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INVESTMENT SOLUTIONS & PRODUCTS  
Latin America



Economics

# Ecuador: Where from, where to

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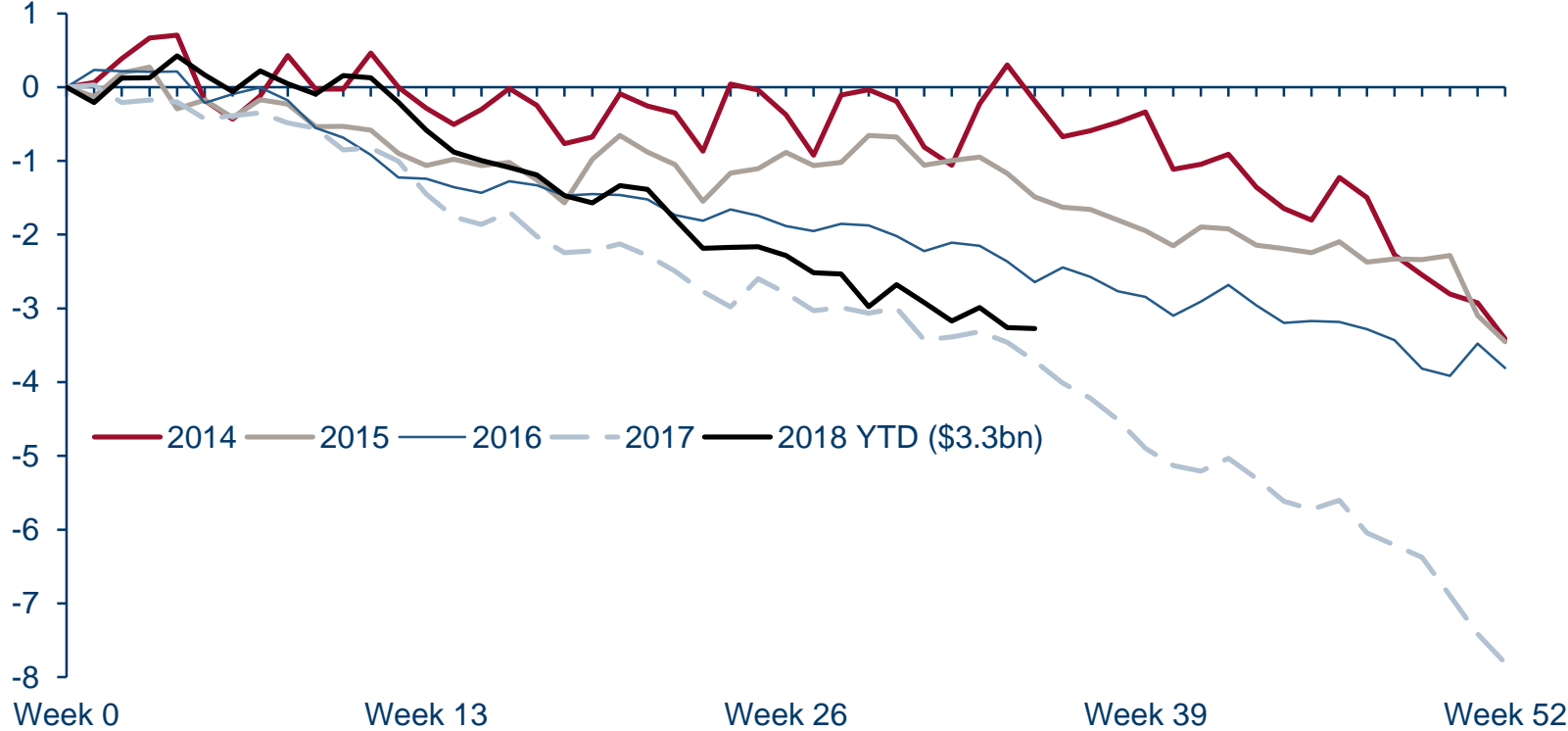
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# The balance of payments tells us that the economy is not in equilibrium.

## Cumulative underlying international reserve loss

\$bn, net of bond issuances, oil-field financing, and bilateral loans linked to oil purchase-sell agreements

