Full Rating Report

Ecuador

Ratings

Foreign Currency	
Long-Term IDR	B-
Short-Term IDR	B
Country Ceiling	B-

Outlook

Foreign-Currency Long-Term IDR Stable

Financial Data

Ecuador

USDbn	2010
GDP	58.9
GDP per head (USD, thousands)	4.3
Population (m)	13.8
International reserves	4.1
Net external debt (% GDP)	-0.5
Central government total debt (% GDP)	21.6
CG foreign-currency debt	12.7
CG domestically issued debt (USDbn)	3.7

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Related Research

Applicable Criteria

- *Sovereign Rating Methodology* (August 2010)

Other Research

- *Global Economic Outlook (October 2010)*
- *Latin America Sovereign Outlook (April 2010)*
- *Ecuador (December 2009)*

Rating Rationale

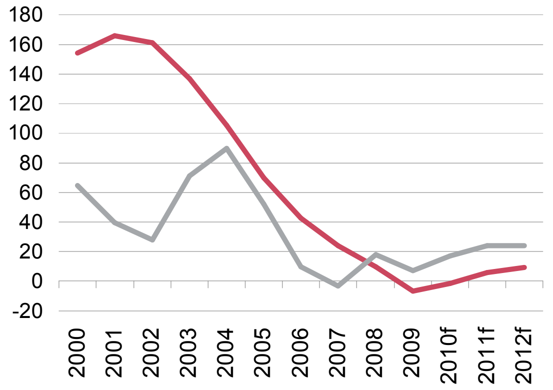
- On 5 November 2010 Fitch Ratings upgraded Ecuador's Foreign-Currency Issuer Default Rating (IDR) to 'B–' with a Stable Outlook. The upgrade reflects the easing of short-term liquidity and financing constraints for the country due to the recovery in international oil prices and increased bilateral lending. Loan agreements with China worth USD2.6bn (4.4% of GDP) and continued financing from the public social security agency have provided Ecuador with resources for budgetary support and infrastructure spending.
- Ecuador's ratings balance moderate levels of public and external debt and the country's comparatively high income and human development levels against demonstrated weak willingness to service debt and the sovereign's fragile payment capacity. Ecuador's ratings are also constrained by limited transparency and disclosure of public finances information.
- Ecuador's external financing needs (current account balance plus external debt amortisations) have declined in tandem with the decline of the current account deficit (CAD). The CAD finished 2009 at 0.6% of GDP and is likely to remain modest at 0.8% of GDP in 2010. Therefore, in the absence of a terms-of-trade shock, external financing needs could remain relatively manageable at 49% of international reserves in 2010 and 65% in 2011.
- Although external liquidity has recovered (126% in 2010) due to improved fiscal performance and bilateral financing, it remains low compared to the median for the 'B' rating category (sovereigns rated 'B+', 'B' and 'B–') of 197%. In light of Ecuador's limited external financing sources and high commodity dependence, Fitch considers that higher liquidity would be necessary to assuage concerns about the sustainability of dollarisation.
- Ecuador's limited sources of recurrent and reliable financing, and the high dependence of external and fiscal accounts on oil prices will continue to weigh on the sovereign's capacity to service its outstanding debt commitments. Moreover, the sovereign's demonstrated weak willingness to pay constitutes a key weakness in Ecuador's credit profile.
- Fitch Ratings considers that growth prospects remain weak by regional standards and in comparison to rating peers due to structural weaknesses related to low private investment, a weak institutional framework and declining oil production. The Ecuadorean economy could expand by 2.6% and 2.8% in 2010 and 2011, respectively, compared with the 5.5% and 5% 'B' medians.

Key Rating Drivers

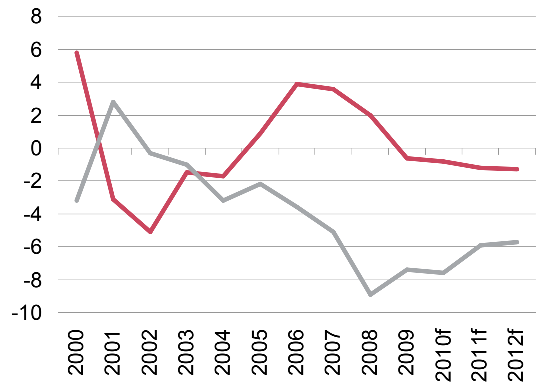
- Evidence of enhanced willingness or strengthened capacity to service outstanding debt according to original terms could benefit Ecuador's creditworthiness.
- Downward pressure on Ecuador's ratings could arise from greater-than-expected deterioration in fiscal and external accounts and from signs of further erosion in willingness to service outstanding debt.

