

## Ecuador

### 1. General trends

Economic growth in Ecuador stood at 6.5% in 2008, significantly higher than the 2.5% posted in 2007. As in other countries of Latin America and the Caribbean, high prices for export commodities—in this case, crude oil—led to a sharp rise in fiscal revenue in 2007 and the first three quarters of 2008, which allowed the government to finance substantially higher public spending, especially public investment. Economic growth is expected to be only 1% in 2009, however, mainly because of lower oil prices.

The Constituent Assembly approved a new Constitution, introducing various significant changes, including economic ones. The State will have a more prominent role in economic matters and, more specifically, the central bank will no longer be independent.

Despite the sharp rise in public revenue, in 2008 the fiscal situation deteriorated markedly relative to 2007, as the primary and overall balances of the non-financial public sector (NFPS) worsened. While the primary balance went, in GDP terms, from a 4.0% surplus in 2007 to a 0.2% deficit in 2008, the overall balance declined from a 2.1%

surplus to a 1.6% deficit. Fiscal policy is likely to be less expansionary in 2009, because of the fiscal constraints the government will face in terms of oil revenue receipts and financing public spending.

Lastly, the balance-of-payments current account also deteriorated, with the surplus in GDP terms falling from 3.6% in 2007 to 2.3% in 2008. This was due to a sharp depreciation in the balance of trade in goods in the fourth quarter, with rising imports driven by higher consumption and a fall in petroleum export earnings caused by lower international oil prices.

### 2. Economic policy

#### (a) Fiscal policy

Public spending continued the upward trend begun in 2007, with total spending by the NFPS rising from 27.4% to 40.6% of GDP. Although this higher expenditure was due to a strong rise in gross fixed capital formation by the State, from 6.9% of GDP in 2007 to 13.5% in 2008, sharp increases were also posted in current spending, including wages, purchases of goods and services, transfers and other expenditure such as the Human Development Bond. In

particular, large amounts were spent on imported petroleum products, which were sold at fixed prices far below cost. Fiscal revenue rose from 29.4% of GDP in 2007 to 39% in 2008. Oil revenue soared from 7.2% to 16.5% of GDP in the same period, almost exclusively because of higher international petroleum prices. Non-petroleum revenue also increased, although to a lesser extent, rising from 20.9% to 21.7% of GDP between 2007 and 2008. In April 2008, the petroleum funds were eliminated and the balances were transferred to the “single current account”.

With larger increases in spending than in revenue, non-petroleum revenue in 2008 was insufficient to cover current spending and, in fact, accounted for only 80.6% of it. This poses serious policy challenges for 2009, owing to financing constraints and lower oil prices. In particular, given the downward rigidity of current spending, the reduction in oil revenue in the context of the international financial crisis makes it more likely that an adjustment in fiscal spending in 2009 will have an especially strong impact on public investment. From the third to the fourth quarter of 2008, petroleum revenue fell by an amount equivalent to 1.8% of GDP, with a larger decrease expected in 2009. It is thus very likely that capital formation by the State will decline sharply in 2009, with the consequent detrimental effects for economic growth.

From 2007 to 2008, the slight fall in nominal total public debt, together with a 6.5% rise in GDP, translated into a decline of the debt-to-GDP ratio from 30.0% to 25.8%. The ratio of internal debt to external debt in nominal terms also changed, while both fell in GDP terms. External debt fell from 22.9% of GDP in December 2007 to 18.9% twelve months later, while internal debt rose from 6.9% of GDP to 7.1%. Internal debt continued to rise in the first quarter of 2009. In April 2009, the Latin American Reserve Fund agreed to extend a US\$ 480 million loan to Ecuador, with three years for repayment of the principal and a one-year grace period. The government has entered into negotiations with other international agencies to obtain loans to meet its 2009 budget.

