ 6,766.4	100.0%	100.0%

(1) Preliminary.

Source: *Banco Central de Reserva de El Salvador.*

Maquila imports, as a percentage of total imports of goods, decreased from 23.1% in 2001 to 20.7% in 2005. Corresponding to the decline in *maquila* exports in 2005, *maquila* imports in 2005 dropped to 20.7% of total imports due to the impact of Hurricanes Stan and Katrina, which temporarily discontinued the importation of inputs from the United States, as well as the expiration of the Agreement on Textiles and Clothing in December 2004. The increase in remittances from abroad during this period helped increase imports of non-durable consumer goods from 21.9% of total imports in 2001 to 24.9% in 2005.

Balance of Payments

The current account of the Republic's balance of payments for the past five years has been characterized by deficits, which have been substantially offset by capital and financial account surpluses. Net international reserves declined in 2001 and 2002, reflecting the adjustment to the dollarization of the economy. In 2003, net international reserves rose as a precautionary measure prior to the March 2004 presidential elections. Since the presidential elections of 2004, net international reserves have declined slightly, decreasing 3.1% in 2005 compared to 2004.

The following table sets forth the Republic's balance of payments for the periods presented.

Balance of Payments

	For the year Ended December 31,				
	2001	2002	2003	2004[1]	2005[1]
	(in millions of US dollars, except percentages)				
Current Account	$ (150.3)	$ (405.1)	$ (702.2)	$ (631.8)	$ (786.5)
Trade and services balance	(2,182.9)	(2,104.7)	(2,393.4)	(2,739.4)	(3,079.6)
Exports (FOB goods and services)	3,595.2	3,803.0	4,101.1	4,411.8	4,572.7
Imports (FOB goods and services)	(5,778.1)	(5,907.7)	(6,494.6)	(7,151.2)	(7,652.3)
Income	(265.7)	(323.4)	(423.1)	(460.1)	(571.4)
Transfers	2,298.3	2,022.9	2,114.3	2,567.7	2,864.6
Private	2,258.9	1,997.6	2,100.7	2,554.1	2,845.4
Remittances	1,910.5	1,935.2	2,105.3	2,547.6	2,830.2
Public	39.4	25.3	13.6	13.6	19.2
Capital and financial account	607.0	1,020.6	845.7	251.5	875.2
Capital account	198.9	208.9	112.9	100.3	93.4
Financial account	408.1	811.7	732.8	151.2	781.8
Direct Investment	288.7	495.9	123.1	429.6	300.2
Abroad	9.7	25.7	(18.6)	53.3	(217.3)
In reporting economy	279.0	470.2	141.7	376.3	517.5
Portfolio Investment	29.0	265.6	189.0	(27.8)	180.0
Assets	(126.5)	(289.2)	(263.7)	(209.7)	93.6
Liabilities	155.5	554.8	452.7	181.9	86.4
Other Investment	(87.3)	(73.3)	737.0	(303.1)	242.7
Assets	(629.1)	(223.7)	19.5	(133.8)	(167.5)
Liabilities	541.8	150.4	717.5	(169.3)	410.2
Change in Reserves [2]	177.7	123.5	(316.2)	52.5	58.9
Net errors and omissions	(456.7)	(615.5)	(143.5)	380.3	(88.7)

(1) Preliminary.
(2) Figures in parentheses indicate an increase.

Source: *Banco Central de Reserva de El Salvador.*

Current Account

In the years following the signing of the Peace Accord, the trade deficit grew from US$1.1 billion for 1992 to approximately US$2.2 billion for 2001 and approximately US$3.1 billion for 2005. The increase in the trade deficit reflects the growth of imports at a higher rate than the growth of exports during the period. Imports increased primarily due to remittances from abroad, which are used in El Salvador mainly for consumption, and lower international coffee prices in 2001 and 2002 that restrained the growth in exports. In addition, since 2001, higher petroleum prices have had a negative impact on the current account, particularly from 2003 to 2005. In 2005, the current account deficit increased by US$154.7 million from 2004 due to increase in imports of goods and services that was not offset by the increase in exports and remittances.

In 2004, the deficit in the trade in goods was US$2,739.4 million due to the increase in imports that more than offset the increase in exports. In 2005, the trade deficit increased to US$3,079.6 million due to the growth of imports at a higher rate than the growth of exports. In 2005, petroleum imports totaled approximately US$289 million, which represented a 27.9% increase from 2004. The services balance surplus decreased in 2005 due to higher payments for freight and insurance that were not fully offset by inflows from the tourism sector.

Transfers from abroad in the form of worker remittances increased from US$858.3 million in 1992 to US$2,830.2 million in 2005. Due to the number of Salvadorans who emigrated to escape the civil war as well as those who left the country seeking improved

economic conditions, worker remittances have been a significant factor in the composition of the Republic's current account, and in 2005 represented approximately 36.8% of all current account inflows in the balance of payments.

The impact of these remittances on the Republic's balance of payments has been two-fold. First, by raising national income, worker remittances generally increase private consumption of foreign and domestic goods and services, which could create inflationary pressures. Second, by partially funding the increased demand for imports, the inflow of worker remittances has reduced the current account deficit. There can be no assurances as to the levels of worker remittances in the future, as the level of remittances is subject to various social and economic factors, such as the return to El Salvador of some of the workers currently in the United States, changes in U.S. immigration policy (including the possibility of a future withdrawal of the temporary protected status afforded to Salvadoran immigrants in the United States), the deaths of older recipients of remittances, the eventual employment of younger recipients of remittances and the establishment of families outside of El Salvador by Salvadorans who remain abroad. Nevertheless, remittances (in nominal terms) have grown each year during the period from 2001 through 2005. Remittances in 2005 outpaced remittances in 2004, rising from US$2,547.6 million to US$2,830.2 million (an increase of 11.1%) and represented 16.7% of GDP in 2005, compared to 16.1% of GDP in 2004.

In the years leading up to and immediately following the signing of the Peace Accord, foreign aid (both monetary and in-kind donations) was an important component in the Republic's balance of payments, partially offsetting the trade deficit. The level of this foreign aid reached US$284.1 million for 1994 partially due to the implementation of the Peace Accord and fell to US$187.8 million for 2000. The level of foreign aid (both monetary and in-kind donations) in 2001 and 2002 rose to US$345.9 million and US$302.2 million, respectively, primarily due to aid related to the January and February 2001 earthquakes. For 2004, foreign aid (both monetary and in-kind donations) declined to US$144.7 compared to US$174.1 million in 2003. Foreign aid in 2005 (both monetary and in-kind donations) increased slightly from 2004 and totaled US$149.6 million.

Capital and Financial Account

For the five-year period ending December 31, 2005, the capital account showed a surplus mainly due to transfers from abroad, primarily through grants from bilateral and multilateral sources. In 2001 and 2002, transfers from grants increased following the earthquakes that struck El Salvador in 2001. In 2004, the capital account registered a surplus of US$100.3 million mainly due to grants received from the United States, Europe and international organizations. In 2005, the capital account registered a surplus of US$93.4 primarily due to transfers of grants from bilateral and multilateral sources, the proceeds of which have been allocated to government projects, non-governmental organizations and churches.

For the five-year period ending December 31, 2005, the financial account consistently reflected a surplus primarily due to inflows from foreign direct investment, issuances by the government of external notes and loans to private banks and the government. In 2005, the financial account surplus was US$781.8 million, compared to US$151.2 million in 2004, mainly due to the issuance by the government of US$375.0 million in external notes in June 2005, other loans to the government and foreign direct investment flows.

During the same five-year period, portfolio investments were affected primarily due to the issuance by the government of external notes amounting to US$353.5 million in 2001, US$1,251.5 million in 2002, US$348.5 million in 2003, US$286.5 million in 2004 and US$375.0 million in 2005, as well as an increase in loans made abroad by Salvadoran banks.

The *Ley de Inversiones* (the "Investment Law"), enacted in 1999, implements reporting requirements that permit a more accurate measurement of foreign direct investment in El Salvador. The Investment Law also clarifies certain rules directed to protect foreign investments in El Salvador. Foreign investment must be registered with the National Investment Office of the Ministry of Economy. While the Investment Law recognizes the protection of investor's property rights, expropriation is permitted for public interest reasons with just compensation paid to the investor. There are no limitations on repatriation of profits. Registered foreign investors are entitled to repatriate their investment plus any capital gains and are exempted from withholding tax on dividends. Investors are still responsible, however, for income tax, labor, social security, bankruptcy and other legal obligations. Foreign direct investment in 2005 declined to US$300.2 million, compared to US$429.6 million in 2004, primarily due to the sale of CTE in December 2004, which resulted in increased levels of foreign direct investment in 2004.

Foreign Currency Reserves

At December 31, 2005, net international reserves were US$1,829.4 million, a decrease of 3.1% from December 31, 2004. As of December 31, 2005, 4.3% of the Republic's net international reserves were held in cash compared to 3.7% as of December 31, 2004. Both percentages reflected historically high cash reserves to support the implementation of the Monetary Integration Act. The decrease in the level of international reserves from December 31, 2004 was due to withdrawals of deposits by the government, the decrease in the reserve requirements for banks and payments made on securities that matured.

The following table sets forth the net international reserves of the Central Bank for the periods presented.

Net International Reserves

	At December 31,				
	2001	2002	2003	2004	2005
	(in millions of US dollars, except months)				
Assets:					
Gold[1]	$ 117.8	$ 117.8	$ 117.8	$ 138.9	$ 110.2
Foreign currencies	1,535.3	1,422.3	1,754.4	1,714.1	1,684.9
Cash	50.6	54.3	85.3	70.1	78.9
Deposits abroad	181.3	121.6	515.9	474.0	580.3
Investments	1,303.3	1,246.4	1,153.2	1,170.0	1,025.7
Special drawing rights	31.3	33.8	37.0	38.7	35.7
Other	27.1	16.6	0.8	1.1	2.2
Liabilities:					
Total liabilities	2.0	1.7	4.2	4.5	3.6
Net international reserves	$ 1,709.5	$ 1,588.8	$ 1,905.8	$1,888.4	$1,829.4
Coverage of imports of goods excluding *maquila* (in months)[2]	5.3	4.9	5.2	4.6	4.1

(1) For 2001, 2002, 2003 and 2004, gold was valued at US$251.10/troy ounce, US$251.10/troy ounce, US$251.20/troy ounce and US$331.42/troy ounce, respectively. For 2005, gold was valued at US$337.89/troy ounce.
(2) Net international reserves over average monthly imports.

Source: *Banco Central de Reserva de El Salvador.*

Exchange Rate Policy and Foreign Exchange Rates

From 1989 to December 31, 2000, El Salvador set no official exchange controls on the *colón* and the exchange rate was permitted to float freely based on market forces. During this period, the Central Bank had a policy of purchasing and selling US dollars periodically for the purpose of limiting excessive volatility in the *colón*/US dollar exchange rate, although no official fluctuation range was established.

On November 30, 2000, the Legislative Assembly approved the Monetary Integration Act, proposed by President Flores on November 22, 2000, fixing the *colón* to the US dollar at ¢8.75 to US$1.00. This legislation went into effect on January 1, 2001. Pursuant to this legislation, the US dollar is legal tender in El Salvador and is allowed to circulate freely in the Salvadoran economy along with the *colón.* Further, the US dollar is the unit of account for the financial system in El Salvador and all of the operations and accounting of the financial system are denominated in US dollars. All deposits, credits, pensions and other operations of the financial system were converted to US dollars on January 1, 2001. Non-financial firms may use either *colones* or US dollars to express their financial records and accounting. Salaries and wages may be denominated in either *colones* or US dollars. Prices of products and services can be specified in *colones* or US dollars but were required to be labeled in both currencies until July 1, 2001. Four cases have been filed with the Supreme Court challenging the constitutionality of the Monetary Integration Act. The Supreme Court dismissed each of the cases and upheld the Monetary Integration Act.

The Central Bank exchanges *colones* for US dollars through the banking system and banks are prohibited from charging commissions for the exchange of *colones* to US dollars and US dollars to *colones.* Each bank must maintain a liquid reserve of US dollars at the Central Bank as a percentage of its obligations. The power of the Central Bank to issue new *colones* or coins ceased as of January 1, 2001.

The benefits that the government sought as a result of the Monetary Integration Act included the following:

- a reduction in interest rates as a result of a reduction in foreign exchange risk;
- the development of a greater variety of financial instruments that are typically not denominated in *colones* but which are common in US dollars;
- an increased level of foreign investment in the financial system, attracted by the protection against devaluation and the attendant improvement in El Salvador's creditworthiness and stability; and
- an increase in the local savings rate due to a reduction in inflation and devaluation risk.

As of December 31, 2005, 95.2%, or US$677.9 million, of all cash in circulation was in US dollars. The domestic currency interest rate (passive basic rate — 180 days) decreased from 10.7% at December 31, 1999 to 3.4% at December 31, 2005. Foreign direct investment in the financial system in El Salvador was US$41.4 million in 2001, US$12.1 million during 2002, US$15.5 million in 2003, US$3.2 million in 2004 and US$102.2 million in 2005. The increase in foreign direct investment in the financial system in 2005 was primarily attributable to the merger of Scotiabank and *Banco de Comercio de El Salvador* and the acquisition of *Banco Salvadoreño* by *Grupo Banistmo, S.A.* (Panama) by means of a public tender offer initiated in November 2005.

MONETARY SYSTEM

The Central Bank (*Banco Central de Reserva de El Salvador*)

Created in 1934, the Central Bank was reorganized in 1991 with the objectives of controlling inflation, preserving the internal and external value of the national currency and maintaining adequate levels of liquidity in the financial system. The Central Bank is prohibited from financing, directly or indirectly, the government or any state-owned entities, or from investing in securities issued by any of them.

The Central Bank is an independent institution governed by a board of six members who are appointed to five-year terms and are removable only for cause. The President of the Central Bank, one of the six board members, is appointed by the President of the Republic. The Executive Cabinet chooses the remaining Board members pursuant to nominations from the banks, the Economic Cabinet, the private sector and professional organizations.

The Central Bank issues *Certificados Negociables de Liquidez* ("CENELIs"), which are short-term US dollar-denominated liquidity management instruments that are auctioned by the Central Bank weekly every Monday, and *Bonos BC*, which are US-dollar denominated medium-term instruments intended to provide greater stability and liquidity to the Central Bank. As of December 31, 2005, a principal amount of approximately US$313.9 million of CENELIs and US$143.5 million of *Bonos BC* were outstanding, compared to US$391.7 million and US$143.5 million, respectively, as of December 31, 2004.

Financial Sector

The entities participating in the financial system in El Salvador include commercial banks (two are state-owned banks specializing in incentive credit), insurance companies, broker/dealers, one security depository, four operating rating agencies, bonded warehouses, financial leasing companies, factoring companies, the El Salvador Stock Exchange and the Deposit Guaranty Institute.

In the early 1980s, the government nationalized all commercial banks and savings and loans associations. During the ensuing years, the operation of the financial system was frequently in the hands of political appointees, and by 1989, the system was essentially insolvent. As the state-owned banks lost public confidence, private entities were formed and accepted deposits and extended credits. Beginning in 1989, the Republic began the modernization of the financial system through the reorganization of the Central Bank, the regulation of financial institutions and the privatization of the banks through the sale of shares to bank employees and individual shareholders.

Following the privatization of the banking system in 1992, the Central Bank recognized an account receivable from the government for approximately US$100 million in connection with bad loans the Central Bank had absorbed from the privatized entities. Since such time, the financial sector in El Salvador has grown steadily and, at December 31, 2005, the aggregate value of deposits in the system was approximately US$7 billion, including deposits held by the two state-owned banks.

