

EBS/83/230
Correction 1

CONFIDENTIAL

November 16, 1983

To: Members of the Executive Board
From: The Secretary
Subject: Ecuador - Staff Report for Review Under Stand-By Arrangement

The following corrections have been made in EBS/83/230
(10/26/83):

Page 12, Table 6, column 3, line 9: for "239" read "314"

Page 18, 1st full para., line 12: for "free market to accelerate" read
"free market and to accelerate"

Corrected pages are attached.

Att: (2)

Table 5. Ecuador Banking System Operations 1/

(In billions of sucres)

	December 31, 1982			June 30, 1983			Dec. 31, 1983 (Rev. Proj.)		
	Central Bank	Other Banks	Total	Central Bank	Other Banks	Total	Central Bank	Other Banks	Total
Net international reserves	9.4	--	9.4	7.3	--	7.3	4.9	--	4.9
Other foreign assets	--	-2.4	-2.4	--	-6.4	-6.4	--	-6.0	-6.0
Domestic credit	6.4	107.5	113.9	10.9	127.1	138.0	25.1	131.6	156.7
Public sector (net)	-16.9	-2.3	-19.2	-15.7	-2.9	-18.6	-6.4	-1.8	-8.2
Private sector	15.9	90.7	106.6	16.8	106.9	123.7	15.5	109.4	124.9
Unclassified assets (net) 2/	7.4	19.1	26.5	9.8	23.1	32.9	16.0	24.0	40.0
Interbank transactions	14.5	-12.0	2.5	17.6	-11.2	6.4	21.7	-15.3	6.4
Credit	28.3	-27.0	1.3	31.6	-30.0	1.6	38.0	-36.4	1.6
Deposits	-13.4	14.6	1.2	-13.5	18.3	4.8	-15.7	20.5	4.8
Other	-0.4	0.4	--	-0.5	0.5	--	-0.6	0.6	--
Intersystem transactions	5.4	--	5.4	5.2	--	5.2	6.0	--	6.0
Credits	7.2	--	7.2	9.0	--	9.0	...	--	...
Deposits	-1.8	--	-1.8	-3.8	--	-3.8	...	--	...
Allocations of SDRs	1.6	--	1.6	1.6	--	1.6	1.6	--	1.6
Medium- and long-term foreign loans	--	2.1	2.1	--	2.0	2.0	19.4 3/	2.0	21.4
Liabilities to private sector	30.5	87.6	118.1	31.4	93.4	124.8	36.7	108.3	145.0
Currency in circulation	20.0	--	20.0	20.8	--	20.8	24.0	--	24.0
Sight deposits	0.6	39.5	40.1	0.7	41.9	42.6	0.8	48.6	49.4
Time and savings deposits	--	11.9	11.9	--	14.3	14.3	--	17.3	17.3
Advance import deposits	6.0	--	6.0	5.4	--	5.4	6.0	--	6.0
Other liabilities in sucres	3.7	24.5	28.2	3.8	25.0	28.8	5.0	28.8	33.8
Liabilities in foreign currency	0.2	1.7	1.9	0.7	1.4	2.1	0.9	1.6	2.5
Capital and reserves	--	10.0	10.0	--	10.8	10.8	--	12.0	12.0
Arrears	3.6	3.4	7.0	8.0	14.1	22.1	--	--	--

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

1/ Foreign exchange accounts are valued at S/. 45 per U.S. dollar.

2/ Including valuation adjustments.

3/ The equivalent of US\$431 million of a new loan from foreign commercial banks.

Table 6. Ecuador: Balance of Payments, 1981-83

(In millions of U.S. dollars)

	1981	1982	1983 Proj. SBA	Rev.
<u>Goods, services, and transfers</u>	-1,002	-1,195	-339	-504
Exports, f.o.b.	2,544	2,343	2,336	2,296
Imports, f.o.b.	-2,362	-2,181	-1,625	-1,545
Freight payments	-220	-164	-146	-152
Interest payments	-670	-767	-845	-757
Other services, credit	456	391	419	323
Other services, debit	-776	-837	-498	-684
Transfers	25	20	20	15
<u>Capital movements 1/</u>	699	524	314	615
Public sector	608	660	342	733
Drawings on loans	(1,522)	(883)	(479)	(855)
Amortizations	(-598)	(-700)	(-137)	(-119)
Oil credits	(-316)	(477)	(--)	(-3)
Private capital	91	-136	-28	-118
Direct investment	(60)	(40)	(60)	(50)
Drawings on loans	(1,246)	(806)	(--)	(12)
Amortizations	(-915)	(-630)	(-140)	(-117)
Import credits)	(-300)	(-160)	(-99)	(-40)
Other 2/)		(-192)	(151)	(-23)
<u>Arrears</u>	--	211	-75	-211
<u>SDR allocation</u>	9	--	--	--
<u>Net international reserves</u> (increase -)	294	460	100	100
<u>Memorandum items</u>				
Renegotiation of public sector debt	--	145	1,332	1,250 3/
Renegotiation of private sector debt	--	536	1,257	1,137 4/

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

1/ Accounts carried on cash basis with debt refinancing shown as a reduction in amortization payments.

