

## Ecuador: the appointment of the new Finance Minister is a real change

- President Lenin Moreno designated Richard Martinez as new Finance Minister. Martinez was formerly the President of Ecuador's Business Committee and the Industrial Chambers of Production, and was a key representative of the business community in Ecuador. We were surprised by the appointment, as we did not expect former minister Maria Elsa Viteri to be removed in the current reshuffle, and because this designation should represent a real departure from the current design of economic policy, which has reigned since the last administration, in our view. We think this appointment could boost local confidence and should be seen favorably by the international investor community, although big challenges remain ahead.

The appointment of Martinez should send a strong signal to the domestic and international investment communities that a closer relationship with the private sector could indeed materialize. We also expect a greater degree of pragmatism, orthodoxy, and transparency in the design of economic policies, likely focused on incentives for the local productive sector.

Martinez could look to implement a greater degree of fiscal discipline, although we are unsure that he will favor increasing indirect taxes such as VAT or further increasing the corporate income tax. Thus, investors may have to wait until the new minister has full details regarding the maneuvering space to trim expenditures before getting a complete idea of how the fiscal trajectory is likely to change.

It remains unclear to us what will be the strategy of the new Finance Minister to tackle external pressures. In our view, the drivers of balance of payments pressures are complex and require that both public and private sectors work together in order to tame the pace of depletion of international reserves. In this sense, his relationship with the private business community could be favorable if a confidence shock results in more private capital being held and deployed domestically. Martinez will likely look to boost export revenues through sector-specific incentives, but we do not expect him to favor a fiscal devaluation strategy, as the private sector rejected this idea when it was first presented by former Minister Carlos de la Torre. Martinez may not favor increasing import taxes either and could look to lower trade barriers, which could have a negative short-term impact on external accounts.

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Another key issue will be how Minister Martinez tackles the current uncertainties regarding Ecuador's debt ceiling and the legality of further debt issuance after the Comptroller's debt audit. The private sector has been highly critical of past finance ministers who have abided by the notion that Ecuador's official debt statistics should refer to the Ministry's definition of Consolidated Debt, which is a change that former President Correa introduced in late 2016. Clarifying reigning uncertainties on this matter would be favorable in order for the new Minister to have maneuvering space in managing public sector liquidity.

Martinez will likely have a more fluid dialogue with international markets than former Minister Viteri, in our view. We think this could help soothe some of the current uneasiness of international investors with Ecuador's external public debt. However, dialogue alone is unlikely to change the reigning macroeconomic forces that the new Finance Minister will inherit. We expect the presentation of the expected economic bill to be delayed, and wouldn't be surprised if a new economic program is presented before an economic bill is introduced to Congress. The downside to this would be that investors will have to continue waiting for specific measures to be implemented, and liquidity needs may arise before any material changes in economic policy are actually enforced.

Finally, Martinez's presence in the Finance Ministry could open the door for more fluid dialogue with multilateral organizations, namely the IMF. We can't say if he would look proactively for IMF support at this point. However, we do believe that he will be more open to the idea of engaging with the organism sooner than previous Finance Ministers. The main limitation for an agreement with the Fund will likely continue to be the political cost it would entail to the President and the left-leaning ideology of the ruling party.

In our view, the appointment of Martinez is a welcomed surprise, as it finally opens the door for real changes in the design and direction of economic policy. However, we remain observant of the type of policies he will try to implement given the complex set of challenges that Ecuador's economy faces. In our view, structural reforms to tackle the real appreciation of the exchange rate, coupled with a fiscal consolidation strategy are needed in order to palliate balance of payments pressures and allow Ecuador to generate a strategy to keep optimum levels of international reserves. At this point, we do not think the new Minister will favor a fiscal devaluation strategy or an aggressive fiscal reform to increase tax revenues, but given his background as business sector representative he may have a stronger push for a more comprehensive labor market reform. We continue watchful of the negative feedback loop and interdependence between the balance of payments and fiscal sectors, the limited capacity of the economy to generate dollars endogenously, and concerned about policies that weaken fiscal accounts or that boost growth through non-tradeable sectors.

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