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ECUADOR

December 2019

SECOND AND THIRD REVIEWS UNDER THE EXTENDED FUND FACILITY ARRANGEMENT AND REQUEST FOR A WAIVER OF NONOBSERVANCE AND MODIFICATIONS OF PERFORMANCE CRITERIA — PRESS RELEASE AND STAFF REPORT

This paper on Ecuador was prepared by a staff team of the International Monetary Fund as background documentation for the periodic consultation with the member country. It is based on the information available at the time it was completed on December 11, 2019.

- A **Press Release** including a statement by the Chair of the Executive Board and summarizing the views of the Executive Board as expressed during its December 19, 2019, consideration of the staff report on issues related to the Article IV Consultation and the IMF arrangement.
- The **Staff Report** prepared by a staff team of the IMF for the Executive Board's consideration on December 19, 2019, following discussions that ended on November 15, 2019, with the officials of Ecuador on economic developments and policies. Based on information available at the time of these discussions, the staff report was completed on December 11, 2019.
- A **Statement by the Executive Director** for Ecuador.

The documents listed below have been or will be separately released:

Letter of Intent sent to the IMF by the authorities of Ecuador*

*Also included in Staff Report

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December 19, 2019

International Monetary Fund
Washington, D.C. 20431 USA

IMF Executive Board Concludes Second and Third Reviews of the Extended Arrangement Under the Extended Fund Facility for Ecuador, Approves US$498.4 Million Disbursement

The Executive Board of the International Monetary Fund (IMF) today completed the combined second and third reviews of Ecuador's performance under its economic program supported by the Extended Arrangement under the Extended Fund Facility (EFF). The completion of both reviews allows the authorities to draw the equivalent of SDR 361.3 million (about US$498.4 million). The 36-month Extended Arrangement with a total access of SDR 3.035 billion (about US$4.2 billion), the equivalent of 435 percent of Ecuador's quota in the IMF, was approved by the IMF's Executive Board on March 11, 2019 (see Press Release 19/72).

Following the Executive Board discussion, Mr. Mitsuhiro Furusawa, Deputy Managing Director and Acting Chair, summarized the Board's findings:

"The Ecuadorian authorities have continued to make progress in strengthening the country's fiscal and external positions and have appropriately recalibrated their economic program to include a more moderate fiscal consolidation and international reserves' paths in response to recent developments and to protect pro-poor growth and social spending.

"The Ecuadorian authorities have demonstrated commitment to fiscal prudence, which remains key to fiscal sustainability. In this context, the recently approved tax reform will raise revenues and make the tax system more growth-friendly, simple, and equitable.

"Protecting the poor and increasing the social safety net are central priorities in the government's program. The authorities have introduced new measures to improve the adequacy and coverage of the social safety net. Continued work is needed to upgrade the social registry, which will allow for a better targeting of social assistance spending. To support the authorities' efforts, the program's floor on social assistance will be raised.

"Public financial management reforms are paramount to secure fiscal sustainability in the longer term. The revised reform of the Organic Budget Code will be key to fortifying expenditure controls, limiting budget discretion, introducing mechanisms to address arrears, and improving the framework for fiscal rules. Continued work will be needed in the area of debt management to reduce borrowing costs and ensure a more efficient allocation of resources.

“The reform of the central bank aimed at strengthening central bank autonomy, accountability, and governance will be instrumental in supporting the dollarization regime, boosting reserves, and ensuring their prudent management.

“The financial system continues to be stable, and sustained reforms will help solidify the system. In this context, strengthening credit risk regulation and closing other regulatory gaps are priorities. Upgrading banking and cooperatives’ supervision, building the macroprudential framework, and simplifying liquidity requirements will help reinforce the financial system in the longer term.

“Efforts to raise competitiveness should continue to focus on improving transparency, strengthening governance, increasing efficiency of the public sector, and creating conditions in the labor market to facilitate hiring and female participation.”

ECUADOR

December 11, 2019

SECOND AND THIRD REVIEWS UNDER THE EXTENDED FUND FACILITY ARRANGEMENT AND REQUEST FOR A WAIVER OF NONOBSERVANCE AND MODIFICATIONS OF PERFORMANCE CRITERIA

EXECUTIVE SUMMARY

Program Context: A 36-month Extended Fund Facility (EFF) arrangement with access of SDR 3.035 billion (435 percent of quota or about US$4.189 billion) was approved on March 11, 2019. The first review was concluded on June 28, 2019. At the beginning of October, an economic reform package was announced, including the immediate liberalization of prices for gasoline and diesel. Following protracted protests and social unrest, the authorities retracted the decree mandating the removal of fuel subsidies. The government continues to negotiate a revised fuel subsidy decree with a broad representation of civil society and hopes to reach an agreement in the foreseeable future. Completing the upgrade of the social safety net, recently initiated by the government, remains a priority and a prerequisite for a successful fuel subsidy reform. On November 17, 70 out of 133 legislators voted to reject an urgent package of economic laws, including key reforms under the program: a tax code, central bank code, and organic budget code. The government submitted a revised version of the tax code to the National Assembly as an urgent economic reform; this version was approved with minor modifications on December 9. The government also intends to submit revised drafts of the central bank and organic budget codes separately in the coming months, after internalizing feedback from lawmakers. Economic growth has slowed as projected in 2019, and in 2020, a less contractionary fiscal stance and higher oil production than previously expected should help mitigate the potential negative impact of political uncertainty and provide a fillip to the economy.

Program Implementation: All end-June and end-September quantitative performance criteria (QPCs) and indicative targets (ITs) were met, with the exception of the end-September QPC on net international reserves (NIR). The authorities request a waiver of nonobservance of the end-September QPC on NIR, on the grounds that the impact of this breach on program implementation was minor. The end-June structural benchmark (SB) on the submission to the National Assembly of amendments to the Organic Budget Code (COPLAFYP) was replaced by a prior action for the combined second and third reviews. This prior action was met when the authorities submitted the amendments to COPLAFYP

to the National Assembly as part of a comprehensive package of reforms on October 18. The structural benchmark on the submission of the tax reform to the National Assembly (end-October SB) was replaced by a prior action for the combined second and third reviews. The prior action envisioned the submission and non-rejection of a revised tax reform bill which yields at least 0.5 percent of GDP in both 2020 and 2021 on a net basis; this was met following the approval vote in the National Assembly on December 9. The end-September structural benchmark on the submission of amendments to the central bank code (Organic Monetary and Financial Code, COMYF) fell short of being fully implemented since the draft law submitted did not incorporate the double veto procedure for the appointment and dismissal of members of the central bank board, though it contained other important provisions that would strengthen the institutional foundations of the central bank. Other structural benchmarks for the second and third reviews were either met or implemented with a slight delay, with the exception of the end-September SB on the submission of the draft anti-corruption law, for which the authorities request an extension, and staff proposes to reset the deadline to end-December to allow more time for implementation of this SB. Given the rejection of the urgent economic law (in particular the amendments to COPLAFYP and COMYF), new program conditionality is proposed to allow the authorities more time to reach consensus and complete these structural reforms. In particular, the submission of the revised COPLAFYP amendments consistent with program commitments are proposed as a structural benchmark for the fourth review and that of the revised COMYF amendments as a structural benchmark for the fifth review. The authorities also request modifications to the end-December 2019 targets on the non-oil primary balance including fuel subsidies (NOPBS) to partially accommodate the shortfall due to the delay in asset monetization, on net international reserves due to a higher deficit and financing shortfalls, and on social assistance spending due to the postponement of one of the programs to 2020.

Staff supports the authorities' request for completion of the second and third reviews. The purchase released upon completion of these reviews would be in the amount of SDR 361.3 million (about US$498 million). Staff also supports the authorities' request for a waiver of the nonobservance of the end-September NIR target, given the minor impact of the breach, and the modifications to the end-December performance criteria on the NOPBS, NIR, and social assistance spending.

Approved By	
Krishna Srinivasan (WHD) and Maria Gonzalez (SPR)	Discussions on the second review took place in Quito during August 12-26, 2019 and discussions on the third review took place in Washington D.C. during November 11-15, 2019. The staff team comprised Anna Ivanova (head), Matteo Ghilardi and Rosalind Mowatt (all WHD), Irene Yackovlev (SPR), Mario Mansilla (MCM), Fernanda Brollo (FAD), Ivana Rossi (LEG), and Julien Reynaud (Resident Representative). Francisco Rivadeneira (OED) participated in the discussions.

ANNEXES

APPENDIX

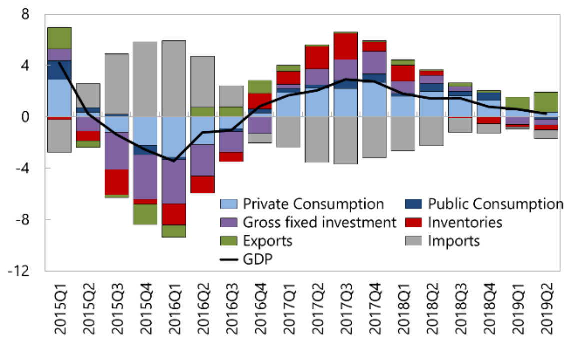
CONTEXT

1. **The government's efforts to implement important economic reforms have faced considerable resistance.** On October 1, President Moreno announced the elimination of gasoline and diesel subsidies as part of a broader package of economic reforms. The announcement was followed by nearly two weeks of widespread protests and social unrest. On October 13, President Moreno agreed to repeal Decree 883, which reversed the removal of diesel and gasoline subsidies. The government is currently negotiating with representatives of civil society, including indigenous groups, to formulate a new decree and hopes to reach an agreement in the foreseeable future. On October 18, the government submitted an emergency economic package to the National Assembly. The package included three laws that are part of commitments under the IMF-supported program: the tax law, the organic budget code, and the central bank code. However, the National Assembly voted on November 17 to reject the package. Following this, the government submitted a revised tax law to the Assembly, which was approved with minor modifications on December 9, and plans to submit revised versions of the organic budget code and the central bank code in the coming months. The submission of a labor reform is also expected in the coming months.

2. **Protests and policy uncertainty have contributed to growth deceleration in 2019.** In line with expectations, real GDP growth decelerated to 0.4 percent (y-o-y) in the first half of 2019 from 1.1 percent (y-o-y) in the second half of 2018. The slowdown was evident in both private consumption and gross fixed capital formation; the latter fell by 2.1 percent in the first half of 2019 (y-o-y). Exports performed relatively well, increasing by 4.6 percent in real terms in the first half of 2019 (y-o-y), consistent with an uptick in petroleum and food production. Consumer confidence has declined since June, and other high frequency indicators of economic activity such as VAT receipts, sales data, and sight deposits already pointed to a deceleration of economic activity before the protests in October. The protests had an additional estimated negative impact on growth of 0.4 percentage points of GDP in 2019 as oil fields and agricultural operations were sabotaged, while stores in many locations closed temporarily. Unemployment rose in September to 4.9 percent from 4.4 percent in June. The protests against the subsidy reform and the rejection of the government's economic package in November resulted in an increase in country risk, and the EMBI has widened by about 400 basis points since early October. It peaked at about 1,400 basis points in the days following the vote, a level last seen in April 2016 soon after the Manabí earthquake (the spreads have since declined to 972 on December 11).

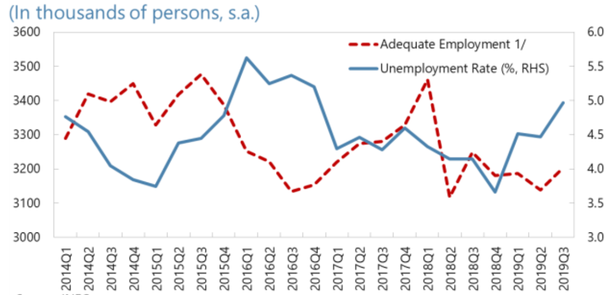
3. **Inflation remains subdued.** Consumer price inflation declined to 0 percent (y-o-y) in November, down from the temporary uptick in October of 0.5 percent, which reflected the impact of the short-lived fuel price hikes on the cost of transportation and other goods. Some other categories, notably clothing and footwear, as well as communication and recreation and culture, have been experiencing falling prices.

Ecuador: Contributions to Growth, 2015-2019Q2
(In percent, yoy)



Sources: Haver, BCE, and IMF staff calculations.

Ecuador: Adequate Employment and Unemployment Rate
(In thousands of persons, s.a.)



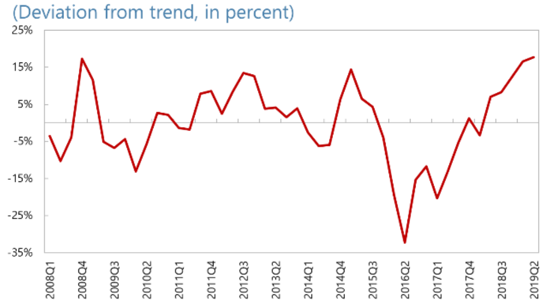
Source: INEC.
1/ Adequate employment is defined as: workers who receive weekly earnings at or above the minimum wage and who work 40 or more hours a week; or workers who earn at or above the minimum wage and work less than 40 hours a week, but have no desire to work additional hours.

4. **The current account balance registered a deficit of about US$0.3 billion in 2019H1 amid slowing global demand which dampened export growth, and resilient import growth, in part fueled by robust credit growth (¶5*)*.** In 2019H1, higher oil, shrimp, and banana production drove goods and services exports up 3.8 percent (y-o-y), but imports grew at an even faster pace (4.5 percent, y-o-y, in nominal terms) led by imports of raw materials and capital goods. In 2019H1, the current account continued to be financed primarily by public sector borrowing with an incipient turnaround in private sector flows, which rose compared to 2018H1. Foreign direct investment, however, was weaker than in 2018H1. Extended maintenance work on domestic oil refineries in August and September, the loss of oil exports due to production stoppages during October, as well as a pick-up in remittances outflows, have further widened the current account in 2019. Ecuador's external position remains weaker than the level consistent with medium-term fundamentals and desirable policies. Staff estimates a large current account gap, which stood at 4.0 percent of GDP at end-2018; the real effective exchange rate (REER) was judged to be overvalued by about 34 percent.

5. **Credit growth remains robust although the gap with deposit growth has narrowed somewhat**. Growth of credit from the financial system to the private sector has slowed but is still robust at 12.1 percent y-o-y in October 2019; the credit-to-GDP gap remains large. Although deposit growth remains below credit growth (7.4 percent y-o-y in October 2019), the gap is narrowing. The segments that have contributed the most to credit growth are consumption and microcredit, both relatively risky and increasingly provided by cooperatives, while credit to corporates has been weaker. The funding structure of the banking system is diversifying, mainly through foreign borrowing (about US$640 million in net disbursements in the year to October), and more stable through an increasing share of term deposits in the total (a 6 percentage points increase up to 36 percent in the last 18 months). Reported indicators of solvency, liquidity, asset quality, and profitability suggest that the banking system remains stable. However, past-due loans in banks' and cooperatives' portfolios have been trending upward, suggesting a gradual deterioration in asset quality and a possible risk buildup. Continued vigilance of asset quality deterioration and liquidity is warranted. The system withstood the recent period of social instability and increase in country risk relatively well. The immediate impact of the social unrest was a short-lived increase in demand for

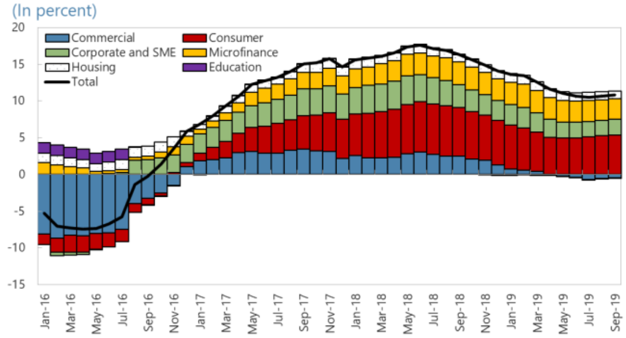
cash which was covered by the BCE. As activities normalized, net flows of cash to and from the BCE vault went back to pre-crisis levels.

Ecuador: Credit to the Private Sector-to-GDP Ratio
(Deviation from trend, in percent)



Sources: Central Bank of Ecuador and IMF staff calculations.
Note: The trend was calculated using a Hodrick–Prescott filter with a smoothing parameter (lambda) equal to 1600.

Ecuador: Contribution of Business Lines to Financial System Credit Growth 1/
(In percent)



Sources: Central Bank of Ecuador, Ecuador Superintendency of Banks, and IMF staff calculations.
1/ Excludes impact of the 2017 reclassification of Diners Club (5 percent of market), which mostly finances consumption, and mutualistas.

OUTLOOK

6. While the growth outlook remains broadly unchanged, the external position is projected to be weaker than at the time of the first review:

- **Growth and Inflation.** Growth in 2019 is forecast at negative 0.5 percent, the lower end of the -0.5 to 0.5 percent range forecast in the first review. The projected composition of growth in 2019 has shifted, with a lower contribution from external demand; domestic demand has been supported by continued robust credit growth. As before, growth is projected at 0.2 percent for 2020 and 1.6 percent for 2021. The unchanged projection reflects both the likely negative impact of the recent political instability and policy uncertainty on investment in 2020, offset by a less negative impulse from fiscal consolidation as well as higher oil production than previously forecast. Average inflation in 2019 and 2020 is projected at 0.3 and 0.9 percent respectively, with the downward revision to the 2020 forecast related to the change in the composition of fiscal measures. Inflation is expected to remain subdued in the medium term.

- **External Position.** The external position is still expected to strengthen in 2019, compared to 2018. However, the improvement in the current account (to a deficit of 0.8 percent of GDP) is expected to be significantly more modest than that envisaged at the time of the first review (to a surplus of 0.5 percent of GDP). This is largely driven by a slowdown in demand from trading partners, refinery closures, the unexpected loss in oil exports in October 2019 (about 2.5 million barrels) in the wake of public protests, as well as higher-than-expected growth in imports. Over the medium-term, oil exports are expected to perform better than previously envisioned, but higher imports, including due to the base revision in 2019, and lower demand from trading partners for traditional non-oil exports are expected to result in a more modest improvement of the current account.

- **Financing.** At about US$10 billion, gross external financing requirements for 2019 are now estimated to be US$1.2 billion higher than at the time of the first review due to the significantly weaker external position. This amount includes the US$1.2 billion needed to close the liability management operation with the bonds maturing in 2020 completed in June.[1] Compared to the financing sources foreseen to come through at the time of the first review, the net public financing in 2019 is expected to have a shortfall of US$2.3 billion. The shortfall emerged due mainly to (i) lower-than-expected net disbursements from multilaterals (US$0.9 billion, with disbursements largely shifting to 2020) [2] and other lenders; (ii) a lower-than-expected non-oil primary balance (by about US$540 million given the delay in the asset monetization project; (iii) a lower oil balance (by about US$350 million), and (iv) additional financing needs (a large statistical discrepancy, which most likely reflects additional repayments on other accounts payable by entities outside of the central government). To offset this shortfall, the authorities issued an international bond for US$2 billion on September 24[3], which, together with the remaining multilateral disbursements, will help cover budget needs and ensure consistency with the revised NIR target by end-2019 (about US$300 million lower compared to the first review).

Ecuador: Changes in Public Sector Financing with Respect to the First Review
(In US$ million)

	2019
Additional Financing Needs (net):	**-2302.0**
Overall Balance	-895.4
Multilaterals (net)	-936.0
Other Financing (net)	19.3
of which: Bilateral	-481.8
Statistical Discrepancy	-475.0
Monetary and Other Factors	-15.0
Additional Financing Sources:	**2302.0**
Market Issuance	2000.0
Revision in NIR Target	302.0

Sources: Ministry of Finance and IMF staff calculations.

PROGRAM IMPLEMENTATION

7. All the quantitative performance criteria for end-June and end-September were met, with the exception of the QPC on NIR in Q3.

(i) NOPBS: The end-June 2019 PC was met with a sizeable margin—an actual deficit of US$386 million, below the programmed deficit adjusted for oil prices of US$1,004 million—thanks to higher-than-expected collection of income taxes and social security contributions, and lower capital spending. Despite lower savings in fuel subsidies, the positive dynamic in the

[1] Ecuador sold US$1.125 billion in bonds maturing in 2029 to buy back US$1.2 billion of its outstanding bonds that were coming due in 2020. The new 2029 bond has a yield of 9.05 percent.

[2] Net multilateral financing in 2019 is now expected to be lower, compared to the first review, due to lags in implementation of both program and project loans. Key delays are linked to: (i) information collection for the upgraded social registry; (ii) implementation of a one-stop shop in the internal revenues service (SRI); (iii) contracting processes and executions of works for various projects.

[3] The US$2 billion issuance was dual tranche, with US$600m issued at 7.875 percent (5-year tranche) and US$1.4 billion at 9.50 percent (10-year tranche).

NOPBS helped achieve an overperformance in the overall balance versus the end-June indicative target (IT)—a surplus of US$691 million versus a programmed surplus of US$59 million. The end-September fiscal targets have also been comfortably met—an actual NOPBS deficit of US$1,625 million, below the programmed deficit adjusted for oil prices of US$2,319 million. The overall balance overperformed expectations as well, with a surplus of US$118 million versus a programmed deficit of US$392 million.

(ii) **NIR:** The end-June 2019 target was met by a margin of US$368 million, aided by a better-than-projected overall fiscal balance. The end-September 2019 target, however, was missed by a margin of US$306 million. Net financing requirements consistent with program objectives rose in September 2019 by about US$1.5 billion due to the shortfalls on multilaterals and some bilateral financing, compared to the first review. To fill the financing gap, the authorities decided (with staff support) to take advantage of a favorable window in global markets, completing an international bond issuance for US$2 billion in late September. The Technical Memorandum of Understanding (TMU) requires that the NIR target for end-September be adjusted upwards by the full amount of the international bond issuance of US$2 billion. Given that a significant portion of the proceeds from international bond issuance was intended to cover the budget gap in Q3 of 2019, the adjusted Q3 NIR target was missed.[4] The authorities are therefore requesting a waiver of nonobservance given the minor impact on program implementation of the breach.

(iii) **Social assistance spending:** The end-June 2019 target of US$380 million was met by a margin of US$47 million and the end-September target of US$695 million was also met by a margin of US$92 million. During 2019Q3, the authorities continued to enhance critical social spending programs, and reduce wait times for new beneficiaries, in line with program commitments (¶18).

(iv) **Continuous performance criteria (CPC).** CPCs have also been met. The CPC on no new gross financing of the NFPS by the central bank has been met. Further, in mid-September the authorities repaid the US$120 million owing to the public bank *Corporación Financiera Nacional (CFN),* per their commitment as part of requesting the waiver of nonobservance of this CPC granted in the First Review. An additional US$210 million owing to CFN was repaid on schedule in October. The CPC on external arrears, non-imposition and non-intensification of restrictions on payments for current international transactions, and non-introduction and non-modification of multiple currency practices have also been met.

[4] Had the Board date for the second review been scheduled before end-September, staff would have proposed a modification to the TMU to allow some of the resources from the bond issuance to be used to fill the budget gap rather than having to save the full amount in reserves.

Table 1: Ecuador: Selected Indicators

(Percent of GDP, unless otherwise indicated)

	2017	2018	2019	2020	2021	2022	2023	2024
			Projections					
Real								
Growth (percent change)	2.4	1.3	-0.5	0.2	1.6	2.7	2.5	2.5
Inflation (average, percent change)	0.4	-0.2	0.3	0.9	1.2	1.2	1.2	1.2
Fiscal								
Non-oil primary balance	-4.1	-1.9	-1.1	0.3	0.5	0.4	0.3	0.3
Non-oil primary balance (incl. fuel subsidies)	-6.1	-4.9	-3.4	-1.7	-1.0	-1.0	-1.1	-1.2
Primary balance	-2.3	1.3	1.5	3.7	4.6	4.2	4.2	4.3
Overall balance	-4.5	-1.2	-1.1	0.7	1.7	1.6	1.7	1.7
Debt (IMF definition)	44.6	46.1	49.6	50.1	48.1	44.8	41.5	38.2
Capital expenditure	9.3	6.6	5.7	6.2	5.6	5.3	5.3	5.3
Gross financing needs - Fiscal (Millions of U.S. dollars)	17,400	9,169	8,669	5,573	3,753	4,733	4,478	4,084
Bonds and bank financing - external ($ mil.)	7,251	4,504	4,341	642	0	1,998	2,573	3,009
Change in NFPS deposits (Millions of U.S. dollars)	562	951	1,745	1,394	831	0	0	0
External								
Current account balance	-0.5	-1.4	-0.8	0.3	0.6	0.7	1.0	1.2
Non-oil current account balance	-4.0	-5.5	-4.7	-3.7	-3.0	-2.6	-2.1	-1.8
Gross financing needs - External (Millions of U.S. dollars)	8,202	10,232	9,993	8,270	7,010	8,308	7,129	7,973
Foreign direct investment (Millions of U.S. dollars)	619	1,408	973	1,154	1,362	1,372	1,421	1,452
Public sector bonds/bank financing (Millions of U.S. dollars)	7,251	4,504	4,341	642	0	1,998	2,573	3,009
Private sector borrowing (Millions of U.S. dollars)	-2,964	2,673	3,368	4,958	6,005	5,801	4,712	4,992
Monetary				(Millions of U.S. dollars)				
Gross International Reserves 1/	2,006	2,158	4,215	6,022	7,576	8,016	9,123	10,105
less Outstanding credit of the BCE to the IMF	373	364	315	135	0	0	0	0
less Short-term foreign liabilities	0	300	0	0	0	0	0	0
less Reserves of Other Depository Institutions (ODIs) at the BCE	3,904	3,172	2,933	3,048	3,166	3,341	3,546	3,784
less Deposits of Other Financial Institutions (excl. BIESS deposits) & short-term liabilities of the central government	1,021	1,218	892	752	781	825	875	934
equals Program NIR 2/	-3,293	-2,895	74	2,087	3,629	3,851	4,701	5,388
Underlying reserves 3/	-3,293	-2,895	-1,319	-699	-551	-329	596	1,573
Decomposition of change in Net International Reserves				(Millions of U.S. dollars)				
Change in Net International Reserves	-1,375	397	2,969	2,013	1,542	222	851	686
Change in NFPS deposits	562	951	1,745	1,394	831	0	0	0
Change in government deposits outside NFPS	-80	-92	198	258	0	0	0	0
Change in credit to public sector (increase, -)	-978	-90	429	41	735	262	891	729
Gold operations 4/	-376	-410	429	400	0	0	0	0
Other	-503	39	169	-81	-25	-40	-40	-43
Reserve adequacy metrics								
GIR as a percent of ARA metric	12	12	23	31	39	41	46	50
GIR as a percent of Ecuador-specific metric 5/	23	26	55	81	106	104	118	124
GIR as percent coverage of first two balances (backing rule) 6/	49	66	140	193	233	234	251	261

Sources: Central Bank of Ecuador, Ministry of Finance, IMF staff calculations.

1/ Excludes non-liquid and encumbered items included in the authorities' definition of GIR.

2/ Program net international reserves is equal to gross international reserves less outstanding credit to the IMF (excl. budget support), short-term foreign liabilities of the BCE, deposits of other depository institutions and other financial institutions (excl. BIESS) at the central bank, and short-term liabilities of the central government.

3/ Underlying reserves refers to program NIR less outstanding obligations of the treasury to the IMF.

4/ Includes operations with BIS and Goldman Sachs International. In 2017, the BCE exchanged 300,000 troy oz. of its monetary gold in a gold derivative transaction. Although this derivative is included in the national definition of reserve assets, it is excluded from the IMF's definition, since it is not liquid. This operation will mature in 2020 when the monetary gold will return to the BCE's reserve assets.

5/ Measures coverage of reserve assets of deposits of ODIs at the BCE, outstanding credit of the BCE to the IMF, outstanding central bank securities, one month of expenditure of the NFPS, and one quarter of public external amortizations due in the year. A similar metric is discussed in Ecuador Selected Issues (Country Report 19/80, pp. 39)

6/ Measures coverage of reserve assets of currency issuance, reserves of other depository institutions, and central bank securities.

Ecuador: Program Implementation in 2019Q2 and Q3
(Millions of U.S. dollars, unless otherwise indicated)

	End-June 2019				End-September 2019			
	Prog. 1/	Adj. 2/	Actual	Status	Prog. 1/	Adj. 2/	Actual	Status
Fiscal Targets 3/								
Quantitative Performance Criteria								
Floor on non-oil primary balance of the non-financial public sector, including petroleum subsidies	-885	-1,004	-386	**Met**	-2,200	-2,319	-1,625	**Met**
Floor on social assistance spending of the central government	380		427	**Met**	695	..	787	**Met**
Indicative Targets								
Floor on overall fiscal balance of the non-financial public sector	59	...	691	**Met**	-392	...	118	**Met**
Monetary Targets								
Quantitative Performance Criterion								
Floor on the change in the stock of NIR - program measure 3/	1,284	1,792	2,160	**Met**	2,057	3,916	3,609	**Not Met**
Continuous Performance Criteria 4/								
Ceiling on the change in external payment arrears 5/	0	0	0	**Met**	0	0	0	**Met**
Ceiling on the new gross central bank direct financing of the NFPS and indirect financing to the NFPS through the public banks	0	0	0	**Met**	0	0	0	**Met**

Sources: Central Bank of Ecuador, Ministry of Finance, IMF staff calculations.

1/ Staff Report for the First Review Under the Extended Fund Facility (July 3, 2019, CR 19/120)
2/ The NOPBS and NIR targets are adjusted according to the Technical Memorandum of Understanding to reflect differences in the actual vs. forecast oil price and actual vs. forecast multilateral financing
3/ Cumulative flow from January, 1 to the test date.
4/ Continuous performance criteria must be observed at all points in time.
5/ Excluding interest on earlier obligations resulting from the 2008 swap that have not been claimed by creditors even though authorities pursued them in good faith.

8. **The authorities have made serious efforts to meet the structural conditionality.** They chose to submit to the National Assembly three key reforms (tax reform, budget code, and the central bank code) under emergency procedures on October 18. A fourth reform—on the labor market—which is not part of conditionality, but important to improve competitiveness, has yet to be submitted. While the emergency package was broadly in line with program commitments (see below), on November 17, the National Assembly voted against it. The rejection hampers core elements of the program and has led to a sharp increase in Ecuador's spreads. The authorities, however, remain strongly committed to implementing their structural reform agenda. The National Assembly approved a revised tax reform as an urgent economic law on December 9; the authorities are planning to submit the revised budget code and a central bank code individually, while taking into consideration feedback from lawmakers and by working to build the needed consensus. Other structural commitments for the second and third reviews were largely implemented. The SBs on the regulation to ensure publication of the audited annual financial statement of all SOEs (end-June SB) and the publication of the eligibility thresholds for social spending (end-September SB) were met and the arrears clearance plan (end-September SB) was implemented with a slight delay in early October. The end-September SB on anti-corruption legislation was not met, as more time is required for the preparation of the law; hence, staff proposes resetting the SB to end-December 2019 (¶33).

- **Organic Budget Code.** The submission to the National Assembly of amendments to the *Organic Code of Planning and Public Finance* (COPLAFYP) was envisaged as a structural benchmark (SB) for end-June 2019 and its submission was later converted into a prior action (PA) for completion of the combined second and third reviews. The reform was meant to strengthen fiscal discipline and transparency by enhancing public financial management and fiscal rules framework. The submission to the National Assembly of the law as part of an emergency package (with some modifications relative to the original SB) has enabled compliance with the PA for completing the joint second and third reviews. Given the rejection of the emergency package, and the need to provide more time to pass the reform, the submission of the revised amendments to this law is now proposed as a new SB for end-February 2020.

