

DOCUMENT OF INTERNATIONAL MONETARY FUND
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FOR
AGENDA

EBS/84/92
Correction 1

CONFIDENTIAL

May 23, 1984

To: Members of the Executive Board

From: The Secretary

Subject: Ecuador - Staff Report for the 1983 Article IV Consultation
and Review Under the Stand-By Arrangement

The following corrections have been made in EBS/84/92 (4/25/84):

Page 3, para. 3, line 2: for "measures in May 1982" read "measures in 1982"

Page 8, 1st full para., last line: for "northwestern" read "northeastern"

2nd full para., line 11: for "are cost" read "are projected to
increase in line with GDP and take into
account the cost"

Page 14, 3rd full para., line 7: for "June 1983" read "March 1983"

line 9: for "September 1983" read "October 1983"

Page 15, 3rd full para., line 11: for "end of July" read "end of June"

Page 26, under In percent of GDP, line 8: for "Current account deficit"
read "Current account deficit (-)"

Page 32, last para., line 2: for "debt owned" read "debt owed"

line 5: for "payments owned" read "payments owed"

Page 38, columns 4-7, line 17: for "-1,173," "-1,573," "-1,656," and "-1,331"
read "-1,199," "-1,600," "-1,688," and "-1,370"

Corrected pages are attached.

Att: (7)

II. Background and Performance Under the Stand-By Program

Following several years of rapid economic growth and a strong balance of payments performance, economic conditions in Ecuador weakened after 1980. Real GDP growth decelerated from 5 percent in 1980 to 1.4 percent in 1982, and inflation accelerated from 13.5 percent in 1980 to nearly 25 percent in 1982. The balance of payments also deteriorated sharply over the same period as a deficit of almost US\$300 million was registered in 1981, the first in four years, and was followed by a deficit of US\$460 million in 1982. In addition, in 1982 there was an accumulation of external payments arrears of US\$211 million.

The weakening of the country's economic situation reflected both adverse external developments and the expansionary demand management policies followed by the Government in an attempt to counter the slowdown in economic activity. The overall public sector deficit rose to 7 percent of GDP in 1982 from 4.9 percent of GDP in 1980. The increase in public sector external borrowing and higher interest rates abroad raised Ecuador's external debt service payments considerably, and the trade account of the balance of payments weakened because of the worsening of the terms of trade.

In response to the rapid deterioration in Ecuador's financial position, the authorities adopted a series of measures in 1982 that included the devaluation of the sucre from S/. 25 per U.S. dollar to S/. 33 per U.S. dollar in May and the doubling of gasoline prices (see EBS/83/230). These efforts at adjustment were considerably strengthened in early 1983 when the authorities adopted a wide-ranging stabilization program which included a series of measures to increase public sector revenues and to control the growth of expenditure. The revenue measures included (1) an increase in the sales tax, (2) the elimination of tax exemption certificates for all exports except hemp, (3) the introduction of import surcharges, (4) a reduction in import duty exemptions, (5) increases in the prices of petroleum products, and (6) increases in electricity, telephone, and water rates. With the aim of strengthening the external sector, in March 1983 the authorities further devalued the sucre in the official market to S/. 42 per U.S. dollar and adopted a crawling peg exchange rate system. The rate of depreciation was set initially at S/. 0.04 per U.S. dollar per working day. Interest rates were adjusted on two occasions during 1983 (in March and October) with the aim of promoting the growth of domestic financial savings.

The Fund supported Ecuador's program with the one-year stand-by arrangement that became effective on July 25, 1983, following the finding by the Fund that satisfactory arrangements had been reached with foreign commercial banks, including the negotiation of debt rescheduling and a new medium-term loan to Ecuador's public sector. An important objective of the program was to limit the loss of net official international reserves of the Central Bank to no more than US\$100 million in 1983. This was to be achieved mainly through a reduction of the overall deficit of the public sector and a more appropriate exchange rate policy.

The program envisioned an acceleration in the rate of depreciation of the sucre in the official market and an enlargement of the scope of the free market in order to reduce the spread between the exchange rates in the official and free markets. The authorities also undertook to eliminate external payments arrears by November 30, 1983 and import restrictions by the end of the program period.

