

EBS/86/148
Correction 1

CONFIDENTIAL

July 24, 1986

To: Members of the Executive Board
From: The Secretary
Subject: Ecuador - Request for Stand-By Arrangement

The following corrections have been made in EBS/86/148
(7/14/86):

Page 1, para. 3, last line: for "August 14, 1987"
read "July 31, 1987"

Page 19, Table 8, column 1, line 9: for "-1,653" read "-1,628"
line 11: for "-865" read "-840"

Page 31, para. 8, line 1: for "S/. 83.4 billion" read
"S/. -83.4 billion"
line 2: for "S/. 83.9 billion" read
"S/. -83.9 billion"
line 3: for "S/. 84.5 billion" read
"S/. -84.5 billion"

Page 32, para. 2.(a), lines 5 and 6: for "August 14, 1987" read
"July 31, 1987"

Corrected pages are attached.

Att. (4)

I. Introduction

Negotiations on a program that would qualify Ecuador for Fund support under a one-year stand-by arrangement were initiated in Quito in the period March 10-24, 1986 and continued during the period May 1-16 at headquarters, where they were concluded on June 19-20, 1986. The Ecuadoran representatives in the discussions included the Minister of Finance and Public Credit, the General Manager of the Central Bank, the President of the Monetary Board, and other senior officials of the Ministry of Finance and the Central Bank. The staff representatives in the mission to Quito were Messrs. Bonangelino (Head-WHD), Antonaya (FAD), de Schaetzen (ETR), Gantt, and Gronlie, and Ms. Eyzaguirre (Secretary) (all WHD). Mr. Terrier (WHD) participated in the discussions held at headquarters.

In the attached letter and accompanying memorandum on the economic policies dated July 14, 1986, the Minister of Finance and Public Credit and the General Manager of the Central Bank of Ecuador have requested a one-year stand-by arrangement in an amount equivalent to SDR 75.4 million (50 percent of quota), including SDR 16.2 million from the Fund's ordinary resources and SDR 59.2 million from borrowed resources. As of June 30, 1986 the Fund's holdings of sucres stood at SDR 499.1 million or the equivalent of 331.2 percent of quota. Concurrently with the stand-by arrangement, Ecuador is requesting a purchase of SDR 39.7 million under the compensatory financing facility. Including the CF purchase, and after taking into account scheduled repurchases, full use of the proposed arrangement would raise the Fund's holdings of sucres to SDR 542 million, or the equivalent of 359.7 percent of quota, at the end of the third quarter of 1987. A waiver of the limitation under Article V, Section 3(b)(iii) of the Articles of Agreement is required.

The program in support of which Ecuador is requesting the stand-by arrangement is described in the memorandum on the economic policies of Ecuador annexed to the attached letter of intent from the authorities. Under the proposed arrangement, purchases shall not exceed the equivalent of SDR 15.1 million until November 14, 1986, the equivalent of SDR 30.2 million until February 13, 1987, the equivalent of SDR 45.3 million until May 15, 1987, and the equivalent of SDR 60.4 million until July 31, 1987 (Table 1).

Ecuador's last stand-by arrangement, for an amount equivalent to SDR 105.5 million (70 percent of quota) expired on March 10, 1986. Ecuador made all purchases to which it was entitled under that arrangement. The last Article IV consultation with Ecuador was concluded on September 20, 1985 (EBM/85/147).

Table 1. Ecuador: Projected Transactions with the Fund During Period of Arrangement

	Outstanding	1986		1987		
	June 30, 1986	July-Sept.	Oct.-Dec.	Jan.-Mar.	Apr.-June	July-Sept.
(In millions of SDRs)						
Purchases under tranche policies	263.0	15.1	15.1	15.1	15.1	15.0
Ordinary resources	134.5	7.5	7.6	1.1	--	--
Enlarged access resources	128.5	7.6	7.5	14.0	15.1	15.0
Repurchases	--	--	-5.5	-12.1	-10.4	-12.1
Ordinary resources	--	--	-5.5	-7.8	-7.7	-7.8
Enlarged access resources	--	--	--	-4.3	-2.7	-4.3
Transactions under special facilities <u>1/</u>	85.4	39.7	--	-10.7	-10.7	-10.7
Purchases	85.4	39.7	--	--	--	--
Repurchases	--	--	--	-10.7	-10.7	-10.7
Total Fund credit outstanding (end of period)	348.4	403.2	412.8	405.1	399.1	391.3
Under tranche policies	263.0	278.1	287.7	290.7	295.4	298.3
Special facilities <u>1/</u>	85.4	125.1	125.1	114.4	103.7	93.0
(In percent of quota)						
Total Fund credit outstanding (end of period)	231.2	267.5	273.9	268.8	264.8	259.7
Under tranche policies	174.5	184.5	190.9	192.9	196.0	197.9
Special facilities <u>1/</u>	56.7	83.0	83.0	75.9	68.8	61.7

Source: International Monetary Fund.