- **Tax Reform.** The end-August SB on the publication of a tax reform plan yielding 1½ to 2 percent of GDP in additional revenues by 2021 and the end-October SB on the submission of the tax reform to the National Assembly were not met. In view of the lack of political appetite for a larger tax reform, particularly a VAT increase, the authorities submitted a modified tax reform to the National Assembly as part of the emergency package in October; this had a gross expected yield of only 0.9 percent of GDP in 2020 and 0.8 percent of GDP in 2021, including about 0.2 percent of GDP savings from a 3-year contribution on companies with revenue exceeding US$50 million. In parallel, the executive proposed a package aimed at economic reactivation including a reduction in international tariffs and taxes for specific sectors with a cost of about 0.2 percent of GDP in each 2020 and 2021. Hence, the net expected yield was 0.7 percent of GDP in 2020 and 0.6 percent of GDP in 2021. The tax reform aimed at making the tax system more growth-friendly, improving revenue mobilization, simplifying the tax regime, increasing efficiency of the tax system, and reducing preferential treatments (see Annex 2 for details). Given the rejection of the emergency package, and the need to secure revenue for the 2020 budget and the medium term, the authorities submitted a revised tax reform to the National Assembly, which is expected to generate net revenues, together with the economic reactivation package, amounting to 0.5 percent of GDP in 2020 and 0.5 percent of GDP in 2021 (Annex 2); the reform was approved with minor modifications on December 9. The submission and non-rejection of this revised tax reform was a prior action for completing the combined second and third review

Table 2: Ecuador: Tax Reform Measures

	Tax Reform Measures	PREVIOUS PROPOSAL		SUBMITTED PROPOSAL		APPROVED REFORM	
		Estimated Fiscal Impact (% of GDP) - 2020	Estimated Fiscal Impact (% of GDP) - 2021	Estimated Fiscal Impact (% of GDP) - 2020	Estimated Fiscal Impact (% of GDP) - 2021	Estimated Fiscal Impact (% of GDP) - 2020	Estimated Fiscal Impact (% of GDP) - 2021
Taxes on consumption	Introduce a tax on electronic commerce	0.01	0.02	0.01	0.02	0.01	0.02
	Introduce or modify excises (ICE) on beer, sugary drinks, plastic bags, telecommunications, and vehicles	0.13	0.14	0.11	0.12	0.09	0.11
	Remove arisanal beers from the identification sistem SIMAR	-	-	0.00	0.00	0.00	0.00
	Introduce a zero VAT rate on certain medical products, newspapers and magazines, flowers, and certain tractors	-0.01	-0.01	-0.01	-0.01	-0.01	-0.01
Taxes on labor	Eliminate deductible expenses for taxpayers who have a net income of more than USD 100,000	-	0.04	-	0.02	-	0.02
Taxes on capital	Harmonize income tax on dividends paid by non-residents with that paid by residents (10%)	0.14	0.14	0.14	0.13	0.14	0.13
	Reduce the existing additional deductions in the corporate income tax by 50%.	-	0.01	-	-	-	-
	Introduce a tax on small businesses of 2 percent of income	0.08	0.17	0.08	0.17	0.08	0.17
	Modify rate for reinvested profits	-	0.00	-	-	-	-
	Eliminate tax exemptions for property tax for the disposal of property	-	0.01	-	-	-	-
	Eliminate tax credit for CIT and introduce a 2.5% ISD on imports of raw materials and capital goods	0.15	0.15	-	-	-	-
	Introduce a deduction limit on interest, based on earnings before interest, tax, depreciation and amortization (EBITDA) 20'	-	0.04	-	0.04	-	0.04
	Eliminate the 5% limit for indirect expenses, considering this expense as non-deductible.	-	0.01	-	-	-	-
	Introduce a singe tax regime in the agricultural sector		-0.04	-	-0.04	-	-0.04
	Introduce a deduction of expenses related to cultural and sport events	-	-0.01	-	0.00	-	-0.01
	Introduce CIT exemptions for private hospitals and private education companies in some provinces	-	-0.02	-	-0.02	-	-0.02
	Introduce a 50 percent additional deductibility for the purchase of insurance for exports	-	-0.01	-	-	-	-0.01
	Reduce tax penalties for repatriation of assets held abroad	0.17	-	-	-	-	-
	Introduce a payment to facilitate the trasition to a simplified regime	0.08	-	0.08	-	0.08	-
	Introduce a temporary contribution 0.2% on income of the companies with revenues in excess of US$50 million	0.16	0.16	0.16	0.16	0.16	0.16
	Introduce a 10% reduction in the income tax rate in the agricultural sector of certain provinces	0.00	-	0.00	-	0.00	-
	Eliminate the advance of the income tax	-	-	-0.23	-	-	-
	Increase the rate of income and VAT witholding	-	-	0.23	-	-	-
Contributions	Inclusion of the credit provided by cooperatives in the contributions to the fight against cancer	-	-	-	-	0.01	0.01
Total (Gross)		**0.93**	**0.80**	**0.58**	**0.59**	**0.57**	**0.58**
	Package to support growth	-0.23	-0.22	-0.11	-0.11	-0.11	-0.11
Total (Net)		**0.70**	**0.58**	**0.47**	**0.48**	**0.46**	**0.47**

- **Central Bank Code.** The reform of the central bank framework in the Organic Monetary and Financial Code aimed at aligning it with best practices for central banks in dollarized economies. It included: (i) streamlined objectives and functions; (ii) strengthened autonomy including in terms of its budget and recapitalization, along with enhanced accountability; (iii) improved governance through the introduction of an independent board with fiduciary responsibilities; (iv) the introduction of strong internal and external audit functions; (v) prohibitions for all future monetary financing and quasi-fiscal operations, including direct and indirect lending to the government; and (vi) the reintroduction of a rule requiring international reserve assets to fully back deposits from other depository institutions at the BCE and coins in circulation. However, the draft submitted to the National Assembly fell short of fully meeting the standards for autonomy as outlined in the end-September SB, as both appointment and dismissal of BCE's board members depended solely on the President of the Republic. The debate of this reform in the National Assembly proved more contentious than anticipated, notably on account of the central bank autonomy. To accommodate the need for extensive discussion and buy-in, the submission of the revised amendments to this law will become a structural benchmark for the fourth review.

- **Transparency of state-owned enterprises (SOEs).** The Ministry of Economy and Finance (MEF) issued a ministerial decree requiring that all SOEs publish audited annual financial statements starting in fiscal year 2019, thereby meeting the end-June SB. In the past, auditors had not been able to certify the accounts of many SOEs due to differences in accounting standards. To address this issue, the ministerial decree gives specific accounting guidelines to SOEs that will standardize accounting practices among SOEs and help consolidate financial information with the rest of the public sector. Nonetheless, significant work remains to be done to achieve unqualified auditor's opinions given the difficulties in valuation of assets, including the prohibition of writing down assets by the controller's office and the heritage of past non-transparent mergers. A reform of the SOE law, currently under consideration by the authorities, should help address some of these issues but the timing of the submission of this reform is uncertain.

- **Expenditure arrears.** The authorities have made progress in identifying the stock of expenditure arrears in the central government and have submitted a plan to clear the stock, implementing the SB for end-September with a slight delay. They plan to introduce a standardized definition of arrears and a 90-day payment deadline (when not established by law, contract, regulation or any other valid public act) for the current and capital expenses associated with the acquisition of goods and services from the date of their accrual. This definition will be included in the amendments to the COPLAFYP. The stock of outstanding central government arrears is estimated at US$1,127 million as of end-September 2019, of which, US$657 million with the private sector.[1] The authorities submitted a plan to clear verified arrears at the Central Government broadly in line with FAD recommendations.

- **Eligibility thresholds for social assistance.** The structural benchmark on the definition and publication of eligibility thresholds for social assistance programs by end-September was met.

[5] Total accounts payable in the central government (of which arrears are a subset) are estimated at US$1,940 million as of end-September 2019, of which US$1,170 million are with the private sector.

Demographic and socioeconomic changes in Ecuador over the past decade rendered the previous thresholds obsolete, since they resulted in very high exclusion rates. In collaboration with the World Bank, the Ministry of Economic and Social Inclusion (MIES) developed a new poverty index based on the Social Registry 2018 database and proceeded to model new eligibility thresholds using the updated index. Under the published baseline scenario, the report estimates that implementation of the new eligibility thresholds would bring an additional 350,000 poor beneficiaries under the social safety net, significantly improving the coverage of poor households (from about 34 percent at end-2018 to over 60 percent).

POLICY DISCUSSIONS

A. Strengthening the Institutional Foundations of Dollarization

Restoring Fiscal Prudence

9. With the difficult social and political landscape and to protect growth, the authorities proposed moderating the fiscal consolidation path while maintaining broad program objectives unchanged. In particular, the NOPBS would narrow by 3.9 percent of GDP in 2019-2021, compared to 5 percent of GDP previously envisaged. A fiscal consolidation of about 4 percent of GDP in the NOPBS would still help put public debt on a sustainable path (Annex 3) and bring it below the 40 percent benchmark by 2024 as the resulting primary balance of 4.6 percent of GDP at the end of the program in 2021 would still far exceed the debt-stabilizing primary balance of 2.5 percent of GDP. Public debt, however, would be slightly higher in 2021 (at 48.1 percent of GDP) than envisioned at the time of the first review (about 46 percent of GDP). The new annual consolidation profile over the course of the program (1.5; 1.7; 0.7 percent of GDP) remains front-loaded with 80 percent of the total (3.2 percent of GDP) expected to be implemented in the first two years.

10. Lower fiscal consolidation and more conservative assumptions on asset monetization result in a reduced build-up of international reserves over the course of the program. The projected NIR is now about US$3.6 billion by end-2021, compared with US$7 billion projected at the time of the first review.[2] Gross reserves are expected to increase to about US$7.6 billion by end-2021, or 39 percent of the ARA metric. While this is a significant downward revision relative to the expectations at the time of the first review, it still represents an important improvement over pre-program levels and would allow for the creation of a liquidity cushion which fully covers financial sector deposits with the BCE, outstanding credit of the BCE to the IMF, a quarter of public external amortizations, and one month of government expenditure at the NFPS level (¶40).

11. The expected fiscal outcome in 2019 is somewhat weaker than previously targetted, and the composition of adjustment has shifted. The projected 2019 NOPBS deficit increased from 2.9 to 3.4 percent of GDP, largely due to the delay in the asset monetization operation. On the

[2] The forecast now does not envision monetization of electricity transmission lines (expected US$800 million) and Sacha oil field (expected US$1.2 billion) while monetization of Sopladora plant (expected US$800 million) is delayed to 2020 and monetization of the oil refinery Esmeralda (expected US$300 million) is projected for 2021.

expenditure side, wage bill savings in 2019 are expected to be small, as projected at the time of the first review. Savings in fuel subsidies from the reforms implemented in late 2018-early 2019 are estimated to be lower than expected at the time of the first review (by 0.3 percentage points of GDP) given higher global oil prices and substitution away from high-octane ("super") to regular ("extra") gasoline. In addition, spending on social security benefits is expected to be about 0.1 percentage points of GDP higher than expected at the time of the first review due to the higher-than-anticipated payments of unemployment benefits associated with the optimization of the public sector wage bill. Lower savings in these categories are expected to be offset by larger reductions in capital spending.

12. The authorities remain committed to reducing the public wage bill, albeit at a slower pace than originally envisioned. Significant efforts took place in 2019, in particular, through the termination of occasional contracts for the NFPS. The authorities also enacted an interinstitutional agreement to restructure public administration, which will allow for the termination of additional contracts by end-2019. While optimization of the wage bill among administrative staff is delivering gradual savings in line with expectations, these efforts have been partially offset by increases in hiring of high-priority personnel in the health and security sectors, partly due to heightened insecurity at the border. These increases in the wage bill reflect the limited ability of the MEF to monitor and influence hiring and remuneration decisions throughout the public sector. The revised reform of the COPLAFYP could help strengthen the MEF's powers and control functions, thereby containing the wage bill growth. The authorities are committed to achieve important savings in the wage bill in 2020 estimated at 0.3 percentage points of GDP with specific compensation and employment measures to achieve the targeted reduction.

13. Fiscal consolidation is expected to continue in 2020-21. Given uncertainties (including passage of the tax law resubmitted to the National Assembly and ongoing negotiations with various stakeholders on the fuel subsidy reform), there was an agreement that a reduction in the consolidation objective for 2020 from 2 percent to 1.7 percent of GDP is appropriate. Savings from the tax reform and economic reactivation tax measures, which are expected to yield on net 0.5 percent of GDP in both 2020 and 2021, will be supplemented with the savings from the rationalization of the wage bill and spending on goods and services. To support fiscal consolidation efforts, reduce economic distortions, and redirect limited fiscal resources into more productive and higher priority arears such as capital investment and social spending, the authorities have announced a fuel subsidy reduction in the 2020 budget; staff proposes for this to be implemented via a gradual removal of subsidies on gasoline, and accompanied by adequate protection to vulnerable groups.[3] Staff estimates that this gradual removal of gasoline subsidies would generate fiscal savings of 0.2 percent of GDP in 2020 and 0.2 percent of GDP in 2021 – the estimates included in the program baseline scenario. In carrying forward this reform, the authorities are engaging in a comprehensive public consultation process to help build a consensus with civil society, including indigenous groups. The authorities also plan to lease several frequency ranges to telecom companies with an expected revenue of 0.4 percent in 2020 and in 2021. The savings generated by these measures would allow for somewhat higher capital investment in 2020 to support growth and an additional increase in social assistance spending (to allow for an expansion of coverage of the social safety net by mid-

[3] This would allow aligning domestic prices with international prices of gasoline by end-2020.

2020 ¶19). The NOPBS deficit is expected to reach 1.7 percent of GDP in 2020—one half of the expected deficit in 2019—while the overall fiscal balance would swing into a surplus of 0.7 percent of GDP. Additional consolidation measures of 0.7 percent of GDP are planned for 2021, including a further rationalization of the wage bill, goods and services, fuel subsidies, and capital spending.

Ecuador: Fiscal Consolidation Measures

(In percent of GDP, Nonfinancial public sector)

Fiscal Consolidation Measures

	2019	2020	2021	2019-2021
Revenue	**-1.0**	**1.5**	**-0.8**	**-0.3**
Planned tax reform	0.0	0.5	0.0	0.5
of which: Permanent measures	*0.0*	*0.3*	*0.1*	*0.4*
Temporary measures	*0.0*	*0.2*	*-0.1*	*0.2*
Package to support growth	*0.0*	*-0.1*	*0.0*	*-0.1*
Other revenues changes 1/	-1.1	-0.1	-0.1	-1.3
Asset monetization (net) 2/	0.0	0.7	-0.7	0.0
Other revenues	0.1	0.5	0.0	0.5
Higher VAT revenues from subsidies reform	0.0	0.0	0.0	0.0
Expenditure	**2.5**	**0.2**	**1.5**	**4.2**
Wages and salaries	0.1	0.3	0.3	0.7
Goods and services	0.8	0.2	0.2	1.2
Other spending	0.1	0.1	0.0	0.1
Capital spending	1.0	-0.4	0.6	1.1
Fuel subsidies	0.7	0.3	0.5	1.5
of which: Price change	*0.3*	*0.1*	*0.3*	0.7
Policy change	*0.4*	*0.2*	*0.2*	0.8
Social spending	-0.3	-0.2	-0.1	-0.6
Total	**1.5**	**1.7**	**0.7**	**3.9**

Difference with the First Review

	2019	2020	2021	2019-2021
Revenue	**-0.7**	**0.1**	**-0.3**	**-0.9**
Planned tax reform	0.0	-0.9	-0.2	-1.1
of which: Permanent measures	-	-	-	-
Temporary measures	-	-	-	-
Package to support growth	-	-	-	-
Other revenues changes 1/	0.1	-0.1	-0.2	-0.2
Asset monetization (net) 2/	-0.8	0.7	0.1	0.0
Other revenues	0.0	0.4	0.0	0.4
Higher VAT revenues from subsidies reform	0.0	0.0	0.0	0.0
Expenditure	**0.2**	**-0.4**	**0.0**	**-0.2**
Wages and salaries	0.0	-0.3	0.1	-0.3
Goods and services	0.0	0.1	0.1	0.2
Other spending	0.0	0.2	-0.1	0.2
Capital spending	0.5	-0.5	0.0	-0.1
Fuel subsidies 3/	-0.4	0.3	0.0	-0.1
of which: Price Change	*-0.3*	*0.1*	*0.2*	*-0.1*
Policy Change	*-0.1*	*0.2*	*-0.2*	*0.0*
Social spending	0.1	-0.2	-0.1	-0.2
Total	**-0.5**	**-0.3**	**-0.3**	**-1.1**

Sources: Ministry of Finance and IMF staff calculations.

1/ For 2019, 1 percent of GDP is a one-off effect from tax amnesty collection in 2018, while 0.2 percent of GDP is the effect of other tax changes introduced in 2018.

2/ Refers to revenues from leasing of government assets to private sub-contractors for temporary use and maintenance.

14. The authorities continue to work to strengthen public spending controls. They have made progress in identifying the stock of central government arrears, but additional work is needed to identify extrabudgetary non-verified arrears in the central government. Further efforts are also needed to compile the stock of arrears at the NFPS level and to address the underlying causes of arrears accumulation, including through enhancing budget formulation, strengthening internal control and oversight mechanisms, and improving liquidity management and fiscal reporting. The authorities have requested technical assistance on cash management, which is scheduled to take place in early 2020. The reform of the COPLAFYP could significantly strengthen the framework for monitoring and reporting of arrears by introducing a legal definition of arrears that will require the update of the information system; and by requiring that (i) arrears are reported in accordance with technical norms to be issued by the MEF; and (ii) that the MEF issues the methodology for estimating the stock of arrears, and technical standards for the public entities to validate accounts payable from previous years. New structural benchmarks will support the implementation of these reforms, as will a new indicative target on central government arrears, which will be introduced starting in June 2020 (¶32).

15. Efforts to strengthen tax administration are ongoing and should complement the tax reform. The powers of tax administration require strengthening—including in combatting unacceptable tax avoidance schemes—while protecting taxpayers' rights. Modifications to the Tax Procedure code are thus needed to secure the gains from the tax reform. These could include: (i) introducing a joint liability/responsibility for tax obligations and offences; (ii) granting powers to tax administration to take precautionary measures to safeguard the recovery of tax debts, even when an assessment has not yet been made; (iii) providing incentives to taxpayers to substantiate their claims within the course of the audit to avoid delay tactics through the use of the appeals process; and (iv) overhauling the administrative penalties regime. Staff will continue the dialogue with the authorities on the appropriate path to implement these amendments. Meanwhile, priorities for the tax administration include implementing a fully-fledged Large Taxpayer Office, strengthening enforcement efforts against VAT non-compliance, abuse of PIT's deduction of personal allowances, misuses of tax incentives, erosion of the CIT base through cross-border transactions, and High Net Wealth Individuals (HNWI) avoidance practices.

B. Promoting Shared Prosperity and Protecting the Poor and Most Vulnerable

16. The social safety net in Ecuador is in the midst of a major and much-needed reform. The previous system did not include most poor households even as many non-poor households received social assistance. Coverage is low, with just 1 in 3 households in the three poorest income deciles receiving social assistance transfers. Moreover, leakage was significant, with 4 in 10 beneficiaries of social assistance belonging to non-poor households. The social registry (based on a 2014 database) remains incomplete and outdated, further exacerbating challenges with adequacy and efficiency. In response, the authorities have embarked on a major reform of Ecuador's social safety net (*Plan Toda Una Vida*) to provide a more effective and integrated social safety net for the poor, disabled, and elderly.

17. In mid-2019, the authorities launched active policy measures to improve the adequacy and coverage of the social safety net. This included full funding of the *Bono de Desarrollo Humano* (BDH) and the related BDH-Variable to eliminate wait lists, increasing funding for in-home services for the elderly and disabled, and expanding the access to child care to support female labor force participation. The main legal bottlenecks to establishing a new social registry have been eliminated and the administrative hurdles for hiring personnel to work on the registry removed through an inter-ministerial agreement. To survey households in the bottom three deciles of the income distribution in remote areas of the country, the Social Registry Unit finalized cooperation agreements with 14 public and private universities in late September. Nevertheless, operationalizing the registry—which will significantly improve the coverage of the safety net—will require timely action and strong political commitment.

18. Going forward, completing the extension of the social safety net is a priority. To support the authorities' efforts, staff proposes to raise the floor on social assistance spending by 0.3 percentage points of GDP in 2020–21. The additional spending would allow implementation of the new eligibility thresholds for social assistance and expansion of the social registry to take place beginning in July 2020. Fund staff, in consultation with the World Bank, will also offer to assist the authorities in the preparation and publication of a time-bound action plan to implement the updated eligibility thresholds for social assistance and to accelerate the completion of the upgraded social registry (newly proposed SB for end-February 2020). The updated eligibility thresholds for social assistance programs, which were published at end-September (SB) should be implemented as soon as feasible and no later than mid-2020 when the social registry upgrade is complete. These actions could lead to a further expansion of coverage of social assistance programs to about 60 percent of the households in the lowest three deciles of the income distribution by 2021. In the medium term, the social safety net could be strengthened by further improving coverage of the poorest households, developing exit strategies for non-poor beneficiaries, and integrating cash benefits with enhanced social services. Programs focused on the specific disadvantages of the indigenous population could also be helpful. Further increases in social assistance spending in 2020 could also result from efforts to compensate poor and vulnerable households for the impact of additional measures, including compensation measures to households for the removal of gasoline subsidies (up to 0.03 percent of GDP). Broader efforts should focus on forging a social compact on the objectives of the fiscal reforms, including a fuel subsidy reform.

C. Boosting Resilience of the Financial System

19. The financial system appears stable, but continued vigilance is warranted while regulatory and supervisory frameworks are being upgraded. The reported FSIs suggest that the financial system remains solvent, profitable, and liquid. However, the divergence between credit and deposit growth warrants continued vigilance. Credit exposure of the system with the government (about US$1.5 billion) has stayed within the normal levels observed during the past two years, and stayed flat during the recent turmoil. Staff encouraged the supervisory authorities to continue monitoring credit growth closely, particularly in riskier segments and institutions, and to develop a contingency plan in case liquidity pressures or signs of asset quality deterioration emerge. The program envisions the establishment of a macroprudential framework. In the interim, there are short-term measures which could be implemented to mitigate emerging risks identified by improved and refocused supervision. These measures could include raising reserve requirements, more conservative loan classification, and provisioning policies for particular asset classes (e.g. housing or consumer loans). The supervisory authorities agree with this diagnosis and are considering regulatory steps that would be viable in the short term.

20. Measures to align credit risk regulation with good practice and to close the regulatory gaps between banks and cooperatives are needed. Given the slowdown in economic activity, supervision and regulation should aim at better reflecting credit risk in banks' balance sheets and establishing a regulatory strategy for all institutions to fully internalize credit risk. The superintendencies of both banks and cooperatives are committed to these objectives and are currently working on their respective plans, with specific regulations for cooperatives already in the works. While there are no indications of a noticeable macroeconomic impact of the change in liquidity requirements introduced in June, the authorities and staff continue monitoring its effects closely.

21. The authorities, with support from IMF technical assistance, completed the stocktaking of key issues in banking supervision, cooperatives' supervision, the macroprudential framework, and liquidity requirements. Each of these areas will require further technical assistance and the authorities are preparing detailed workplans to implement specific measures in these areas. Some of these recommendations are expected to be implemented via regulation and supervisory entities, which are already working on them. A thorough reform of the financial supervisory framework in the organic law (COMYF) will have to be decided once the current reforms under discussion are passed, though the political feasibility has declined. The main recommendations include:

(i) *Banking supervision:* review the legal framework to provide operational independence to and improve the governance of the superintendency; and review supervisory practices to better evaluate public and private banks' credit risk management (with emphasis on credit standards) and the quality of their loan portfolios.

(ii) *Cooperatives regulation and supervision:* review the legal framework to clarify the perimeter of supervision; develop better practices to supervise credit and liquidity risk and improve data collection for those purposes; establish minimum standards for the governance of cooperatives; use a graduated approach in regulation according to the complexity of entities; and harmonize the regulatory framework for larger cooperatives with that of banks.

(iii) *Macroprudential framework:* build institutional understanding and analytical capacity on financial stability issues and macroprudential arrangements and establish the legal basis for the framework; the member agencies (central bank and superintendencies of banks and cooperatives) should start producing a joint biannual internal financial stability report; strengthen monitoring capabilities in key areas; and consider implementing borrower-based and lender-based macroprudential measures. Further technical assistance in this area is expected to include a high-level seminar to build on a common understanding of the policy instruments and the institutional arrangements required.

(iv) *Liquidity requirements:* simplify gradually the current liquidity requirements replacing them with a single requirement applied uniformly across the system; review eligible instruments to ensure they are truly liquid; develop a Basel-like liquidity coverage ratio and net stable funding ratio adapted to domestic needs to be implemented over time.

D. Boosting Competitiveness and Job Creation

22. A labor market reform is planned to be submitted to the National Assembly in the coming months. Although not a structural benchmark under the Fund program, labor market reform is critical for restoring competitiveness and reducing informality. The authorities have been working closely with the World Bank to design the reform while consulting with labor unions and the business sector. The draft reform proposal contains provisions for more flexible work days and working hours. This could help to reduce formal employment costs and boost more dynamic job creation. The reform also contains measures to promote female labor force participation such as allowing the mandated 12 weeks of maternity leave to be shared between both parents. Prospects for submitting and passing the law will depend on progress made with negotiations with social groups, which are still ongoing.

E. Improving Transparency and Governance

23. Work to increase transparency on public debt statistics is ongoing. The authorities have published a new public debt bulletin on public debt statistics, but further progress on compliance with international standards is pending. The new bulletin includes a new table with the information on contingent liabilities and a technical note that explains the methodology adopted in computing the stock of public debt.[4] Staff urged the authorities to fully adopt the methodology in the IMF's Public Sector Debt Statistics: Guide for Compilers and Users to evaluate and inform the domestic public and the markets on the situation with public debt. Staff also encouraged the authorities to develop and publish a debt management strategy, begin tracking cost-risk indicators of the entire debt portfolio, as well as introduce investor relations practices. The authorities expressed openness to this proposal, which could be discussed further in the context of the program.

24. The authorities are working on a new law for state-owned enterprises (SOEs) with the assistance from the IADB. The law seeks to improve efficiency, increase transparency, and strengthen governance of SOEs. It aims at bringing SOEs to the same standards as private companies by requiring them to pay taxes at the same rate as private firms, complying with the same labor regulations, and adopting the same accounting standards. Regarding the latter, the law will eliminate one of the obstacles to the preparation of the audited financial statements by allowing SOEs to hire their own external auditors.

25. The government is also preparing a new law on private-public partnerships (PPPs) with the assistance of the World Bank and the IADB. In line with best international practices, the new law allows for the creation of a proper structuring agency, establishes a process for reviewing and approving PPPs, establishes limits on PPP commitments, puts in place procedures that help hedge fiscal risks arising from PPPs, and organize the process of unsolicited proposals. The law will help reduce pressures on the budget while providing new tools to handle needed green- and brown-field projects that will contribute to raising economic efficiency and productivity. However, the law should be accompanied by regulations to establish a gateway process for MEF to effectively discuss risk with line ministries, select projects, and manage PPP fiscal risks.

26. Enhancing the anticorruption legal framework and strengthening its effective implementation are fundamental steps to address significant corruption risks. Initiatives such as the working group on democracy and institutional reform under the National Agreement 2030, as well as the inter-institutional agreement to implement the "National Asset Recovery Plan", provide useful spaces for collaboration among anticorruption institutions. However, recent events in the

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[4] Despite the progress, gaps in the debt compilation methodology in relation to international standards remain, in particular: (i) the definition of debt instruments does not include CETES, advanced oil sales and other debt to suppliers; and (ii) the level of consolidation presented in the bulletin is only for the total public sector, including the central bank, while for the purposes of transparency and to better understand the macro-economic impact it would be desirable to also present the consolidated debt at the level of the NFPS and other sub-levels of the public sector.

country resulted in changes in the Anticorruption (AC) Secretary leadership and rotation among dedicated staff that slowed down progress in the agenda. Legal reform efforts underway have focused on non-conviction-based asset forfeiture and access to public information legislation. The Assembly approved reforms to the Criminal Code (COIP) that impacted provisional measures and confiscation of corruption proceeds but the Executive vetoed the reforms for unconstitutionality; the Constitutional Court is expected to issue a final decision soon clarifying the standing of these reforms. Important procedural limitations for the prosecution of illicit enrichment and embezzlement were recently resolved, and the AC Secretary is working on a new package of reforms to the COIP to specifically address remaining issues in the criminalization of acts of corruption in line with international standards. Similarly, adopting reforms aimed at enhancing PFM, (¶8), central bank governance (¶8) and financial sector oversight (¶21) should further strengthen governance and reduce vulnerabilities to corruption.

27. **Reforms to ensure the AML/CFT framework more effectively supports anticorruption efforts should start materializing soon**. The authorities have launched multi-sectoral working groups and data collection for the national risk assessment exercise, undertaken with the World Bank support. In parallel, a review of the AML/CFT legal framework, particularly focused on enhancing preventive measures for politically exposed persons, as well as strengthening the implementation of a risk-based approach to AML/CFT bank supervision will help prevent the laundering of proceeds from corruption acts. Developing specific legal reforms and supporting the implementation of an effective AML/CFT risk-based supervision are fundamental steps in line with the international standard that should also contribute towards the AML/CFT evaluation the country will undergo in 2021.

PROGRAM MODALITIES AND RISKS

28. **Modifications to conditionality are proposed.** Modifications to the NOPBS, NIR, and social assistance QPCs for end-December 2019 are proposed. New PCs are proposed for end-March and end-June 2020. New ITs are proposed for end-September 2020 and end-December 2020. The authorities are also requesting, and staff supports, an introduction of an adjustor for half of the potential payment related to a pending lawsuit in 2020 as well as technical modifications to the NIR adjustor on market borrowing to reflect its cumulative nature.

29. **In light of their macro-criticality, two prior actions were set for the combined second and third reviews.** The end-August SB on the publication of a broad-based tax reform plan and the end-October SB on the submission of the tax reform to the National Assembly were not met. The latter was converted into a prior action for the combined second and third reviews, requiring the submission and non-rejection of the revised tax reform with a net yield of at least 0.5 percent of GDP in 2020 and 2021. The end-June SB on the submission of amendments to COPLAFYP to the National Assembly, which was delayed due to the decision of the authorities to submit several legislative reforms as a package, also became a prior action for the completion of the combined reviews.

30. **The authorities are requesting modifications to the NOPBS, NIR and social assistance spending targets for Q4 2019.** The revised NOPBS target would reflect partially the revenue lost in

2019 due to the postponement of an asset monetization operation to 2020 which was caused, in part, by the time lost during the October protests. Given this revenue shortfall linked to the postponement of the asset monetization project and lower-than-expected oil balance due to the refinery closure as well as higher-than-expected repayments of past obligations by the social security and public enterprises (¶6), the authorities are requesting, and staff supports, a modification to the Q4 NIR target. A postponement of the expansion of the Crédito de Desarrollo Humano to 2020, earlier planned for 2019 (US$0.1 billion), which is intended to provide microcredits to vulnerable households whose income has risen above the poverty line, has led to a reprofiling of social assistance spending in 2019, which is reflected in a slightly lower proposed end-December 2019 target of US$1.1 billion (compared to US$1.2 billion).

31. Given the rejection of the economic reform package by the National Assembly, two new structural benchmarks are proposed for end-February and end-April 2020 respectively. The government plans to submit the revised amendments to the COPLAFYP and COMYF laws as separate reforms in early 2020 (SBs for end-February 2020 and end-April 2020, respectively). Relatedly, the SBs on the establishment by the central bank of an audit committee and the approval of an internal audit charter for the BCE are proposed to be shifted from end-March to end-August 2020.

32. Five new structural benchmarks are proposed to strengthen PFM. They are aimed at enhancing the credibility of the budget by strengthening budget formulation, improving cash management and strengthening monitoring of arrears. A new SB (for end-June 2020) is proposed for the adoption of a single budget circular that establishes binding expenditure ceilings for both current and capital expenditure Second, to strengthen cash management, the authorities plan to formalize the operation of the Financial Committee (SB for end-January 2020). Third, it is proposed that the MEF will publish a Financial Plan as a mechanism to align the execution of the budget with the cash availability to accompany the 2021 budget to be submitted to the Assembly by end-February 2020. Fourth, a new SB aimed at strengthening monitoring of arrears for the entire NFPS is proposed for end-June 2020. Fifth, a new SB on the arrears clearance and prevention in the NFPS is proposed (for end-December 2020). These benchmarks will help address the perennial and sizable problem of expenditure arrears that hamper economic activity. Furthermore, a new IT is proposed to be introduced on central government arrears starting from June 2020.

33. The structural benchmark on the submission of anti-corruption legislation (end-September SB) is proposed to be reset to end-December 2019 and slightly modified, and a new structural benchmark is proposed for end-June 2020. While a recent resolution from the Constitutional Court has resolved important procedural limitations for the prosecution of illicit enrichment and embezzlement, further progress is needed to address United Nations Convention against Corruption (UNCAC) review recommendations with regards to criminalization of acts of corruption and the freezing, seizing and confiscation of corruption proceeds; therefore, the test-date for the SB is proposed to be reset to end-December 2019. With the aim of strengthening public officials' asset declarations as a prevention and enforcement tool, a new SB to expand public access to information in declarations is proposed for end-June 2020.

34. The structural benchmark on the publication of an action plan to strengthen the efficiency and quality of primary education and health spending, in coordination with World Bank technical assistance, is proposed to be reset to end-June 2020. While the work with the World Bank on this issue has started, the authorities are still awaiting conclusions of the technical experts. The action plan will be developed based on the conclusions of the technical assistance and the authorities would need more time to design it than originally envisaged.

35. A new structural benchmark for end-February 2020 related to social assistance is proposed. An SB on the preparation and publication of an action plan to (i) implement the updated eligibility thresholds for social assistance and to (ii) accelerate the completion of the upgraded social registry is also proposed. These are important stages in the process of the much-needed strengthening of the social safety net.

36. Ecuador's capacity to repay remains adequate, although risks have risen substantially, and the program remains fully financed for the next 12 months. The revisions to the projected reserve path imply a worsening of indicators of fund credit relative to gross reserves (Table 8). If the current increase in country risk is sustained, it could prove a source of strain (¶40). The program remains fully financed and the updated program framework incorporates changes in the composition of financing, compared to the first review.

- In 2019, new market financing of US$2.0 billion issued in September, together with the somewhat lower NIR target for end-2019, will compensate for the US$0.9 billion shortfall in gross multilateral financing in 2019 and previously planned financing from commercial sources (including some linked to oil-sales) as well as the shortfall due to the delay in asset monetization project and repayment of past obligations by public entities outside the central government..

- In 2020, gross financing needs at the NFPS level are estimated at about US$5.6 billion. These needs will be covered by a total resources of US$7.2 billion consisting of a mix of multilateral disbursements of about US$3.9 billion, bilateral financing of about US$300 million, bank loans of about US$650 million, as well as domestic issuance of bonds of about US$2.4 billion, including US$1.8 billion rollover of short-term government securities (CETES). The excess financing of US$1.7 billion contributes to the accumulation of net international reserves. Staff obtained financing assurances from multilaterals of US$4 billion for 2020, including US$710 million re-phased from 2019; the World Bank has offered additional budget financing in 2020 of US$250 million, which is included in the revised program scenario, and indicated a possibility of additional project financing, which is not yet included. Staff will continue closely monitoring the financing situation with the authorities and provide advice on debt management, including on the design of a comprehensive debt management strategy and communication with investors.

37. Exchange restrictions. The tax on transfers abroad is both an exchange restriction subject to Fund approval under Article VIII and a capital flow management measure (CFM) under the IMF's Institutional View on Liberalization and Management of Capital Flows (IV). The authorities are committed to phasing out the tax on transfers abroad as macroeconomic stability is restored and the reserves position is strengthened. The Monetary and Financial Board passed a resolution in August

2019 that implemented changes to the legal framework for the exchange system based on recommendations made in the recent Article VIII assessment.

38. Safeguards. An update safeguards assessment, which was finalized in June 2019, provided recommendations on restoring the autonomy of the BCE as well as strengthening the credibility of the dollarization regime. The enactment of the new central bank law would allow the implementation of other safeguards recommendations, such as the approval of an internal audit charter and the establishment of the Audit Committee. The BCE is taking steps to adopt the International Financial Reporting Standards (IFRS) as its financial reporting framework.

39. Financing assurances: The authorities continue to make good faith efforts to resolve outstanding arrears to external private creditors. A total of around US$52 million (including accrued interest) remains outstanding to international private bondholders from those international bonds that the authorities repudiated in 2008/2009, the majority of which were subsequently repurchased by the government.[5] Staff is of the view that, based on the authorities' actions, they are making good faith efforts as required under the Fund's Lending into Arrears policy.