In November 2008, the government made public a report on the country's debt, prepared by the Ecuadoran Integral Public Credit Audit Commission (CAIC). At the same time, it decided to declare technical default on the payment of interest on its 2012 Global Bonds, and in February 2009 on that of its 2030 Global Bonds. In December 2008, the 2012 bonds and the 2030 bonds each represented a commitment of US\$ 3.24 billion, equivalent to 23.6% of the country's total public debt and 32.1% of its external public debt. Lastly, on 20 April 2009, the government proposed that holders of these bonds submit bids to trade their bonds for cash in a modified Dutch auction. The government set a floor price of 29.5% plus 50 basis points over nominal value. This did not extend to the third Global Bond, due in 2015. As a result, in June 2009, the government announced that 92.8% of the 2030 bonds and 81.3% of the 2012 bonds had been withdrawn from the market.

### **(b) Monetary policy**

Between 2008 and early 2009, benchmark interest rates in the country's financial sector fell. Whereas in April 2008, the maximum rate for corporate loans stood at 10.9%, by April 2009, it had dropped to 9.3%. The

maximum rate for the small and medium-sized enterprise sector fell from 14.5% to 11.8% in the same period.

Banking sector assets increased until November 2008, when they reached the equivalent of 33.9% of GDP, up from 32.2% in December 2007. From then until early 2009, they began to decline in nominal terms. Between November 2008 and March 2009, the cumulative decline in bank assets was equivalent to 4.5% in dollars. This may reflect the sharp decline in oil prices and the consequent reduction in assets to finance the more than US\$ 1.5 billion deficit of the balance-of-payments current account during the fourth quarter of 2008.

In 2008 and early 2009, the composition of assets also shifted. In particular, the liquid assets held by open banks in proportion to total assets has been decreasing since July 2008, especially in terms of deposits abroad. Despite the fiscal constraints, the banking sector continued to show little interest in lending to the State; hence, government bonds represented only 0.5% of the banking sector's portfolio. Lastly, starting in November, the decline in asset values began to affect especially loans to companies in the non-financial public sector, which declined by 8.3% in nominal terms—nearly twice as much as that of total assets—between November 2008 and March 2009. By contrast, growth in lending to other residents, including consumer credit, was sluggish, only 0.4% in the same period.

### **(c) Other policies**

As a result of the turmoil stemming from the global financial crisis, the currencies of several of the country's leading trading partners, including the European Union, Brazil and Colombia, depreciated against the dollar starting in mid-2008. This, combined with a higher rate of inflation in Ecuador than in the United States and some trading partners, translated into a 9.8% effective real exchange rate appreciation between December 2007 and December 2008. This trend continued for the first three months of 2009, and the effective real exchange rate fell by 1.4% from December 2008 to March 2009.

Lastly, in response to the deterioration in the current account since late 2008, the government adopted a series of policies to restrict imports. The measures introduced in January 2008 included safeguard measures on imports, introduced initially for one year, to partially mitigate the balance-of-payments deficit expected for 2009, and Resolution 467 of the Foreign Trade and Investment Council of Ecuador, on the distribution of import quotas. This provision increased ad valorem tariffs on some sub-items and set specific tariffs for others, especially textiles, footwear and two sub-items in the ceramics sector. Quantitative restrictions were also adopted on imports of a series of products by assigning importer and sub-item quotas.

### 3. The main variables

#### (a) Economic activity

The economy grew by 6.5% in 2008, mainly on the strength of the construction sector (13.8%), in addition to services, manufacturing and government services. On the demand side, private consumption and gross fixed capital formation were the most powerful economic engines in 2008, in particular because of the strong increase in public investment. While private consumption grew by 7%, gross fixed capital formation increased by 16.1%. The reason for this increase in GDP was the strong fiscal stimulus the economy received thanks to the recovery in fiscal receipts, especially as a result of higher oil prices.

It is useful to examine the performance in 2008 of the oil sector, which accounts for 18.6% of the country's GDP. Although the volume of oil produced declined by 1%, the performance of the State-owned company PETROECUADOR (including Petroamazonas, which operates block 15) should be distinguished from that of private companies: output by the former increased by 3.4%, while that of the private companies fell by 5.5%. In particular, extraction by private companies declined steadily starting in April 2008, possibly owing to the lack of investment in a context in which the Ecuadorian government is attempting to increase its share of oil revenues. Also, PETROECUADOR embarked on an investment plan to increase its oil-extraction capacity in 2008. The 2009 investment budget, however, has been cut because of fiscal constraints.