Peer Comparison

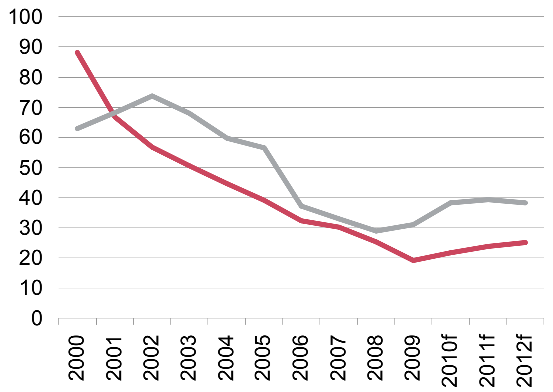
Net External Debt
% of CXR



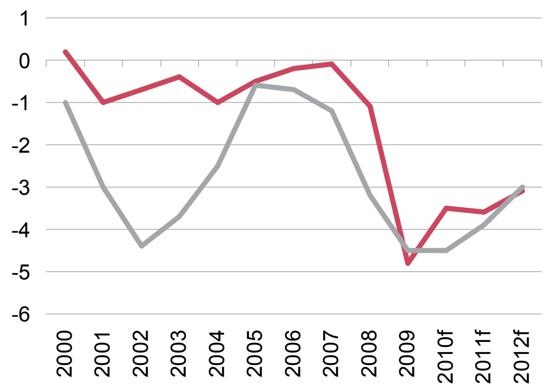
Current Account Balance
% of GDP



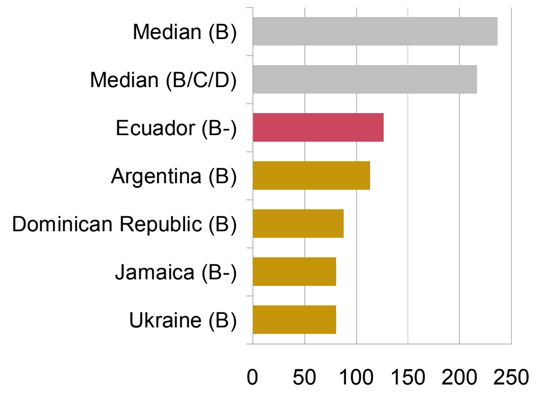
General Government Debt
% of GDP



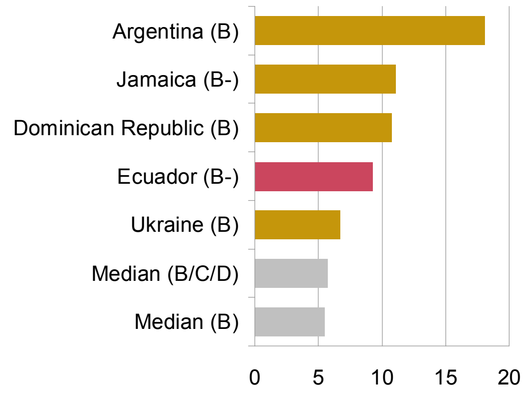
General Government Balance
% of GDP



International Liquidity Ratio, 2010
%



GDP per capita Income, 2010e
At market exchange rates, USA=100



Ecuador
Medians

Peer Group

Rating	Country
B	Argentina
	Benin
	Cameroon
	Dominican Republic
	Lebanon
	Mongolia
	Mozambique
	Rwanda
	Suriname
	Uganda
	Ukraine
B-	**Ecuador**
	Jamaica
	Seychelles

Rating History

Date	Long-Term Foreign Currency	Long-Term Local Currency
05 Nov 10	B-	n.a.
04 Sep 09	CCC	
15 Dec 08	RD	
17 Nov 08	CCC	
30 Oct 07	CCC	
23 Jan 07	CCC	
14 Dec 05	B-	
29 Aug 05	B-	
07 Oct 04	B-	
21 Jul 04	CCC+	
25 Sep 03	CCC+	
24 Mar 03	CCC+	
08 Nov 02	CCC+	

Rating Factors

Summary: Strengths and Weaknesses

Rating Factor	Macroeconomic	Public Finances	External Finances	Structural Issues
Status	Weakness	Neutral	Neutral	Weakness
Trend	Stable	Stable	Stable	Stable

Note: relative to 'B' category

Strengths

- Ecuador has relatively high per capita income and human development indicators compared with peers.
- The sovereign has stronger fiscal and external solvency indicators than peers due to the positive commodity cycle and limited access to external financing in recent years. However, it has demonstrated lower debt tolerance than peers.

Weaknesses

- Ecuador has undergone two restructuring processes (2000 and 2009) in the past 10 years. In spite of improved capacity to service debt, willingness to pay has eroded noticeably under the administration of President Rafael Correa. As a result, the government decided to default on a portion of its market debt in December 2008.
- Fiscal and external accounts are vulnerable to adjustment in international oil prices due to the increased weight of oil revenue in the fiscal accounts, the eroding competitiveness of non-commodity exports and the elimination of counter-cyclical fiscal funds.
- Limited access to external sources of financing increases the country's vulnerability to external shocks. Access to international capital markets is minimal due to the coercive debt purchase in 2009. Strained relations with the International Monetary Fund (IMF) and World Bank also constrain multilateral support.
- Despite progress on inflation due to dollarisation since 2000, the country's macroeconomic performance remains more volatile than in other low non-investment-grade sovereigns.
- The Ecuadorean economy faces structural weaknesses in terms of low investment, declining oil production, a weak institutional and policy framework, and high potential for political instability.

Local Currency Rating

As a formally dollarised economy, Ecuador does not have a Local-Currency Long-Term IDR.

Country Ceiling

Ecuador's Country Ceiling is at the same level as the Long-Term Foreign-Currency IDR due to limited international financial integration and concerns about the sustainability of the dollarisation regime.

Outlook and Key Issues

The recovery in international oil prices and ad hoc bilateral financing from China provided some “breathing space” for Ecuador’s fiscal and external accounts, and assuaged short-term concerns about the sustainability of the dollarisation regime. Nevertheless, growth prospects remain comparatively weak and are highly dependent on the government’s capacity to provide a fiscal stimulus through public investment.

Expenditure commitments and plans are likely to continue to require increased borrowing from domestic and international sources. The improvement in the sovereign’s solvency indicators resulting from the coercive debt buy-back operation of 2009, which allowed the government to write off 78% of its outstanding external bond debt, is likely to reverse over the forecast period.

Ecuador’s limited sources of recurrent and reliable financing and the high dependence of external and fiscal accounts on oil prices will continue to weigh on the sovereign’s capacity to service its outstanding debt commitments. Moreover, the sovereign’s demonstrated weak willingness to pay constitutes a key weakness in its credit profile.

External liquidity, dependent on favourable terms of trade (TOT) and external financing availability, will continue to be a concern for the sustainability of the country’s dollarisation regime. A shortage could not only further erode growth prospects but also increase the financial system’s instability.