40. The program is subject to a number of downside risks, some of which have heightened significantly since the first review:

On the external side:

- A sharp fall in oil prices could necessitate a larger and more accelerated adjustment; on the other hand, an increase in oil prices remains an upside risk.
- A sharp rise in risk premia globally could result in higher debt service and refinancing risks. Regional risks, including those related to political instability in other parts of South America may also contribute to volatility in risk premia.
- Rising global protectionism could reduce global growth and the demand for Ecuador's exports.
- Continued spillovers from the Venezuela crisis could have fiscal costs. Ecuador is one of the countries in the region with the highest inflow of Venezuelan refugees and migrants relative to the local population (after Colombia, Peru, and Panama). As of November 2019, there were an estimated 385,042 Venezuelan refugees and migrants living in Ecuador.[6] Preliminary estimates suggest that government expenditure on border security, humanitarian assistance, and social services for Venezuelans arriving in Ecuador is in the range of 0.1–0.2 percent of GDP and could reach 0.4 percent of GDP over the medium term if migrant flows continue unabated. While the inflow of working-age Venezuelans could lead to weakening of the labor market conditions in the short term,

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[5] The authorities' advisors continue to negotiate with bondholders that have been identified, while litigation initiated by one bondholder continues.

[6] Estimated number of refugees and migrants according to the Response for Venezuelans Coordination Platform for Refugees and Migrants from Venezuela, November 2019 update.

the increased labor supply from migration will likely increase Ecuador's potential growth in the medium term.

- Ongoing legal disputes may generate additional fiscal costs in 2020.

- Lower-than-expected disbursements from multilaterals. The team analyzed a possible scenario (text table below) with the delay of one-half of the expected disbursements from multilaterals in 2020 and only one-half of the non-disbursed funds in 2020 being disbursed in 2021. This scenario would imply a lower reserve accumulation with the coverage of ARA metric falling from 39 percent to 36 percent though still amply covering the bank deposits in the central bank and falling only slightly short of the staff-designed Ecuador-specific reserve metric. Staff has encouraged the authorities to strengthen implementation of various programs and projects with other IFIs, in particular, by building capacity of the various units responsible for the implementation of these programs and projects and by improving coordination between various government entities. Staff has also been in touch with other IFIs to reaffirm the common goals and expedite disbursements whenever possible to ensure sufficient program financing.

Ecuador: Reserve Coverage
(US$ millions, unless otherwise indicated)

	Nov-19	Dec-19	Dec-20	Dec-21
		Projections		
Baseline: Reserve floors				
ARA metric	18,624	18,624	19,282	19,559
Two balances 1/	2,607	3,013	3,128	3,249
Ecuador-specific metric 2/	7,286	7,704	7,477	7,128
Gross international reserves 3/	**2,532**	**4,215**	**6,022**	**7,576**
(Reserve coverage, %)				
As a percent of ARA metric	13.6	22.6	31.2	38.7
Percent coverage of first two balances	97.1	139.9	192.5	233.2
Percent coverage of Ecuador-specific metric	34.8	54.7	80.5	106.3
Sensitivity Analysis: Lower Multilateral Financing 4/				
ARA metric	18,624	18,624	19,034	19,435
Two balances 1/	2,607	3,013	3,128	3,249
Ecuador-specific metric 2/	7,286	7,704	7,477	7,128
Gross international reserves 3/	**2,532**	**4,215**	**4,783**	**6,957**
(Reserve coverage, %, with lower multilateral financing)				
as a percent of ARA metric	13.6	22.6	25.1	35.8
Percent coverage of first two balances	97.1	139.9	152.9	214.1
Percent coverage of Ecuador-specific metric	34.8	54.7	64.0	97.6

1/ Currency issuance, reserves of other depository institutions, and central bank securities
2/ Covers deposits of ODIs, outstanding credit of the BCE to the IMF, central bank securities, one quarter of public external amortizations, and one month of government expenditure at NFPS level. A similar metric is discussed in Ecuador Selected Issues (Country Report 19/80, pp.39); one month of expenditure is suggested in Kosovo Selected Issues (Country Report 13/23, pp. 15)
3/ IMF definition of gross international reserves (excludes non-liquid and encumbered items).
4/ Assumes 50 percent (about US$1.24 billion) of programmed multilateral financing does not disburse in 2020. Half of the undisbursed amount disburses in 2021 instead; the other half does not disburse.

- A recent sharp increase in country risk may result in additional payments due to margin calls embedded in some existing debt contracts though higher bond prices would mitigate this risk.

On the domestic side:

- The political landscape has become significantly more complex and the executive has been weakened by the social unrest in October and the rejection of the urgent law in November. There is a risk that the two remaining legislative proposals (the budget code and the central bank law) to be submitted separately are weakened in the Assembly or do not pass at all if consensus on the needed reforms cannot be reached. Heightened uncertainty may also deter investors from proceeding with asset monetization. The specifics of the subsidy reform are yet to be determined. Hence, the government's consolidation plan is subject to a number of important downside risks, including: (i) delays and lower-than-expected revenues from the asset monetization program; (ii) delays and lower-than-expected revenues from leasing of the frequency ranges; (iii) a lower-then-expected yield from the fiscal reform; and (iv) lower social spending, which could jeopardize a successful implementation of the fuel subsidy reform. Weak expenditure controls, including in the wage bill, could undermine the achievement of the program's fiscal objectives. These concerns are exacerbated by the risks of politically-related spending in a pre-election year by government sectors over which the central government has relatively less control, such as the local governments.

- Insufficient coordination between government entities complicates overall macroeconomic management and creates risks in meeting the program targets.

41. The authorities have identified contingency measures that could be deployed to safeguard program objectives in 2019 and 2020. Since asset monetization envisaged for 2019 was delayed to 2020, the authorities are working on partially compensating the lost revenue with lower net lending and other current spending. Separately, to hedge against the risks of payment for the lawsuit, a partial adjustor to accommodate for one-half of the awarded payment is proposed.[7] The rest will have to be compensated by drawing on contingency measures. In particular, there is space to reduce spending on goods and services, recalibrate the pace of rescaling capital investment, reduce net lending, and implement additional cuts in other areas of expenditure.

STAFF APPRAISAL

42. The political, economic, and social environment has proved challenging for program implementation. Economic growth has slowed in 2019. While the authorities have made serious efforts to meet program conditionality, the social unrest in October and the rejection of the government's reform package by the National Assembly in November substantially weakened program implementation. This has necessitated a recalibration of the program, including to help provide space to garner political and social consensus on key institutional reforms, and to recognize a changed outlook.

43. The authorities have made progress with fiscal consolidation and building reserve buffers in 2019. The authorities' efforts to reduce the wage bill have been commendable, but savings have been diluted partially by the hiring of high-priority personnel in the health and security sectors. Savings from the fuel subsidy reform implemented in late 2018 were also lower than expected and expected revenues from asset monetization did not materialize. These shortfalls were to a large extent offset through cuts in capital spending. At the same time, reserve buffers have increased over the course of 2019, resulting in an improvement in reserve adequacy across various metrics relative to end-2018.

44. Going forward, a moderation of the envisaged fiscal consolidation path will be required to align the program with current political and economic realities. A lowering of the fiscal consolidation target from 5 to 4 percent of GDP in the non-oil primary balance including fuel subsidies (NOPBS) over the course of the program would protect the program objective of placing public debt on a downward path. In 2020, eventual savings from the tax reform would need to be supplemented with savings from rationalizing current expenditure Strengthening tax administration,

[7] These are detailed in the Technical Memorandum of Understanding (TMU).

including via amendments to the tax procedure code, should help secure gains from the tax reform. In 2021, the composition of adjustment is expected to shift towards expenditure measures.

45. A lower path for reserve accumulation is also envisaged. Lower fiscal consolidation, more conservative assumptions on asset monetization, and higher amortizations result in a projected build-up of international reserves that is about US$3.4 billion lower than at the time of the first review. While less ambitious than before, the level of reserves by the end of the program is still projected to meet basic liquidity requirements and the standards of the backing rule envisioned in the recently submitted amendments to the central bank code.

46. It will be important for the authorities to continue demonstrating their commitment to protect the most vulnerable, notably through steps to strengthen the social safety net. Progress made in this area has included a reduction of wait times and a removal of some administrative hurdles in critical social spending programs, as well as the publication of new eligibility thresholds for social assistance. In this context, staff also urge the authorities to accelerate the expansion of the Crédito de Desarrollo Humano program in 2020. The completion of the upgrade of the social registry to enhance the identification of poor and extremely poor households in the social safety net is a priority in 2020H1 and an additional increase in social assistance spending to allow for coverage expansion has been programmed for 2020H2 and 2021.

47. Strengthening public financial management is a key priority. The revised reform of the Organic Budget Code expected to be submitted to the National Assembly early next year should aim at bolstering the top-down approach to budget formulation, limiting the discretion of the Executive to amend the budget, and putting in place a clearer mechanism for dealing with arrears and, more broadly, provide a much-needed strengthening of expenditure controls. These amendments could also strengthen the existing framework for fiscal rules. Going forward, additional measures will be needed to address the underlying causes of arrears accumulation, including enhancing budget formulation, strengthening internal control and oversight mechanisms, and improving liquidity management and fiscal reporting.

48. Strengthened central bank autonomy, accountability and governance remain critical program objectives, to ensure sound reserve management and protect the dollarized framework. A reform of the Organic Monetary and Financial Code should improve the autonomy of the BCE and its governance through the creation of a board with fiduciary responsibility. In addition, the reform should help solidify the existing prohibition in secondary legislation on monetary financing and quasi-fiscal activities by the central bank and enshrine a backing rule to guide the BCE's reserve management, both key safeguards for the dollarized framework.

49. The financial system is stable and weathered the recent turmoil well, but continued vigilance is warranted while regulatory and supervisory frameworks are being upgraded. Although the gap between credit and deposit growth is narrowing, the slowdown in economic activity poses some risks to the financial system, as does the recent composition of credit growth, which has been heavily skewed to microfinance and consumption. It will be important to monitor closely the riskiest segments and institutions. Aligning credit risk regulation with good practice and closing the regulatory gaps between banks and cooperatives is also recommended.

50. Enhancements to the anticorruption and AML/CFT frameworks are needed to strengthen governance and reduce vulnerabilities to corruption. The efforts made in the area of asset recovery are welcome. However, it will be important to complete the legislative work on criminalization of acts of corruption and the freezing, seizing and confiscation of corruption proceeds, as well as the regulatory amendments on customer due diligence on senior officials. Continuing to engage in coordination initiatives to avoid conflicting efforts, defining agreed strategic priorities, and advancing preventive measures focused on public officials are important priorities moving forward. Specific legal reforms to support the implementation of an effective AML/CFT risk-based supervision should be developed.

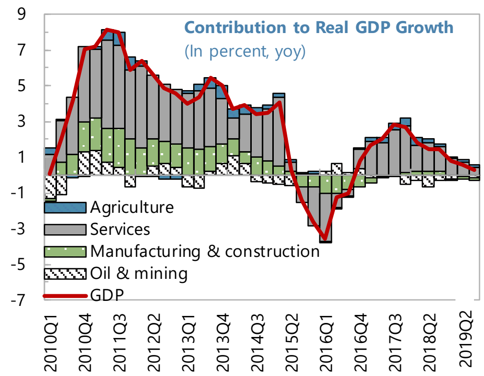
51. The authorities should continue pushing forward with other elements of their structural reform agenda. Substantial progress has been made, with the collaboration of other international financial institutions, in preparing draft reforms on the labor market, state-owned enterprises, and public-private partnerships. These much-needed reforms would help raise economic efficiency and productivity, and, in the case of the SOE and PPP laws, enhance governance and reduce fiscal risks.

52. Program implementation going forward will be challenging. An unfavorable external environment (lower oil prices, slower global growth, heightened risk aversion in the financial markets) could create headwinds to the program. Downside risks are significant and emanate from a complex domestic political environment, weak expenditure controls, potentially lower-than-expected disbursements from multilaterals, and continued spillovers from the Venezuela crisis. The identification of contingency measures to safeguard program objectives in the near term is welcome; the authorities should consider further cuts in goods and services spending, limiting the scaling-up of public investment, reducing net lending, and implementing additional cuts in other areas of expenditure, as part of these contingency measures.

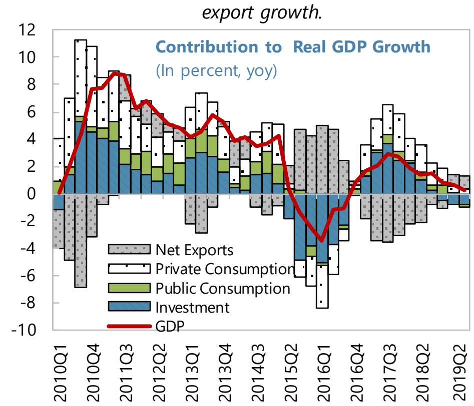
53. In view of the authorities' performance under the program, staff recommends completion of the second and third reviews. Staff supports the authorities' request for a waiver of nonobservance for the end-September performance criterion on net international reserves given the minor nature of the breach, and proposed modifications of conditionality.

Figure 1. Ecuador: Recent Economic Developments

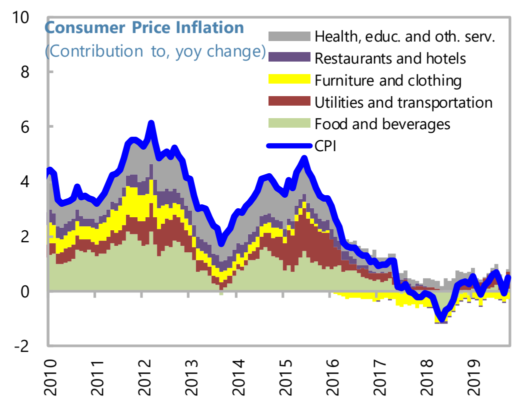
Real GDP growth fell to 0.3% in 2019Q2...



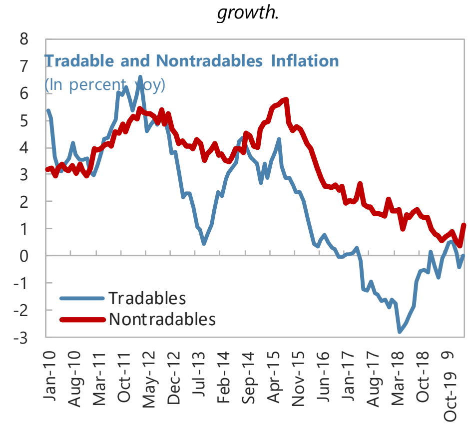
... as a fall in public consumption and investment outweighed export growth.



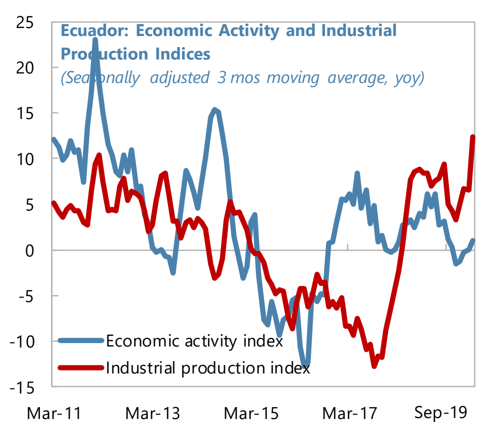
Inflation remains low, with transportation costs the main driver.



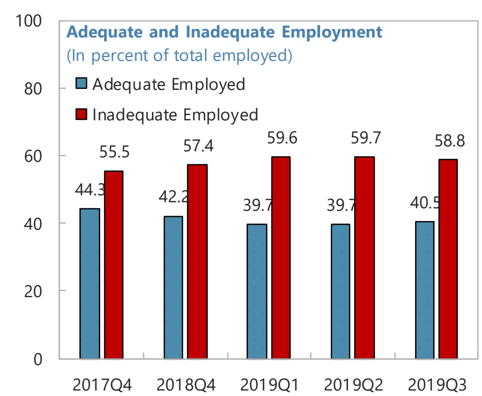
Tradables inflation has shifted to positive territory while nontradables inflation has slowed in line with wage growth.



The industrial production index has risen in 2019 while overall economic activity has been sluggish...



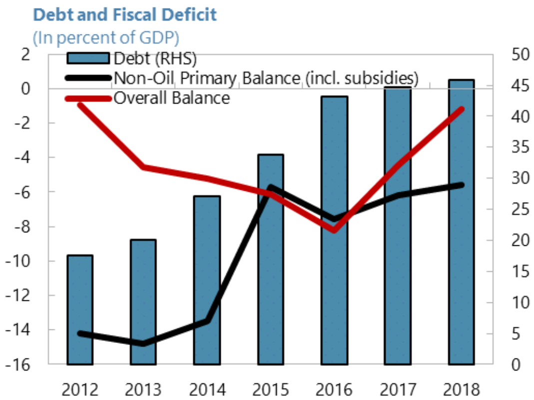
...and job quality has deteriorated.



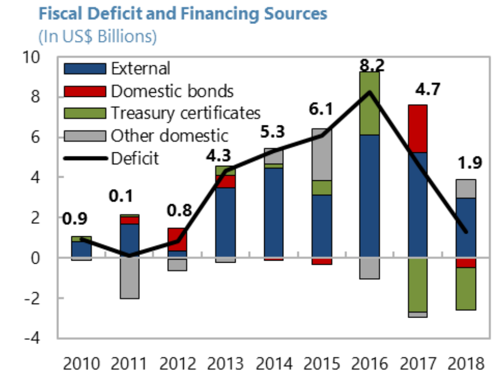
Sources: Central Bank of Ecuador, National Statistical Institute of Ecuador (INEC), and IMF staff calculations.

Figure 2. Ecuador: Fiscal Developments

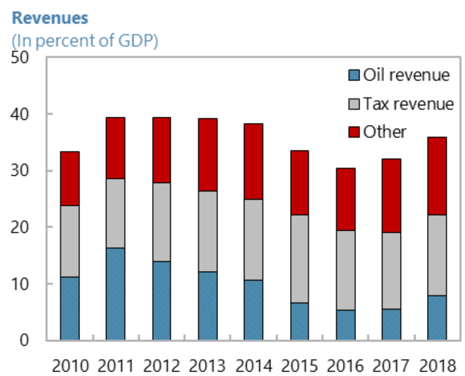
Despite declining fiscal deficit over the past two years, public debt continued rising.



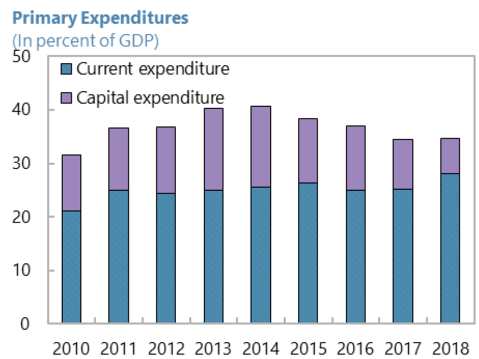
The deficit was financed largely by external bonds issuance.



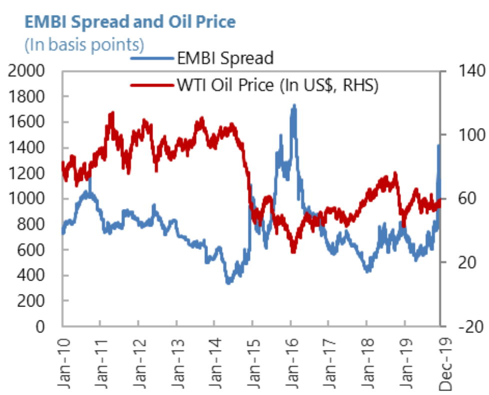
The recovery in oil revenues supported deficit reduction...



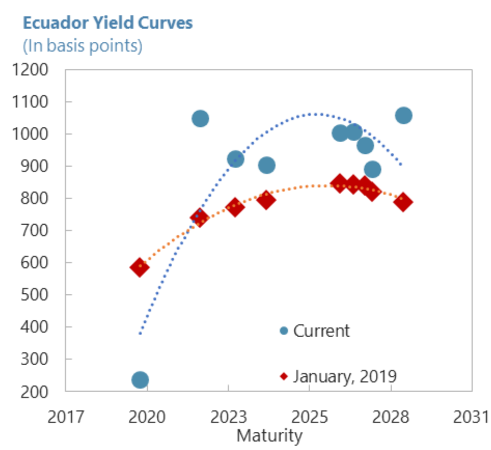
... while capital expenditure contraction helped offset the increase in current primary spending.



Recent events have increased EMBI spreads, which had previously mirrored fluctuations in oil prices...

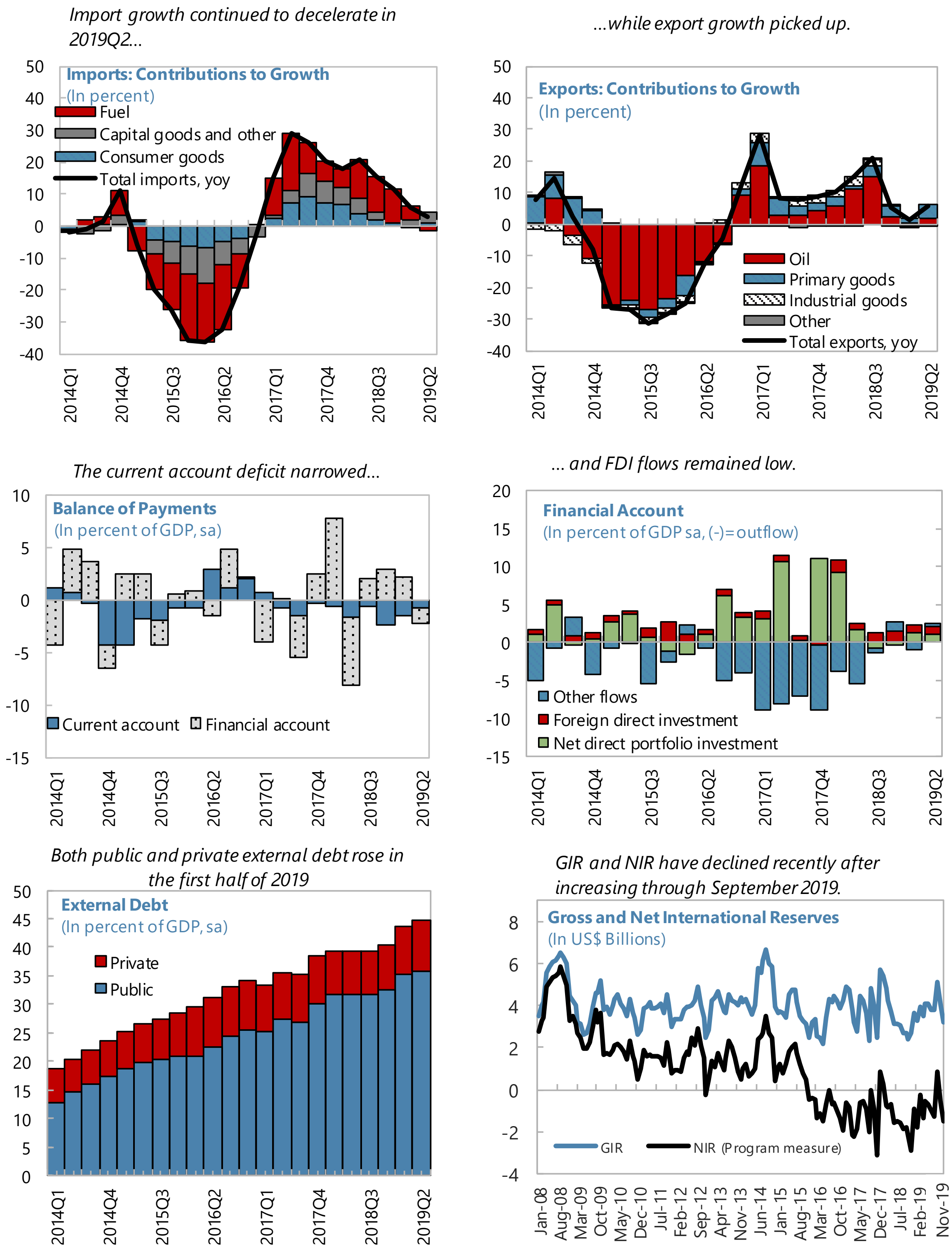


...resulting in an increase in the yield curve.



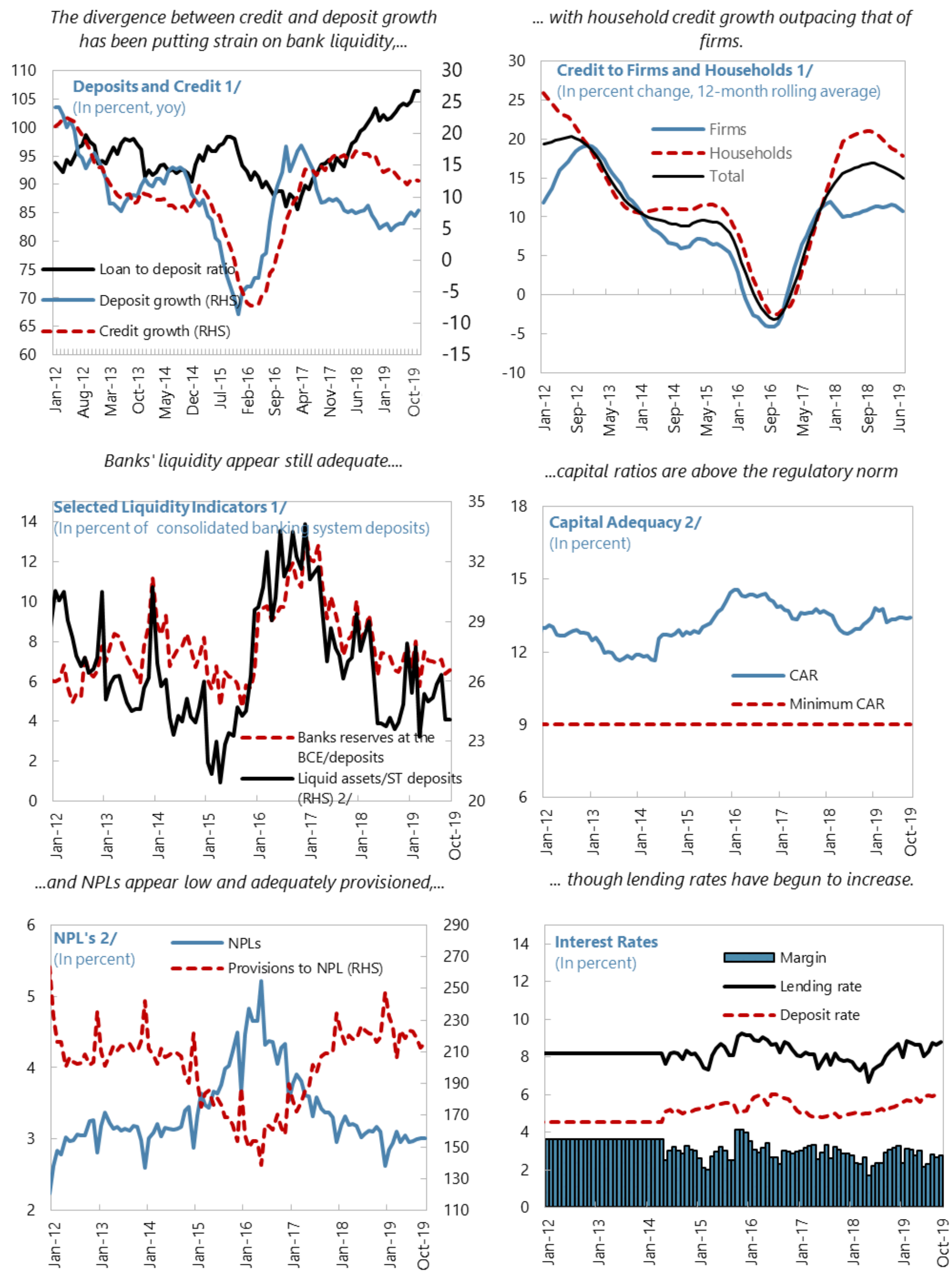
Sources: Central Bank of Ecuador, Ministry of Finance, Haver, Bloomberg, and IMF staff calculations.

Figure 3. Ecuador: A Vulnerable External Position



Sources: Central Bank of Ecuador and IMF staff calculations.

Figure 4. Ecuador: Financial System Developments

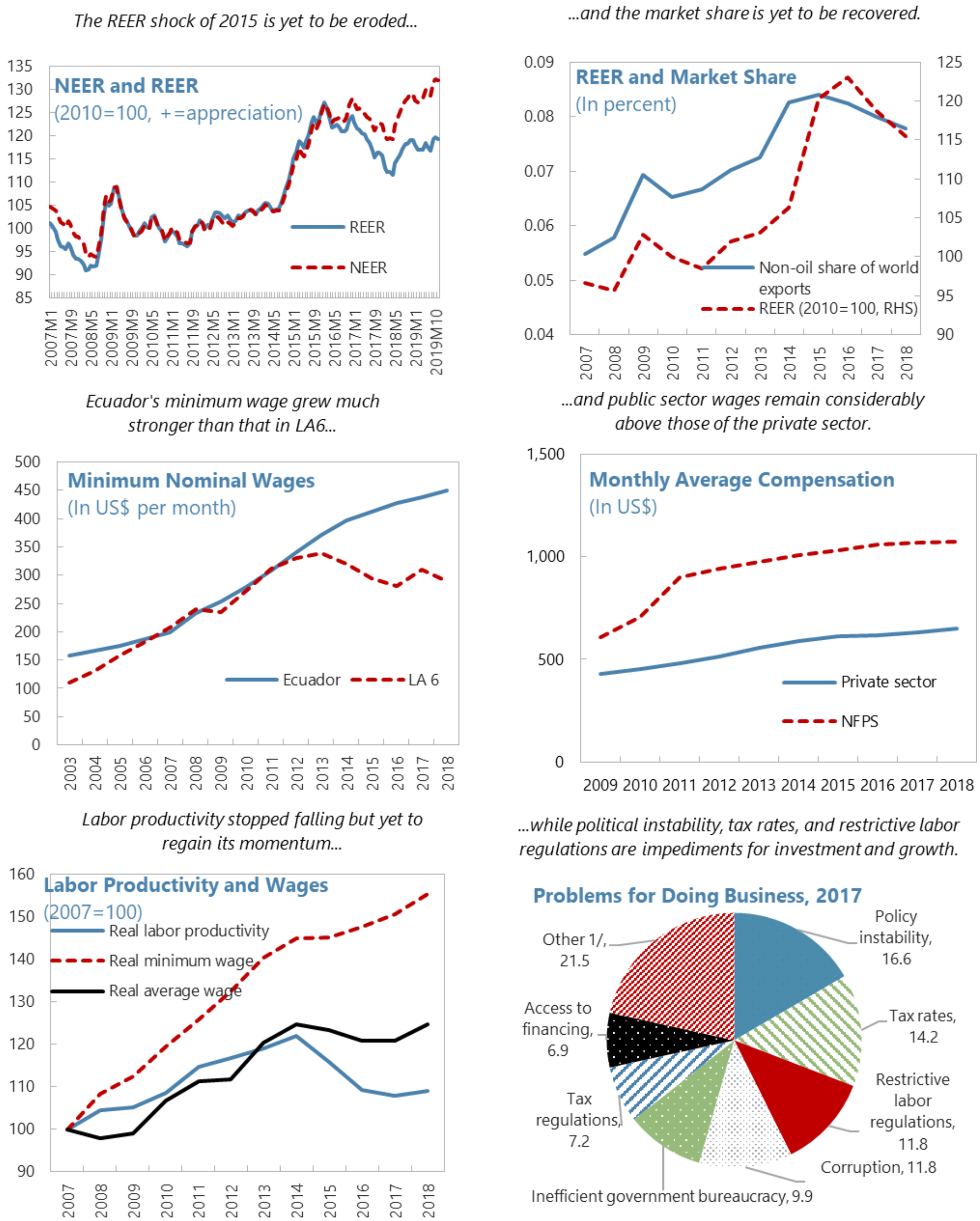


Sources: Central Bank of Ecuador, Superintendency of Banks, IMF Monetary and Financial Statistics, and IMF staff calculations.

1/ Loan to deposit data corresponds to Other Depository Institutions, which include private banks, *Banecuador*, *Banco del Pacifico*, private financial companies, mutualists, cooperatives, and credit card companies. While credit and deposit data corresponds to the whole financial system.

2/ Data corresponds to the private banks aggregate, which includes *Banco del Pacifico*.

Figure 5. Ecuador: Competitiveness



Source: INEC, BCE, ILO, INS database, Haver, World Economic Forum (Executive Opinion Survey 2017), and IMF staff calculations.

1/ Other includes: Foreign currency regulations, poor work ethic in national labor force, inadequate supply of infrastructure, government instability/coups, restrictive labor regulations, tax regulations, insufficient capacity to innovate, poor public health, and crime and theft (in order of importance).

