



Rabobank

Country Report Ecuador

Country Report
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In 2014, Ecuador returned to the international capital markets with a bond issue that improved liquidity. But, the external position remains weak and under pressure from low oil prices and falling remittances. The interventionist and nationalist tendencies of the Correa government continue.

Strengths (+) and weaknesses (-)

(+) Generous resources endowment

Ecuador is rich in resources, both below ground, such as oil and gas, and above ground, such as a high potential for generating hydropower and a diverse climate, which makes Ecuador suitable for growing various crops and attractive for tourists.

(-) Bad payment morale

Since independence, Ecuador has defaulted 10 times on sovereign debt and has spent 58% of the time in default. This track record has given Ecuador the reputation of a serial defaulter. Unwillingness to pay was the reason behind some default incidents, which makes matters worse.

(-) Reliance on the oil sector

Oil accounts for around 25-30% of total government income and 57% of total exports. Besides, economic growth is highly reliant on public investments and, thus, on oil revenues. Therefore, Ecuador's economy is susceptible to volatility in global oil markets.

(-) Populist regime hurts business climate

Ever since in office, President Correa has consolidated power in his function and economic policy has become increasingly interventionist (e.g. interest rate ceilings, imports restrictions), which is detrimental for the business climate.

Key developments

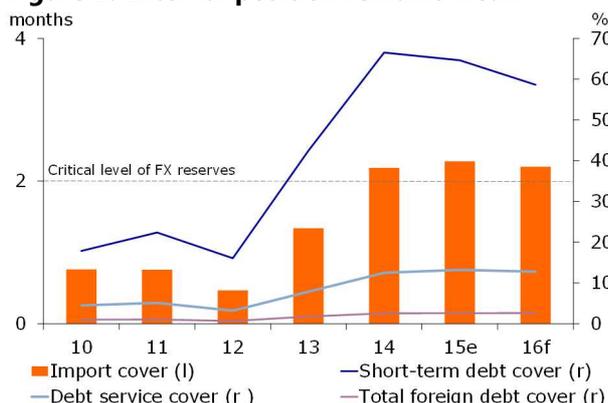
1. New bond issue improves external position, but from a very low base

Following the default in 2008, Ecuador lost access to international financial markets. Consequently, Ecuador became reliant on financing from South American multilateral organisations and China. In June 2014, Ecuador returned to the international capital markets with the issuance of a USD 2bn 10 year bond. The receipts have improved Ecuador's external liquidity position, though coming from a very low base. For example, import cover soared from 1.3 months in 2013 to 2.2 months in 2014, but this is still alarmingly low. Besides, an expansive fiscal policy and lower FX receipts due to lower oil prices and lower remittances, against the background of a dollarized economy that needs high USD inflows, will lead to higher pressures on the already low FX reserves. This could threaten the dollarization regime that has led to macroeconomic stability and increase the chances of a balance of payments crisis. Readily available external financing provides some comfort, though. Moreover, large hydroelectric projects expected to be completed in 2016 should reduce Ecuador's fuel imports and ease pressures on the current account balance as a result.

2. Fiscal balances deteriorate

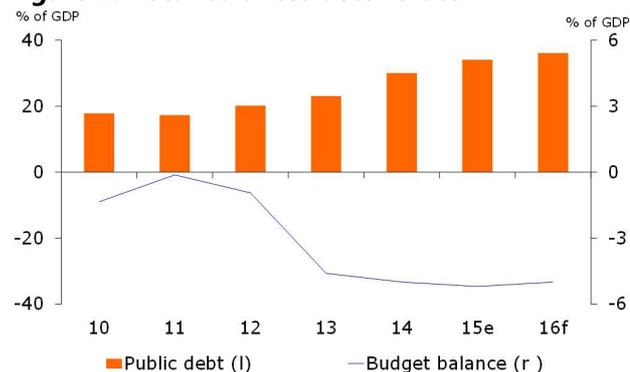
Significant public sector investment in especially infrastructure, which accounted for around 16% of GDP in 2013, has supported solid economic growth in recent years. But, it also led to a steep increase in the budget deficit, which soared from around 1% of GDP in 2010-2012 to around 5% of GDP in 2013 and 2014. Consequently, public debt is expected to double between 2010 and 2015 to around 34% of GDP. Public debt levels remain low, but this is mainly the result of a USD 3.2bn default on government debt in 2008 (restructured in 2009), which reduced public debt from 21% of GDP in 2008 to 15% of GDP in 2009. A long period of low oil prices is poised to seriously hurt government income, which increases the chances of another voluntary default on debt, as the government might once again prioritize social and capital spending above the interests of its creditors, as it did in 2008. Lower government income would also affect economic growth and could spark social unrest.

