THE WALL STREET JOURNAL.

http://www.wsj.com/articles/cheap-oil-and-strong-dollar-ecuadors-twin-troubles-1448320496

MARKETS | CREDIT MARKETS

Cheap Oil and Strong Dollar: Ecuador's Twin Troubles

Two of the most punishing trends in emerging markets are the rising dollar and falling oil. And caught between them is Ecuador.

Guillermo Granja/Reuters

By **CAROLYN CUI** and **MANUELA BADAWY**

Nov. 23, 2015 6:14 p.m. ET

Two of the most punishing trends in emerging markets are the rising dollar and falling oil. And caught between them is Ecuador.

The South American country has the misfortune to be an oil producer with a "dollarized" economy that uses the U.S. currency as legal tender.

Dollarization helped officials rein in inflation in 2000. Now, it is depriving them of the relief valve a depreciating local currency can provide at a time when the drop in oil prices is hurting its exports.

Investors could get caught in the squeeze. Ecuador's bonds have recently rallied in part on the expectation the government will repay a $650 million bond due in December. But the country has billions of dollars more in debt—including bonds due in 2020, 2024 and 2025—and the outlook for those is less certain.

Sarah Glendon, head of sovereign research at Gramercy Funds Management, an emerging-market manager with $6 billion in assets, has doubts that Ecuador will be able to manage its debt load after this year.

Given oil prices' slide, Ecuador is trying to beef up its nonpetroleum exports such as flowers, like these at a Tabacundo plantation. *PHOTO: GUILLERMO GRANJA/REUTERS*

"I'm convinced that they have the willingness to pay, but what I'm more concerned about now is their ability to pay," she said.

"Beyond 2015, I'm more skeptical. We'll see additional weakness thereafter because of the challenges the economy faces," Ms. Glendon added.

Ecuador's position makes it a vulnerable case in the precarious world of emerging-market debt. Much of Ecuador's income derives from oil exports, and a plunge of energy prices this year created a shortfall in the country's budget and put pressure on its bonds. Yields on Ecuadorean debt soared to 16% by the end of September amid a broad selloff in emerging markets, making it nearly impossible for the country to tap the markets again.

As a result, prices on Ecuador's government debt have been volatile: They were down 19% in the third quarter before rebounding 10% since Oct. 1, outpacing all sovereign bonds except those issued by Venezuela, according to J.P. Morgan Chase. An emerging-market dollar debt index was up 2.2% during the same period.

To be sure, the Ecuadorean government has been trying to lessen its dependence on oil revenues, with this year's creation of the Ministry of International Trade to help foster non-oil exports. But the surging dollar has stymied these efforts, as it has made Ecuador's products less competitive than those from its neighbors such as Colombia and Brazil whose currencies have depreciated dramatically.

During the first eight months of this year, Ecuador's non-oil exports, such as bananas, flowers and shrimp, fell 4% from the year-ago period, largely due to a gain in the value of the dollar, according to official data. That came as oil-export revenue plunged 48%

In an interview with The Wall Street Journal last month, Diego Aluestia, Ecuador's trade minister, said he wasn't alarmed by the decline in non-oil exports, but is focusing on medium- to long-term efforts such as tax reforms, education and bilateral commercial agreements to help promote exports and solicit foreign investment.

Such moves have won plaudits from credit-rating firms. In late October, Moody's confirmed Ecuador's credit rating at B3, which is in "junk" territory. "This rating incorporates the stress that Ecuador is currently facing because of the lower oil price and the government's pragmatic and proactive policies that stand to face the challenges," said Renzo Merino, a sovereign analyst at Moody's Investors Service.

But many investors aren't convinced.

"This is not an improving economy," said Javier Murcio, an emerging-market portfolio manager at Standish Mellon Asset Management, which has $170 billion in assets. Lower oil prices, use of the dollar and political uncertainties put the country at a disadvantage, Mr. Murcio added.

Also keeping some bond investors away from Ecuador is the country's checkered borrowing history. Ecuador has defaulted twice during the past 25 years when its foreign reserves were able to cover the debt.

The country had been shut out of the capital markets since 2008, and just regained access last year.

Since then, it has made a foray back into the markets by issuing billions of dollars in debt. Total external debt has increased 45% since late 2013 to $27 billion this year, according to Moody's.

Write to Carolyn Cui at carolyn.cui@wsj.com