Table 3. Ecuador: Selected Economic and Financial Indicators

	2014	2015	2016	2017	2018	2019	2019	2020	2020	2021	2022	2023	2024
				Prel.	Est.	Prog. 1/	Proj.	Prog. 1/		Projections			
Social Indicators													
Life expectancy at birth (years)	75.9	76.1	76.3										
Infant mortality (per thousand live births)	13.4	13.0	12.7	12.5									
Adult literacy rate	94.2	94.5	94.4										
Poverty rate at national line (total)	22.5	23.3	22.9	21.5	23.2								
Unemployment rate	3.8	4.8	5.2	4.6	3.7	4.3	4.3	4.7	4.8	4.8	4.6	4.4	4.2
Population (millions)	16.0	16.3	16.5	16.8	17.0	17.3	17.3	17.5	17.5	17.8	18.0	18.3	18.5
	(Percent change, unless otherwise indicated)												
National income and prices													
Real GDP	3.8	0.1	-1.2	2.4	1.3	-0.5	-0.5	0.2	0.2	1.6	2.7	2.5	2.5
Domestic demand (contribution to growth)	3.6	-2.2	-4.3	5.3	2.2	-2.9	-1.2	-0.9	-1.6	1.1	2.3	1.9	2.2
External Demand (contribution to growth)	0.2	2.3	3.1	-3.0	-0.9	2.4	0.7	1.1	1.8	0.5	0.4	0.6	0.3
Consumer price index period average	3.6	4.0	1.7	0.4	-0.2	0.4	0.3	1.2	0.9	1.2	1.2	1.2	1.2
Consumer price index end-of-period	3.7	3.4	1.1	-0.2	0.3	0.6	0.4	1.4	0.9	1.2	1.2	1.2	1.2
Banking system													
Net domestic assets	20.5	1.4	20.5	18.3	7.6	-4.9	2.2	-1.7	3.0	-0.7	5.7	4.6	6.0
Liabilities	10.9	-6.2	21.2	9.4	4.7	3.4	5.3	5.0	3.9	3.9	5.5	6.1	6.7
Credit to the private sector	8.7	-3.4	6.2	16.4	14.9	7.3	10.6	6.6	5.7	4.6	5.3	6.0	6.9
External sector													
Exports	4.8	-25.9	-8.7	11.5	13.1	1.6	0.4	2.2	2.5	0.8	2.5	3.2	3.3
Oil	-5.9	-49.8	-18.0	26.6	27.3	-7.2	-3.1	-3.0	0.5	-5.7	-1.3	0.1	1.0
Non-oil	16.0	-7.0	-3.4	6.2	4.9	7.3	2.5	4.9	3.6	4.3	4.3	4.7	4.4
Imports	2.0	-20.8	-20.3	18.6	13.4	-5.2	-2.5	-0.8	-2.1	0.5	2.1	1.9	2.6
Terms of trade	0.9	-13.4	0.7	7.6	2.0	-1.4	0.3	-0.6	-1.5	-1.5	-0.8	-0.7	-0.1
Real effective exchange rate (2010=100)	106.3	120.3	123.0	118.7	115.4								
Real effective exchange rate, end-of-period (depreciation, -)	3.2	13.2	2.2	-3.5	-2.8								
	(Percent of GDP)												
External current account balance	-0.7	-2.2	1.3	-0.5	-1.4	0.5	-0.8	1.4	0.3	0.6	0.7	1.0	1.2
Public finances													
Revenue	38.4	33.6	30.3	32.0	36.1	34.7	34.2	37.3	36.2	35.5	34.9	34.9	34.9
Expenditure	43.6	39.7	38.6	36.5	37.3	35.0	35.3	34.1	35.5	33.8	33.3	33.2	33.2
Overall balance (deficit -)	-5.2	-6.1	-8.2	-4.5	-1.2	-0.3	-1.1	3.2	0.7	1.7	1.6	1.7	1.7
Non-oil primary balance	-7.4	-4.0	-6.7	-4.1	-1.9	-1.0	-1.1	0.9	0.3	0.5	0.4	0.3	0.3
Non-oil primary balance (incl. fuel subsidies)	-13.5	-5.7	-7.6	-6.1	-4.9	-2.9	-3.4	-1.0	-1.7	-1.0	-1.0	-1.1	-1.2
Public debt 2/	27.1	33.8	43.2	44.6	46.1	48.4	49.6	47.4	50.1	48.1	44.8	41.5	38.2
Domestic	8.4	11.5	15.0	12.6	12.4	11.7	12.2	11.4	12.2	11.4	10.9	9.2	8.0
External	18.7	22.3	28.1	32.0	33.8	36.7	37.5	36.0	37.9	36.6	33.8	32.3	30.2
Saving-investment balance													
Consumption	73.3	75.9	74.5	74.5	74.4	74.2	74.5	73.6	73.7	73.5	73.5	73.5	73.5
Private	59.0	61.4	59.9	59.9	59.7	60.5	60.7	60.5	60.3	60.6	60.6	60.6	60.6
Public	14.3	14.4	14.6	14.6	14.7	13.7	13.8	13.1	13.4	12.9	12.9	12.9	12.9
National saving	27.7	24.6	26.3	25.8	25.4	25.0	25.2	25.8	26.0	26.5	26.5	26.5	26.6
Private	17.8	18.8	22.6	21.0	19.9	18.9	20.5	16.4	19.1	19.2	19.6	19.5	19.5
Public	9.9	5.8	3.7	4.8	5.4	6.7	4.6	10.0	6.9	7.3	6.9	7.0	7.1
Gross investment	28.3	26.9	25.0	26.3	26.7	24.5	26.0	24.4	25.8	25.9	25.8	25.5	25.4
Private 3/	12.6	13.4	13.5	15.6	19.0	18.2	19.6	18.2	18.8	19.6	19.8	19.5	19.4
Public	15.7	13.4	11.5	10.6	7.7	6.3	6.4	6.2	7.0	6.3	6.0	6.0	6.0
Memorandum items:													
Nominal GDP (US$ millions)	101,726	99,290	99,938	104,296	107,562	107,778	107,270	109,020	107,991	110,554	114,653	118,758	123,203
GDP per capita (US$)	6,347	6,099	6,046	6,217	6,318	6,241	6,212	6,226	6,167	6,226	6,367	6,504	6,654
Gross international reserves (US$ millions) 4/	3,762	2,351	4,216	2,006	2,158	4,679	4,215	8,446	6,022	7,576	8,016	9,123	10,105
Gross international reserves (as a percent of ARA metric)	29	18	28	12	12	26	23	46	31	39	41	46	50
Net international reserves (US$ millions) 5/	425	-498	-1,917	-3,293	-2,895	237	74	3,668	2,087	3,629	3,851	4,701	5,388
Net international reserves (US$ millions, at program exchange rates) 5/				-2,498	-2,889	248	-56	3,679	1,957	3,499	3,721	4,571	5,258
Underlying reserves (US$ millions) 6/				-3,293	-2,895	-1,159	-1,319	879	-699	-551	-329	596	1,573
Oil price Ecuador mix (US$ per barrel)	84.1	41.9	35.0	45.7	60.6	52.0	55.9	51.9	53.5	51.0	50.4	50.4	51.0
Oil production (millions of barrels)	203.1	198.2	200.7	193.9	188.8	194.0	193.1	194.0	197.2	195.6	195.5	195.5	195.5
Exports of oil (millions of barrels) 7/	157.5	156.9	156.6	150.9	145.1	156.4	152.1	152.1	159.6	157.9	157.8	157.8	157.8

Sources: Ministry of Finance; Central Bank of Ecuador; Haver; World Bank Development Indicators; and Fund staff calculations and estimates.

1/ First Review under the Extended Fund Facility Arrangement, Requests for Waiver of Nonobservance of Performance Criterion, Modification of Performance Criteria, and Financing Assurances Review (July 3, 2019, CR 19/210).

2/ Gross debt consolidated at the level of the NFPS. Includes the outstanding balance for advance oil sales, treasury certificates, central bank loans, other liabilities and the stock of domestic floating debt. The public debt estimates are preliminary and subject to revisions in accordance with the IMF's Public Sector Debt Statistics: Guide for Compilers and Users (PSDSG).

3/ Includes inventories.

4/ GIR excludes non-liquid and encumbered items included in the authorities' measure of GIR.

5/ Net international reserves is equal to gross international reserves less outstanding credit to the IMF (excl. budget support), short-term foreign liabilities of the BCE, deposits of other depository institutions and other financial institutions (excl. BIESS) at the central bank, and short-term liabilities of the central government. Program exchange rates are those in effect on January 31, 2019 (see TMU).

6/ Underlying reserves refers to NIR less outstanding obligations of the treasury to the IMF. The values for "Prog. 2019" and "Prog. 2020" have been updated to reflect the revised program definition of NIR, which was changed at the time of the first review.

7/ Includes both crude and derivatives

Table 4a. Ecuador: Operations of the Nonfinancial Public Sector (Net Accounting)

(Millions of U.S. dollars, unless otherwise indicated)

				Prel.	Est.	Prog. 1/	Proj.	Prog. 1/	Projections				
	2014	2015	2016	2017	2018	2019	2019	2020	2020	2021	2022	2023	2024
Revenue	**39,032**	**33,322**	**30,314**	**33,426**	**38,866**	**37,449**	**36,646**	**40,670**	**39,041**	**39,246**	**40,036**	**41,452**	**43,024**
Oil revenue, net 2/	10,906	6,487	5,402	5,840	8,621	7,676	7,627	8,648	8,184	8,385	8,237	8,577	8,917
Nonpetroleum revenue	23,939	25,758	24,294	25,473	27,644	27,155	26,401	29,002	28,264	28,192	29,012	30,067	31,172
Taxes	14,460	15,588	14,017	14,078	15,422	14,148	14,378	15,815	14,772	15,206	15,900	16,489	17,100
Social security contributions 3/	4,718	5,057	4,741	5,414	5,553	5,521	6,038	5,585	6,078	6,223	6,453	6,684	6,924
Other	4,761	5,113	5,535	5,981	6,670	7,486	5,985	7,603	7,414	6,763	6,658	6,894	7,149
Operating surplus of public enterprises	4,187	1,076	618	2,113	2,600	2,618	2,618	3,020	2,592	2,669	2,786	2,808	2,935
O/w profits of oil companies withheld for investment	3,999	833	487	2,077	2,535	2,518	2,424	3,020	2,451	2,669	2,786	2,808	2,935
Expenditure	**44,346**	**39,398**	**38,540**	**38,079**	**40,166**	**37,741**	**37,833**	**37,169**	**38,297**	**37,396**	**38,222**	**39,417**	**40,871**
Primary expenditure	43,323	37,976	36,980	35,870	37,488	34,938	35,030	34,095	35,080	34,209	35,204	36,498	37,784
Current	27,968	26,129	25,043	26,198	30,355	28,367	28,879	27,593	28,350	27,979	29,108	30,172	31,219
Wages and salaries	9,478	9,904	10,014	10,365	10,672	10,412	10,490	9,858	10,235	10,152	10,528	10,905	11,295
Purchases of goods and services	5,328	5,112	4,684	5,056	6,183	5,299	5,276	5,340	5,132	5,024	5,210	5,396	5,589
Social security benefits 3/	3,665	4,222	4,655	4,999	5,382	5,462	5,613	5,574	5,574	5,807	6,074	6,301	6,522
Other	9,497	6,890	5,691	5,777	8,118	7,194	7,499	6,821	7,410	6,997	7,296	7,570	7,813
Cost of imports of oil derivatives	6,103	3,788	2,332	2,889	4,041	3,521	3,983	3,278	3,855	3,714	4,056	4,217	4,343
Payments to private oil companies (SH) 4/	1,578	1,439	1,117	1,385	1,984	1,383	1,468	1,120	1,302	930	739	739	739
Other	1,815	1,664	2,242	1,502	2,093	2,290	2,048	2,423	2,253	2,353	2,500	2,613	2,730
Capital	15,354	11,848	11,937	9,672	7,133	6,572	6,151	6,502	6,729	6,230	6,096	6,326	6,565
Fixed capital spending	13,980	10,178	10,293	8,648	6,456	5,680	5,367	5,636	5,892	5,434	5,376	5,578	5,789
O/w investment in oil	4,023	2,804	2,375	1,766	1,669	1,649	1,757	1,649	1,835	1,873	1,858	1,857	1,857
Net-lending	1,375	1,669	1,644	1,024	678	892	784	866	837	796	721	748	776
Primary balance	**-4,291**	**-4,655**	**-6,666**	**-2,444**	**1,377**	**2,511**	**1,616**	**6,575**	**3,961**	**5,037**	**4,831**	**4,954**	**5,240**
Interest	**1,024**	**1,421**	**1,561**	**2,209**	**2,678**	**2,803**	**2,803**	**3,074**	**3,217**	**3,187**	**3,018**	**2,919**	**3,087**
O/w external	829	1,143	1,335	1,850	2,306	2,409	2,409	2,701	2,821	2,779	2,641	2,594	2,946
Current balance	**10,040**	**5,772**	**3,710**	**5,019**	**5,833**	**6,280**	**4,964**	**10,004**	**7,473**	**8,080**	**7,910**	**8,361**	**8,718**
Overall balance	**-5,314**	**-6,076**	**-8,226**	**-4,653**	**-1,300**	**-292**	**-1,187**	**3,502**	**744**	**1,850**	**1,814**	**2,035**	**2,153**
Memorandum items:													
Non-oil primary balance 5/	-7,491	-3,944	-6,730	-4,320	-2,086	-1,130	-1,227	955	317	501	461	383	328
Non-oil PB (incl. fuel subsidies)	-13,707	-5,610	-7,615	-6,394	-5,320	-3,148	-3,691	-1,054	-1,838	-1,155	-1,157	-1,274	-1,419
Cyclically Adjusted Non-oil Primary Balance	-8,099	-4,154	-6,350	-4,324	-2,269	-403	-795	2,226	1,226	1,463	1,205	965	707
Cyclically Adjusted Non-oil Primary Balance (incl. fuel subsidies)	-14,316	-5,820	-7,234	-6,399	-5,502	-2,420	-3,259	218	-929	-193	-414	-691	-1,040
Structural non-oil primary balance	-8,099	-4,018	-5,437	-4,249	-2,724	-1,253	-795	1,426	26	1,063	1,205	965	707
Structural non-oil primary balance (incl. fuel. subsidies)	-14,316	-5,684	-6,321	-6,324	-5,957	-3,270	-3,259	-582	-2,129	-593	-414	-691	-1,040
Oil balance 6/	3,200	-711	64	1,876	3,463	3,642	2,843	5,620	3,644	4,537	4,371	4,571	4,912
Oil balance excluding oil investment	7,223	2,093	2,440	3,642	5,132	5,290	4,600	7,270	5,478	6,410	6,228	6,429	6,769
Public Debt 7/	27,543	33,558	43,139	46,533	49,628	52,150	53,233	51,684	54,142	53,123	51,309	49,275	47,122
Change in social spending, program definition						400	308	0	170	120	0	0	0

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

1/ First Review under the Extended Fund Facility Arrangement, Requests for Waiver of Nonobservance of Performance Criterion, Modification of Performance Criteria, and Financing Assurances Review (July 3, 2019, CR 19/210).

2/ Net of operational cost.

3/ From 2011 on, includes additional public pension sytems which previously had not been consolidated into the NFPS accounts.

4/ Reflects service contract payments to private oil companies beginning in 2011.

5/ The primary balance less oil balance.

6/ Oil revenue plus profits of state-owned oil companies, which is retained for investment in the oil sector, less oil-related expenditure (the costs of imports of oil derivatives, service payments to private oil companies, and investment in oil).

7/ Gross debt consolidated at the level of the NFPS. Includes the outstanding balance for advance oil sales, treasury certificates, central bank loans, other liabilities and the stock of domestic floating debt. The public debt estimates are preliminary and subject to revisions in accordance with the IMF's Public Sector Debt Statistics: Guide for Compilers and Users (PSDSG).

Table 4b. Ecuador: Operations of the Nonfinancial Public Sector (Net Accounting)
(Percent of GDP, unless otherwise indicated)

				Prel.	Est.	Prog. 1/	Proj.	Prog. 1/	Projections				
	2014	2015	2016	2017	2018	2019	2019	2020	2020	2021	2022	2023	2024
Revenue	**38.4**	**33.6**	**30.3**	**32.0**	**36.1**	**34.7**	**34.2**	**37.3**	**36.2**	**35.5**	**34.9**	**34.9**	**34.9**
Oil revenue, net 2/	10.7	6.5	5.4	5.6	8.0	7.1	7.1	7.9	7.6	7.6	7.2	7.2	7.2
Nonpetroleum revenue	23.5	25.9	24.3	24.4	25.7	25.2	24.6	26.6	26.2	25.5	25.3	25.3	25.3
Taxes	14.2	15.7	14.0	13.5	14.3	13.1	13.4	14.5	13.7	13.8	13.9	13.9	13.9
Social security contributions 3/	4.6	5.1	4.7	5.2	5.2	5.1	5.6	5.1	5.6	5.6	5.6	5.6	5.6
Other	4.7	5.1	5.5	5.7	6.2	6.9	5.6	7.0	6.9	6.1	5.8	5.8	5.8
Operating surplus of public enterprises	4.1	1.1	0.6	2.0	2.4	2.4	2.4	2.8	2.4	2.4	2.4	2.4	2.4
O/w profits of oil companies withheld for investment	3.9	0.8	0.5	2.0	2.4	2.3	2.3	2.8	2.3	2.4	2.4	2.4	2.4
Expenditure	**43.6**	**39.7**	**38.6**	**36.5**	**37.3**	**35.0**	**35.3**	**34.1**	**35.5**	**33.8**	**33.3**	**33.2**	**33.2**
Primary expenditure	42.6	38.2	37.0	34.4	34.9	32.4	32.7	31.3	32.5	30.9	30.7	30.7	30.7
Current	27.5	26.3	25.1	25.1	28.2	26.3	26.9	25.3	26.3	25.3	25.4	25.4	25.3
Wages and salaries	9.3	10.0	10.0	9.9	9.9	9.7	9.8	9.0	9.5	9.2	9.2	9.2	9.2
Purchases of goods and services	5.2	5.1	4.7	4.8	5.7	4.9	4.9	4.9	4.8	4.5	4.5	4.5	4.5
Social security benefits 3/	3.6	4.3	4.7	4.8	5.0	5.1	5.2	5.1	5.2	5.3	5.3	5.3	5.3
Other	9.3	6.9	5.7	5.5	7.5	6.7	7.0	6.3	6.9	6.3	6.4	6.4	6.3
Cost of imports of oil derivatives	6.0	3.8	2.3	2.8	3.8	3.3	3.7	3.0	3.6	3.4	3.5	3.6	3.5
Payments to private oil companies (SH) 4/	1.6	1.4	1.1	1.3	1.8	1.3	1.4	1.0	1.2	0.8	0.6	0.6	0.6
Other	1.8	1.7	2.2	1.4	1.9	2.1	1.9	2.2	2.1	2.1	2.2	2.2	2.2
Capital	15.1	11.9	11.9	9.3	6.6	6.1	5.7	6.0	6.2	5.6	5.3	5.3	5.3
Fixed capital spending	13.7	10.3	10.3	8.3	6.0	5.3	5.0	5.2	5.5	4.9	4.7	4.7	4.7
O/w investment in oil	4.0	2.8	2.4	1.7	1.6	1.5	1.6	1.5	1.7	1.7	1.6	1.6	1.5
Net-lending	1.4	1.7	1.6	1.0	0.6	0.8	0.7	0.8	0.8	0.7	0.6	0.6	0.6
Primary balance	**-4.2**	**-4.7**	**-6.7**	**-2.3**	**1.3**	**2.3**	**1.5**	**6.0**	**3.7**	**4.6**	**4.2**	**4.2**	**4.3**
Interest	**1.0**	**1.4**	**1.6**	**2.1**	**2.5**	**2.6**	**2.6**	**2.8**	**3.0**	**2.9**	**2.6**	**2.5**	**2.5**
O/w external	0.8	1.2	1.3	1.8	2.1	2.2	2.2	2.5	2.6	2.5	2.3	2.2	2.4
Current balance	**9.9**	**5.8**	**3.7**	**4.8**	**5.4**	**5.8**	**4.6**	**9.2**	**6.9**	**7.3**	**6.9**	**7.0**	**7.1**
Overall balance	**-5.2**	**-6.1**	**-8.2**	**-4.5**	**-1.2**	**-0.3**	**-1.1**	**3.2**	**0.7**	**1.7**	**1.6**	**1.7**	**1.7**
Memorandum items:													
Non-oil primary balance 5/	-7.4	-4.0	-6.7	-4.1	-1.9	-1.0	-1.1	0.9	0.3	0.5	0.4	0.3	0.3
Non-oil primary balance (percent of non-oil GDP)	-8.3	-4.2	-7.0	-4.4	-2.1	-1.1	-1.2	0.9	0.3	0.5	0.4	0.3	0.3
Non-oil PB (incl. fuel subsidies)	-13.5	-5.7	-7.6	-6.1	-4.9	-2.9	-3.4	-1.0	-1.7	-1.0	-1.0	-1.1	-1.2
Cyclically Adjusted Non-oil Primary Balance	-8.0	-4.2	-6.4	-4.1	-2.1	-0.4	-0.7	2.0	1.1	1.3	1.1	0.8	0.6
Cyclically Adjusted Non-oil Primary Balance (incl.fuel subsidies)	-14.1	-5.9	-7.2	-6.1	-5.1	-2.2	-3.0	0.2	-0.9	-0.2	-0.4	-0.6	-0.8
Structural non-oil primary balance	-8.0	-4.0	-5.4	-4.1	-2.5	-1.2	-0.7	1.3	0.0	1.0	1.1	0.8	0.6
Structural non-oil primary balance (including fuel. subsidies)	-14.1	-5.7	-6.3	-6.1	-5.5	-3.0	-3.0	-0.5	-2.0	-0.5	-0.4	-0.6	-0.8
Oil balance 6/	3.1	-0.7	0.1	1.8	3.2	3.4	2.7	5.2	3.4	4.1	3.8	3.8	4.0
Oil balance excluding oil investment	7.1	2.1	2.4	3.5	4.8	4.9	4.3	6.7	5.1	5.8	5.4	5.4	5.5
Public Debt 7/	27.1	33.8	43.2	44.6	46.1	48.4	49.6	47.4	50.1	48.1	44.8	41.5	38.2
Change in social spending, program definition						0.4	0.3	0.0	0.2	0.1	0.0	0.0	0.0

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

1/ First Review under the Extended Fund Facility Arrangement, Requests for Waiver of Nonobservance of Performance Criterion, Modification of Performance Criteria, and Financing Assurances Review (July 3, 2019, CR 19/210).

2/ Net of operational cost.

3/ From 2011 on, includes additional public pension sytems which previously had not been consolidated into the NFPS accounts.

4/ Reflects service contract payments to private oil companies beginning in 2011.

5/ The primary balance less oil balance.

6/ Oil revenue plus profits of state-owned oil companies, which is retained for investment in the oil sector, less oil-related expenditure (the costs of imports of oil derivatives, service payments to private oil companies, and investment in oil).

7/ Gross debt consolidated at the level of the NFPS. Includes the outstanding balance for advance oil sales, treasury certificates, central bank loans, other liabilities and the stock of domestic floating debt. The public debt estimates are preliminary and subject to revisions in accordance with the IMF's Public Sector Debt Statistics: Guide for Compilers and Users (PSDSG).

Table 5. Ecuador: Nonfinancial Public Sector Financing
(Millions of U.S. dollars, unless otherwise indicated)

	2014	2015	2016	Prel. 2017	Est. 2018	Prog. 1/ 2019	Proj. 2019	Prog. 1/ 2020	Projections 2020	2021	2022	2023	2024
Gross financing needs	**11,035**	**14,181**	**19,086**	**17,400**	**9,169**	**8,109**	**8,669**	**2,091**	**5,573**	**3,753**	**4,733**	**4,478**	**4,084**
Nonfinancial public sector deficit	5,314	6,076	8,226	4,653	1,300	292	1,187	-3,502	-744	-1,850	-1,814	-2,035	-2,153
Amortization	5,721	8,105	10,859	12,747	7,868	7,817	7,482	5,592	6,317	5,603	6,547	6,513	6,238
External	3,549	3,985	3,336	4,012	4,871	5,226	4,890	3,755	4,089	3,050	4,573	3,860	5,058
Multilateral	942	560	771	709	685	1,118	785	667	1,040	737	1,258	1,695	1,949
Bilateral	737	636	659	1,322	1,614	1,031	1,008	1,124	1,151	920	990	1,005	924
Private sector and other	35	898	399	845	879	2,124	2,124	1,584	1,783	1,296	2,177	1,160	2,186
Oil related financing	1,848	1,901	1,510	1,136	1,692	952	974	380	114	97	148	0	0
Domestic	2,172	4,120	7,523	8,735	2,998	2,592	2,592	1,838	2,228	2,553	1,974	2,654	1,180
Bonds	1,420	3,168	5,866	3,912	884	932	932	178	468	793	214	994	350
Treasury certificates	752	953	1,657	4,822	2,113	1,660	1,660	1,660	1,760	1,760	1,760	1,660	830
Gross financing sources	**11,035**	**14,181**	**19,086**	**17,475**	**9,169**	**8,109**	**8,669**	**2,091**	**5,573**	**3,753**	**4,733**	**4,478**	**4,084**
External	8,013	7,105	9,430	9,252	7,817	8,404	8,744	3,467	4,830	2,624	2,873	3,448	3,884
Multilateral	1,497	1,933	1,092	943	1,640	4,715	3,446	3,022	3,882	2,624	875	875	875
World Bank	7	115	18	175	236	978	646	644	909	255	100	100	100
Inter-American Development Bank	508	1,321	604	349	485	1,084	784	251	551	281	400	400	400
CAF	355	485	465	415	549	500	509	600	272	600	300	300	300
Other	627	13	5	4	370	750	105	124	747	85	75	75	75
IMF	0	0	0	0	0	1,403	1,403	1,403	1,403	1,403	0	0	0
Bilateral	1,180	957	2,267	658	978	1,017	512	0	305	0	0	0	0
Private sector and other	3,735	1,880	3,946	7,251	4,504	2,227	4,341	0	642	0	1,998	2,573	3,009
Oil related financing	1,600	2,335	2,125	400	695	445	445	445	0	0	0	0	0
Domestic	2,143	5,540	9,233	9,947	2,175	-295	400	-1,376	744	1,129	1,860	1,030	200
Bonds	1,310	2,844	5,853	6,258	403	274	583	0	636	200	200	200	200
Treasury certificates	953	1,657	4,822	2,113	1,660	1,660	1,760	1,660	1,760	1,760	1,660	830	0
Change in deposits (+= drawdown)	-120	1,040	-1,443	-562	-951	-1,899	-1,745	-3,036	-1,394	-831	0	0	0
Privatization and BCE transfers	0	0	0	2,137	0	0	0	0	0	0	0	0	0
Convenios de liquidez	0	0	0	0	564	-330	-198	0	-258	0	0	0	0
Other	0	0	0	0	498	0	0	0	0	0	0	0	0
Net Arrears acumulation and other financing 2/	998	1,503	499	-1,643	-823	0	0	0	0	0	0	0	0
Discrepancy	-118	32	-76	-81			-475						
Financing Gap						**0**	**0**	**0**	**0**	**0**	**0**	**0**	**0**
Exceptional Financing						**1,403**	**1,403**	**1,403**	**1,403**	**1,403**	**0**	**0**	**0**
IMF 3/						1,403	1,403	1,403	1,403	1,403	0	0	0
Net financing	**5,314**	**6,076**	**8,226**	**4,728**	**1,300**	**292**	**1,187**	**-3,502**	**-744**	**-1,850**	**-1,814**	**-2,035**	**-6,038**
External	4,464	3,120	6,093	5,240	2,947	3,179	3,854	-288	740	-426	-1,699	-411	-5,058
Domestic	-29	1,420	1,710	1,212	-823	-2,887	-2,191	-3,214	-1,484	-1,424	-114	-1,624	-980
Net Arrears acumulation and other financing 2/	998	1,503	499	-1,643	-823	0	0	0	0	0	0	0	0
Discrepancy	-118	32	-76	-81	0	0	-475	0	0	0	0	0	0
Public Sector Debt 3/	**27,543**	**33,558**	**43,139**	**46,533**	**49,628**	**52,150**	**53,233**	**51,684**	**54,142**	**53,123**	**51,309**	**49,275**	**47,122**
External	19,046	22,123	28,122	33,376	36,323	39,501	40,176	39,214	40,917	40,490	38,791	38,380	37,206
o.w. oil related financing	1,464	1,898	2,442	1,626	629	123	101	188	-13	-110	-259	-259	-259
Domestic	8,497	11,435	15,018	13,157	13,306	12,648	13,057	12,470	13,225	12,633	12,519	10,895	9,915
Bonds	3,810	3,437	3,461	5,866	5,417	4,760	5,068	4,582	5,237	4,644	4,630	3,837	3,687
Treasury certificates	953	1,657	4,822	2,113	1,660	1,660	1,760	1,660	1,760	1,760	1,660	830	0
Other liabilities	3,735	6,341	6,735	5,178	6,228	6,228	6,228	6,228	6,228	6,228	6,228	6,228	6,228
						(In percent of GDP)							
Gross financing needs	**10.8**	**14.3**	**19.1**	**16.7**	**8.5**	**7.5**	**8.1**	**1.9**	**5.2**	**3.4**	**4.1**	**3.8**	**3.3**
Nonfinancial public sector deficit	5.2	6.1	8.2	4.5	1.2	0.3	1.1	-3.2	-0.7	-1.7	-1.6	-1.7	-1.7
Amortization	5.6	8.2	10.9	12.2	7.3	7.3	7.0	5.1	5.8	5.1	5.7	5.5	5.1
Gross financing sources	**10.8**	**14.3**	**19.1**	**16.8**	**8.5**	**7.5**	**8.1**	**1.9**	**5.2**	**3.4**	**4.1**	**3.8**	**3.3**
External	7.9	7.2	9.4	8.9	7.3	7.8	8.2	3.2	4.5	2.4	2.5	2.9	3.2
Domestic	2.1	5.6	9.2	9.5	2.0	-0.3	0.4	-1.3	0.7	1.0	1.6	0.9	0.2
Arrears acumulation and other financing 2/	1.0	1.5	0.5	-1.6	-0.8	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Public sector debt 3/	**27.1**	**33.8**	**43.2**	**44.6**	**46.1**	**48.4**	**49.6**	**47.4**	**50.1**	**48.1**	**44.8**	**41.5**	**38.2**
External	18.7	22.3	28.1	32.0	33.8	36.7	37.5	36.0	37.9	36.6	33.8	32.3	30.2
Domestic	8.4	11.5	15.0	12.6	12.4	11.7	12.2	11.4	12.2	11.4	10.9	9.2	8.0
Memorandum items:													
Stock of other accounts payable (in millions of U.S. dollars)				876	1,475	1,575	1,170	1,575	1,170	1,170	1,170	1,170	1,170

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

1/ First Review under the Extended Fund Facility Arrangement, Requests for Waiver of Nonobservance of Performance Criterion, Modification of Performance Criteria, and Financing Assurances Review (July 3, 2019, CR 19/210).

2/ Includes domestic floating debt and statistical discrepancy.

3/ Gross debt consolidated at the level of the NFPS. Includes the outstanding balance for advance oil sales, treasury certificates, central bank loans, other liabilities and the stock of domestic floating debt. The public debt estimates are preliminary and subject to revisions in accordance with the IMF's Public Sector Debt Statistics: Guide for Compilers and Users (PSDSG).

Table 6. Ecuador: Balance of Payments

(Millions of U.S. dollars, unless otherwise indicated)

				Prel.	Est.	Prog. 1/	Proj.	Prog. 1/	Projections				
	2014	2015	2016	2017	2018	2019	2019	2020	2020	2021	2022	2023	2024
Current account	**-669**	**-2,221**	**1,321**	**-490**	**-1,487**	**515**	**-876**	**1,491**	**286**	**621**	**771**	**1,163**	**1,418**
Trade balance	-64	-1,650	1,567	312	-263	1,317	395	1,976	1,426	1,463	1,574	1,917	2,154
Exports, f.o.b.	26,597	19,049	17,425	19,618	22,123	22,464	22,189	22,920	22,726	22,839	23,371	24,098	24,884
Oil	13,276	6,660	5,459	6,914	8,802	8,165	8,533	7,922	8,573	8,081	7,976	7,986	8,068
Non-oil	13,321	12,388	11,966	12,705	13,321	14,299	13,657	14,997	14,154	14,758	15,395	16,111	16,816
Imports, f.o.b.	26,660	20,699	15,858	19,307	22,386	21,147	21,794	20,943	21,301	21,376	21,796	22,181	22,731
Oil	6,417	3,950	2,490	3,182	4,341	3,831	4,348	3,828	4,275	4,191	4,256	4,384	4,474
Non-oil	20,243	16,748	13,368	16,125	18,045	17,316	17,446	17,115	17,026	17,186	17,540	17,797	18,257
Services	-1,171	-805	-1,054	-1,103	-711	-562	-643	-462	-540	-496	-490	-474	-466
Credits	2,346	2,391	2,140	2,191	2,540	2,592	2,561	2,697	2,642	2,732	2,832	2,940	3,055
Debits	3,517	3,197	3,194	3,294	3,250	3,154	3,205	3,159	3,182	3,228	3,322	3,413	3,522
Primary income	-1,543	-1,728	-1,846	-2,363	-2,922	-3,112	-3,184	-3,002	-3,262	-3,097	-3,141	-3,188	-3,254
Credits	121	140	164	187	238	387	186	529	185	227	271	286	374
Debits	1,664	1,869	2,010	2,550	3,160	3,499	3,370	3,530	3,446	3,324	3,412	3,474	3,628
Secondary income	2,108	1,963	2,654	2,665	2,409	2,873	2,557	2,978	2,661	2,751	2,827	2,908	2,984
Of which: workers' remittances, net	2,277	2,100	2,314	2,483	2,578	2,687	2,370	2,790	2,474	2,559	2,628	2,701	2,770
Capital account	**67**	**-69**	**-814**	**69**	**-193**	**71**	**71**	**71**	**71**	**71**	**73**	**76**	**78**
Financial account	**-402**	**-766**	**-800**	**1,424**	**-1,745**	**-615**	**-1,591**	**-605**	**171**	**405**	**404**	**131**	**514**
Direct investment	-772	-1,323	-769	-619	-1,408	-1,221	-973	-1,244	-1,154	-1,362	-1,372	-1,421	-1,452
Other public sector flows	-4,464	-3,120	-6,093	-5,240	-2,947	-1,776	-2,451	1,691	663	1,829	1,699	411	1,174
Disbursements	-8,013	-7,105	-9,430	-9,252	-7,817	-7,001	-7,341	-2,064	-3,426	-1,221	-2,873	-3,448	-3,884
Amortizations	3,549	3,985	3,336	4,012	4,871	5,226	4,890	3,755	4,089	3,050	4,573	3,860	5,058
Other private sector flows	4,834	3,676	6,062	7,283	2,609	2,382	1,832	-1,051	662	-62	76	1,141	792
Portfolio investment	2,235	407	1,745	761	1,903	1,868	882	-327	715	-42	17	-110	251
Other investment	2,599	3,270	4,317	6,523	706	514	951	-724	-53	-20	59	1,251	541
Of which: Asset monetization							0		-800	-300	0	0	0
Of which: without asset monetization							951		747	280	59	1,251	541
Errors and omissions	**-225**	**35**	**-101**	**-13**	**-158**	**0**	**0**	**0**	**0**	**0**	**0**	**0**	**0**
Overall balance	**-424**	**-1,489**	**1,207**	**-1,858**	**-92**	**1,202**	**786**	**2,167**	**185**	**287**	**439**	**1,107**	**982**
Financing	**425**	**1,488**	**-1,207**	**1,859**	**92**	**-1,202**	**-786**	**-2,167**	**-185**	**-287**	**-439**	**-1,107**	**-982**
Change in GIR (increase, -) 2/	412	1,453	-1,763	1,808	-226	-2,559	-2,143	-3,389	-1,408	-1,554	-439	-1,107	-982
IMF net credit and loans	0	0	365	0	0	1,357	1,357	1,222	1,222	1,267	0	0	0
Net EFF lending to BCE	0	0	0	0	0	0	0	0	0	0	0	0	0
Net lending RFI	0	0	365	0	0	-45	0	-45	-180	-135	0	0	0
Net lending to Treasury	0	0	0	0	0	1,403	1,403	1,403	1,403	1,403	0	0	0
Exceptional financing 3/	13	35	191	51	317	0	0	0	0	0	0	0	0
Memorandum items:													
Current account balance (percent of GDP)	-0.7	-2.2	1.3	-0.5	-1.4	0.5	-0.8	1.4	0.3	0.6	0.7	1.0	1.2
Oil balance (percent of GDP)	6.7	2.7	3.0	3.6	4.1	4.0	3.9	3.8	4.0	3.5	3.2	3.0	2.9
Exports	13.1	6.7	5.5	6.6	8.2	7.6	8.0	7.3	7.9	7.3	7.0	6.7	6.5
Imports	6.3	4.0	2.5	3.1	4.0	3.6	4.1	3.5	4.0	3.8	3.7	3.7	3.6
Non-oil balance (percent of GDP)	-7.4	-5.0	-1.6	-4.0	-5.5	-3.5	-4.7	-2.4	-3.7	-3.0	-2.6	-2.1	-1.8
Goods export volume growth rate (percent)	5.8	-0.3	4.3	-0.3	-0.2	5.4	2.7	2.0	3.9	1.9	2.3	2.5	2.1
Goods import volume growth rate (percent)	4.9	-7.5	-10.5	16.0	4.0	-3.2	0.3	-1.6	-2.3	0.1	1.1	0.5	1.3
Goods terms of trade growth rate (percent)	0.9	-13.4	0.7	7.6	2.0	-1.4	0.3	-0.6	-1.5	-1.5	-0.8	-0.7	-0.1
Oil price Ecuador mix (U.S. dollars per barrel)	84	42	35	46	61	52	56	52	54	51	50	50	51
External debt (percent of GDP)	25.2	29.4	36.6	39.7	41.7	42.8	45.6	44.3	48.5	48.9	46.2	43.7	40.9

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

1/ First Review under the Extended Fund Facility Arrangement, Requests for Waiver of Nonobservance of Performance Criterion, Modification of Performance Criteria, and Financing Assurances Review (July 3, 2019, CR 19/210).