Growth Outlook

The Ecuadorean economy avoided contraction in 2009, according to official statistics, and achieved positive growth of 0.4% of GDP. This was driven by public expenditure and improvements in net trade. Concerns have been raised about the reliability of central bank data, as the final 2009 numbers were the result of a second revision of GDP methodology during the Correa administration.

Growth is likely to reach 2.6% in 2010. Structural constraints related to low private investment, weak institutional framework and declining oil production have not allowed the country to recover at the same speed of neighbouring economies or peer commodity exporters. Continued uncertainty about the future track of economic policy and increased interventionism by the government in the economy are also likely to weigh on credit availability and investment. Consumption will continue to be constrained by rising unemployment and weakened remittances.

Growth prospects will be dependent on the dynamics of the oil sector and the capacity of the government to continue providing a fiscal stimulus. The recently signed agreements between Ecuador and China for budgetary support, infrastructure and the construction of a hydroelectric plant have provided the current administration with the space to continue maintaining a high level of public investment.

The uncertainty surrounding the final contractual arrangements between the government and private oil companies and the technical limitations of the state-owned company, Petroecuador, have resulted in continued decline in crude production. In January-August 2010, total oil production declined by 2.6% yoy, and therefore could contract for a fourth consecutive year. Private companies’ (responsible for 40% of the country’s oil output) production declined by a yearly average of 11.7% during 2007-2009, and their performance in the first eight months of the year was 7% down yoy. The oil sector is therefore likely to provide only a limited boost to economic activity.

Financial System

Credit to the private sector grew by 16% in the first nine months of 2010. Past-due loans represented 7.8% of total loans at the beginning of October 2010, slightly down from a year before. As long as dollarisation is maintained, deterioration in the quality of the credit portfolio does not represent the main threat to the stability of the financial system, as current asset quality compares favourably with that of the late 1990s. Private banks' liquidity position continues to be strong, and these have a net external creditor position of about USD3.7bn (6.2% of GDP).

Sight and time deposits were up by 15% and 12%, respectively, in the first nine months of 2010, and the system did not experience deposit flight during the political volatility at the end of September. Nevertheless, there were deposit outflows in Q408 and 2009, prompted by the deteriorating prospects of the economy, policy uncertainty, and concerns about the commitment of the present administration to the current exchange rate regime.

Dollarisation has helped the financial sector increase its resilience to episodes of political instability in the nine years since its introduction. Despite their reasonable liquidity position and relatively sound balance sheets, banks could face a confidence crisis if the government tapped into the banking system's assets for financing and if there were increased concerns about the sustainability of dollarisation.

New legislation to "allow" banks to keep a portion of their reserve requirements at the central bank in the form of government paper could increase nervousness in the local economy about the government's willingness to tap into private banks' liquidity to finance its policy objectives.

Expansive Fiscal Policy

Although the recovery in international oil prices has brought some relief to fiscal accounts, Fitch believes that the sovereign is likely to continue to have a fragile fiscal position due to an expected timid economic recovery and increased expenditure commitments in 2011.

Ecuador's fiscal policy has been markedly pro-cyclical under the Correa administration and has become increasingly dependent on international oil prices. Oil revenue halved to 4.2% of GDP in 2009 from 8.5% in 2008. This deterioration was partly compensated for by an increase in non-oil tax revenue. Revenue loss in 2008-2009 was therefore 3.9 percentage points (pp) of GDP. Expenditure remained almost constant in nominal terms; most notably salaries rose by 1.5pp to 8.7% of GDP, and capital spending remained close to 10% of GDP. Consequently, the central government deficit rose to 4.8% of GDP in 2009 from 1.1% in 2008.

In 2010 increased oil revenue and continued growth in the non-oil tax base could result in a 2% of GDP recovery in revenue. Fitch expects capital expenditure to be boosted to 10.5% of GDP, while current spending will continue at its strong pace. The central government deficit could therefore decline slightly to 4.2% of GDP. Financing needs for 2011 could reach 6.7% of GDP. The government projects about USD7.3bn in capital spending, but its execution capacity and funding availability could result in a lower amount at year-end. Moreover, the government has not provided details on the funding mix and sources for USD3.8bn in external financing requirements, according to its 2011 budget proposal.

The government has placed more than USD1bn in the local market in 2010. Most of this issuance was absorbed by the public social security fund (IESS), after this institution already had taken on USD1.2bn in government paper during December 2008-February 2009. In June 2010 the IESS held more than 50% of its portfolio in government paper. The social security institute has USD558n in deposits at the central bank, highlighting its limited capacity to continue supporting the government's financing strategy.

Government deposits at the central bank reached USD1.1bn at the beginning of October, while deposits in the banking system were USD1.4bn. Recent changes to the financing legislation could allow the government to increase short-term financing (through issuance of treasury bills, CETES) and give the Minister of Finance power to increase budgeted expenditure (by up to 15%).

Ecuador has relied heavily on bi-lateral external financing, most notably from China. Loans from China in 2008-2009 totalled USD3.6bn. Petrochina provided a USD1bn "cash advance" in 2009, and China's Development Bank provided a similar amount in 2010 for budget support. In addition, the Export-Import Bank of China has committed to providing USD1.6bn in financing for the Coca-Codo Sinclair hydropower plant project.

Ecuador is likely to continue relying on loans from the Inter-American Development Bank (IADB) and the Corporación Andina de Fomento (CAF). These could total USD700m combined. Greater financing availability will therefore remain dependent on continued agreements with China or other friendly governments.

