Ecuador

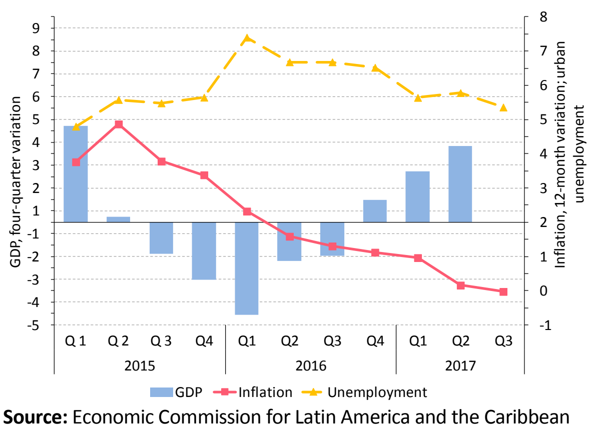
Following a 1.5% contraction last year, the Ecuadorian economy staged a recovery as from the second quarter of 2017, and ECLAC forecasts economic growth of 1.0% for the year as a whole. The recovery has been led by private consumption and, to a lesser extent, by government spending and exports. The public-sector deficit (estimated at 4.7% of GDP for the full year) added to the consolidated public debt, which grew to 31.8% of GDP in October and, in aggregate terms (considering internal debts with private and public entities) is set to reach 45.7% of GDP. This higher level and rapid growth of debt pose short- and medium-term challenges for fiscal policy, since, if the projected revenue is not forthcoming, public spending cuts would be needed, and this would undermine domestic demand.

A benign external scenario with the rise in oil prices and ample liquidity in the international market, enabled Ecuador to issue bonds for a total of US$ 5.5 billion, which financed a moderate expansion of public spending, staunched the decline in international reserves, maintained the liquidity of the financial system and enabled domestic credit growth in all segments (of 14% as of October 2017). The credit expansion was crucial, since in the first half of 2017 household final consumption grew by 3.8% year on year, thereby boosting trade and financial and other services, despite also fuelling import growth of 9.4% in volume terms. Consumption levels were also sustained by low inflation (-0.1% per year to October), which generated a slight real increase in the unified basic wage (by 2% relative to its 2016 level), and by a fall in unemployment (by 1.1 percentage points in the twelve months to September).

Between January and August 2017, the total income of the non-financial public sector grew by 13.7% year on year, while expenses rose by 7.3%, thereby enabling a twelve-month reduction in the overall deficit from -5.4% to -3.2% of GDP, and of the primary deficit from 3.7% to 0.7% of GDP. For the year as a whole, an overall deficit equivalent to 4.7% of GDP is forecast (compared to 7.4% in 2016). Thanks to the rise in oil prices (up by 20% year-on-year in September), oil revenues increased by 14.4%, while non-oil income harnessed the incipient recovery in domestic demand to grow by 9%. In October, measures were announced to increase revenue (including a rise from 23% to 25% in the income tax rate on firms with profits above US$ 300,000) and to stimulate small and medium-sized enterprises.

Investment expenditure was held in check, while current spending increased. A comparison of the budgets of January to October between 2016 and 2017 shows that spending on transfers for investment, on goods and services for investment, and on public works decreased by 43.9%, 12.2% and 5.8%, respectively. In contrast, current expenditure in the same periods show that personnel expenses, consumption goods and services, current transfers and financial expenses posted increases of 4.7%, 9.7%, 16.8% and 28.4%, respectively.

Ecuador: GDP, Inflation and Unemployment, 2015-2017



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

At the same time, the public debt also grew. As of October, the consolidated public debt and the external debt represented 31.8% and 30.9% of GDP, respectively (compared to 27.2% and 26.0% in 2016). If all domestic public debt is included, the aggregate debt is equivalent to 45.7% of GDP. Three sovereign bond issues were made in 2017: the first in January for US$ 1 billion; the second in May, for US$ 2 billion, and the third in October for US$ 2.5 billion.

In October 2017, the M2 monetary aggregate registered annual growth of 10.4% (while M1 was up by 11.3%), and the gross portfolio posted an increase of 23.2% (compared to 0% in the previous year). Deposits, meanwhile, were up by 7.2%. Real interest rates on loans averaged 7.86%, representing an annual drop of 108 basis points, and the interest-rate spread narrowed by 6 basis points in 12 months.

The declining trend in international reserves was mainly offset by the sovereign bond issues, by drawing down the Latin American Reserve Fund (FLAR) by US$ 638 million and by a US$ 500 million central bank gold swap operation. This enabled reserves to fluctuate around US$ 3.9 billion between January and October.

