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Ecuador: Negotiations end favorably

Agreements with China closed on a high

Yesterday Ecuador announced a new free trade agreement with China, concluding the round of talks initiated when Mr. Lasso visited Beijing in Feb-22.

Yesterday Ecuador announced a new free trade agreement with China, concluding the round of talks initiated when Mr. Lasso visited Beijing in Feb-22. The agreement was closed in under 10 months in four rounds of negotiations. The main points to highlight in the agreement include the reduction of tariffs, improved customs procedures, cooperation for investment, promotion of electronic commerce, enhanced competition and transparency in a framework of increased economic cooperation. The agreement will allow preferential access for 99% of Ecuador's current exports to China, mainly products such as shrimp, bananas, flowers, cocoa and coffee but it will also open the doors for the export of non-traditional products, mostly of agricultural or agro-industrial origin. The agreement anticipated the sensibilities of the manufacturing and agricultural sectors, and establishes several exceptions, in addition to a gradual tariff reduction to allow the country to adapt. In addition, tariff free access to raw materials, inputs, tools and equipment should reduce production costs for the Ecuadorian industry, benefitting the sector and consumers. The signing of the agreement still has to take place and is expected to occur after the respective governments finalize formalizing the offers and reviewing the agreement.

Figure 1: The agreement favors Ecuador's largest export set

USDmn	Jan-Oct-21	Jan-Oct-22	Δ %	Δ USDmn
Exports	21,989	27,482	25.0%	5,493
Oil	**7,491**	**9,859**	**31.6%**	**2,368**
o/w China	450	104	-76.9%	-346
Non-Oil	**14,498**	**17,623**	**21.6%**	**3,125**
o/w China	2,323	4,901	110.9%	2,578
Traditional	8,146	10,148	24.6%	2,002
Non- Traditional	6,352	7,476	17.7%	1,124
Total China	2,774	5,005	80.4%	2,231
Imports	19,189	25,224	31.5%	6,035
o/w China	3,604	4,580	27.1%	975
Trade Balance	**2,800**	**2,258**	**-19.4%**	**-542**
o/w China	-831	425	-151.2%	1,256

Source: TPCG Research based on the IMF

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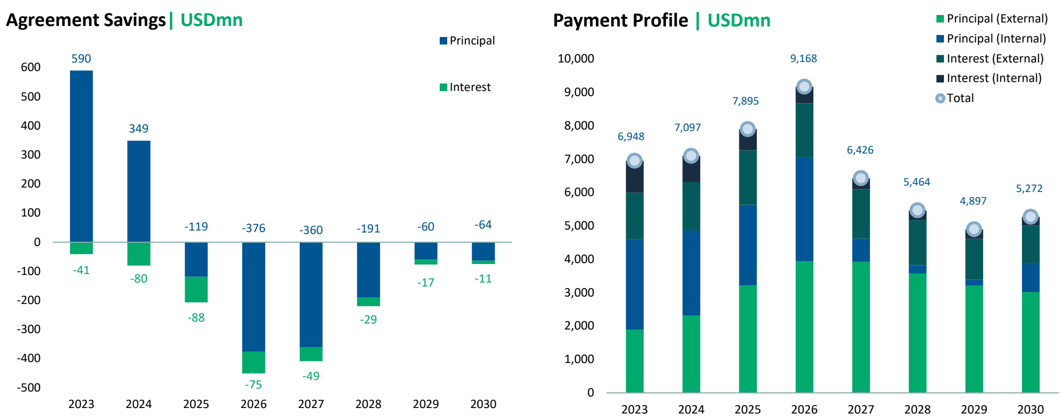
We believe the agreement should be beneficial for Ecuador, with the focus on non-Oil products being appropriate. Currently, the joint trade between Ecuador and China exceeds USD10bn, with the latter becoming the former's main non-oil trade partner. In this context, the agreement is likely to be very beneficial for Ecuador's exports. Looking at YTD data, Ecuador enjoys a trade surplus with China (USD425mn), with the Latin American country exporting more to China than receiving imports, putting it in pole position to benefit from the agreement, especially if the global scenario continues to favor commodities. In addition, both Ecuador's exports and imports to and from China are 98% Non-oil, making the focus of the agreement adequate. Finally, even as the country's oil exports boomed throughout 2022 (+31.5%yoy) even compensating for a decrease in volume (-7.4%yoy), Non -oil exports continue to be the largest subsection, accounting for 64% of exports, and have also increased by +21.6%yoy. All in all, the trade agreement is likely to benefit the largest sector of Ecuadoran exports in a context the latter have the upper hand relative to Chinese imports. However, the implementation of the treaty is still unclear, and the final impact of the accord is likely to be determined by said details.

In addition, in a previous round of talks, Ecuador was able to restructure the country's bilateral debt with China.

