http://www.imf.org/external/np/sec/pr/2014/pr14393.htm

IMF Executive Board Concludes 2014 Article IV Consultation with Ecuador

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On July 30, 2014, the Executive Board of the International Monetary Fund (IMF) concluded the Article IV consultation[1] with Ecuador.

Ecuador has made significant economic and social progress over the last decade. Economic growth has averaged about 4.5 percent since 2001, and inflation has gradually declined to around 3 percent a year. Financial stability, achieved with dollarization, was preserved and together with low inflation, sustained growth, and higher social spending, helped reduce poverty and improve social indicators. High oil prices in the last several years have generated a windfall income that supported the balance of payments and fiscal accounts, facilitating higher public spending.

After rebounding strongly from the impact of the global financial crisis, growth moderated somewhat over the last two years. Real GDP growth leveled out at 4.5 percent in 2013 from 5 percent in 2012, reflecting less buoyant domestic demand, but remains slightly above potential. Inflation fell to 2.7 percent in 2013, from 4.2 percent in 2012, owing to the unwinding of supply side shocks. The unemployment rate fell to a historic low while real wages continue rising. A fiscal deficit has re-emerged despite buoyant tax revenue collection. Higher capital spending widened the fiscal deficit to 4.7 percent of GDP, financed mainly by loans from China. Ecuador's gross public debt stood at 24.4 percent of GDP at the end of 2013, which is low by regional standards. The current account deficit widened to 1.3 percent of GDP in 2013 from 0.4 percent in 2011–12. Credit to the private sector and banks' profitability declined but the financial system remains healthy.

The economy is expected to grow at 4 percent in 2014−15 but the outlook is less favorable than in the past as oil prices are expected to fall and interest rates in the U.S. are expected to rise over the medium-term. Risks to the outlook are broadly balanced. The ability to respond to these risks is limited given the absence of monetary policy in a fully dollarized economy and the limited ability to react on the fiscal side. On the downside, a more pronounced increase in U.S. dollar interest rates (and additional strengthening of the dollar) could jeopardize growth prospects and competitiveness. On the upside, geopolitical tensions could increase oil prices which would support growth and improve the fiscal position.

While the public sector was an important engine of growth over the past several years, the private sector needs a larger role to avoid potential fiscal and external imbalances. The emergence of sizeable fiscal deficits calls for restraint in public spending plans, and moderation in current spending is necessary to accommodate the scaling-up of the public sector investment program (PSIP). The rationale of the PSIP is to eventually reverse the expected decline in oil revenues, not only by increasing oil production, but also by replacing fuel imports and diversifying energy resources. In the financial system, it would be important for new banking legislation and regulation to support growth prospects. Given the economy's need to attract U.S. dollars as currency, consideration should be given to have alternative controls on the external flows to the financial system and to gradually phase out restrictions on foreign exchange transactions.

Executive Board Assessment[2]

Executive Directors agreed with the thrust of the staff appraisal. They welcomed the authorities' reengagement with the Fund through the Article IV consultation and commended the significant improvements in Ecuador's social and economic indicators over the past decade. They noted that Ecuador's growth prospects are generally favorable and risks are broadly balanced.

However, a potentially less favorable external environment, reduced financial buffers, and limited policy flexibility in the context of dollarization could complicate macroeconomic management going forward. Accordingly, Directors called on the authorities to restore policy space, continue to strengthen the financial system, and pursue further reforms to boost competitiveness and sustain high growth.

Directors encouraged the authorities to address emerging fiscal imbalances. In this regard, they welcomed the authorities' intention to moderate current spending and prioritize capital expenditure to accommodate large planned and ongoing public investments. They noted that implementation of these projects under strict economic criteria will improve the economy's productive capacity and reduce dependence on oil over the medium term. More broadly, Directors emphasized the need to create additional fiscal space. They agreed that a carefully planned overhaul of fuel subsidies which safeguards the welfare of the poor is needed to reduce the drain on the budget. They also recommended improving revenues further, focusing on achieving better enforcement of tax laws and greater efficiency in tax administration. Some Directors saw merit in saving oil revenue windfalls in a fiscal stabilization and wealth fund.