2/ Reflects the national definition of gross international reserves

3/ Includes foreign arrears and net flows from oil funds held abroad and flows associated with debt default and restructuring

Table 7. Ecuador: External Financing
(Millions of U.S. dollars)

				Prel.	Est.	Prog. 1/		Prog. 1/	Projections				
	2014	2015	2016	2017	2018	2019	2019	2020	2020	2021	2022	2023	2024
Gross external financing requirements	**6,835**	**8,799**	**5,095**	**8,202**	**10,232**	**8,726**	**9,993**	**6,427**	**8,270**	**7,010**	**8,308**	**7,129**	**7,973**
Current account financing need	669	2,221	-1,321	490	1,487	-515	876	-1,491	-286	-621	-771	-1,163	-1,418
Public sector amortizations	3,549	3,985	3,336	4,012	4,871	5,226	4,890	3,755	4,089	3,050	4,573	3,860	5,058
Private sector amortizations	2,617	2,593	3,079	3,700	3,875	4,015	4,227	4,163	4,466	4,580	4,506	4,433	4,332
Identified External Financing	**6,411**	**7,311**	**6,301**	**6,344**	**10,142**	**9,928**	**10,779**	**8,594**	**8,455**	**7,297**	**8,747**	**8,236**	**8,955**
Public Sector	8,013	7,105	9,430	9,252	7,820	7,001	7,341	2,064	3,426	1,221	2,873	3,448	3,884
Multilateral	1,497	1,933	1,092	943	1,642	3,312	2,043	1,619	2,479	1,221	875	875	875
Bilateral	1,180	957	2,267	658	978	1,017	512	0	305	0	0	0	0
Oil related financing	1,600	2,335	2,125	400	695	445	445	445	0	0	0	0	0
Private sector	3,735	1,880	3,946	7,251	4,504	2,227	4,341	0	642	0	1,998	2,573	3,009
Private sector	-1,444	240	-2,213	-2,964	2,673	2,855	3,368	6,459	4,958	6,005	5,801	4,712	4,992
Direct investment	772	1,323	769	619	1,408	1,221	973	1,244	1,154	1,362	1,372	1,421	1,452
Portfolio investment Financing	-443	-217	-596	-717	253	327	479	1,043	761	928	886	658	708
Other investment Financing	-1,773	-867	-2,386	-2,866	1,013	1,307	1,916	4,172	3,043	3,714	3,543	2,633	2,832
Net Transfers 2/	-158	-34	-915	56	-351	71	71	71	71	71	73	76	78
Gross external financing sources	**6,424**	**7,346**	**6,858**	**6,395**	**10,460**	**11,285**	**12,136**	**9,816**	**9,678**	**8,564**	**8,747**	**8,236**	**8,955**
Identified External Financing	6,411	7,311	6,301	6,344	10,142	9,928	10,779	8,594	8,455	7,297	8,747	8,236	8,955
Exceptional financing	13	35	191	51	317	0	0	0	0	0	0	0	0
IMF Net Financing	0	0	365	0	0	1,357	1,357	1,222	1,222	1,267	0	0	0
IMF Net EFF Financing	0	0	0	0	0	1,403	1,403	1,403	1,403	1,403	0	0	0
IMF Net RFI Financing	0	0	365	0	0	-45	0	-180	-180	-135	0	0	0
Net international reserves (-, increase) 3/	**412**	**1,453**	**-1,398**	**1,808**	**-226**	**-2,605**	**-2,189**	**-3,570**	**-1,589**	**-1,690**	**-439**	**-1,107**	**-982**
Net international reserves, prog. definition (-, increase) 4/				**1,375**	**-397**	**-3,132**	**-2,969**	**-3,432**	**-2,013**	**-1,542**	**-222**	**-851**	**-686**
Gross international reserves (-, increase) 5/	**412**	**1,453**	**-1,763**	**1,808**	**-226**	**-2,559**	**-2,143**	**-3,389**	**-1,408**	**-1,554**	**-439**	**-1,107**	**-982**
Financing Gap 6/	**13**	**35**	**556**	**51**	**317**	**1,357**	**1,357**	**1,222**	**1,222**	**1,267**	**0**	**0**	**0**
o/w closed by IMF Net Lending	0	0	365	0	0	1,357	1,357	1,222	1,222	1,267	0	0	0

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

1/ First Review under the Extended Fund Facility Arrangement, Requests for Waiver of Nonobservance of Performance Criterion, Modification of Performance Criteria, and Financing Assurances Review (July 3, 2019, CR 19/210).

2/ Net transfers is defined as capital account flows plus unidentified flows (errors and omissions)

3/ Changes in NIR are defined as changes in GIR minus IMF net lending excluding direct budget support.

4/ Program net international reserves is equal to gross international reserves less outstanding credit to the IMF (excl. budget support), short-term foreign liabilities of the BCE, deposits of other depository institutions and other financial institutions (excl. BIESS) at the central bank, and short-term liabilities of the central government.

5/ Reflects the national definition of gross international reserves

6/ Financing gap is the difference between total external financing sources and identified external financing

Table 8. Ecuador: Monetary Survey

(Millions of U.S. dollars, unless otherwise indicated)

					Est.	Prog. 1/	Proj.	Prog. 1/					
	2014	2015	2016	2017	2018	2019	2019	2020	2020	2021	2022	2023	2024
I. Central Bank													
Net foreign assets	**4,536**	**2,964**	**4,435**	**3,584**	**3,902**	**6,500**	**6,063**	**9,444**	**7,009**	**8,725**	**9,207**	**10,357**	**11,385**
Of which: gross international reserves 2/	3,762	2,351	4,216	2,006	2,158	4,679	4,215	8,446	6,022	7,576	8,016	9,123	10,105
Net domestic assets	**-865**	**306**	**1,806**	**1,964**	**1,108**	**-1,766**	**-1,687**	**-4,188**	**-2,558**	**-4,105**	**-4,337**	**-5,194**	**-5,884**
Credit to the nonfinancial public sector, net	-2,752	-1,381	310	-1,248	-2,086	-4,433	-4,205	-6,814	-5,108	-6,297	-6,268	-7,014	-6,975
Of which: central government, net	103	718	2,999	2,057	1,398	-1,210	-730	-3,553	-1,609	-2,715	-2,554	-3,166	-2,990
credits	889	1,302	4,298	3,027	3,035	2,930	2,927	3,580	3,577	3,200	3,200	2,421	2,421
debits	786	584	1,299	970	1,637	4,140	3,657	7,133	5,186	5,915	5,754	5,587	5,410
Credit to financial institutions	2,544	2,179	2,200	4,448	4,531	4,454	4,237	4,412	4,352	3,994	3,732	3,621	2,891
Other depository institutions	531	433	454	933	1,006	985	981	985	1,020	974	882	790	790
Other financial institutions	2,013	1,747	1,746	3,515	3,524	3,469	3,256	3,428	3,332	3,020	2,850	2,831	2,101
Credit to the private sector	26	27	24	20	17	16	9	16	9	9	10	10	10
Other, net	-684	-520	-728	-1,258	-1,353	-1,803	-1,728	-1,803	-1,811	-1,811	-1,811	-1,811	-1,811
Liabilities	**3,671**	**3,270**	**6,241**	**5,548**	**5,011**	**4,734**	**4,376**	**5,256**	**4,451**	**4,620**	**4,869**	**5,163**	**5,501**
Currency and electronic money	87	87	92	94	84	81	80	82	81	82	86	89	92
Banks' reserves	3,506	3,053	6,044	5,244	4,859	4,584	4,226	5,106	4,301	4,468	4,714	5,004	5,340
Other depository institutions 3/	2,697	1,927	4,825	3,904	3,172	2,941	2,933	3,444	3,048	3,166	3,341	3,546	3,784
Other financial institutions 4/	809	1,126	1,219	1,340	1,688	1,643	1,293	1,662	1,253	1,302	1,373	1,458	1,556
Other 5/	78	130	105	209	68	69	70	69	70	70	70	70	70
II. Other Depository Institutions (ODI) and Other Financial Institutions (OFI) 3/ 6/													
Net foreign assets	**5,891**	**5,391**	**5,826**	**5,633**	**4,965**	**5,063**	**4,173**	**4,539**	**3,879**	**3,974**	**4,125**	**4,276**	**4,440**
Net domestic assets	**24,580**	**22,392**	**26,968**	**30,166**	**32,666**	**33,848**	**35,455**	**36,311**	**37,301**	**38,806**	**41,011**	**43,639**	**46,687**
Assets held at the BCE, net	913	450	3,346	2,400	1,757	1,823	2,005	2,325	2,120	2,285	2,551	2,849	3,086
Credit to the nonfinancial public sector, net	1,612	1,379	1,972	1,959	1,107	767	832	627	692	326	326	326	246
Of which: central government, net	1,830	1,448	2,053	2,073	1,284	944	1,009	804	869	502	502	502	422
Credit to the private sector	29,131	28,141	29,886	34,785	39,980	42,898	44,244	45,736	46,749	48,893	51,486	54,570	58,324
Other items, net	-7,075	-7,579	-8,236	-8,977	-10,179	-11,640	-11,626	-12,378	-12,259	-12,698	-13,352	-14,106	-14,970
Liabilities	**30,471**	**27,782**	**32,794**	**35,799**	**37,631**	**38,910**	**39,629**	**40,850**	**41,181**	**42,779**	**45,136**	**47,915**	**51,126**
Of which: Private sector deposits	30,415	27,782	32,794	35,799	37,631	38,910	39,629	40,850	41,181	42,779	45,136	47,915	51,126
III. Consolidated Banking System													
Net foreign assets	**10,426**	**8,355**	**10,261**	**9,218**	**8,867**	**11,563**	**10,236**	**13,984**	**10,888**	**12,699**	**13,331**	**14,633**	**15,825**
Net domestic assets	**18,593**	**18,856**	**22,730**	**26,885**	**28,915**	**27,497**	**29,542**	**27,017**	**30,443**	**30,233**	**31,960**	**33,441**	**35,463**
Credit to the nonfinancial public sector, net	-1,140	-3	2,282	711	-979	-3,666	-3,373	-6,187	-4,416	-5,971	-5,942	-6,688	-6,728
Credit to the private sector	29,157	28,169	29,910	34,805	39,998	42,914	44,253	45,753	46,758	48,902	51,495	54,580	58,335
Other items, net	-9,424	-9,310	-9,462	-8,631	-10,104	-11,751	-11,337	-12,549	-11,899	-12,698	-13,593	-14,451	-16,143
Liabilities	**29,019**	**27,211**	**32,991**	**36,103**	**37,782**	**39,060**	**39,779**	**41,001**	**41,331**	**42,932**	**45,291**	**48,074**	**51,288**
Memorandum items:													
Credit to the private sector (percent change, yoy) 7/	8.7	-3.4	6.2	16.4	14.9	7.3	10.6	6.6	5.7	4.6	5.3	6.0	6.9
Deposits of the private sector (percent change, yoy) 7/	10.4	-8.6	18.0	9.3	5.0	3.4	5.3	5.0	3.9	3.9	5.5	6.2	6.7
Credit to the nonfinancial public sector (percent change, yoy) 7/	64.9	-1.5	110.2	-17.0	-10.6	-8.9	-7.4	10.8	10.7	-14.1	0.0	-17.2	-2.1
Deposits of the nonfinancial public sector (percent change, yoy) 7/	5.1	-26.4	41.1	8.2	21.3	36.0	32.2	36.3	19.1	8.4	-0.3	-0.3	-0.4
Broad money (M2) (percent change, yoy)	14.4	-1.1	16.5	10.0	5.7	2.3	3.7	3.9	3.0	3.5	5.0	5.4	5.9
Broad money velocity	2.5	2.5	2.2	2.1	2.0	1.8	1.8	1.7	1.7	1.7	1.6	1.5	1.4
ODI and OFI's reserves at the central bank as a share of liabilities (percent) 3/ 4/	11.5	11.0	18.4	14.6	12.9	11.8	10.7	12.5	10.4	10.4	10.4	10.4	10.4
Credit to the private sector (percent of GDP)	28.7	28.4	29.9	33.4	37.2	39.8	41.3	42.0	43.3	44.2	44.9	46.0	47.3
Liabilities (percent of GDP)	28.5	27.4	33.0	34.6	35.1	36.2	37.1	37.6	38.3	38.8	39.5	40.5	41.6

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

1/ First Review under the Extended Fund Facility Arrangement, Requests for Waiver of Nonobservance of Performance Criterion, Modification of Performance Criteria, and Financing Assurances Review (July 3, 2019, CR 19/210).

2/ Excludes non-liquid and encumbered reserves included in the authorities' definition of GIR

3/ ODI include private banks, *Banecuador* (formerly *Banco Nacional de Fomento)*, *Banco del Pacifico*, private financial companies, mutualists, cooperatives, and credit card companies.

4/ Reserves of OFIs includes deposits of *Corporación Financiera Nacional,* COSEDE, BIESS, and a transitory account for the payments system.

5/ Includes monetary deposits, *Titulos del Banco Central de Ecuador*, stabilization bonds, and accounts payable.

6/ OFI comprise Corporación Financiera Nacional and *Banco Ecuatoriano de Vivienda*.

7/ Consolidated banking system.

Table 9. Ecuador: Financial Soundness Indicators 1/

	2005	2010	2011	2012	2013	2014	2015	2016	2017	2018	Q1 2019	Q2 2019	Q3 2019
	(In percent, unless otherwise indicated; end-of-period values)												
Capital Adequacy													
Regulatory capital to risk-weighted assets (CAR)	13.8	12.4	13.0	12.8	11.9	12.7	14.4	13.9	13.7	13.4	13.8	13.3	13.4
Asset Quality and Distribution													
Nonperforming loans to gross loans	2.9	2.2	2.2	2.8	2.6	2.9	3.7	3.5	3.0	2.6	3.1	3.0	3.0
Provisions to nonperforming loans	222.8	252.1	263.9	235.7	242.0	221.7	187.1	189.5	234.4	247.7	206.2	223.6	212.5
Gross loans to assets	87.0	87.6	89.3	86.0	84.2	86.2	86.2	80.0	84.4	86.0	88.6	88.0	88.2
Earnings and Profitability													
Return on average assets (ROA)	1.2	1.3	1.7	1.1	0.9	1.0	0.9	0.6	1.0	1.4	1.3	1.4	1.5
Return on average equity (ROE)	13.2	14.3	18.9	12.8	10.1	12.0	9.0	6.7	10.4	13.6	12.0	13.0	13.7
Interest margin to assets	1.0	1.2	1.4	0.9	0.8	1.0	0.8	0.4	0.9	1.6	1.5	1.5	1.6
Noninterest expenses to spread	85.0	82.1	79.7	86.3	86.8	84.3	87.4	92.6	85.0	76.9	77.4	76.9	76.6
Liquidity													
Liquid assets to short-term liabilities	35.2	32.4	28.7	30.5	30.7	26.0	29.6	33.9	29.4	27.9	23.2	25.2	24.1
Deposit to loan ratio	148.4	142.4	136.1	138.4	140.6	136.5	126.1	137.0	121.9	111.8	111.4	108.4	106.5

Source: Superintendency of Banks.

1/ Values refer to private banks and *Banco del Pacifico* .

Table 10. Ecuador: Indicators of Fund Credit 2019–2028

(Units as indicated)

	Prog. 1/ 2019	Proj. 2019	Prog. 1/ 2020	Projections 2020	2021	2022	2023	2024	2025	2026	2027	2028
Existing and prospective Fund arrangements						**(millions of SDRs)**						
Disbursements 2/	1,011	1,011	1,011	1,011	1,011	0	0	0	0	0	0	0
Stock of existing and prospective Fund credit	1,241	1,241	2,121	2,121	3,035	3,035	2,981	2,770	2,391	1,885	1,379	873
Obligations	47	53	174	168	168	90	145	304	471	577	553	532
Principal	33	33	131	131	98	0	54	211	379	506	506	506
Charges/interest	14	20	43	37	70	90	91	94	92	72	47	26
Obligations, relative to key variables						**(percent)**						
Quota	6.7	7.5	24.9	24.1	24.1	12.9	20.8	43.6	67.5	82.8	79.3	76.2
Gross domestic product	0.1	0.1	0.2	0.2	0.2	0.1	0.2	0.3	0.5	0.6	0.6	0.5
Gross international reserves 3/	1.4	1.7	2.9	3.8	3.1	1.6	2.2	4.1	5.9	6.9	6.5	6.1
Exports of goods and services	0.3	0.3	0.9	0.9	0.9	0.5	0.7	1.5	2.2	2.7	2.5	2.4
Revenues of the NFPS	0.2	0.2	0.6	0.6	0.6	0.3	0.5	1.0	1.5	1.7	1.6	1.5
External debt service	0.4	0.5	1.6	1.8	2.0	1.0	1.7	3.2	6.6	8.2	6.6	7.1
Fund credit outstanding, relative to key variables						**(percent)**						
Quota	177.8	177.8	304.1	304.1	435.0	435.0	427.2	397.0	342.7	270.1	197.6	125.1
Gross domestic product	1.6	1.6	2.7	2.7	3.8	3.6	3.5	3.1	2.6	2.0	1.4	0.8
Gross international reserves	36.8	40.5	34.8	48.5	55.2	52.1	45.0	37.8	29.8	22.6	16.2	10.0
External debt	3.7	3.7	6.1	5.6	7.7	7.9	7.9	7.6	6.8	5.4	4.1	2.7
Memorandum items:												
Exports of goods and services (US$m)	25,055	24,751	25,617	25,369	25,571	26,202	27,037	27,940	28,918	29,540	30,176	30,825
External debt service (US$m)	15,641	13,333	14,848	12,738	11,615	12,768	11,717	12,900	9,795	9,724	11,480	10,284
External debt (US$m)	46,039	46,039	48,348	52,418	54,112	53,005	51,919	50,425	48,740	47,976	46,157	44,292
Quota (SDRm)	697.7	697.7	697.7	697.7	697.7	697.7	697.7	697.7	697.7	697.7	697.7	697.7
NIR, program definition (US$m)	237	74	3,668	2,087	3,629	3,851	4,701	5,388	5,517	5,682	5,635	5,586
Gross international reserves (US$m)	4,679	4,215	8,446	6,022	7,576	8,016	9,123	10,105	11,036	11,490	11,760	12,061
Gross international reserves (% ARA metric)	26	23	46	31	39	41	46	50	55	56	57	58
Underlying reserves (US$m)	-1,159	-1,319	879	-699	-551	-329	596	1,573	2,224	3,086	3,735	4,383
Nominal GDP (US$m)	107,778	107,270	109,020	107,991	110,554	114,653	118,758	123,203	127,837	132,495	137,322	142,326
SDRs per U.S. dollar	0.7	0.7	0.7	0.7	0.7	0.7	0.7	0.7	0.7	0.7	0.7	0.7

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

1/ First Review under the Extended Fund Facility Arrangement, Requests for Waiver of Nonobservance of Performance Criterion, Modification of Performance Criteria, and Financing Assurances Review (July 3, 2019, CR 19/210).

2/ An RFI of 37.5% of quota disbursed in 2016; an EFF of 435% of quota disbursed beginning March 2019.

3/ GIR excludes non-liquid and encumbered items included in the authorities' measure of GIR.

Table 11. Ecuador: Access and Phasing Under the Extended Fund Arrangements

Review	Availability Date 2/	Action	SDR million	US$ million	Percent of quota 1/	
					Disbursement	Cumulative
	March 11, 2019	Board approval of EFF	469.70	651.47	67.32	67.32
First Review	June 15, 2019	Observance of continuous and end-March 2019 performance criteria, completion of first review	180.65	250.14	25.89	93.21
Second Review	September 15, 2019	Observance of continuous and end-June 2019 performance criteria, completion of second review	180.65	249.06	25.89	119.11
Third Review	December 15, 2019	Observance of continuous and end-September 2019 performance criteria, completion of third review	180.65	249.06	25.89	145.00
Fourth Review	March 15, 2020	Observance of continuous and end-December 2019 performance criteria, completion of fourth review	252.92	348.69	36.25	181.25
Fifth Review	June 15, 2020	Observance of continuous and end-March 2020 performance criteria, completion of fifth review	252.92	348.69	36.25	217.50
Sixth Review	September 15, 2020	Observance of continuous and end-June 2020 performance criteria, completion of sixth review	252.92	348.69	36.25	253.75
Seventh Review	December 15, 2020	Observance of continuous and end-September 2020 performance criteria, completion of seventh review	252.92	348.69	36.25	290.00
Eighth Review	March 15, 2021	Observance of continuous and end-December 2020 performance criteria, completion of eighth review	252.92	348.69	36.25	326.25
Ninth Review	June 15, 2021	Observance of continuous and end-March 2021 performance criteria, completion of ninth review	252.92	348.69	36.25	362.50
Tenth Review	September 15, 2021	Observance of continuous and end-June 2021 performance criteria, completion of tenth review	252.92	348.69	36.25	398.75
Eleventh Review	December 15, 2021	Observance of continuous and end-September 2021 performance criteria, completion of eleventh review	252.91	348.68	36.25	435.00
Total			**3035.0**	**4189.3**	**435.0**	

Source: IMF staff estimates

1/ Ecuador's quota is SDR 697.7 million.

2/ The Board date for the first review was June 28, 2019.

Annex I. Explaining the Program Target on Net International Reserves

One of the main objectives of the authorities' Fund-supported program is to increase reserve buffers, which have been depleted significantly in recent years. The program condition on net international reserves is designed to target only what is within the authorities' control. Given Ecuador's status as a dollarized economy with no monetary policy, this implies a target which is essentially a fiscal one and which is strongly correlated with the build-up of deposits of the non-financial public sector at the central bank.

One of the goals of the Extended Fund Facility is to increase reserve buffers. Ecuador is a dollarized economy and does not need international reserves to defend its currency. Nevertheless, liquidity buffers in foreign currency may still be needed to fund the domestic financial sector or the public sector in cases of unexpected fluctuations in government revenue or spending (e.g. due to natural disasters), or if external financial support is not available. Moreover, as an oil exporter, Ecuador may need to hold larger liquidity buffers than more diversified economies, because of the greater volatility of foreign currency flows. Reserve accumulation is more constrained in dollarized economies than in countries with their own currencies, as the central bank cannot print money to exchange for foreign currency.

While the ultimate objective is an accumulation of gross reserves (GIR), the measure of reserves used in program conditionality is designed to target only what is reasonably within the authorities' control, namely, net international reserves (NIR). NIR is defined as reserve assets minus reserve liabilities, the latter constituting foreign exchange liabilities to both residents and non-residents which could potentially drain reserves.[1] Since Ecuador is a dollarized economy, 100 percent of central bank liabilities are in foreign exchange, which makes it somewhat of a special case. Thus, all liabilities to the domestic banking system are excluded from the calculation of NIR target, as are short-term foreign liabilities, and central bank liabilities to the IMF (see Selected Indicators text table for a decomposition of NIR).[2] During this first review, the definition of NIR was modified to exclude additional liabilities that, although mostly managed by the public sector, belong to the private sector. These include the deposits of the public entity which manages the resources of the deposit insurance fund and the bank liquidity fund (COSEDE), as well as deposits in transitory payments systems accounts. This has brought NIR closer to a target on accumulation of government deposits. NIR has persistently fallen into negative territory since 2015, a sign that foreign exchange liabilities are not fully backed by reserves.

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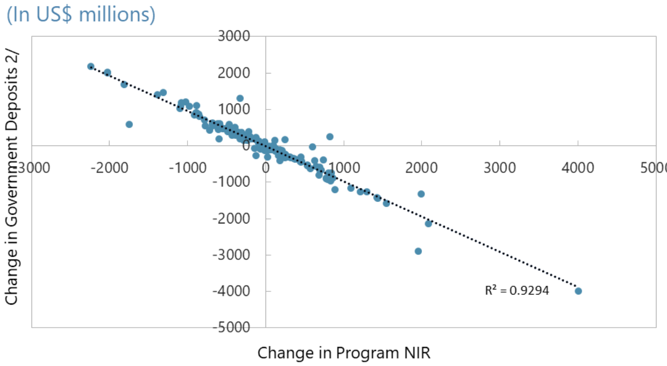
[1] See the Technical Memorandum of Understanding for a more detailed definition of NIR.

[2] NIR targets have not typically been used in other IMF programs with dollarized/euroized economies. The Ecuador program in 2003, for example, had a target on government deposits, as did the recent programs with Kosovo. However, in the current case of Ecuador, given the recent history of monetary financing and the large stock of credit to the public sector on the balance sheet of the central bank, it was thought prudent to target NIR.

The NIR target is therefore designed to build reserves through an accumulation of government deposits as well as gradual winding down of credit to the public sector. As an accounting relationship, NIR is closely aligned with government deposits at the central bank. The expansion of the central bank's domestic assets through direct and indirect financing of the government caused this relationship to break down starting around the end of 2008 (see charts below). However, abstracting from credit to government, movements in NIR have been very closely correlated with movements in government deposits.[3]

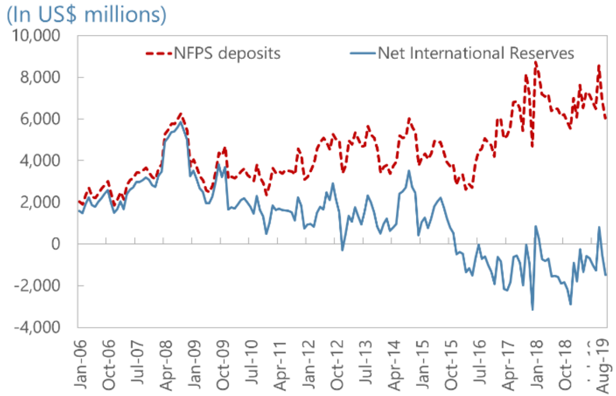
What about gross reserves? While the NIR target is designed to be achieved through government saving, it is envisaged that GIR accumulation will occur because of an improvement in the current account balance over the course of the program as well as higher net capital inflows from the private sector.

Ecuador: Change in Net Government Deposits and Program NIR 1/
(In US$ millions)



Sources: Central Bank of Ecuador and IMF staff calculations.
1/ Month-over-month change.
2/ Net of change in credit to the government.

Ecuador: NIR and Government Deposits
(In US$ millions)



Sources: Central Bank of Ecuador and IMF staff calculations.

[3] Weekly movements in the new measure of NIR are more closely correlated with movements in NFPS deposits compared with the current definition (0.98 versus 0.91).

Annex II. Tax Reform in Ecuador

Tax revenues in Ecuador are low compared to regional peers while the current tax regime discourages investments. A comprehensive tax reform could increase revenues equitably and efficiently, simplify the regime and reduce the administrative and tax burden on investment. The revised tax reform submitted to the National Assembly in November is an important step towards making the tax system more efficient, simple, and growth-friendly.

Tax revenues in Ecuador are relatively low due to low tax rates, a relatively small base, high personal allowances, complexity, and weak enforcement. Non-oil tax revenues reached 13.5 percent of GDP in 2017, compared to an average of 18.4 percent in South American countries. VAT is the main tax, accounting for 5.7 percent of GDP in 2017. However, at 12 percent, the VAT rate in Ecuador is more than 5 percentage points below the average rate in South America and 3 percentage points below the average rate of Latin America and the Caribbean. Revenue loss from VAT exemptions is relatively low by regional standards (only on basic food and services). Personal income tax collection amounted to only 1 percent of GDP in 2017, compared to 1.8 percent for South American countries. This is the result of: (i) a high personal allowance of US$11,290 (or 1.8-times GDP per capita); (ii) low progressivity—a very high income is needed to reach the highest tax bracket (only individuals with income above 11 times GDP per capita are subject to the maximum rate); and (iii) high deductions—taxpayers can deduct personal expenses from their taxable income. Tax revenues from other goods and services reached 1.4 percent of GPD in 2017, compared to an average of 3.6 percent of GDP in South American countries. This is explained by the fact that Ecuador does not impose excises on oil derivatives and excise revenues from cigarettes are low due to smuggling. Furthermore, tax enforcement is weak compared to other countries in the region.

The current tax regime discourages investments. Corporate taxes are among the highest in Latin America. While the corporate income tax rate of 25 percent is below the regional average of 27.5 percent, at 10 percent, the rate of personal income tax on dividends is higher than 6.5 percent on average in the region, and businesses are subject to a mandatory profit-sharing arrangement with the workers of 15 percent, which is equivalent to an additional tax burden. At 42.6 percent, a combined corporate tax burden in Ecuador by far exceeds the regional average of 31.6 percent. Furthermore, capital goods and raw materials imports are subject to taxes on transfers abroad and import tariffs.

Staff recommended several reform options to make the tax system more efficient, simple, and growth-friendly:

- *Increase in the VAT rate.* VAT is a growth-friendly tax that does not discourage investment and does not distort the relative prices. Unlike income taxes, a well-designed VAT does not distort the decisions of companies on the forms and methods of doing business. In fact, the VAT rate for final consumers is the same, irrespective of whether the product is made: (i) in the corporate or non-corporate sector; (ii) with capital-intensive or labor-intensive technology, (iii) by integrated or specialized firms. Empirical studies confirm the economic advantages of the VAT.[1] of all the major taxes besides property taxes, the VAT appears to be the least harmful in terms of economic growth. Given that the VAT rate in Ecuador (12 percent) is significantly lower that the regional average (15.5 percent), an increase in the VAT rate by 3 percentage points would put Ecuador at part with its neighbors while generating 1.25 percent of GDP in permanent revenue. The increase in the VAT rate will not have a significant impact on the poor. About 78 percent of the consumption basket of the poor is exempt from the VAT and more than 50 percent of the consumption of the poor comes from the informal markets. Staff analysis suggests that a 3 percentage points increase in the VAT rate in Ecuador will raise the amount paid in VAT by the poor by only 1 percent of their consumption. The estimated cost of a 3-percentage point increase in the VAT rate to the people in the lowest 30 percent of income distribution comprise only 0.1 percent of GDP. Hence, the increase in social spending of this magnitude could compensate those affected by the VAT increase provided that the coverage of the existing social assistance programs is improved.

- *Other taxes on consumption*; There is scope to increase other consumption taxes by (i) introducing or increasing excises on beer, e-cigarettes, sugary drinks, plastic bags, and vehicles; (ii) increasing green taxes on vehicles and on disposable bottles; (iii) eliminating the VAT tax credit for the acquisition of goods and services not related to the core business; and (iv) introducing a tax on electronic commerce. Some of these taxes e.g. on e-cigarettes and sugary drinks are not only aimed at revenue collection increase but also at discouraging harmful activities.

- *Taxes on personal income*. The reform could modify the PIT brackets for high-income earners with the goal of increasing progressivity of the PIT, reduce personal allowances and deductions.

- *Taxes on capital*. Key permanent measures could include: (i) applying income tax to dividends paid to non-residents with the aim of harmonizing the treatment with dividends paid to residents; (ii) introducing a tax on small businesses of 2 percent of income to equalize the tax burden among taxpayers and to facilitate transition to formalization; and (iii) reducing the rate of the tax on transfers abroad (ISD). This measure implies a lower cost of imports of capital and intermediate goods and was expected to boost investments and promote growth.

- *Measures to simplify and modernize the tax system*. Reducing the number of withholding agents from about 102,000 to 2,000 and eliminating the reduced CIT rate and several administrative regulations could go a long way in simplifying the tax system. Measures to avoid base erosion and profits shifting (by preventing thin capitalization and adopting a new definition of tax heavens) could also help modernize the tax system.

The tax reform submitted in October included measures aimed at making the tax system more growth-friendly, improving revenue mobilization, simplifying the tax regime, increasing

[1] Arnold, J. 2008; Arnold et al., 2011; and Acosta-Ormaechea, S., and Y. Yoo. 2012.

efficiency of the tax system, and reducing preferential treatments. It contained the following measures (text table): (i) introduction or modification to excise taxes on drinks, telecommunications, vehicles and other products; (ii) harmonization of the income tax on dividends paid to non-residents; (iii) introduction of a tax on small businesses; (iv) elimination of tax credit for CIT and a reduction in ISD rate on imports of raw materials and capital goods to 2.5 percent[2]; (v) elimination of some tax exemptions; (vi) introduction of measures to simplify the tax system by reducing the number of withholding agents from about 102,000 to 2,000; (vii) introduction of a general anti-avoidance rule, and (viii) introduction of measures to avoid base erosion and profit shifting (BEPS). The package aimed at increasing productivity and job creation (economic reactivation measures) included reduction in imports' tariffs and facilitation of tax payments procedures for exporters. These measures do not require legislative approval and, therefore, were not included as part of the tax reform. However, the reform did not include an increase in the VAT rate.

