Ecuador

Prepared by: Rajesh Ramroop
rajesh.ramroop@firstcitizenstt.com
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First Citizens
Research & Analytics

COUNTRY		CREDIT RATING			
Real GDP growth (%) 2016	-0.90%	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**

The economy of Ecuador expanded by 1.0% during the second quarter of 2015, down from 3.0% in the first quarter. The weakening was attributed to a deterioration in domestic demand and the decline in oil revenues. Increases were noted in house spending (1.18%), government spending (0.65%) and exports (0.09%). Economic activity in Ecuador is fairly diversified with no one sector accounting for more than 15% of GDP. That said, **while the Petrochemical sector accounts for 12% of GDP, oil and derivative products represent approximately 50% of exports and 25% of fiscal revenues**. As such the poor outlook on oil prices will have serious implications for the economy. The petrochemical sector grew by 11% in the first quarter of 2014 but contracted significantly during the remainder of the year. The manufacturing sector (12% GDP) grew by 3.0% while the Construction sector (10% of GDP) and Commerce sector (11% of GDP) grew by 9.10% and 3.3% respectively. Growth was 3.8% in 2014 and has averaged 4.26% for the last five years. An expansion of 4.1% was initially forecast for 2015, but was cut to -0.8% for 2015 by the BMI (as a direct result of oil prices).

LABOUR, INFLATION AND THE FINANCIAL SYSTEM — **STABLE**

The inflation rate was recorded at 3.38% in Dec 2015. The government has targeted an inflation rate of 3.9% for 2015 but this may be revised on oil price shocks. **Ecuador has a dollarized economy** and therefore lacks the ability to use monetary policy to influence market conditions. Credit to the private sector expanded by 23% (y/y) in September 2014. The largest increases were reported in corporate loans (31%), housing (25%) and business loans (24%). A contraction was reported for retail loans (5.21%). The rate of unemployment stood at 4.7% in the third quarter of 2014, down from 5.7% in the second quarter.

EXTERNAL ACCOUNTS — **NEGATIVE**

Oil remains Ecuador's principal export. According to S&P, non-oil exports such as bananas, flowers, shrimp, and other seafood have lost competitiveness as neighboring countries have gained market share through numerous free trade agreements throughout the world. The current account deficit is forecasted to average 6.7% of GDP over the coming five years after an estimated shortfall of 7.1% of GDP in 2015. Dollarization has made shifting away from a dependence on oil exports highly difficult without major political changes or a collapse in domestic demand through a painful internal devaluation. Without new sources of export revenue, the country is at risk of running out of foreign exchange reserves, which stood at USD2.7 billion (1.1 months of import cover) at the beginning of 2016, down from a peak of USD6.7 billion in September 2014.

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.