The Banking Law imposed on financial institutions capital adequacy requirements and other standards corresponding to the Basle Accords. Under applicable law, the capital adequacy requirement of 11.5% in 2004 was increased to 12.0% in 2005. The Superintendency of the Financial System supervises compliance with these standards. The Banking Law, enacted in 1999, includes limits on loans to shareholders, establishes minimum capital requirements and regulates supervisory powers and the independence of the Superintendency of the Financial System. The Deposit Guaranty Institute, created by the Banking Law, guarantees deposits up to US$7,890 and has the authority to contribute funds to banks with liquidity problems. It was originally funded by the government and currently receives obligatory contributions from banks operating in the financial system. The Banking Law also governs the transparency and reporting requirements of banks, imposes audit standards and limits related party loans and other transactions to increase the responsibility of the banks. Subsequent amendments to the Banking Law provide greater protections to depositors by creating stricter capital and risk management requirements and granting broader authority to the Superintendency of the Financial System with respect to troubled financial institutions.

In 2005, the Superintendency of the Financial System raised the paid-in capital stock requirement for banks, increasing it from US$12.0 million to US$13.0 million.

Commercial Banks

At December 31, 2005, El Salvador had 11 private commercial banks, including two foreign banks. Along with the two foreign banks, five other commercial banks have substantial foreign ownership. In 2005, Scotiabank and *Banco de Comercio de El Salvador*, two private commercial banks, merged to form Scotiabank El Salvador. In addition, in 2005 *Grupo Banistmo, S.A.* (Panama) acquired

a majority stake in *Banco Salvadoreño*. At December 31, 2005, the total assets of Salvadoran commercial banks, excluding the two state-owned banks, were US$10.7 billion.

Commercial banks are under the supervision of the Superintendency of the Financial System and are subject to periodic reporting requirements and mandatory audits. Commercial banks are required to maintain a certain percentage of their deposits as a reserve deposited at the Central Bank in the form of cash or securities issued by the Central Bank. See "— Interest Rates and Money Supply."

Banking System[(1)]

	For the Year Ended December 31,				
	2001	2002	2003	2004	2005
Total assets (in billions of US dollars)	8.7	8.9	9.7	10.2	10.7
Non-performing loans (as % of total loans)	3.5%	2.8%	2.3%	2.1%	1.9%

(1) Excluding the two state-owned banks.

Source: *Banco Central de Reserva de El Salvador.*

Non-banking Financial Intermediaries

The financial system in El Salvador also includes non-banking financial intermediaries, consisting primarily of cooperatives/credit unions (entities constituted to provide financial services to their members), federations (organizations of cooperatives engaging in the same type of financial activity that provide assessment and technical assistance services to their member cooperatives) and savings and loans associations (non-governmental financial entities that may collect deposits from the public and make loans). The non-banking financial intermediaries are supervised by the Superintendency of the Financial System pursuant to the *Ley de Intermediarios Financieros No Bancarios* (the "Non-Banking Financial Intermediaries Law"), which became effective July 1, 2001. The purpose of the creation of these entities by the Non-Banking Financial Intermediaries Law is to improve access to the financial system for micro and small enterprises through competition.

Pension Funds

In 1996, the Republic enacted a new pension system law, pursuant to which a substantial portion of the public, pay-as-you-go pension system was replaced by a private system based on individual accounts. Under the private system, which became effective April 15, 1998, participating workers make monthly contributions to private pension funds which invest in permitted Salvadoran securities. Currently, there are two operating pension funds, plus one additional fund which is in liquidation and the assets of which will be transferred to the other two funds. See "The Salvadoran Economy — Employment and Wages — Pension Reform."

State-Owned Financial Institutions

In addition to the Central Bank and the mezzanine bank *Banco Multisectorial de Inversiones,* the state owns four other financial institutions, each of which was chartered for the purpose of extending credit to a specific sector of the economy:

- *Banco de Fomento Agropecuario* (Rural Development Bank);
- *Banco Hipotecario de El Salvador, S.A.* (Mortgage Bank of El Salvador);
- *Fondo de Financiamiento y Garantía de la Pequeña Empresa* (Small Business Finance and Guaranty Fund); and
- *Fondo Social para la Vivienda* (Social Housing Fund).

Certain of these institutions extend credit on favorable terms. These state-owned entities are governed by special legislation in addition to the general rules applicable to private financial institutions and, at December 31, 2005, had an aggregate of approximately US$1.2 billion in total assets and approximately US$1.0 billion in total liabilities.

Capital Markets

El Salvador's capital markets have grown in recent years as the financial system has modernized; however, retail trading of debt and equity securities of private Salvadoran issuers is relatively new and has remained limited thus far. Most of the trading on Salvadoran capital markets involves the purchase and sale of government securities. The El Salvador Stock Exchange opened in 1992

and currently lists 53 companies, 4 public institutions and 15 sovereign states and foreign central banks and 2 international entities. In 2004, securities exchanged on the El Salvador Stock Exchange increased 17.8% compared to 2003, due primarily to the government sale of CTE and the merger of Scotiabank and *Banco de Comercio de El Salvador* by means of a public tender offer that began in 2004. In 2005, US$7.5 billion worth of securities were exchanged on the El Salvador Stock Exchange compared to US$9.1 billion in 2004, representing a decrease of 17.6%. The Salvadoran capital markets are regulated by the *Ley Orgánica de la Superintendencia de Valores* (the "Superintendency of Securities Law") enacted in 1996 and are supervised by the Superintendency of Securities.

Interest Rates and Money Supply

The following table sets forth the average annual interest rates for the periods presented.

Average Interest Rates[1]

	2001	2002	2003	2004	2005
	(in percentages)				
Loans					
Short-term	9.6%	7.1%	6.6%	6.3%	6.9%
Long-term	10.8	8.7	8.0	7.7	8.2
Interbank	5.3	4.4	3.9	4.5	5.3
Central Bank[2]	4.1	3.5	3.2	4.4	6.5
Deposits					
30-day	5.4	3.1	3.2	3.2	3.2
180-day	5.5	3.4	3.4	3.3	3.4

(1) Market rates other than with respect to the Central Bank.
(2) Rates are the interest rates charged by the Central Bank to *Banco Multisectorial de Inversiones* in December of each year.

Source: *Banco Central de Reserva de El Salvador.*

As a result of the Monetary Integration Act and the decrease of interest rates internationally, the average interest rates on short-term and long-term loans, which reached historical lows in 2004, fell to 6.9% and 8.2%, respectively, in 2005. In 2005, 30-day and 180-day term deposits fell to 3.2% and 3.4%, respectively.

The following table sets forth the principal monetary indicators for the periods presented.

Principal Monetary Indicators

	At December 31,				
	2001	2002	2003	2004	2005[1]
	(in millions of US dollars)				
Currency in circulation	$ 220.8	$ 61.2	$ 36.4	$ 35.4	$ 34.2
Demand deposits	950.4	995.1	1,032.2	1,167.0	1,257.2
M1	1,171.2	1,056.4	1,068.7	1,202.5	1,291.3
Savings	1,781.1	1,915.5	2,005.2	2,046.2	2,136.9
Term deposits	3,248.5	3,044.2	2,974.4	2,943.5	2,924.6
M2 (M1 plus savings plus term deposits)	6,200.8	6,016.1	6,048.3	6,192.2	6,1352.8
Deposits in foreign currency	0.0	0.0	0.0	0.0	0.0
Others	323.5	340.7	416.7	465.3	631.3
M3 (M2 plus deposits in foreign currency plus others)	$ 6,524.3	$ 6,356.8	$ 6,465.1	$ 6,657.5	$ 6,894.2

(1) Preliminary.

Source: *Banco Central de Reserva de El Salvador.*

From 1997 to 2000, the Central Bank influenced the money supply through the issuance of *Certificados de Administración Monetaria* at par and, from 1998 to 2000, through the issuance of *Certificados de Administración Monetaria a Descuento*, both of which were *colón*-denominated instruments, which have not been issued since the effectiveness of the Monetary Integration Act in January 2001. The reserve requirements applicable to checking accounts, savings accounts and deposit certificates are currently 25.0%, 20.0% and 15.0%, respectively. As a precautionary measure to provide liquidity in anticipation of the presidential elections in 2004, the Superintendency of the Financial System required all commercial banks gradually to increase their reserves by an additional 9.0% of total deposits, 3.0% of which was required to be in cash and 6.0% of which was required to be in the form of securities issued by the Ministry of Finance or the Central Bank, or highly liquid external securities with minimum credit ratings requirements. In 2004, the 3.0% additional cash reserve requirement was eliminated while the 6.0% additional reserve requirement with respect to such securities was maintained. In April 2005, the 6.0% additional reserve requirement with respect to these securities was reduced to 3.0% of total deposits and modified to require reserves in the form of highly liquid external securities with minimum credit ratings requirements or deposits at the Central Bank.

Effective January 1, 2001, pursuant to the Monetary Integration Act, the US dollar is legal tender and permitted to circulate freely in El Salvador. Cash in circulation, which is a measure of *colones* in circulation and does not include US dollars in circulation in El Salvador, decreased by approximately 93.8% from December 31, 2000 to December 31, 2005, as the US dollar was integrated into the

Salvadoran economy. Further, pursuant to the Monetary Integration Act, all *colón*-denominated deposits were converted into US dollars effective January 1, 2001, and the US dollar became the unit of account in the financial system. As a result, US dollar deposits that in prior periods were classified as deposits in foreign currency are for periods from and after January 1, 2001 classified as demand deposits, savings or term deposits, as applicable.

Inflation

El Salvador has experienced moderate levels of inflation, even during episodes of unfavorable economic conditions. The highest rate of inflation registered in El Salvador was 31.9%, which occurred in 1985. The establishment of an independent central bank caused this rate to decline substantially and, since 1991, the rate of inflation has continued to decline. The enactment of the Monetary Integration Law has caused El Salvador's inflation to approach the inflation levels of the United States.

The following table sets forth the rate of inflation in the Republic as measured by the CPI for the periods presented.

Inflation

	For the Year Ended December 31,				
	2001	2002	2003	2004	2005
Inflation	1.4%	2.8%	2.5%	5.4%	4.3%

Source: *Dirección General de Estadística y Censos (DIGESTYC).*

In 2001, the inflation rate decreased to 1.4%, continuing the post-Peace Accord downward trend that had been interrupted during the 1998-2000 period by the distorting effects that Hurricane Mitch had on prices. Inflation was also influenced by the elimination of a charge to consumers on purchases of gasoline of approximately six *colones* per gallon which had subsidized diesel fuel for public transportation, as well as the decrease in international oil prices during the fourth quarter of 2001.

In 2002, the inflation rate increased to 2.8%. The increase in 2002 was primarily attributable to the increases in gasoline and electricity prices resulting from rising international oil prices, as well as to an increase in rates charged by telecommunication companies. In 2003, inflation was slightly lower than in 2002 at 2.5%, but was still within the target of 2.0% and 3.0% for the year, primarily due to higher food and housing prices. The inflation rate in 2004 reached 5.4% primarily due to higher oil prices that affected the price of gasoline, transportation and food. In 2005, the inflation rate declined to 4.3%. During 2005, prices continued to be affected directly and indirectly by high oil prices, which resulted in higher costs for fuel, transportation services and food. Further, in October 2005, food prices rose temporarily due to Hurricane Stan, which caused the closure of certain highways.

PUBLIC SECTOR FINANCES

Overview

Budget Process

El Salvador's Constitution requires that for each fiscal year a general budget must be prepared and submitted to the Legislative Assembly for approval. The budget contains estimates of revenues expected to be collected, and authorizes expenditures during the fiscal year. State-owned autonomous entities, other than those in the financial public sector, prepare individual budgets that they submit to the Legislative Assembly for approval.

The *Ley de Administración Financiera del Estado* (the "Law on the Administration of Public Finances" or "AFI"), a statute enacted in 1995 to regulate several financial matters of the Republic, implements the constitutional principles relating to budgetary matters. Pursuant to the AFI, the Republic's nonfinancial public sector's budget consists of the General Budget (as defined below), budgets for municipalities and the Salvadoran Social Security Institute and budgets for the non-financial autonomous entities (such as CEL and CEPA).

The Ministry of Finance prepares the general budget (the "General Budget"), which consists of the budget for the agencies and ministries of the central government and the budgets for the legislative and judicial branches, by following budgetary guidelines adopted by the president and the cabinet. The Supreme Court prepares the budget for the judicial branch, which it submits to the Ministry of Finance for inclusion, without modifications, in the General Budget. The legislative branch approves the budget for the Legislative Assembly after consultation with the Executive Branch. Simultaneously with the presentation of the General Budget, the Ministry of Finance submits individual budgets to the Legislative Assembly prepared by each non-financial autonomous entity, with such modifications as the Ministry of Finance deems appropriate. Pursuant to the Constitution, at least 6.0% of the central government's current revenues contained in the General Budget must be allocated to the judiciary and, pursuant to the Economic and Social Development Fund Law, 7.0% of net current revenues must be allocated to municipalities.

The Legislative Assembly must approve the budget for the non-financial public sector before December 31 of each year. In the event the new budget is not approved by January 1, the budget for the prior year remains in effect until the Legislative Assembly approves the new budget. The Ministry of Finance, however, has authority to make changes to the extended budget by executive decree in order to meet existing obligations, including debt service obligations, of the Republic in excess of those of the prior year. Expenditures are capped at the levels in the budget approved by the Legislative Assembly.

At the end of each fiscal year, the Executive Branch must submit a report on the execution of the budget to the Legislative Assembly and to the *Corte de Cuentas de la República,* the supervisory board in charge of overseeing the Republic's public finances.

Fiscal Policy

The government has been implementing fiscal policies designed to increase its overall tax revenues, while allocating its expenditures in order to further its economic and social policies, principally combating poverty, improving the education system, enhancing security throughout the country, increasing the availability of healthcare and providing opportunities for job creation in the private sector.

With respect to government expenditures, the government's fiscal policies contemplate:

- increasing expenditures in education under the *Plan Nacional de Educación 2021*;
- reducing overall government expenditures for subsidies in the areas of electricity and water consumption and public transportation, while focusing subsidies on those sectors of the population most in need of such assistance;
- mandating that all public sector entities apply strict measures aimed at increasing public savings;
- increasing spending on programs designed to enhance security throughout the country, such as through the establishment of a rural police force;
- implementing a conditional cash transfer program, known as *Programa Red Solidaria* or the Solidarity Network, to encourage extremely poor families to send their 5-15 year old children to pre-school and primary school, fully immunize children younger than 5, and regularly monitor the health and nutrition status of pregnant mothers and infants; and

- increasing expenditures in the healthcare sector to, among other things, increase the availability of healthcare services throughout the country, principally in rural areas.

In terms of revenues, the government has been implementing tax reforms designed to increase revenues by expanding the overall tax base, while minimizing increases of existing taxes and limiting the imposition of new taxes or levies for specific purposes, such as the special contribution levies imposed on lodging and airport departures.

Non-Financial Public Sector Revenues and Expenditures

The following table sets forth actual revenues and expenditures for the consolidated non-financial public sector for the periods presented, as well as revenues and expenditures budgeted for 2006.