The revised tax reform approved by the National Assembly in December is expected to generate a gross yield of only 0.6 percent of GDP in 2020 and in 2021. The net yield of 0.5 percent of GDP in 2020 and 2021 is, however, only somewhat lower than in the law submitted in October (by 0.2 percentage points of GDP in 2020 and 0.1 percentage points of GDP in 2021) since the authorities also adjusted the proposed *economic reactivation package* to boost the net yield. Among the tax measures that have been excluded in the revised tax law are (i) elimination of tax credit for CIT and a reduction in ISD rate on imports of raw materials and capital goods to 2.5 percent; (ii) elimination of tax exemption for property tax for the disposal of property, (iii) introduction of a general anti-avoidance rule, and (vi) reduction in tax penalties for the repatriation of profits held abroad (text table). The reform has been approved on December 9.[3]

Alongside the tax reform, the authorities are planning to introduce an additional package with fiscal measures aimed at supporting growth. The package of economic reactivation measures is designed to increase productivity and job creation and support export-oriented SMEs. It consists of reduction in import tariffs for investment in industrial, construction, and agricultural sectors as well as automatic drawback mechanism for exports. The measures envisaged in the October package were expected to subtract revenues of about 0.3 percent of GDP in 2020 while the revised package contains measures totaling only 0.1 percent of GDP.

[2] The ISD is both a capital flow management measure (CFM) under the Institutional View and an exchange restriction subject to Fund approval under Article VIII. The easing of the measure is consistent with previous staff advice (see 2019 staff report for Ecuador's First Review Under the EFF).

[3] Further to this, reforms in the Tax Procedures Code are also needed as well to secure the collection of the projected yield from the tax reform; staff will discuss this with the authorities in the near future.

Ecuador: Comparison of Tax Indicators, 2017

	Ecuador	Commodity producers 1/	South America	Latin America	OECD
Tax Revenue (% of GDP)	**13.6**	**16.0**	**18.4**	**16.6**	**25.2**
Income Taxes	4.0	6.7	5.6	5.4	11.7
Personal Income Tax	1.0	2.6	1.8	1.8	8.6
Corporate Income Tax	3.0	4.1	3.8	3.6	3.0
VAT	6.1	6.2	7.0	6.1	6.7
Other Goods and Services	1.4	2.1	3.6	1.8	1.8
Property Tax	0.1	0.4	0.4	0.3	1.4
Other Taxes	2.0	0.6	1.9	3.0	1.1
Social Security Contributions	**5.2**	**1.9**	**4.9**	**4.3**	**9.1**
Tax Revenue and Contributions	**18.8**	**17.9**	**23.3**	**20.9**	**34.3**
VTA Tax Rate	12.0	17.0	17.1	15.5	19.1
VAT Non-Compliance		26.9	29.2	30.0	12.2
Tax Expenditure (% of GDP)	4.7	2.8	3.5	4.0	
Tax Expenditure (% of Total Tax Collection)	34.5	16.5	19.6	24.9	
Income Tax Rate, Top Bracket	35.0	33.3	30.2	27.7	37.4
Income Tax Rate, Bottom Bracket	5.0	4.6	8.3	9.3	11.0
Corporate Income Tax, General Rate	25.0	27.4	26.7	27.5	22.6
Corporate Income Tax and Dividends Rate	32.5	30.0	29.4	31.6	

Sources: WEO, OECD, IBFD, and country tax laws.

1/ Commodity producers include: Mexico, Chile, and Peru which have a pension savings account.

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Annex III. Debt Sustainability Analysis

Under the baseline projection, Ecuador's public debt is on a sustainable path, thanks to the envisaged fiscal consolidation. Debt is expected to peak in 2020 at around 50 percent of GDP and decline to below 40 percent of GDP by 2024. Gross financing needs are estimated at 8.1 percent of GDP in 2019 but are expected to decline to 5.2 percent of GDP in 2020 and further to 2.7 percent of GDP in the medium term. The debt profile is particularly vulnerable to unexpected and large terms of trade shocks and a sharp deceleration in growth though debt remains sustainable even under the stress scenarios.

Definition and debt profile. Public-sector debt includes the obligations of the non-financial public sector (central government and non-financial sector state-owned enterprises), as reported by the authorities, as well as liabilities under oil related financing, treasury certificates, central bank lending to the government, and other liabilities. Under this measure, public debt more than doubled between 2012 and 2018 (from 17.5 to 46.1 percent of GDP).

Macroeconomic and fiscal assumptions. Growth is projected at about 2.5 percent and inflation (GDP deflator) at about 1 percent over the medium term. The fiscal position is projected to improve to reach a primary surplus of about 5 percent of GDP by 2021 and stay broadly at that level over the medium term. Over the medium-term, the interest rate for private external borrowing is forecasted to converge to about 8 percent from the average of 9,4 in 2019 as a result of the full implementation of the proposed fiscal consolidation. Under these assumptions, the gross financing needs of the public sector are projected to fall from about 8.5 percent in 2018 to 5.2 percent of GDP in 2020 and to 2.7 percent of GDP in the medium term. The public-debt-to GDP ratio is projected to peak in 2020 at 50.4 percent of GDP, and slowly decline to 38.6 percent by 2024.

Stress tests. The fiscal consolidation path would reduce gross financing needs risks significantly in the short- and medium-term. As a result, gross financing needs do not breach the low-risk threshold of 15 percent of GDP in the baseline scenario nor under any of the stress-tests scenarios. The gradual phasing-out of treasury certificates (CETES) over the medium term would also reduce gross financing needs a source of risks going forward. The public-debt-to GDP ratio is below the critical threshold for emerging economies of 70 percent of GDP in the baseline and in the stress-tests scenarios but is particularly sensitive to a real GDP growth shock, an oil shock or a combined shock. In case of a real GDP growth shock, debt would reach 55.8 percent of GDP in 2021, while in the case of a combined macro-fiscal shock debt would increase to 56.4 percent of GDP in the same year. In both cases, debt is expected to gradually decline over the medium-term. A terms of trade shock -like the oil shock experienced in 2014–15 - could pose concerns to sustainability as debt would reach almost 62.5 percent of GDP at the end of 2022. However, as in the previous cases, it would gradually decline reaching 58.8 percent in 2024. Debt is expected to decline gradually and not differ significantly from the medium-term level in the baseline scenario even in the event that spreads will remain at the 2019 average level for a prolonged period of time. This is owning to the fact that the next bond issuance at market rates is envisioned only in 2022, hence, the increase in interest payments will be relatively modest.

Risks and vulnerabilities. The public DSA risk assessment identifies the ratio of public debt held by non-residents as a high risk for Ecuador, while the recent widening of the spread has increased once-more the market perception of risk to high. At about 73 percent of the total debt, non-residents' holdings of Ecuador's public debt are high but about half of external debt is owed to official creditors and therefore mitigates this vulnerability. Thanks to the recent liability management operation, near-term external debt rollover risks are limited.

Ecuador Public Sector Debt Sustainability Analysis (DSA) - Baseline Scenario

(in percent of GDP unless otherwise indicated)

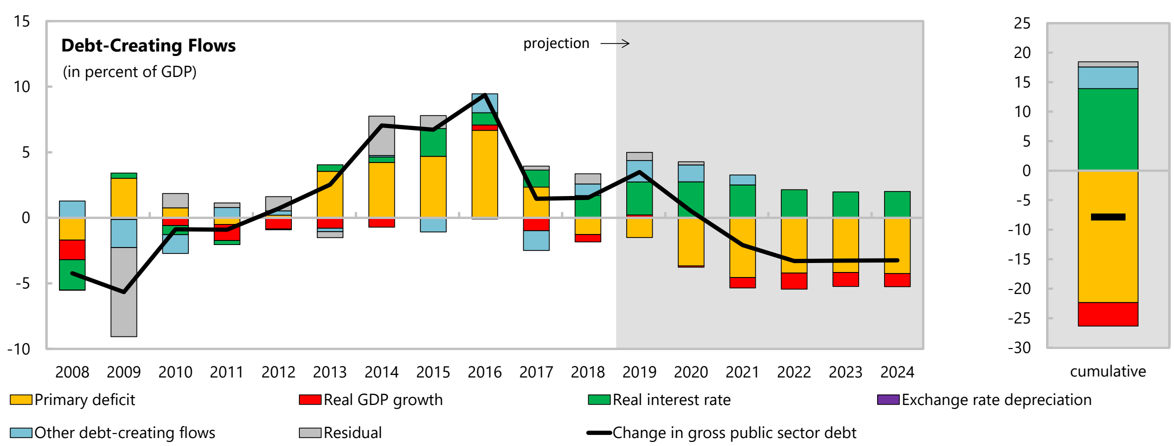
Debt, Economic and Market Indicators [1/]

	Actual			Projections					
	2008-2016 [2/]	2017	2018	2019	2020	2021	2022	2023	2024
Nominal gross public debt	24.3	44.6	46.1	49.6	50.1	48.1	44.8	41.5	38.2
Public gross financing needs	7.5	16.7	8.5	8.1	5.2	3.4	4.1	3.8	3.3
Net public debt	19.0	39.6	40.3	42.2	41.5	38.8	35.9	32.9	30.0
Real GDP growth (in percent)	3.5	2.4	1.3	-0.5	0.2	1.6	2.7	2.5	2.5
Inflation (GDP deflator, in percent)	4.2	1.9	1.8	0.2	0.5	0.7	1.0	1.1	1.2
Nominal GDP growth (in percent)	8.0	4.4	3.1	-0.3	0.7	2.4	3.7	3.6	3.7
Effective interest rate (in percent) [4/]	4.6	5.1	5.8	5.6	6.0	5.9	5.7	5.7	6.3

As of December 11, 2019		
Sovereign Spreads		
EMBIG (bp) 3/		972
5Y CDS (bp)		n.a
Ratings	Foreign	Local
Moody's	B3	B3
S&Ps	B-	B-
Fitch	B-	B-

Contribution to Changes in Public Debt

	Actual			Projections							
	2008-2016	2017	2018	2019	2020	2021	2022	2023	2024	cumulative	debt-stabilizing primary balance [9/]
Change in gross public sector debt	1.6	1.5	1.5	3.5	0.5	-2.1	-3.3	-3.3	-3.2	-7.9	
Identified debt-creating flows	1.7	1.1	0.7	2.9	0.3	-2.1	-3.3	-3.3	-3.2	-8.8	
Primary deficit	2.3	2.3	-1.3	-1.5	-3.7	-4.6	-4.2	-4.2	-4.3	-22.4	1.0
Primary (noninterest) revenue and grants	35.4	32.0	36.1	34.2	36.2	35.5	34.9	34.9	34.9	210.6	
Primary (noninterest) expenditure	37.7	34.4	34.9	32.7	32.5	30.9	30.7	30.7	30.7	188.2	
Automatic debt dynamics [5/]	-0.5	0.3	1.1	2.7	2.6	1.7	0.9	0.9	1.0	9.9	
Interest rate/growth differential [6/]	-0.5	0.3	1.1	2.7	2.6	1.7	0.9	0.9	1.0	9.9	
Of which: real interest rate	0.1	1.3	1.7	2.5	2.7	2.5	2.1	2.0	2.0	13.9	
Of which: real GDP growth	-0.6	-1.0	-0.6	0.2	-0.1	-0.8	-1.2	-1.1	-1.0	-4.0	
Exchange rate depreciation [7/]	0.0	0.0	0.0	…	…	…	…	…	…	…	
Other identified debt-creating flows	-0.1	-1.5	0.9	1.6	1.3	0.8	0.0	0.0	0.0	3.7	
Deposits Drawdown (negative)	-0.1	-1.5	0.9	1.6	1.3	0.8	0.0	0.0	0.0	3.7	
Contingent liabilities	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	
Residual, including asset changes [8/]	-0.1	0.3	0.8	0.6	0.2	0.0	0.0	0.0	0.0	0.9	



Source: IMF staff calculations.

1/ Public sector is defined as non-financial public sector.

2/ Based on available data.

3/ Long-term bond spread over U.S. bonds.

4/ Defined as interest payments divided by debt stock (excluding guarantees) at the end of previous year.

5/ Derived as [(r - π(1+g) - g + ae(1+r)]/(1+g+π+gπ)) times previous period debt ratio, with r = interest rate; π = growth rate of GDP deflator; g = real GDP growth rate; a = share of foreign-currency denominated debt; and e = nominal exchange rate depreciation (measured by increase in local currency value of U.S. dollar).

6/ The real interest rate contribution is derived from the numerator in footnote 5 as r - π (1+g) and the real growth contribution as -g.

7/ The exchange rate contribution is derived from the numerator in footnote 5 as ae(1+r).

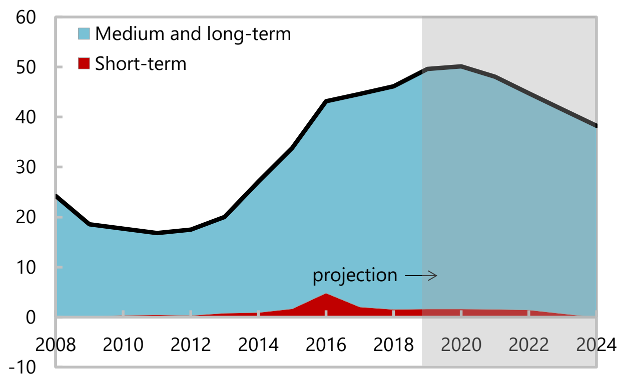
8/ Includes asset changes and interest revenues (if any). For projections, includes exchange rate changes during the projection period.

9/ Assumes that key variables (real GDP growth, real interest rate, and other identified debt-creating flows) remain at the level of the last projection year.

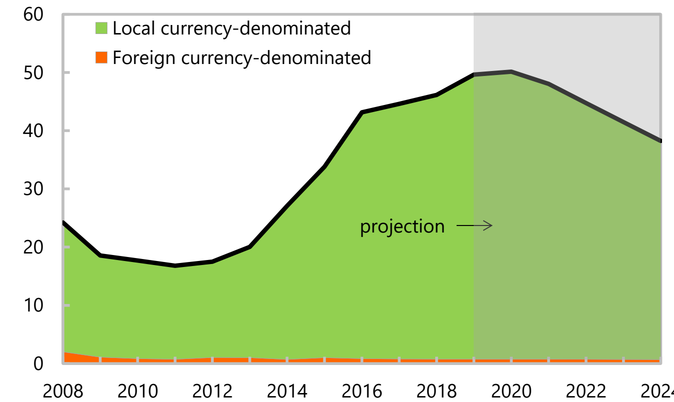
Ecuador Public DSA - Composition of Public Debt and Alternative Scenarios

Composition of Public Debt

By Maturity
(in percent of GDP)



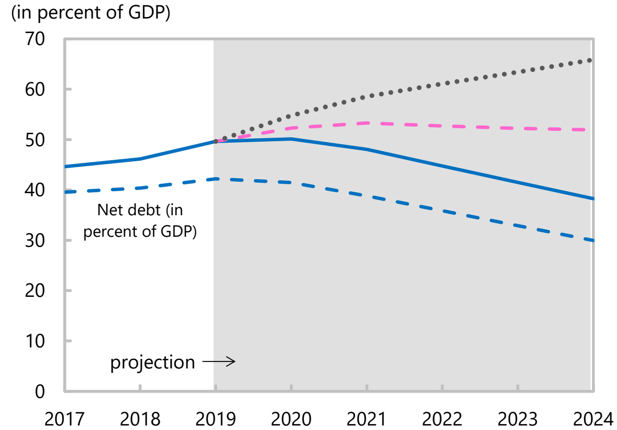
By Currency
(in percent of GDP)



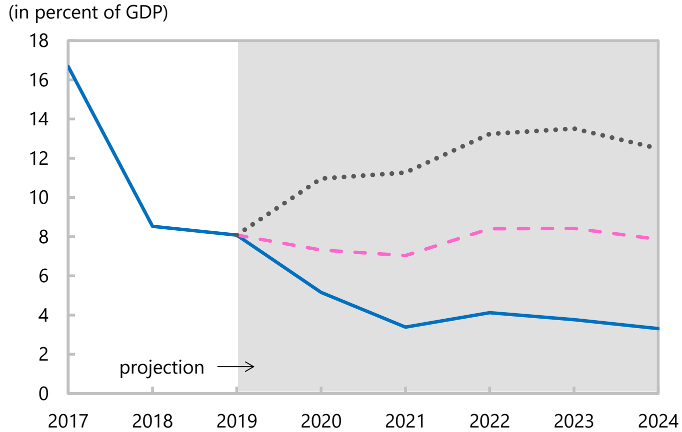
Alternative Scenarios

Baseline   Historical   Constant Primary Balance

Gross Nominal Public Debt
(in percent of GDP)



Public Gross Financing Needs
(in percent of GDP)



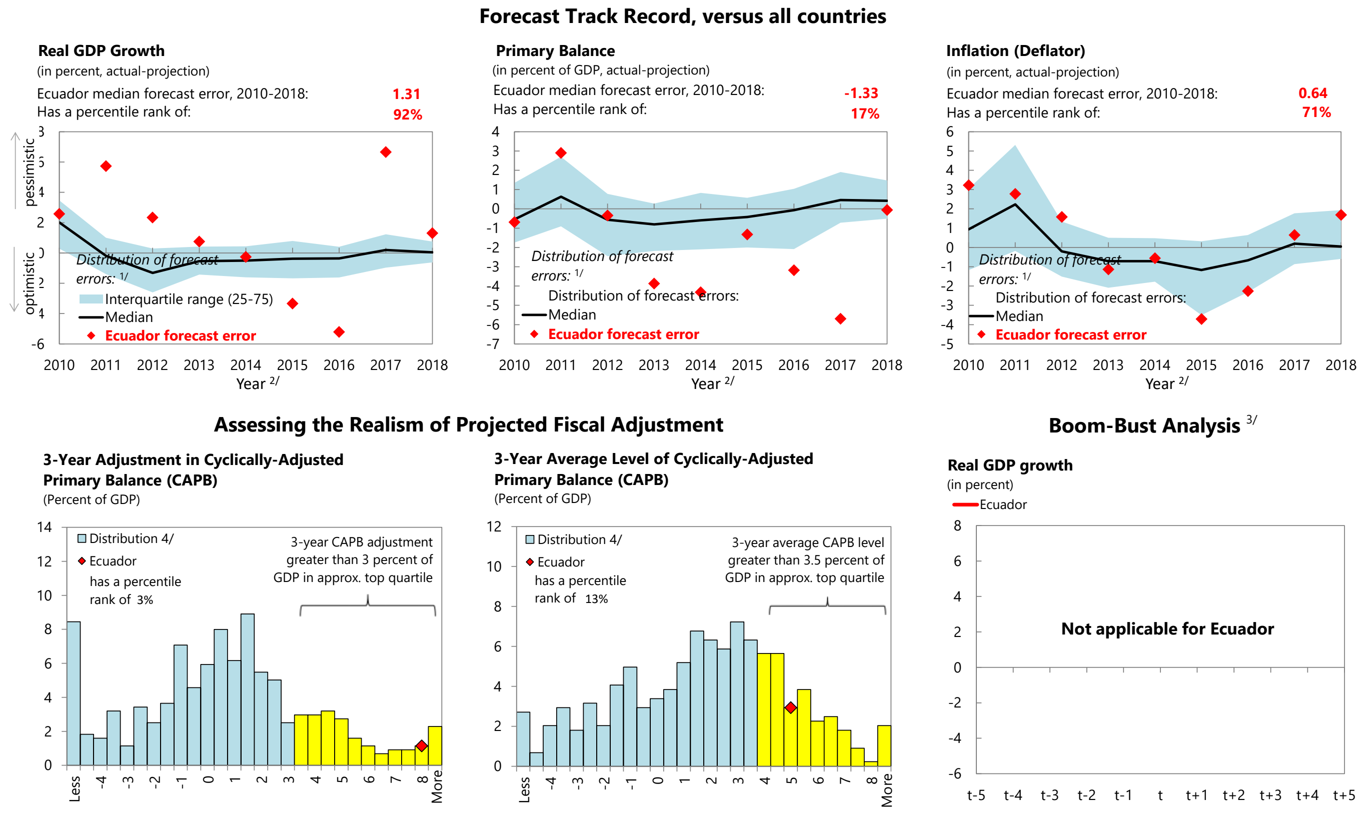
Underlying Assumptions
(in percent)

Baseline Scenario	2019	2020	2021	2022	2023	2024
Real GDP growth	-0.5	0.2	1.6	2.7	2.5	2.5
Inflation	0.2	0.5	0.7	1.0	1.1	1.2
Primary Balance	1.5	3.7	4.6	4.2	4.2	4.3
Effective interest rate	5.6	6.0	5.9	5.7	5.7	6.3
Constant Primary Balance Scenario						
Real GDP growth	-0.5	0.2	1.6	2.7	2.5	2.5
Inflation	0.2	0.5	0.7	1.0	1.1	1.2
Primary Balance	1.5	1.5	1.5	1.5	1.5	1.5
Effective interest rate	5.6	6.0	5.8	5.5	5.6	6.1

Historical Scenario	2019	2020	2021	2022	2023	2024
Real GDP growth	-0.5	2.9	2.9	2.9	2.9	2.9
Inflation	0.2	0.5	0.7	1.0	1.1	1.2
Primary Balance	1.5	-2.4	-2.4	-2.4	-2.4	-2.4
Effective interest rate	5.6	6.0	5.0	4.2	4.0	4.3

Source: IMF staff calculations.

Ecuador Public DSA - Realism of Baseline Assumptions



Source : IMF Staff calculations.

1/ Plotted distribution includes all countries, percentile rank refers to all countries.

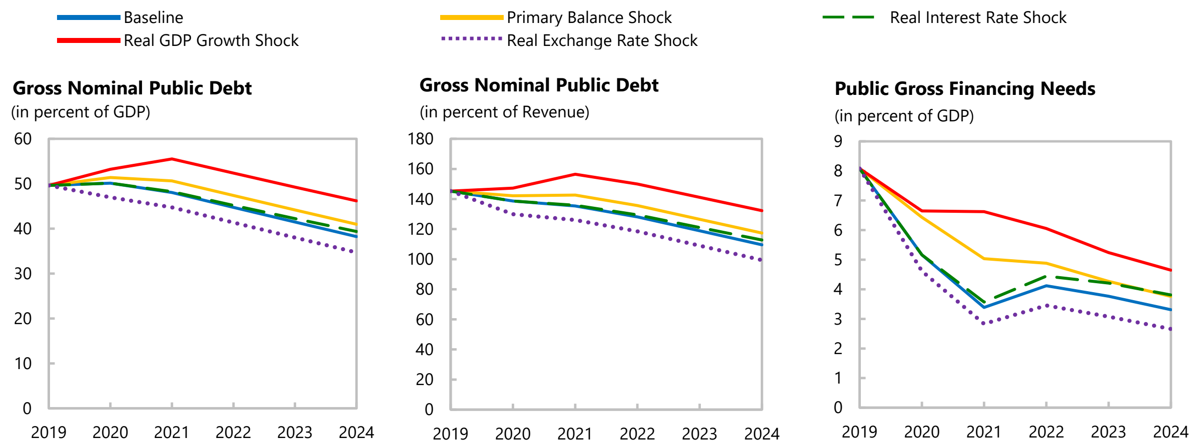
2/ Projections made in the spring WEO vintage of the preceding year.

3/ Not applicable for Ecuador, as it meets neither the positive output gap criterion nor the private credit growth criterion.

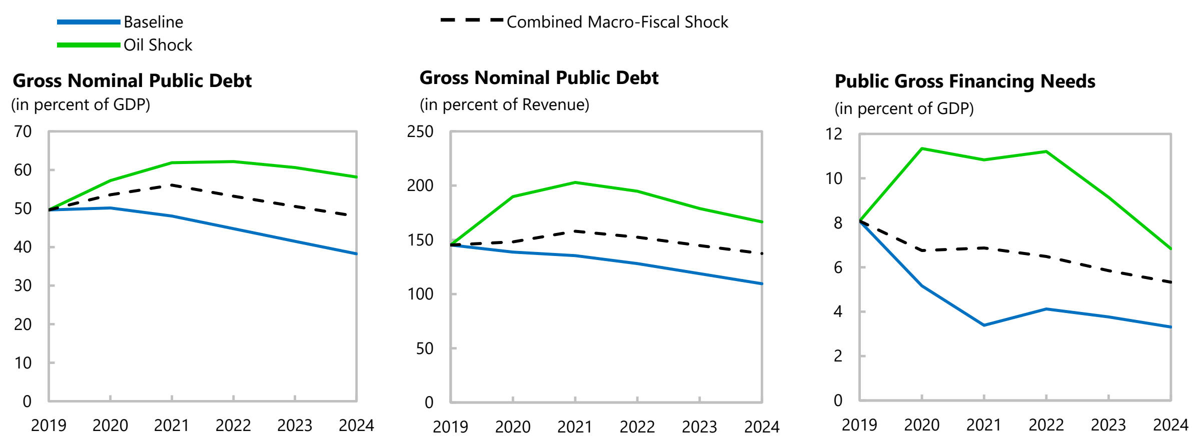
4/ Data cover annual observations from 1990 to 2011 for advanced and emerging economies with debt greater than 60 percent of GDP. Percent of sample on vertical axis.

Ecuador Public DSA - Stress Tests

Macro-Fiscal Stress Tests



Additional Stress Tests



Underlying Assumptions
(in percent)

Primary Balance Shock	2019	2020	2021	2022	2023	2024
Real GDP growth	-0.5	0.2	1.6	2.7	2.5	2.5
Inflation	0.2	0.5	0.7	1.0	1.1	1.2
Primary balance	1.5	2.4	3.3	4.2	4.2	4.3
Effective interest rate	5.6	6.0	5.9	5.7	5.7	6.3
Real Interest Rate Shock						
Real GDP growth	-0.5	0.2	1.6	2.7	2.5	2.5
Inflation	0.2	0.5	0.7	1.0	1.1	1.2
Primary balance	1.5	3.7	4.6	4.2	4.2	4.3
Effective interest rate	5.6	6.0	6.3	6.2	6.4	7.2
Combined Shock						
Real GDP growth	-0.5	-2.6	-1.2	2.7	2.5	2.5
Inflation	0.2	-0.2	0.0	1.0	1.1	1.2
Primary balance	1.5	2.4	2.3	4.2	4.2	4.3
Effective interest rate	5.6	6.0	6.3	6.2	6.5	7.2

Real GDP Growth Shock	2019	2020	2021	2022	2023	2024
Real GDP growth	-0.5	-2.6	-1.2	2.7	2.5	2.5
Inflation	0.2	-0.2	0.0	1.0	1.1	1.2
Primary balance	1.5	2.5	2.3	4.2	4.2	4.3
Effective interest rate	5.6	6.0	5.9	5.7	5.7	6.2
Real Exchange Rate Shock						
Real GDP growth	-0.5	0.2	1.6	2.7	2.5	2.5
Inflation	0.2	7.1	0.7	1.0	1.1	1.2
Primary balance	1.5	3.7	4.6	4.2	4.2	4.3
Effective interest rate	5.6	6.0	5.9	5.7	5.7	6.3
Oil Shock						
Real GDP growth	-0.5	-1.8	-0.4	2.7	2.5	2.5
Inflation	0.2	0.5	0.7	1.0	1.1	1.2
Primary balance	1.5	-2.3	-0.4	1.2	3.2	4.3
Effective interest rate	5.6	6.0	6.4	6.2	6.3	6.8

Source: IMF staff calculations.

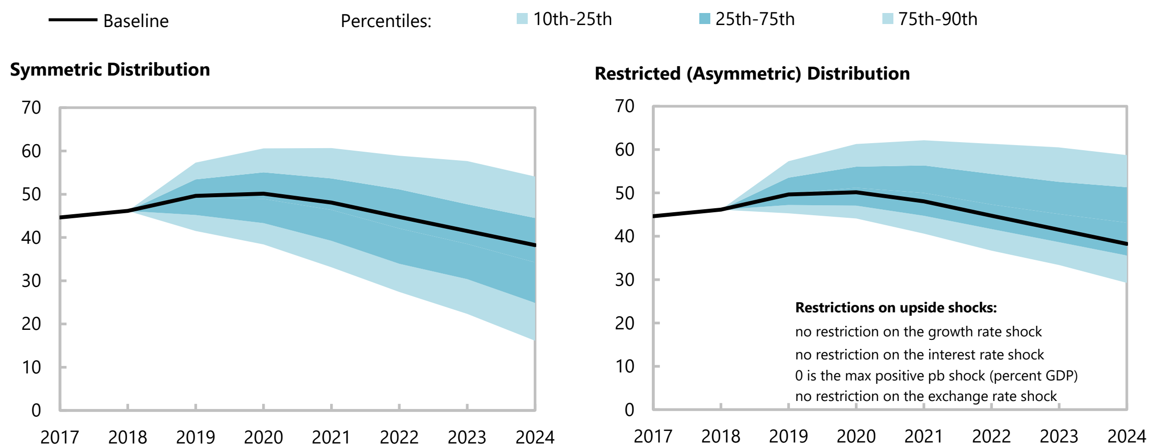
Ecuador Public DSA Risk Assessment

Heat Map

Debt level 1/	Real GDP Growth Shock	Primary Balance Shock	Real Interest Rate Shock	Exchange Rate Shock	Contingent Liability shock
Gross financing needs 2/	Real GDP Growth Shock	Primary Balance Shock	Real Interest Rate Shock	Exchange Rate Shock	Contingent Liability Shock
Debt profile 3/	Market Perception	External Financing Requirements	Change in the Share of Short-Term Debt	Public Debt Held by Non-Residents	Foreign Currency Debt

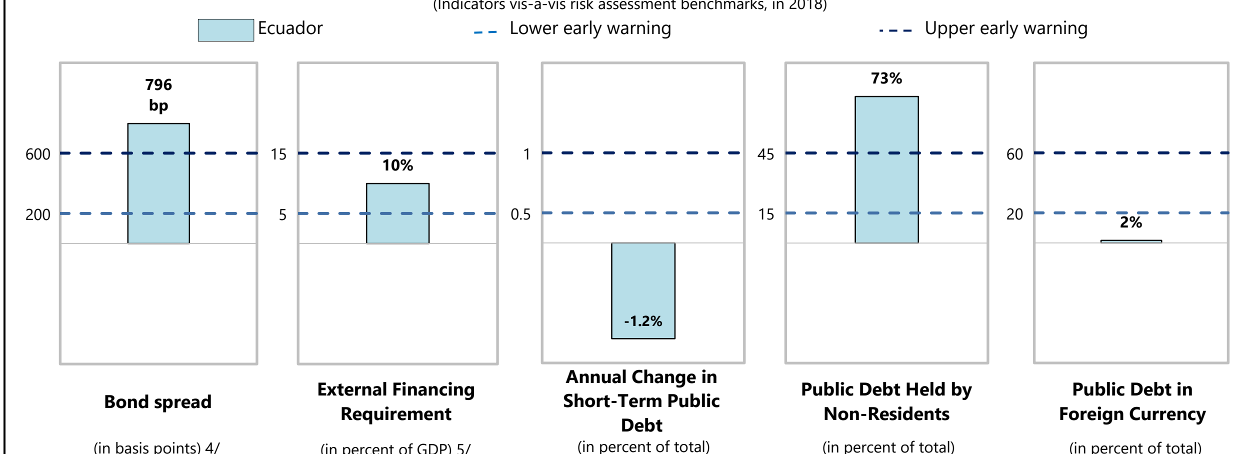
Evolution of Predictive Densities of Gross Nominal Public Debt

(in percent of GDP)



Debt Profile Vulnerabilities

(Indicators vis-à-vis risk assessment benchmarks, in 2018)



Source: IMF staff calculations.

1/ The cell is highlighted in green if debt burden benchmark of 70% is not exceeded under the specific shock or baseline, yellow if exceeded under specific shock but not baseline, red if benchmark is exceeded under baseline, white if stress test is not relevant.

2/ The cell is highlighted in green if gross financing needs benchmark of 15% is not exceeded under the specific shock or baseline, yellow if exceeded under specific shock but not baseline, red if benchmark is exceeded under baseline, white if stress test is not relevant.

3/ The cell is highlighted in green if country value is less than the lower risk-assessment benchmark, red if country value exceeds the upper risk-assessment benchmark, yellow if country value is between the lower and upper risk-assessment benchmarks. If data are unavailable or indicator is not relevant, cell is white.

200 and 600 basis points for bond spreads; 5 and 15 percent of GDP for external financing requirement; 0.5 and 1 percent for change in the share of short-term debt; 15 and 45 percent for the public debt held by non-residents; and 20 and 60 percent for the share of foreign-currency denominated debt.

4/ Long-term bond spread over U.S. bonds, an average over the last 3 months, 05-Sep-19 through 04-Dec-19.

5/ External financing requirement is defined as the sum of current account deficit, amortization of medium and long-term total external debt, and short-term total external debt at the end of previous period.

Appendix I. Letter of Intent

December 11, 2019

Mrs. Kristalina Georgieva
The Managing Director
International Monetary Fund
Washington, D.C.

Dear Mrs. Georgieva:

Ecuador has embarked upon a historic transition that will both modernize the economy and strengthen economic growth and job creation for generations to come. These efforts are being undertaken with special regard to Ecuador's vulnerable citizens ensuring their living standards improve as this transition proceeds. We are moving ahead with utmost transparency, which we believe should be the hallmark of a modern Ecuador, leaving behind the opaque practices of the recent past and consulting closely with the Ecuadorian people as we embark upon our program of prosperity.

It is in this context that we have sought the support of the International Monetary Fund. We have updated our comprehensive social and macroeconomic program called *Plan de Prosperidad*, which is detailed in the attached Memorandum of Economic and Financial Policies. This economic program is aligned with the objectives of our National Development Plan and has the achievement of the U.N. Sustainable Development Goals 2030 as its north star. Our program is based on four basic tenets: (i) to rebuild and strengthen the institutional foundations of dollarization; (ii) to generate employment and growth through more competitiveness; (iii) to promote equality of opportunity and protect the poor and vulnerable; and, (iv) to ensure full transparency and good governance. Additionally, strengthening Ecuador´s dollarized system will require efforts on the following fronts: restoring prudence in fiscal policy, strengthening the institutional framework of the Central Bank, boosting resilience of the financial system, and supporting job creation through competitiveness and growth.

To further the implementation of our program, we are requesting completion of the second and third review of the arrangement under the IMF's Extended Fund Facility and the disbursement of the associated amount of SDR 361.3 million (the equivalent of about US$498.0 million). We are requesting that the full amount of this Fund financing be made available for budget support. We are further requesting a waiver of nonobservance of the performance criterion on net international reserves given that the macroeconomic impact of the breach is minor, as well as modifications to program requirements reflected herein. We have also secured the necessary support for our program from other international partners that have collectively agreed to provide additional financing of about US$6 billion over the course of the three years of the program.