1/ Compensatory financing facility.

Table 8. Ecuador: Medium-Term Balance of Payments Projections

(In millions of U.S. dollars)

	1986	1987	1988	1989	1990	1991
<u>Current account</u>	<u>-720</u>	<u>-590</u>	<u>-507</u>	<u>-491</u>	<u>-443</u>	<u>-358</u>
Trade account	455	607	743	798	859	980
Exports, f.o.b.	2,080	2,307	2,533	2,715	2,912	3,180
Petroleum	900	1,084	1,230	1,295	1,363	1,476
Other	1,180	1,223	1,303	1,420	1,549	1,704
Imports	-1,625	-1,700	-1,789	-1,917	-2,053	-2,199
Service account	-1,200	-1,227	-1,285	-1,329	-1,347	-1,383
Service credits	428	445	471	504	547	586
Service debits	-1,628	-1,672	-1,756	-1,834	-1,894	-1,969
Interest payments <u>1/</u>	-788	-809	-831	-842	-832	-831
Other service debits	-840	-864	-925	-990	-1,062	-1,137
Transfers	25	30	35	40	45	45
<u>Capital account</u>	<u>670</u>	<u>422</u>	<u>355</u>	<u>254</u>	<u>-57</u>	<u>-17</u>
Direct investments	70	90	105	115	125	125
Medium- and long-term debt	420	297	210	94	-232	-192
Drawings	726	687	758	782	838	862
Amortization <u>2/</u>	-306	-390	-548	-688	-1,070	-1,054
Other	180	35	40	45	50	50
<u>Overall balance</u>	<u>-50</u>	<u>-168</u>	<u>-152</u>	<u>-237</u>	<u>-501</u>	<u>-376</u>
Net international reserves (increase -)	-50	--	-56	-18	-11	-12
Arrears (decrease -)	--	--	--	--	--	--
Financing gap	--	168	209	255	512	388
<u>Memorandum items</u>						
Current account in percent of GDP	-6.9	-5.4	-4.3	-3.9	-3.3	-2.5
Interest payments in percent of exports of goods and nonfactor services	31.4	29.4	27.7	26.2	24.1	22.1
Net international reserves (in months of imports)	0.6	0.9	1.0	1.0	1.0	1.0

Sources: Central Bank of Ecuador; and Fund staff estimates.

1/ Includes IMF charges.2/ Net of amounts rescheduled.

payments would decline from 31 percent in 1986 to 22 percent by 1991. Noninterest service payments are projected to remain around 8 percent of GDP throughout the period, while service income would be around 4 percent of GDP. On this basis, the current account deficit would decline gradually from US\$720 million in 1986 to US\$590 million in 1987 and to less than US\$360 million in 1991. In relation to GDP, the current account deficit would decline steadily from 6.9 percent in 1986 to 2.5 percent in 1991.

The medium-term projections assume that gross annual disbursements from the World Bank would increase from US\$156 million in 1986 to about US\$204 million in 1987-91, while disbursements on IDB loans would increase from US\$150 million to about US\$216 million in the same period. A significant part of these disbursements would be under sectoral loans aimed at strengthening Ecuador's outward-looking growth strategy. Net capital inflows are expected to decrease from US\$670 million in 1986 to just over US\$250 million in 1989, as amortization payments to foreign commercial banks increase, and to become negative starting in 1990, the first year not covered by the MYRA with banks.

Under these assumptions, the overall balance of payments deficit would rise from an annual average of US\$185 million in 1987-89 to about US\$500 million in 1990, before declining to below US\$380 million in 1991. Allowing for a modest increase in net international reserves, sufficient to keep their level to the equivalent of one month of imports, the financing gap would average a little more than US\$300 million a year in the period 1987-91. The authorities believe that such financing gap could be covered by additional borrowing on commercial terms. Given the rising debt amortization payments scheduled with banks, borrowing from banks to entirely finance the gap would imply an increase in the banks' exposure of less than 2 percent in 1987 and less than 1/2 of 1 percent in 1988, and a reduction in banks' exposure of 2.8 percent a year in 1989-91.

