Interview: Santiago Caviedes – Founder and Chief Economist, Humboldt Management, Ecuador



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Santiago Caviedes, Harvard graduate, founder and chief economist of Humboldt Management, a company awarded multiple times for the precision of its forecasts in Ecuador by international institutions, gives a detailed overview of the country's current economic situation and positive outlook for the future. Mr. Caviedes describes the country as a jewel to be discovered, which compares very well with its Andean counterparts, notably in terms of current growth and potential.

Considering your expertise in macroeconomics and forecasting, could you give an overview of Ecuador's recent economic context as well as your predictions for the years to come?

Despite the country's reputation of being unstable and volatile, Ecuador is a stable, functioning and growing economy that compares very well with other economies in the region. In fact, regardless of the country's economy and high dependency on the performance of the oil industry, it only experienced one year of recession as a result of the longest and deepest oil shock worldwide since 1982. The government used foreign debt market to sustain the economy's growth in 2015 and 2016 and postpone the adjustment while the oil price recovered.

Also, over the past ten years, Ecuador has gone through a development process that has allowed it to reduce poverty levels, increase its income per capita and grow at a regionally unrivaled eight percent nominal compound annual growth rate. As a result of its dollarized economy, I would even

say that Ecuador’s economy is more stable than economies of neighboring Colombia and Peru. Ecuador has no currency risk.

Looking forward and considering that Ecuador is highly connected to the world’s economy, I reckon the economic outlook of Ecuador is very positive. Indeed, the rest of the world is increasing its manufacturing activities, which calls for higher demand rates of commodities- one of which is oil that Ecuador exports. Furthermore, the price of oil is increasing again, which will allow the government to reduce its fiscal pressure following the large overseas debt that allowed the country to sustain growth in recent years. Conjunctly, since the world’s economy is growing faster than in the past, worldwide household demand for products Ecuador currently exports, notably chocolate, shrimps and bananas, will also help our domestic industries. Also, Ecuador has enormous mining potential that will yield results in the following years.

Finally, national consumer confidence rates have increased and this has positively impacted consumer spending. As a result, companies from all sectors with local operations have seen their sales figure significantly increase. Furthermore, I believe consumer confidence rates can continue increasing and that there is room for additional consumer expenditure. Nonetheless, the country needs to undertake a gradual fiscal consolidation in order to maintain access to international markets.

Overall, I believe that Ecuador’s economic outlook is more positive than negative due to main risks being a potential decline in oil prices or a natural catastrophe such as an earthquake that would prevent the country to export crude oil- I believe both are not likely to happen in the short term. To those that say that Ecuador’s economy is overly dependent on oil exports, I would say that it is an issue that is slowly but consistently being addressed. As a matter of fact, the non-oil trade deficit in 2006 represented around ten percent of GDP and today the gap has been reduced to a healthier level of two to three percent.

What are some of the main economic challenges lying ahead of Ecuador?

In comparison to its Andean counterparts, Peru and Colombia, Ecuador has the highest investment rate. As a result, the country’s infrastructure, namely airports, road, electric grid and health facilities, are of much better quality than in the aforementioned countries. However, the government remains a large contributor to these investments. Thus, Ecuador’s main challenge will be to swap public investment for private investment.

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Although our national revenues have been increasing, the public expenditure levels remain too high to be sustainable- even more so, considering that international bonds will start coming to a term in 2020. I believe the government has to act towards a stabilization and progressive decrease of its spending to prepare for this debt repayment starting in 2020. Indeed, Ecuador's current fiscal deficit is almost six percent when a three percent rate would be optimal to allow the country to repay the loans it has contracted. This gives the country three years to achieve a one percent annual reduction in its fiscal deficit.

Finally, the country's lack of trade agreements with developed countries is a burden the country should be looking forward to address if it wants to improve its international economic presence. In this regard, one can only be satisfied that the country concluded a free trade agreement with the European Union and the Moreno administration is considering to start talks with the United States.