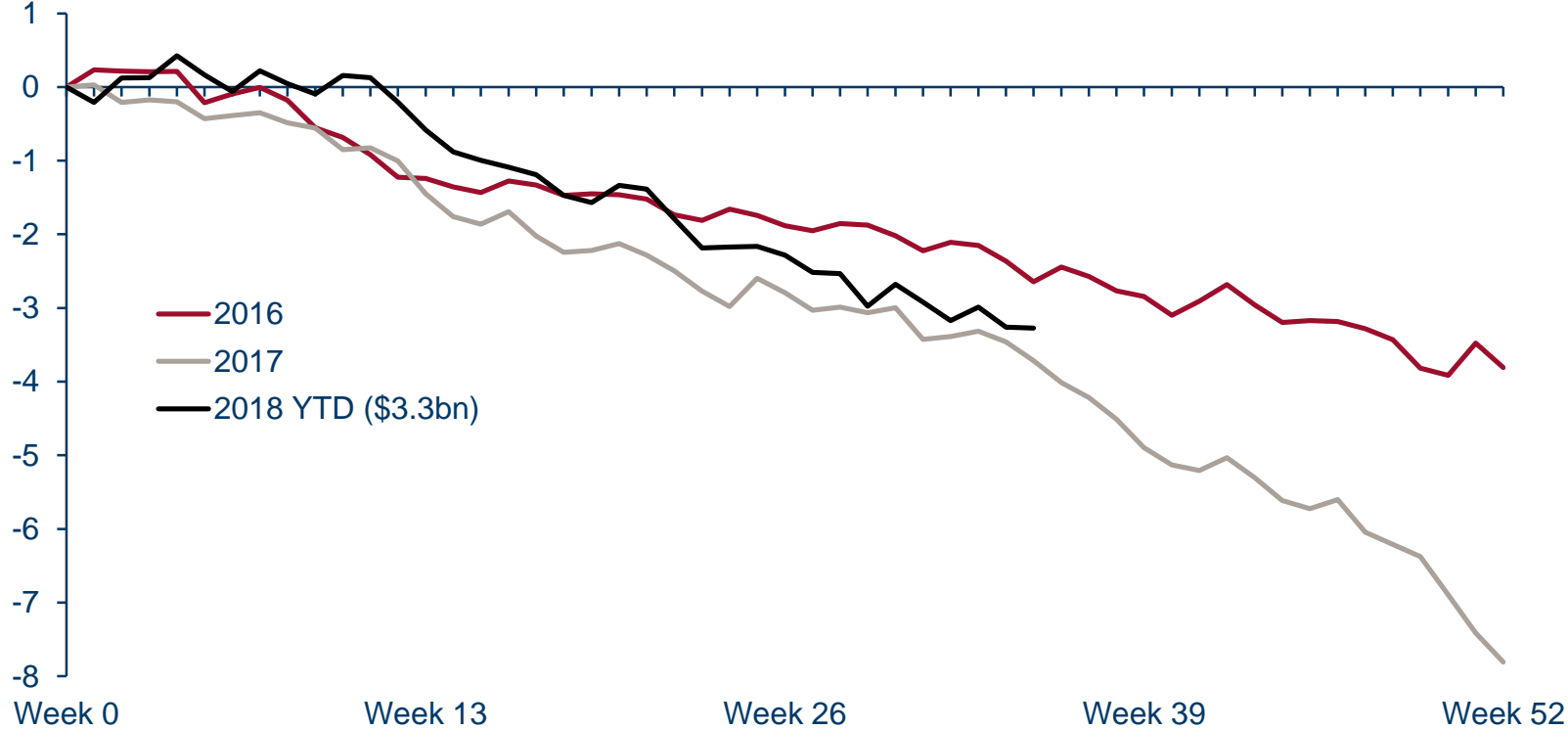


Source: Central bank, Credit Suisse

# The underlying loss of international reserves year-to-date has been broadly in line with that of 2017...

## Cumulative underlying international reserve loss

\$bn, net of bond issuances, oil-field financing, and bilateral loans linked to oil purchase-sell agreements

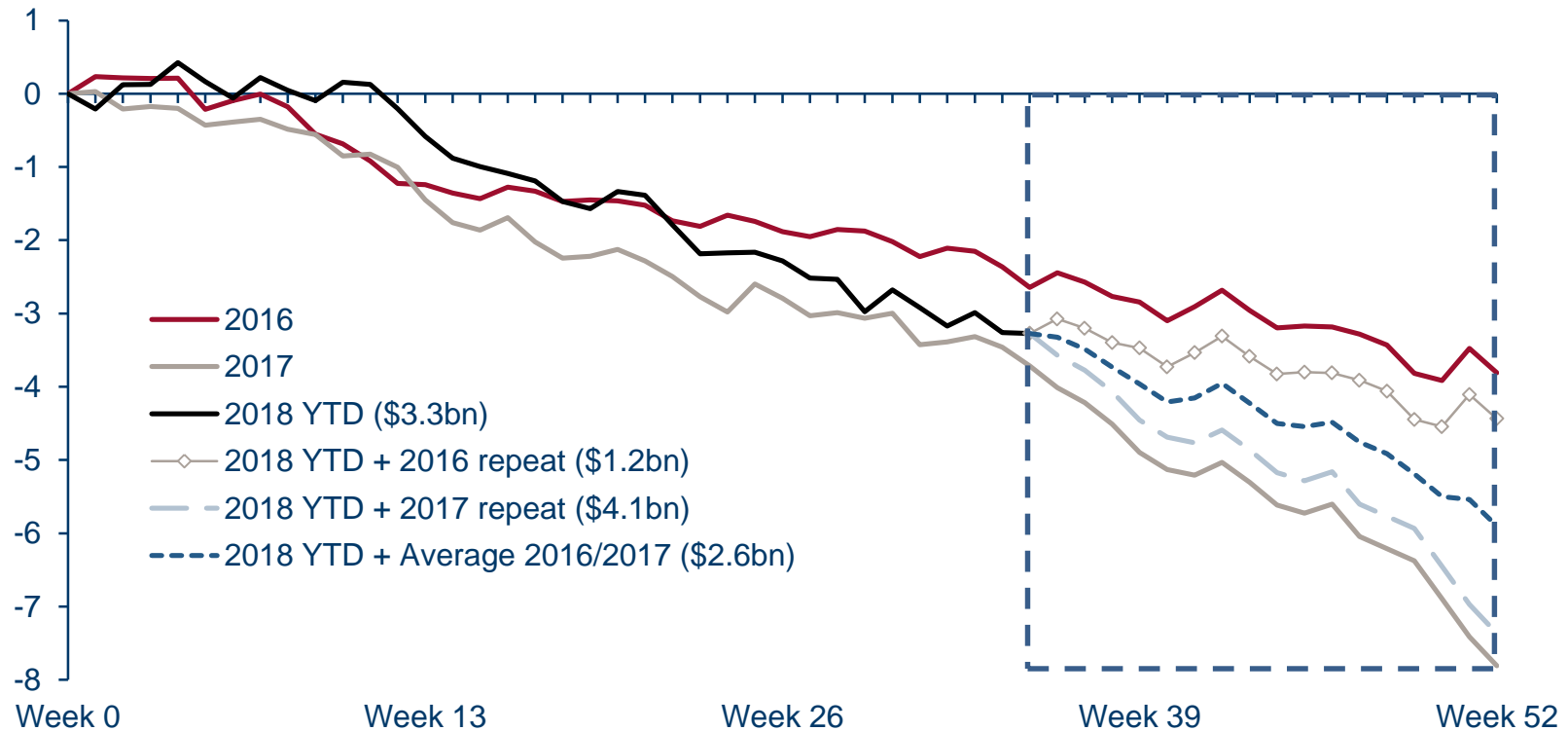


Source: Central bank, Credit Suisse

...and pressure may intensify in the remainder of the year due to seasonality.

### Cumulative underlying international reserve loss

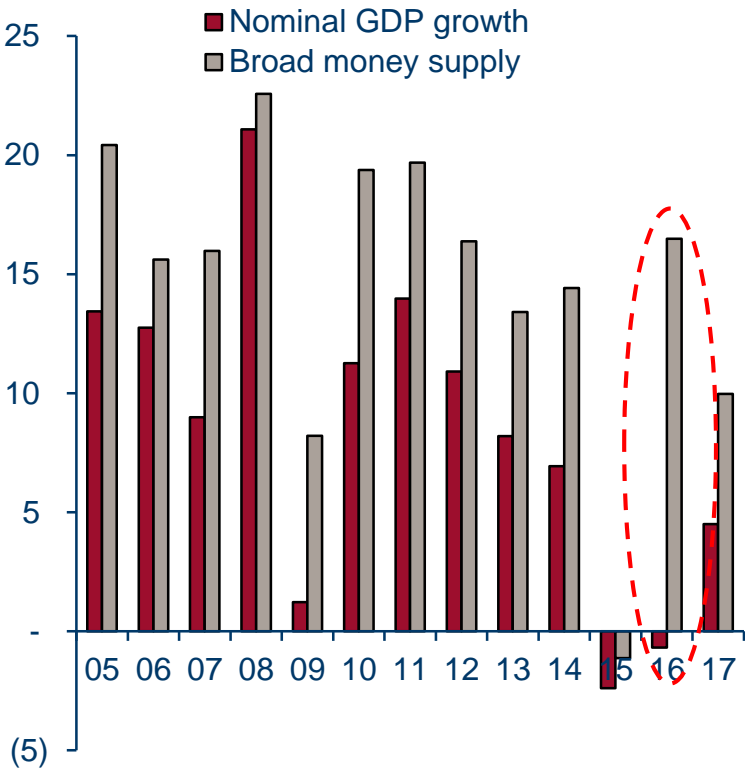
\$bn, net of bond issuances, oil-field financing, and bilateral loans linked to oil purchase-sell agreements



