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TPCG LATAM
ECUADOR STRATEGY VIEW

Ecuador – Strategy
January 13, 2023

The 2023 Year Ahead: Life after the IMF program

- **With high-frequency indicators exhibiting solid growth, we expect current dynamics to spill over to 2023, with our baseline scenario expecting growth at +2.5%.** Economic activity seems resilient against the political and social turmoil enveloping 2022, with solid growth perspectives. Looking at GDP figures, we expect Ecuador to grow by +2.9% in 2022, slightly over official forecasts, as the 3Q22 print surprised on the upside, while 2023 growth should be driven by the services sector but could prove vulnerable to the global scenario.
- **As previously announced, Ecuador managed to comply with most of the QPC and IT in the Sixth review, and a new program with the IMF could be in the works for 2023.** With this, Ecuador successfully completed its IMF program, and received the last USD700mn disbursement in December, as the administration is allegedly on talks to access a new program with the Fund. On paper, the likelihood of a fully-fledged program seems unlikely unless the international scenario turns against Ecuador.
- **The political situation should remain fragile, with all eyes zeroing in on February's dual referendum and elections.** In this context, the referendum stands to be the government's silver bullet, as a solid result could make the "Muerte cruzada" threat more meaningful. If the popular consultation verifies the divergence between popular opinion and Assembly composition, Mr. Lasso could have an extra bargaining chip to unlock the Gordian Knot Ecuadoran politics have become.
- **Without the straitjacket of the IMF program, fiscal figures should suffer in 2023, especially as Oil prices decrease, albeit still in line with the administration's track record.** Ecuador's fiscal consolidation has been robust since the start of Mr. Lasso's tenure, with the 12m-rolling deficit figures in October exhibiting a 1.4pp compression relative to 2021. Rising Oil Revenues, cuts in Non-current expenditure, and Non-Oil Income mostly drove consolidation. For 2023, the budget expects the fiscal deficit to close at -2.1 of GDP, with the primary balance at -0.1pp of GDP, an estimate which looks wide. Our baseline scenario sees the deficit ending the year at +0.2pp, with a primary balance of +1.7%.
- **Looking at GFNs, we construct three different scenarios, stress-testing the resilience of the primary balance and the resulting borrowing needs against variations in Oil Prices.** Our baseline scenario points at Ecuador possibly tapping international markets next year, with a financing gap of around USD0.6bn. The second scenario sees Ecuador returning to international markets by 2025, while the third could see Ecuador enter a comprehensive IMF program this year. Beyond 2025 Ecuador's GFN's spike, clouding the country's medium-term outlook, especially with the presidential elections muddling expectations even further.
- **We expect both Imports and Exports to slow down their growth in 2023, conditional on the international scenario.** BoP flows continue to be supportive, worsening slightly relative to 2021 as the strong recovery in disposable income drove a surge in Imports. For 2023, figures should plateau, but incoming trade agreements could keep some momentum for the external sector.
- **We maintain our OW in the ECUA space.** We believe the EXD curve has a significant upside if the political arena stabilizes as macro fundamentals continue strong.

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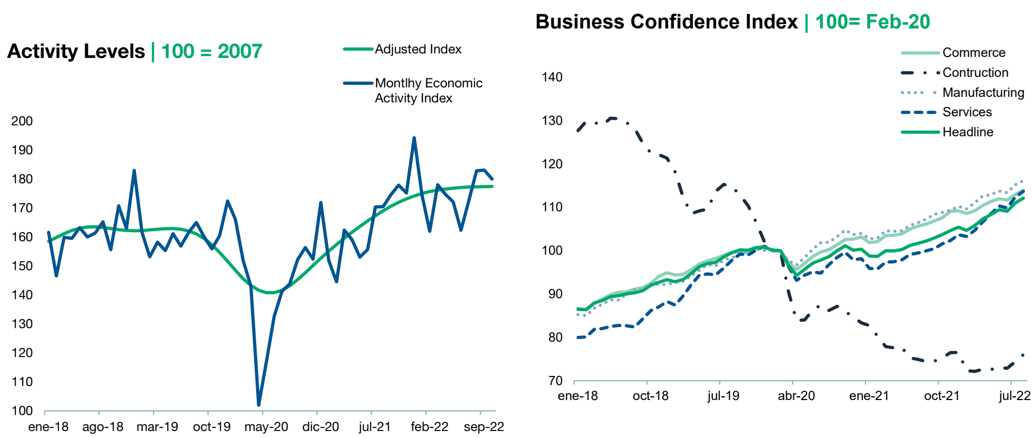
The economy should close a solid 2022

Economic activity seems resilient against the political and social turmoil enveloping 2022, with solid growth perspectives.

Economic activity seems resilient against the political and social turmoil enveloping 2022, with solid growth perspectives. Most high-frequency indicators convey that activity levels continue to perform in line with expectations, with the economy forecasted to grow by around +2.7% in 2022. The monthly activity indicator (IDEAC) exhibited a +7.5% improvement up to October, leaving the economy well over pre-COVID levels. Confidence indicators also point to a recovering economy. The three items gathered by the Consumer Confidence Index (Present Situation, Future Expectations, and Consumer Confidence) exhibit positive yoy variations YTD. The Present Situation index is, in fact, +6.9%yoy over the Jan-Oct-21 average. On the other hand, future expectations rose marginally, by +1.5%yoy against a still pandemic stricken 2021. Finally, consumer confidence is up by +4.9%yoy on average against the Jan-Oct-21 period. Still, the three indexes suffered a mom reversal in October. Up to September, all indicators exhibited a relatively solid trend, especially in the unstable political and social scenario, which weakened figures from June to August. Finally, the Business Confidence Index indicates several sectors' solid economic performance. The Commerce (+7.0%yoy), Manufacturing (+7.9%yoy), and Services (+11%yoy) subsections of the indicator performed robustly YTD, explaining the headline index's +8.1%yoy rise. However, on negative news, the Construction subsection of the indicator is down by -5.6%yoy, likely explained by the severe social turmoil affecting long-term investment, adding substantial uncertainty. All in all, high-frequency indicators point to a robust economic recovery, still somewhat bloated by the baseline effect of the pandemic-stricken 2021 figures.

Figure 1: Activity levels point to a solid economic recovery

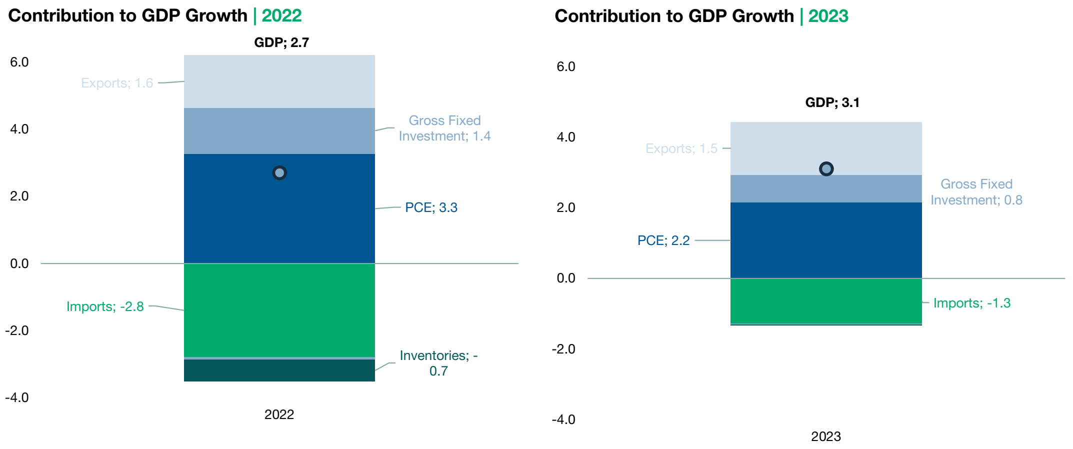


Source: TPCG Research based on the BCE

Looking at GDP figures, we expect Ecuador to grow by +2.9% in 2022, slightly over official forecasts, as the 3Q22 print surprised on the upside.