Public Finances: Sources and Uses (% GDP)

	2009	2010f	2011f	2012f
Uses	11.8	6.4	6.8	6.8
Budget balance	-4.8	-4.2	-4.1	-4.4
Amortisation (by place of issue)				
Domestic	0.5	0.8	0.7	0.7
Foreign	6.4	1.5	1.9	1.8
Sources	11.8	6.4	6.7	6.8
Gross borrowing (by place of issue)				
Domestic	2.5	2.4	1.9	1.9
Foreign	6.3	5.9	2.8	2.8
Privatisation				
Use of cash (- = accumulation)	3	-2	2	2

Source: Fitch Ratings

Although fiscal solvency indicators compare favourably with those of other sovereigns in the 'B' category, the government's weak willingness to continue servicing its debt will remain a key credit weakness. General government debt declined to 19.2% of GDP in 2009, below the 28.5% 'B'/'C'/'D' median, but this is likely to increase to 22.3% in 2010 as a result of increased financing from China. The Asian country accounts for 40% of Ecuador's sovereign external debt.

Fragile External Liquidity

Despite improvements in external liquidity in 2010, Fitch considers that external liquidity will remain a concern for Ecuador, as it is highly dependent on the sovereign's external financing availability. Even the improved external liquidity, at 121%, is lower than that of peers. Moreover, there seems to be limited upside for considerable international reserve build-up due to the government's commitment to an expansionary fiscal policy.

Additional multilateral support in combination with downward adjustments to the public-sector external financing requirements would be required to avoid tighter liquidity conditions weighing on growth prospects and/or increased concerns about the sustainability of the dollarisation regime.

Balance-of-payments vulnerabilities stem from heavy dependence on commodities, most notably oil, migrants' remittances, and low non-debt capital inflows. Oil and traditional export products accounted for 75% of total merchandise exports in 2009. Oil export revenue declined by 40% in 2009, but still accounted for 50% of export revenue. Migrant remittance flows, averaging 6.3% of GDP during 2004-2008, dropped by an accumulated 12% in 2009. Nevertheless, the current account had a moderate deficit of 0.6% of GDP, as imports fell sharply by 20%.

External Finances: Sources and Uses

(USDbn)	2009	2010f	2011f	2012f
Uses	4.4	1.9	2.5	2.6
Current account balance	-0.3	-0.5	-0.8	-0.9
MLT amortisation				
Sovereign	3.5	0.9	1.2	1.2
Non-sovereign	0.6	0.6	0.5	0.5
Sources	4.4	1.9	2.4	2.2
Gross MLT borrowing				
Sovereign	1.9	1.4	1.1	0.9
Non-sovereign	0.2	0.5	0.6	0.6
Net FDI	0.3	0.5	0.3	0.5
Other	1.1	-0.5	0.2	0.5
Change in fx reserves (- = accumulation)	0.9	0.1	0.2	-0.3

f - Forecast
Source: Fitch

Although external financing needs rose to almost 100% of GDP in 2009, mostly driven by the sovereign debt repurchase operation, they are likely to be 49% in 2010 and 65% in 2011. Fitch forecasts non-debt-creating inflows, mostly FDI (0.8% of GDP), to remain low due to the state's increasing role in the economy and continued changes to the regulatory framework. The current government's ideological position and its policy mix also preclude Ecuador from accessing liquidity facilities or other type of financing from the IMF and the World Bank. Multilateral financing is restricted to the CAF and IADB. Continued bilateral disbursements from China are uncertain.

Political Scenario

President Correa continues to be popular and the main force in the country's political landscape. The concentration of power in the executive branch has allowed him to move ahead with his policy agenda in terms of increasing the role of the state in the economy. However, political stability and institutional independence and strength have not shown signs of improvement, as shown by a recent revolt in September 2010 by police officers against benefit cuts, and tensions between the National Assembly and the president.

Forecast Summary

	2006	2007	2008	2009	2010[f]	2011[f]	2012[f]
Macroeconomic Indicators and Policy							
Real GDP growth (%)	3.9	2.0	7.2	0.4	2.6	2.8	2.9
Consumer prices (annual average % change)	3.0	2.3	8.4	5.2	3.7	3.6	4.1
Short-term interest rate (%)[a]	9.5	10.7	9.1	9.2	10.2	10.8	11.2
General government balance (% of GDP)	-0.2	-0.1	-1.1	-4.8	-4.2	-4.1	-4.4
General government debt (% of GDP)	32.3	30.2	25.2	19.2	22.3	24.9	27.4
LC per USD (annual average)	1.0	1.0	1.0	1.0	1.0	1.0	1.0
Real effective exchange rate (2000=100)	147.1	140.8	141.8	151.8	146.5	145.5	145.9
External Finance							
Current account balance (USDbn)	1.6	1.7	1.1	-0.3	-0.5	-0.8	-0.9
Current account balance (% of GDP)	3.9	3.6	2.0	-0.6	-0.8	-1.2	-1.3
Current account balance plus net FDI (% of GDP)	4.5	4.0	3.9	0.0	0.0	-0.8	-0.6
Net external debt (USDbn)	7.5	4.8	2.3	-1.2	-1	1.6	3.0
Net external debt (% of GDP)	17.9	10.4	4.2	-2.3	0.0	2.5	4.4
Net external debt (% of CXR)	42.4	24.1	9.8	-6.7	0.0	7.1	12.5
Official international reserves including gold (USDbn)	2.0	3.5	4.5	3.8	3.7	3.6	3.9
Official international reserves (months of CXP cover)	1.5	2.3	2.4	2.4	2.1	1.9	1.9
External interest service (% of CXR)	7.3	6.9	6.2	6.6	5.4	5.7	6.1
Gross external financing requirement (% int. reserves)	-26.0	-18.3	1.2	98.9	49.0	65.2	70.2
Memo: global forecast summary							
Real GDP growth (%)							
US	2.7	1.9	0.0	-2.6	2.7	2.5	2.6
Japan	2.0	2.4	-1.2	-5.2	3.0	1.6	1.7
Euro area	3.1	2.7	0.4	-4.1	0.9	1.5	2.0
World	3.8	**3.7**	**1.4**	**-2.5**	**3.1**	**2.9**	**2.7**
Commodities							
Oil (USD/barrel)	65.4	72.7	97.7	64.0	80.0	85.0	85.0