In 1983 the balance of payments situation improved as the deficit on current account was drastically reduced, but real GDP fell and the rate of inflation increased. Last year's loss of net official international reserves was smaller than that permitted under the program. However, external payments arrears were not completely eliminated as had been intended. While no significant progress was made in reducing import restrictions, prior import deposit requirements which had been established several years ago were eliminated on January 1, 1984.

Real GDP is estimated to have declined by a little more than 3 percent last year, compared with the original estimate of no growth. The weak performance of the economy can be attributed to a large extent to reduced agricultural production as a result of heavy rains in the latter part of 1982 and in the first semester of 1983. This disruption in the agricultural sector caused a strong acceleration of inflation. In addition, the rate of price increase was raised by the adjustments in the exchange rate and by increases in administered prices. The end of period rate of inflation--as measured by the consumer price index--rose from 24 percent in 1982 to 53 percent in 1983, with the rate of increase of food prices jumping from 26 percent in 1982 to 86 percent last year.

Ecuador met all the quantitative performance criteria under the stand-by arrangement as of the end of 1983 except that pertaining to the elimination of external payment arrears. In particular, the ceiling on net central bank credit to the public sector was observed with a wide margin, reflecting a fiscal performance that was substantially better than had been projected (Table 2). This margin was offset to a considerable extent by a larger than projected increase in central bank credit to banks and to the private sector as well as a faster increase of unclassified assets, mainly reflecting exchange losses.

III. Report on Discussions and Program for 1984

The discussions with the Ecuadoran authorities centered on a review of the progress achieved during 1983 in the implementation of the stand-by program and on the policies that would form the basis for the establishment of the targets and limits for the period of the stand-by arrangement falling in 1984.

The authorities emphasized the progress made during 1983 in the implementation of the stabilization program, despite the adverse effects of the severe floods on production and prices. They were particularly encouraged by the substantial reduction of the public sector deficit, and the improvement in the balance of payments situation.

Table 3. Ecuador: Summary of Public Sector Operations

	1983				1983			
	1982	Stand-By Arrangement	Prel.	Proj. 1984	1982	Stand-By Arrangement	Prel.	Proj. 1984
	(In billions of sucres)				(In percent of GDP)			
<u>Revenues</u>	<u>102.5</u>	<u>145.2</u>	<u>159.8</u>	<u>218.0</u>	<u>25.1</u>	<u>28.3</u>	<u>27.8</u>	<u>29.1</u>
<u>Expenditures</u>	<u>130.3</u>	<u>166.7</u>	<u>161.3</u>	<u>217.7</u>	<u>31.9</u>	<u>32.5</u>	<u>28.1</u>	<u>29.0</u>
<u>Deficit</u>	<u>-27.8</u>	<u>-21.5</u>	<u>-1.5</u>	<u>0.3</u>	<u>-6.8</u>	<u>-4.2</u>	<u>-0.3</u>	<u>0.1</u>
<u>External financing</u>	<u>18.7</u>	<u>12.3</u>	<u>4.3</u>	<u>-0.3</u>	<u>4.6</u>	<u>2.4</u>	<u>0.8</u>	<u>-0.1</u>
Drawings	24.2	18.7	8.2	10.4	5.9	3.6	1.4	1.4
Amortizations	-19.8	-6.4	-3.9	-10.7	-4.8	-1.2	-0.6	-1.5
Oil credits	14.3	--	--		3.5	--	--	--
<u>Internal financing</u>	<u>9.1</u>	<u>9.2</u>	<u>-2.8</u>	<u>--</u>	<u>2.2</u>	<u>1.8</u>	<u>-0.5</u>	<u>--</u>
Central Bank	7.9	6.0	-1.6	--	1.9	1.2	-0.3	--
Other banks	0.6	0.5	-1.2	--	0.1	0.1	-0.2	--
Other	0.6	2.7	--	--	0.2	0.5	--	--

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

spending categories. Wage and salary increases were kept below the rise in the consumer price index and curbs were placed on the payment of overtime to public sector employees, on the creation of new jobs, and on the purchases of goods and services. In spite of the serious dislocation which occurred because of the flooding in the coastal regions of Ecuador, transfers to the rest of the public sector were restricted as transfers arising from the emergency were offset by reductions in other categories. Capital expenditures of the Central Government were reduced in absolute amounts as only priority projects that already were in progress were funded.