Figure 1: External position remains weak



Source: EIU

Figure 2: Fiscal balances deteriorate



Source: EIU

3. Increasingly autocratic political regime

President Correa is currently attempting to change the constitution to remove the limit on presidential terms so that he can run for president indefinitely. Given Ecuador's track record of political instability and the fact that Correa is its longest serving president, the change could improve political stability in Ecuador. However, it will also erode the already weak democratic checks and balances. It also increases the chances that the President will further consolidate his power and that Ecuador evolves into an administered socialist regime

similar to Venezuela. Last but not least, recent local elections indicated that anti- government sentiment is growing, so such a move could spark mass popular protests.

Factsheet of Ecuador

Ecuador						
National facts			Social and governance indicators rank / total			
Type of government	Republic		Human Development Index (rank)	98 / 187		
Capital	Quito		Ease of Doing Business Index (rank)	135 / 189		
Surface area (thousand sq km)	283		WEF Global Competitiveness Index (rank)	n.a. / 144		
Population (millions)	15.3		Corruption Perceptions Index (rank)	110 / 175		
Main languages	Spanish		Press Freedom Index (rank)	95 / 180		
Main religions	Quechua		Gini index (income distribution)	46.57		
	Roman Catholic (95%) Other (5%)		Population below \$1.25 per day (PPP)	4%		
Head of State (president)	Rafael Correa Delgado		Foreign trade 2013			
Head of Gov (president)	Rafael Correa Delgado		Main export partners (%)		Main import partners (%)	
Monetary unit	United States Dollar (USD)		Brazil	45	Brazil	29
			China	10	China	13
			Chile	8	US	9
			US	4	Germany	7
Economy 2014			Main export products (%) 2014			
Economic size bn USD % world total			Main import products (%)			
Nominal GDP	102	0.13	Processed agricultural products	55		
Nominal GDP at PPP	182	0.17	Manufactures	9		
Export value of goods and services	29	0.13	Primary	5		
IMF quotum (in m SDR)	348	0.16	Fuel and energy	5		
Economic structure 2014 5-year av.			Main import products (%)			
Real GDP growth (%)	4.3	4.4	Intermediate goods	29		
Agriculture (% of GDP)	6	6	Capital goods	26		
Industry (% of GDP)	34	34	Consumer goods	16		
Services (% of GDP)	60	60	Fuels	24		
Standards of living USD % world av.			Openness of the economy			
Nominal GDP per head	6,656	57	Export value of G&S (% of GDP)	29		
Nominal GDP per head at PPP	11,888	74	Import value of G&S (% of GDP)	30		
Real GDP per head	3,971	46	Inward FDI (% of GDP)	0.6		

Source: EIU, CIA World Factbook, UN, World Economic Forum, Transparency International, Reporters Without Borders, World Bank.

Background information

Ecuador is a small country on the North-Western Coast of South America, bordering Colombia and Peru. Following many currency regimes and a banking, economic and currency crisis in 1999, Ecuador adopted the US Dollar in 2000, thereby giving up control of monetary policy and of the possibility for the Central Bank to act as a lender of last resort. The full dollarization of the economy has improved macro-economic stability. However, the investment climate is very difficult on the back of unpredictable policies, weak institutions and a high level of corruption. Import restrictions and capital controls further contribute to the cumbersome business climate. A large share of the Ecuadorian population, between two and three million people, lives abroad and provides a structural inflow of remittances that support the current account balance and domestic demand. At home, development is poor and inequality remains high despite significant progress in recent years. Ecuador gained independence from Spain in 1822 and was part of the Gran Colombia Federation until 1830. Civilian governments have been in power since 1974, but this period was marred by political instability, including presidents being ousted through popular protests. Rafael Correa is the first president to stay in office for a longer period of time, namely almost eight years. During his time in office, the president has concentrated power in his function. General elections are held every four years and the last ones took place in 2013. Ecuador's society is characterized by tensions between the economic heartland in the coastal region and the administrative and educational centre in the highlands. Ecuador hosts the most active volcano in the

world, the Cotopaxi in the Andes, so earthquakes are frequent.