[a] Short-term market rate (annual average).
Source: Fitch

Comparative Analysis: Macroeconomic Performance and Policies

Ecuador

	2010						
	Ecuador 'B-'	Argentina 'B'	Dominican Republic 'B'	Ukraine 'B'	Jamaica 'B-'	'B' median	'B'/'C'/'D' median
Real GDP(5yr average % change)	3.2	6.3	6.8	1.4	0.2	6.1	6.0
Volatility of GDP (10yr rolling SD)	2.4	7.0	3.6	7.6	1.7	2.4	2.4
Consumer prices (5yr average)	4.5	8.8	6.3	14.6	12.5	9.4	8.8
Volatility of CPI (10yr rolling SD)	10.8	6.9	15.3	6.5	4.6	5.2	5.7
Years since double-digit inflation	8.0	4.0	2.0	0.0	0.0	n.a.	n.a.
Unemployment rate	7.9	9.0	15.0	9.5	11.5	8.7	8.3
Type of exchange rate regime	Dollarisation	Managed float	Managed float	Managed float	Managed float	n.a.	n.a.
Dollarisation ratio*	100.0	20.0	37.0	47.2	43.5	38.4	38.4
REER volatility (10yr rolling SD)	13.6	19.8	13.9	8.7	7.3	7.2	7.3

Source: Fitch; * 2009 figures

Strengths

- Ecuador's inflation performance is better than that of peers. Inflation has not only declined dramatically since 2000, when it averaged 96%, but average inflation has remained in single digits since 2003.
- Dollarisation has improved macroeconomic stability in recent years and reduced the impact of recurrent political volatility on the financial system.

Weaknesses

- Growth has underperformed that of peers and other commodity exporters. Growth prospects remain weak due to the increased role of the state in the economy, and limited upside for the oil sector.
- The country's macroeconomic performance, measured on a 10-year basis, has been more volatile than for peers, due not only to overdependence on commodity-related revenue, but also to persistent political instability in the first half of the 2000s.
- Real effective exchange rate (REER) volatility has been higher than for peers due to the appreciation of trade partners' currencies and higher inflation in the early part of the 2000s.

Commentary

Although dollarisation, adopted in 2000, has increased macroeconomic stability in spite of repeated political crises, the absence of structural reforms and political instability have prevented Ecuador from realising competitiveness gains for its non-traditional export base.

Moreover, dollarisation has not constituted a "straitjacket" for fiscal accounts, and the government's expansionary fiscal policies and the limited availability of financing sources could erode confidence in the Correa administration's commitment to the sustainability of the regime.

Fitch considers that an exit from dollarisation could be a net negative for Ecuador because real competitive gains for Ecuador's non-traditional exports could be wiped out by high inflation, as economic agents would expect continued depreciation or devaluations of the new currency due to historical precedents, the absence of reserve support, and low credibility in the policy framework.

In addition, and again based on historical precedents, economic actors would be likely to prefer to continue saving, pricing and carrying operations in US dollars continuing with a de facto dollarisation.

Comparative Analysis: Structural Features

Ecuador

	2010						
	Ecuador 'B-'	Argentina 'B'	Dominican Republic 'B'	Ukraine 'B'	Jamaica 'B-'	'B' median	'B'/'C'/'D' median
GNI per capita PPP (USD, latest)*	7,760	14,020	7,890	7,210	7,360	3,810	4,140
GDP per capita (USD, mkt exchange rates)	4,274	8,355	4,980	3,084	5,023	2,539	2,650
Human Development Index (percentile, latest)	56.3	73.4	50.8	53.5	45.3	37.6	38.1
Ease of Doing Business (percentile, latest)	24.8	35.8	53.3	22.6	59.4	39.4	39.1
Trade openness (CXR and CXP % GDP)	36.4	24.0	33.5	53.1	56.1	n.a.	n.a.
Gross domestic savings (% GDP)	25.2	26.2	5.2	17.9	2.4	15.2	16.5
Gross national savings (% GNP)	23.0	24.2	9.2	18.5	15.1	17.6	18.0
Gross domestic investment (% GDP)	23.3	22.1	16.1	19.0	22.5	22.5	22.5
Private credit (% GDP)	28.1	12.4	20.8	57.7	27.1	25.9	26.9
BSR Indicators	D1	E2	D1	E3	n.a.	n.a.	n.a.
Bank system CAR*	13.8	18.6	15.8	18.1	18.3	n.a.	n.a.
Foreign bank ownership (% assets)*	2.3	20.0	10.0	47.0	55.0	n.a.	n.a.
Public bank ownership (% assets)*	12.6	45.0	31.0	13.4	0.0	24.9	24.9
Default record (year cured) [a]	2009	2009	2005	2000	2010	n.a.	n.a.

[a] Default on Globals in 2008, defaults on Globals, Bradys and locally issued debt in 1999-2000. Extensive earlier rescheduling

Source: Fitch and World Bank; *2009 figures

Strengths

- Ecuador is a richer economy than its peers in US dollar terms, both at market rates and in terms of purchasing power parity. The country's "level of human development" is considered as "high" by the United Nations, in light of progress in life expectancy and adult literacy.
- The country's investment rate is in line with those of peers. Nevertheless, recent investment growth has been driven by the public sector and is dependent on the government's fiscal position.