Looking at GDP figures, we expect Ecuador to grow by +2.9% in 2022, slightly over official forecasts, as the 3Q22 print surprised on the upside. With the economy enjoying a positive momentum since 2021, we expect growth to be driven by the services branch, as recovering disposable income and increased dynamism should boost the tertiary sector. Additionally, Commerce and Transportation are expected to be the biggest growth drivers inside the sector, each adding 0.4pp and 0.3pp to the GDP increase, respectively. In addition, Oil & Mineral extraction is expected to grow by +7.1%yoy, the single largest contributor to the yearly GDP print. The sky-high prices throughout 2022 allowed Ecuador to enjoy a substantial windfall. In this context, government forecasts estimate the Oil sector's contribution to GDP growth at 0.6pp (roughly 1/4th of the total print). Consistently, on the demand side, growth is expected to come on the back of increased Exports (1.5pp contribution), a direct result of oil prices, and the rebound of disposable income, which should fuel PCE (3.3pp). However, the recovery of families' income has an extra caveat, as the latter should continue to fuel a large surge in Imports, which are expected to stump GDP growth significantly (-2.8pp). Mr. Lasso's tenure has improved Ecuador's credibility and reduced uncertainty, even if undermined by a context of heavy social protests and political turmoil. Still, Investment is expected to contribute 0.7pp to GDP growth, reflecting the government's efforts to provide a more stable framework for investment. All in all, with the 3Q GDP coming in at +3.2%yoy, we believe the economy is poised to grow by +2.9%yoy, slightly over the official BCE's scenario for +2.7% yearly growth, and the pre-print Bloomberg surveys which put growth at the +2.5% mark.

Figure 2: Official govt. forecasts put growth at +3.1% for 2023

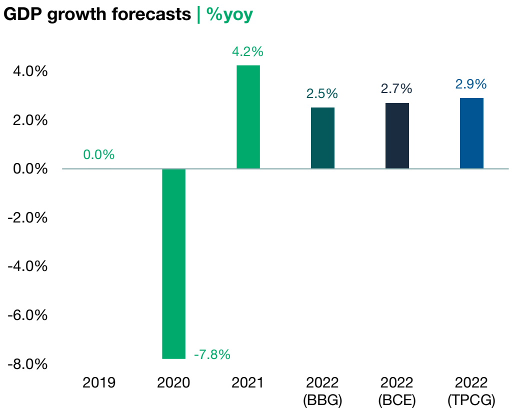


Source: TPCG Research based on the BCE

We expect the positive dynamics to spill over to 2023, with our baseline scenario pointing at a +2.5% GDP increase.

We expect the positive dynamics to spill over to 2023, with our baseline scenario pointing at a +2.5% GDP increase. However, we find growth to be heavily linked to the international scenario. Official government forecasts put growth at +3.1% for 2023. The estimate identifies next year's growth drivers in the Services sector, which is expected to contribute roughly a third of the GDP print, and the primary sector, which in turn will grow on the back of Oil extraction and increases in Banana and shrimp production. On the demand side, the administration expects private consumption to continue as the bulwark of Ecuadoran growth, contributing 2.2pp to growth, even as Imports are forecasted to slow down. In contrast, Exports continue enjoying the current positive dynamics. In our view, however, the administration's estimates for Oil's contribution to GDP look rather optimistic. The government expects the segment to exceed 2022's growth, rising by +7.2%yoy, therefore contributing 0.7pp to GDP growth. While Ecuador's oil production has some space to increase, now standing -12% below 2016 levels, the space enjoyed a tremendous increase in prices, with the Ecuador Mix average yearly price standing at +44% over 2021's average price. In this context, the Brent future curve is pricing a USD78.8 average price per barrel for 2023, and adjusted by the lighter Ecuador mix's price would result in an average price of 67.6, marking a -23.4% decrease relative to 2022. In this context, for the sector to grow at the 2022's level, it would need a huge boost in production. In turn, on the demand side, a weaker oil sector would strain Export levels, which would likely suffer, with exports poised to increase by +5.1% relative to 2022. In our view, while we expect the positive dynamics in the services sector to continue, oil prices will be a key determinant for Ecuador's growth next year. With the current global scenario and the possibility of an extended conflict in Ukraine, Ecuador could go either way.

Figure 3: Our baseline scenario sees the economy growing by +2.9% in 2022



Real GDP Growth	2022		2023	
	%yoy	Contribution	%yoy	Contribution
GDP	**2.7%**	**2.7%**	**3.1%**	**3.1%**
Agriculture	-2.6%	-0.2%	1.7%	0.1%
Shrimp	16.9%	0.3%	5.5%	0.1%
Fishing (non-shrimp)	-3.5%	0.0%	5.9%	0.0%
Oil and Mining	7.1%	0.6%	7.2%	0.7%
Oil Refining	1.0%	0.0%	3.2%	0.0%
Manufacturing	2.0%	0.2%	2.6%	0.3%
Water and Electricity	4.0%	0.1%	2.6%	0.1%
Construction	-2.0%	-0.1%	3.5%	0.2%
Commerce	4.1%	0.4%	3.0%	0.3%
Hotels & restaurants	6.4%	0.1%	2.8%	0.1%
Transport	3.8%	0.3%	2.1%	0.2%
Communications	2.9%	0.1%	2.8%	0.1%
Financial Services	3.6%	0.1%	2.6%	0.1%
Professional Activities	2.9%	0.2%	2.1%	0.1%
Health & Education	1.4%	0.1%	1.6%	0.1%
Public Administration	-0.5%	0.0%	-0.8%	-0.1%
Domestic Service	1.5%	0.0%	1.0%	0.0%
Other Services	3.4%	0.2%	4.6%	0.3%
Others	7.0%	0.2%	7.6%	0.2%

Source: TPCG Research based on the BCE & IMF

The IMF program ended on a high

Ecuador ended 2022 after complying with most of the QPC and IT in the Sixth review, effectively completing its IMF program.

Ecuador ended 2022 after complying with most of the QPC and IT in the Sixth review, effectively completing its IMF program. All end-August QPCs were met comfortably, with the overall balance of the budgetary central government and CFDD turning in a surplus of USD338mn (vs. a USD1,455mn deficit target) and the administration accumulating USD2,270mn of NFPS deposits at the central bank (vs. a USD1264mn PC). The QPCs on no new central bank financing and the non-accumulation of external payment of arrears were both met. The August ITs were also met, except for low-income family coverage by the SocSec system, which was missed by a small margin. The overall balance of the NFPS in August performed better than the adjusted targets by USD1,411mn (+USD1,966mn vs. +USD555mn). A tighter margin of USD733mn achieved the Non-oil primary balance of the NFPS target (-USD3,762mn vs. -USD4,495mn). In addition, the IT on the change in the stock of NIR was also comfortably met, as the administration was required to collect USD790mn in NIR by the end of August and ended the month having accumulated USD2,031mn. Finally, looking at the social assistance ITs, the administration complied with the first, as the administration covered 385,782 families in the first income decile nationwide with cash transfer programs, with the target requiring 280,716. The second stated that the administration, on aggregate, was required to cover 947,713 families in the lowest three income deciles with cash programs. Total country coverage totaled 1,181,777 families, meeting the overall target. However, at a provincial level, the government failed to comply with the figures established for three provinces out of 25 (Galápagos, Orellana, and Zamora Chichipe), missing very narrowly on a perfect score on the last review.