The Ecuadorian government will collaborate with Fund staff to keep track of economic developments and performance under our program, and we stand ready to take additional policy decisions that may become necessary to achieve our program objectives. In accordance with Fund policies, we will consult with the IMF on the adoption of these decisions and in advance of any changes to our policy plans. We are committed to providing the Fund with timely and accurate data in order to facilitate the tracking of our progress in the implementation of our program.

We believe that to reach a positive outcome, these and future policy decisions should continue to be designed through mechanisms that help build consensus across different stakeholders and protect the poor and vulnerable, a principle that we applied in tabling the latest tax reform and that proved to be successful.

In line with the government's transparent approach to policymaking, we consent to the publication of this letter, the Memorandum of Economic Policies, and the Staff Report associated with our request for support.

Sincerely yours,

/s/	/s/
Richard Martínez Alvarado Minister of Economy and Finance	Verónica Artola Jarrín General Manager The Central Bank of Ecuador

Attachments:

1. Memorandum of Economic and Financial Policies
2. Technical Memorandum of Understanding

Attachment I. Memorandum of Economic and Financial Policies

1. The foundations of our dollarized economic system have been undermined by a steady erosion of domestic institutions, including the independence of the Central Bank; by a weakened system of public governance; and by persistent fiscal imbalances that are inconsistent with our dollarized economy. It is our strong commitment to reverse these trends in order to leave the next administration with a well-managed, and more socially equitable, efficient, and competitive economy.

2. We have already made important progress in implementing our policy plans in a range of areas. In 2018, we reached consensus in the National Assembly to pass the *Ley de Fomento Productivo*. This law put an end to Central Bank financing of the budget and introduced a new fiscal framework that will help guide policies and reduce our public debt in the short and medium term. We have also adopted measures to carefully reduce the cost and distortions rooted in how fuel subsidies are provided, generating efficiencies and social equity as we redirect those resources to better support for lower income households.

3. The following sections of this memorandum outline in detail our policy plans for the coming two years that will underpin our goals of strengthening the institutional foundations of dollarization, raising the living standards of our most vulnerable citizens, bolstering competitiveness and job creation, and ensuring our government is accountable to the people that it serves.

A. Restoring Prudence to Fiscal Policy

Background

4. Over the past decade, our total public debt has almost doubled from 24 percent of GDP in 2008 to 46 percent of GDP in 2018 according to IMF metrics and institutional coverage. This happened despite Ecuador benefitting from unusually high world oil prices during this period. Buffers, including the Central Bank's international reserves and savings in the Oil Fund, have been eroded and the government's ability to respond to national emergencies has been seriously weakened.

Program objectives

Achieving Fiscal Sustainability

5. The government is committed to restoring order to Ecuador´s fiscal accounts. Our goal is to quickly reverse the upward trajectory of our public debt-GDP ratio and, over time, bring our debt below our benchmark target of 40 percent of GDP. That target will once again become a legally binding limit on future public indebtedness. Our fiscal plan is carefully designed to minimize the impact of this transition on the real economy and the living standards of the

Ecuadorian people, helping generate opportunities in the near future. To bridge this transition, we have asked the Fund to provide temporary financing to the budget.

6. We commit to reducing the Non-Financial Public Sector non-oil primary deficit including fuel subsidies, by about 3.9 percent of GDP during 2019-2021, with efforts for 2019 well underway. The burden of the realignment of our fiscal position will mostly be borne by the ongoing streamlining of the operations of the government but also with a broad-based effort on the part of the people of Ecuador. This effort will remain focused on promoting high quality employment, and on continued wide access to services, including health and education. The main pillars of this effort includes the following: (i) a realignment of the public sector wage bill respecting labor rights and protecting the provision of services; (ii) an optimization of the system of fuel subsidies to benefit the poor and vulnerable and reduce distortions; (iii) a reform of the tax system to make it more equitable, growth-friendly and simpler; and, (iv) a reduction in public spending on capital and goods and services. The savings and revenues generated from these efforts will allow us to increase spending on social assistance and phase out the distortionary tax on transfers abroad once macroeconomic stability is restored and the reserve position is strengthened.

7. A significant down-payment on this deficit reduction effort is being made already in 2019. This year, we expect to achieve our fiscal goals through a rationalization of primary spending and prioritizing capital projects. The measures envisaged for 2019 include:

- *A careful realignment of the wage bill through a balanced strategy of wage restraint and prudent decisions on the renewal of occasional contracts and new hiring of public employees.* We have already announced measures in this regard, including changes in state-owned enterprises, though the savings have been accruing at a slower pace than originally envisioned due to the need for new hires in police and wage inertia. We will continue these efforts, including by renewing only one of every two expiring contracts in the non-social sectors and harmonizing the wages of newly hired public employees with those in the private sector, which are currently generally lower than public sector wages. All these efforts will be reflected not only in a reduction in the public sector wage bill but also in the improved efficiency and financial health of public enterprises and Social Security (IESS).

- *We expect to continue to benefit from a reduction in subsidies for gasoline and diesel used for industrial purposes that were implemented in 2018 and earlier in 2019.* A The normalization of diesel prices for industrial purposes have helped reduce distortions and ensure that the intended population benefits from the subsidy. These measures are not only aimed at reducing public spending but also at getting Ecuador closer to having a system to administer fuel subsidies in a way that promotes social equity and efficiency and reduces the environmental and health effects of excessive consumption. It is worth noting that these and future policy decisions have been and will continue to be designed through mechanisms that help build consensus around these measures, and not to affect the poor and vulnerable;

- *Improving the terms and conditions in the procurement of goods and services by using competitive bidding, framework and wholesale agreements, making processes more transparent and timelier, and improving inventory management.* These measures will facilitate reduction in spending on goods and services;

- *Updating the schedule of fees charged for government services* to more accurately reflect their costs and the markets they serve;

8. In 2020 we will continue our efforts of reducing the deficit and improving the fiscal position. Next year, we expect to achieve our fiscal goal of reducing the Non-Financial Public Sector non-oil primary deficit including fuel subsidies by 1.7 percent of GDP through further rationalizing primary spending and measures to boost revenue collection. The measures envisaged for 2020 include:

- *Savings from the tax reform and economic reactivation tax package.*

- *Updating the schedule of fees charged for government services* to more accurately reflect their costs and the markets they serve.

- *A further careful realignment of the wage bill through a balanced strategy of wage restraint and prudent decisions on the renewal of occasional contracts and new hiring of public employees;*

- *Continuing the rationalization of spending on goods and services, as well as subsidies;*

- *Leasing concession rights of public assets to private partners while ensuring that they remain under public ownership.* This will be done using utterly transparent processes that maximize the benefit to the state, while ensuring coverage of services will not be affected, and protect the budget from contingent liabilities;

9. In the event fiscal outcomes are projected to fall short of program targets, we are committed to deploying contingency measures to fully comply with program targets. Such measures could include a further rationalization of spending (on a commitment basis) on goods and services, capital, and fuel subsidies. Part of the savings and revenue generated from these measures will allow the government to increase social assistance spending and provide greater support to the most vulnerable. *Plan Toda Una Vida,* the Government´s emblematic program will be strengthened. This program ensures access to health, education, safe and healthy habitat, housing and water by all segments of the population, with a greater emphasis on the most vulnerable, women, the elderly and disabled. It is our strong commitment to ensure that all Ecuadorian citizens have access to equal opportunities and a decent and fulfilling life.

Strengthening the Fiscal Framework

10. We are committed to strengthening the structural underpinnings of our fiscal system. The revisions to the medium-term fiscal policy framework contained in the Ley de Fomento

Productivo in 2018 were a major step forward in creating a consistent, prudent, and accountable framework for the conduct of fiscal policies. We have also published an action plan aimed at strengthening our public financial management at the end of April of 2019 (structural benchmark). The amendments to the Código Orgánico de Planificación y Finanzas Públicas (COPLAFYP), which further propel these reforms, were submitted as part of the package of reforms to the National Assembly in October as a prior action for the combined second and third reviews under the program. In light of the rejection of the package of laws by the National Assembly, the revised amendments to COPLAFYP will be submitted to the Assembly by end-February 2020. The amendments will ensure that the role of the Minister of Economy and Finance as the fiscal oversight authority is strengthened; that annual budgets are prepared in line with best international practices; that fiscal rules framework is further strengthened, including escape clauses, automatic correction mechanisms, and in-year fiscal reporting; that government discretion to amend approved budgets is limited and a robust framework for contingency allocation is introduced; that budget execution is kept in check by comprehensive, timely, and proper government accounting and reporting, including a comprehensive definition of public debt, as well as the adoption of better cash management practices and commitment controls. The amendments will also introduce a standardized definition of arrears and the 90-day payment deadline for the current and capital expenses associated with the acquisition of goods and services from the date of their accrual. As part of these efforts, we intend to create a system of information collection on domestic expenditure arrears, assess the current stock of expenditure arrears, develop a plan of arrears clearance (end-September 2019 structural benchmark), and implement institutional arrangements to better report on and control expenditure commitments. As part of the effort to monitor and eventually reduce public sector arrears over time, we will introduce an indicative target on central government arrears starting from June 2020. The work on the modernization of the computer system currently underway will facilitate compliance with this target. We will also continue working on strengthening the system of monitoring and control of arrears in the whole of the NFPS. To aid these comprehensive efforts, we are working with technical assistance experts from international institutions to modernize our budget and cash management processes and controls.

11. To increase our accountability to the Ecuadorian people we will strengthen our current system of data disclosure, provision and monitoring at all stages of the budget cycle as well as institute clear and automatic enforcement mechanisms and effective sanctions for non-adherence to the law.

12. In order to safeguard the creditworthiness of our country, we commit to refrain from new government international borrowing arrangements that are based on repurchase agreements or the pledging of Central Bank assets.

B. Strengthening the Institutional Framework of the Central Bank

Background

13. Regrettably, the institutional foundations of the Central Bank of Ecuador seriously eroded in the past. Our strong commitment to the dollarization regime requires that the institutional basis governing the Central Bank is rebuilt and fortified with a clear legal framework. These efforts to strengthen dollarization will ensure that the purchasing power of all Ecuadorian families is protected and the financial value of their homes and other family assets is maintained, allowing access to credit and stability and predictability when making economic decisions.

Program objectives

Strengthening the Legal Framework of the Central Bank

14. The *Ley de Fomento Productivo* passed in 2018 prohibited the Central Bank (BCE) from investing in securities issued by public sector entities. This was reinforced by a subsequent regulation that prohibits all quasi-fiscal activities of the Central Bank as well as direct and indirect lending to the government or public sector (including loans, advances, guarantees or transactions that indirectly support lending operations of the public sector).

15. In keeping with the end-September 2019 structural benchmark, we submitted to the National Assembly amendments to the organic code of the Central Bank (*Código Orgánico Monetario Financiero, COMYF*). These amendments aimed to ensure that the Central Bank had clear objectives and limited functions, designed to fully support the dollarization regime. They encompassed measures to strengthen the BCE's autonomy including in terms of its budget, improve the BCE's governance by establishing a board with fiduciary responsibilities to the Central Bank, and build a strong internal and external audit function. The amendments prohibited all direct and indirect lending by the Central Bank to the government or the public sector, while remaining able to provide temporary liquidity support to public banks, if needed for prudential purposes. However, those amendments were rejected by the National Assembly. We intend to resubmit the amendments to the Central Bank part of the COMYF by April 2020 (Table 2) after consultation with various stakeholders and building consensus. We believe that addressing institutional weaknesses of the central bank is an important step in fortifying the dollarization regime, which has been so beneficial for the country. We also intend to unwind past transactions that resulted in the Central Bank holding either directly or indirectly government debt (including the transfer of equity in public banks to the Central Bank's balance sheet). Finally, we wish to highlight that we have reversed the rollover of previously contracted debt, which resulted in an inadvertent breach of the continuous performance criterion on no new gross financing from the central bank to the NFPS.

Rebuilding reserve buffers

16. To further strengthen the basis for dollarization, our goal is to gradually build international reserves over the remainder of this program to ensure that, by the end of this arrangement, international reserve assets of the Central Bank fully back both: (i) the reserves held at the Central Bank of private financial institutions and public financial institutions that receive deposits from the public; and (ii) national coins in circulation. Coverage for other relevant liabilities, such as government deposits, will be defined through regulation issued by the Central Bank's Board.

C. Boosting the Resilience of the Financial System

Background

17. We are confident that our financial system is strong, liquid, and well-capitalized. We have seen private credit growing at a rapid pace, calling for greater supervisory scrutiny, particularly of cooperatives which have grown rapidly of late. To improve our ability to better understand and manage financial stability risks, we intend to strengthen our monitoring of household indebtedness and housing prices and will consider whether a new macroprudential framework is needed to mitigate risk accumulation in the system. New requirements—including loan-to-value ratios for mortgage lending—will be under consideration.

Program Objectives

Boosting the Resilience of the Financial System

18. To bolster confidence in the banking system, we intend to re-examine our banking resolution procedures, our crisis preparedness framework, and the adequacy of the liquidity fund and deposit insurance scheme. Over time, we will continue diversifying the deposit insurance fund's assets away from sovereign debt under our revised portfolio strategy based on best international practice.

Simplifying Liquidity Requirements

19. Finally, to deepen financial intermediation and reduce sovereign-financial linkages we intend to simplify the various liquidity requirements for banks to better align minimum and domestic liquidity requirements with international best practice. The liquidity constraints imposed on the financial sector will be gradually removed in order to achieve a simpler and more efficient reserve requirement system. To create a more competitive financial system, we intend to improve our interest rate policies to foster savings, investment and production.

D. Supporting Job Creation, Competitiveness and Growth

Background

20. Our administration is committed to restoring the international competitiveness of our economy and to catalyzing private sector-led growth while raising living standards for all of Ecuador's people. Our goal is to make Ecuador a preferred destination for businesses worldwide and to boost employment and reduce informality in the economy. This will require fundamental changes on a number of fronts.

Program Objectives

Revamping the Tax System

21. As part of the urgent package of economic reforms, the government submitted to the National Assembly a draft tax legislation aimed at upgrading our current system of taxation to make it more equitable, growth-friendly and simpler in October. The reform package, however, was rejected by the National Assembly. A revised version of amendments to the tax code, taking into account feedback from lawmakers, was approved by the National Assembly. The goals of the approved tax reform, with a net yield of 0.5 percent of GDP in both 2020 and 2021, are: (i) to simplify the tax system, (ii) to broaden the tax base; (iii) to enhance progressivity; and (iv) eliminate unwarranted and inequitable tax exemptions, special regimes and preferences which now benefit the wealthier segments of the population. We believe this reform will strengthen Ecuador's competitiveness and create better opportunities for job and employment creation.

Promoting Entrepreneurship

22. Our administration is committed to foster entrepreneurship and innovation as a way to bolster job creation and growth. In addition to the measures established in the Ley de Fomento Productivo in 2018, we are currently discussing an Entrepreneurship Law that will eliminate obstacles to business formation and operation and provide a strong legal framework for new businesses.

Broadening Housing Opportunities

23. Our housing program "Casa Para Todos" is helping promote job creation and activity in the construction sector, while broadening the opportunity for low and middle-income households to own their own home. We are partnering with private businesses and financial institutions in this effort and are confident that broader home ownership will provide a path for wealth creation, help the poor move out of poverty by increasing their ownership of assets and providing them a safe and healthy habitat, while also strengthening and expanding the middle class.

Improving Labor Market Conditions

24. Ecuador is in urgent need of a labor market reform that will improve access to formal jobs -especially for women and young workers-; and increase the ability and willingness of entrepreneurs and firms to hire and grow. The planned labor reform will involve adapting to market and social conditions, and carefully rolling back the current constraints that result in less opportunities for the unemployed. With this reform we intend to gradually reduce implicit hiring costs and provide a strong incentive to create new jobs and for small and medium enterprises to grow. This reform will converge to a labor market that adapts to different industries and responds to the needs of women and the youth.

Facilitating Public-Private Partnerships

25. To encourage private investment, we are preparing a new law, which will legislate an institutional framework for public-private partnerships guided by best international practices. We believe this will increase productivity, lessen the pressures on the budget, and create efficiency gains to support economy-wide increases in productivity.

Improving Efficiency of State-Owned Enterprises

26. We are also preparing a new legislation for state-owned enterprises (SOEs), which seeks to improve efficiency, increase transparency, and strengthen governance of SOEs. We will bring SOEs to the same standards as private companies by requiring them to pay taxes, and adopt the same accounting standards as the private companies.

Deepening Capital Markets

27. To provide capital for new investments, we are modifying our legal framework for capital markets to increase the flow of resources from investors to corporations that are in need of financing.

Facilitating Trade

28. Our administration has already taken steps in opening Ecuador to world trade. The Ley de Fomento Productivo ensured that companies will have access to international arbitration mechanisms in line with our constitutional framework. This helps us attract foreign investors. Our recent trade agreements with the European Union and the European Free Trade Association (EFTA) will also help further increase business opportunities and incentivize private investment. Our intent is to continue seeking trade agreements with both regional and international players. In this regard, we are in the process of joining the Pacific Alliance, and expect these negotiations to be concluded in the near future.

Fostering Gender Equality

29. While Ecuador compares favorably to other countries in the region on pay gap between men and women, we are committed to further promote fairness and gender equality. We will continue our policies of supporting families with young children and ensuring provision of childcare programs. The introduction of a broad range of employment contracts will particularly benefit women who may prefer to work part-time or in temporary employment likely increasing their participation in the workforce. Other policies aimed at making the labor market more dynamic will help stimulate the growth of the services sector, which would support participation of women in the labor market. We are committed to the reduction of gender-based violence in all its forms as shown by the recently approved legislation to prevent and eradicate it.

E. Promoting Shared Prosperity and Protecting the Poor and Vulnerable

Background

30. Our nation is proud of the gains we have made in supporting those who struggle to make ends meet in their daily lives. *"Plan Toda Una Vida"* is a government priority and we intend to expand the coverage of the program during our administration to further reduce poverty. Poverty rates among the rural and indigenous populations are particularly worrying. We are committed, therefore, to do more to protect the neediest members of our society.

Program Objectives

31. Our economic program incorporates a significant increase (of around US$300 million) on social assistance spending in 2019; and an increase of 0.6 percentage points of GDP by the end of the program.

Strengthening Social Assistance Programs

32. We are currently working with international partners to extend coverage and raise the level of benefits for the existing "*Bono de Desarrollo Humano*" conditional cash transfer program. We are also increasing spending to support our disabled population through the "*Misión Las Manuelas*" program and the elderly through the "*Mis Mejores Años*" program. We intend to expand the coverage of our system of non-contributory pensions and will design a comprehensive plan to strengthen our social programs, ensuring their resources are concentrated on supporting those most in need. In this vein, we have defined and published new eligibility thresholds for our social assistance programs (end-September 2019 structural benchmark). These changes are being supported by an ongoing update and modernization of the social registry (which identifies those citizens in need of assistance). This will ensure proper targeting, comprehensive coverage, and better information management of administrative data. By end-February 2020, we will publish an action plan to implement the updated eligibility thresholds for social assistance and to accelerate the completion of the upgraded social registry. As a result of these ongoing efforts, over 200,000 additional poor and vulnerable households will be covered by Ecuador's social safety net by 2021.

Improving education and health outcomes

33. We are committed to strengthening the efficiency and quality of primary education and health spending to improve our education and health outcomes and to underpin our longer-term efforts to build human capital and improve inclusion and mobility. Learning, preventive health and stunting are areas where our social programs will be working. We will identify efficiency gains in sectoral budgets without sacrificing coverage and quality of service provision, while prioritizing investments with high human capital returns (end-June 2020 structural benchmark).

F. Transparency and Good Governance

Background

34. Much has been achieved in promoting transparency and fighting corruption in the country during the present administration, but there is a lot more to be done, through a multi-pronged strategy that covers various areas. The combination of these efforts will help improve the business climate, lower the cost of public financing, and support private investment and job creation.

Program Objectives

Strengthening Anti-Corruption Institutions

35. At the core of our strategy is the strengthening of the anti-corruption legal framework in line with international standards, comprising legislative initiatives that we intend to submit to the National Assembly later this year (end-December 2019 structural benchmark). The legal reforms will enhance prevention and criminalization of acts of corruption; ensure that the proceeds of acts of corruption can be frozen, seized and confiscated in line with the Constitution and the FATF standards; increase the independence and power of law enforcement agencies and the judiciary; strengthen anti-corruption institutions and domestic and international coordination of anti-corruption efforts among different agencies; and improve access to information about government operations to facilitate civil society oversight. In advance of this legislation, this administration has already taken steps to improve governance through the appointment of a transitional Citizens Participation and Social Control Council last year and the creation of the Anticorruption Secretary and the International Experts Commission to Fight Corruption in 2019. This will deepen our commitment as signatories of the United Nations Convention against corruption.

Improving Fiscal Transparency

36. We are working to increase transparency and improve practices in Ecuador´s fiscal management. Our recent publication of public debt data that is in conformity with international standards is an important first step. We have also adopted a regulation that requires publication of audited financial statements by all public enterprises (end-June 2019 structural benchmark). We are committed to publishing greater information on our draft budget to better quantify fiscal measures and risks and to better assess our compliance with our fiscal rules. We are working with international partners to strengthen our public procurement processes and will, in the near future, require all procurement contracts to be published always in compliance with the regulations protecting personal data. Additionally, we are improving our budget management practices to ensure transparency, timeliness, quality and efficiency, and will encourage observatories to hold the government accountable on its commitments. As part of our transparency effort, we are providing detailed information on external non-financial public-sector debt, including information on all collateralized debt and debt with similar arrangements to the IMF on regular basis (quarterly structural benchmarks for end-March, end-June, end-September, and end-December 2019).

Improving Transparency of the Central Bank

37. We have published the Central Bank's financial statements for 2017, and will publish future statements as they become available. In 2019, we intend to produce the financial statements of the Central Bank in conformance with International Financial Reporting Standards and will begin publishing financial statements of the Central Bank under this new standard starting in 2021.

Improving Transparency in the Oil Sector

38. We will begin publishing externally-audited financial statements of the state-owned enterprises, including oil companies (end-June 2019 structural benchmark) and will increase the transparency of employment policies in oil companies. To achieve greater efficiency and improve governance, we intend to merge the operations of the two state-owned oil companies, with the technical assistance from the Inter-American Development Bank. To further institutionalize transparency in our oil sector, over the course of the extended arrangement we will seek technical assistance to assist us in pursuing membership of the Extractive Industries Transparency Initiative.

Strengthening Anti-Money Laundering and Countering Financing of Terrorism.

39. In line with the FATF standard, we intend to develop an AML/CFT national risk assessment that properly prioritizes corruption-related threats by 2020. In parallel, we will upgrade our regulatory and risk-based supervisory tools to ensure that banks and other relevant entities adequately monitor business relationships with senior officials (item in end-September structural benchmark revised to end-December 2019), and that the existing asset declaration regime for senior government officials is strengthened by expanding public access to information in declarations (June 2020 structural benchmark). The Government will review the existing AML/CFT legal framework to ensure it is in line with FATF standards by mid-2020, and will strengthen the implementation of a risk-based approach to AML/CFT bank supervision by end-2020, with technical support from Fund staff.

G. Program Issues

40. We request a waiver of non-observance for end-September 2019 quantitative performance criterion on NIR given the minor macro-economic impact of the breach.

41. The program will be monitored based on performance criteria, indicative targets, and structural benchmarks as set out in Tables 1 and 2 based on definitions in the TMU attached hereto. It is expected that the fourth review by the executive board will take place on or after March 15, and the fifth on or after June 15.

Table 1. Ecuador: Quantitative Performance Criteria and Indicative Targets, 2019-2020

(Millions of U.S. dollars, unless otherwise indicated)

	2019										2020			
	End-Mar		End-Jun			End-Sep			End-Dec		End-Mar	End-Jun	End-Sep	End-Dec
	Prog. PC 1/	Actual	Prog. PC 1/	Adj. PC	Actual	Prog. PC 1/	Adj. PC	Actual	Prog. PC	Revised PC	PC	PC	IT	IT
Fiscal Targets 2/														
Quantitative Performance Criteria														
Floor on non-oil primary balance of the non-financial public sector, including petroleum subsidies	-712	-124	-885	-1,004	-386	-2,200	-2,319	-1,625	-3,148	-3,691	-300	-300	-1,100	-1,838
Floor on social assistance spending of the central government - program definition 3/	175	183	380	...	427	695	...	787	1,202	1,110	275	550	850	1,280
Indicative Targets														
Floor on overall fiscal balance of the non-financial public sector	277	135	59	...	691	-392	...	118	-291	-1,187	152	897	832	744
Monetary Targets 2/														
Quantitative Performance Criterion														
Floor on the change in the stock of NIR - program definition 3/4/	1,823	2,388	1,284	1,792	2,160	2,057	3,916	3,609	3,132	2,830	275	1,116	1,454	2,013
Continuous Performance Criteria 5/														
Ceiling on the change in external payment arrears 6/	0	0	0	...	0	0	0	0	0	0	0	0	0	0
Ceiling on the new gross central bank direct financing of the NFPS and indirect financing to the NFPS through the public banks	0	120	0	...	0	0	0	0	0	0	0	0	0	0

Sources: Central Bank of Ecuador, Ministry of Finance, IMF staff calculations.

1/ Staff Report for the First Review Under the Extended Fund Facility Arrangement (July 2019, CR 19/210)

2/ Cumulative flow from January 1 to the test date.

3/ PCs for end-March 2019 are based on the original definition, as defined in the TMU of the Staff Report for the 2019 Article IV Consultation and Request for an Extended Arrangement Under the Extended Fund Facility (March 20, 2019, CR/19/79)

4/ Based on program exchange rates as defined in the TMU.

5/ Continuous performance criteria must be observed at all points in time.

6/ Excluding interest on earlier obligations resulting from the 2008 swap that have not been claimed by creditors even though authorities pursued them in good faith.

Table 2. Ecuador: Prior Actions and Structural Benchmarks		
Past Prior Actions		**Implementation Status**
1.	Passage by the Monetary Board (Junta de Política y Regulación Monetaria y Financiera) of a regulation that prohibits quasi-fiscal spending by the Central Bank, as well as any direct or indirect lending to the non-financial public sector, including that via public banks. This PA covers the purchase of securities, advances, or guarantees, or financial transactions that are a condition precedent for lending operations entered into by the government. This PA does not cover trade credits.	Met
2.	Publication of the Central Bank's financial statements.	Met
3.	Provision of detailed information on external non-financial public-sector debt, including information on all collateralized debt and debt with similar arrangements, such as repo transactions, debt requiring escrow or other encumbered accounts overseas that may serve the function of collateral, and other similar debt involving the pledge, sale/resale, or encumbrance of assets. The information on collateralized debt and debt with similar arrangements will include all contracts related to such debt; information on the escrow or similar accounts overseas that may serve as the function of collateral; and detailed information for each creditor on the stock of debt, its terms (including on the amounts pledged, sold/resold, or encumbered, as well as any related commitments or obligations to purchase related or unrelated goods and/or services from the lender), and expected repayment schedules.	Met
Prior Actions for the Second and Third Reviews		
4.	Submission and non-rejection of the revised growth-friendly tax reform aimed at improving revenue mobilization, increasing efficiency, simplicity, and equity, and reducing exemptions and preferential treatment under a 30-day emergency procedure. This reform, jointly with the economic reactivation package, will be expected to generate a net yield of 0.5 percent of GDP in 2020 and 0.5 percent of GDP in 2021.	Met
5.	Submission to the National Assembly of amendments to the Organic Code of Planning and Public Finances and any other relevant laws, in consultation with Fund staff, to (i) limit the discretion of the Executive to amend the annual budget that is approved by the National Assembly and introduce a robust framework for a contingency allocation in the budget, (ii) restrict the use of CETES (treasury certificates) for short-term financing and develop a plan of reducing the current stock of CETES, (iii) explicitly define the institutional coverage of the public debt to be the consolidated nonfinancial public sector and the institutional coverage of the expenditure rule apply to the General Government; (iv) adopt binding annual targets for the NFPS non-oil primary balance, excluding subnational governments, while providing for control over the fiscal balance and borrowing in subnational governments; (v) introduce the necessary mechanisms to support the effective operation of expenditure rule and its interaction with the Constitutional "golden rule," (vi) adopt a standardized definition of arrears and strengthen their monitoring and reporting, and (vii) introduce a 90-day payment deadline for the current and capital expenses associated with the acquisition of goods and services from the date of their accrual ("devengo" according to Ecuadorian statutes).	Converted and modified from SB, met

Table 2. Ecuador: Prior Actions and Structural Benchmarks (Continued)

Structural Benchmarks		Objective	Date	Implementation Status
1.	Provision of detailed information on new external non-financial public-sector debt incurred during the previous quarter, including on all collateralized debt and debt with similar arrangements, such as repo transactions, debt requiring escrow or other encumbered accounts overseas that may serve the function of collateral, and other similar debt involving the pledge, sale/resale, or encumbrance of assets. The information on collateralized debt and debt with similar arrangements will include all contracts related to such debt; information on the escrow or similar accounts overseas that may serve as the function of collateral; and detailed information for each creditor on the stock of debt, its terms (including on the amounts pledged, sold/resold, or encumbered, as well as any related commitments or obligations to purchase related or unrelated goods and/or services from the lender), and expected repayment schedules.	To ensure transparency of new debt operations.	End-March, June, September, and December 2019	Met at end-March, end-June, and end-September
2.	Publication of an action plan, in coordination with IMF technical assistance, to strengthen public financial management aimed at preparing budgets with a top-down approach and medium-term orientation; implementing sound budget execution and cash management practices, and transparent fiscal reporting.	To improve budget processes.	End-April 2019	Met
3.	Submission to the Cabinet, in coordination with Fund staff, of amendments to the Central Bank's legal framework to (i) introduce autonomous governance arrangements, (ii) improve its objectives and functions in line with best practice, (iii) provide for the phased-in recapitalization of the Central Bank, (iv) introduce a backing rule that requires a timetable to cover specific Central Bank liabilities with international reserve assets and (v) introduce a prohibition on quasi-fiscal activities of the Central Bank and on monetary financing of the government that prohibits quasi-fiscal spending by the Central Bank, as well as any direct or indirect lending to the non-financial public sector, including that via public banks (this covers the purchase of securities, advances, or guarantees, or financial transactions that are a condition precedent for lending operations entered into by the government but not trade credits), and (vi) introduce modifications to allow for the publication of external auditor's opinion and detailed notes.	To strengthen the institutional underpinnings of dollarization.	End-May 2019	Met

Table 2. Ecuador: Prior Actions and Structural Benchmarks (Continued)

Structural Benchmarks		Objective	Date	Implementation Status
4.	Submission to the National Assembly of amendments to the Organic Code of Planning and Public Finances and any other relevant laws, in consultation with Fund staff, to (i) limit the discretion of the Executive to amend the annual budget that is approved by the National Assembly and introduce a robust framework for a contingency allocation in the budget, (ii) restrict the use of CETES (treasury certificates) for short-term financing and develop a plan of reducing the current stock of CETES, (iii) explicitly define the institutional coverage of the public debt and expenditure rules to be the consolidated nonfinancial public sector (NFPS) (iv) adopt binding annual targets for the NFPS non-oil primary balance; (v) introduce the necessary mechanisms to support the effective operation of expenditure rule and its interaction with the Constitutional golden rule," (vi) adopt a standardized definition of arrears and strengthen their monitoring and reporting, and (vii) introduce a 90-day payment deadline for the current and capital expenses associated with the acquisition of goods and services from the date of their accrual ("*devengo*" according to Ecuadorian statutes).	To strengthen fiscal management and clarify the fiscal rules framework.	End-June 2019	Not met; converted into a prior action (#5) for the Second and Third Reviews with modification
5.	Adoption of a government regulation to ensure the publication of audited, annual financial statements by all state-owned enterprises starting in fiscal year 2019.	To strengthen transparency of state enterprises.	End-June 2019	Met
6.	Publication of a plan, in coordination with IMF technical assistance, to upgrade our current system of taxation to make it more growth-friendly, simpler, and more equitable. The tax reform will be aimed at improving revenue mobilization, increasing efficiency, simplicity, and equity, shifting from direct to indirect taxes, and reducing exemptions and preferential treatment. This reform will target an increase in revenues of 1½ to 2 percent of GDP by 2021.	To improve the tax system.	End-August 2019	Not met, converted into a prior action (#4) for the Second and Third Reviews with modification
7.	Define and publish the eligibility thresholds for social assistance (non-contributory) cash transfer programs included in the definition of the floor on social assistance spending of the central government.	To strengthen social protection.	End-September 2019	Met

Table 2. Ecuador: Prior Actions and Structural Benchmarks (Continued)

Structural Benchmarks		Objective	Date	Implementation Status
8.	Submission of an anti-corruption legislation to the National Assembly including measures to (i) ensure that acts of corruption are criminalized in line with the UNCAC and that preventive measures, in particular with a focus on public officials, are implemented, (ii) freeze, seize and confiscate proceeds of acts of corruption in line with FATF Recommendation 4, and adoption of regulations to ensure that banks and other relevant institutions and professions are required to implement enhanced customer due diligence on senior officials in line with FATF Recommendation 12.	To improve governance and tackle corruption.	End-September 2019	Not met. Proposed to be modified and date proposed to be reset to end-December 2019.
9.	Submission to the National Assembly, in consultation with Fund staff, of amendments to the Central Bank's legal framework to (i) introduce autonomous governance arrangements, (ii) improve its objectives and functions in line with best practice, (iii) provide for the phased-in recapitalization of the Central Bank, (iv) introduce a backing rule that requires a timetable to cover specific Central Bank liabilities with international reserve assets and (v) introduce a prohibition on quasi-fiscal activities of the Central Bank and on monetary financing of the government that prohibits quasi-fiscal spending by the Central Bank, as well as any direct or indirect lending to the non-financial public sector, including that via public banks (this covers the purchase of securities, advances, or guarantees, or financial transactions that are a condition precedent for lending operations entered into by the government but not trade credits), and (vi) introduce modifications to allow for the publication of external auditor's opinion and detailed notes.	To strengthen the institutional underpinnings of dollarization.	End-September 2019	Not met, converted into a structural benchmark (#19) for the Fifth Reviews
10.	Submit to IMF staff a plan of arrears clearance based on the survey of arrears at the central government level.	To strengthen expenditure controls.	End-September 2019	Not met, implemented with delay mid-October 2019.
11.	Submission to the National Assembly, in consultation with Fund staff, of a broad-based growth-friendly tax reform aimed at improving revenue mobilization, increasing efficiency, simplicity, and equity, shifting from direct to indirect taxes, and reducing exemptions and preferential treatment. This reform will target an increase in revenues of 1½ to 2 percent of GDP by 2021.	To improve the tax system.	End-October 2019	Not met, converted into a prior action (#4) for the Second and Third Reviews with modification.