Non-Financial Public Sector
Consolidated Revenues and Expenditures[(1)]

	For the Year Ended December 31,					
	2001	2002	2003	2004	2005[(2)]	2006 Budgeted[(3)]
	(in millions of US dollars, except percentages)					
Revenues						
Current revenues[(4)]	$ 2,075.3	$ 2,193.4	$ 2,442.6	$ 2,628.2	$ 2,832.0	$ 2,942.9
Capital revenues	0.9	64.9	0.4	0.1	0.1	5.2
Foreign aid	61.0	49.9	69.7	48.3	52.1	25.8
Total revenues	$ 2,137.2	$ 2,308.2	$ 2,512.7	$ 2,676.6	$ 2,884.3	$ 2,974.0
Expenditures						
Current expenditures[(4)]	$ 2,022.0	$ 2,077.2	$ 2,274.1	$ 2,410.7	$ 2,585.1	$ 2,544.7
Consumption	1,512.9	1,526.9	1,667.9	1,751.1	1,885.1	1,933.4
Interest	200.2	245.5	307.1	334.4	389.4	424.3
Transfers	308.9	304.8	299.0	325.1	310.6	187.1
Capital expenditures	619.6	706.2	549.5	369.1	481.3	512.7
Gross investment	602.2	609.4	541.6	334.5	429.6	479.5
Capital transfers	17.4	96.9	7.9	34.6	51.7	33.2
Net lending	(0.2)	(0.3)	(0.6)	(0.5)	(1.4)	(0.7)
Total expenditures	$ 2,641.4	$ 2,783.1	$ 2,823.0	$ 2,779.3	$ 3,065.0	$ 3,.056.8
Current account surplus (deficit)[(5)]	$ 53.3	$ 116.2	$ 168.5	$ 217.5	$ 246.9	$ 398.2
Surplus (deficit) excluding foreign aid	(565.2)	(524.8)	(380.0)	(151.0)	(232.8)	(108.6)
Surplus (deficit) including foreign aid	(504.2)	(474.9)	(310.3)	(102.7)	(180.7)	(82.8)
External financing	614.9	1,253.5	432.1	241.6	342.6	383.9
Internal financing[(6)]	(110.7)	(778.5)	(121.8)	(138.8)	(161.9)	(301.1)
Current account surplus (deficit)/Nominal GDP	0.4%	0.8%	1.1%	1.4%[(2)]	1.5%	2.3%
Surplus (deficit) excluding foreign aid/Nominal GDP	(4.1)%	(3.7)%	(2.5)%	(1.0)%[(2)]	(1.4)%	(0.6)%
Surplus (deficit) including foreign aid/Nominal GDP	(3.6)%	(3.3)%	(2.1)%	(0.6)%[(2)]	(1.1)%	(0.5)%
Nominal GDP	$ 13,812.7	$ 14,306.7	$ 15,046.7	$ 15,821.6[(2)]	$ 16,974.0	$ 17,640.1

(1) All figures are presented on a cash basis.
(2) Preliminary.
(3) Budgeted figures are based on amounts contained in the 2006 budget approved by the Legislative Assembly.
(4) Current revenues and current expenditures are presented on a gross basis.
(5) The current account equals current revenues less current expenditures.
(6) Includes pension costs.

Source: *Ministerio de Hacienda.*

In 2000, the non-financial public sector deficit was equal to 3.0% of nominal GDP, primarily due to an increase in the electricity subsidy during the first half of 2000 in order to lessen the impact of higher electricity rates. Although the current account balance improved from a deficit of US$80.2 million in 2000 to a surplus of US$53.3 million in 2001, the non-financial public sector fiscal deficit in 2001 was equal to 3.6% of GDP, primarily due to the investment by the government of US$194.5 million in the earthquake reconstruction effort, as well as additional expenditures of US$7.9 million for emergency relief relating to the earthquakes.

In 2002, the non-financial public sector deficit declined to US$475.0 million, equivalent to 3.3% of 2002 nominal GDP and US$8.3 million less in nominal terms than provided for in the budget. The non-financial public sector deficit included spending of US$282.0 million, or 2.0% of GDP, related to the earthquake reconstruction effort. Excluding expenditures relating to the reconstruction effort, the underlying deficit decreased from US$309.7 million in 2001 to US$193.0 million in 2002. Reconstruction spending increased from US$202.4 million in 2001 to US$282.0 million in 2002, an increase equivalent to 0.6% of GDP. The non-

financial public sector deficit declined further to US$310.3 million in 2003, equivalent to 2.1% of GDP, and to US$102.7 million in 2004, equivalent to 0.6% of GDP. The non-financial public sector deficit in 2004 was US$40.5 million less than the target set forth in the 2004 budget.

In 2005, the non-financial public sector deficit was equal to US$180.7 million or US$10.1 below the target set forth in the 2005 budget. The non-financial public sector deficit was 1.1% of nominal GDP in 2005, lower than the 1.2% target set forth in the 2005 budget. The non-financial public sector deficit figure for 2005 reflects total revenues of US$142.3 million over the 2005 budget projections, which was partially offset by expenditures of US$132.2 million over the 2005 budget projections. The increase in total revenues was primarily due to higher than forecasted tax collections due in part to the approval and implementation of certain tax reforms. On the expenditure side, expenditures above those that were budgeted were mainly the result of government subsidies to lessen the impact of high international oil prices affecting the prices of natural gas, electricity and public transportation.

Central Government Revenues

The following table shows the composition of the Salvadoran central government's revenues and foreign aid for the periods presented.

Central Government Revenues and Foreign Aid[1]

	For the Year Ended December 31,				
	2001	2002	2003	2004	2005[5]
	(in millions of US dollars)				
Tax revenues[2]					
Income	$ 455.4	$ 480.2	$ 530.1	$ 564.7	$ 699.6
Property transfers	11.6	13.0	14.5	15.3	16.3
Imports	146.0	154.8	177.6	177.1	180.9
Consumption	49.3	66.5	61.7	74.2	95.4
Value added tax	866.3	903.9	960.3	1,026.2	1,169.9
Others	0.1	1.8	0.9	0.6	0.9
Special contributions (FOVIAL)[3]	1.6	64.8	67.2	67.1	66.4
Total tax revenues	1,530.3	1,685.0	1,812.3	1,925.2	2,229.4
Non-tax revenues[4]	87.0	119.5	123.8	205.6	115.3
Total current revenues	1,617.3	1,804.5	1,936.1	2,130.8	2,344.7
Capital revenues	0.5	2.4	0.4	0.1	0.1
Foreign aid	32.1	18.5	49.4	23.9	6.6
Total revenues	$ 1,649.9	$ 1,825.4	$ 1,985.9	$ 2,154.8	$ 2,351.4

(1) All figures are presented on a cash basis.
(2) Tax revenues are presented on a gross basis.
(3) In 2001, the government imposed a levy, the *Fondo de Conservación Vial* (Road Maintenance Fund or "FOVIAL"), of US$0.20/gallon on gasoline and diesel which is specifically used for road maintenance and improvements.
(4) Includes fines, license fees, plate issuance fees, passport fees, and gasoline related revenues.
(5) Preliminary.

Source: *Ministerio de Hacienda.*

One of the challenges facing the government is the collection of income taxes, as evidenced by the dependence of the government on indirect taxes such as the value added tax. To a lesser extent, collection of the value added tax is also a challenge, particularly in connection with transactions related to the informal sector of the economy. Continuing a trend that began in 1992, the value added tax was the principal component of tax revenues for 2005, generating approximately 52.5% of total tax revenues compared to 53.3% for 2004. Revenues from the value added tax grew 14.0% during 2005 compared to 2004 and grew 6.9% during 2004 compared to 2003. Income tax revenues accounted for approximately 31.4% of tax revenues for 2005, compared to 29.3% for 2004. Income tax revenues grew 23.9% during 2005 compared to 2004 and grew 6.5% during 2004 compared to 2003. Import duties, the third largest component of tax revenues, accounted for approximately 8.1% of tax revenues for 2005. The FOVIAL special contributions accounted for 3.0% of tax revenue for 2005.

The existence of a large informal sector of the economy inhibits tax collection, but the value added tax assists the government in collecting revenues from certain transactions in which that sector engages. Tax revenues increased 15.8% during 2005 as compared to an increase of 6.2% for 2004 and 7.6% for 2003. See "— Taxation."

Central Government Expenditures

The following table shows the actual central government expenditures for the periods presented.

Central Government Expenditures[1]

	For the Year Ended December 31,				
	2001	2002	2003	2004	2005[2]
	(in millions of US dollars, except percentages)				
Education	$ 394.1	$ 451.2	$ 451.0	$ 457.3	$ 493.0
Public health	205.0	205.2	232.3	230.4	260.9
Public security[3]	155.9	182.0	188.1	188.8	197.8
Public works[4]	130.2	168.7	165.3	122.4	97.8
Judiciary	106.6	104.2	113.5	120.9	130.0
Defense	130.5	107.1	106.5	106.9	107.2
Presidency	73.0	58.7	61.4	77.4	91.3
Finance[5][6]	56.6	42.0	38.6	39.4	48.1
Agriculture	25.6	25.0	25.9	27.6	33.2
Foreign relations	23.4	23.8	22.1	25.2	29.4
Economy	39.7	19.4	20.8	20.0	26.2
Attorney General	18.5	19.2	19.5	19.6	19.6
Electoral tribunal	10.7	25.1	21.0	18.6	10.2
Controller	13.0	14.4	18.1	17.7	19.0
Legislature	15.5	16.7	17.5	16.9	19.6
General Prosecutor	12.9	12.5	12.6	12.7	14.6
Labor	6.4	6.2	6.1	7.2	6.0
Environmental	4.1	5.5	5.7	5.5	5.9
National Judicial Council	3.5	3.9	3.6	3.9	3.9
Defense of human rights	3.3	3.6	3.5	3.9	3.9
Civil service tribunal	0.1	0.2	0.2	0.3	0.2
Tourism	0.0	0.0	0.0	0.1	3.2
Interior[3]	36.2	0.0	0.0	0.0	0.0
Housing and urban development	7.3	0.0	0.0	0.0	0.0
Transport	5.3	0.0	0.0	0.0	0.0
Public Treasury[6]	491.1	638.7	729.8	746.2	875.1
Interest payments	176.2	222.8	294.8	321.3	371.1
Current transfers	152.1	234.8	260.4	213.8	232.9
General obligations	136.6	154.7	179.1	194.2	216.9
Other obligations	15.5	80.1	81.3	19.6	15.9
Capital transfers	162.9	181.0	174.6	211.1	271.1
Financial investments	0.0	0.0	0.0	0.0	0.0
Total	$ 1,968.5	$ 2,133.2	$ 2,263.2	$ 2,268.9	$ 2,496.3
Central government expenditure/Nominal GDP	14.3%	14.9%	15.0%	14.3%[2]	14.7%

(1) All figures are presented on a cash basis.
(2) Preliminary.
(3) Includes expenditures of *Policía Nacional Civil* ("National Civil Police") and *Academia Nacional de Seguridad Pública* ("National Police Academy") and the Ministry of Justice budget. In June 2001, the Ministry of Justice and Public Safety merged with Ministry of the Interior to form the Ministry of Governance.
(4) Includes Housing, Urban Development and Transportation in 2002.
(5) Includes operating expenses of the Ministry of Finance.
(6) Excludes amortizations.

Source: *Ministerio de Hacienda.*

After the signing of the Peace Accord in 1992, government expenditures on public works, public health, education and human rights and law enforcement increased, while defense spending decreased as a result of the termination of the armed conflict and the demobilization of military personnel. Expenditures relating to social goals, including health, education and housing represented approximately 21.0% of government expenditures in 1992 and 38.6% in 2005, compared to 38.4% for 2004 and 36.7% for 2003.

Central government expenditures increased from US$1,968.5 million in 2001 (14.3% of GDP) to US$2,133.2 million in 2002 (14.9% of GDP), reflecting the increase in spending related to social goals, including education, health and other social programs, such as the hiring of new teachers, doctors and nurses, spending on construction and maintenance of roads, as part of the reconstruction program after the 2001 earthquakes, and an increase in expenditures related to public security.

The increases in expenditures relating to social goals and public security were partially affected by reforms undertaken during 2001 in order to reduce central government expenditures. The reforms included:

- the elimination prior to 2005 of subsidies for public transportation;
- the reduction or elimination of subsidies for middle- and high-income households and businesses for electricity and water consumption; and
- an amendment to the Civil Service Law which enables the government to implement a more flexible public sector employment policy.

Central government expenditures increased 6.1% in nominal terms from US$2,133.2 in 2002 to US$2,263.2 in 2003. This increase was mainly attributable to an increase in government expenditures in public health and increased interest payments under the external notes issued in 2002 to finance the reconstruction due to the earthquakes in 2001.

In 2004, central government expenditures as a percentage of nominal GDP decreased to 14.3% compared to 15.0% in 2003. Central government expenditures on wages and salaries for 2004 rose by 1.3% in nominal terms compared to 2003 and were 4.7% of GDP. Overall expenses increased to approximately US$2,268.9 million in 2004 compared to approximately US$2,263.2 million in 2003. Central government expenditures in 2004 increased in part due to the impact of higher international oil prices on certain government subsidies in the areas of public transportation and electricity.

In 2005, central government expenditures as a percentage of nominal GDP increased to 14.7% compared to 14.3% in 2004, primarily due to increased healthcare and education expenses. Central government expenditures on wages and salaries for 2005 rose by 2.7% in nominal terms compared to 2004 and represented 4.5% of GDP. Overall expenses increased to approximately US$2,496.3 million in 2005 compared to approximately US$2,268.9 million in 2004.

2006 Budget

The 2006 budget, submitted to the Legislative Assembly in September 2005 and approved on December 21, 2005, contemplates a deficit of 0.5% of GDP for the non-financial public sector (including expenditures related to the reconstruction effort estimated at 0.5% of GDP and excluding obligations related to the pension system estimated at 2.3% of GDP). The main assumptions underlying the 2006 budget include an inflation rate between 3.0% and 4.0%, a real GDP growth rate between 3.0% and 4.0%, remittances from abroad growing at 10.0% relative to the prior year, stable coffee prices and a rate of growth for the U.S. economy similar to that of 2005.

Taxation and Customs

The Salvadoran Constitution authorizes the levy and collection of taxes by tax authorities at the national level. The central government collects taxes on personal and corporate income and on transfers of real estate. In addition, it collects import duties and a 13.0% value added tax on tangible assets and services.

Approximately 95.1% of the central government's current revenues came from various forms of taxation in 2005. The central government's tax revenues were US$2,229.4 million in 2005, an increase of 15.8% compared to tax revenues in 2004, the largest increase since 1995. Such increase was principally a result of the tax reforms approved in late 2004 and 2005. Tax revenues as a percentage of GDP reached 13.1% for 2005, compared 12.2% for 2004.

The value added tax typically is the principal component of tax revenues, generating 52.5% of the total tax revenues in 2005. The value added tax applies to most sales of tangible assets as well as most services, except for educational, transportation and cultural services, among others.

The second largest component of tax revenues is the income tax, which accounted for 31.4% of tax revenues during 2005. Effective personal income tax rates for residents and non-residents who file tax returns in the Republic range from 0% to 25.0%. A flat 25.0% rate applies to non-resident taxpayers and corporate entities. Import duties, the third largest component of tax revenues, accounted for 8.1% of tax revenues in 2005.

Tax Reforms

The Legislative Assembly approved a new tax code that became effective in January 2001 and allows the government to unify collection procedures for different taxes and expedite the process of imposing and collecting fines from taxpayers that do not comply with the legal framework. In addition, the Legislative Assembly approved a levy of US$0.20/gallon on gasoline and diesel which is used for road maintenance and improvements and, effective January 2002, eliminated the ¢75,000 exemption from the corporate income tax.

In November and December 2004, the Legislative Assembly approved several tax measures intended to increase revenues, close tax loopholes and reduce tax evasion. Reforms to the tax laws included, among others, clarifying the requirements for eligibility for tax credits, limiting deductions related to inter-company loans, disallowing deductions for expenses incurred in certain taxing jurisdictions, establishing a unified nondiscretionary period for taxpayers to pay delinquent tax liabilities, prohibiting settlement of cases involving customs smuggling, raising the jail term that may be imposed on tax evaders and eliminating the possibility of tax evaders avoiding prison sentences.

In addition, the government enacted in December 2004 a new law that aims to encourage the informal sector to register with the government tax authority by requiring large taxpayers to withhold a 1% value added tax on transactions with small taxpayers.

In 2005, the government increased the excise tax on tobacco products and alcoholic beverages and imposed a tax on the sale of guns, ammunition, and fireworks. The additional revenue collected from new excise taxes will be used to increase public healthcare coverage, improve health services in rural areas and provide patients better access to healthcare facilities in urban and rural areas.

The Tourism Law enacted in December 2005 imposes a special contribution levy of US$7.00 for each person leaving the country through the international airport, as well as a special contribution levy of 5% on lodging.