Current expenditure in the rest of the public sector was restricted and major investment projects by the public enterprises were postponed. The Electricity Institute (INECEL) stopped construction of electricity transmission lines and postponed the initiation of the final phase of the hydroelectric generating plant at Paute. In addition, the State Petroleum Company (CEPE) increased investment only marginally in 1983, postponing a major exploration and petroleum drilling project in both the northeastern region and in an offshore area.

The authorities indicated that they were determined to continue to implement a prudent fiscal policy in 1984 with the objective of achieving overall equilibrium in the accounts of the public sector. Total revenues are projected to grow somewhat faster than GDP in 1984, reflecting the full impact of the measures introduced last year and the effect of the depreciation of the sucre in the official exchange market during 1984 on revenue from petroleum exports and other taxes on foreign trade. Public sector outlays are projected to grow slightly faster than GDP in 1984, reflecting a pickup of capital expenditure by the Central Government and the public enterprises. Current outlays in 1984 are projected to increase in line with GDP and take into account the cost of a salary increase equivalent to almost 18 percent, which was approved by Congress before the end of last year and became effective in January 1984.

The operations of the Central Government will be strengthened in 1984 because of a change in the distribution of petroleum revenues. Beginning late last year petroleum receipts derived from an exchange rate in excess of S/. 44 per U.S. dollar were fully earmarked for the budget. Consequently, petroleum revenues accruing to the Central Government are projected to rise by 3 percentage points of GDP in 1984, to almost 10 percent. Central government nonpetroleum revenues also are expected to rise faster than GDP reflecting the full impact of the tax measures adopted in 1983. Overall outlays of the Central Government are projected to increase from 15 percent of GDP in 1983 to 16 percent of GDP in 1984, reflecting a rise in capital outlays in relation to GDP. Investment by the Central Government will be concentrated on the rebuilding of roads and other infrastructure following the damages caused by the floods in 1983. The operations of the Central Government are projected to result in a small overall surplus in 1984, compared with a deficit of 2 percent of GDP in 1983.

Table 6. Ecuador: Balance of Payments

(In millions of U.S. dollars)

	1981	1982	1983		Proj.
			SBA	Prel.	1984
<u>Current account</u>	<u>-1,003</u>	<u>-1,195</u>	<u>-339</u>	<u>-104</u>	<u>-115</u>
Exports, f.o.b.	2,544	2,343	2,336	2,365	2,524
Imports, f.o.b.	-2,362	-2,181	-1,625	-1,408	-1,580
Freight payments	-220	-164	-146	-120	-123
Interest payments <u>1/</u>	-670	-767	-845	-716	-724
Other services, credit	456	391	419	323	370
Other services, debit	-776	-837	-498	-572	-602
Transfers	25	20	20	24	20
<u>Capital account</u>	<u>699</u>	<u>524</u>	<u>314</u>	<u>155</u>	<u>242</u>
Public sector	608	660	342	543	325
Drawings on loans <u>2/</u>	(1,522)	(883)	(479)	(671)	(570)
Interest rescheduling	(--)	(--)	(--)	(33)	(30)
Amortization <u>2/</u>	(-598)	(-700)	(-137)	(-98)	(-313)
Other <u>3/</u>	(-316)	(477)	(--)	(-63)	(38)
Private sector	91	-136	-28	-388	-83
Direct investment	(60)	(40)	(60)	(50)	(51)
Drawings on loans <u>2/</u>	(1,246)	(806)	(--)	(12)	(--)
Amortization <u>2/</u>	(-915)	(-630)	(-140)	(-117)	(-44)
Other <u>4/</u>	(-300)	(-352)	(52)	(-333)	(-90)
<u>Arrears</u>	<u>--</u>	<u>211</u>	<u>-75</u>	<u>-109</u>	<u>-102</u>
<u>SDR allocation</u>	<u>9</u>	<u>--</u>	<u>--</u>	<u>--</u>	<u>--</u>
<u>Changes in net official international reserves</u>					
(increase -)	295	460	100	58	-25
<u>Memorandum items</u>					
Renegotiation of public debt	--	156	1,332	924	449
Amortization: Banks	(--)	(156)	(...)	(838)	(353)
Paris Club	(--)	(--)	(...)	(53)	(66)
Interest: Paris Club	(--)	(--)	(...)	(33)	(30)
Renegotiation of private debt	--	536	1,257	1,167 <u>5/</u>	241
Regulation 101 <u>6/</u>	(--)	(--)	(...)	(1,045)	(221)
Other	(--)	(536)	(1,257)	(122)	(20)

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

1/ On accrual basis.