Figure 4: Ecuador complied with almost all of its QC and IT in the 6th review

	End-Aug. 2022 Program		
Quantitative performance criteria	**Adj.QPC**	**Actual**	**Status**
Overall balance of the budgetary central government and CFDD	-1,455	388	Met
Accumulation of NFPS deposits at the central bank	1,264	2,270	Met
Non-accumulation of external payments arrears	0	0	Met
Gross credit to government from the central bank	0	0	Met
Indicative targets			
Non-oil primary balance of the NFPS	-4,495	-3,762	Met
Overall balance of the NFPS	555	1,966	Met
Change in the stock of the NIR	790	2,031	Met
Number of families in the first income decile nationwide covered by cash transfer programs	280,716	385,782	Met
Number of families in the lowest three income deciles by province covered by cash transfer programs	947,713	1,181,777	Not Met*
*Target met on aggregate but missed by a small margin in three provinces.			

Source: TPCG Research based on the IMF

With this, Ecuador has successfully completed the IMF program and received the last USD700mn

With this, Ecuador has successfully completed the IMF program and received the last USD700mn disbursement in December. The administration is allegedly in talks to initiate a new program with the Fund. The administration navigated complex social and political tensions throughout the program and remained committed to compliance with IMF targets and policies. Fiscal consolidation under Mr. Lasso's tenure was impressive, as the administration was very strongly

disbursement in December. The administration is allegedly in talks to initiate a new program with the Fund.

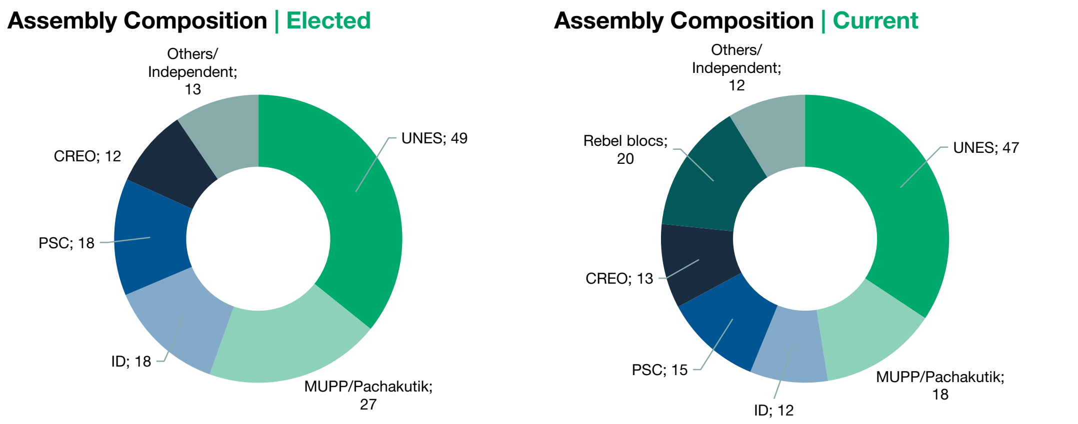
committed to tightening the fiscal balance with tax reform and expenditure measures. Even as oil prices did help to solidify the weakened fiscal balance, the non-oil primary balance conveys that the administration engineered a substantial fiscal consolidation beyond the oil windfall. Unless the administration enters a new program with the IMF, it will have to service the debt with the IMF, which should average nearly 0.9pp of GDP per year, starting in 2023 and ending in 2030. Regarding this last issue, the Ecuadoran government is holding talks with the IMF, which could end with a new agreement under the new Resilience and Sustainability Trust. However, Finance Minister Arosemena pointed out that the administration already has enough financing sources to secure the 2023 budget, rendering a financial aid program ineffective. Still, the administration will continue to evaluate this possibility throughout 1Q23 and actively seek to cooperate with the IMF in other areas, such as technical assistance and governance.

Politics: The February referendum has the potential to make or break the Lasso administration

The political situation should remain fragile, with all eyes zeroing in on February's dual referendum and elections.

The political situation should remain fragile, with all eyes zeroing in on February's dual referendum and elections. Finally, a nightmarish 2022 ended for the Lasso administration, as the government's position was strained nearly to a breaking point, as the governing party had to endure an impeachment attempt, barely managing to avoid elections in a context of profound social protests led by several indigenous movements, as Correism mobilized its base to oust Mr. Lasso. The administration's chronic (and overwhelming) lack of support in the Assembly was and should continue to be, the main thorn in its side. In addition, the crisis itself was deemed more acute by the fracture of the ID and Pachakutik blocks, which saw dissident members of said parties flock towards the Correist caucus, widening the administration's disadvantage in the Legislative organ. In this context, the Assembly was able to block the halfhearted attempts of the administration to pass any reform and actively harassed the government, destroying the fragile balance Mr. Lasso had been able to create up until the start of 2022. Furthermore, the opposition seized control of the CAL, the ruling organ of the Legislative Assembly, impeaching non-Correist members (for more details, click here), including the Assembly's president, which Mr. Virgilio Saquicela replaced. Not only having to deal with a hostile Assembly, the administration also had to appease the indigenous movements, which brought the country to a halt, reaching several agreements (for a detailed list of the agreements, click here). In this context, Mr. Lasso ended the year still in the presidential palace but weakened relative to the start of the year and politically exhausted, having to muddle through a year riddled with extremely complex issues. Even though the opposition shouldn't be able to impeach him again in this tenure, an actively hostile assembly puts to rest any possibility of achieving meaningful reforms via the Legislative power.

Figure 5: The divergence between Assembly and public opinion could be a positive catalyst in the political sphere.



Source: TPCG Research based on the TSE

In this context, the referendum stands to be the government's silver bullet, as a solid result

In this context, the referendum stands to be the government's silver bullet, as a solid result could make the "Muerte cruzada" threat more meaningful. Even as the administration is massively outnumbered in the Assembly, the referendum might prove to be a measure of the government's popularity, which in turn could allow Mr. Lasso to act on the divergence between the Assembly's

could make the "Muerte cruzada" threat more meaningful.