Customs Reforms

The government has reformed a number of laws to modernize customs procedures and accommodate the Republic's international commitments, especially those contained in the DR-CAFTA. The reforms establish the *Dirección General de Aduanas* (the "Customs Administration") to oversee the modernization of the customs service. The main purpose of such reforms is to permit the Customs Administration to perform its activities more efficiently, focusing on the supervision and control of international trade duties and taxes, simplifying customs procedures, granting more authority to custom officers to review questionable declarations, and ensuring compliance with the rules of origin applicable to goods imported into the Republic. In addition to the Republic's commitments pursuant to the DR-CAFTA, the reforms are also intended to permit the Republic to comply with its other international commitments, such as those under the CAUCA and other international agreements concerning international trade of goods.

In February 2006, a reform to the law governing the *Tribunal de Apelaciones de Impuestos Internos*, an administrative body initially created to review taxes and fines imposed by the *Dirección General de Impuestos Internos* (the internal tax office of the Ministry of Finance), granted authority to the tribunal to also review decisions of the Customs Administration. As a result of the reform, the tribunal has been renamed the *Tribunal de Apelaciones de Impuestos Internos y de Aduanas* and will review decisions of the Customs Administration related to the imposition of taxes and duties, penalties, customs decisions and classifications and the determination of the origin of goods.

PUBLIC DEBT

General

Public sector debt, including the internal and external debt of the financial and non-financial public sector and the external Central Bank debt balance, was approximately US$7,674.3 million at December 31, 2005, compared to US$7,281.4 million at December 31, 2004 and US$7,119.0 million at December 31, 2003. However, the ratio of total public sector debt to GDP declined from 46.0% at December 31, 2004 to 45.2% at December 31, 2005.

Under the Constitution, the Legislative Assembly has the power to adopt legislation governing the issuance of public debt and to appropriate funds required for debt service. Acting pursuant to this constitutional mandate, the Legislative Assembly approved the AFI, which governs, among other matters, the procedures that must be observed in all matters regarding public debt. AFI rules concerning public debt apply to all state-owned entities, with the exception of the Central Bank and the state-owned financial institutions, as well as to obligations of the municipalities guaranteed by the national government. The Central Bank and the state-owned financial institutions are subject to restrictions in their respective charters regarding the issuance of debt. They are also subject to AFI if they issue obligations guaranteed by the Republic.

Because all AFI-governed public debt must comply with the public indebtedness policies adopted by the executive branch, a non-financial public sector entity must obtain the prior written approval of the Ministry of Finance before entering into any negotiations with respect to borrowing. Any contract executed by such entities without the approval of the Ministry of Finance is null and void and unenforceable as against that entity or the Republic and may give rise to civil and criminal liability for the individuals involved. Once approval of the Ministry of Finance is obtained, the entity may proceed to negotiate the terms and conditions of the obligations to be incurred, provided that its own charter gives it the authority to conduct such negotiations on its own behalf; otherwise, the Ministry of Finance conducts the negotiations with the participation of the Ministry of Foreign Relations in the case of transactions with multilateral and bilateral international lenders. Loan proceeds are disbursed to the Republic which, in turn, transfers such proceeds to the ultimate borrower pursuant to an agreement between the Ministry of Finance and such entity.

Although public debt service is the primary responsibility of the entity for whose benefit the loan was received, AFI-governed debt is an obligation of the Republic. Accordingly, transfers from the central government to any entity pursuant to the annual budget take into account debt service obligations for the following year.

Treasury Bills ("LETES")

To finance temporary revenue shortages, the Ministry of Finance is authorized to issue short-term debt instruments known as "LETES." LETES, which are US dollar-denominated, are sold in the Salvadoran exchange market at discounts and reflect market conditions at the time of issuance. The maximum maturity of LETES is 360 days. As of December 31, 2005, US$180.0 million in aggregate principal amount of LETES were outstanding.

External Debt

External debt obligations of El Salvador are to multilateral organizations, bilateral institutions and commercial lenders, as well as investors in the external capital markets. The total external debt of the public sector in El Salvador, excluding the Central Bank, was US$5,999.0 million at December 31, 2005, compared to US$5,542.7 million at December 31, 2004, and US$5,355.5 million at December 31, 2003. The increase in public sector external debt since December 31, 2003 is primarily the result of the issuance by the Republic of US$375.0 million of external bonds in June 2005, which was partially offset by payments on maturing loans and exchange rate adjustments made during 2005. The Central Bank's external debt at December 31, 2005 was US$195.3 million, compared to US$197.9 million at December 31, 2004. Currently, the Republic is seeking legislative approval for loans from the Inter-American Development Bank and the World Bank for US$357.0 million in the aggregate, which are expected to be disbursed for investment projects over the next five years.

Since the signing of the Peace Accord in 1992, most of the external debt of the Republic has been entered into with multilateral organizations, and the funds borrowed have been used primarily for the reconstruction and improvement of physical infrastructure. Since 1999, the Republic has been involved in the following note issuances that are included in its external debt:

- US$150.0 million of external notes issued by the Republic in August 1999 that mature on August 15, 2006;
- US$50.0 million of external notes issued by the Republic in January 2000 that mature on January 15, 2007;

- zero coupon notes issued by the Coffee Emergency Fund of El Salvador, with a guaranty of the Republic, for an aggregate issue price of US$80.0 million with an aggregate face amount at maturity of US$123,248,752, that mature from 2001 to 2010;
- US$353.5 million of external notes issued by the Republic in July 2001 that mature on July 25, 2011;
- US$500.0 million of external notes issued by the Republic in April 2002 that mature on April 10, 2032;
- US$300.0 million of external notes issued by the Republic in July 2002 that mature on July 25, 2011 and form a single series with the external notes issued in July 2001;
- US$451.5 million of external notes issued by the Republic in October 2002 that mature on January 24, 2023;
- US$348.5 million of external notes issued by the Republic in March 2003 that mature on January 24, 2023 and form a single series with the external notes issued in October 2002;
- US$286.5 million of external notes issued by the Republic in September 2004 that mature on September 21, 2034; and
- US$375.0 million of external notes issued by the Republic in June 2005 that mature on June 15, 2035.

To finance reconstruction associated with the January and February 2001 earthquakes, the Republic received US$327.0 million in new loans from multilateral and bilateral sources, including US$238.0 million in loans from the Inter-American Development Bank, and secured the reallocation of US$116.4 million of existing loans from such sources to the reconstruction effort. The proceeds of these loans were disbursed over the period from 2001 to 2005.

The following table sets forth the total public external debt for the periods presented.

Public Sector External Debt

	At December 31,				
	2001	2002	2003	2004	2005[1]
	(in millions of US dollars, except percentages)				
Central government	$ 2,991.1	$ 4,532.8	$ 5,008.6	$ 5,251.4	$ 5,631.5
Public financial and non-financial entities	278.5	284.8	346.9	291.3	367.5
Sub-total	3,269.6	4,817.6	5,355.5	5,542.7	5,999.0
Central Bank	120.2	95.4	262.5	197.9	195.3
Total	$ 3,389.8	$ 4,913.0	$ 5,618.0	$ 5,740.6	$ 6,194.3
External public debt as a percentage of nominal GDP	24.5%	34.3%	37.3%	36.3%[1]	36.5%

(1) Preliminary.

Source: *Ministerio de Hacienda.*

The following table shows the composition of the Republic's external public debt by type of creditor for the periods presented.

Public Sector External Debt by Type of Creditor

	At December 31,				
	2001	2002	2003	2004	2005[1]
	(in millions of US dollars)				
Central government and public financial and non-financial entities	$ 3,269.6	$ 4,817.6	$ 5,355.5	$ 5,542.7	$ 5,999.0
Multilateral	1,972.0	2,232.6	2,376.7	2,300.7	2,437.8
Bilateral	665.0	710.2	763.1	748.3	672.7
Commercial	632.6	1,874.8	2,215.7	2,493.7	2,888.5
Central Bank	120.2	95.4	262.5	197.9	195.3
Multilateral	106.3	84.6	177.8	141.1	172.1
Bilateral	13.9	10.8	7.7	4.6	1.5
Commercial	0.0	0.0	77.0	52.2	21.7
Total Public Sector	$ 3,389.8	$ 4,913.0	$ 5,618.0	$ 5,740.6	$ 6,194.3

(1) Preliminary.

Source: *Ministerio de Hacienda.*

The increases in the multilateral indebtedness of the central government and the public financial and non-financial entities from December 31, 2001 to December 31, 2005 are due primarily to the impact of the disbursement of loans for reconstruction and other infrastructure investments. The US$137.8 million increase in multilateral indebtedness of the central government and the public financial and non-financial entities in 2005 was mainly due to disbursements of US$100.0 million under a development policy loan from the World Bank and US$40.0 million under a loan from the Inter-American Development Bank to support the development of competition policies. The increase in commercial indebtedness from December 31, 2001 to December 31, 2004 is due primarily to the Republic's issuance of external notes to cover partially expenses related to reconstruction efforts from the 2001 earthquakes and the financing of the pension system.

The following table shows the rates of interest applicable to the outstanding principal balance of the Republic's public external debt at the dates indicated.

Interest on Public Sector External Debt

	At December 31, 2005[1]		At December 31, 2004	
	Amount	Percentage	Amount	Percentage
	(in millions of US dollars, except percentages)		(in millions of US dollars, except percentages)	
Fixed Rate				
0-3%	$ 1,169.2	18.9%	$ 1,216.0	21.2%
3-6%	323.0	5.2	265.0	4.6
6-9%	3,016.1	48.7	2,677.5	46.6
More than 9%	246.1	4.0	256.1	4.5
Floating Rate	1,439.9	23.2	1,326.0	23.1
Total	$ 6,194.3	100.0%	$ 5,740.6	100.0%

(1) Preliminary.

Source: *Ministerio de Hacienda.*

The following table sets forth the government's projections as of December 31, 2005 regarding external debt service with respect to debt already disbursed to the public sector, not including the Central Bank, for the years 2006 to 2015.

Public Sector External Debt Service 2006-2015[1]

	For the Year Ending December 31,									
	2006	2007	2008	2009	2010	2011	2012	2013	2014	2015
	(In millions of US dollars)									
Central government	$ 701.0	$ 580.0	$ 512.0	$ 491.0	$ 477.0	$1,114.0	$ 390.0	$ 357.0	$ 333.0	$ 319.0
Principal	362.0	266.0	214.0	202.0	197.0	842.0	181.0	156.0	138.0	129.0
Interest	339.0	314.0	298.0	289.0	280.0	272.0	209.0	201.0	195.0	190.0
Rest of Public Sector	31.0	33.0	30.0	28.0	26.0	16.0	15.0	15.0	13.0	13.0
Principal	21.0	24.0	23.0	22.0	21.0	12.0	12.0	12.0	11.0	11.0
Interest	10.0	9.0	7.0	6.0	5.0	4.0	3.0	3.0	2.0	2.0
Total Debt Service	$ 732.0	$ 613.0	$ 542.0	$ 519.0	$ 503.0	$1,130.0	$ 405.0	$ 372.0	$ 346.0	$ 332.0

(1) Medium- and Long-Term debt.

Source: *Ministerio de Hacienda.*

Debt Record

Since 1993, El Salvador has not rescheduled any loans and has not defaulted on any of its indebtedness.

During the civil war, El Salvador was unable to service a portion of its international debt. Between 1990 and 1993, the Republic successfully negotiated a rescheduling of certain loans totaling US$382.5 million and forgiveness of certain other obligations with some of its international creditors. In 1993, the U.S. Agency for International Development, upon its own initiative, forgave US$463.9 million of the Republic's outstanding debt and Canada converted Cnd$8.1 million of outstanding debt to an obligation of the Republic to use amounts which would have been applied to service this debt for environmental projects. In 1999, the government of France, upon its own initiative, forgave FF133.0 million of the Republic's outstanding debt. The funds previously allocated to repay El Salvador's outstanding debt to France have been reallocated to establish the *Fondo Franco-Salvadoreño*, a fund that provides financing for infrastructure projects.

Internal Debt

The public sector's internal debt, excluding the Central Bank, was US$1,480.0 million at December 31, 2005 compared to US$1,540.8 million at December 31, 2004. The Republic's current public sector debt is denominated in both US dollars and *colones.* As of 2004, as a result of the Monetary Integration Act, all issuances and amortizations of existing public sector internal debt are in US dollars.

The central government's internal debt consists of obligations to both public sector and private entities. Although pursuant to its current charter, the Central Bank is not allowed to finance the government, this restriction did not become effective until 1994. Prior to 1994, the Central Bank had extensively financed government operations. At December 31, 2005, the outstanding principal balance of obligations related to such activity was US$704.4 million. No interest obligations were outstanding at such date.

The following table sets forth the public sector internal debt for the periods presented.

Public Sector Internal Debt[1]

	At December 31,				
	2001	2002	2003	2004	2005[2]
	(in millions of US dollars, except percentage)				
Central government[3]	$ 1,473.9	$ 758.3	$ 844.7	$ 960.6	$ 951.7
Public non-financial entities	14.9	66.4	32.7	9.7	0.3
Public financial entities	631.0	647.4	613.7	561.2	518.7
Municipalities and other government institutions	7.4	11.6	9.9	9.3	9.3
Total	$ 2,127.2	$ 1,483.7	$ 1,501.0	$ 1,540.8	$ 1,480.0
Internal public debt as a percentage of nominal GDP	15.4%	10.4%	10.0%	9.7%[2]	8.7%

(1) Does not include internal debt obligations of the Central Bank.
(2) Preliminary.
(3) Includes obligations to the Central Bank.

Source: *Ministerio de Hacienda.*

Central government internal debt decreased from US$1,473.9 million at December 31, 2001 to US$951.7 million at December 31, 2005, due primarily to the Republic's repayment of internal debt with proceeds of its external notes issued in 2002 and the amortization of certain internal debt. This balance represents bonds issued by the government for various purposes, including the payment of compensation for lands expropriated prior to 1989 and loans from the Central Bank that were used to fund the fiscal deficit prior to 1994. The internal debt incurred by public financial entities is largely represented by bonds issued by the *Fondo de Saneamiento del Sistema Financiero* (the "Financial Strengthening Fund"), a special purpose public entity created to acquire loans in arrears and other assets of a similar nature from state-owned banks and other financial institutions prior to their privatization. The internal debt obligations of the Central Bank represent, in large part, indebtedness incurred through open market operations prior to 2001. The Central Bank discontinued all open market operations when the Monetary Integration Act became effective in 2001.

TERMS AND CONDITIONS OF THE NOTES

The following are the Terms and Conditions of the Notes that will appear on the reverse of each of the Notes (the "Terms and Conditions"). Certain provisions of the Notes refer to and are subject to the Fiscal Agency Agreement dated as of June 10, 2005, among the Republic, Deutsche Bank Trust Company Americas, as Fiscal Agent, Principal Paying Agent, Registrar and Transfer Agent and the paying agents and the transfer agents named therein, as amended by Amendment No. 1 dated as of April 26, 2006 and further amended by Amendment No. 2 to be dated as of July 20, 2006, among the parties thereto. The description of the Notes set forth herein does not purport to be complete and is qualified in its entirety by reference to the Notes and the Fiscal Agency Agreement, as so amended.

1. General. (a) This Note is one of a duly authorized issue of 7.65% Notes due 2035 (the "Notes") of the Republic, limited to the aggregate principal amount of US$225,000,000 (except as otherwise provided below) issued pursuant to a Fiscal Agency Agreement dated as of June 10, 2005 and amended by Amendment No. 1 dated as of April 26, 2006 and Amendment No. 2 dated as of July 20, 2006 (as amended, the "Fiscal Agency Agreement"), among the Republic, Deutsche Bank Trust Company Americas, as fiscal agent (the "Fiscal Agent"), principal paying agent (the "Principal Paying Agent"), registrar (the "Registrar") and transfer agent (the "Transfer Agent"), which expressions shall include any successors thereto, in its capacity as such, and Deutsche Bank Luxembourg SA, as transfer agent (a "Transfer Agent") and paying agent (a "Paying Agent" and together, the "Agents," which term shall include the Fiscal Agent, the Paying Agents, the Registrar and the Transfer Agents). If not previously redeemed (see Section 7 below), the entire principal amount of the Notes together with accrued interest thereon is payable on June 15, 2035.