In addition, in a previous round of talks, Ecuador was able to restructure the country's bilateral debt with China. The country has four active loans with Chinese banks, including the Bank of China (USD365mn), the Chinese Development Bank (USD1.5bn) and China's Eximbank (USD2.2bn). The amount outstanding of said loans amounts to nearly USD4bn, with Ecuador having to pay back the bulk of the principal between 2023 and 2030. With the restructuring, the administration was able to space the profile payment, which was heavily frontloaded, as between 2023 and 2024 principal payments amounted to USD2.3bn. After the negotiations, for the same years Ecuador will have to cancel only USD1.3bn. In addition, China granted a slightly lower interest rate for the remainder of the payments, albeit the postponement of the principal payments over a longer period does outweigh the reduction in the borrowing costs, compounding into higher interest payments for the country. Therefore, net savings for 2023 would total USD550mn, as a 590mn reduction in principal payments is slightly offset by the USD40mn increase in interest payments, while for 2024 said savings would amount to USD268mn (-USD350mn in principal, +80mn in interest).

Figure 2: The restructuring has negative implications in the medium term



Source: TPCG Research based on the Finance Ministry

In our view, the move is positive for short term financing needs, as the administration was able to punt a substantial payment down the field, albeit raising questions around medium term debt sustainability.

In our view, the move is positive for short term financing needs, as the administration was able to punt a substantial payment down the field, albeit raising questions around medium term debt sustainability. Even as the restructuring was able to decompress financing needs for 2022, 2023 and 2024, those payments now fall mostly in the 2026-27 period, as instead of USD445mn Ecuador will have to pay around USD1.2bn, plus increased interest. In fact, net savings are very negative for the 2026-27 period. Interest payments are increased by USD124mn, while principal payments spike by USD736mn, marking a nearly 1bn increase in financing needs. Compounding the restructuring with Ecuador's full payment profile, the effect tends to be somewhat negative for the medium term. With Ecuador's entire payment profile spiking in 2026, as the Eurobonds principal starts to sink, the agreement carries the potential to crowd out Ecuador's payment profile. Still, Mr. Lasso punted the ball beyond his current tenure, ensuring a relatively easier time from now until the next elections in 2025.

The economy evolves favorably, with 3Q GDP rising by +3.2%yoy

GDP figures in 3Q22 surprised on the upside, posting a +3.2%yoy increase, driven by a solid performance of the services sector.

GDP figures in 3Q22 surprised on the upside, posting a +3.2%yoy increase, driven by a solid performance of the services sector. The main drivers behind the quarterly rise came on the back of the tertiary sector, with Commerce (+2.3%yoy; contributing 0.3pp to growth), Transport (+4.3%yoy; 0.3pp) Communications (+8%yoy; 0.3pp) and Health & Education (+3.4%yoy; 0.3pp) spearheading the increase. As exhibited by the mentioned figures, the tertiary sector grew evenly, as a boost in disposable income increased PCE. In addition, Hotels & Restaurants (+11.8%yoy), Professional Activities (+3.6%yoy) and Other Services (+3%yoy) contributed 0.2pp to growth each, with only

Financial Services (+3%yoy; 0.1pp), Public Administration (+1.1%yoy; 0.1pp) and Domestic Services (-0.8%yoy; 0.0pp) contributing less. On the primary sector, the standout performer was Shrimp Fishing (+14.5%yoy; 0.2pp), which is expected to close a record year in exports. Oil and Mines also exhibited some moderate growth (+0.8%yoy; 0.1pp), contrasted by the weak Agriculture sector (-1.5%yoy; -0.1pp) and a substantial drop in the Fishing sector (ex. Shrimp), which fell -7.2%yoy, slashing 0.1pp from GDP growth. Finally, the secondary sector closed an average quarter, with solid growth in Power & Water (+9.5%yoy; 0.3pp) and a moderate performance of Manufactures (+0.5%yoy; 0.1pp) being partially offset by a substantial -16.7%yoy drop in Oil refining, slashing 0.2pp from GDP growth, as the sector was strongly affected by the social protests. Finally, Construction came roughly level with 3Q22 levels, rising by just 0.1%yoy, and having no impact on GDP growth.

Figure 3: Growth surprised on the upside during 3Q22

%yoy	2021	1Q22	2Q22	3Q22
GDP	4.2%	4.0%	1.9%	3.2%
Internal Demand	8.1%	6.0%	4.6%	3.0%
PCE	10.2%	6.6%	4.8%	3.8%
Govt. Consumption	-1.7%	6.1%	1.8%	2.0%
Investment	4.3%	2.1%	2.5%	1.0%
Exports	-0.1%	-0.6%	-0.8%	0.1%
Imports	13.2%	6.4%	8.6%	-0.4%