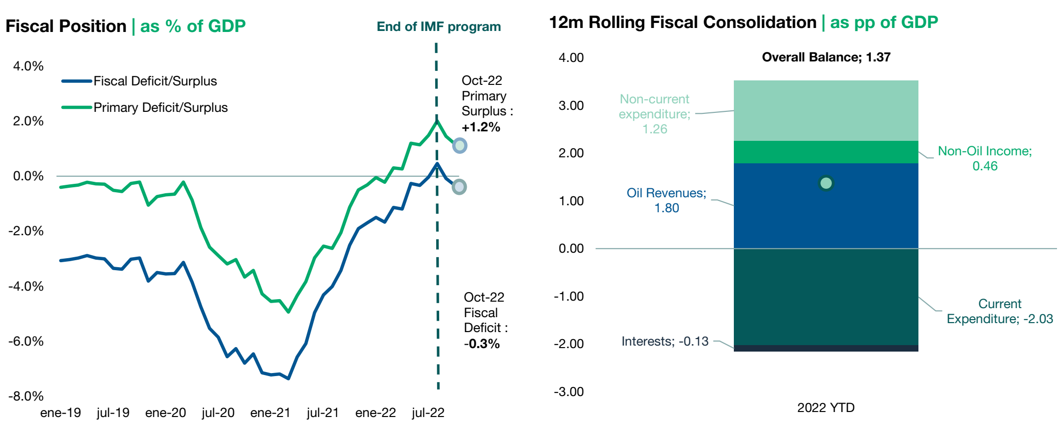
composition and popular support, unlocking the gordian knot the Assembly has become. The referendum will be composed of eight clearly framed questions encompassing many topics, including security, institutional and environmental issues. In this context, the advantages of the referendum could prove twofold, as (i) it could show the popular opinion sides with Mr. Lasso's plan, making popular consultations such as this one a viable option to bypass the Assembly to sanction legislation and (ii) it could showcase the administration enjoys more support than the current Assembly composition showcases. Regarding the first item, while true, it has an evident shortcoming, as unpopular legislation, such as the labor reform (which is rumored the government is planning on sending to referendum), should be hard for the population to vote for. Regarding the second item, if the administration does reasonably well, even if it does not win, the referendum results would convey that the Assembly composition is not representing current popular opinion. In turn, this could give Mr. Lasso a bargaining chip to deal with the Assembly, knowing that an election would end with a more balanced seat arrangement in favor of the administration. In other words, the opposition would have more incentives to work with Mr. Lasso, or at least not to actively hinder the administration's program, as the latter can trigger the "Muerte cruzada," calling at any moment for elections and dissolving the Assembly. However, a strong popular rebuke for the proposed policies would leave the administration completely cut off in the political arena, with few alternatives to continue propelling its reform agenda. Instead, a win could make some headway to present additional reforms to popular consultation or use it as a bargaining chip to soften the Assembly. In addition, with the economy performing robustly, the rebound in disposable income will likely result in better metrics for Mr. Lasso.

Fiscal accounts could suffer without the framework of the IMF agreement and lower oil prices.

Ecuador's fiscal consolidation has been robust since the start of Mr. Lasso's tenure, with the 12m-rolling deficit figures in October exhibiting a 1.4pp compression relative to 2021.

Ecuador's fiscal consolidation has been robust since the start of Mr. Lasso's tenure, with the 12m-rolling deficit figures in October exhibiting a 1.4pp compression relative to 2021. The tightening of the fiscal position was outstanding up to Aug-22, where 12m-rolling figures marked a 2.2pp improvement over Dec-21 figures, standing at a +0.5pp of GDP surplus. The primary balance mimicked said trend, with a +2% of GDP surplus in August, 2.3pp over Dec-21 figures. Since then, the fiscal position deteriorated to a -0.3pp deficit by Oct-22, as the primary balance surplus tightened to 1.2pp. In our view, the reasons are twofold. On the one hand, the IMF program's last review marked August as the last hurdle, with all QC and IT considering YTD figures up to end-August. Once the administration secured the Dec-22 disbursement, it likely slightly relaxed its fiscal policy, which is still contractive. On the other hand, the 2H expenditure seasonality is also weighing on the fiscal balance as the government hurries to execute postponed budget items. Compounding both factors, it seems the administration was holding off budgeted outlays to comply with the IMF targets, and is now thinking about increasing fiscal impulse.

Figure 6: Fiscal figures are on track to close a solid 2022



Source: TPCG Research based on BCE

Consolidation was solid up to October, mostly driven by rising Oil Revenues, cuts in Non-

Consolidation was solid up to October, mostly driven by rising Oil Revenues, cuts in Non-current expenditure, and to a lesser extent, Non-Oil Income. The former contributed 1.8pp to fiscal consolidation, skyrocketing by +31.2%yoy, driving the improvement in Income sources (+18.7%yoy). In addition, Non-Oil income rose substantially (+12.4%yoy), contributing 0.5pp to the

current expenditure, and to a lesser extent, Non-Oil Income

GDP increase, on the back of the tax reform, which could now be disputed next year, in addition to recovering activity levels shoring up Tax collection (+12.8%yoy). On the expenditure side, outlays also climbed strongly, rising by +11.7%yoy. However, this came mostly from increases in Current expenditure, which increased by +15.9%yoy, adding 2pp to the fiscal deficit. Along its subsections, Purchases of Goods & Services rose significantly (+32.6%yoy), explaining most of the increase, with Current Transfers (+57%yoy) also making a dent in fiscal consolidation. On the contrary, Non-current expenditure was trimmed, dropping by -2.9%yoy, and contributing nearly 1.3pp to fiscal consolidation, mostly on the back of a reduction in Central Government non-current expenditures. YTD figures are much more impressive, as the fiscal balance up to October exhibited a 1.9% of GDP surplus, with the primary balance clocking in with a 3.2pp surplus, outstanding figures for the first ten months of the year. Even as a heavily expenditure-ridden 4Q should put a dent in yearly figures, we believe the 12m-rolling figures should tend to improve, as a very weak Dec-21 figure currently weighs them down.

Figure 7: We expect 2023 to be slightly more dovish, accounting for a reduction in Oil revenues and the absence of an IMF program

in pp of GDP	2021	2022 4th & 5th Reviews	2022 Actual	2023	2024	2025
Revenue	**34.1**	**36.1**	**36.5**	**35.4**	**35**	**34.7**
Oil revenue	8.5	10.1	11.4	9.6	9.2	8.9
Non-oil revenue	23.1	23.3	23	23.4	23.7	23.9
Taxes	12.8	13.3	13.2	13.4	13.5	13.6
Social security contributions	5	4.9	4.9	4.9	5	5
Other	5.2	5.1	4.9	5.1	5.2	5.3
o/w Interest income	1.1	1.1	1.1	1.1	1.1	1.1
Operating surplus of public enterprises	2.6	2.7	2	2.4	2.2	1.9
Expenditure	**35.8**	**35.2**	**35.4**	**33.9**	**33.1**	**32.6**
Primary expenditure	34.5	33.7	34	32.4	31.5	30.8
Current	27.6	27.8	28	26.5	25.7	25.1
Wages and salaries	10.6	9.6	9.6	9.6	9.2	8.9
Purchases of goods and services	2.4	2.1	2.1	2	2	1.9
Social security benefits	6.8	6.6	6.5	6.6	6.5	6.5
Other	8.4	9.5	10	8.3	8	7.7
Capital	6.4	5.9	5.8	5.9	5.8	5.7
o/w investment in oil	1.5	1.5	1.6	1.5	1.4	1.4
Extra budgetary expenses	0.5	0.0	0.1	0	0	0
Primary balance (excl. Interest Income)	**-1.5**	**1.2**	**1.4**	**1.9**	**2.4**	**2.8**
Interest	1.3	1.5	1.5	1.5	1.6	1.8
Overall balance	**-1.6**	**0.9**	**1**	**1.6**	**2**	**2.1**

	2023 Budget	2023 IMF	2023 TPCG view
Macro Assumptions			
Real GDP growth (%yoy)	3.1%	3.0%	2.5%
Average Ecuador oil mix Price (USD/b)	64.8	76.0	67.6
Fiscal Balance			
Revenues (% of GDP)	19.5%	35.4%	34.3%
o/w oil	2.7%	9.6%	8.5%
Outlays (% of GDP)	21.50%	33.9%	34.1%
o/w oil subsidies	-	2.3%	2.0%
Primary Balance	**-0.1%**	**3.0%**	**1.7%**
Overall Balance	**-2.1%**	**1.6%**	**0.2%**

Source: TPCG Research based on BCE & IMF

For 2023, the administration expects the fiscal deficit to close at -2.1 of GDP, with the primary balance standing near a neutral stance at -0.1pp of GDP deficit, an estimate which looks wide.

