Ecuador

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First Citizens Research & Analytics

COUNTRY		CREDIT RATING			
Real GDP growth (%) 2016	-3.20%	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 growth fell to 0.3% in 2015 (the lowest since 1999) as the economy was dragged down by the crash in commodity prices. 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 April 2016 earthquake has added further challenges as the government struggles to rebuild its infrastructure and residential areas namely in the two hardest hit provinces of Manbai and Esmeraldas. Initial estimates for the cost of reconstruction efforts are approximately USD3 billion, or roughly 2.8% of GDP. The economy is expected to enter recession this year and decline by 3.2% in 2016.

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 current account inflows stem primarily from exports of oil, while imports are mainly composed of capital goods. The current account deficit is forecasted to widen to 4.5% of GDP from 2.1% of GDP in 2015 due to the continued weakness in oil prices. However, the widening is expected to be tempered by a pullback in imports of goods and services which fell by 22.4% in 2015. 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**

Ecuador's fiscal deficit is expected to widen to 6.2% of GDP in 2016 (USD6.7 billion). Revenue is forecasted to fall by 4.3% mainly due to the decline in oil revenue and slowdown in private consumption. The country relies on the oil sector for 17.8% of total revenues. Expenditure is expected to increase by 1.5% in 2016 after falling by an average 6.6% yoy for 1Q16 as the government boosts spending in response to the April earthquake.

Debt to GDP is low measuring 32.6% of GDP for 2015 mainly because the government has lacked access to capital market for years and instead utilized revenue from its oil industry to finance its social spending programs. It is expected that government will look to use its newfound access to markets to issue debt to address its deficit. The widening current account gap, capital flight and recessionary pressures can 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

The global low oil price environment will continue to put significant downward pressure on Ecuador's economy. The April 2016 earthquake also put further pressure on the fledgling economy and though reconstruction efforts through financing from China and the IMF will provide support, the country is not expected to show growth in 2016. The lack of diversification of their economy and resulting reliance on the oil and gas sector and susceptibility to natural disasters are inherent problems with no short term solution. Their ability to service 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.

First Citizens Research & Analytics maintains a negative outlook on Ecuador due to its persistent fiscal deficits, once again rising indebtedness and dependency on its oil and gas sector for revenue generation.