Economic activity is expected to decline sharply in 2009, within a context of fiscal-management and balance-of-payment constraints and the general sluggishness of the global economy owing to the international financial crisis; this is likely to result in low economic growth for Ecuador. Specifically, the buoyancy seen in the construction sector in 2008 is unlikely to continue, given that significantly lower public investment and internal demand and tighter credit could reduce demand for housing.

#### (b) Prices, wages and employment

Inflation stood at 8.8% in 2008, as measured by the variation in the consumer price index from December 2007 to December 2008. Inflation rose in early 2008 and peaked in August before gradually falling to 5.4% in May 2009. During the first five months of 2009, cumulative inflation stood at 2.9%. Although the international crisis

led to a downward trend for many products in this period, the restrictive trade measures imposed by the government in early 2009 could explain part of the inertial inflation in sectors such as clothing and footwear.

Labour force participation in urban areas decreased from 61.2% to 60.1%, while the fall in the employment rate was smaller (from 56.8% to 56.0%); hence, the unemployment rate dropped moderately (from 7.4% to 6.9%). The real minimum wage rose by 8.5% over the year.

#### (c) The external sector

The current account surplus was US\$ 1.194 billion in 2008, equivalent to 2.3% of GDP, down from 3.6% of GDP in 2007. However, a US\$ 1.526 billion deficit was posted in the fourth quarter of 2008, equivalent to 2.9% of GDP. The balance of trade in goods was particularly favourable, as a result of high oil prices until the third quarter. The income balance also improved during 2008; the deficit fell from 4.0% of GDP in 2007 to 2.5% in 2008, especially as a result of declining income from direct foreign investment. Remittances from Ecuadorian emigrants declined in 2008. The United States accounts for 46.8% of all remittances, Spain 41%, and Italy in a distant third place, with 7.5%. Because of the crisis in those countries, remittances fell by 8.6% on a nominal basis, while in GDP terms they declined from 6.7% to 5.3% between 2007 and 2008. The sharpest decline was in remittances from the United States. Given that economic problems will persist in the United States and Spain in 2009, remittances from Ecuadorian emigrants are expected to remain stagnant and to continue the trend seen since the second quarter of 2008.

Regarding the balance-of-payments financial account, the net outflow of hard currency from Ecuador was equivalent to 0.9% of GDP in 2008. Net FDI rose during the year, but from a very low level, and reached 1.8% of GDP. The branch of economic activity that received most FDI was mining and quarrying. Along with the acquisition of foreign assets like deposits abroad and, to a lesser extent, other assets outflows occurred as both the public and private-sectors paid down their loans. Hence, the net outflow of foreign currency, in the category "other investments," which comprises the items mentioned above, was 3.1% of GDP, outstripping the higher flows of FDI received during the year.