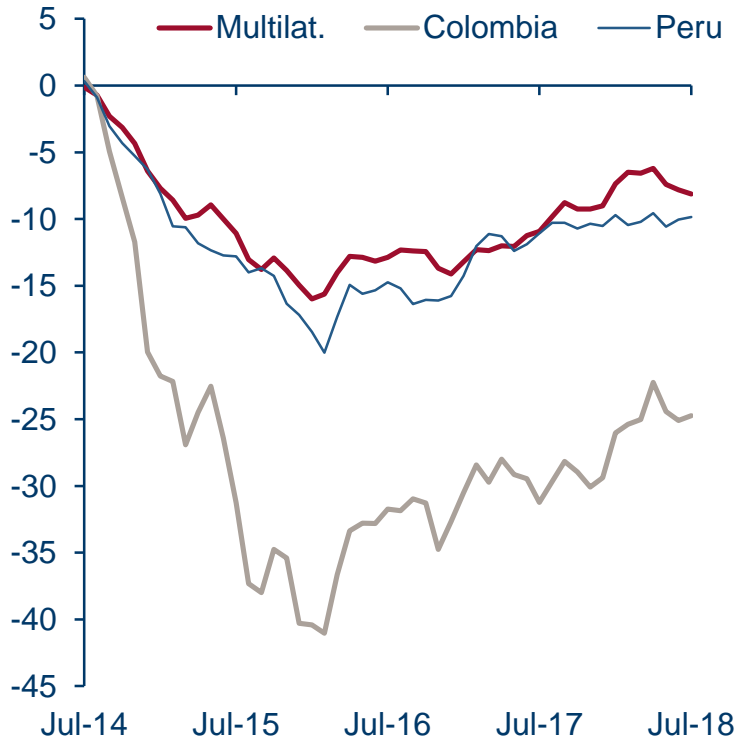
Source: Central bank, Credit Suisse

# What are the roots of this disequilibrium? Policy actions and the structure of the economy, in our view.

Nominal GDP growth and money supply  
% yoy



Real multilateral and bilateral exchange rates  
% change since June 2014

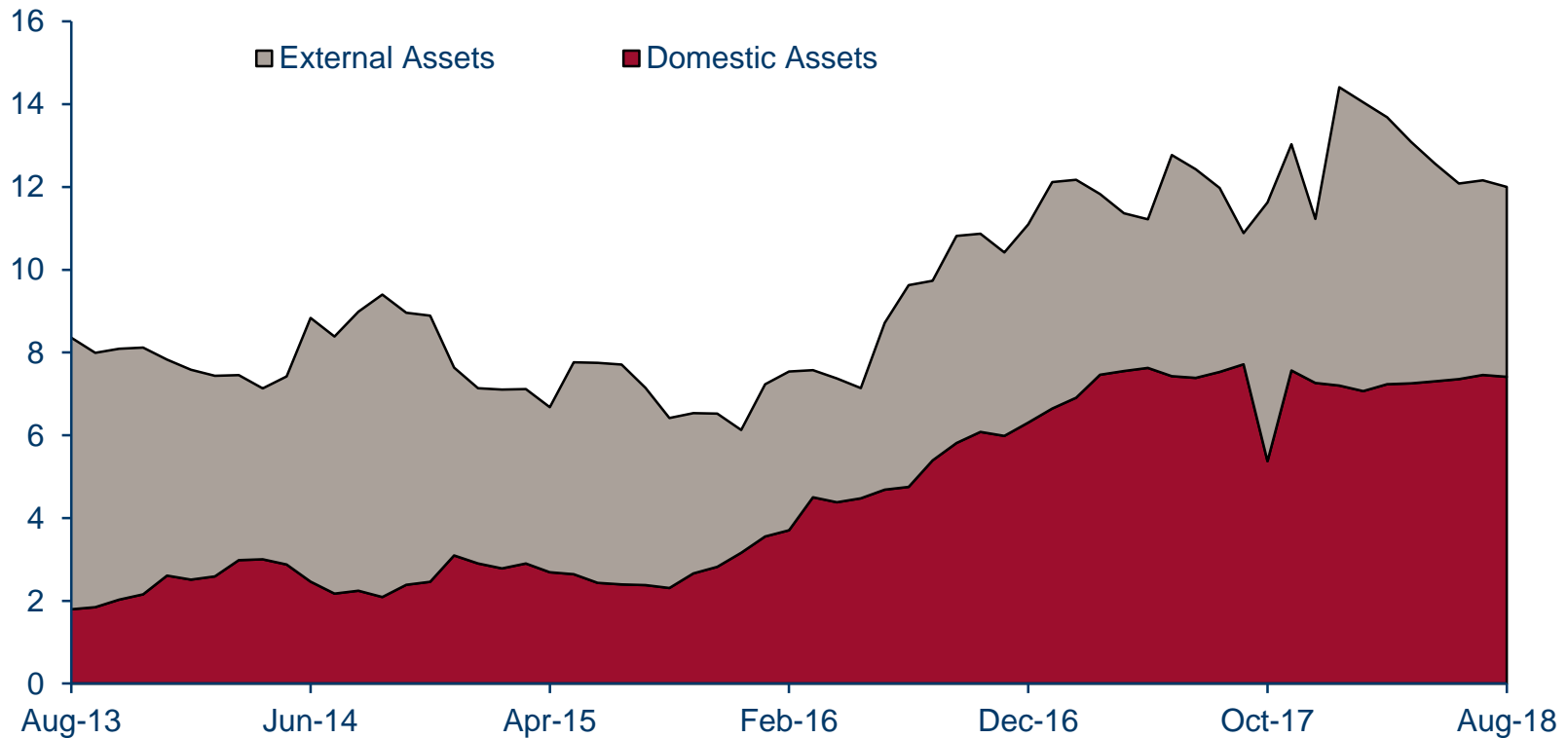


Source: Central bank, Credit Suisse

# 1) The contagion of the fiscal shock to the monetary sector via the Central Bank's balance sheet expansion...

Central Bank's balance sheet assets

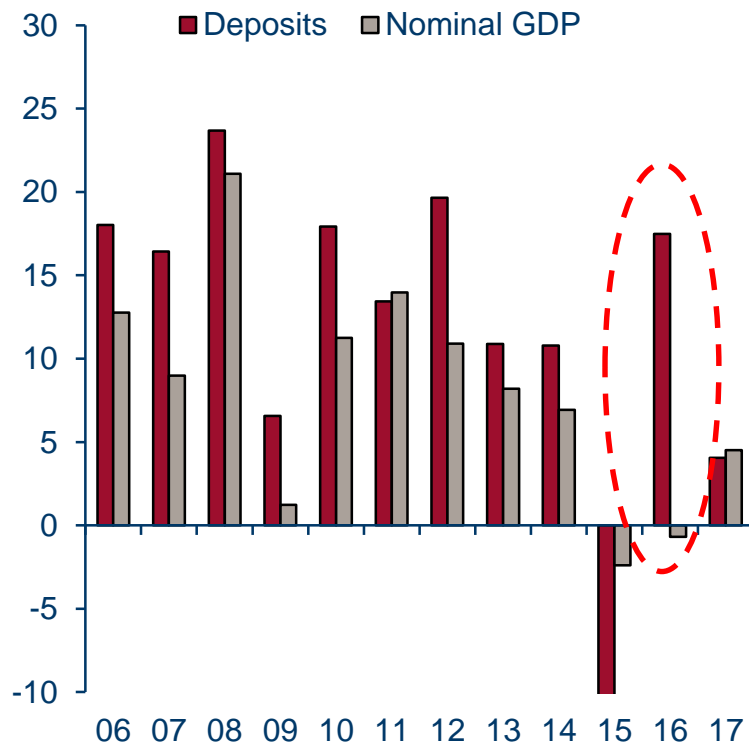
\$bn