2/ Including errors and omissions.

3/ Including US\$309 million in oil advances and US\$86 million Paris Club rescheduling (US\$53 million principal and US\$33 interest).

4/ Including a rollover of the refinancing in 1982.

No change has been introduced recently in the system of import restrictions. The authorities confirmed their intention to remove those restrictions by the end of the program period, as indicated in paragraph 11 of the letter of intent of March 24, 1983, but they have not yet formulated concrete plans for their elimination and believe that it is still too early to begin dismantling such restrictions.

IV. Staff Appraisal

In recent years Ecuador's economic performance has weakened considerably. Economic growth has slowed, inflation has accelerated, and the balance of payments shifted into deficit. These developments resulted from the combination of external factors, inappropriate demand management policies, and an inadequate exchange rate policy which resulted in an overvaluation of the sucre. Beginning in 1982, the Ecuadorian Government started to adopt adjustment measures in an effort to arrest the economic and financial deterioration. Early in 1983, the Government embarked on a wide-ranging stabilization program which was supported by the one-year stand-by arrangement approved by the Executive Board on June 1, 1983 and which became effective on July 25, 1983, following agreement between Ecuador and a group of foreign commercial banks on a financing package.

The government's stabilization program included measures to increase substantially public sector revenues and to control the growth of expenditure, with the aim of reducing the public sector deficit from 7 percent of GDP in 1982 to about 4 percent of GDP in 1983. In addition, the program assumed the pursuit of more flexible and realistic exchange rate and interest rate policies. The exchange rate was adjusted from S/. 33 per U.S. dollar to S/. 42 per U.S. dollar in March 1983, and a crawling peg system was established with the aim of reducing significantly the spread between the official and the free exchange rates by the end of the program period. The authorities also transferred 30 percent of nontraditional exports and an equivalent amount of imports from the official to the free market. Interest rates were raised in March 1983 and the authorities expressed their intention to continue adjusting interest rates in order to move toward positive real interest rates in the domestic financial market and to reflect developments in world capital markets.

Ecuador has complied with all quantitative performance criteria under the stand-by arrangement, but external payments arrears have risen rather than declined as planned and no significant progress has been made in narrowing the spread between the official and free market exchange rates.

The authorities have reaffirmed their commitment to the ceilings and targets of the program and to the elimination of external payments arrears. However, their ability to reduce arrears will depend to a large extent on the timing of disbursements under a new medium-term

loan for US\$431 million from foreign commercial banks. Based on the prospective disbursements of this loan, the authorities indicated their intention to reduce the level of arrears from an estimated US\$565 million as of September 30, 1983 to US\$250 million by the time the Executive Board meets to discuss Ecuador's review under the stand-by arrangement, and to continue reducing arrears, thereafter, until they are completely eliminated. The staff would urge the authorities to make every effort to eliminate external payments arrears as soon as possible.

Notwithstanding the lack of progress in reducing the spread between the official and free market exchange rates, the view of the authorities is that the present rate of depreciation in the official market is adequate since it is expected to result in a small gain of competitiveness during 1983. Furthermore, they believe that pressures in the free market will subside once they begin paying off external arrears in a substantial amount. In a move to strengthen export competitiveness, however, the authorities transferred additional transactions from the official to the free market, both on the export and import side, in an amount equivalent to 10 percent of nonpetroleum traditional exports. The staff welcomes this measure but believes that the authorities should be prepared to make further transfers to the free market and to accelerate the pace of depreciation of the currency in the official exchange market in light of developments both in inflation and in the free market rate.

In the fiscal area the authorities are confident that the overall public sector deficit will be kept within the amount targeted. The staff notes the authorities' intention of continuing to pursue a fiscal policy consistent with the program. The staff also wishes to stress the importance of limiting expenditure in line with the availability of financing, and with the need to contain inflation and pressures on the balance of payments.

The authorities recently raised domestic interest rates with a view to stimulating the growth of domestic financial savings. The staff supports this action and considers it a step in the right direction. However, the staff would emphasize the need to review interest rates periodically until positive real rates are established. In this regard, it will be important to assure growth in real domestic financial savings.

The staff welcomes the recent signing of the agreement on debt rescheduling with foreign commercial banks, as well as the agreement reached last July under the aegis of the Paris Club regarding debt owed to official bilateral creditors. The staff is concerned, however, about the exchange losses that the Central Bank may suffer from the assumption of private debt, notwithstanding the establishment of a commission by the Central Bank to cover exchange risks. Any such losses, should they materialize, would make the pursuit of a sound monetary policy more difficult. Therefore, the staff would urge the authorities to explore the means for offsetting the effects of possible exchange losses.