Economic indicators of Ecuador

Ecuador							
Selection of economic indicators	2010	2011	2012	2013	2014	2015e	2016f
<i>Key country risk indicators</i>							
GDP (% real change pa)	3.5	7.9	5.2	4.6	4.3	3.5	4.8
Consumer prices (average % change pa)	3.6	4.5	5.1	2.7	3.9	3.9	4.6
Current account balance (% of GDP)	-2.3	-0.3	-0.2	-1.2	0.4	-0.2	0.6
Total foreign exchange reserves (m USD)	1,435	1,664	1,080	3,328	5,517	5,920	6,350
<i>Economic growth</i>							
GDP (% real change pa)	3.5	7.9	5.2	4.6	4.3	3.5	4.8
Gross fixed investment (% real change pa)	10.2	14.3	10.6	10.7	6.2	6.0	6.1
Private consumption (real % change pa)	7.7	5.1	2.7	3.2	3.8	3.6	3.7
Government consumption (% real change pa)	4.4	8.7	11.1	7.7	4.0	3.6	4.5
Exports of G&S (% real change pa)	-0.2	5.7	4.7	2.4	6.8	4.9	5.5
Imports of G&S (% real change pa)	14.8	3.6	0.8	7.0	5.3	3.8	7.5
<i>Economic policy</i>							
Budget balance (% of GDP)	-1.3	-0.1	-0.9	-4.6	-5.0	-5.2	-5.0
Public debt (% of GDP)	18	17	20	23	30	34	36
Money market interest rate (%)	5.8	6.0	6.0	6.0	6.0	6.0	6.0
M2 growth (% change pa)	20	17	16	14	21	17	15
Consumer prices (average % change pa)	3.6	4.5	5.1	2.7	3.9	3.9	4.6
Exchange rate LCU to USD (average)	1.0	1.0	1.0	1.0	1.0	1.0	1.0
Recorded unemployment (%)	7.6	6.0	4.9	4.7	5.0	4.8	4.5
<i>Balance of payments (m USD)</i>							
Current account balance	-1,585	-220	-183	-1,177	436	-250	650
Trade balance	-1,504	-161	50	-646	670	190	1,200
Export value of goods	18,137	23,082	24,569	25,685	27,069	27,340	31,520
Import value of goods	19,641	23,243	24,519	26,331	26,399	27,150	30,310
Services balance	-1,523	-1,563	-1,391	-1,502	-1,707	-1,730	-1,840
Income balance	-1,040	-1,221	-1,323	-1,429	-1,419	-1,810	-2,010
Transfer balance	2,481	2,723	2,481	2,399	2,892	3,090	3,290
Net direct investment flows	163	644	585	590	600	700	850
Net portfolio investment flows	-726	41	67	648	-2,126	-90	-840
Net debt flows	1,135	1,474	357	2,417	2,654	1,510	1,540
Other capital flows (negative is flight)	-157	-1,603	-1,300	-609	91	-1,460	-1,770
Change in international reserves	-1,170	335	-475	1,869	1,655	410	430
<i>External position (m USD)</i>							
Total foreign debt	14,963	16,497	16,931	19,242	21,824	23,150	24,630
Short-term debt	804	745	673	783	829	920	1,080
Total debt service due, incl. short-term debt	3,209	3,273	3,406	4,241	4,425	4,490	4,980
Total foreign exchange reserves	1,435	1,664	1,080	3,328	5,517	5,920	6,350
International investment position	-9,233	-9,282	-9,449	-10,565	n.a.	n.a.	n.a.
Total assets	19,550	22,356	23,148	26,546	n.a.	n.a.	n.a.
Total liabilities	28,783	31,637	32,597	37,111	n.a.	n.a.	n.a.
<i>Key ratios for balance of payments, external solvency and external liquidity</i>							
Trade balance (% of GDP)	-2.2	-0.2	0.1	-0.7	0.7	0.2	1.0
Current account balance (% of GDP)	-2.3	-0.3	-0.2	-1.2	0.4	-0.2	0.6
Inward FDI (% of GDP)	0.2	0.8	0.7	0.6	0.6	0.6	0.7
Foreign debt (% of GDP)	22	21	19	20	21	21	21
Foreign debt (% of XGSIT)	66	59	58	63	67	69	65
International investment position (% of GDP)	-13.3	-11.7	-10.8	-11.2	n.a.	n.a.	n.a.
Debt service ratio (% of XGSIT)	14	12	12	14	14	13	13
Interest service ratio incl. arrears (% of XGSIT)	2	2	3	2	3	3	3
FX-reserves import cover (months)	0.8	0.8	0.5	1.3	2.2	2.3	2.2
FX-reserves debt service cover (%)	45	51	32	78	125	132	128
Liquidity ratio	111	115	114	114	125	124	125

Source: EIU

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