Weaknesses

- Ecuador has undergone two restructuring processes since 2000, reflecting low debt tolerance and weak willingness to service debt.
- Ecuadorean institutions fare poorly even against the 'B' median in terms of political stability, government effectiveness and rule of law, according to the World Bank's governance indicators.
- The country's business environment is rather poor. Ecuador is placed 138th in the world (out of 183 economies) due to labour market inflexibility, excessive red tape, weak protection of investor rights and/or contract enforcement.
- The low degree of openness in the Ecuadorean economy in the context of dollarisation limits growth prospects and increases the importance of a greater availability of external funding sources.

Commentary

Fitch's Banking System Indicator of 'D' characterises Ecuador's system as "very weak". However, the country's Macro-Prudential Indicator of '1' implies a "low" potential vulnerability to systemic stress. Like that of Venezuela, the Ecuadorean government has increased its involvement in the banking sector through the implementation of interest rate caps and the elimination of commissions and fees.

More importantly, increased public perceptions of a weaker official commitment to dollarisation, government intentions to tap into banks' external assets for financing purposes or hints at increased direct participation of the government in the financial system (ie, nationalisations) could increase the risk of deposit flight and severely weaken the financial system.

Comparative Analysis: External Finances

Ecuador

	2010					Last 10 years	
	Ecuador 'B-'	Argentina 'B'	Dominican Republic 'B'	Ukraine 'B'	Jamaica 'B-'	'B' median	'B'/'C'/'D' median
GXD (% CXR)	69.5	157.3	109.0	148.3	192.5	97.8	107.7
GXD (% GDP)	25.0	38.9	32.5	78.0	100.1	49.0	51.3
NXD (% CXR)	0.0	-65.9	54.5	-10.0	148.2	24.0	26.0
NXD (% GDP)	0.0	-16.3	16.3	-5.3	77.1	11.0	13.9
GSXD (% GXD)	60.2	58.7	76.2	26.5	57.3	63.9	64.3
NSXD (% CXR)	24.0	32.7	66.5	-6.7	78.4	22.4	25.9
NSXD (% GDP)	8.6	8.1	19.8	-3.5	40.8	10.6	13.7
SNFA (USDbn)	-5.1	0.0	-10.1	5.0	-5.7	-0.9	-0.9
SNFA (% GDP)	-8.6	-8.1	-19.8	3.5	-40.8	-9.9	-13.5
Ext. debt service ratio (% CXR)	12.1	24.0	10.5	28.4	29.2	8.7	9.6
Ext. interest service ratio (% CXR)	5.4	9.9	3.1	7.7	11.1	2.6	3.0
Liquidity ratio (latest)	105.8	112.9	87.6	80.0	80.1	163.7	147.6
Current account balance (% GDP)	-0.8	1.5	-7.3	-0.9	-8.1	-5.0	-4.2
CAB plus net FDI (% GDP)	0.0	2.4	-3.8	2.3	-5.6	-1.5	-0.8
Commodity dependence (% CXR, latest)	67.8	52.6	31.9	19.1	12.3	38.0	39.8
Sovereign net FX debt (% GDP)	14.7	9.7	20.6	3.0	50.6	-	-

Source: Fitch

Strengths

- Ecuador's external solvency indicators are stronger than those of peers, as debt has declined since the sovereign's restructuring in 2000 due to limited access to international capital markets and favourable oil price dynamics. External debt declined further in 2009 due to the government's coercive debt repurchase with a significant discount.
- Net external debt is lower than for peers due to the considerable external asset position of Ecuadorean banks.

Weaknesses

- Dollarised economies such as Ecuador's normally have comparatively low international reserves. This is reflected in weaker external liquidity and net external debt indicators. Nevertheless, a weaker external liquidity position, 105.8%, represents a liability for Ecuador, due to its high dependence on oil revenue and concerns about the sustainability of dollarisation.
- Commodity dependence in Ecuador is higher than for peers due to the importance of oil exports (50% of total exports). In addition, CXRs are also dependent on remittances from Ecuadoreans abroad.
- The country's available external financing sources are limited by low FDI inflows, interrupted relations with multilateral financial institutions such as the World Bank and IMF, and the coercive debt buy-back operation by the Correa administration.

Commentary

External financing needs for 2009 and 2010 have declined due to the narrowing of the country's CAD and the lower-than-expected deterioration of international reserves. Nevertheless, Ecuador's external financing continues to be heavily dependent on international oil prices and non-recurrent sources of bilateral funding.

Comparative Analysis: Public Finances

Ecuador

	2010					Last 10 years	
	Ecuador 'B-'	Argentina 'B'	Dominican Republic 'B'	Ukraine 'B'	Jamaica 'B-'	'B' median	'B'/'C'/'D' median
Budget balance (% GDP)	-4.2	-0.7	-3.6	-7.0	-6.6	-2.8	-2.6
Primary balance (% GDP)	-3.1	1.8	-1.8	-5.5	6.5	0.3	0.4
Revenues and grants (% GDP)	23.2	36.3	13.6	41.8	26.4	31.4	30.5
Volatility of revenues/GDP ratio	16.8	13.1	9.7	8.9	5.2	10.3	10.3
Interest payments (% revenue)	4.4	6.8	12.7	3.5	49.5	6.2	7.3
Debt (% revenue)	96.1	152.7	208.0	66.4	468.1	159.3	174.3
Debt (% GDP)	22.3	55.4	28.3	27.8	123.6	42.4	45.2
Net debt (% GDP)	17.4	52.1	26.0	28.0	123.0	35.9	41.2
FC debt (% total debt)	100.0	44.1	88.6	98.1	54.3	74.6	74.8
CG debt maturities (% GDP)	2.6	7.5	2.5	3.6	2.0	3.9	4.8
Average duration of CG debt (years)	n.a.	n.a.	n.a.	n.a.	n.a.	1.6	7.4

[a] GG if not otherwise specified

Source: Fitch

Strengths

- Central government debt, measured both in terms of GDP and revenue, is lower than for peers due to a combination of a relatively conservative fiscal stance until 2006, favourable oil prices in 2007 and 2008, and the coercive debt buy-back of 2009.
- Debt maturities and interest payments compare favourably with those of peers, and are likely to remain comparatively manageable in terms of GDP.