2/ Carried on cash basis.

3/ Includes all the petroleum-related trade credits.

4/ Includes errors and omissions.

5/ Including a rollover of the rescheduling of 1982.

6/ Debt assumed by the Central Bank.

US\$75 million when the stand-by arrangement was negotiated, but that amount was revised upward to US\$211 million at the time of the review mission of September 1983.^{1/}

The authorities indicated to the staff that it had not been possible to eliminate payments arrears completely in 1983 because total capital inflows were lower than originally projected and because of the need to be prepared to cover debt service payments of US\$250 million in early 1984. In fact, arrears have increased in the first months of 1984, and as of the end of March they amounted to US\$174 million.

The authorities intend to eliminate all remaining external payments arrears as soon as a financial package with a group of foreign banks is completed, as is discussed below. They are aware that under the existing performance criteria of the stand-by arrangement no purchase can be made after November 30, 1983, so long as external payments arrears are outstanding.

The program called for the pursuit of a flexible exchange rate policy, including the transfer of transactions from the official to the free market. As was described above, a crawling peg system was adopted in March 1983, and in June 1983 the rate of depreciation of the sucre in the official market was increased from the initial S/. 0.04 per U.S. dollar per working day to S/. 0.05 per U.S. dollar each calendar day. In March 1983 the authorities transferred to the free market 30 percent of foreign exchange proceeds from nontraditional exports and an equivalent value of imports, and in October 1983 they transferred 10 percent of non-oil traditional exports and an equivalent amount of imports.

As a result of the policies just described, the sucre in the official market depreciated from an average of S/. 36 per U.S. dollar in March 1983 to S/. 53 per U.S. dollar in December 1983, and to S/. 58 per U.S. dollar by March 1984. Meanwhile, the sucre in the free market depreciated from an average of S/. 83 per U.S. dollar (buying) in March 1983 to S/. 96 per U.S. dollar in July before moving to S/. 87 per U.S. dollar in September 1983. Since then, the value of the sucre in the free market has fluctuated in the range of S/. 85-89 per U.S. dollar. The spread between the official and free market exchange rates has declined from a peak of over 50 percent in June-July 1983 (measured as a percent of the free market rate) to about 35 percent in March 1984.

The authorities are determined to continue with the flexible exchange rate policy adopted last year. The rate of depreciation of the sucre in the official market is being maintained at S/. 0.05 per U.S. dollar each calendar day. Such a policy, together with the anticipated deceleration of domestic inflation, is expected to result in a further gain of competitiveness during 1984. In addition, in a major move

^{1/} For a detailed explanation of the basis for the revision of the figure on arrears see EBS/82/230, page 3, footnote 1.

toward the unification of the exchange markets, on February 29, 1984 the Government made further transfers of transactions to the free market to reach 50 percent of nonpetroleum exports and an amount equivalent to US\$600 million of imports (on a yearly basis). It also transferred to the free market all service receipts and payments except those for interest on foreign debt, profit remittances of registered foreign investment, and a few other minor service transactions. It is estimated that as a result of these measures the proportion of private sector transactions in the free market is now over 55 percent of the total.

The authorities have reaffirmed their commitment to dismantle all import restrictions by the end of the program period. In a major step toward the achievement of this objective, effective February 29, 1984, the prohibition has been lifted for a list of imports representing in value about 75 percent of the total which had been prohibited since late 1982. Ecuador still maintains the following exchange measures involving restrictions and multiple currency practices subject to the approval of the Fund under Article VIII: (a) the multiple currency practice arising from the dual exchange market referred to above; (b) an exchange restriction evidenced by external payments arrears; (c) bilateral payment agreements with Hungary and Romania; and (d) minimum financing or alternatively barter trade requirements for all imports.