Table 2. Ecuador: Prior Actions and Structural Benchmarks (Concluded)

	Structural Benchmarks	Objective	Date	Implementation Status
12.	Publication of an action plan, in coordination with World Bank technical assistance, to strengthen the efficiency and quality of primary education and health spending.	To improve education and health outcomes.	End-December 2019	Date proposed to be reset to end-June 2020
13.	Submission of a plan to IMF staff, prepared jointly by the Ministry of Economy and Finance and the Central Bank, setting out a plan for divesting the shares in public banks received by the BCE in 2017.	To strengthen the institutional underpinnings of dollarization.	End-December 2019	Date proposed to be reset to end-January 2020
14.	Amend Ministerial Agreement (Acuerdo Ministerial) 447 to formalize the operation of the Financial Committee by establishing at a minimum the following key elements: a) specifying the members of the Committee that include [the Minister, the Vice ministers and the Undersecretaries of SP, STN, SFP, and SPF], b) specifying the roles and responsibilities including in cash management, c) requiring the creation of a Technical Committee composed of [technical staff of Undersecretariats offices] to support the implementation of the Financial Committee decisions and make proposals to the Financial Committee as needed.	To strengthen policy formulation for cash management	End-January 2020	Newly proposed benchmark
15.	Preparation and publication of an action plan to implement the updated eligibility thresholds for social assistance and to accelerate the completion of the upgraded social registry with assistance from Fund staff and in collaboration with the World Bank	To strengthen the social safety net	End-February 2020	Newly proposed benchmark
16.	Modernize computer systems at the level of the central government to introduce necessary changes to collect information on domestic payment arrears of the central government.	To strengthen expenditure controls.	End-January 2020	Date proposed to be reset to end-June 2020
17.	Publication of a Financial Plan, that will accompany the budget proforma to be submitted to the National Assembly, as a mechanism to align the execution of the budget to cash availability.	To strengthen policy formulation for cash management	End-February 2020	Newly proposed benchmark
18.	Submission to the National Assembly of the revised amendments to the Organic Code of Planning and Public Finances and any other relevant laws, in consultation with Fund staff, to (i) limit the discretion of the Executive to amend the annual budget that is approved by the National Assembly and introduce a robust framework for a contingency allocation in the budget, (ii) restrict the use of CETES (treasury certificates) for short-term financing and develop a plan of reducing the current stock of	To strengthen fiscal management and clarify the fiscal rules framework.	End-February 2020	Newly proposed benchmark

	CETES, (iii) explicitly define the institutional coverage of the public debt to be the consolidated nonfinancial public sector and the institutional coverage of the expenditure rule apply to the General Government; (iv) adopt binding annual targets for the NFPS non-oil primary balance, excluding subnational governments, while reinforcing the system of controls over the fiscal balance and borrowing of public entities of the NFPS; (v) introduce the necessary mechanisms to support the effective operation of expenditure rule and its interaction with the Constitutional "golden rule," (vi) adopt a standardized definition of arrears and strengthen their monitoring and reporting, and (vii) introduce a 90-day payment deadline, unless otherwise established by law, contract, regulation or any other valid public act, for the current and capital expenses associated with the acquisition of goods and services from the date of their accrual ("devengo" according to Ecuadorian statutes).			
19.	Submission to the National Assembly, in consultation with Fund staff, of the revised amendments to the Central Bank's legal framework to (i) introduce autonomous governance arrangements, (ii) improve its objectives and functions in line with best practice, (iii) provide for the phased-in recapitalization of the Central Bank, (iv) introduce a backing rule that requires a timetable to cover specific Central Bank liabilities with international reserve assets and (v) introduce a prohibition on quasi-fiscal activities of the Central Bank and on monetary financing of the government that prohibits quasi-fiscal spending by the Central Bank, as well as any direct or indirect lending to the non-financial public sector, including that via public banks (this covers the purchase of securities, advances, or guarantees, or financial transactions that are a condition precedent for lending operations entered into by the government but not trade credits), and (vi) introduce modifications to allow for the publication of external auditor's opinion and detailed notes.	To strengthen the institutional underpinnings of dollarization.	End-April 2020	Newly proposed benchmark
20.	Adopt and implement regulation to enhance the existing online publication of asset declarations of high-level public officials, expanding the quantity of information provided, by including itemized information on assets and	To improve transparency and governance.	End-June 2020	Newly proposed benchmark

	liabilities, and ensuring the easy, searchable, and timely access to declarations.			
21.	Adopt a single budget circular for both current (permanent) and capital (non-permanent) expenditure that includes expenditure ceilings (overall and by category) in consultation with Fund staff.	To strengthen the top-down budgeting approach	End-June 2020	Newly proposed benchmark
22	The Ministry of Finance issues guidelines to the NFPS entities establishing strict information requirements for all the entities of the NFPS on the quarterly and annual data on the stocks of accounts payable and arrears, and on the stocks of financial assets and liabilities (in accordance with the provisions of the COPLAFYP Law (Art. 152) and Regulation (Art 160 and Art 162) requiring that public sector entities (GADs, PEs, and social security institutions) submit financial and accounting information and financial statements and accounting reports to the MEF on a monthly basis). The guidelines should include a requirement on the provision of information on the future repayment schedule of arrears and other accounts payable. The guidelines should also establish information requirements on the steps taken by NFPS entities to prevent accumulation of arrears.	To strengthen expenditure controls.	End-June 2020	Newly proposed benchmark.
23.	Submit to IMF staff a strategy of arrears clearance and prevention based on quarterly and annual data on the stocks of accounts payable and arrears and on the stocks of financial assets and liabilities, by sub-sector of the entire NFPS.	To strengthen expenditure controls.	End-December 2020	Newly proposed benchmark.
24.	Establishment by the BCE of an audit committee, consisting of non-executive directors of the BCE Board, including at least one member with accounting expertise.	To strengthen the institutional underpinnings of dollarization.	End-March 2020	Date proposed to be reset to end-August 2020
25.	Approval of an internal audit charter by the new BCE audit committee, which (i) states the function's mandate, independence, authority, and objectivity; (ii) requires adherence to the Institute of Internal Auditors (IIA) standards; (iii) ensures full coverage of all BCE's activities; and (iv) defines the reporting lines and modalities.	To strengthen the institutional underpinnings of dollarization.	End-March 2020	Date proposed to be reset to end-August 2020

Attachment II. Technical Memorandum of Understanding

This Technical Memorandum of Understanding (TMU) sets out the understandings regarding the definitions of the performance criteria (PCs), indicative targets (ITs), and that will be applied under the Extended Fund Facility, as specified in the Memorandum of Economic and Financial Policies (MEFP) and its attached tables. It also describes the methods to be used in assessing the program's performance and the information requirements to ensure adequate monitoring of the targets.

Any variable that is mentioned herein for the purposes of monitoring a PC or IT and that is not explicitly defined, is defined in accordance with the Fund's standard statistical methodology, such as the Government Finance Statistics. For any variable or definition that is omitted from the TMU but is relevant for program targets, the authorities of Ecuador shall consult with the Fund staff on the appropriate treatment to reach an understanding based on the Fund's standard statistical methodology.

Program exchange rates. For the purposes of the program, the exchange rate of the U.S. dollar for the duration of the program is set as shown in Table 1.

Table 1. Ecuador: Program Exchange Rates

US Dollar to Euro	0.87
US Dollar to Renminbi	6.70
US Dollar to Yen	108.89
US Dollar to SDR	0.71
US Dollar to British Pound	0.76
US Dollar to South Korean Won	1,112.72
US Dollar to Swiss Franc	0.99
US Dollar to Canadian Dollar	1.31
US Dollar to Danish Krone	6.52
US Dollar to Swedish Krone	9.05
US Dollar to Norwegian Krone	8.43
US Dollar to Australian Dollar	1.37
US Dollar to Mexican Peso	19.11
US Dollar to Colombian Peso	3,106.50
Gold prices (US$/ounce)	1,321.25

Source: Bloomberg, as of January 31, 2019.

In addition to the performance criteria listed in Table 1 of Attachment I the arrangement will include the performance criteria standard to all Fund arrangements, namely:

(i) no imposition or intensification of restrictions on the making of payments and transfers for current international transactions;
(ii) no introduction or modification of multiple currency practices;
(iii) no conclusion of bilateral payments agreements that are inconsistent with Article VIII of the IMF Articles of Agreement;

(iv) no imposition or intensification of import restrictions for balance of payments reasons;

These four performance criteria will be monitored continuously.

A. Quantitative Performance Criteria: Definition of Variables

Floor of the Non-Oil Primary Balance of the Non-Financial Public Sector, Including Petroleum Subsidies

Definitions

The Non-Financial Public Sector (NFPS, Sector Público No Financiero) for the purposes of the program consists of the central government (PGE, including universities), Decentralized Autonomous Governments (including municipal governments, provincial governments and parish boards), Social Security Funds (including IESS, ISSFA, ISSPOL and BIESS), Non-Financial Public Corporations (detailed in the table below) and Development Bank of Ecuador (BDE)**.**

Table 2. Ecuador: Non-Financial Public Sector Corporations Covered Under the Definition of NFPS
Empresa Pública de Exploración y Explotación de Hidrocarburos Petroamazonas EP
Empresa Pública de Hidrocarburos del Ecuador Petroecuador EP
Empresa Pública Flota Petrolera Ecuatoriana-EP FLOPEC
Ferrocarriles del Ecuador Empresa Pública - FEEP
Empresa Pública TAME Línea Aérea del Ecuador TAME EP

The non-oil primary balance of NFPS, including petroleum subsidies, is defined as the non-oil primary balance of the NFPS minus spending on subsidies on petroleum products.

The non-oil primary balance of the NFPS is defined as total non-oil revenues (*ingresos no petroleros*) minus primary non-oil spending (*gastos primarios no petroleros*). Primary non-oil revenues are recorded on cash basis.

Revenues explicitly included are:

- Tax revenues (ingresos tributarios), but excluding corporate income tax paid by state-owned oil companies;
- Social security contributions (contribuciones sociales);
- Other revenues (otros ingresos);
- Proceeds from asset monetization (i.e. revenues from the leasing of assets owned by the non-financial public sector);
- Revenues that are explicitly excluded from primary non-oil revenues are:
- Interest income (recorded on cash basis);
- Proceeds from the sale of financial assets;
- Revenues from the privatization of government-owned entities;

- Revenues from oil exports;
- Revenues from the domestic sales of oil derivatives;
- The operating surplus of state-owned oil companies (PetroAmazonas and PetroEcuador);

Primary non-oil spending is recorded on accrual basis and comprises spending on wages and salaries (*sueldos y salarios*), purchases of goods and services (*compra de bienes y servicios*), social security benefits (*prestaciones sociales*), other current spending, capital expenditures not related to oil investment, and net lending. Other current spending excludes cost of imports of petroleum derivatives (*Cuenta de Financiamento de Derivados Deficitarios*) and payments to private operators of oil concessions (*Ministerio de Energía y Recursos Naturales no Renovables*).

Subsidies on petroleum products include, among others, subsidies on gasoline, kerosene, diesel, natural gas and liquified petroleum gas. The subsidies are defined as the difference between the retail sales price of a product and the cost of this product. The cost for imported petroleum derivative products will be estimated as import price plus transportation, storage and commercialization costs and for domestically-produced petroleum products as refinery gate price plus transport, storage and commercialization costs.

Government-funded, public-private partnerships will be treated as traditional public procurements. NFPS government obligations that are accrued on public private partnerships would be recorded transparently in budget data and measured as part of the NFPS government deficit as they accrue. The accrued but not settled obligations related to these public private partnerships will be transparently recorded either as public debt or as a contingent liability of the government (e.g. public guarantees) depending on the nature of the obligation.

Costs associated with divestment operations or the liquidation of public entities, such as the cancellation of existing contracts or severance payments to workers, will be recorded as spending.

All expenditures recorded as a credit in "Account 99" (due to the lack of corresponding budget allocations) will be recorded as spending above-the-line on an accrual basis as the spending obligations accrue.

Adjustor to the floor of non-oil primary balance including petroleum subsidies

The floor on non-oil primary balance including petroleum subsidies will be adjusted downward/upward by US$23.85 million (quarterly) for each US$1 per barrel that the quarterly average APSP crude oil price (i.e. the simple average of dated Brent, West Texas Intermediate, and the Dubai Fateh prices) is above/below the program assumption defined in the table below. This adjustor is capped at US$119.33 million (quarterly).

In the event that the government is required to pay damages in, or settles, the lawsuit that the oil company Perenco has filed against it, the floor on the non-oil primary balance including petroleum subsidies will be adjusted downward by one-half of the amount the government has to pay to Perenco in a given quarter of 2020.

Table 3. Ecuador: Cap on Adjustor Due to Changes in Oil Prices

	2019	2020		
	Q4	Q1	Q2	Q3
Program petroloeum spot crude price (APSP) forecast (US$ per barrel) 1/	61.8	59.9	58.3	57.2

Sources: Ministry of Finance, WEO, and IMF Staff Calculations

1/ APSP is a simple average of UK Brent, Dubai, and West Texas Intermediate spot prices reflecting world exports of light, medium, and heavy crude oil

Monitoring

All fiscal data referred to above and needed for program monitoring purposes will be provided to the Fund within 60 calendar days from the end of each quarter. Preliminary monthly data will be provided with the lag of no more than 45 days after the end of each month.

A floor on social assistance spending of the central government

Definitions

Social assistance spending for the purposes of the program is computed as the sum of central government spending on social assistance programs for the poor, elderly, disabled, and very young comprised of: (i) benefits payments; (ii) financial transaction costs, (iii) costs related to monitoring, accompaniment, and implementation (*gastos conexos*) where applicable; (iv) one-off payments to beneficiaries (e.g. *bonos de emergencia)*; (v) and capital costs related to *Centros de Desarrollo Infantil (CDI), Centros Infantiles del Buen Vivir* (CIBV) and the Social Registry. The social assistance programs included in the definition are as follows:

Mission Less Poverty, More Development

- Bono de Desarrollo Humano
- Bono de Desarrollo Humano – Variable

Mission My Best Years

- Pensión Adultos Mayores
- Pensión Mis Mejores Años
- Servicio de Atención Domiciliar para Adultos Mayores en Extrema Pobreza, Pobreza, y Vulnerabilidad

Mission Las Manuelas

- Pensión Para Personas Con Discapacidad
- Bono Joaquín Gallegos Lara
- Brigada Las Manuelas
- Ayudas Técnicas

Mission Tenderness

- Centros de Desarrollo Infantil (CDI)
- Centros Infantiles del Buen Vivir (CIBV)

Social Registry

Stronger Social Protection

- Programs aimed at protecting poor and vulnerable households from the impact of economic adjustment.

Monitoring

Data recorded at monthly frequency will be provided to the Fund with a lag of no more than 30 calendar days after the end of each month. Data provided the Fund will include expenditure execution, broken down by program and expenditure type (benefits payments, financial transaction costs, costs related to monitoring and implementation ("*costos conexos*"), one-off payments to beneficiaries, and capital costs, if any). Monthly data to also include number of beneficiaries and benefit amount. The authorities will also report any changes to the eligibility requirements under each program.

A floor on the change in the stock of Net International Reserves (NIR)

Definitions

Net International Reserves (NIR) of the central bank (program measure) are computed as the US dollar value of the usable gross international reserve assets of the BCE minus (i) gross reserve-related liabilities to nonresidents of the BCE, and (ii) the reserve holdings of domestic banks and deposits of other financial institutions held at the BCE. Non-U.S. dollar denominated foreign assets and liabilities will be converted into U.S. dollar at the program exchange rates.

Usable gross international reserve assets comprise all readily available claims on non-residents denominated in convertible foreign currencies and controlled by monetary authorities, consistent with the Balance of Payments and International Investment Position Manual (Sixth Edition). Specifically, they include: (i) currency and deposits; (ii) monetary gold; (iii) holdings of SDRs; (iv) the reserve position in the IMF; (v) securities (including debt and equity securities); (vi) financial derivatives; and (vii) other claims (loans and other financial instruments).

- Specifically excluded from gross international reserves are:
- Any precious metals or metal deposits, other than monetary gold, held by the BCE
- Assets in nonconvertible currencies and illiquid assets
- Claims on residents

- Any reserve assets that are pledged, collateralized or otherwise encumbered (in so far as those assets are not already excluded from gross international reserve assets of the central bank), including assets tied up in repurchase agreement transactions
- Net positions with ALADI and SUCRE

Gross reserve-related liabilities comprise:

- All short-term liabilities of the BCE vis-à-vis non-residents denominated in convertible foreign currencies with a remaining maturity of one year or less
- Short-term liabilities of the central government with maturity of less than 30 days
- The stock of IMF credit outstanding but excluding credit transferred by the Fund into a Treasury account to meet the government's financing needs directly
- The nominal value of all derivative positions (including swaps, options, forwards, and futures) of the BCE, implying the sale of foreign currency or other reserve assets

The reserve holdings of domestic banks held at the BCE comprise:

- All liabilities of the BCE to other depository institutions (*otras sociedades de depósitos*, as defined in the BCE's Metodología: Información Estadística Mensual, 4th Edition of May 2017).

The deposits of other financial institutions at the BCE comprise:

- All liabilities of the BCE to other financial institutions (*otras sociedades financieras*, as defined in the BCE's Metodología: Información Estadística Mensual, 4th Edition of May 2017), with the exception of deposits of the BIESS, including those held in trust funds ("fideicomisos BIESS y fideicomisos IESS).

Adjustors to the floor on the change in the stock of Net International Reserves

The floor on net international reserves will be adjusted upward/downward by the amount of borrowing from non-residents above/below that envisioned under the program, as reported in the table below and net of issuances related to liability-management operations that have no net impact on the outstanding stock of NFPS debt. Borrowing from non-residents will comprise issuance of international bonds.

Table 4. Ecuador: Cumulative Adjustors Due to International Borrowing in Excess of Program Assumptions

	2019		2020	
in US$ million	Q4	Q1	Q2	Q3
Total market issuance consistent with program targets (cumulative) 1/	3000	0	0	0

1/ These adjustors will be applied from the third review onwards.

The floor on the change in the stock of net international reserves will be adjusted downward/upward by the shortfall/excess in program loan disbursements from the IMF and other multilateral institutions (IADB, World Bank, CAF, and FLAR) as well as grants, relative to the baseline projection reported in Table 5. Program loan disbursements are defined as external loan disbursements (excluding project financing disbursements) from official creditors that are freely usable for the financing of the NFPS budget operations.

Table 5. Ecuador: Cumulative Adjustors Due to Shortfall in Program Loan Disbursements by Multilaterals

	2019		2020	
in US$ million	Q4	Q1	Q2	Q3
Expected disbursement of program loans by multilaterals (cumulative) 1/	2693	501	1152	2289

1/ These adjustors will be applied from the third review onwards.

The floor on the change in net international reserves will be adjusted upward/downward by US$21.7 million (quarterly) for each US$1 per barrel that the quarterly average APSP crude oil price (i.e. the simple average of dated Brent, West Texas Intermediate, and the Dubai Fateh prices) is above/below the program assumption defined in Table 6. This adjustor is capped at US$108.5 million (quarterly).

Table 6. Ecuador: Cap on Adjustor Due to Changes in Oil Prices

	2019		2020	
	Q4	Q1	Q2	Q3
Program petroloeum spot crude price (APSP) forecast (US$ per barrel) 1/	61.8	59.9	58.3	57.2

Sources: Ministry of Finance, WEO, and IMF Staff Calculations

1/ APSP is a simple average of UK Brent, Dubai, and West Texas Intermediate spot prices reflecting world exports of light, medium, and heavy crude oil

In the event that the government is required to pay damages in, or settles, the lawsuit that the oil company Perenco has filed against it, the stock of Net International Reserves will be adjusted downward by one-half of the amount the government is required to pay to Perenco in a quarter of 2020 when the payment falls due.

Monitoring

The change in net international reserves will be measured as the change in the stock of NIR at each test date relative to the stock on December 31, 2018 which stood at US$2.9 billion, according to the

NIR definition adopted in the first review. Foreign exchange asset and liability data will be provided to the Fund at weekly frequency within 5 business days.

Ceiling on external payment arrears by the non-financial public sector

Definitions

External debt is determined according to the residency criterion except in the case of the debt securities for which the criterion is the place of issuance of the instrument. The term "debt" will be understood to mean a current, i.e., not contingent, liability, created under a contractual arrangement through the provision of value in the form of assets (including currency) or services and which requires the obligor to make one or more payments in the form of assets (including currency) or services, at some future point(s) in time; these payments will discharge the principal and/or interest liabilities incurred under the contract. Debts can take several forms; the primary ones being as follows: (i) loans, i.e., advances of money to the obligor by the lender made on the basis of an undertaking that the obligor will repay the funds in the future (including deposits, bonds, debentures, commercial loans and buyers' credits) and temporary exchanges of assets that are equivalent to fully collateralized loans under which the obligor is required to repay the funds and usually pay interest, by repurchasing the collateral from the buyer in the future (such as repurchase agreements and official swap arrangements); (ii) Suppliers' credits, i.e., contracts where the supplier permits the obligor to defer payments until sometime after the date on which the goods are delivered or services are provided; and (iii) Leases, i.e., arrangements under which property is provided which the lessee has the right to use for one or more specified period(s) of time that are usually shorter than the total expected service life of the property, while the lessor retains the title to the property. For the purposes of the program, the debt is the present value (at the inception of the lease) of all lease payments expected to be made during the period of the agreement excluding those payments that cover the operation, repair or maintenance of the property.

Under the definition of debt set out above, arrears, penalties and judicially awarded damages arising from the failure to make payment under a contractual obligation that constitutes debt are debt. Failure to make payment on an obligation that is not considered debt under this definition (e.g., payment on delivery) will not give rise to debt.

External payment arrears for program monitoring purposes are defined as external debt obligations (principal and interest) falling due after March 11, 2019 that have not been paid within 90 days of the due date, considering the grace periods specified in contractual agreements.

Coverage

This performance criterion covers the non-financial public sector. This performance criterion does not cover (i) arrears on short-term trade credit or letters of credits; (ii) arrears on debt subject to renegotiation or restructuring; and (iii) arrears resulting from the nonpayment of commercial claims that are the subject of any litigation initiated prior to March 11, 2019.

Monitoring

This PC will be monitored on a continuous basis.

Ceiling on new gross central bank direct financing to the NFPS and indirect financing to the NFPS through the public banks.

Definitions

Central bank (BCE) direct financing to the NFPS and indirect financing to the NFPS through the public banks includes overdraft transfers from the BCE to the entities of the NFPS as defined above, advance distribution of unrealized profits from the BCE, the BCE acquisition of government debt on the primary market or by purchase from public institutions, and the BCE lending to public banks for the purpose of acquisition of government debt on the primary market or by purchase from public institutions.

Monitoring

This PC will be monitored on a continuous basis. Monthly data on amortizations and disbursements of credit to NFPS and to publicly-owned banks for the purposes of financing the non-financial public sector will be provided within 5 business days to the Fund.

B. Indicative Targets (IT): Definition of Variables

A floor on the overall balance of the non-financial public sector (IT)

Definitions

The Non-Financial Public Sector (NFPS) is defined as above.

The overall balance of the NFPS is defined as the non-oil primary balance of the NFPS plus the oil balance of the NFPS plus interest revenues of the NFPS minus interest expenditures of the NFPS.

The oil balance of the NFPS will be defined as the sum of (i) revenues from oil exports, (ii) revenues from the domestic sales of oil derivatives, and (iii) the operating surplus of state oil companies (PetroAmazonas and PetroEcuador) minus the sum of (i) expenditures on investment in the oil sector, (ii) expenditures on imports of petroleum derivatives (de Financiamento de Derivados Deficitarios), and (iii) payments to private oil companies (Ministerio de Energia y Recursos Naturales no Renovables).

NFPS interest expenditures are measures on cash basis while all other expenditures are measured on accrual basis.

Monitoring

All fiscal data referred to above and needed for program monitoring purposes will be provided to the Fund with a lag of no more than 60 calendar days after the end of each quarter and preliminary data with the lag of no more than 45 days after the end of each month.

C. Other Information Requirements

In addition to the data needed to monitor program conditionality, the authorities will also provide to Fund staff the following data to ensure adequate monitoring of economic variables:

For the purposes of the program, the NFPS debt stock will be defined in accordance with IMF Government Finance Statistics Manual 2014 (GFSM 2014) and Public Sector Debt Statistics: Guide for Compilers and Users. Total gross NFPS debt will cover all liabilities that are debt instruments. A debt instrument is defined as a financial claim that requires payment(s) of interest and/or principal by the debtor to the creditor at a date, or dates, in the future. The following instruments are considered debt instruments:

- Special drawing rights (SDRs);
- Currency and deposits;
- Debt securities;
- Loans;
- Insurance, pension, and standardized guarantee schemes; and
- Other accounts payable.

All liabilities included in the GFSM balance sheet are considered debt, except for liabilities in the form of equity and investment fund shares and financial derivatives and employee stock options. Equity and investment fund shares are not debt instruments because they do not require the payment of principal or interest. For the same reason, financial derivatives are not considered debt liabilities because no principal is advanced that is required to be repaid, and no interest accrues on any financial derivative instrument.

Following the above manuals, Ecuador's debt should include the following instruments:

- Debt securities (held by non-residents and residents, not included in the NFPS entities)
- Bonds
- Treasury certificates
- Loans
- Other accounts payables
- Advanced oil sales
- Schlumberger deal
- Arrears with resident suppliers.

Any liabilities issued by entities of the NFPS, held as an asset by other entity of the NFPS should be netted out. Since the consolidation is done at the level of NFPS, central bank lending to the government is included in the stock of NFPS debt.

Monitoring

The data on NFPS stock of debt in U.S. dollars will be provided to the Fund monthly with a lag of no more than 30 calendar days after the end of each month.

Weekly

Consolidated balance sheets of the banking system, by main accounts, including deposits in the banking system, available funds, and credit to the private sector; BCE balance sheet; Financial indicators: interest rates, deposits of banks at the BCE, interbank rates.

Monetary data in the template agreed with Fund staff, no later than 5 business days.

Monthly

NFPS financing data compiled based on the detailed information on financial assets and liabilities, namely, deposits, loans, securities, equities, other accounts payable including oil related, and their amortizations, disbursements and arrears accumulation when the information on the latter becomes available.

NFPS cash flow data from the beginning to the end of the current fiscal year, with a lag of no more than 60 days after the closing of each month. This will include expected monthly amortizations and repayments on NFPS debt as defined above.

Provision of detailed information on collateralized debt and debt with similar arrangements, such as repo transactions and other similar debt involving the pledge, sale/resale, or encumbrance of assets within 2 weeks of signing new contracts. The information on collateralized debt and debt with similar arrangements will include all contracts related to such debt; information on the escrow accounts overseas that serve as collateral; and detailed information for each creditor on the stock of debt, its terms (including on the amounts pledged, sold/resold, or encumbered, as well as any related commitments or obligations to purchase related or unrelated goods and/or services from the lender), and expected repayment schedules.

Quarterly

Detailed balance of payments data, no later 90 days.

Statement by Afonso S. Bevilaqua, Executive Director for Ecuador
Pedro Fachada, Alternate Executive Director, and
Francisco Rivadeneira, Advisor to Executive Director

December 19, 2019

1. On behalf of our Ecuadorian authorities, we thank the mission team for its comprehensive report and continuous engagement with Ecuador. We would also like to extend our gratitude to management, staff and Executive Board members for their unwavering support to Ecuador's economic transformation and for indispensable technical assistance. This support is greatly appreciated, even more so considering the exceptional circumstances the country has experienced in recent months.

2. Despite a challenging environment, the Ecuadorian authorities continue to make satisfactory progress in the implementation of the Extended Fund Facility (EFF) arrangement. All performance criteria and indicative targets for end-June were comfortably met, particularly for the non-oil primary balance including fuel subsidies (NOPBS), the main fiscal anchor under the program. Similarly, for end-September 2019, performance criteria and indicative targets were met, except for the criterion on the net international reserves. The main structural benchmarks and all prior actions have also been met for the combined second and third reviews.

3. The authorities are fully committed to their reform agenda notwithstanding the recent social unrest, which made policy implementation more difficult. The situation of social discontent that has unfortunately recently occurred in Ecuador has also taken place in other countries in the region and has complex causes that are not unique to Ecuador's circumstances. In his effort to restore peace, President Moreno engaged directly with all the main segments of Ecuadorian civil society. This dialogue proved fruitful as the political and social situation in Ecuador has since returned to a relative state of normalcy.

4. The authorities acknowledge that the need to move away from the unaffordable level of fiscal spending seen in the period of high oil prices triggers social resistance and requires determination and a diligent effort to build consensus. Despite the possible negative reaction to some of the measures, the authorities maintained their resolve to undertake the necessary structural adjustment, consistent with macroeconomic rebalancing. All options were carefully considered, including revenue measures such as an increase in VAT rate. Unfortunately, the political forces represented in the National Assembly did not ensure enough support to approve a VAT increase. In those circumstances, the administration decided in early October to eliminate the subsidy on low-octane gasolines and diesel fuels, not without first consulting and seeking consensus from involved parties of the transport sector. Subsidy reform, which depends uniquely on an executive branch decision, had been successful at the beginning of the year when the subsidy on high-octane gasoline was eliminated. It is important to emphasize that the Executive never considered removing the subsidy on gas used for cooking by lower income population, given the impact on the most vulnerable in society.

5. In mid-October, the authorities decided to suspend the elimination of energy subsidies to reestablish social cohesion. However, they maintain the view that energy subsidies, in general, are regressive and biased towards the wealthier segments of society. They also contend that these subsidies have a negative impact on the environment and leads to considerable smuggling of gasoline and diesel across the Ecuadorian border. Negotiations with vast sectors of civil society are underway to reach an agreement on the progressive reduction of subsidies during next year. This process will take into account measures to protect the most socially and economically vulnerable. The authorities are working with the World Bank to rapidly update the social registry and its thresholds in order to maximize the impact of the social protection measures on those affected.

6. Despite the lack of political and popular support to increases in VAT and reduction in energy subsidies, the authorities have not abandoned their quest for viable alternatives. An important milestone was the successful approval by the National Assembly of a tax reform on December 9, 2019. This will enable the government to collect additional taxes amounting to approximately 0.5 percent of GDP in both 2020 and 2021, only slightly below the 0.7 percent of GDP in net terms expected to be collected with the package of economic reforms rejected by the Assembly on November 17, 2019.

7. The authorities intend to undertake additional reforms that will be presented to the Assembly in due course. The Organic Budget Code and the Central Bank Code are two vital reforms that will be reintroduced at the beginning of next year. The anticorruption reforms will be presented at the end of this month. Moreover, the state-owned enterprises and the Public-Private Partnerships bills will also be presented in 2020. The government is determined to build sufficient support to pass these laws through the legislative body.

8. The authorities are firmly committed to strengthening public financial management (PFM), improving the credibility of the budget, enhancing cash management operations and better managing expenditure arrears. This is intended to boost fiscal transparency and improve budget formulation and expenditure controls to align the country's fiscal reporting with international best practice. Efforts are also under way to strengthen tax administration.

9. The economy continues to exhibit the expected performance as growth decelerates, and inflation remains subdued. The latest available data indicates that real GDP expanded by 0.3 percent year-on-year in the second quarter of 2019, compared with growth of 0.6 percent in the previous quarter. Household consumption and net exports contributed positively to quarterly GDP growth during the two first quarters of GDP, while government consumption and gross fixed capital formation contracted in the period. For the second half of 2019, growth is estimated to be weaker given the adverse impact of protest actions on the oil, agriculture and retail sectors, ongoing fiscal consolidation and weaker confidence compared to the first half of the year.

10. Consumer prices continue to be relatively stable as inflationary pressures have been muted. On a year-to-year basis, headline inflation was zero percent in November 2019, a deceleration from the temporary uptick of 0.5 percent in the previous month when the first-round effect of the short-lived withdrawal of fuel subsidies had a noticeable impact on the cost of transportation and other goods. Nonetheless, inflation is expected to remain low over the medium term, contributing to increase Ecuador’s external competitiveness.

11. Growth in private sector credit and in banking deposits have been encouraging in 2019 thus far, despite slowing marginally in recent months. In the twelve months prior to October, lending to the private sector increased by 12.1 percent, reflecting some resilience in economic activity. Partly, this coincided with the continuous improvements in business sentiments, which prevailed during the year until the social unrest in October. Despite the episode of social and political instability, bank deposits also continued to increase over the year. It is important to highlight that deposits are a fundamental indicator of confidence in a dollarized economy, and Ecuador indeed suffered a dangerous contraction of deposits in 2015-2016.

12. Fiscal consolidation this year is relatively less than initially expected due to delays in asset monetization operations and lower savings on compensation in the public sector. Furthermore, the anticipated savings from reducing fuel subsidies are also expected to be lower. As such, the non-oil primary balance is projected to be -3.4 percent of GDP for 2019, down from -2.9 percent of GDP at the time of the first review. Nonetheless, the authorities will continue their fiscal consolidation effort in 2020 and 2021, with an estimated 1.7 percent of GDP and 1 percent of GDP adjustment, respectively. They also noted the importance of engaging in an effective public consultation with all stakeholders to mitigate the likelihood of adverse social consequences in their continued effort to ensure fiscal sustainability.

13. Against the backdrop of the unfortunate events that occurred recently, the authorities are recalibrating the envisaged improvement in NOPBS from 5 percent of GDP between 2018 and 2021 to 3.9 percent of GDP. The authorities believe that a 3.9 percent of GDP adjustment in three years will be significant, realistic, and sufficient to ensure public debt sustainability. Net international reserves have also been reduced for the rest of the program to adjust to the new reality, this without jeopardizing the foundations of the dollarization and the stability of the financial system by, for example, fully covering their deposits at the Central Bank. These modifications will give the government some room to have necessary policies that permit resuming growth in 2020 and maintaining social stability.

14. In conclusion, we thank again the Executive Board for the support to Ecuador. With the slight adjustments to the EFF agreed with staff, the authorities are confident that the program with the Fund will advance and reach a successful conclusion in 2022, overcoming the country's fiscal challenges, while promoting inclusive growth and protecting the most vulnerable.