Weaknesses

- The increased importance of oil revenue, estimated by Fitch at 24% of total central government revenue in 2010, is likely to keep revenue volatility above the 10-year 'B' median.
- The elimination and use of the sovereign's oil savings funds in 2008[1], and accelerated expenditure growth in 2007 and 2008, have increased the vulnerability of fiscal accounts to adjustments in international oil prices.
- The central government's revenue/GDP ratio remains below those of commodity exporters and other similarly rated sovereigns, implying lower debt tolerance.

Commentary

The financing options available to the sovereign to adjust to low oil prices are constrained by limited multilateral support, the coercive debt buy-back of a portion of its market debt and a relatively underdeveloped domestic market. As a result, Ecuador has relied on increased bilateral funding from China for budgetary support and infrastructure spending.

In the absence of adjustments to the government's expansionary fiscal policy or revenue-enhancing measures, the sovereign's solvency indicators are likely to deteriorate due to rapidly rising domestic and foreign borrowing (mostly bilateral) to fund public investment.

[1] The Correa administration decided to incorporate the oil savings funds (USD1.4bn) into the central government's budget in April 2008.

Fiscal Accounts Summary

% of GDP	2007	2008	2009	2010f	2011f	2012f
General government						
Revenue	**18.5**	**25.2**	**21.3**	**23.2**	**22.4**	**22.1**
Expenditure	**18.8**	**26.4**	**26.1**	**27.3**	**26.5**	**26.4**
o/w interest payments	2.0	1.5	0.9	1.0	1.2	1.1
Primary balance	1.7	0.3	-4.0	-3.1	-3.0	-3.3
Overall balance	**-0.1**	**-1.1**	**-4.8**	**-4.2**	**-4.1**	**-4.4**
General government debt	**30.2**	**25.2**	**19.2**	**22.3**	**24.9**	**27.4**
% of general government revenue	163.1	99.8	90.0	96.1	111.3	124.2
General government deposits	9.7	8.9	6.6	4.8	3.2	2.0
Net general government debt	22.4	20.5	16.3	17.4	21.8	25.4
Central government						
Revenue	18.5	25.2	21.3	23.2	22.4	22.1
o/w grants	0.0	0.0	0.0	0.0	0.0	0.0
Expenditure and net lending	18.8	26.4	26.1	27.3	26.5	26.4
o/w current expenditure and transfers	13.1	15.5	16.4	16.8	17.5	17.9
- interest	2.0	1.5	0.9	1.0	1.2	1.1
o/w capital expenditure	5.7	10.8	9.7	10.5	9.0	8.6
Current balance	5.4	9.7	4.9	6.4	4.8	4.1
Primary balance	1.7	0.3	-4.0	-3.1	-3.0	-3.3
Overall balance	-0.1	-1.1	-4.8	-4.2	-4.1	-4.4
Central government debt	30.2	25.2	19.2	22.3	24.9	27.4
% of central government revenues	163.1	99.8	90.0	96.1	111.3	124.2
Central government debt (USDbn)	**13.8**	**13.8**	**10.4**	**13.1**	**n.a.**	**n.a.**
By residency of holder						
Domestic	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.
Foreign	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.
By place of issue						
Domestic	3.2	3.6	2.8	3.8	n.a.	n.a.
Foreign	10.6	10.1	7.4	9.3	n.a.	n.a.
By currency denomination						
Local currency	0.0	0.0	0.0	0.0	n.a.	n.a.
Foreign currency	13.8	13.8	10.4	13.1	n.a.	n.a.
in USD equivalent (eop exchange rate)	13.8	13.8	10.4	13.1	n.a.	n.a.
By maturity						
Less than 12 months (residual maturity)	2.8	2.5	3.8	1.0	n.a.	n.a.
Average maturity (years)	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.
Average duration (years)	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.
Memo:						
Non-financial public-sector balance (% GDP)	6.5	0.0	0.0	0.0	0.0	0.0
Net non-financial public-sector debt (% GDP)	0.0	0.0	0.0	0.0	0.0	0.0
Nominal GDP (USDbn)	45.8	54.7	54.4	58.9	63.4	68.8