In the area of external debt management, the Ecuadoran authorities have held negotiations with foreign commercial banks to reschedule amortization payments on public and private external debt falling due in 1984 and to obtain a new medium-term loan for the Central Bank. The amortization payments to be rescheduled amount to approximately US\$350 million on public debt and about US\$240 million on private debt. The new loan of US\$350 million being requested by the authorities for the public sector is smaller than the one obtained from the foreign commercial banks in 1983 (US\$431 million), and on a net basis it represents only US\$150 million since Ecuador is scheduled to pay the banks this year 10 percent of the public and private debt rescheduled last year, or approximately US\$200 million.

The steering committee of the foreign commercial banks has agreed in principle to reschedule the original maturities falling due this year and to extend to the end of 1984 the three pending payments of approximately US\$50 million each, which are part of the payment on the total amount rescheduled in 1983, and which become due in April, July, and October (a first payment of US\$46 million was made in January 1984). In addition, the steering committee has agreed to extend to the end of 1984, through successive 90-day periods, the maturity of trade related payments currently in arrears with banks or that are to come due. This extension of maturities will cover an amount of up to US\$150 million through the end of June, and up to US\$200 million at any time on or after July 1, 1984.^{1/} A new medium-term loan for US\$350 million will be considered by

^{1/} Trade arrears are owed to banks because of the use of letters of credit as a means of payment for certain imports.

the banks in the second half of the year, once a new program with the Fund has been negotiated to succeed the present one which expires on July 24, 1984. The proceeds of the new loan will be used to cancel the three payments on the 1983 rescheduling, which would have been extended as just described, and to refinance the amount of trade payments extended. The agreement reached in principle between Ecuador and the banks is consistent with the program for the remainder of the stand-by arrangement and with the balance of payments projections for the year 1984 as a whole.

The Ecuadoran authorities also intend to seek the rescheduling of debts owed to official creditors which fall due after May 31, 1984; the rescheduling arrangement agreed last year under the aegis of the Paris Club covered principal and interest payments falling due during the one-year period through the end of May 1984.

As a result of the rescheduling of public and private external debt completed last year and the latest agreements, the debt service burden was reduced significantly in 1983 and 1984. The debt service ratio (including registered private debt) is estimated at about 33 percent and 36 percent of exports of goods and services in 1983 and 1984, respectively, whereas in absence of the debt rescheduling it would have reached 111 percent in 1983 and 60 percent in 1984 (Table 7). The mission discussed with the authorities the medium-term outlook for Ecuador's external debt situation on the basis of some tentative debt and balance of payments projections prepared by the staff. These projections point to the need for a strong export effort on the part of Ecuador in the next few years. On the assumption of an export growth averaging 7 percent a year in U.S. dollars, the debt service ratio (including private sector debt) will average about 66 percent of exports of goods and services during the next six years, and the ratio of interest payments to exports of goods and services will average 26 percent. The medium-term balance of payments projections show that Ecuador will probably need to reschedule most of the amortization payments falling due in the next several years (Statistical Appendix Table 8).^{1/}

III. Staff Appraisal

Economic and financial performance in Ecuador weakened significantly in recent years. The growth of the economy slowed, inflation accelerated, and the balance of payments turned into deficit. These developments were the result of adverse external factors, inadequate demand management policies, and an inappropriate exchange rate policy. The Ecuadoran Government responded to these developments by the adoption of a wide-ranging stabilization program in mid-1983 which was supported by a one-year stand-by arrangement.

^{1/} For the main assumptions underlying the medium-term projections see Attachment IV.

B. Nonfinancial Relations

- V. Exchange Rate: Official rate (February 29, 1984): S/. 57.10 per U.S. dollar buying rate and S/. 58.24 per U.S. dollar selling rate. The sucre in the official market is being depreciated by S/. 0.05 per U.S. dollar per day. Ecuador also has a free exchange market in which quotations fluctuate daily. On February 29, 1984, the buying and selling rates in this market were S/. 87.26 and S/. 89.00 per U.S. dollar, respectively.
- VI. Last Article IV Consultation: The 1982 Article IV consultation was completed and Ecuador's request for a stand-by arrangement was granted by the Executive Board on June 1, 1983 (EBS/83/91 and SM/82/198). A review of that arrangement (EBS/83/230) was completed by the Board on November 23, 1983.
- VII. Technical Assistance: An expert from the Fiscal Affairs Department is assigned to Quito to assist in implementing a public sector accounting system and an expert from the Central Banking Department is assigned to Quito to advise the Central Bank of Ecuador on the implementation of Ecuador's financial program.
- VIII. Statistical Data: The currentness and coverage of Ecuador's statistical data in the IFS is considered reasonably adequate at this time.