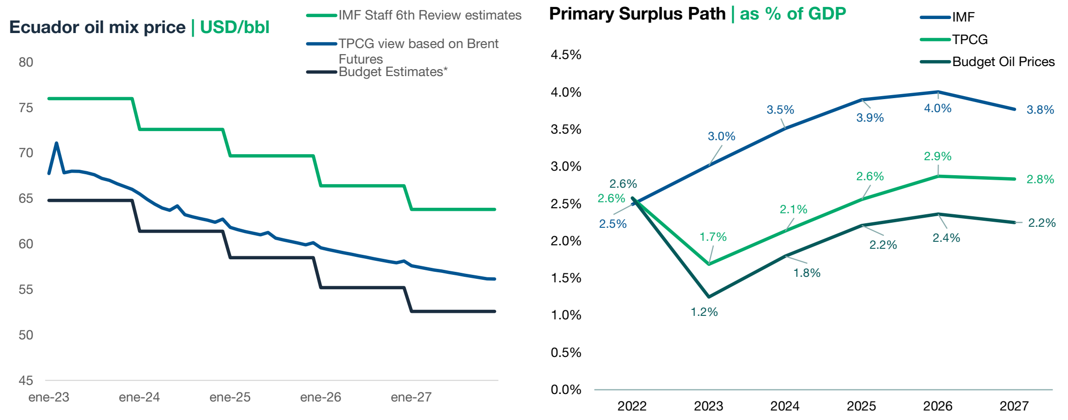
For 2023, the administration expects the fiscal deficit to close at -2.1 of GDP, with the primary balance standing near a neutral stance at -0.1pp of GDP deficit, an estimate which looks wide. With this year's fiscal figures on track to end 2022 with an ample primary surplus in addition to a tight fiscal deficit, the administration's track record points to a better result for 2023, especially as the government is likely to carry forward the positive momentum it is currently enjoying. On the other hand, the IMF expects next year's fiscal surplus to total +1.6% of GDP, with a primary surplus of +3%, improving on their 2022 estimates (+1% and +2.5%, respectively). While we believe the administration could comply with the 2022 IMF forecasts, 2023 estimates seem somewhat tight. We expect the administration's fiscal position next year to come in between the administration´s budgetary forecasts and IMF predictions and probably closer to the latter, exhibiting a primary surplus and with the fiscal balance closer to a neutral position. In our view, the end of the agreement with the Fund could continue to give the administration some leeway to slow down fiscal consolidation. While a new agreement could realign the government's objectives with a steep deficit compression, fiscal accounts' current health points to a smoother consolidation for next year. In addition, 2022's consolidation was heavily driven by the increase in Oil revenues. In a context where Oil prices could falter, Income sources are poised to suffer, dampening further the fiscal balance's result. Our baseline scenario expects Oil revenues to drop by roughly USD3bn relative to 2022, with the average oil barrel price hovering around the 67USD/b mark. In addition, complications with the tax reform, carried ahead by a hostile Assembly, could strain Income prices further. Besides, the IMF expects the average price for Ecuador's mix to be around USD76/b, while the administration's budget forecasts an average price of 64.8 USD/b. All in all, we expect the fiscal position to close the year hovering around the +0.2% mark, with a primary surplus of +1.7% of GDP.

The administration piled up GFNs beyond its current tenure, with the primary balance as the key to ensuring debt sustainability.

Looking at GFNs, we construct three different scenarios, stress-testing the resilience of the primary balance and the resulting borrowing needs against variations in Oil Prices.

Looking at GFNs, we construct three different scenarios, stress-testing the resilience of the primary balance and the resulting borrowing needs against variations in Oil Prices. We try to pinpoint where Ecuador's ability to stay current with its obligations starts to run thin, as to identify how likely another IMF agreement looks like, and when the administration might be forced to arrange a new program with the Fund, or when the government might have its hand forced to make a return to international markets. Our baseline scenario expects oil prices to evolve as the current Brent Future curve indicates, coming in below IMF estimates for the Ecuador mix. Our second scenario respects the IMF's price curve, resulting in a higher primary surplus, while our third scenario parts from the 2023's budget's estimate, which presents an even lower estimate for Oil prices than our baseline scenario. With said price, we assume a constant difference with the IMF's projections to extend the forecast beyond 2023 and up to 2027. With said prices, we adjust oil revenues for the year, impacting the administration's income sources and widening or tightening the primary surplus. In addition, we adjust the administration's expenditures in Oil subsidies, which are also determined by international prices. As expected, the former effect prevails, as the ratio of fuel subsidies to collected Oil revenues averages 0.21 throughout the 2022-2027 period, starting near the 0.3 mark in 2022 and converging to a 0.18 mark by the end of the analyzed period.

Figure 8: We design three scenarios to stress test the primary balance's resilience to a shock in Oil prices.



Source: TPCG Research based on BCE & IMF

Our baseline scenario points at Ecuador possibly tapping international markets next year, with a financing gap of around USD0.6bn.

Our baseline scenario points at Ecuador possibly tapping international markets next year, with a financing gap of around USD0.6bn. If oil prices hover around our base scenario, we expect Ecuador's primary surplus to total USD2bn (+1.7% of GDP), marking a significant drop relative to 2022, as discussed above. Gross financing needs for 2023 amount to 7.2bn, composed mainly of USD5.5bn of amortizations, while USD1.8bn in Interest payments complete the picture. On the amortization side, the bulk comes from domestic debt (USD3.5bn), while External Amortizations total USD2bn, composed mainly of Multilateral (USD1bn) and Bilateral (USD0.6bn) sinkings. Interest payments show the opposite trend: External services total USD1.3bn, while domestic only USD0.5bn. Looking at identified financing, we expect IFI financing to total USD2.3bn, while the Domestic market should provide another USD1.4bn. Compiling it with the forecasted primary surplus, identified financing totals USD5.7bn, leaving a USD1.5bn financing gap. We expect the administration to have some excess financing from 2022, given that the primary surplus comes in line with IMF estimates, presenting the administration with some Liquid assets to tighten the gap, leaving it at USD0.6bn. Given the aforementioned context, the administration has two choices. It can either enter a new program with the IMF to secure funding for its needs or tap international markets for 0.6bn. The 2023's budget poses an international issuance of USD600mn as a financing source, which would plug the gap perfectly. However, the latter option would present much higher borrowing costs unless the administration can guarantee said bond with IFI lines or present it as a green/blue bond, which could help reduce financing costs slightly.