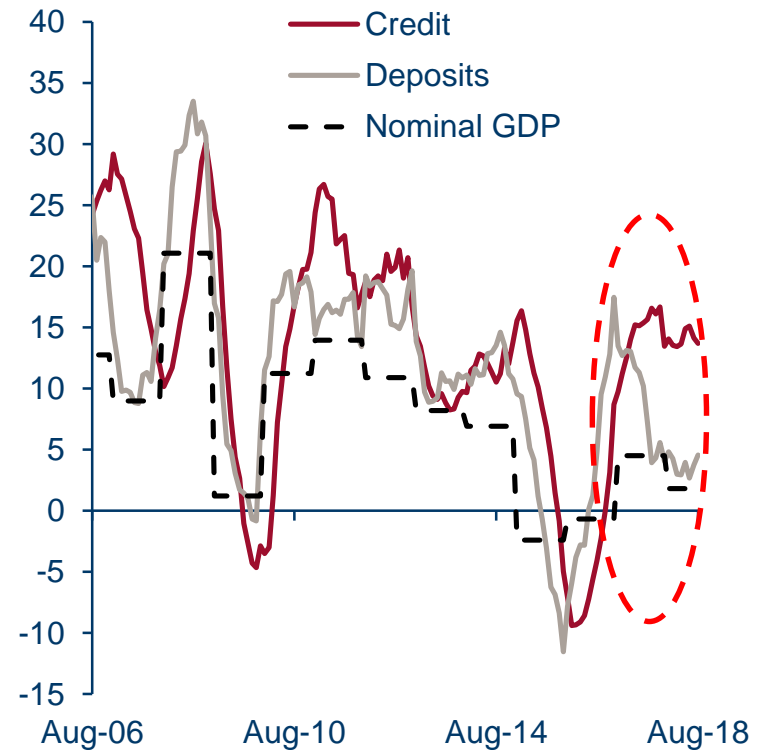
Source: Central bank, Credit Suisse

# ...led to a surge in domestic liquidity and to a credit cycle inconsistent with macroeconomic fundamentals.

Nominal GDP growth and financial system deposits  
% yoy



Nominal GDP growth vs. credit and deposit cycles  
% yoy

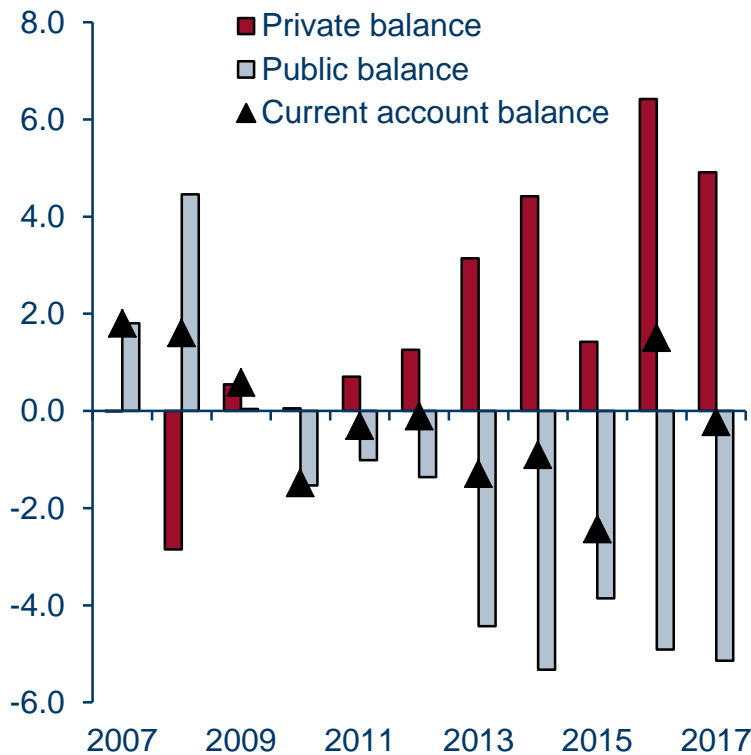


Source: DATALAB Asobanca, Central bank, Credit Suisse

# That is why a fiscal adjustment, while necessary to balance external accounts, is not sufficient...

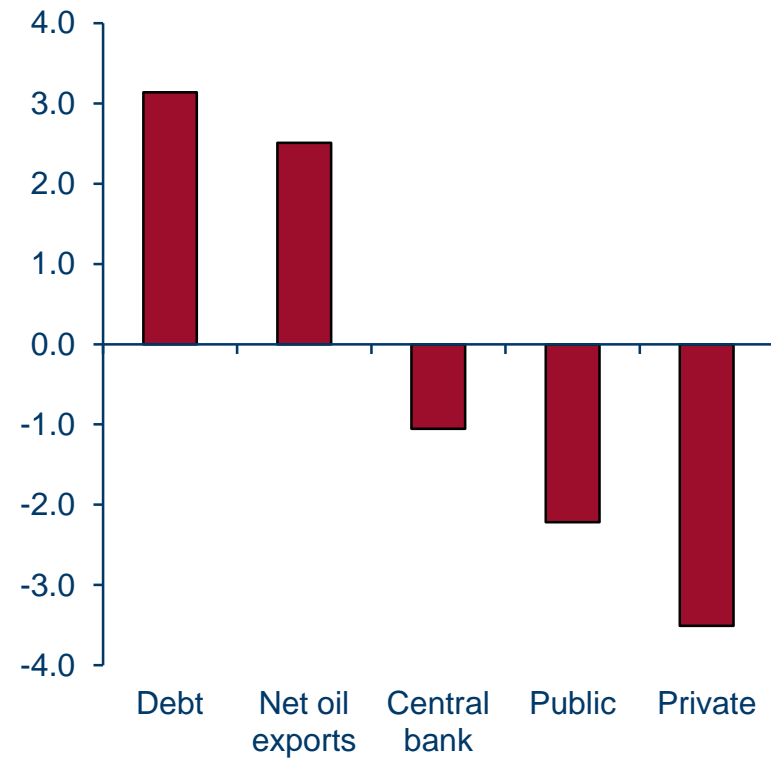
Public, private, and current account balances