Ecuador: Selected Economic and Financial Indicators, 1980-84

	1980	1981	1982	SBA 1983	Prel. 1983	Proj. 1984
(Annual percent changes, unless otherwise specified)						
National income and prices						
GDP at constant prices	4.9	4.5	1.4	--	-3.3	0.5
GDP deflator	19.5	13.1	16.2	31.0	45.1	30.0
Consumer prices (average)	12.8	14.7	16.3	35.0	48.4	32.0
Consumer prices (end of period)	13.7	17.3	24.4	31.0	52.5	25.0
External sector (on the basis of U.S. dollars)						
Exports, f.o.b.	18.3	--	-7.9	--	0.9	6.7
Petroleum exports	34.8	8.8	-11.7	-3.4	14.8	4.0
Imports, f.o.b.	6.9	5.3	-7.6	-25.5	-35.4	12.3
Export volume	-2.7	2.3	-1.2	15.0	11.3	7.1
Import volume	-6.3	2.9	-12.0	-26.9	-36.8	8.0
Terms of trade (deterioration -)	6.5	-4.5	-11.3	-14.6	-11.2	-4.0
Nominal effective exchange rate (depreciation -)	1.2	7.2	-10.0	-32.8	-31.3	-32.8
Real effective exchange rate (depreciation -)	0.8	12.4	-4.1	-14.3	-5.3	-15.3
Central government budget						
Revenue	41.6	4.1	22.3	...	35.9	70.1 ^{1/}
Total expenditure	33.8	31.4	27.3	...	9.0	36.4
Money and credit						
Domestic credit ^{2/3/}	18.9	22.2	51.2	24.8	63.5	51.5
Public sector ^{3/}	(-3.8)	(-7.0)	(8.0)	(5.0)	(-2.4)	(--)
Private sector	(19.6)	(22.9)	(21.5)	(14.6)	(49.1)	(43.6)
Money and quasi-money (M2)	26.5	11.2	21.0	23.5	32.0	30.0
Velocity (GDP relative to M2)	5.5	5.8	5.7	5.8	6.1	6.1
Interest rate (1-6 months savings deposits)	6.0	8.0	12.0	15.0	16.0	18.0
(In percent of GDP)						
Overall public sector deficit	-4.6	-5.6	-6.8	-4.2	-0.3	0.1
Central government savings	1.5	-0.6	-0.7	...	1.1	4.6
Central government deficit (-)	-1.1	-4.7	-4.2	...	-2.0	1.2
Domestic financing	(0.8)	(2.5)	(1.7)	(...)	(2.2)	(-0.2)
Foreign financing	(0.3)	(2.2)	(2.5)	(...)	(-0.2)	(-1.0)
Gross domestic investment	26.1	24.6	24.6	16.0	16.4	...
Gross national savings	20.4	16.4	14.1	12.1	14.8	...
Current account deficit (-)	-5.7	-8.2	-10.5	-3.9	-1.6	-2.5
External debt ^{4/}						
Inclusive of use of Fund credit (end of year)	30.1	31.8	33.4	45.4	48.1	58.6
Debt service ^{4/}	6.3	7.6	9.2	6.7	4.9 ^{5/}	8.2
Debt service (in percent of exports of goods and services)	24.5	35.2	46.2	28.0	23.4 ^{5/}	33.3
Interest payments ^{4/} (in percent of exports of goods and services)	10.5	15.3	20.6	21.1	19.8	22.6
(In millions of SDRs, unless otherwise specified)						
Overall balance of payments	174	-249	-417	-91	-55	24
Gross official reserves (months of imports of the following year) ^{6/}	5.5	3.7	3.6	4.1	6.7	6.1
External payments arrears	--	--	191.0	--	102.0	--

^{1/} Reflects a change in the distribution of petroleum revenue in favor of the budget.

^{2/} In relation to liabilities to the private sector at the beginning of the period.

^{3/} Includes adjustment for gold revaluation in 1982.