Figure 9: Scenario I

USDbn	2022	2023	2024	2025	2026	2027
Gross Financing Needs	7.2	7.3	8.2	10.5	12.0	11.3
Interest Payments	1.7	1.8	2.0	2.4	2.5	2.6
External	1.2	1.3	1.5	1.8	2.1	2.2
Internal	0.5	0.5	0.5	0.5	0.5	0.4
Amortization	5.5	5.5	6.3	8.2	9.5	8.7
External	2.4	2.0	2.4	3.9	4.8	5.0
Multilateral	1.1	1.0	1.4	2.9	3.0	3.3
Bilateral	0.9	0.7	0.7	0.7	0.7	0.6
Private Sector and Other	0.2	0.2	0.1	0.1	0.1	0.1
Oil Related Financing	0.1	0.1	0.1	0.1	0.1	0.0
Domestic	3.1	3.5	3.9	4.3	4.6	3.7
Loans	0.0	0.0	0.0	0.0	0.0	0.3
Bonds	0.7	1.2	1.6	2.0	2.3	1.1
Treasury Certificates	2.4	2.3	2.3	2.3	2.3	2.3
Other Liabilities	0.9	0.5	0.2	0.2	0.0	0.0
Identified Financing	8.1	5.7	5.7	7.5	8.4	8.0
Primary Surplus	3.0	2.0	2.7	3.4	3.9	4.0
IFI financing	4.4	2.3	1.8	1.2	1.2	1.2
Domestic Market	0.7	1.4	1.2	2.9	3.3	2.8
Net Financing Needs	-0.9	1.5	2.5	3.1	3.5	3.3
Liquid Assets	0.9	0.0	0.0	0.0	0.0	0.0
Use of Assets	0	0.9	0.0	0.0	0.0	0.0
Financing Gap (market)	0.0	0.6	2.5	3.1	3.5	3.3

Source: TPCG Research based on BCE & IMF

The second scenario sees Ecuador returning to international markets by 2025, while the third could see Ecuador enter a comprehensive IMF program this year. With financing needs and identified financing sources remaining constant relative to our base scenario, the main adjustment comes from the primary surplus. The second scenario, based on IMF estimates, expects a 3.7bn (+3% of GDP) primary surplus in 2023, followed by surpluses of USD4.4bn (+3.5%) and USD5.1bn (+3.9%) in 2024 and 2025 respectively. In this context, Ecuador would have secured financing sources to face its GFNs until 2025, when its payment profile starts to spike. By that year, the administration would have to return to international markets, issuing a USD1.2bn bond. Finally, the third scenario, posting the most conservative oil prices, results in a USD1.5bn (1.2% of GDP) primary surplus in 2023, which results in a USD1.1bn financing gap for the year. In this scenario, with a more significant financing gap to address, the administration might opt to re-enter a program with the IMF to ensure the coverage of the gap, either by new IMF money or by increased IFI loans, which might result from the program. All in all, even as lower oil prices should force the primary balance to tighten, the administration still has ample options to address any unforeseen lack of funding, as another IMF program is still an option, and so is a more expensive (and probably bite-sized) market issuance. However, covering financing needs could be an issue if the administration abruptly abandoned its current consolidation path. The lack of an IMF program to corset the government will probably test Mr. Lasso's mettle. On positive news, a credit event looks extremely unlikely in the short run, with the first Eurobond payments well beyond the current presidential tenure.

Figure 10: Scenarios II & III

USDbn	2022	2023	2024	2025	2026	2027
Gross Financing Needs	7.2	7.3	8.2	10.5	12.0	11.3
Interest Payments	1.7	1.8	2.0	2.4	2.5	2.6
External	1.2	1.3	1.5	1.8	2.1	2.2
Internal	0.5	0.5	0.5	0.5	0.5	0.4
Amortization	5.5	5.5	6.3	8.2	9.5	8.7
External	2.4	2.0	2.4	3.9	4.8	5.0
Multilateral	1.1	1.0	1.4	2.9	3.0	3.3
Bilateral	0.9	0.7	0.7	0.7	0.7	0.6
Private Sector and Other	0.2	0.2	0.1	0.1	0.1	0.1
Oil Related Financing	0.1	0.1	0.1	0.1	0.1	0.0
Domestic	3.1	3.5	3.9	4.3	4.6	3.7
Loans	0.0	0.0	0.0	0.0	0.0	0.3
Bonds	0.7	1.2	1.6	2.0	2.3	1.1
Treasury Certificates	2.4	2.3	2.3	2.3	2.3	2.3
Other Liabilities	0.9	0.5	0.2	0.2	0.0	0.0
Identified Financing	8.0	7.3	7.4	9.2	10.0	9.3
Primary Surplus	2.9	3.7	4.4	5.1	5.5	5.3
IFI financing	4.4	2.3	1.8	1.2	1.2	1.2
Domestic Market	0.7	1.4	1.2	2.9	3.3	2.8
Net Financing Needs	-0.8	-0.1	0.8	1.3	2.0	2.0
Liquid Assets	0.8	0.9	0.1	-1.2	-3.2	-5.2
Use of Assets	0	0	0.8	0.1	0	0
Financing Gap (market)	0.0	0.0	0.0	1.2	2.0	2.0

USDbn	2022	2023	2024	2025	2026	2027
Gross Financing Needs	7.2	7.3	8.2	10.5	12.0	11.3
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External	1.2	1.3	1.5	1.8	2.1	2.2
Internal	0.5	0.5	0.5	0.5	0.5	0.4
Amortization	5.5	5.5	6.3	8.2	9.5	8.7
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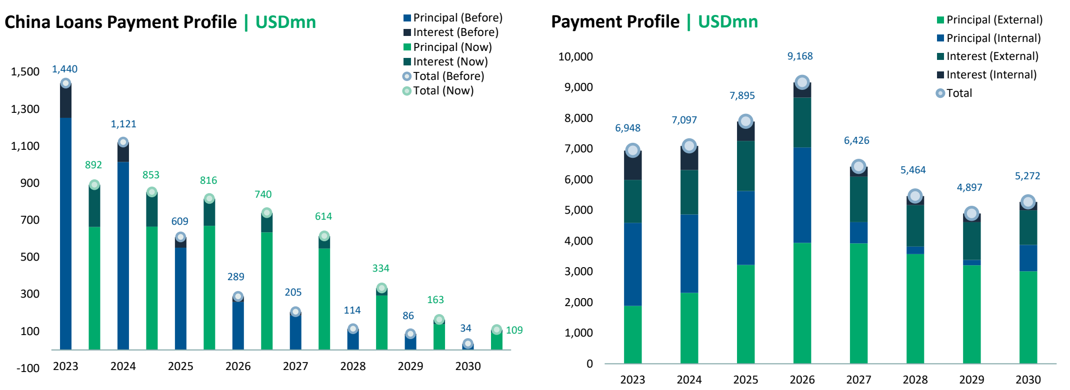
Private Sector and Other	0.2	0.2	0.1	0.1	0.1	0.1
Oil Related Financing	0.1	0.1	0.1	0.1	0.1	0.0
Domestic	3.1	3.5	3.9	4.3	4.6	3.7
Loans	0.0	0.0	0.0	0.0	0.0	0.3
Bonds	0.7	1.2	1.6	2.0	2.3	1.1
Treasury Certificates	2.4	2.3	2.3	2.3	2.3	2.3
Other Liabilities	0.9	0.5	0.2	0.2	0.0	0.0
Identified Financing	8.1	5.2	5.3	7.0	7.7	7.1
Primary Surplus	3.0	1.5	2.3	2.9	3.2	3.2
IFI financing	4.4	2.3	1.8	1.2	1.2	1.2
Domestic Market	0.7	1.4	1.2	2.9	3.3	2.8
Net Financing Needs	-0.9	2.1	3.0	3.5	4.2	4.2
Liquid Assets	0.9	0.0	0.0	0.0	0.0	0.0
Use of Assets	0	0.9	0.0	0.0	0.0	0.0
Financing Gap (market)	0.0	1.1	3.0	3.5	4.2	4.2