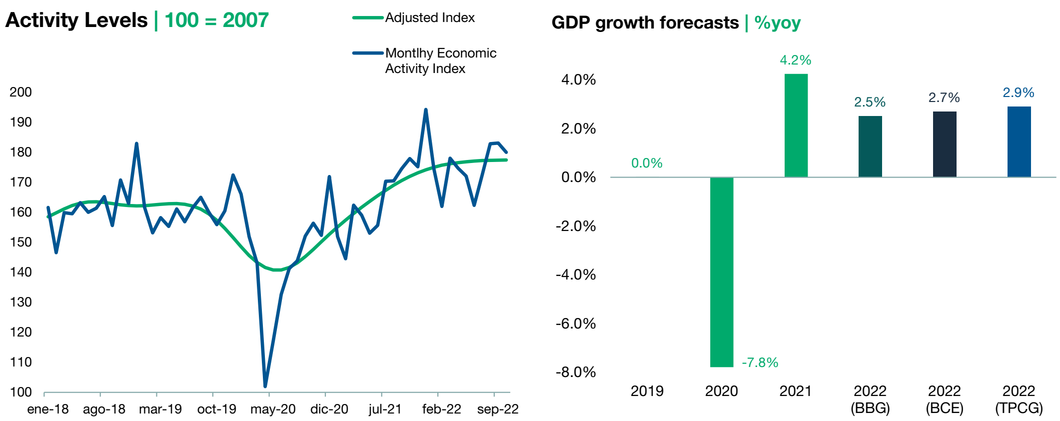
%yoy	2021	1Q22	2Q22	3Q22
GDP	4.2%	4.0%	1.9%	3.2%
Agriculture	0.4%	-1.3%	-3.8%	-1.5%
Shrimp	16.2%	28.5%	13.5%	14.5%
Fishing (w/o shrimp)	11.0%	-5.4%	-10.0%	-7.2%
Oil and Mines	0.8%	-3.9%	-5.2%	0.8%
Oil refining	23.9%	-1.4%	-4.8%	-16.7%
Manufactures	3.1%	2.2%	0.4%	0.5%
Power and Water	0.8%	8.4%	7.5%	9.5%
Construction	-6.6%	-0.5%	0.1%	0.1%
Commerce	11.0%	6.6%	4.2%	2.3%
Restaurants and Hotels	17.4%	11.0%	13.6%	11.8%
Transport	13.1%	6.6%	4.4%	4.3%
Communications	9.7%	9.7%	10.1%	8.0%
Financial Services	10.0%	1.2%	1.7%	3.0%
Professional Activities	2.0%	2.4%	3.3%	3.6%
Health and Education	-0.8%	6.2%	0.9%	3.4%
Public Administration	-0.6%	4.2%	2.8%	1.1%
Domestic Service	-9.2%	-1.0%	-0.7%	-0.8%
Other Services	3.1%	2.8%	1.2%	3.0%

Source: TPCG Research based on BCE

On the demand side, growth was mainly driven by recovering PCE, which came in at record levels during 3Q22.

On the demand side, growth was mainly driven by recovering PCE, which came in at record levels during 3Q22. As the economy recovered and disposable income rebounded, PCE spearheaded GDP growth, exceeding the headline economy's increase, rising by +3.8%yoy. This explained over 80% of Ecuador's growth, contributing 2.5pp. Govt. Consumption also experienced healthy growth, hiking by +2%yoy, adding a timid 0.3pp contribution. Investment underperformed the general trend, coming in at +1%yoy, adding 0.2pp to GDP growth. The segment was very likely affected by the strong uncertainty presented by the social turmoil that enveloped the start of the quarter. On the external side, contributions were minimal, as both a marginal drop in Imports (-0.4%yoy) and a slight rise of Exports (+0.1pp) did not manage to make a dent in GDP figures. Finally, the print was able to surpass 4Q19 levels, positioning itself over pre-pandemic levels.

Figure 4: We expect the economy to grow by +2.9%yoy in 2022



Source: TPCG Research based on BCE

With 3Q GDP figures coming in over forecasts, we expect the economy to overperform the BCE's estimate of +2.7% for 2022.

With 3Q GDP figures coming in over forecasts, we expect the economy to overperform the BCE's estimate of +2.7% for 2022. With the +3.2%yoy increase in the 3Q22, now just the statistical carry would allow the economy to reach the BCE target. Even posting a small -0.3qoq contraction during 4Q22 would end up compiling to a +2.7% yearly growth. High frequency indicators point at a slight deacceleration of economic activity during October, which might signal a minor slowdown in economic activity during 4Q, as the index showed practically no variation, against a steady +0.1%mom rise during 3Q. Still, we expect the economy to perform robustly, albeit marginally below 3Q22. In this context, we expect growth to come in just shy of the +3% mark, at +2.9%, which is consistent with a +3%yoy growth in the 4Q22, and a 0.5%qoq increase, which hovers very closely to the historic growth for the 4Q. A pre-print Bloomberg survey indicated analysts expected growth to underperform the mark established by the BCE, with the median expecting an annual growth of +2.5%yoy.

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