^{4/} Public debt, including short-term, and the private sector debt assumed by the Central Bank after rescheduling. GDP was converted into U.S. dollars using the official exchange rate.

^{5/} After 1983 rescheduling.

^{6/} Gold valued at US\$300 per troy ounce.

measure introduced in 1983. The Government intends to continue its policy of expenditure moderation in 1984, including the continued pursuit of a prudent salary policy. As a result, current outlays are projected to grow in line with GDP. Capital expenditures are projected to increase in real terms by about 10 percent in 1984, following a sharp decline in 1983.

5. The operations of the rest of the public sector are also expected to result in near equilibrium in 1984. The rate of growth of revenues is projected to slowdown because of the changes in the distribution of petroleum revenues mentioned above, and in spite of the impact of the adjustments of public enterprises' tariffs and prices introduced in 1983. Electricity rates were raised by 10 percent (20 percent for commercial and industrial users) in May 1983 and are being raised by 2 percent per month since then. The domestic prices of petroleum derivatives (other than gasoline) were increased by an average of about 15 percent in March 1983 and by a range of 30-40 percent in the period April-December 1983 (gasoline prices were doubled in October 1982). Additional price increases of petroleum derivatives, which will represent between 18 percent and 40 percent in 1984, have been approved and are being implemented on a quarterly basis. The estimate of expenditure for the rest of the public sector assumes a moderate increase in current expenditure. Capital expenditure by the public enterprises are estimated to increase by 50 percent and will concentrate on the initiation of construction of the third phase of the Paute hydroelectric complex by the Electricity Institute (INECEL) and on oil explorations by the State Petroleum Company (CEPE).

6. The further strengthening of the financial position of the public sector should permit it to avoid resorting to net credit from the domestic banking system in 1984 and, thus, allow for an adequate supply of bank credit to the private sector with few risks of pressures on domestic prices and the exchange rate. The interest rate policy of the Government will continue to be aimed at providing adequate incentives to the growth of financial savings and establishing interest rates that are positive in real terms. Thus, in a further step toward this aim, credit and deposit rates are soon to be raised by 2 percentage points to a level of 21 percent and 18 percent, respectively.

7. Consistent with the policies described above, the monetary program specifies ceilings for the remaining period of the stand-by arrangement on the central bank net credit to the public sector, as detailed in the attached Table 1, and on the net domestic assets of the Central Bank, as presented in the attached Table 2. The expansion programmed in the net domestic assets of the Central Bank is consistent with an increase in net official international reserves of US\$25 million in 1984. However, net official international reserves are projected to decline by US\$8 million in the first semester of the year, because of the planned elimination of remaining external payments arrears and a relatively smaller capital inflow estimated for the first semester. Quarterly targets for net official international reserves, incorporating seasonal factors, have been established as shown in the attached Table 3.

8. In 1983 the end-of-period inflation rate--as measured by the consumer price index--reached 52 percent, compared with 24 percent in 1982. To a large extent, the rise in the rate of price increase reflected the sharp jump in food prices caused by shortages following severe floods. The end-of-period inflation rate is projected to fall to around 25 percent in 1984. Price developments in 1983 have given rise to strong pressures for wage increases from both the public and the private sectors. The Government has responded by implementing a controlled salary policy and will ensure that any adjustments in salaries in 1984 will be consistent with the fiscal and monetary objectives described earlier.

9. The efforts made during 1983 to strengthen competitiveness through the pursuit of a more realistic exchange rate policy will be continued in 1984. The rate of depreciation of the sucre in the official market is being maintained at S/. 0.05 per U.S. dollar a day (seven days a week). Such a policy, together with the anticipated deceleration in domestic inflation, is expected to result in a further gain in competitiveness during 1984. In addition, in a significant move toward the strengthening of competitiveness, on February 29, 1984 the Government made further transfers of transactions to the free market to reach 50 percent of nonpetroleum exports, an amount equivalent to US\$600 million of imports (on a yearly basis), and all service receipts and payments except those for interest on foreign debt, profit remittances of registered foreign investment, and a few other minor service transactions. It is estimated that the proportion of private sector current payments in the free market after the above measures will exceed 55 percent of the total.