Table 1  
ECUADOR: MAIN ECONOMIC INDICATORS

	2000	2001	2002	2003	2004	2005	2006	2007	2008 <sup>a</sup>
<b>Annual growth rates<sup>b</sup></b>									
<b>Gross domestic product</b>	2.8	5.3	4.2	3.6	8.0	6.0	3.9	2.5	6.5
<b>Per capita gross domestic product</b>	1.3	3.8	2.8	2.1	6.5	4.5	2.4	1.0	5.0
<b>Gross domestic product, by sector</b>									
Agriculture, livestock, hunting, forestry and fishing	-0.1	3.6	5.4	5.6	1.9	7.8	5.1	4.1	5.4
Mining and quarrying	8.0	1.1	-2.5	6.0	25.3	1.1	1.0	-4.8	0.0
Manufacturing	-32.4	11.6	6.3	3.7	-10.3	20.0	1.0	9.3	11.3
Electricity, gas and water	2.6	0.6	8.2	1.2	-8.7	1.3	0.5	15.5	12.7
Construction	18.3	19.7	20.0	-0.7	4.0	7.3	3.8	0.1	13.8
Wholesale and retail commerce, restaurants and hotels	3.8	4.8	2.2	3.5	3.9	5.3	4.9	3.4	6.5
Transport, storage and communications	7.7	1.9	1.2	4.3	4.8	8.9	7.2	5.7	5.4
Financial institutions, insurance, real estate and business services	2.3	3.6	7.9	2.7	6.2	9.0	7.3	5.3	7.6
Community, social and personal services	5.8	0.4	-0.4	2.3	2.7	2.5	3.6	5.3	14.0
<b>Gross domestic product, by type of expenditure</b>									
Consumption	3.9	5.8	6.3	4.7	4.5	6.9	5.3	3.8	7.5
General government	4.7	-0.6	4.3	1.4	3.6	3.5	3.7	6.1	11.6
Private	3.8	6.8	6.6	5.2	4.7	7.3	5.5	3.5	7.0
Gross domestic fixed investment	12.1	23.5	18.9	-0.2	4.9	10.9	3.8	2.5	16.1
Exports (goods and services)	-1.0	-0.8	-0.8	9.6	15.9	9.0	8.9	2.2	3.3
Imports (goods and services)	15.8	24.8	16.7	-3.9	11.1	13.7	9.3	7.3	10.2
<b>Percentages of GDP</b>									
<b>Investment and saving<sup>c</sup></b>									
Gross domestic investment	20.1	24.3	26.5	21.5	23.4	23.8	23.4	24.1	25.6
National saving	25.9	21.3	21.3	20.0	21.7	24.7	27.3	27.7	27.8
External saving	-5.8	2.9	5.1	1.5	1.7	-0.9	-3.9	-3.6	-2.3
<b>Millions of dollars</b>									
<b>Balance of payments</b>									
Current account balance	921	-624	-1 271	-422	-542	348	1 618	1 650	1 194
Goods balance	1 395	-356	-902	80	284	758	1 768	1 823	1 361
Exports, f.o.b.	5 137	4 821	5 258	6 446	7 968	10 468	13 176	14 870	19 147
Imports, f.o.b.	3 743	5 178	6 160	6 366	7 684	9 709	11 408	13 047	17 786
Services trade balance	-420	-572	-716	-744	-954	-1 130	-1 305	-1 371	-1 548
Income balance	-1 405	-1 335	-1 305	-1 528	-1 902	-1 942	-1 950	-2 047	-1 607
Net current transfers	1 352	1 639	1 652	1 769	2 030	2 661	3 104	3 246	2 989
Capital and financial balance <sup>d</sup>	-6 618	394	1 144	558	823	318	-1 748	-263	-246
Net foreign direct investment	720	1 330	1 275	872	837	493	271	193	974
Other capital movements	-7 338	-936	-132	-313	-14	-175	-2 019	-457	-1 220
Overall balance	-5 697	-230	-127	136	281	666	-131	1 387	948
Variation in reserve assets <sup>e</sup>	-307	106	66	-152	-277	-710	124	-1 497	-952
Other financing	6 004	124	62	17	-4	43	7	111	4
<b>Other external-sector indicators</b>									
Real effective exchange rate (index: 2000=100) <sup>f</sup>	100.0	70.7	61.8	60.3	61.6	64.8	65.4	68.2	68.8
Terms of trade for goods (index: 2000=100)	100.0	84.6	86.8	89.8	91.5	102.4	109.9	113.0	124.0
Net resource transfer (millions of dollars)	-2 020	-817	-100	-953	-1 084	-1 580	-3 691	-2 200	-1 850
Total gross external debt (millions of dollars)	1 180	1 074	1 008	1 160	1 437	2 147	2 023	3 521	4 473
<b>Average annual rates</b>									
<b>Employment</b>									
Labour force participation rate <sup>g</sup>	57.3	63.1	58.3	58.2	59.1	59.5	59.1	61.2	60.1
Unemployment rate <sup>h</sup>	14.1	10.4	8.6	9.8	9.7	8.5	8.1	7.4	6.9
Visible underemployment rate <sup>i</sup>	16.1	12.6	10.2	9.8	8.1	7.3	6.3	10.8	9.9
<b>Prices</b>									
<b>Annual percentages</b>									
Variation in consumer prices (December-December)	91.0	22.4	9.4	6.1	1.9	3.1	2.9	3.3	8.8
Variation in producer prices (December-December)	64.9	-5.6	17.7	4.5	4.3	21.6	7.2	18.2	-28.3
Variation in nominal exchange rate (annual average) <sup>j1</sup>	112.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Variation in minimum urban wage	-3.6	11.5	0.9	6.1	2.4	3.0	3.3	3.9	8.5
Nominal deposit rate <sup>k</sup>	8.2	6.6	5.1	5.3	4.0	3.8	4.4	5.3	5.5
Nominal lending rate <sup>k</sup>	15.2	15.5	14.1	12.6	10.2	8.7	8.9	10.1	9.8