\$bn, 2017 is an estimate



Contributions to international reserves by sector

12-month accumulated through July 2018



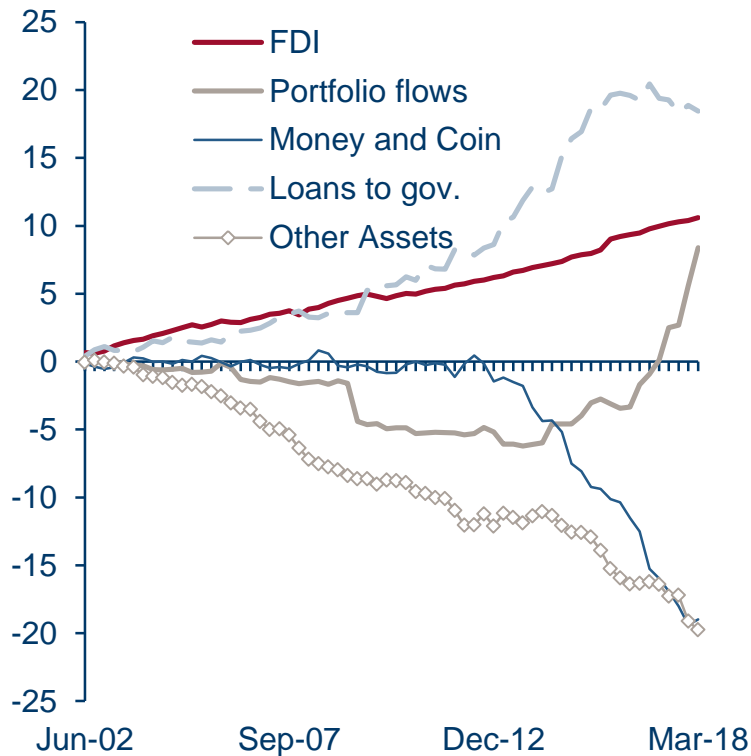
Source: Central bank, Credit Suisse



...as the disequilibrium is holistic and also requires that private sector outflows on the capital account decline.

