Ecuador

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First Citizens Research & Analytics

COUNTRY		CREDIT RATING			
Real GDP growth (%) Q42015	-1.20%	S&P Foreign Currency	B (Stable)	Major Trade Partners	US 37.3%, Chile 8.1%, Peru 6.5%, Japan 4.5%, Russia 4.5%
Next General Election	2017	Fitch Foreign Currency	B (Stable)	Major Exports	Petroleum, bananas, cut flowers, shrimp, cacao, coffee, wood, fish
Exchange Rate	ECS 25,000 (fixed)	Moody's Foreign Currency	B3 (Stable)	GDP Composition	Agriculture: 5.9%, industry: 35.1% and services: 59%

RECENT ECONOMIC DEVELOPMENTS

ECONOMIC OUTLOOK — **NEGATIVE**

Ecuador's GDP in Q42015 slowed for second consecutive quarter, recording a 1.2% decline.This represents the lowest in six years, and was dragged down by contractions in all components of domestic demand. The collapse in oil prices has resulted in implications for Ecuador's growth, and the dollarization of the economy has prevented the country from undergoing a currency devaluation that would alleviate some of the pressure. Moreover, the recent earthquake will add further challenges as the government struggles to rebuild its infrastructure and residential areas namely in the two hardest hit provinces of Manbai and Esmeraldas. The Ecuadorian economy will fall by 4.5% this year and 4.3% in 2017 according to the IMF.

INFLATION — **STABLE**

Inflation has been falling steadily since June 2015, and dropped from 2.6% in February to 2.3% in March, the lowest reading since November 2013. **Ecuador has a dollarized economy** and therefore lacks the ability to use monetary policy to influence market conditions. The restaurants and hotels component of the consumer price index saw minimal gains in the last few months, while prices for clothing fell substantially. The strong USD, which the country has adopted as its currency, has pushed down the price for imported goods, limiting inflationary pressures.

EXTERNAL ACCOUNTS — **NEGATIVE**

Ecuador's external account position is expected to continue to deteriorate in 2016 as low oil prices impact on the country's trade balance. Ecuador's current account deficit is projected to widen to 8% in 2016 as the dollarization of the economy will ensure that Ecuador's imports will not fall as fast as its exports. Ecuador's financial account position will be supported by Chinese investment in 2016 as the government of President Rafael Correa benefits from the continued financial support from the Chinese government and investors.

FISCAL PROFILE — **NEGATIVE**

A fiscal deficit of 4.7% of GDP was recorded in 2013. Ecuador's fiscal deficits are expected to persist in 2014 and 2015 on account of the country's infrastructure development program, at levels similar to that of 2013. The country has operated deficits since 2008 (save for a balanced budget in 2011). On account of this, gross debt (as a % of GDP) has increased steadily from 16% in 2009 (after the default) to an estimated 27% in 2014. This is projected to climb further to 30% in 2015. As noted previously, oil and its derivatives accounts for 25% of fiscal revenues. As a result of the low price of oil, the government has indicated that it will cut the 2015 budget by 1.4% of GDP. Additionally, the government has already announced an overhaul of its tax collection policies and continues to rely on external sources of funding, particularly China. Falling revenue due to the drop in global oil prices and growing expenditure are forecasted to lead to expansion in the fiscal deficit from 7.7% of GDP (2015) to 8.4% of GDP (2016). It is expected that the Government will turn to capital markets to finance the deficit. This will boost government debt from a 24.6% of GDP to 30% of GDP by 2017. The widening current account gap, capital flight and the fact that the country is currently in recession could result in a government default if the government is unable to generate enough revenues to cover its expenditure. **Default History:** Ecuador defaulted on debt in 2008 and in 2009. Ecuador used a reverse Dutch auction to price and pay 35 cents on the dollar to holders of 91% of the USD3.2 billion worth of defaulted bonds. By 2014, remaining holdouts represented less than USD100 million, or 3% of the defaulted bonds and the government is working on settlements for the remainders. Ecuador returned to the international capital markets in June 2014 with a 10-year bond yielding 7.95%.

CREDIT RATING

Moody's upgraded its rating of Ecuador from Caa1 to B3 in December 2014. Despite the acknowledged importance of oil, the ratings agency believes that Ecuador has the ability to withstand the oil shock, particularly due to savings on imports of refined products and subsidies. Ecuador's metrics are now in line with the B3 median, hence the upgrade. S&P rates Ecuador at B+, two notches above Moody's rating. Both rating outlooks are stable. The S&P rating is based upon what is seen as the government's greater fiscal flexibility, better external liquidity position, and the improving investment climate in the country. On August 2015, Standard & Poor's lowered Ecuador's sovereign rating by one level to B (five levels below investment grade) due to downward pressure on government revenue due to falling oil prices and political instability diminishing chances of legislative reform.

OUTLOOK

First Citizens Research & Analytics maintains a cautious outlook on Ecuador on account of its persistent fiscal deficits and once again rising indebtedness. Their ability to service these obligations is vulnerable to volatility in the international energy markets while alternative foreign currency earning sectors are in decline. The global low oil price environment will continue to put strong downward pressure on the country's revenue and weaken it economic stability.