Currently Ecuador witnesses one of the lowest FDI levels in the region according to the OECD. What are the reasons behind this?

Firstly, when comparing the levels of FDI inflow of Ecuador with its regional counterparts, one must take into account the fact that a majority of the FDI inflow in countries as Peru or Colombia is targeted at the mining and oil industries. On the other hand, Ecuador has implemented very restrictive policies on these sectors. Therefore, it must be taken into account that if the country has more flexible politics for these sectors in terms of international investment, Ecuador's FDI inflow levels would be higher than what they currently stand at. Nonetheless, I agree with the fact that our country has not yet realized the full potential of its attractiveness; it is a jewel yet to be discovered. There are several factors that contribute to this situation.

Prior to 2006, Ecuador was subject to vast instability. Following former President Correa's election in 2007, the country benefited from political stability, but his economic standpoint made international private investments in the country difficult. President Moreno's administration is much more open to international trade and is looking forward to attracting investment to Ecuador. Precisely, the government is on the cusp of submitting a bill to the national assembly that will facilitate capital circulation to and from Ecuador. I believe taxes on capital-exits should be scrapped or at least some exemptions that will allow foreigners to retrieve the capital invested in the country free of tax. Such legislation is a great opportunity for the country and international investors.

In addition, Ecuador still suffers from an unjustified reputation of instability. In fact, many would consider Ecuador as a worse destination than its neighbors in terms of investment attractiveness.

What is really missing here is a different narrative for the country. The international community of investors needs to be more aware of the real state of Ecuador's economy. Also, taking into account that the country is dollarized and does not face the risk of de-dollarization should be highlighted, as this means that any investment in Ecuador is hedged against the risk of devaluation.

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To what extent can the healthcare and pharmaceutical sectors contribute to Ecuador's growth in the future?

In this case, Ecuador also compares well to its neighbors. One must know that the Ecuadorian population is healthy and that it has the highest life expectancy of Andean countries.

The healthcare expenditure in the country has been growing rapidly in the last few years, which brought Ecuador from being a laggard to one of the countries with the highest levels of healthcare expenditure as a percentage of GDP- even approaching Colombian levels.

Since the government has and continues to prioritize investment levels in education and healthcare, one can only assume that the government will soon reap the benefits of such policies.

Additionally, as poverty levels decrease, disposable income increases. Given the fact that one of the main items of household expenditure is healthcare, they are likely to spend more on quality healthcare products and related services. Either they will do so through the government, or they will choose to upgrade towards private healthcare services. Moreover, in the case that growth doesn't go as expected, since consumptions of healthcare related products are very inelastic to a household's revenue variations, the sector should be protected.

The current government announced its ambition to increase pharmaceutical exports by 200% by 2020. What do you consider the competitive advantages of domestic producers?

The country compensates for its high minimum wages with low levels of utilities costs. More specifically, energy prices and social security taxes are among the lowest of the continent, and transportation costs within the country are low due to the size of the country and a reliable infrastructure. Additionally, the inflation rate in Ecuador is low and our export competitiveness has increased as a result of dollar depreciation. Indeed, Trump's policies have led to a weakened dollar and allowed us to recover competitiveness levels of 2011, when the country was in excellent economic shape. Precisely, this year the country's exports are growing ten percent a year.

In light of these elements, Ecuador’s competitiveness is much better than what is commonly assumed of Ecuador, even by the IMF. The lack of free trade agreement could have been an issue. Nonetheless, in the case of the pharmaceutical industry, Ecuador’s main export destinations are Andean countries, which we have no trade restrictions with.

What strategic advice would you give to international companies looking forward to benefiting from the opportunities in Ecuador’s market?

I would advise to avoid reading the newspaper to prevent being put off by it. Instead, travel to Ecuador and find out for yourself. You will find a country that is a promise, a frontier market about to be discovered and that could become one of the big stories of Latin America.

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