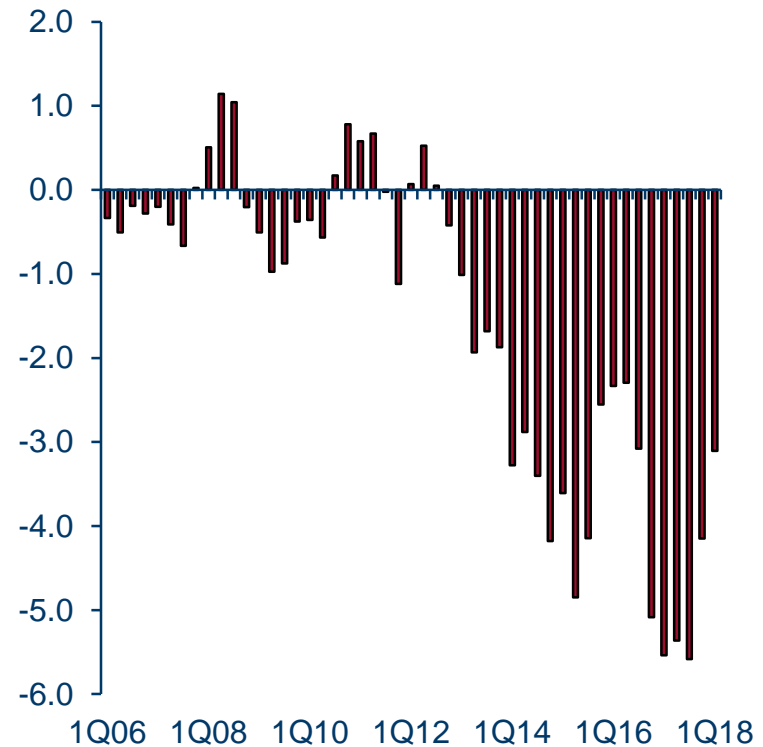
### Capital account flows

\$bn, accumulated since Q1 2002



### Money and coin balance

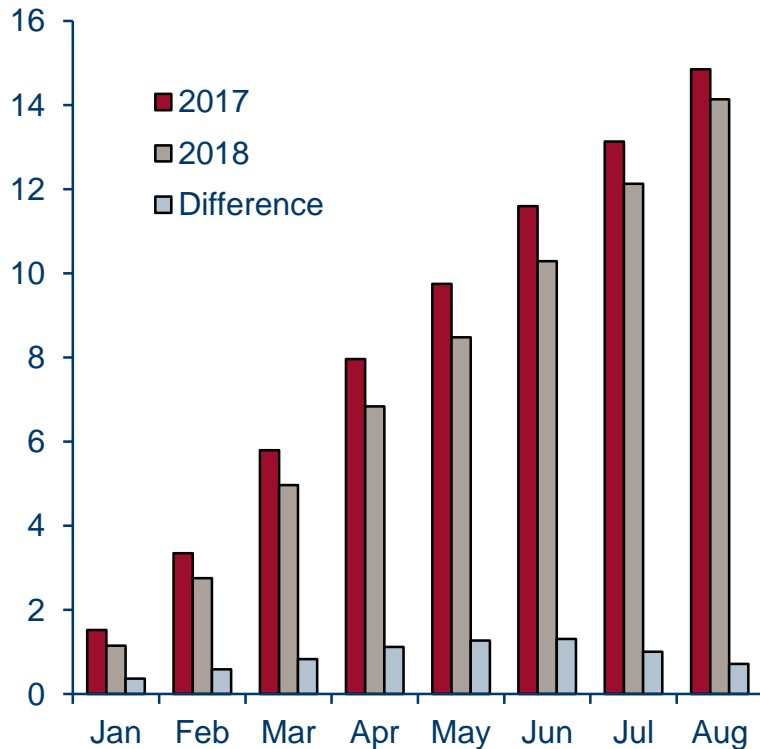
\$bn, 4-quarter rolling



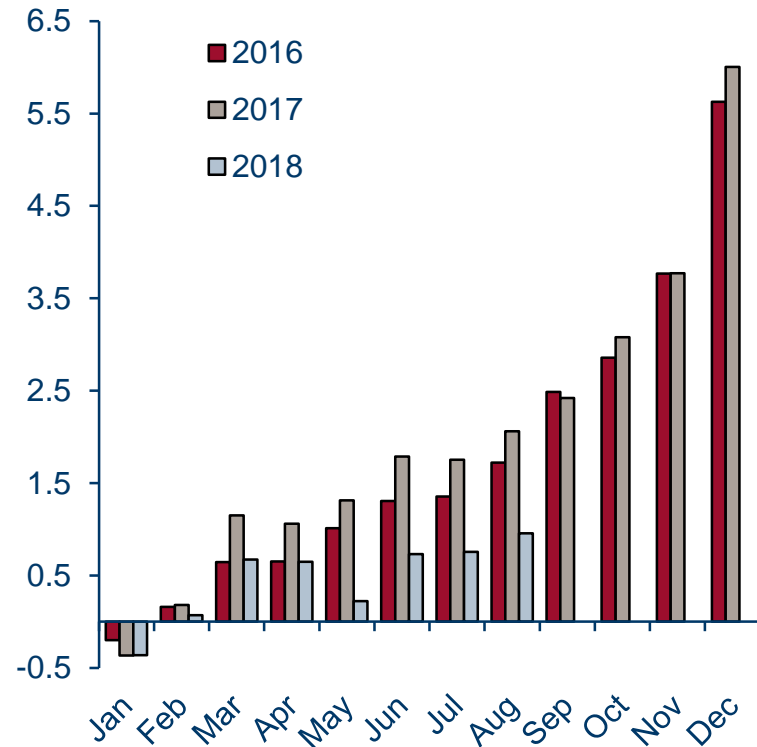
Source: Central bank, Credit Suisse

# As a result, international reserve losses have persisted in 2018, despite an important reduction in public capex.

Current and capital spending  
\$bn, current spending in 2018 net of CFDD



Estimated cumulative fiscal deficit  
% of GDP

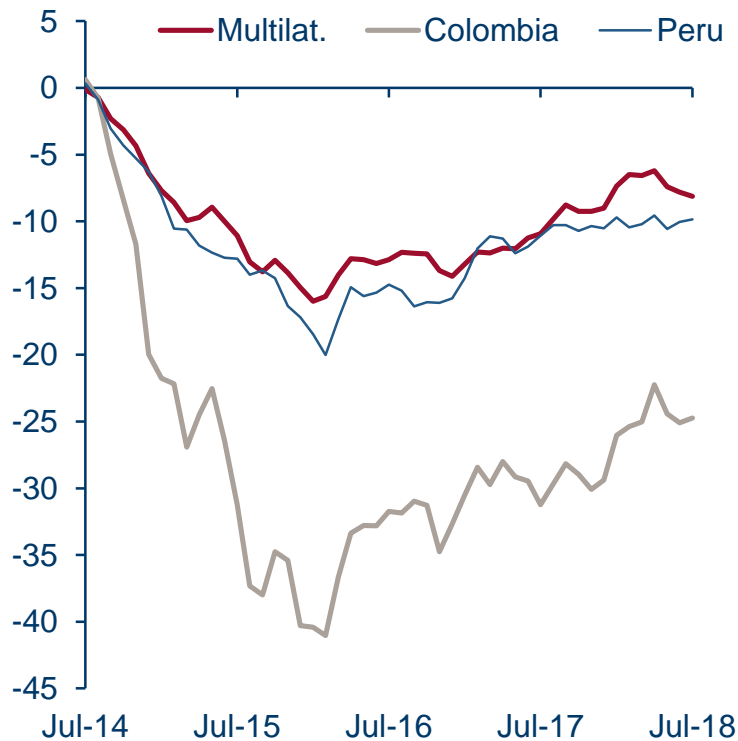


Source: Finance Ministry, Central bank, Credit Suisse

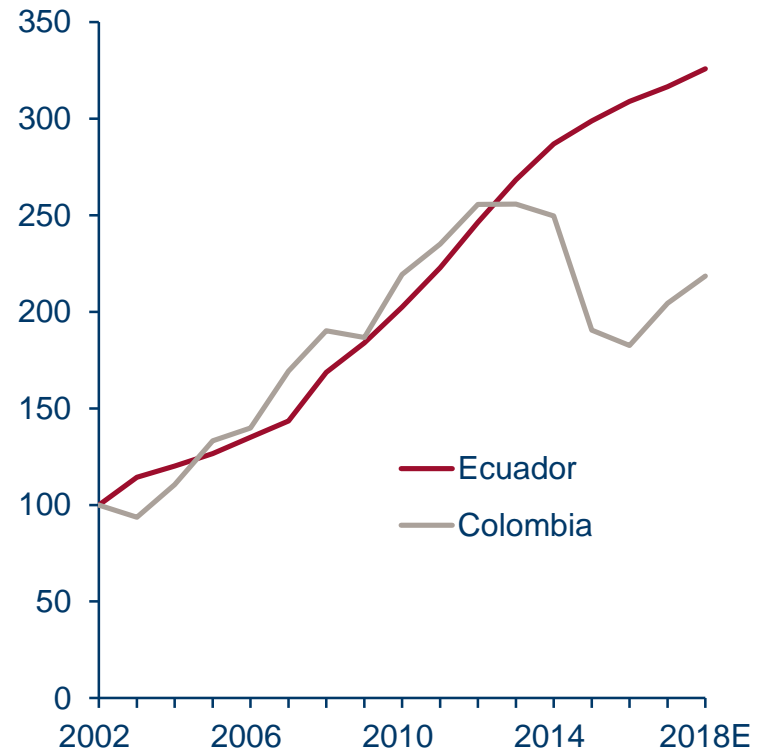
## 2) The inability of the economy to absorb and adjust to a foreign shock is seen in its rigid real exchange rate.

Real multilateral and bilateral exchange rates

% change since June 2014



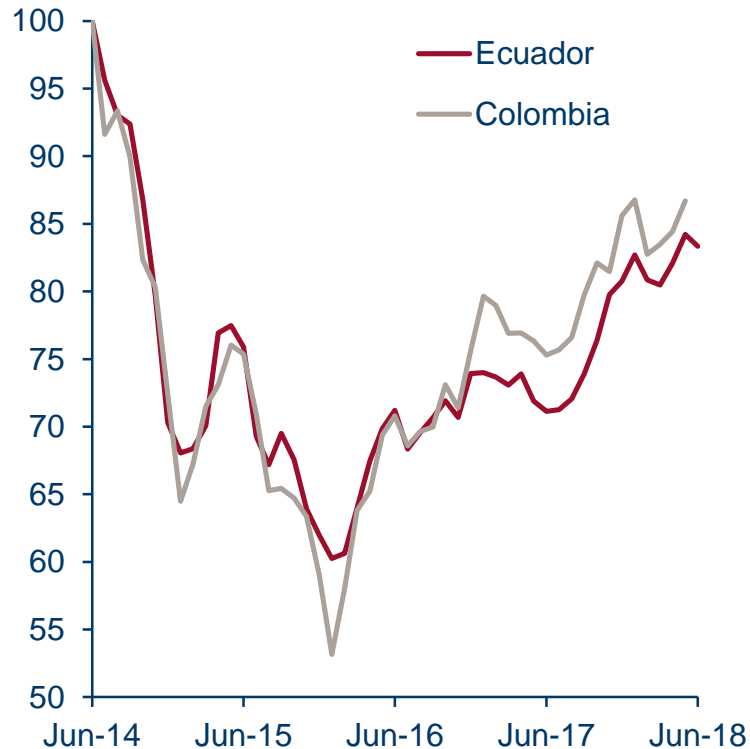
Minimum wage in dollar terms  
Index, 2002 = 100