Ecuador's real effective exchange rate was 14.9% higher year on year in October 2017, although the size of this movement largely reflected a 183.3% variation with respect to the bolivar. In the same period, the real bilateral exchange rate depreciated against those of Germany (8.6%), Chile (7.6%), China (2.8%), Colombia (3.5%), Spain (7.6%), the United States (2.4%) and Peru (6.4%). The key reasons for this are the widespread nominal depreciation of the dollar and Ecuador's very low annual inflation.

Ecuador: main economic indicators, 2015-2017

	2015	2016	2017 [a]
	Annual growth rate		
Gross domestic product	0.2	-1.5	1.0
Per capita gross domestic product	-1.3	-2.9	-0.5
Consumer prices	3.4	1.1	-0.1 [b]
Money (M1)	10.6	10.4	14.1 [c]
Real effective exchange rate [d]	-8.9	-1.6	3.1 [c]
Terms of trade	-25.1	-5.7	7.8
	Annual average percentage		
Urban unemployment rate [e]	5.4	6.8	5.5
Central government			
Overall balance / GDP	-3.8	-5.6	-4.7
Nominal deposit rate [g]	5.3	5.7	4.9 [f]
Nominal lending rate [h]	8.3	8.7	8.0 [c]
	Millions of dollars		
Exports of goods and services	21 440	19 565	22 059
Imports of goods and services	23 895	19 052	22 513
Current account balance	-2 108	1 438	92
Capital and financial balance [i]	620	-231	-1 626
Overall balance	-1 489	1 207	-1 533

Source: Economic Commission for Latin America and the Caribbean (ECLAC), on the basis of official figures.
a/ Estimates.
b/ Figures as of October.
c/ Figures as of September.
d/ A negative rate indicates an appreciation of the currency in real terms.Refers to the global real effective exchange rate.
e/ Includes hidden unemployment.
f/ Figures as of August.
g/ Benchmark deposit rate.
h/ Effective benchmark lending rate for the corporate commercial segment.
i/ Includes errors and omissions.

The growth in household consumption, in conjunction with the phasing-out of the safeguard measures, which were eliminated in June, fuelled import growth of 23.2% in year-on-year terms between January and September. Within this overall increase, consumer goods imports grew by 28%, while those of capital goods increased by 14%, in line with the weak performance of fixed capital formation. Exports grew by 15.5% between January and September relative to the year-earlier period (29% in the case of oil and 9% in the case of non-oil exports). In the non-oil category, shrimp exports benefited from a temporary increase in demand from China. The import growth reduced the trade surplus, which, in conjunction with a 23% widening of the deficit on the income account, explains the bulk of the decrease in the current account surplus (a cumulative US$ 367 million between January and June 2017, compared to US$ 899 million in the same period of the previous year).

During the first half of 2017, debt securities inflows amounted to US$ 3.67 billion (compared to US$ 2.75 billion in the previous year), and the counterpart of the current-account surplus was an outflow of US$ 1.141 billion in respect of other investments, mainly commercial loans. Foreign direct investment (FDI) in this semester totalled US$ 360 million, representing a year-on-year increase of 10%.

At mid-year, GDP was 2.8% up on the year-earlier figure, largely owing to expansions in electricity and water supply, financial services, shrimp aquaculture and trade, which posted six-monthly year-on-year real increases of 19.0%, 11.3%, 5.9% and 5.3%, respectively. Construction, however, continued to contract (-8.3%); and gross fixed capital formation posted a year-on-year fall of 2.8% in the first six months of the year.

Weak domestic demand and moderate liquidity growth resulted in very low inflation, with a cumulative yearly variation of -0.1% in the consumer price index (CPI) in October, reflecting significant price falls in alcoholic beverages and tobacco and in clothing and footwear items. In line with the recovery of agricultural activities and trade, nationwide unemployment dropped to 4.1% in September 2017 (compared to 5.2% a year earlier). This good news is tempered by a rise in the rate of underemployment, which increased from 19.4% to 20.5% in the same period. Between January and September there were small year-on-year rises in the real wage index, which registered a minimum of 1.3% in May 2017 and a maximum of 2.6% in October.

In 2018, Ecuador is again likely to record positive growth, since the budget as presented does not envisage any overall reduction in spending, if debt amortizations are excluded; and crude oil prices are projected to be slightly higher than in 2016. The fiscal stimulus will probably be less than in 2017. The Central Bank of Ecuador’s real estate credit programme and the *Casa para Todos* popular housing plan could partially compensate for the loss of fiscal space. Lastly, considering the liquidity that still persists in the markets, domestic credit should continue to boost household consumption, leading to a growth projection of around 1.3% for 2018, which indicates that Ecuador’s economic recovery is set to continue.