Source: Ministry of Finance and Fitch estimates and forecasts

External Debt and Assets

(USDbn)	2001	2002	2003	2004	2005	2006	2007	2008	2009	2010[f]
Gross external debt	**14.4**	**16.3**	**16.8**	**17.2**	**17.2**	**17.1**	**17.4**	**16.9**	**13.4**	**14.7**
% of GDP	67.8	65.4	58.5	52.7	46.4	40.9	38.1	30.9	24.6	25.0
% of CXR	194.2	206.5	183.3	155.5	120.1	97.1	88.4	71.0	73.0	69.5
By maturity										
Medium- and long-term	11.4	12.3	12.4	12.0	11.8	11.1	11.5	11.0	8.5	9.7
Short -term	3.0	4.0	4.4	5.3	5.5	6.0	5.9	5.9	4.9	4.9
% of total debt	21.1	24.6	26.1	30.5	31.8	35.0	34.0	35.0	36.5	34.1
By debtor										
Monetary authorities	-	-	-	-	-	-	-	-	-	-
General government	**11.4**	**11.4**	**11.5**	**11.1**	**10.9**	**10.2**	**10.6**	**10.1**	**7.4**	**8.6**
o/w central government	11.4	11.4	11.5	11.1	10.9	10.2	10.6	10.1	7.4	8.6
Banks	**0.6**	**0.6**	**0.6**	**0.6**	**0.6**	**0.7**	**0.7**	**0.7**	**0.7**	**0.8**
Other sectors	**2.5**	**4.3**	**4.6**	**5.5**	**5.8**	**6.2**	**6.2**	**6.1**	**5.3**	**5.3**
Gross external assets (non-equity)	**2.1**	**3.6**	**4.2**	**5.6**	**7.2**	**9.6**	**12.7**	**14.6**	**14.6**	**14.7**
International reserves, incl. gold	1.1	1.0	1.2	1.4	2.1	2.0	3.5	4.5	3.8	3.8
Other sovereign assets nes	0.0	0.0	0.1	0.1	0.3	1.3	1.4	0.0	0.0	0.0
Deposit money banks' foreign assets	1.1	1.4	2.0	2.7	3.1	3.5	4.5	4.6	5.2	5.2
Other sector foreign assets	0.0	1.2	1.0	1.5	1.9	4.1	4.7	5.5	5.6	5.7
Net external debt	**12.3**	**12.7**	**12.5**	**11.6**	**10.0**	**7.5**	**4.8**	**2.3**	**-1.2**	**0.0**
% of GDP	57.9	51.0	43.8	35.7	26.9	17.9	10.4	4.2	-2.3	0.0
% of CXR	166.0	161.1	137.0	105.2	69.9	42.4	24.1	9.8	-6.7	0.0
Net sovereign external debt	10.3	10.4	10.3	9.6	8.7	8.2	7.1	5.6	3.6	5.1
% of GDP	48.4	41.7	36.1	29.5	23.4	19.6	15.5	10.3	6.6	8.6
Net bank external debt	-0.5	-0.8	-1.4	-2.0	-2.5	-2.9	-3.8	-3.8	-4.5	-4.4
Net other external debt	2.5	3.1	3.6	4.0	3.9	2.1	1.5	0.5	-0.3	-0.7
Net international investment position	**-19.0**	**-19.4**	**-19.8**	**-19.7**	**-18.8**	**-16.9**	**-**	**-**	**-**	**-**
% of GDP	-89.6	-78.0	-69.0	-60.2	-50.6	-40.5	-	-	-	-
Sovereign net foreign assets	**-9.0**	**-9.1**	**-9.0**	**-8.1**	**-7.2**	**-6.5**	**-5.3**	**-3.8**	**-2.6**	**-5.1**
% of GDP	-42.4	-36.6	-31.3	-24.8	-19.4	-15.7	-11.6	-6.9	-4.8	-8.6
Debt service (principal & interest)	**1.9**	**1.7**	**2.0**	**2.2**	**2.5**	**2.4**	**2.6**	**2.6**	**5.3**	**2.5**
Debt service (% of CXR)	26.1	21.0	22.1	19.9	17.5	13.4	13.4	11.1	29.0	12.1
Interest (% of CXR)	14.5	13.0	12.2	10.6	9.6	7.3	6.9	6.2	6.6	5.4
Liquidity ratio (%)	39.3	45.4	39.9	48.5	52.7	67.5	64.2	93.3	80.5	120.8
Net sovereign FX debt (% of GDP)	61.6	52.8	46.6	40.2	33.3	27.5	22.5	17.0	12.2	14.7
Memo:										
Nominal GDP	21.2	24.9	28.6	32.6	37.2	41.8	45.8	54.7	54.4	58.9
Gross sovereign external debt										
Inter-company loans	-	-	-	-	-	-	-	-	-	-

Sources: NBP, IMF, World Bank and Fitch estimates and forecasts

Balance of Payments

(USDbn)	2007	2008	2009	2010[f]	2011[f]	2012[f]
Current account balance	**1.7**	**1.1**	**-0.3**	**-0.5**	**-0.8**	**-0.9**
% of GDP	3.6	2.0	-0.6	-0.8	-1.2	-1.3
% of CXR	8.4	4.7	-1.7	-2.1	-3.5	-3.7
Trade balance	**1.8**	**1.4**	**0.1**	**-0.8**	**-1.4**	**-1.2**
Exports, fob	14.9	19.1	14.3	16.8	18.0	19.4
Imports, fob	13.0	17.8	14.3	17.6	19.4	20.5
Services, net	**-1.4**	**-1.6**	**-1.4**	**-1.1**	**-0.9**	**-1.1**
Services, credit	1.2	1.3	1.2	1.3	1.5	1.6
Services, debit	2.6	3.0	2.6	2.5	2.3	2.7
Income, net	**-2.0**	**-1.6**	**-1.4**	**-1.2**	**-1.4**	**-1.6**
Income, credit	0.3	0.2	0.0	0.2	0.2	0.2
Income, debit	2.3	1.8	1.5	1.4	1.6	1.7
O/w: interest payments	1.4	1.5	1.2	1.2	1.3	1.5
Current transfers, net	**3.2**	**3.0**	**2.4**	**2.7**	**2.8**	**3.0**
Memo:						
Non-debt-creating inflows (net)	0.2	1.0	0.3	0.5	0.3	0.5
o/w equity FDI	0.2	1.0	0.3	0.5	0.3	0.5
o/w portfolio equity	0.0	0.0	0.0	0.0	0.0	0.0
o/w other	0.1	0.0	2.0	0.0	0.0	0.0
Change in reserves (-=increase)	1.5	1.0	-0.9	0.1	0.2	-0.3
Gross external financing requirement	-0.4	0.0	4.4	1.8	2.4	2.6
Stock of international reserves, incl. gold	3.5	4.5	3.8	3.8	3.6	3.9

Sources: IMF and Fitch estimates and forecasts

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