(b) The Notes are direct, general and unconditional obligations of the Republic. The Notes shall at all times rank equally without any preference among themselves and at least *pari passu* with all other present and future unsecured and unsubordinated Public External Indebtedness of the Republic.

(c) The holders of the Notes will be entitled to the benefits of, be bound by, and be deemed to have notice of, all of the provisions of the Fiscal Agency Agreement. Copies of the Fiscal Agency Agreement are on file and may be inspected at the office of the Fiscal Agent and at the offices of the paying agents referred to below.

(d) The issue of the Notes is authorized under Legislative Decree No. 921 (as published in the *Diario Oficial* on December 20, 2005) of the Republic's Legislative Assembly.

(e) The Notes will be a further issuance of, and will be consolidated to form a single series with the Existing Notes.

2. Form, Denomination and Title. (a) Each Note will be issued in minimum denominations of US$10,000 and integral multiples of US$1,000 in excess thereof. The Notes, and the transfer thereof, shall be registered as provided in Section 9 below and in the Fiscal Agency Agreement. In this Note, "Noteholder" and (in relation to a Note) "holder" mean the person in whose name a Note is registered. A Noteholder may (to the fullest extent permitted by law) be treated at all times, by all persons and for all purposes, as the absolute owner of such Note, regardless of any notice of ownership, theft or loss or of any writing thereon.

(b) Notes initially sold within the United States in reliance on Rule 144A under the Securities Act will be represented by the Restricted Global Note and will be deposited with a custodian for, and registered in the name of a nominee of, DTC.

(c) Notes initially sold outside the United States pursuant to Regulation S under the Securities Act will be represented by the Regulation S Global Note deposited with a custodian for, and registered in the name of a nominee of, DTC.

(d) Registration of title to Notes initially represented by the Restricted Global Note in a name other than DTC or a successor depositary or one of their respective nominees will not be permitted unless (i) such depositary notifies the Republic that it is no longer willing or able to discharge properly its responsibilities as depositary with respect to the Restricted Global Note or ceases to be a "clearing agency" registered under the United States Securities Exchange Act of 1934, as amended (the "Exchange Act"), or is at any time no longer eligible to act as such, and the Republic is unable to locate a qualified successor within 90 days of receiving notice of such ineligibility on the part of such depositary or (ii) following a failure to pay at maturity or upon acceleration of any Note, the Fiscal Agent has received a notice from the registered holder of the Restricted Global Note requesting exchange of a specified amount of the Restricted Global Note for individual note certificates (the "Restricted Note Certificates").

Registration of title to Notes initially represented by the Regulation S Global Note in a name other than DTC or a successor depositary or one of their respective nominees will not be permitted unless (i) such depositary notifies the Republic that it is no longer willing or able to discharge properly its responsibilities as depositary with respect to the Regulation S Global Note or ceases to be a "clearing agency" registered under the Exchange Act, or is at any time no longer eligible to act as such, and the Republic is unable to locate a qualified successor within 90 days of receiving notice of such ineligibility on the part of such depositary or (ii) following a

failure to pay principal in respect of any Note at maturity or upon acceleration of any Note, and the Fiscal Agent has received a request from the registered holder of the Regulation S Global Note requesting exchange of the Regulation S Global Note for individual note certificates (the "Regulation S Note Certificates" and together with the Restricted Note Certificates, the "Note Certificates").

(e) The Notes will not be issued in bearer form. So long as Euroclear or Clearstream, Luxembourg, if applicable, or DTC or its nominee is the registered owner of a Global Note, it will be considered the sole owner or holder of the Notes represented thereby for all purposes under the Notes and the Fiscal Agency Agreement. Neither the Republic nor any Agent will have any responsibility or liability for any aspect of the records relating to or payments made by Euroclear, Clearstream, Luxembourg, if applicable, or DTC on account of beneficial interests in a Global Note.

3. Interest. (a) Interest on the Notes will be calculated on the basis of a 360-day year consisting of 12 months of 30 days each and, in the case of an incomplete month, the number of days elapsed.

(b) The Notes will bear interest from and including June 15, 2006 to, but excluding, June 15, 2035 at the rate of 7.65% per annum on the principal amount thereof payable semi-annually in arrears on June 15 and December 15 of each year commencing on December 15, 2006. Each Note will cease to bear interest from and including the due date for redemption unless, upon due presentation and surrender, payment of principal is improperly withheld or refused. In such event it shall continue to bear interest at such rate (both before and after judgment) until the earlier of (i) the day on which all sums due in respect of such Note up to that day are received by or on behalf of the relevant holder and (ii) the day seven days after the Fiscal Agent or the Principal Paying Agent has notified Noteholders of receipt of all sums due in respect of all the Notes (except to the extent that there is failure in the subsequent payment to the relevant holders).

4. Payment and Paying Agents. (a) Payment of principal of the Notes (together with accrued interest) will only be made to the person in whose name such Note is registered as of the close of business on the due date for payment of the principal, following presentation and surrender of such Note at the office of the Principal Paying Agent or any other Paying Agent, by U.S. dollar check drawn on, or by transfer to a U.S. dollar account maintained by the holder with, a bank located in New York City. Payment of interest on a Note will be made to the person in whose name such Note is registered at the close of business on the fifteenth day (if the Notes are represented by Note Certificates) or the third day (if the Notes are represented by Global Notes) (whether or not a Business Day) (the "Record Date") prior to the relevant due date for the payment of interest. Payment of such interest will be made by a U.S. dollar check drawn on a bank in New York City mailed to the holder at such holder's registered address, or, upon application of the holder to the Principal Paying Agent or any other Paying Agent in New York City or in Luxembourg not later than the relevant Record Date, by transfer of immediately available funds to a U.S. dollar account maintained by the holder with a bank in New York City. If any day for payment of principal or interest in respect of any Note ("Payment Date") is not a Business Day the holder shall not be entitled to payment until the next Business Day following such day in the applicable jurisdiction, with the same force and effect as if made on the date for such payment, and no additional interest in respect of such Payment Date shall accrue as a result of the delay in payment. "Business Day" means a day, other than a Saturday or Sunday, in which the commercial banks and foreign exchange markets are open, or not authorized to close, in Luxembourg, New York City, San Salvador, or the city of the Paying Agent to which the Note is surrendered for payment.

(b) The Republic agrees that so long as any of the Notes are outstanding, it will maintain (i) a Principal Paying Agent in a Western European or United States city for payments on the Notes, (ii) so long as the Notes are listed on the Luxembourg Stock Exchange and the rules of such Exchange so require, a Paying Agent and Transfer Agent in Luxembourg, (iii) a Registrar having a specified office in New York, and (iv) a Paying Agent having a specified office in New York. The Republic has initially appointed Deutsche Bank Trust Company Americas, as fiscal agent and as principal paying agent, registrar and transfer agent and Deutsche Bank Luxembourg SA, as paying agent and transfer agent. Subject to the foregoing, the Republic shall have the right at any time to terminate any such appointments and to appoint any other Agents in such other places as it may deem appropriate upon notice in accordance with Section 13 below.

(c) Payments in respect of the Notes shall be made in such coin or currency of the United States of America as at the time of payment shall be legal tender for the payment of public and private debts.

5. Payment of Additional Amounts. (a) All payments by the Republic in respect of the Notes shall be made without withholding or deduction for or on account of any present or future taxes, duties, fines, penalties, assessments or other governmental charges of whatsoever nature (or interest on any taxes, duties, fines, penalties, assessments or other governmental charges of whatsoever nature) imposed or levied by or on behalf of the Republic or any political subdivision or authority thereof or therein having power to tax, unless the Republic is compelled by law to deduct or withhold such taxes, duties, fines, penalties, assessments or governmental charges (or interest on any taxes, duties, fines, penalties, assessments or other governmental charges). In such event, the

Republic shall make such withholding, make payment of the amount so withheld to the appropriate governmental authority (and promptly forward to each holder of a Note an official receipt (or a certified copy) or other documentation evidencing such payment) and forthwith pay such additional amounts ("Additional Amounts") as may be necessary to ensure that the net amounts receivable by the holders of Notes after such withholding or deduction shall equal the respective amounts of principal and interest which would have been receivable in respect of the Notes in the absence of such withholding or deduction. No such Additional Amounts shall be payable:

(i) to, or to a third party on behalf of, a holder who is liable for such taxes, duties, fines, penalties, assessments or governmental charges (or interest thereon) in respect of such Note by reason of such holder's having some connection with the Republic other than the holding of the Note; or

(ii) to, or to a third party on behalf of, a holder who is liable for such taxes, duties, fines, penalties, assessments or governmental charges (or interest thereon) in respect of any Note by reason of such holder's failure to comply with any reasonable certification, identification or other reporting requirement concerning the nationality, residence, identity or connection with the Republic, or any political subdivision or taxing authority thereof or therein, of such holder or the holder of any interest in such Note or rights in respect thereof, if compliance is required by the Republic, or any political subdivision or taxing authority thereof or therein, as a precondition to exemption from such deduction or withholding; provided, however, that the Republic shall be obligated to pay Additional Amounts if such certification, identification or other reporting requirement would be materially more onerous, in form, in procedure, or in substance of information disclosed by the relevant holders or beneficial owners than comparable information or other reporting requirements imposed under United States tax law, regulation and administrative practice; or

(iii) to, or to a third party on behalf of, a holder who is liable for such taxes, duties, fines, penalties, assessments or governmental charges (or interest thereon) in respect of any Note by reason of the failure of such holder to present such holder's Note for payment (where such presentment is required) within 30 calendar days after the date on which such payment thereof became due and payable or is duly provided for and notice thereof is given to the holder, whichever occurs first.

(b) Whenever there is mentioned herein, in any context, the payment of the principal of or interest on, or in respect of, a Note, such mention shall be deemed to include mention of the payment of Additional Amounts provided for in this Section, to the extent that, in such context, Additional Amounts are, were or would be payable in respect thereof pursuant to the provisions of this Section, and express mention of the payment of Additional Amounts (if applicable) in any provisions hereof shall not be construed as excluding Additional Amounts in those provisions hereof where such express mention is not made.

6. The Agents. (a) In acting under the Fiscal Agency Agreement and in connection with the Notes, the Fiscal Agent, the Principal Paying Agent, the Paying Agents, the Registrar, the Transfer Agents and each other Agent are acting solely as agent of the Republic and do not assume any obligation toward or relationship of agency or trust for or with the owner or holder of any Note, except that any funds held by any such Agent for payment of principal of or interest (or any Additional Amounts) on the Notes shall be held in a segregated account by it and applied as set forth herein. For a description of the duties and the immunities and rights of the Fiscal Agent, the Principal Paying Agent, the Paying Agents, the Registrar and the Transfer Agents under the Fiscal Agency Agreement, reference is made to the Fiscal Agency Agreement, and the obligations of the Fiscal Agent, the Principal Paying Agent, the Paying Agents, the Registrar and the Transfer Agents to the owners or holders of Notes are subject to such immunities and rights.

(b) All monies paid by or on behalf of the Republic to the Principal Paying Agent or any other paying agent for the payment of the principal of or interest on any Note which remain unclaimed at the end of two years after such principal or interest shall have become due and payable will be repaid to the Republic upon the Republic's written request therefor and the holder of such Note will thereafter look only to the Republic for payment. Upon such repayment, all liability of the Principal Paying Agent and any other paying agent with respect thereto shall thereupon cease, without, however, limiting in any way the obligation of the Republic in respect of the amount so paid.

7. Redemption and Purchase; Further Issues. (a) The entire principal amount of the Notes together with accrued interest thereon is payable on June 15, 2035. The Notes will not be redeemable prior to maturity at the option of the Republic or (except on acceleration following an Event of Default) the Noteholders.

(b) The Republic may at any time, directly or indirectly, purchase Notes in the open market or otherwise at any price. Any purchase by tender shall be made available to all Noteholders alike. The Notes so purchased, while held by or on behalf of the Republic, shall not entitle the holder to vote the Notes and shall not be deemed to be outstanding for purposes of calculating quorums. All Notes so purchased may at the Republic's discretion be held, resold or surrendered to the Fiscal Agent for cancellation.

(c) The Republic may, without the consent of Noteholders, create and issue additional notes having the same terms and conditions as the Notes (or the same except for the amount of the first interest payment) in accordance with applicable law; provided that such additional notes do not have, for purposes of U.S. federal income taxation (regardless of whether any holders of such notes are subject to the U.S. federal tax laws), a greater amount of original issue discount than the Notes have as of the date of the issue of such notes. The Republic may consolidate the additional notes to form a single series with the outstanding Notes.

8. Events of Default. In the event that one or more of the following events (herein referred to as "Events of Default") shall have occurred and be continuing:

(a) the Republic shall default in the payment of principal in respect of the Notes when and as the same are due, and such default shall continue for a period of thirty days thereafter;

(b) the Republic shall default in the payment of interest in respect of any of the Notes when and as the same are due, and such default shall continue for a period of thirty days thereafter;

(c) the Republic shall fail to perform any of its other obligations under the Notes, which default shall continue unremedied within 60 days after notice of such default shall have been given to the Republic by the Fiscal Agent or the Noteholders;

(d) as a result of any default or event of default resulting from the failure to make any payment of principal or of interest thereunder when due contained in any agreement or instrument related to any External Indebtedness (as defined herein) of the Republic in excess of US$25,000,000, such External Indebtedness becomes due and payable prior to the stated maturity thereof or if the Republic defaults in the payment or repayment of any of its External Indebtedness in excess of US$25,000,000 on the maturity thereof as extended by any applicable days of grace or any guarantee or indemnity given by the Republic of any External Indebtedness in excess of US$25,000,000 of others shall not be honored when due and called or within any period of grace applicable thereto;

(e) a moratorium shall be declared on the payment of any Public External Indebtedness of the Republic which does not expressly exclude the Notes; or

(f) the Republic shall deny, repudiate or contest the validity of its obligations under the Notes;

then the holders of not less than 25 percent in principal amount of the Notes outstanding may by written notice to the Republic and the Fiscal Agent declare the Notes then outstanding to be due and payable immediately at their principal face amount plus interest accrued thereon to the date of payment, including any Additional Amounts, unless prior to receipt of such demand by the Republic all such defaults have been cured. If an Event of Default shall give rise to a declaration which shall be effective and all Events of Default shall cease to continue following such declaration, then such declaration may be rescinded and annulled by the affirmative vote or written consent of the holders of not less than 66 2/3% in aggregate principal amount of the Notes then outstanding in accordance with the procedures set forth in Paragraph 12 below.

9. Replacement, Exchange and Transfer. (a) If any Note shall become mutilated or defaced or be destroyed, lost or stolen, the Fiscal Agent shall, subject to having received the prior approval of the Republic (such approval not to be unreasonably withheld), authenticate and deliver a new Note at the offices of the Registrar in New York, on such terms as the Republic or the Registrar may require, in exchange and substitution for the mutilated or defaced Note or in lieu of and in substitution for the destroyed, lost or stolen Note. In every case of mutilation or defacement or destruction, loss or theft, the applicant for a substitute Note shall furnish to the Republic, the Fiscal Agent and the Registrar such indemnity as the Republic, the Fiscal Agent or the Registrar, as the case may be, may require and evidence to their satisfaction of the destruction, loss or theft of such Note, and of the ownership thereof. In every case of mutilation or defacement of a Note, the holder shall surrender to the Registrar the Note so mutilated or defaced. In addition, prior to the issuance of any substitute Note, the Republic may require the payment of a sum sufficient to cover any tax or other governmental charge that may be imposed in relation thereto and any other expenses (including the fees and expenses of the Fiscal Agent or the Registrar) connected therewith. If any Note which has matured or is about to mature shall become mutilated or defaced or be apparently destroyed, lost or stolen, the Republic may pay or authorize payment of the same without issuing a substitute Note.