Directors underscored the importance of an efficient and well-regulated banking sector in supporting growth and the private sector's participation in the economy. They noted that banks remain well capitalized and liquid but that profitability has declined. Accordingly, they recommended a gradual lifting of interest rate caps and greater competition in the determination of interest rates. Directors encouraged the authorities to better communicate the provisions of the new financial code, and welcomed their clarification that more directed lending is not envisaged under the framework. They also encouraged the authorities to phase out restrictions on foreign transactions; instead, macroprudential measures could be considered to better control cross-border capital flows. Strengthening the anti-money laundering regime remains an urgent policy priority.

Directors considered that dollarization has played an important role in securing macroeconomic stability and has served the country well. They took note of the staff assessment that Ecuador's real effective exchange rate appears to be broadly in line with medium-term fundamentals.

Directors underscored the importance of deeper structural reforms to raise productivity and sustain high economic growth. Further efforts should focus on improving the business climate, increasing labor market flexibility, upgrading human capital, and strengthening institutions and the legal framework.

The next Article IV consultation with Ecuador is expected to be held in Quito on the standard 12-month cycle.

Ecuador: Selected Economic Indicators

					Proj.	
	2010	2011	2012	2013	2014	2015

Social Indicators						
Life expectancy at birth (years)	75.5	75.6	...	...	...	...
Infant mortality (per thousand live births)	20.3	19.6	...	...	...	...
Adult literacy rate	91.9	91.6	...	...	...	...
Poverty rate (total)	32.8	28.6	27.3	25.5	...	...
Unemployment rate	7.6	6.0	4.9	4.7		
	(Percent change, unless otherwise indicated)					
Production and prices						
Real GDP 1/	3.5	7.8	5.1	4.5	4.0	4.0
Real domestic demand	8.0	7.4	4.8	4.4	6.0	4.9
Consumer price index period average	3.6	4.5	5.1	2.7	3.1	3.0
Consumer price index end-of-period	3.3	5.4	4.2	2.7	3.0	3.0
External sector						
Exports	25.8	27.3	6.4	4.6	5.4	-0.8
Imports	37.7	18.3	5.5	7.3	9.1	4.5
Terms of trade, national accounts data (deterioration -)	5.4	5.8	0.9	1.0	0.2	-0.7

Real effective exchange rate (depreciation -)	-2.1	-1.3	4.4	2.7	…	…
Money and credit						
Broad money	20.6	20.5	16.0	13.0	7.6	7.3
Credit to the private sector	24.4	22.6	14.7	10.5	9.1	7.7
			(In percent of GDP)			
Public sector						
NFPS Revenue	33.3	39.1	39.5	39.6	39.0	38.6
NFPS Primary expenditure	34.1	38.5	39.8	43.3	42.1	41.7
NFPS Primary balance	-0.8	0.6	-0.3	-3.7	-3.1	-3.1
NFPS Overall balance (deficit -)	-1.3	0.0	-1.1	-4.7	-4.2	-4.5
External Sector						
External current account balance	-2.3	-0.4	-0.4	-1.3	-2.3	-3.8
Net international reserves (US$ millions)	2,622	2,958	2,483	4,361	4,450	4,560
Debt						
Total external debt	20.1	19.2	18.3	19.9	22.6	26.2
NFPS Gross	19.2	18.3	21.3	24.4	27.0	29.7

debt						
External	6.7	5.6	8.9	10.6	10.4	9.6
Domestic	12.5	12.6	12.4	13.8	16.5	20.2
Saving investment balance						
Gross investment	28.0	29.0	28.3	28.6	28.5	28.5
National saving	25.7	28.6	27.9	27.3	26.3	24.7
Memorandum items:						
Nominal GDP (US$ millions)	69,555	79,780	87,499	93,746	100,500	107,244
GDP per capita (US$)	4,633	5,226	5,637	5,943	...	...

Sources: Central Bank of Ecuador; Ministry of Economy and Finance; and IMF staff estimates and projections.

1/ New GDP, base year 2007.

[1] Under Article IV of the IMF's Articles of Agreement, the IMF holds bilateral discussions with members, usually every year. A staff team visits the country, collects economic and financial information, and discusses with officials the country's economic developments and policies. On return to headquarters, the staff prepares a report, which forms the basis for discussion by the Executive Board. The 2014 Article IV with Ecuador, however, took place in Washington D.C. through discussions with officials, and via video and phone contacts with the public and private sector in Ecuador.

[2] At the conclusion of the discussion, the Managing Director, as Chairman of the Board, summarizes the views of Executive Directors, and this summary is transmitted to the country's authorities. An explanation of any qualifiers used in summing up can be found here: http://www.imf.org/external/np/sec/misc/qualifiers.htm.