Ecuador's external debt, including the borrowing needed to close the financing gap just discussed, would decline from about 82 percent of GDP in 1986 to 68 percent in 1991 (Table 9). The debt service ratio, including servicing of the debt to the IMF, is projected to remain at about 49 percent of exports of goods and nonfactor services in 1987-89 and to increase to 57 percent in 1990 before falling back to about 52 percent in 1991. In the absence of the multiyear debt rescheduling arrangements concluded in 1985 with the banks and the Paris Club, the debt service ratio would have averaged 76 percent in the period 1987-89.

The above scenario shows a tight but viable external position in which Ecuador can service its external debt, including the servicing of the debt to the Fund, provided that adequate policies are followed. Many of the underlying assumptions, however, remain beyond the authorities' control and large divergences from this scenario could occur, particularly with regard to developments in the world oil market. If petroleum prices were to remain at the level estimated for 1986, the

6. Maintenance of tight control on overall expenditure. Current expenditures are projected to grow somewhat more rapidly than GDP, while capital expenditures are to be kept at 7.1 percent of GDP in 1986.

Monetary

7. Limits on the net domestic assets of the Central Bank of Ecuador of S/. 35 billion through June 30, 1986, of S/. 36 billion from July 1, 1986 through September 30, 1986, and of S/. 36.2 billion from October 1, 1986 through December 31, 1986.

8. Limits on central bank net credit to the public sector of S/. -83.4 billion through June 30, 1986, of S/. -83.9 billion from July 1, 1986 through September 30, 1986, and of S/. -84.5 billion from October 1, 1986 through December 31, 1986.

9. Reduction in the minimum denomination of the special certificates of deposit from S/. 1 million to S/. 750,000 before consideration of Ecuador's program by the Executive Board, and further to S/. 500,000 on or before December 31, 1986. A freeing by March 31, 1987 of interest rates on all time and savings deposits offered by financial intermediaries and on rates charged on all loans funded with these resources.

Ecuador--Stand-By Arrangement

Attached hereto is a letter with annexed memorandum, dated July 14, 1986 from the Minister of Finance and Public Credit of Ecuador and the General Manager of the Central Bank of Ecuador requesting a stand-by arrangement and setting forth:

- (a) the objectives and policies that the authorities of Ecuador intend to pursue for the period of this stand-by arrangement; and
- (b) understandings of Ecuador with the Fund regarding a review that will be made of progress in realizing the objectives of the program and of the policies and measures that the authorities of Ecuador will pursue for the remaining period of this stand-by arrangement.

To support these objectives and policies, the International Monetary Fund grants this stand-by arrangement in accordance with the following provisions:

1. For the period of one year from August --, 1986 Ecuador will have the right to make purchases from the Fund in an amount equivalent to SDR 75.4 million, subject to paragraphs 2, 3, 4, 5, and 6 below, without further review by the Fund.

2. (a) Purchases under this stand-by arrangement shall not, without the consent of the Fund, exceed the equivalent of SDR 15.1 million until November 14, 1986, the equivalent of SDR 30.2 million until February 13, 1987, the equivalent of SDR 45.3 million until May 15, 1987, and the equivalent of SDR 60.4 million until July 31, 1987.

(b) None of the limits in (a) above shall apply to a purchase under this stand-by arrangement that would not increase the Fund's holdings of Ecuadoran currency in the credit tranches beyond 25 percent of quota or increase the Fund's holdings of that currency resulting from purchases of borrowed resources beyond 12.5 percent of quota.

3. Purchases under this stand-by arrangement shall be made from ordinary and borrowed resources in the ratio of one-to-one until purchases under this arrangement reach a total of SDR 32,434,092 and thereafter each purchase shall be made from borrowed resources, provided that any modification by the Fund of the proportions of ordinary and borrowed resources shall apply to amounts that may be purchased after the date of modification.

4. Ecuador will not make purchases under this stand-by arrangement that would increase the Fund's holdings of Ecuadoran currency in the credit tranches beyond 25 percent of quota or increase the Fund's