(b) Upon the terms and subject to the conditions set forth in the Fiscal Agency Agreement, and subject to Section 9(e) below, a Note or Notes may be exchanged for a Note or Notes of equal aggregate principal amount, but in such different authorized denominations as may be requested by the holder, by surrender of such Note or Notes to the office of the Registrar, or to the office of any transfer agent, together with a written request for the exchange.

(c) Upon the terms and subject to the conditions set forth in the Fiscal Agency Agreement, and subject to Section 9(e) below, a Note may be transferred in whole or in part (in the principal amount of US$10,000 and integral multiples of US$1,000 in excess

thereof) by the holder or holders surrendering the Note for registration of transfer at the office of the Registrar or at the office of any transfer agent, duly endorsed by, or accompanied by a written instrument of transfer in form satisfactory to the Republic and the Registrar or any such transfer agent, as the case may be, duly executed by, the holder or holders thereof or such holder's or holders' attorney-in-fact or attorneys-in-fact duly authorized in writing.

(d) The costs and expenses of effecting any exchange or registration of transfer pursuant to the foregoing provisions, except for the expenses of delivery by other than regular mail (if any) and except, if the Republic shall so require, the payment of a sum sufficient to cover any tax or other governmental charge or insurance charges that may be imposed in relation thereto or, in connection with Section 9(a) above, the fees and expenses of the Registrar or Fiscal Agent, will be borne by the Republic.

(e) The Registrar may decline to register the transfer or exchange of Notes for a period of 15 days preceding the due date for any payment of principal of or interest on the Notes.

10. Negative Pledge. (a) Negative Pledge. So long as any Note remains outstanding (as defined in the Fiscal Agency Agreement), the Republic will not create or permit to subsist any Security (as defined herein) upon the whole or any part of its present or future revenues, property or assets to secure any present or future Public External Indebtedness (as defined herein) of the Republic without at the same time or prior thereto securing the Notes equally and ratably therewith or providing such other security for the Notes as shall be approved by the holders of a majority of the aggregate principal amount outstanding of the Notes.

(b) Exceptions. The following exceptions apply to the Republic's obligations under subparagraph (a) above:

(i) any Security upon property to secure Public External Indebtedness of the Republic incurred for the purpose of financing the acquisition of such property and any renewal or extension of any such Security which is limited to the original property covered thereby and which secures any renewal or extension of the original secured financing;

(ii) any Security existing upon property to secure Public External Indebtedness of the Republic at the time of the acquisition of such property and any renewal or extension of any such Security which is limited to the original property covered thereby and which secures any renewal or extension of the original secured refinancing;

(iii) any Security in existence as of the date of the Fiscal Agency Agreement or any renewal or extension thereof which secures only the renewal or extension of the original secured financing;

(iv) any Security securing Public External Indebtedness incurred for the purpose of financing all or part of the costs of the acquisition, construction or development of a project or any renewal or extension of such Security, provided that (A) the holders of such Public External Indebtedness expressly agree to limit their recourse to the assets and revenues of such project or the proceeds of insurance thereon as the principal source of repayment of such Public External Indebtedness and (B) the property over which such Security is granted consists solely of such assets and revenues; and

(v) any Security or Securities in addition to those permitted pursuant to clauses (i) through (iv) above, and any renewal or extension thereof, provided that the aggregate amount of Public External Indebtedness secured by such additional Security or Securities shall not exceed the equivalent of US$25,000,000.

(c) Definitions. For the purposes of this Note:

(i) "External Indebtedness" means any Indebtedness which is issued pursuant to agreements or evidenced by instruments subject to Chapter XII of the Commerce Code of the Republic.

(ii) "Indebtedness" means any obligation (whether present or future, actual or contingent) for the payment or repayment of borrowed money or arising from bonds, debentures, notes or other similar instruments.

(iii) "Person" means any individual, company, corporation, firm, partnership, joint venture, association, organization, state or agency of a state or other entity, whether or not having a separate legal personality.

(iv) "Public External Indebtedness" means any External Indebtedness which is in the form of, or represented by, bonds, notes or other securities which are or are intended to be or are securities which are commonly quoted, listed or ordinarily dealt in on any stock exchange, automated trading system, over-the-counter or other securities market (including, without limiting the generality of the foregoing, securities eligible for resale pursuant to Rule 144A under the Securities Act), and which has an original maturity of more than one year or is combined with a commitment so that the original maturity of one year or less may be extended at the option of the Republic to a period in excess of one year.

(v) "Security" means any mortgage, pledge, lien, hypothecation, security interest or other charge or encumbrance including, without limitation, any equivalent created or arising under the laws of the Republic.

11. Covenants. So long as any Note is outstanding, the Republic will:

(a) Ranking: ensure that its obligations under the Notes will at all times constitute direct, general and unconditional obligations of the Republic ranking at all times *pari passu* without any preference among themselves and at least equally with all other present and future unsecured and unsubordinated Public External Indebtedness of the Republic; and

(b) Listing: use reasonable efforts to maintain the listing of the Notes on the Luxembourg Stock Exchange.

12. Modifications, Amendments and Waivers. (a) At any meeting of Noteholders duly called and held as specified in the Fiscal Agency Agreement, upon the affirmative vote, in person or by proxy thereunto duly authorized in writing, of the holders of not less than 66 2/3% in aggregate principal amount of the Notes then outstanding represented at such meeting, or with the written consent of the holders of not less than 66 2/3% in aggregate principal amount of the Notes then outstanding, the Republic and the Fiscal Agent, upon agreement between themselves, may modify, amend or supplement the terms of the Notes or the Fiscal Agency Agreement, in any way, and the holders of Notes may make, take or give any request, demand, authorization, direction, notice, consent, waiver or other action provided by the Fiscal Agency Agreement or the Notes to be made, given or taken by Noteholders; provided, however, that no such action may, without the consent or affirmative vote, in person or by proxy thereunto duly authorized in writing, of the holders of not less than 75% in aggregate principal amount of the Notes then outstanding, (i) change the due date for the payment of the principal of (or premium, if any) or any installment of interest on any Note, (ii) reduce the principal amount of any Notes, the portion of such principal amount that is payable upon acceleration of the maturity of such Notes, the interest rate thereon or the premium payable upon redemption thereof, (iii) change the coin or currency in which payment with respect to interest, premium or principal in respect of Notes is payable or the place or places in which any such payment is required to be made, (iv) shorten the period during which the Republic is not permitted to redeem the Notes, or permit the Republic to redeem the Notes if, prior to such action, the Republic is not permitted to do so, (v) reduce the proportion of the principal amount of Notes the vote or consent of the holders of which is necessary to modify, amend or supplement the Fiscal Agency Agreement or the terms and conditions of the Notes or to make, take or give any request, demand, authorization, direction, notice, consent, waiver or other action provided hereby or thereby to be made, taken or given, (vi) change the obligation of the Republic to pay Additional Amounts, if any, pursuant to the Notes, (vii) amend the definition of "Outstanding" in Section 1.1 of the Fiscal Agency Agreement, (viii) change the governing law provisions of the Notes, (ix) change the Republic's agreement to submit to arbitration in respect of disputes relating to or arising under the Fiscal Agency Agreement or the Notes, each as set forth in Sections 17 and 18 of the Fiscal Agency Agreement and in the Notes, (x) change the ranking of the Notes as set forth in Paragraph 1(b) hereof or (xi) in connection with an offer to acquire all or any portion of the Notes where the consideration consists of either cash, new securities to be issued by the Republic, or any combination of the foregoing, amend any Event of Default. Any such modification, amendment or supplement shall be binding on all Noteholders.

(b) The Republic and the Fiscal Agent may, upon agreement between themselves, without the vote or consent of any Noteholder modify, amend or supplement the Fiscal Agency Agreement or the Notes for the purposes of curing any ambiguity, or curing, correcting or supplementing any defective or inconsistent provisions contained therein or in any manner which the Republic and the Fiscal Agent may deem mutually necessary or desirable that will not adversely affect, in any material respect, the interests of the Noteholders.

13. Notices. All notices to holders of Notes will be valid if (a) given in writing and mailed to the holders of Notes at their respective addresses shown in the Note register and (b) (so long as the Notes are listed on the Luxembourg Stock Exchange and the rules of such Exchange so require) published in a leading newspaper having general circulation in Luxembourg (which is expected to be the *d'Wort*) or in such other publication or city or cities as specified in the Fiscal Agency Agreement. Any such notice shall be deemed to have been given (x) on the date of mailing, in the case of mailed notice, and (y) on the date of such publication or, if published more than once, on the first date on which publication is made, in the case of published notice.

14. Prescription. All claims against the Republic for payment of principal of or interest on or in respect of the Notes shall be prescribed unless made within five years from the date on which such payment first became due.

15. Governing Law. These Notes are governed by, and construed in accordance with, the law of the State of New York, except that all matters concerning authorization and execution by the Republic, as well as the bringing of any actions and the enforcement of any judgment against the Republic in the courts of the Republic, will be governed by the laws of the Republic.

16. Arbitration. Any dispute, controversy or claim arising out of or relating to the Notes (other than any action arising out of or based on the United States federal or state securities laws), including the performance, interpretation, construction, breach, termination

or invalidity thereof shall be finally settled by arbitration in accordance with the Arbitration Rules of the United Nations Commission on International Trade Law (excluding Article 26 thereof) as in effect on the date of the Fiscal Agency Agreement (the "UNCITRAL Arbitration Rules"). The number of arbitrators shall be three, to be appointed in accordance with Section II of the UNCITRAL Arbitration Rules. The appointing authority shall be the Chairman of the International Court of Arbitration of the International Chamber of Commerce. The third arbitrator may be (but need not be) of the same nationality as any of the parties to the arbitration. The place of arbitration shall be New York, New York. The language to be used in the arbitration proceedings shall be English. Any arbitral tribunal constituted under this paragraph shall make its decisions entirely on the basis of the substantive law of the State of New York.

The decision of any arbitral tribunal shall be final to the fullest extent permitted by law, and a court judgment may be entered thereon by any Salvadoran court lawfully entitled to enter such judgment. In any arbitration or related legal proceedings for the conversion of an arbitral award into a judgment, the Republic will not raise any defense that it could not raise but for the fact that it is a sovereign state. The Republic has not consented to the jurisdiction of any court outside El Salvador, in connection with actions arising out of or based on the Notes or in connection with the enforcement of any judgment arising out of such actions, nor has the Republic appointed an agent for service of process outside El Salvador. The Republic waives any *forum non conveniens* defense in any proceeding in El Salvador.

No arbitration proceedings hereunder shall be binding upon or in any way affect the right or interest of any person other than the claimant or respondent with respect to such arbitration.

The Republic's consent to arbitration shall not preclude a holder of any Note from instituting legal proceedings against the Republic in the courts of El Salvador.

17. Sovereign Immunity. The Republic represents and warrants that it has no right to immunity on the grounds of sovereignty or otherwise, from the execution of any judgment in El Salvador, or from the execution or enforcement in El Salvador of any arbitral award (except, in each case, for the limitation on alienation of public property) in respect of any proceeding or any other matter arising out of or relating to its obligations contained in the Notes. The enforcement by a Salvadoran court of a foreign arbitral award is subject to recognition by the Supreme Court of Justice of the Republic, which will recognize such award if all the required formalities are observed and the award does not contravene Salvadoran national sovereignty, public policy and "good morals." The public property (*bienes de uso público*) of the Republic located in El Salvador is not subject to execution or attachment, either prior or after judgment. The execution of a judgment against El Salvador in El Salvador is only available in accordance with the procedures set forth in Article 450 et seq. of the Salvadoran Civil Procedure Code, which envisions registration of the judgment for inclusion in the budget for payment in a subsequent fiscal year of the Republic.

The Republic hereby irrevocably waives, to the fullest extent permitted by law, any requirement or other provision of law, rule, regulation or practice which requires or otherwise establishes as a condition to the institution, prosecution or completion of any action or proceedings (including appeals) in El Salvador arising out of or relating to the Notes, the posting of any bond or the furnishing, directly or indirectly, of any other security.

18. Judgment Currency. All payments required to be made hereunder by the Republic shall be in US dollars, regardless of any law, rule, regulation or statute, whether now or hereafter in existence or in effect in any jurisdiction, which affects or purports to affect such obligations. The obligation of the Republic in respect of any such amount due hereunder shall, notwithstanding any payment in any other currency (whether pursuant to a judgment or otherwise), be discharged only to the extent of the amount of US dollars that any of the Agents may, in accordance with normal banking procedures, purchase with the sum paid in such other currency (after any premium and costs of exchange) on the Business Day immediately following the day on which any of the Agents receives such payments. If the amount in US dollars that may be so purchased for any reason falls short of the amount originally due, the Republic shall pay such additional amounts, in US dollars, as may be necessary to compensate for such a shortfall. Any obligation of the Republic not discharged by such payment shall be due as a separate and independent obligation and, until discharged as provided herein, shall continue in full force and effect.

SUBSCRIPTION AND SALE

J.P. Morgan Securities Inc. and Citigroup Global Markets Inc. are acting as Joint Lead Managers of the offering. Subject to the terms and conditions in the subscription agreement dated the date of this Offering Circular (the "Subscription Agreement"), the Joint Lead Managers will agree severally to purchase, and the Republic will agree to sell to the Joint Lead Managers, the principal amount of the Notes set forth opposite such Joint Lead Manager's name in the following table.

Joint Lead Managers	Principal Amount
Citigroup Global Markets Inc.	US$112,500,000
J.P. Morgan Securities Inc..	US$112,500,000
Total...	US$225,000,000

The Subscription Agreement provides that the obligations of the Joint Lead Managers to purchase the Notes are subject to approval of legal matters by counsel and to other conditions. The Joint Lead Managers must purchase all the Notes if they purchase any of the Notes.

The Republic has been advised that the Joint Lead Managers propose to resell the Notes at the offering price set forth on the cover page of this Offering Circular within the United States to qualified institutional buyers (as defined in Rule 144A) in reliance on Rule l44A and outside the United States in reliance on Regulation S. See "Transfer Restrictions." The price at which the Notes are offered may be changed at any time without notice.

The Notes have not been and will not be registered under the Securities Act and may not be offered or sold within the United States or to, or for the account or benefit of, U.S. persons (as defined in Regulation S) except in transactions exempt from, or not subject to, the registration requirements of the Securities Act. See "Transfer Restrictions."

Accordingly, the Joint Lead Managers have agreed that, except as permitted by the Subscription Agreement and set forth in "Transfer Restrictions," they will not offer or sell the Notes within the United States or to, or for the account or benefit of, U.S. persons as part of the distribution of the Notes.

In addition, until 40 days after the commencement of this offering, an offer or sale of Notes within the United States by a dealer that is not participating in this offering may violate the registration requirements of the Securities Act if that offer or sale is made otherwise than in accordance with Rule l44A.

In relation to each Member State of the European Economic Area which has implemented the Prospectus Directive (each, a Relevant Member State), each Joint Lead Manager will represent and agree in the Subscription Agreement that, with effect from and including the date on which the Prospectus Directive is implemented in that Relevant Member State (the "Relevant Implementation Date"), it has not made and will not make an offer of Notes to the public in that Relevant Member State prior to the publication of a prospectus in relation to the Notes which has been approved by the competent authority in that Relevant Member State or, where appropriate, approved in another Relevant Member State and notified to the competent authority in that Relevant Member State, all in accordance with the Prospectus Directive, except that it may, with effect from and including the Relevant Implementation Date, make an offer of Notes to the public in that Relevant Member State at any time:

(i) to legal entities which are authorized or regulated to operate in the financial markets or, if not so authorized or regulated, whose corporate purpose is solely to invest in securities;

(ii) to any legal entity which has two or more of (1) an average of at least 250 employees during the last financial year; (2) a total balance sheet of more than €43,000,000 and (3) an annual net turnover of more than €50,000,000, as shown in its last annual or consolidated accounts;

(iii) to investors with the minimum total consideration per investor of €50,000; or

(iv) in any other circumstances which do not require the publication by the issuer of a prospectus pursuant to Article 3 of the Prospectus Directive.

