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Ecuador's economic woes increased with its partial default on Brady-bond interest payments. Although negotiations with the International Monetary Fund (IMF) also moved slowly, but President Jamil Mahuad said an agreement was finally reached. Ecuador is the first country to partially default on its Brady-bond payments, and analysts believe it could be followed by a moratorium on the payment of US$500 million in Eurobonds, which would also be unprecedented.

Brady bonds, devised by former US treasury secretary Nicholas Brady, are repackaged defaulted commercial bank debt from the 1980s backed by US Treasury bonds as collateral. Held largely by private investors, they account for roughly half of developing countries' bonds.

In 1994, when Ecuador renegotiated its foreign debt as part of the Brady Plan, foreign banks reduced the value of the country's loans by 30% in exchange for a guarantee that the rest would be paid. Ecuador's US$6 billion in Brady bonds are about 37% of the US$16 billion foreign debt, proportionally the largest in Latin America.

Of the Brady bonds, 52% is owed to private banks, 30% to multilateral lending institutions, and 18% to the governments that form the Paris Club. "We will pay what we can, nothing more," said President Mahuad in a message to the nation. Mahuad said the country has "no economic or social future if its external debt is not considerably reduced." "How can a country progress if it has to pay more than 50% [of its budget] in interest on the debt?" he asked.

Economy Minister Guillermo Lasso resigned Sept. 27 because of his disagreement with the default decision. The Mahuad administration was scheduled to make debt- service payments of US$2.4 billion this year half its national budget. Meanwhile, US$1.5 billion went to bail out the banking system, which saw 11 institutions go under in the past 10 months.

Bondholders oppose decision

Mahuad said Ecuador would meet interest payments only on those bonds not backed by the US Federal Reserve. On Sept. 28, the Banco Central confirmed it would pay only US$51 million of the US$96 million that it owed. It asked bondholders to use the collateral to cover the interest due while it restructures the foreign debt. The collateral can be paid out when at least 25% of bondholders agree.

The decision was announced Sept. 27 at the annual meeting of the IMF in Washington by the president of Ecuador's central bank, Pablo Better. Ecuador's default on its Brady bonds will not help the perception by some investors that Latin America has not overcome the problems caused by the Asian and Russian crises, said Mexican Central Bank President Guillermo Ortiz.

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Ecuador's debt-restructuring proposal was opposed by bondholders who said it would set an unacceptable legal precedent for the multibillion dollar Brady-bond market by discriminating among creditors. Several investors said they would rather let the country default than pick and choose its payments. "For Ecuador to pay on uncollateralized bonds and not pay on collateralized bonds has severe implications for the value of Mexico, Brazil, Venezuela, and a host of other collateralized bonds," said one investor.

IMF criticized for its role in the default

The default angered many bankers who think the IMF encouraged Ecuador to write off some of its debt. The IMF wants them to share the burden of easing payment terms on the country's US $6 billion in Brady bonds. An IMF official denied that it encouraged Ecuador to default. But he underlined the seriousness of Ecuador's financial position, saying even with IMF and other official credits and a rescheduling by the Paris Club, Quito still faced a US$500 million external financing shortfall before the end of next year.

One bank official said the IMF had chosen a very poor test case to get the private sector to share the burden in financial crises, because Ecuador has been in default for three years on its official Paris Club debt. IMF managing director Michel Camdessus said he regretted Ecuador's inability to reach agreement on restructuring its Brady-bond debt, and said an IMF loan would depend on "good faith" efforts to strike a deal with creditors.

Decision is risky in short term

Economy Minister Alfredo Arizaga defended the decision, despite risks of losing international lines of credit or even of confiscations of assets held outside the country. He said the risk was small, but measures had been taken to safeguard assets outside the country. "The default is not the end of the world, and it will not hinder negotiations between the government and the IMF," said Arizaga. For eight months, the government and the IMF have been negotiating a US$400 million line of credit that would give Ecuador some breathing room.

The Mahuad administration is also hoping for US$1 billion from the World Bank and the Inter-American Development Bank. To sign the accord, the IMF wants the government to balance the budget, raise taxes by 50%, and refrain from bailing out banks that go under. Mahuad and the IMF signed a letter of intent Sept. 30, clearing the war for the new credits. The 2000 budget sent to Congress contains the tax increases the IMF is seeking, but approval of the budget is far from a sure thing. And last week yet another bank, the Banco Popular, was handed over to the state-run Agencia de Garantia de Depositos (AGD), set up in 1998 to clean up the banking sector.

Last March to avoid a run on banks, the government decreed a bank holiday for a week and partially froze accounts (see NotiSur, 1999-03-19). Although Mahuad ordered an overhaul of the system and insisted that the worst of the banking crisis was over, some analysts predicted a second wave of problems. The government is counting on the new loans from international institutions to recapitalize the sector. Banco Popular was considered one of the strongest banks in the country. Its problems question the effectiveness of the bank audits and highlight the severity of the banking crisis.

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When Ecuador seized control of Banco Popular, it named assistant central bank chief Miguel Davila as the new executive president. The bank's assets were temporarily frozen in the US at the request of the Colombian government, which accused the bank of helping siphon off US$64 million of Colombian tax revenues.

Decision has support with opposition

Meanwhile, opposition parties and indigenous groups praised Mahuad for his decision to default. "It's a very positive step and deserves the people's support," said Antonio Posso, a deputy for the indigenous Pachakutik party. "We're part of the opposition, but we think this was the correct move for the president."

Some asked him to go farther and call a moratorium on all of Ecuador's debt, both foreign and domestic. "We are not completely in agreement with a partial default," said Ivan Narvaez, head of the Frente Patriotico, an umbrella group of trade unionists, teachers, students, farmers, and government workers. "Instead we want a total moratorium for both foreign and domestic debt as should be done for all Latin American countries." [Sources: CNN, 09/26/99; Associated Press, Inter Press Service, The Miami Herald, 09/27/99; Reuters, 09/13/99, 09/27/99, 09/28/99; Notimex, 09/16/99, 09/28/99; Spanish news service EFE, 09/26/99,09/28/99; The Financial Times (London), 09/28/99, 09/29/99; The New York Times, 09/29/99]

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