Table 1 (concluded)

	2000	2001	2002	2003	2004	2005	2006	2007	2008 <sup>a</sup>
	<b>Percentages of GDP</b>								
<b>Central government</b>									
Total income	20.4	18.1	18.4	16.7	15.9	16.3	16.5	18.5	26.2
Tax income	10.2	11.2	11.0	9.7	9.7	10.1	10.2	10.4	12.5
Total expenditure	20.3	19.1	19.1	17.0	16.8	16.8	16.7	18.7	27.4
Current expenditure	16.1	12.4	14.2	12.4	12.6	12.7	12.7	12.9	16.1
Interest	6.3	4.4	3.3	2.9	2.5	2.3	2.3	2.0	1.5
Capital expenditure	4.1	6.8	4.9	4.6	4.3	4.1	4.0	5.7	11.3
Primary balance	6.5	3.4	2.6	2.5	1.5	1.8	2.0	1.9	0.3
Overall balance	0.1	-1.0	-0.7	-0.4	-1.0	-0.5	-0.2	-0.1	-1.2
<b>Public-sector debt</b>									
Domestic <sup>l</sup>	17.8	13.2	11.1	10.5	10.7	9.9	7.8	7.1	6.9
External	63.9	49.5	43.2	38.6	33.0	28.7	24.1	22.9	18.9
<b>Money and credit<sup>m</sup></b>									
Domestic credit	34.7	26.5	20.4	17.3	16.6	16.8	17.1	18.0	18.0
To the public sector	3.6	-0.1	-0.3	-2.5	-4.5	-6.1	-6.7	-6.9	-9.2
To the private sector	31.1	26.6	20.7	19.8	21.1	22.8	23.9	24.9	27.2
Liquidity (M2)	25.6	24.2	23.4	20.3	21.7	23.0	24.0	25.9	27.5

Source: Economic Commission for Latin America and the Caribbean (ECLAC), on the basis of official figures.

<sup>a</sup> Preliminary figures.

<sup>b</sup> Based on figures in local currency at constant 2000 prices.

<sup>c</sup> Based on figures in local currency expressed in dollars at current prices.

<sup>d</sup> Includes errors and omissions.

<sup>e</sup> A minus sign (-) denotes an increase in reserves.

<sup>f</sup> Annual average, weighted by the value of goods exports and imports.

<sup>g</sup> Economically active population as a percentage of the working-age population, three cities.

<sup>h</sup> Percentage of the economically active population, urban total. Up to 2003, the figures relate to Cuenca, Guayaquil and Quito. Includes hidden unemployment.

<sup>i</sup> Percentage of the economically active population, three cities.

<sup>j</sup> In January 2000, the country adopted the United States dollar as its official currency.

<sup>k</sup> Reference rate in dollars, monthly average.

<sup>l</sup> Refers to the central government.

<sup>m</sup> The monetary figures are end-of-year stocks.

The value of Ecuadorian exports rose by 29.3% in 2008, up from the 12.7% growth posted in 2007. Some 80% of this increase stemmed from petroleum-related sales, especially those of crude oil (75%). The value of exports increased by 42.3%, owing mainly to the rise in international oil prices from an average of US\$ 59.9 per barrel in 2007 to US\$ 83 in 2008. The quantity of crude oil exported rose by only 2.6% from 2007 to 2008. The value of exports of petroleum products increased by 22.7%, but solely because of higher prices, since the volume exported declined slightly. Non-petroleum exports were up 14.1% in value terms, accounting for 20% of the increase in exports. The most noteworthy of the products contributing to exports were bananas, which were up 25.9% and accounted for about 10% of the increase in exports,

and tinned fish and vegetable oils, which rose 21.5% and 57.5%, respectively. In the first three months of 2009, the value of exports was down 69.3%, mainly because of the decrease in oil exports (67.2%), although the value of non-petroleum exports also declined by 4.5%.