Source: TPCG Research based on BCE & IMF

Beyond 2025 Ecuador's GFN's spike, clouding the country's medium-term outlook, especially with the presidential elections muddling expectations even further. GFNs scale steadily from 2023 to 2025, where they spike to USD10.5bn before peaking in 2026 at USD12bn. Interest payments increase substantially in those years as the market bonds' coupons start to add up step-ups. In addition, External amortization payments also rise significantly, on the back of a climb in Multilateral payments, as from 2025 onwards, the administration has to service its debt with the IMF, which totals USD1.5bn between 2025 and 2026, against USD0.87bn in 2023 and 2024. In addition, the administration was recently able to restructure its debt with China (for more details, click here), which decompressed its payments profile in the short term at the cost of piling more amortizations in the 2025-27 period. The agreement reduced payments by roughly USD800mn combining 2023 and 2024 while increasing the service between 2025 and 2027 by USD1.1bn. Even if the news is net positive for Mr. Lasso's tenure, the medium-term outlook suffered significantly with the arrangement. All in all, given that IMF and Bilateral payments start to pile up beyond 2025, it is difficult to imagine Ecuador will be able to muddle through the period without IMF support.

Figure 11: The recent restructuring with China piles up more sinkings in the 2026-27 window



Source: TPCG Research based on BCE

BoP flows should be favored by the prospect of increased trade agreements, albeit slowing down their growth relative to 2022.

BoP flows continue to be supportive, worsening slightly relative to 2021 as the strong recovery in disposable income drove a surge in Imports.

BoP flows continue to be supportive, worsening slightly relative to 2021 as the strong recovery in disposable income drove a surge in Imports. The external sector enjoyed an eventful 2022, as the international scenario benefited Ecuadoran exports. YTD, they exhibit a USD5.5bn increase over 2021 figures, equally driven by the strong surge in Oil (+USD2.5bn) and Non-Oil (+USD3bn) exports, with the latter representing roughly 2/3rds of the total exported value. Within the Non-Oil segment, Conventional exports explained most of the overperformance, posting a USD1.9bn improvement over 2021, driven singlehandedly by Shrimp (+USD2bn), which had a record campaign, while other traditional products such as Coffee and Bananas suffered slight contractions. In the Non-conventional department, Mining spearheaded the USD1.1bn increase over 2021, explaining more than half of the overperformance (USD0.7bn). However, the strong surge in Exports was offset by an equally sharp rise in Imports, which benefited substantially from the improved economic conditions, and suffered the rise in fuel prices. The latter rose by USD5.6bn YTD, with the main component explaining the increase being Oil-related Imports, which spiked by USD2.5bn. Nevertheless, Consumer goods and raw material imports also increased substantially, rising by USD0.7bn and USD1.7bn, respectively. All in all, the surge in Imports offset the exports hike, resulting in a tighter trade balance relative to 2021. Still, the overall trade balance amounts to USD2.1bn, compressing by just USD200mn, suggesting BoP flows are still on Ecuador's side. In addition, with more support from the financial account, both the GIR and NIR position improved, with the former rising by +5.8%yoy (USD500mn). At the same time, the latter crept up to -USD381mn, marking an +82% improvement over Dec-21 figures, accumulating an extra USD1.8bn in net reserves throughout the year.

Figure 12: Import growth managed to edge export's outstanding performance

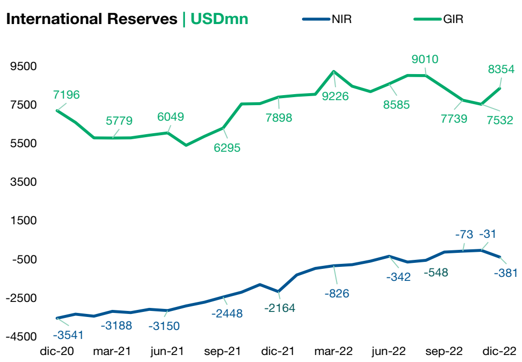
USDmn	2021 1Q	2021 2Q	2021 3Q	2022 1Q	2022 2Q	2022 3Q	Jan-Sept 2021	Jan-Sept 2022	Δ
Current Account	705	1187	139	699	1139	-63	2031	1775	-255
Trade Balance	826	1205	295	933	1068	130	2326	2130	-196
Exports	5861	6725	6825	8085	8783	7990	19411	24858	5447
Oil	1980	2304	2248	2857	3379	2767	6533	9003	2471
Non-Oil	3881	4421	4577	5228	5404	5224	12878	15855	2977
Conventional	2140	2474	2610	3043	3105	2945	7224	9093	1869
Non-Conventional	1741	1947	1967	2185	2299	2279	5655	6762	1107
Imports	5035	5520	6530	7153	7715	7860	17085	22728	5643
Consumer Goods	1095	1190	1390	1345	1423	1633	3675	4401	726
Raw Materials	1869	2101	2531	2789	2675	2745	6500	8209	1709
Capital Goods	1090	1230	1348	1431	1393	1517	3668	4341	673
Oil-related	959	973	1231	1543	2194	1919	3163	5656	2493
Services Balance	-515	-558	-732	-775	-643	-734	-1804	-2152	-348
Primary Income	-407	-413	-442	-478	-327	-461	-1262	-1267	-5
Secondary Income	801	952	1018	1019	1042	1003	2771	3064	293
Capital Account	18	30	60	16	19	27	108	63	-45
Financial Account	680	1388	148	716	1502	456	2216	2674	459
FDI	249	-138	-156	-134	-676	-51	-45	-861	-816
Portfolio Investment	434	-651	101	689	-948	357	-115	98	214
Derivatives	0	0	0	0	0	0	0	0	0
Other Investment	25	-902	1032	839	1983	-297	156	2525	2369
Net Errors & Ommisions	-42	171	-52	1	343	492	77	836	759
Reserve Assets	-1156	343	218	1193	-503	-44	-594	646	1240

Source: TPCG Research based on BCE

Looking at 2023, we expect both Imports and Exports to slow down their growth, conditional on the international scenario, with coming trade agreements shoring up the external sector.

Looking at 2023, we expect both Imports and Exports to slow down their growth, conditional on the international scenario, with coming trade agreements shoring up the external sector. With the strong acceleration of Imports and Exports in 2022, we expect said sectors to slow down their growth during 2023 as they respond to lower international prices and a negative international scenario. However, there is a silver lining for the external sector, as the administration is bent on signing several new trade agreements with up to five countries. These efforts follow the successful signing of trade agreements with Costa Rica and China (for an in-depth analysis on the second, click here), as the latter positioned itself as the largest Non-Oil partner of Ecuador. In this context, Mr. Lasso plans to sign agreements with five other countries: South Korea, Canada, Panama, Dominican Republic, and Singapore. The administration is expected to participate in a round of negotiations with South Korea by late Jan-23, it being the next agreement in the pipeline. Of these countries, the most relevant seems to be an agreement with Panama, as the total trade volume YTD between both countries totals nearly USD7bn, 70% of China and Ecuador's traded volume this year. The agreements with Canada and South Korea come in as far seconds. In contrast, the rest of the agreements are not expected to significantly impact the external sector due to the small trade volume with Ecuador. All in all, we believe that putting in motion of these agreements could further dynamize the external sector. However, the full effect of these agreements should be felt beyond 2023, as even the agreement with China is not expected to come into fruition until 2Q23, having a limited impact on 2023's trade balance.