For the purposes of this provision, the expression an "offer of Notes to the public" in relation to any Notes in any Relevant Member State means the communication in any form and by any means of sufficient information on the terms of the offer and the Notes to be offered so as to enable an investor to decide to purchase or subscribe the Notes, as the same may be varied in that Relevant Member

State by any measure implementing the Prospectus Directive in that Relevant Member State and the expression "Prospectus Directive" means Directive 2003/71/EC and includes any relevant implementing measure in each Relevant Member State.

Each Joint Lead Manager will represent and agree in the Subscription Agreement that:

(i) (x) it is a person whose ordinary activities involve it in acquiring, holding, managing or disposing of investments (as principal or agent) for the purposes of its business and (y) it has not offered or sold and will not offer or sell the Notes other than to persons whose ordinary activities involve them in acquiring, holding, managing or disposing of investments (as principal or agent) for the purposes of their businesses or who it is reasonable to expect will acquire, hold, manage or dispose of investments (as principal or agent) for the purposes of their businesses where the issue of the Notes would otherwise constitute a contravention of Section 19 of the Financial Services and Markets Act (the "FSMA") by the Republic;

(ii) it has only communicated or caused to be communicated and will only communicate or cause to be communicated an invitation or inducement to engage in investment activity (within the meaning of Section 21 of the FSMA) received by it in connection with the issue or sale of the Notes in circumstances in which Section 21(1) of the FSMA does not apply to the Republic; and

(iii) it has complied and will comply with all applicable provisions of the FSMA with respect to anything done by it in relation to the Notes in, from or otherwise involving the United Kingdom.

Each Lead Manager will represent and agree in the Subscription Agreement that the offer in The Netherlands of the Notes included in this offering is exclusively limited to persons who trade or invest in securities in the conduct of a profession or business (which include banks, stockbrokers, insurance companies, pension funds, other institutional investors and finance companies and treasury departments of large enterprises).

Although application is being made to list the Notes on the Luxembourg Stock Exchange and to have the Notes trade on the Euro MTF Market, the alternative market of the Luxembourg Stock Exchange, the listing does not assure that a trading market for the Notes will develop. The Joint Lead Managers intend to make a secondary market for the Notes. However, they are not obligated to do so and may discontinue making a secondary market for the Notes at any time without notice. No assurance can be given as to how liquid the trading market for the Notes will be. The Republic cannot assure you that the prices at which the Notes will trade in the market after this offering will not be lower than the initial offering price or that an active trading market for the Notes will develop and continue after this offering.

No action has been or will be taken by the Republic or the Joint Lead Managers that would or is intended to permit an offering of the Notes or the possession, circulation or distribution of this Offering Circular in preliminary or final form or any other offering material relating to the Republic or the Notes, in any country or jurisdiction where action for that purpose is required. Accordingly, the Notes may not be offered, sold or delivered, directly or indirectly, and neither this Offering Circular nor any circular, prospectus, form of application, other offering material or advertisement relating to the Notes may be distributed or published, in or from any country or jurisdiction, except in compliance with all applicable laws and regulations of any such country or jurisdiction.

In connection with the offering, the Joint Lead Managers may purchase and sell Notes in the open market. These transactions may include over-allotment, covering transactions and stabilizing transactions. Over-allotment involves sales of Notes in excess of the principal amount of Notes to be purchased by the Joint Lead Managers in this offering, which creates a short position for the Joint Lead Managers. Covering transactions involve purchases of the Notes in the open market after the distribution has been completed in order to cover short positions. Stabilizing transactions consist of certain bids or purchases of Notes made for the purpose of preventing or retarding a decline in the market price of the Notes while the offering is in progress. Any of these activities may have the effect of preventing or retarding a decline in the market price of the Notes. They may also cause the price of the Notes to be higher than the price that otherwise would exist in the open market in the absence of these transactions. The Joint Lead Managers may conduct these transactions in the over-the-counter market or otherwise. If the Joint Lead Managers commence any of these transactions, they may discontinue them at any time.

The Joint Lead Managers and their affiliates have provided investment banking, commercial banking and financial advisory services for the Republic from time to time for which they have received customary fees and reimbursements of expenses and may in the future provide additional services for which they will receive customary fees and reimbursements of expenses.

The Republic has agreed to indemnify the Joint Lead Managers against certain liabilities, including liabilities under the Securities Act, or to contribute to payments that the Joint Lead Managers may be required to make because of any of those liabilities.

It is expected that delivery of the Notes will be made against payment therefor on or about the date specified on the cover page of this Offering Circular, which will be the fifth business day following the date of pricing of the Notes (this settlement cycle being referred to as "T+5"). Under Rule 15c6-1 under the Exchange Act, trades in the secondary market generally are required to settle in three business days, unless the parties to any such trade expressly agree otherwise. Accordingly, U.S. purchasers who wish to trade Notes on the date of pricing or the next four succeeding business days will be required, by virtue of the fact that the Notes initially will settle in T+5, to specify an alternate settlement cycle at the time of any such trade to prevent a failed settlement. Purchasers of Notes in other countries who wish to trade the Notes on the date of pricing or the next four succeeding business days should consult their own advisor.

BOOK-ENTRY SETTLEMENT AND CLEARANCE

Global Notes

The Notes will initially be issued in the form of two registered notes in global form (which we refer to in this offering memorandum as “Global Notes”), without interest coupons, as follows:

- Notes sold to qualified institutional buyers in reliance on Rule 144A under the Securities Act will be represented by a Global Note (which we refer to in this Offering Circular as the “Restricted Global Note”); and
- Notes sold in offshore transactions to non-U.S. persons in reliance on Regulation S will be represented by a Global Note (which we refer to in this Offering Circular as the “Regulation S Global Note”).

Upon issuance, each of the Global Notes will be deposited with the Fiscal Agent (as defined in “Terms and Conditions of the Notes”) as custodian for DTC and registered in the name of a nominee of DTC.

Ownership of beneficial interests in each Global Note will be limited to persons who have accounts with DTC (which we refer to in this offering memorandum as the “DTC participants”) or persons who hold interests through DTC participants. The Republic expects that under procedures established by DTC:

- upon deposit of each Global Note with DTC’s custodian, DTC will credit portions of the principal amount of the Global Note to the accounts of the DTC participants designated by the Joint Lead Managers; and
- ownership of beneficial interests in each Global Note will be shown on, and transfer of ownership of those interests will be effected only through, records maintained by DTC (with respect to interests of DTC participants) and the records of DTC participants (with respect to other owners of beneficial interests in each Global Note).

Investors may hold their interests in the Regulation S Global Note directly through Euroclear or Clearstream, Luxembourg, if they are participants in those systems, or indirectly through organizations that are participants in those systems. Investors may also hold their interests in the Regulation S Global Note through organizations other than Euroclear or Clearstream, Luxembourg that are DTC participants. Each of Euroclear and Clearstream, Luxembourg will appoint a DTC participant to act as its depositary for the interests in the Regulation S Global Note that are held within DTC for the account of each of these settlement systems on behalf of its respective participants.

Beneficial interests in the Global Notes may not be exchanged for Notes in physical certificated form except in the limited circumstances described below.

Each Global Note and beneficial interests in each Global Note will be subject to restrictions on transfer as described under “Transfer Restrictions.”

Exchanges between the Global Notes

Beneficial interests in one Global Note may generally be exchanged for interests in another Global Note. Depending on whether the transfer is being made during or after the 40-day restricted period, and to which Global Note the transfer is being made, the Fiscal Agent may require the seller to provide certain written certifications in the form provided in the Fiscal Agency Agreement (as defined in “Terms and Conditions of the Notes”).

A beneficial interest in a Global Note that is transferred to a person who takes delivery through another Global Note will, upon transfer, become subject to any transfer restrictions and other procedures applicable to beneficial interests in the other Global Note.

Book-Entry Procedures for the Global Notes

All interests in the global notes will be subject to the operations and procedures of DTC and, if applicable, Euroclear and Clearstream, Luxembourg. The Republic provides the following summaries of those operations and procedures solely for the convenience of investors. The operations and procedures of each settlement system are controlled by that settlement system and may be changed at any time. Neither the Republic nor the Joint Managers is responsible for those operations or procedures.

DTC has advised that it is:

- a limited purpose trust company organized under the laws of the State of New York;
- a "banking organization" within the meaning of the New York State Banking Law;
- a member of the U.S. Federal Reserve System;
- a "clearing corporation" within the meaning of the Uniform Commercial Code; and

a "clearing agency" registered under Section 17A of the U.S. Securities Exchange Act of 1934.

DTC was created to hold securities for its participants and to facilitate the clearance and settlement of securities transactions between its participants through electronic book-entry changes to the accounts of its participants. DTC's participants include securities brokers and dealers, including the Joint Lead Managers; banks and trust companies; clearing corporations; and other organizations. Indirect access to DTC's system is also available to others such as banks, brokers, dealers and trust companies; these indirect participants clear through or maintain a custodial relationship with a DTC participant, either directly or indirectly. Investors who are not DTC participants may beneficially own securities held by or on behalf of DTC only through DTC participants or indirect participants in DTC.

So long as DTC's nominee is the registered owner of a Global Note, that nominee will be considered the sole owner or holder of the Notes represented by that Global Note for all purposes under the Fiscal Agency Agreement. Except as provided below, owners of beneficial interests in a Global Note:

- will not be entitled to have Notes represented by the Global Note registered in their names;
- will not receive or be entitled to receive physical, certificated notes; and
- will not be considered the owners or holders of the Notes under the Fiscal Agency Agreement for any purpose, including with respect to the giving of any direction, instruction or approval to the Fiscal Agent under the Fiscal Agency Agreement.

As a result, each investor who owns a beneficial interest in a Global Note must rely on the procedures of DTC to exercise any rights of a holder of Notes under the Fiscal Agency Agreement (and, if the investor is not a participant or an indirect participant in DTC, on the procedures of the DTC participant through which the investor owns its interest in the Notes).

Payments of principal and interest with respect to the Notes represented by a Global Note will be made by the Fiscal Agent to DTC's nominee as the registered holder of the Global Note. Neither the Republic nor the Fiscal Agent will have any responsibility or liability for the payment of amounts to owners of beneficial interests in a Global Note, for any aspect of the records relating to or payments made on account of those interests by DTC, or for maintaining, supervising or reviewing any records of DTC relating to those interests.

Payments by participants and indirect participants in DTC to the owners of beneficial interests in a Global Note will be governed by standing instructions and customary industry practice and will be the responsibility of those participants or indirect participants and DTC.

Transfers between participants in DTC will be effected under DTC's procedures and will be settled in same-day funds. Transfers between participants in Euroclear or Clearstream, Luxembourg will be effected in the ordinary way under the rules and operating procedures of those systems.

Cross-market transfers between DTC participants, on the one hand, and participants in Euroclear or Clearstream, Luxembourg, on the other hand, will be effected within DTC through the DTC participants that are acting as depositaries for Euroclear and Clearstream, Luxembourg. To deliver or receive an interest in a Global Note held in a Euroclear or Clearstream, Luxembourg account, an investor must send transfer instructions to Euroclear or Clearstream, Luxembourg, as the case may be, under the rules and procedures of that system and within the established deadlines of that system. If the transaction meets its settlement requirements, Euroclear or Clearstream, Luxembourg, as the case may be, will send instructions to its DTC depositary to take action to effect final settlement by delivering or receiving interests in the relevant Global Notes in DTC, and making or receiving payment under normal procedures for same-day funds settlement applicable to DTC. Euroclear and Clearstream, Luxembourg participants may not deliver instructions directly to the DTC depositaries that are acting for Euroclear or Clearstream, Luxembourg.

Because of time zone differences, the securities account of a Euroclear or Clearstream, Luxembourg participant that purchases an interest in a Global Note from a DTC participant will be credited on the business day for Euroclear or Clearstream, Luxembourg

immediately following the DTC settlement date. Cash received in Euroclear or Clearstream, Luxembourg from the sale of an interest in a Global Note to a DTC participant will be received with value on the DTC settlement date but will be available in the relevant Euroclear or Clearstream, Luxembourg cash account as of the business day for Euroclear or Clearstream, Luxembourg following the DTC settlement date.

DTC, Euroclear and Clearstream, Luxembourg have agreed to the above procedures to facilitate transfers of interests in the Global Notes among participants in those settlement systems. However, the settlement systems are not obligated to perform these procedures and may discontinue or change these procedures at any time. Neither the Republic nor the Fiscal Agent will have any responsibility for the performance by DTC, Euroclear or Clearstream, Luxembourg or their participants or indirect participants of their obligations under the rules and procedures governing their operations.

Certificated Notes

Notes in physical, certificated form will be issued and delivered to each person that DTC identifies as a beneficial owner of the related Notes only if:

- DTC notifies the Republic at any time that it is unwilling or unable to continue as depositary for the Global Notes and a successor depositary is not appointed within 90 days;
- DTC ceases to be registered as a clearing agency under the U.S. Securities Exchange Act of 1934 and a successor depositary is not appointed within 90 days; or
- the Fiscal Agent receives a notice from the registered holder of the Global Note requesting exchange of a specified amount for individual note certificates following a failure to pay at maturity or upon acceleration of any Note.

TRANSFER RESTRICTIONS

The Notes are subject to the following restrictions on transfer. By purchasing Notes, each prospective investor will be deemed to have made the following acknowledgments, representations to and agreements with the Republic and the Joint Lead Managers:

(1) Each prospective investor acknowledges that:

- the Notes have not been registered under the Securities Act or any other securities laws and are being offered for resale in transactions that do not require registration under the Securities Act or any other securities laws; and
- unless so registered, the Notes may not be offered, sold or otherwise transferred except under an exemption from, or in a transaction not subject to, the registration requirements of the Securities Act or any other applicable securities laws, and in each case in compliance with the conditions for transfer set forth in paragraph (4) below.

(2) Each prospective investor represents that it is not an affiliate (as defined in Rule 144 under the Securities Act) of the Republic, that it is not acting on the Republic's behalf and that either:

- it is a qualified institutional buyer (as defined in Rule 144A) and is purchasing Notes for its own account or for the account of another qualified institutional buyer, and it is aware that the Joint Lead Managers are selling the Notes to it in reliance on Rule 144A; or
- it is not a U.S. person (as defined in Regulation S under the Securities Act) or purchasing for the account or benefit of a U.S. person, other than a distributor, and it is purchasing Notes in an offshore transaction in accordance with Regulation S.

(3) Each prospective investor acknowledges that neither the Republic nor the Joint Lead Managers nor any person representing the Republic or the Joint Lead Managers has made any representation to such prospective investor with respect to the Republic or the offering of the Notes, other than the information contained in this Offering Circular. Each prospective investor represents that it is relying only on this Offering Circular in making its investment decision with respect to the Notes. Each prospective investor agrees that it has had access to such information concerning the Republic and the Notes as it has deemed necessary in connection with its decision to purchase Notes, including an opportunity to ask questions of and request information from the Republic.

(4) Each prospective investor represents that it is purchasing Notes for its own account, or for one or more investor accounts for which it is acting as a fiduciary or agent, in each case not with a view to, or for offer or sale in connection with, any distribution of the Notes in violation of the Securities Act, subject to any requirement of law that the disposition of its property or the property of that investor account or accounts be at all times within its or their control and subject to its or their ability to resell the Notes pursuant to Rule 144A or any other available exemption from the registration requirements of the Securities Act. Each prospective investor agrees on its own behalf and on behalf of any investor account for which it is purchasing Notes, and each subsequent holder of the Notes by its acceptance of the Notes will agree, that until the end of the resale restriction period (as defined below), the Notes may be offered, sold or otherwise transferred only:

(a) to the Republic;

(b) under a registration statement that has been declared effective under the Securities Act;

(c) for so long as the Notes are eligible for resale under Rule 144A, to a person whom the seller reasonably believes is a qualified institutional buyer that is purchasing for its own account or for the account of another qualified institutional buyer and to whom it has given notice that the transfer is being made in reliance on Rule 144A;

(d) through offers and sales that occur outside the United States within the meaning of Regulation S; or

(e) under any other available exemption from the registration requirements of the Securities Act; subject in each of the above cases to any requirement of law that the disposition of the seller's property or the property of an investor account or accounts be at all times within the seller or such account's control.