The value of imports rose by 35.1% in 2008, driven by higher international prices for several products, such as intermediate goods, and higher domestic demand. Raw materials imports accounted for 38.4% of this increase, while an additional 26.2% stemmed from capital goods purchases. As a result of the lower prices for imported goods and, probably, the economic slowdown starting in the last quarter of 2008, imports decreased by 1.7% in the first few months of 2009, almost entirely because of the 3.8% decrease in the value of raw materials imports.

Table 2  
ECUADOR: MAIN QUARTERLY INDICATORS

	2007				2008 <sup>a</sup>				2009 <sup>a</sup>	
	I	II	III	IV	I	II	III	IV	I	II
Gross domestic product (variation from same quarter of preceding year) <sup>b</sup>	1.6	1.1	1.4	5.8	6.5	8.3	8.0	3.4	1.2	...
Goods exports, f.o.b. (millions of dollars)	2 878	3 353	3 826	4 264	4 623	5 497	5 178	3 213	2 623	...
Goods imports, c.i.f. (millions of dollars)	3 094	3 161	3 556	4 083	3 747	4 508	5 374	5 058	3 669	...
Gross international reserves (millions of dollars)	2 182	3 204	3 611	3 521	4 144	6 103	6 477	4 473	3 244	2 675
Real effective exchange rate (index: 2000=100) <sup>c</sup>	66.1	68.1	68.5	70.0	70.7	70.8	69.4	64.4	62.7	63.5 <sup>d</sup>
Unemployment rate	8.8	7.4	7.1	6.1	6.9	6.4	7.1	7.3	8.6	...
Consumer prices (12-month percentage variation)	1.5	2.2	2.6	3.3	6.6	9.7	10.0	8.8	7.4	4.5
Average nominal exchange rate (sucres per dollar) <sup>e</sup>	25 000	25 000	25 000	25 000	25 000	25 000	25 000	25 000	25 000	25 000
Nominal interest rates (annualized percentages)										
Deposit rate <sup>f</sup>	5.1	5.1	5.4	5.7	5.9	5.8	5.3	5.1	5.2	5.5
Lending rate <sup>f</sup>	9.4	9.8	10.7	10.7	10.6	10.0	9.4	9.2	9.2	9.2
Interbank interest rate <sup>g</sup>	2.4	2.5	2.5	2.5	1.7	1.1	1.0	0.6	0.9	0.7
Sovereign bond spread (basis points) <sup>h</sup>	659	711	616	614	662	596	1 001	4 731	3 568	3 003
Stock price index (national index to end of period, 31 December 2000=100)	369	354	342	329	353	347	341	349	342	302
Domestic credit (variation from same quarter of preceding year)	26.6	16.2	12.5	15.0	2.1	-5.4	-2.9	14.8	16.1	30.2 <sup>i</sup>
Non-performing loans as a percentage of total credit	10.5	10.0	10.1	9.2	9.2	8.4	7.9	7.7	8.7	9.2 <sup>d</sup>

Source: Economic Commission for Latin America and the Caribbean (ECLAC), on the basis of official figures.

<sup>a</sup> Preliminary figures.

<sup>b</sup> Based on figures in local currency at constant 2000 prices.

<sup>c</sup> Quarterly average, weighted by the value of goods exports and imports.

<sup>d</sup> Data to May.

<sup>e</sup> In January 2000, the country adopted the United States dollar as its official currency.

<sup>f</sup> Reference rate in dollars, monthly average.

<sup>g</sup> Interbank market, weighted average.

<sup>h</sup> Measured by JP Morgan's EMBI+ index.

<sup>i</sup> Data to April.