Figure 13: The administration plans on negotiating up to five new trade agreements



Country	Exports	Imports	Trade Volume	Trade Balance	Status
	Jan-Oct-22				
Agreements					
China	5005	4580	9585	425	Signature by 2Q23
Costa Rica	31	73	104	-43	Signature by Feb-23
Prospects					
Panama	3811	3043	6854	768	-
South Korea	183	586	770	-403	Round of negotiations by end-Jan23
Dom. Rep	95	16	111	79	-
Singapore	17	43	60	-26	-
Canada	233	363	595	-130	-
Total	27482	25224	52706	2258	
as % of Total	34.1%	34.5%	34.3%	29.7%	

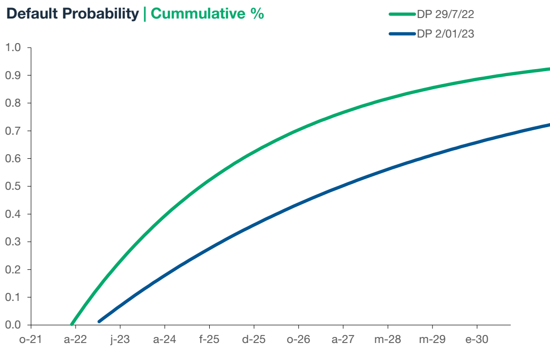
Source: TPCG Research based on BCE

The market is starting to return its confidence in Ecuador after the political crisis.

The default probability implicit in market prices has compressed significantly since the social crisis, consistent with Ecuador's latest rally.

The default probability implicit in market prices has compressed significantly since the social crisis, consistent with Ecuador's latest rally. The political crisis near the year's halfway mark made Ecuador's default probability term structure spike. Since then, the default probability curve implied in market prices has tightened significantly. By the end of 2025, the market was pricing a default probability rate of around 62% in July, while current prices indicate a 36% default probability for the same period, as the curve compressed significantly. For end-2023, default probabilities stood near the 32% mark in July, while it currently stands at 13%. Given that the Assembly can now not unseat Mr. Lasso, we find the market default probability is still marginally overstated. We believe that, until the end of Mr. Lasso's tenure in 2025, the chances of a credit event are smaller than those implicit in market prices. After the next election, credit risks could increase substantially, on the back of a change in the political regime, in addition to the start of sinking payments. In this context, we find value in the ECUA space, as we believe it is still overly punished by the market. While the latest crisis cut the possibility of a reform story in Ecuador, as Mr. Lasso will probably have a very hard time passing even minor legislation, we do not believe the probability of default up until the end of his tenure has changed substantially based on the government's track record, macro fundamentals and the Eurobond payment profile, which sees Ecuador start paying sinkings in 2026.

Figure 14: Default probabilities have compressed significantly since July



Calibrated to current market PX

NPVs under default prob. term structure implicit in market prices						
	Clean PX	V_0	Discounted Cash Flows			Recovery Value
			Total	2023-2025	2026-EOL	
PDI30	39.32	44.39	37.27	0.00	37.27	7.12
Discount 30	64.40	66.40	59.49	12.07	47.42	7.12
Discount35	46.28	46.08	37.91	6.87	31.05	8.38
Par 40	41.23	37.73	28.96	4.99	23.97	8.98
Avg excl PDI	**50.64**	**50.07**	**42.12**	**7.98**	**34.15**	**8.16**

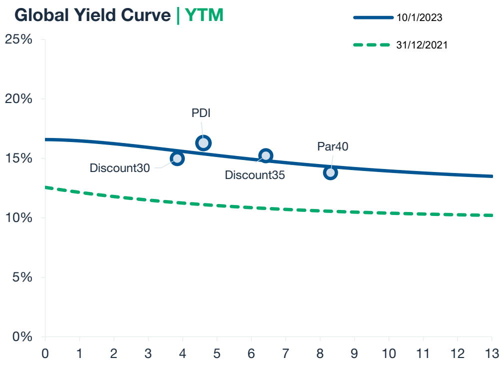
Source: TPCG Research based on TPCG Trading Desk

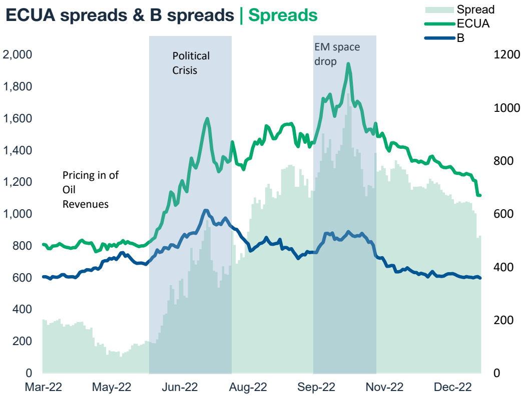
Strategy: We maintain our OW positioning in the ECUA space.

We maintain our OW in the ECUA space, as we believe the space has significant ground to recover as the political arena stabilizes and macro fundamentals continue strong.

We maintain our OW in the ECUA space, as we believe the space has significant ground to recover as the political arena stabilizes and macro fundamentals continue strong. After closing a 2022 to forget, the ECUA space is starting to regain some ground, as the market overly punished Ecua bonds due to the political crisis, now starting to give credit to the macro fundamentals and Mr. Lasso's efforts to comply with the IMF agreement and endure market-friendly reforms. Looking at ECUA spreads with the UST, the space started the year near the 800bp mark, doubling to 1600bp by mid-July, as the political crisis was priced in, and finally peaking in October, at 1945bp, before rallying to end the year at 1250bp. Said spikes were not general to its B-rated peers, as the idiosyncratic nature of the political crisis saw Ecuador's spread with its peers double to 580bp in July and then to 1050bp in October. In this context, even as Mr. Lasso came out weakened by the strong political and social crisis, we find he remains a more competitive force than the opposition in the Assembly. With a more income-supportive policy mix, and without the Damocles sword of the "Muerte Cruzada" dangling over his administration, Mr. Lasso should be able to bide his time and bolster his weakened public image, which should result in better referendum results than expected, which in turn should give him some space to maneuver in the political arena. Still, Assembly dynamics do seem off rails, and unless the referendum marks a clear victory for the administration, it should have virtually no chance of advancing with his political reforms. All in all, we believe the space has some ground to recover, as we believe the political scenario is not as dire as expected, and macro fundamentals exhibited by the country continue to be strong. We position ourselves in the Discount35, favoring the increased convexity in a context the space has some upside pricewise.

Figure 15: Having closed a difficult 2022, the space has some ground to recover in 2023





	30-dic.-22			Last Week			Last Month			YTD		
	MD	YTM	PX (Conv.)	Carry (bps)	Δ Clean PX (bps)	Total Return (bps)	Carry (bps)	Δ Clean PX (bps)	Total Return (bps)	Carry (bps)	Δ Clean PX (bps)	Total Return (bps)
PDI	4,5	18,9	39,50	0	0	0	0	604	604	0	-3.009	-3.009
DISCOUNT30	3,8	17,1	64,50	14	0	14	64	496	560	559	-2.205	-1.647
DISCOUNT35	6,3	16,8	46,50	4	0	4	18	499	517	146	-2.901	-2.754
PAR40	8,0	15,0	41,50	2	0	2	10	307	317	86	-2.876	-2.790

Source: TPCG Research based on the TPCG Trading Desk

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