Each prospective investor also acknowledges that:

- the above restrictions on resale will apply from the closing date of the offering of the Notes until the date that is two years after the later of the closing date and the last date that the Republic or any of its affiliates was the owner of the Notes or any predecessor of the Notes (which we refer to in this Offering Circular as the "resale restriction period"), and will not apply after the resale restriction period ends;

- the Republic and the fiscal agent reserve the right to require, in connection with any offer, sale or other transfer of Notes before the resale restriction period ends under clauses (d) and (e) above, the delivery of an opinion of counsel, certifications and/or other information satisfactory to the Republic and the fiscal agent; and

- each Note will contain a legend substantially to the following effect:

THIS NOTE HAS NOT BEEN AND WILL NOT BE REGISTERED UNDER THE U.S. SECURITIES ACT OF 1933, AS AMENDED (THE "SECURITIES ACT"), OR ANY SECURITIES LAW OF ANY STATE IN THE UNITED STATES OF AMERICA, AND MAY NOT BE REOFFERED, RESOLD, PLEDGED OR OTHERWISE TRANSFERRED EXCEPT AS PERMITTED BY THE FOLLOWING SENTENCES. THE HOLDER HEREOF, BY ITS ACCEPTANCE OF THIS NOTE, REPRESENTS, ACKNOWLEDGES AND AGREES THAT IT WILL NOT REOFFER, RESELL, PLEDGE OR OTHERWISE TRANSFER THIS NOTE EXCEPT (A) IN COMPLIANCE WITH RULE 144A UNDER THE SECURITIES ACT, TO A PERSON WHOM THE SELLER REASONABLY BELIEVES IS A QUALIFIED INSTITUTIONAL BUYER (AS DEFINED IN RULE 144A) PURCHASING FOR ITS OWN ACCOUNT, OR FOR THE ACCOUNT OF A QUALIFIED INSTITUTIONAL BUYER WHOM THE SELLER HAS INFORMED, IN EACH CASE, THAT THE REOFFER, RESALE, PLEDGE OR OTHER TRANSFER IS BEING MADE IN RELIANCE ON RULE 144A; (B) IN THE UNITED STATES, PURSUANT TO AN EXEMPTION FROM REGISTRATION UNDER THE SECURITIES ACT PROVIDED BY RULE 144 THEREUNDER (IF AVAILABLE AND UPON DELIVERY OF AN OPINION OF COUNSEL IN A FORM SATISFACTORY TO THE REPUBLIC); OR (C) OUTSIDE THE UNITED STATES IN COMPLIANCE WITH RULE 904 OF REGULATION S UNDER THE SECURITIES ACT; IN EACH CASE IN ACCORDANCE WITH ANY APPLICABLE SECURITIES LAW OF ANY STATE OF THE UNITED STATES AND ANY OTHER JURISDICTION. TERMS USED IN THIS PARAGRAPH HAVE THE MEANINGS GIVEN TO THEM BY REGULATION S OR RULE 144A, AS APPLICABLE, UNDER THE SECURITIES ACT.

Each prospective investor acknowledges that the Republic, the Joint Lead Managers and others will rely upon the truth and accuracy of the above acknowledgments, representations and agreements. Each prospective investor agrees that if any of the acknowledgments, representations or agreements such prospective investor is deemed to have made by its purchase of Notes is no longer accurate, it will promptly notify the Republic and the Joint Lead Managers. If any prospective investor is purchasing any Notes as a fiduciary or agent for one or more investor accounts, such prospective investor represents that it has sole investment discretion with respect to each of those accounts and that it has full power to make the above acknowledgments, representations and agreements on behalf of each account.

TAXATION

El Salvador Taxation

The following is a general discussion of Salvadoran tax considerations. The discussion is based upon the tax laws of El Salvador as in effect on the date of this Offering Circular, which are subject to change. Prospective investors should consult their own tax advisers with respect to Salvadoran tax consequences of the investment. This summary does not discuss the effects of any treaties that may be entered into by, or be effective with respect to, El Salvador.

Under current Salvadoran law, including Legislative Decree No. 921 dated December 20, 2005, payments of principal and interest on the Notes are not subject to income or withholding tax in El Salvador. In addition, gains realized on the sale or other disposition of the Notes are not subject to income or withholding tax in El Salvador provided the transaction takes place outside El Salvador or, if within El Salvador, through a Salvadoran stock exchange by an individual. There are no Salvadoran transfer, inheritance, gift or succession taxes applicable to the Notes.

United States Taxation

Circular 230 Disclosure: Any U.S. federal taxation discussion in this Offering Circular was not intended or written to be used, and cannot be used, by any taxpayer for purposes of avoiding U.S. federal tax penalties that may be imposed on the taxpayer. Any such tax discussion was written to support the promotion or marketing of the Notes to be issued or sold pursuant to this Offering Circular. Each taxpayer should seek advice based on the taxpayer's particular circumstances from an independent tax adviser.

The following summary of certain United States federal income tax consequences to original purchasers of the Notes of the purchase, ownership and disposition of the Notes is based upon existing United States federal income tax law, which is subject to change, possibly with retroactive effect. This summary does not purport to discuss all aspects of United States federal income taxation which may be relevant to a particular investor in light of that investor's individual investment circumstances, such as investors whose functional currency is not the United States dollar or certain types of investors subject to special tax rules (*e.g.*, financial institutions, insurance companies, dealers in securities or currencies, certain securities traders, regulated investment companies, and tax-exempt organizations and investors holding Notes as a position in a "straddle," "conversion transaction," or "constructive sale" transaction). In addition, this summary does not discuss any foreign, state, or local tax considerations. This summary only applies to investors that hold Notes as "capital assets" (generally, property held for investment) within the meaning of the United States Internal Revenue Code of 1986, as amended (the "Code"). Prospective investors should consult their own tax advisors regarding the U.S. federal, state, and local, as well as foreign, tax considerations of investing in the Notes.

For purposes of this summary, a "US Holder" includes an individual who is a citizen or resident of the United States, a corporation or partnership (including an entity treated as a corporation or partnership for United States federal income tax purposes) created or organized in or under the laws of the United States, any state of the United States or the District of Columbia (other than a partnership that is not treated as a United States person under any applicable Treasury regulations), an estate whose income is subject to United States federal income tax regardless of its source or a trust if a court within the United States is able to exercise primary supervision over the administration of the trust and one or more United States persons have the authority to control all substantial decisions of the trust. Notwithstanding the preceding sentence, to the extent provided in Treasury regulations, certain trusts in existence on August 20, 1996, and treated as United States persons under the Code and applicable Treasury regulations prior to that date, that elect to continue to be treated as United States persons under the Code or applicable Treasury regulations also will be US Holders. As used herein, the term "non-US Holder" means a holder of a Note that is not a US Holder.

Payments of Interest and Additional Amounts

Payments of interest on a Note (including Additional Amounts, if any) generally will be taxable to a US Holder as ordinary interest income at the time it is received or accrued, depending on the US Holder's regular method of tax accounting. Interest on the Notes will constitute income from sources outside the United States and under the foreign tax credit rules, interest paid in taxable years beginning before January 1, 2007, with certain exceptions, will be "passive" or "financial services" income, while interest paid in taxable years beginning after December 31, 2006 will, depending on the U.S. Holder's circumstances, be "passive" or "general" income, which, in either case, is treated separately from other types of income for purposes of computing the foreign tax credit allowable to a US Holder under the United States federal income tax laws.

Sale, Exchange or Retirement of a Note

A US Holder will generally recognize taxable capital gain or loss upon the sale, exchange, retirement or other disposition of a Note (including payments as a result of an acceleration) in an amount equal to the difference between the amount realized upon that sale, exchange, retirement or other disposition (other than amounts representing accrued and unpaid interest) and that US Holder's adjusted tax basis in the Note. A US Holder's adjusted tax basis in a Note generally will equal that US Holder's initial investment in the Note. That gain or loss will generally be long-term capital gain or loss if the Note is held for more than one year, and generally will be U.S. source income or loss for U.S. foreign tax credit purposes. Under current law, net capital gains of individuals may be taxed at lower rates than items of ordinary income. The ability of a US Holder to offset capital losses against ordinary income is limited.

Non-US Holders

Subject to the discussion below of special rules that may apply to certain non-US Holders and the discussion below of "backup" withholding, payments of interest and any Additional Amounts on the Notes are currently not subject to U.S. federal income tax, including withholding tax, if paid to a "non-US Holder," whether or not that non-US Holder is engaged in a trade or business in the United States, unless:

(i) the holder is an insurance company carrying on a U.S. insurance business to which the interest is attributable, within the meaning of the Code, or

(ii) the holder has an office or other fixed place of business in the United States to which the interest is attributable and the interest is derived in the active conduct of a banking, financing or similar business within the United States and certain other conditions exist.

In addition, (i) subject to the discussion below of special rules that may apply to certain non-US Holders and the discussion below of backup withholding, a non-US Holder will not be subject to U.S. federal income or withholding tax on any gain realized on the sale or exchange of a Note, and (ii) the Notes will be deemed to be situated outside the United States for purposes of the U.S. federal estate tax and will not be includible in the gross estate for purposes of that tax in the case of a non-US Holder who was not a citizen of the United States at the time of death if income on the Notes would not have been effectively connected with a United States trade or business at the time of the holder's death.

Special rules may apply in the case of non-US Holders that are (i) engaged in a U.S. trade or business, (ii) former citizens or long-term residents of the United States, "controlled foreign corporations," "foreign personal holding companies," corporations which accumulate earnings to avoid U.S. federal income tax, or certain foreign charitable organizations, each within the meaning of the Code, or (iii) non-resident alien individuals who are present in the United States for 183 days or more during a taxable year. Such persons are urged to consult their U.S. tax advisors before purchasing Notes.

Backup Withholding and Information Reporting

In general, information reporting requirements will apply to payments of principal of and interest and any Additional Amounts on the Notes to non-corporate US Holders if those payments are made within the United States or by or through a custodian or nominee that is a United States Controlled Person, as defined below. Backup withholding tax will apply to those payments if such a US Holder fails to provide an accurate taxpayer identification number or, in the case of interest payments and the accrual of interest, fails to certify that it is not subject to backup withholding or is notified by the Internal Revenue Service that it has failed to report all interest and dividends required to be shown on its United States federal income tax return. Payments of principal and interest to beneficial owners who are non-US Holders generally will not be subject to information reporting and backup withholding, but those holders may be required to establish their exemption from information reporting and backup withholding by certifying their status on United States Internal Revenue Service Forms W-8BEN.

The payment of proceeds of a sale or redemption of Notes effected at the U.S. office of a broker will generally be subject to the information reporting and backup withholding rules described above. In addition, the information reporting rules will apply to payments of proceeds of a sale or redemption effected at a foreign office of a broker that is a United States Controlled Person, unless the broker has documentary evidence that the holder or beneficial owner is not a US Holder (and has no actual knowledge or reason to know to the contrary) or the holder or beneficial owner otherwise establishes an exemption.

Under U.S. Treasury regulations, a payment to a foreign partnership is treated, with some exceptions, for backup withholding purposes as a payment directly to the partners, so that the partners are required to provide any required certifications. Investors who

hold a Note through a partnership or other pass-through entity should consult their own tax advisors regarding the application of these regulations to their own situation.

A "United States Controlled Person" is:

- a United States person (as defined in the United States Treasury regulations);
- a controlled foreign corporation for United States federal income tax purposes;
- a foreign person 50% or more of whose gross income is derived for tax purposes from a U.S. trade or business for a specified three-year period; or
- a foreign partnership in which United States persons hold more than 50% of the income or capital interests or which is engaged in a U.S. trade or business.

Any amounts withheld under the backup withholding rules from a payment to a holder of a Note generally will be allowed as a refund or a credit against the holder's United States federal income tax liability as long as the holder provides the required information to the Internal Revenue Service.

European Union Directive on Taxation of Certain Interest Payments

Under European Council Directive 2003/48/EC on the taxation of savings income, Member States of the European Union are required to provide to the tax authorities of another Member State details of payments of interest (or similar income) paid by a person within its jurisdiction to an individual resident in that other Member State. However, for a transitional period, Belgium, Luxembourg and Austria are instead required (unless during that period they elect otherwise) to operate a withholding system in relation to such payments (the ending of such transitional period being dependent upon the conclusion of certain other agreements relating to information exchange with certain other countries). A number of non-EU countries and territories have agreed to adopt similar measures (some of which involve a withholding system). No additional amounts will be payable if a payment on a debt security to an individual is subject to any withholding or deduction that is required to be made pursuant to any European Union Directive on the taxation of savings income or any law implementing or complying with, or introduced in order to conform to, any such Directive.

Prospective investors should consult their own tax advisors regarding the application of Directive 2003/48/EC or any similar Directive.

VALIDITY OF THE NOTES

The validity of the Notes will be passed upon on behalf of the Republic by Lic. Félix Garrid Safie, the *Fiscal General* (the "Attorney General") of the Republic and by Bufete Dr. F.A. Arias, S.A. de C.V., Salvadoran counsel to the Republic, and by Arnold & Porter LLP, U.S. counsel to the Republic. The validity of the Notes will be passed upon on behalf of the Joint Lead Managers by Guandique Segovia Quintanilla, Salvadoran counsel to the Joint Lead Managers, and by Cleary Gottlieb Steen & Hamilton LLP, U.S. counsel to the Joint Lead Managers. As to all matters of Salvadoran law, Arnold & Porter LLP will rely on the opinions of the Attorney General and Bufete Dr. F.A. Arias, S.A. de C.V., and Cleary Gottlieb Steen & Hamilton LLP will rely upon the opinion of Guandique Segovia Quintanilla.

GENERAL INFORMATION

1. The Regulation S Global Note will be accepted for clearance through Euroclear and Clearstream, Luxembourg and the Restricted Global Note will be accepted for clearance through DTC. The CUSIP numbers for the Regulation S Global Note and the Restricted Global Note are P01012 AN 6 and 283875 AN 2, respectively. The common codes for the Regulation S Global Note and the Restricted Global Note are 022168134 and 022168100, respectively, and the International Securities Identification Numbers for the Regulation S Global Note and the Restricted Global Note are USP01012AN67 and US283875AN23, respectively.

2. The Republic has obtained all necessary consents, approvals and authorizations in the Republic of El Salvador in connection with the issue and performance of the Notes. The issue of the Notes is authorized under Legislative Decree No. 921 (as published in the *Diario Oficial* on December 20, 2005) of the Republic's Legislative Assembly.

3. Neither the Republic nor any Ministry of the Republic is involved in any litigation or arbitration proceedings which are material in the context of the issue of the Notes nor, so far as the Republic is aware, are any such litigation or arbitration proceedings pending or threatened.

4. Application has been made to list the Notes on the Luxembourg Stock Exchange and to have the Notes admitted to trading on the Euro MTF Market, the alternative market of the Luxembourg Stock Exchange. So long as any of the Notes are listed on the Luxembourg Stock Exchange and the rules of such stock exchange shall so require, the Republic will maintain a paying agent and transfer agent in Luxembourg.

5. Copies of the following documents may be obtained on any business day (Saturdays, Sundays and public holidays excepted) at the office of the Paying Agent in Luxembourg so long as any of the Notes are listed on the Luxembourg Stock Exchange:

(a) the Fiscal Agency Agreement incorporating the forms of Global Notes and Note Certificates;

(b) copies of the Constitution of the Republic, and the Legislative Decrees of the Republic referred to in paragraph 2 above (in Spanish); and

(c) copies of the Republic's consolidated public sector fiscal accounts for the last calendar year (as and when available in English).

6. Other than as disclosed herein, there has been no material adverse change in the financial condition of the Republic which is material in the context of the issue of the Notes since December 31, 2005.

ISSUER

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REPUBLICA DE EL SALVADOR EN LA AMERICA CENTRAL