10. The Government reaffirms its commitment to eliminate by the end of the program period the prohibition placed on certain imports late in 1982. To this end, effective February 29, 1984, the prohibition has been lifted for a list of imports representing in value about 75 percent of the total which had been prohibited until now. The Government of Ecuador does not intend to introduce any new or modify any existing multiple currency practice other than those described in paragraph 9 of this memorandum, impose new or intensify existing restrictions on payments or transfers for current international transactions, conclude new bilateral payments agreements which are inconsistent with Article VIII of the Articles of Agreement, or impose or intensify restrictions on imports for balance of payments purposes.

11. During 1983 Ecuador concluded the renegotiation of public and private sector debt owed to foreign commercial banks which fell due in the period November 1982-December 1983. In addition, debt relief was obtained under the aegis of the Paris Club on principal and interest payments owed to official bilateral creditors, falling due in the 12-month period ending May 31, 1984. The Government of Ecuador and a group of foreign banks have reached an agreement in principle on the rescheduling of public and private sector debt falling due in 1984 and on a financial package equivalent to US\$350 million. The Government also intends to seek the rescheduling of debts owed to official bilateral creditors which fall due after May 31, 1984. Should the 1984

Table 4. Ecuador: Limits on the Outstanding External Debt of the Public Sector or Guaranteed by the Public Sector with Original Maturity of Up to and Including 12 Years 1/2/3/4/

(In millions of U.S. dollars)

Maturity Range	Up to July 24, 1984
Up to and including 1 year	350
Up to and including 12 years	4,725

1/ These limits will be lowered for any reduction in external debt via shifts in maturity structure occasioned by the renegotiation of external debts.

2/ The private sector foreign debt rescheduled and assumed by the Central Bank will not be included in these limits.

3/ Excludes external debt of up to one year of the Central Bank of Ecuador, with exception that the limit includes external debt arising from oil advances.

4/ These limits exclude the amount of trade-related payments obligations to foreign commercial banks, which have been extended.

Table 8. Ecuador: Balance of Payments Projections

(In millions of U.S. dollars)

	1984 <u>1/</u>	1985	1986	1987	1988	1989	1990
<u>Current account</u>	-115	-307	-248	-235	-253	-189	-75
Exports, f.o.b.	2,524	2,674	2,835	3,008	3,194	3,393	3,608
Petroleum	(1,705)	(1,773)	(1,844)	(1,918)	(1,995)	(2,074)	(2,157)
Other	(819)	(901)	(991)	(1,090)	(1,199)	(1,319)	(1,451)
Imports, c.i.f.	-1,703	-1,812	-1,921	-2,036	-2,159	-2,288	-2,425
Interest payments	-724	-906	-898	-938	-1,003	-990	-931
Other services, credit	370	410	450	490	520	550	580
Other services, debit	-602	-693	-735	-779	-825	-875	-927
Transfers	20	20	20	20	20	20	20
<u>Capital account</u>	-768	-807	-691	-874	-1,274	-1,466	-1,260
Direct investment	51	80	100	110	120	130	140
Drawings on loans <u>2/</u>	250	240	250	260	270	280	290
Amortization <u>3/</u>	-1,017	-1,127	-1,041	-1,244	-1,664	-1,876	-1,690
Other	-52	--	--	--	--	--	--
<u>Arrears</u>	-102	--	--	--	--	--	--
<u>Change in net official international reserves</u> (increase -)	-25	-100	-100	-90	-73	-32	-34
<u>Financing gap</u>	-1,010	-1,214	-1,039	-1,199	-1,600	-1,688	-1,370
<u>Memorandum items</u>							
Financing	1,010	1,214	1,039	1,199	1,600	1,688	1,370
For amortization	1,017	1,127	1,041	1,241	1,654	1,860	1,666
Banks <u>4/</u>	(847)	(967)	(927)	(1,132)	(1,468)	(1,688)	(1,495)
Other	(170)	(160)	(114)	(109)	(187)	(172)	(171)
Net additional borrowings	-7	87	-2	-45	-64	-188	-320

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

1/ On accrual basis for comparison of 1985-89 projection.

2/ Starting 1985, these reflect disbursements from international organizations and bilateral loans.

3/ Includes amortization on past financing gaps, assuming they are financed by commercial loans.

4/ Includes amortization by the private sector on the unrescheduled debt.