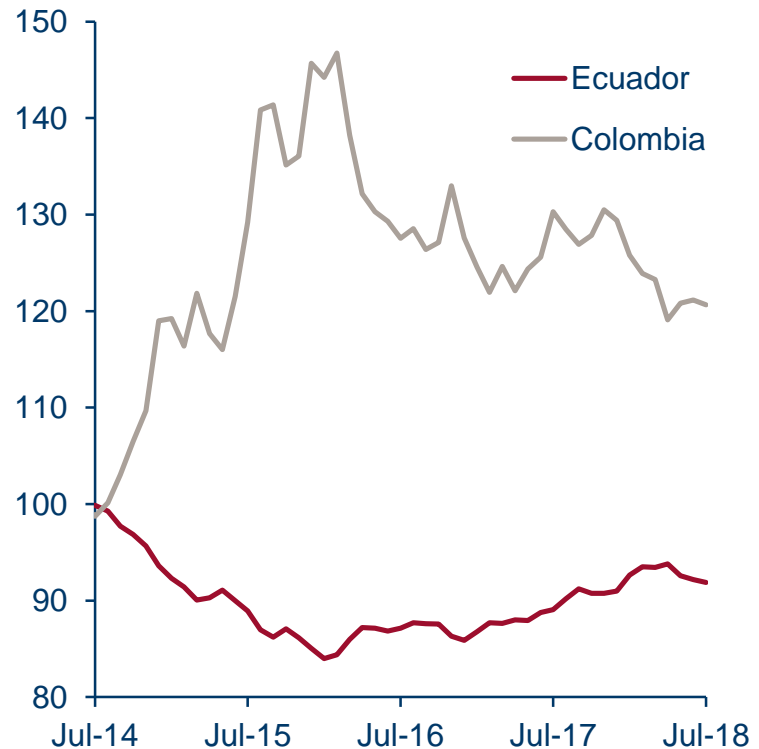
Source: Central banks, Credit Suisse

# Ecuador's economy has been unable to rebalance itself after the terms of trade shock...

Terms of trade  
Index, June 2014 = 100



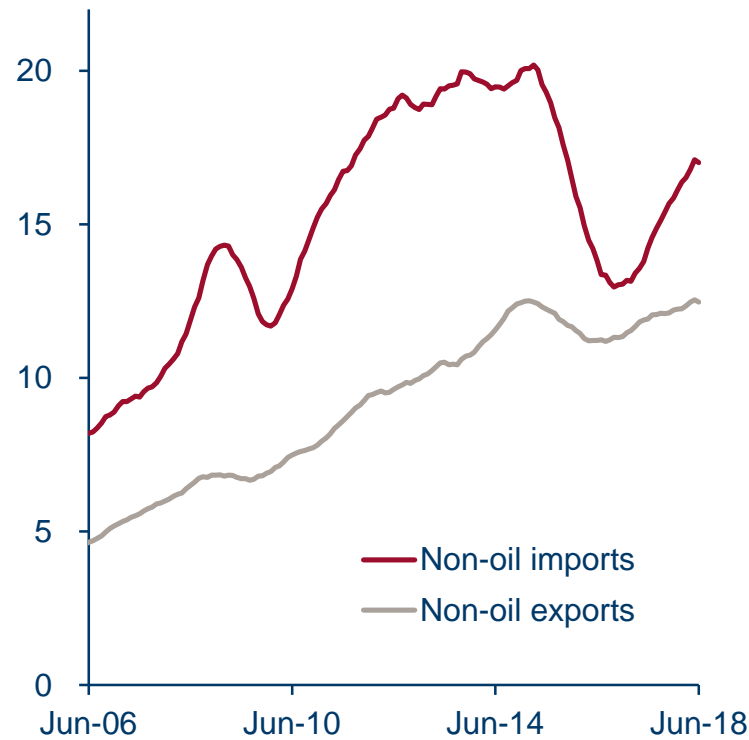
Real effective exchange rate  
Index, June 2014 = 100



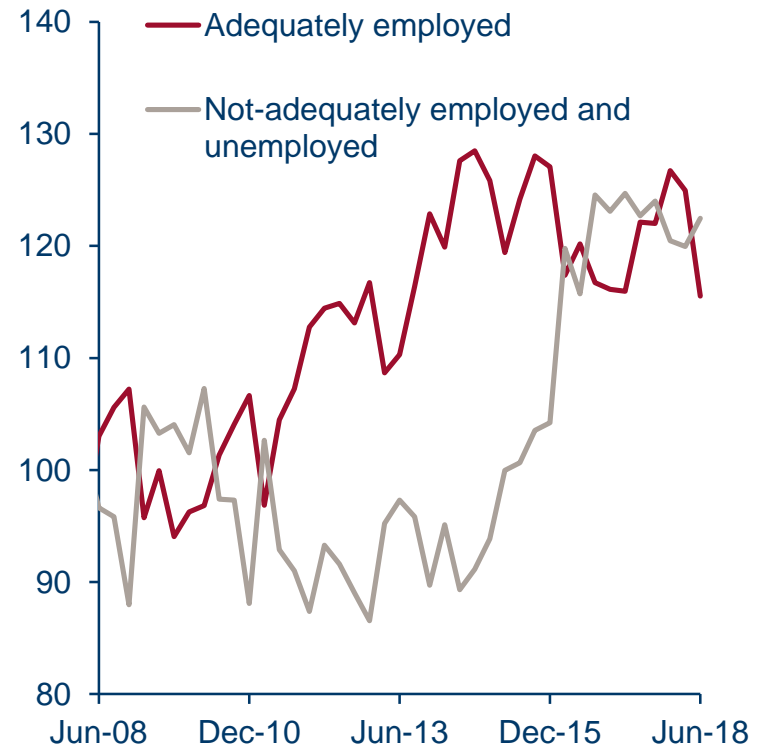
Source: Central banks, Credit Suisse

...inhibiting its ability to propel non-oil exports, and leading to a sharp deterioration in the labor market.

Non-oil imports and exports  
\$bn, 12-month accumulated



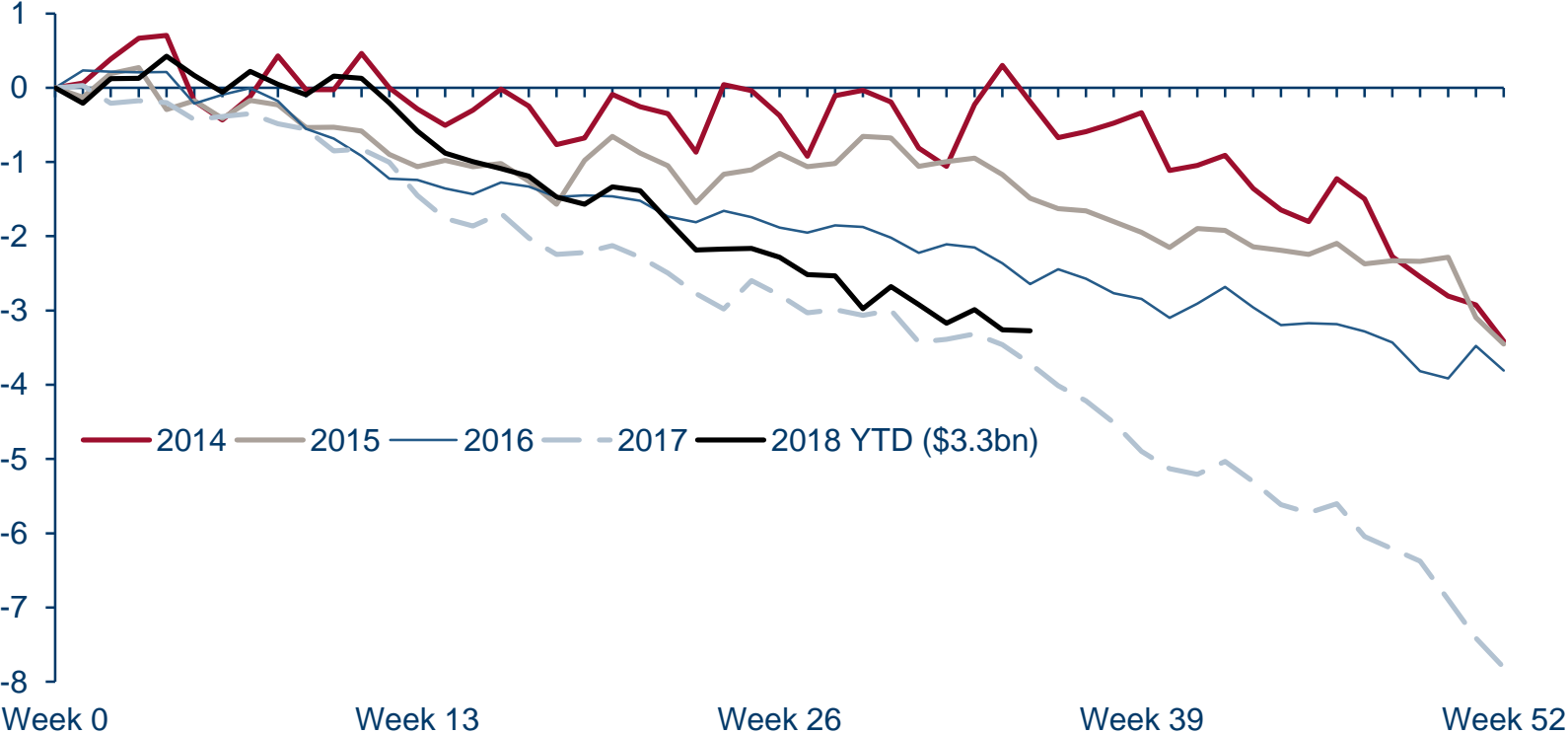
Employment  
Index, June 2007 = 100



Source: Central bank, INEC, Credit Suisse

# Hence, the balance of payments presents a structural deficit, perpetuating its dependence on foreign lending.

Cumulative underlying international reserve loss  
\$bn, net of bond issuances, oil-field financing, and bilateral loans linked to oil purchase-sell agreements

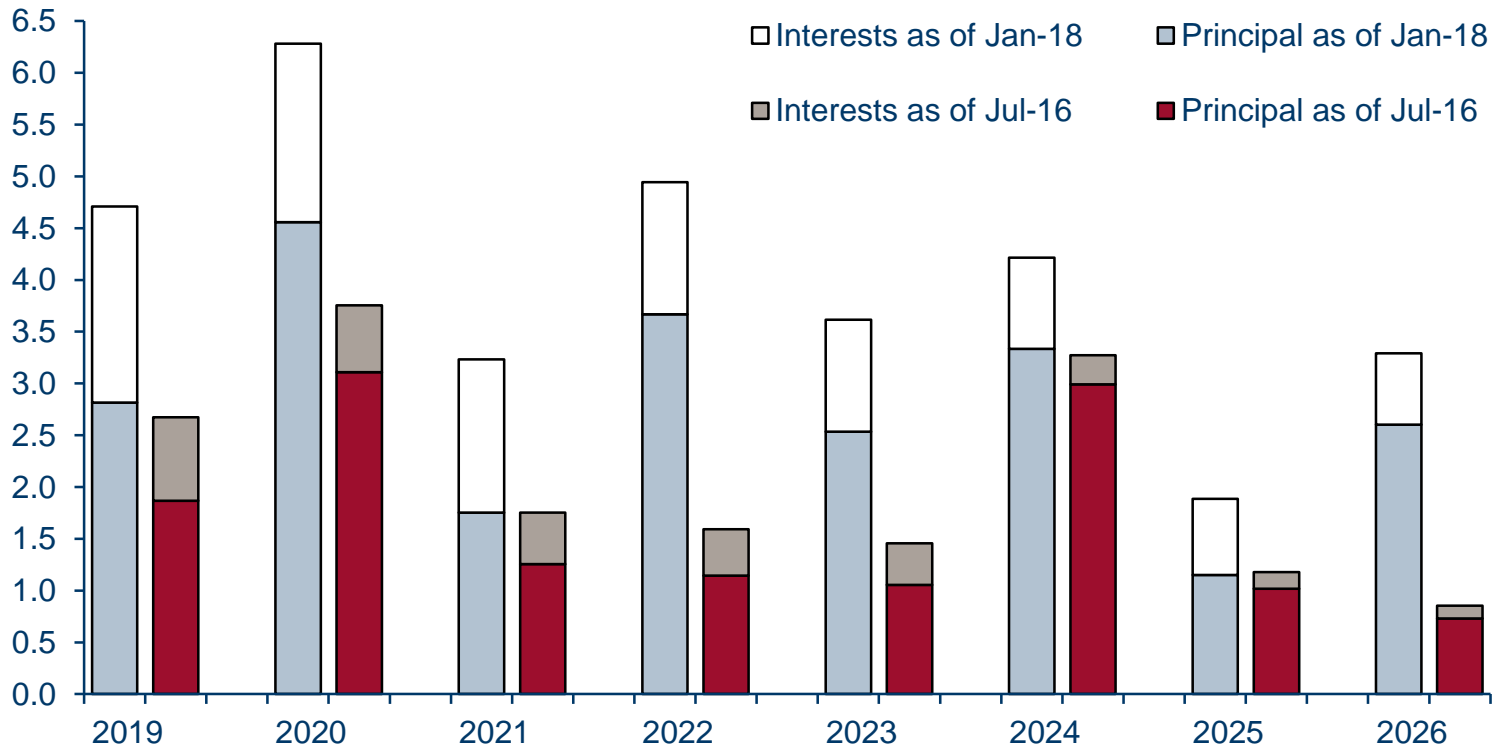


Source: Central bank, Credit Suisse

# Ecuador needs to fix its BoP dynamics to avoid relying on market access to meet upcoming bond payments.

## External debt service for 2019 - 2026

\$bn, as of January 2018



Source: Sovereign bond prospectuses, Credit Suisse

Although there are challenges ahead, there are also reforms that could be implemented to navigate them.

## What are the risks ahead?

- Normalization of global monetary policy
- Strong dollar
- Trade wars
- Idiosyncratic risks
- Chinese economic growth
- Lower commodity prices

## What could be done?

- Continued fiscal discipline
- Use foreign savings to fund private investment
- Promote FDI for mining sector
- Boost oil investment and production
- Fiscal devaluation
- Labor market reform



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