COUNTRY RISK ANALYSIS

Ecuador

DIN SÄKERHET I EXPORTAFFÄRER

COUNTRY RISK CATEGORY

6/7

The country risk categories range from 0 to 7. The lower the number the better the credit rating the country has.

0 1 2 3 4 5 6 7

EKN'S OUTSTANDING GUARANTEES TO THE COUNTRY

SHORT-TERM TRANSACTIONS: SEK 133 MILLION

MEDIUM AND LONG-TERM TRANSACTIONS: SEK 15 MILLION

DATE

18/12/2014

Nationalist but also pragmatic policies

Ecuador has been shut out of the international financial market since the country suspended payments on bond loans in 2008. The operating environment in the country is complicated, and its economic policies are characterised by strong nationalist tendencies. However, the country has pursued a more pragmatic policy over the past two years. The country has attempted to attract foreign investment, resumed relations with multilateral institutions and made public investments to improve infrastructure. Last but not least, Ecuador has re-entered the international capital market with the successful launch of a bond loan. This recently led to EKN improving Ecuador's country risk categorisation. The country is fully dollarised and it seems that this policy will remain in place. This forces Ecuador to pursue responsible economic policies and creates stable conditions for all parties in various export transactions.

Oil will continue to serve as the foundation of the Ecuadorian economy for many years to come. The nationalist policy line of the country will likely persist, but its aspirations for greater financial integration reduce the risks of abrupt political changes.

THE COUNTRY'S STRENGTHS AND WEAKNESSES

Strengths

- Large and increasing oil production
- Inflation under control
- Dollarisation has created greater monetary and financial stability

Weaknesses

- Weak institutions, including the judiciary and the educational system
- High vulnerability to oil price decreases
- Increased centralisation of presidential power, nationalistic policies and limitation of the freedom of the press

EKN'S POLICY

EKN's policy

EKN upgraded Ecuador to country risk category 6 in October 2014, for both short and long guarantees – an assessment made in collaboration with the other OECD countries. EKN has a restrictive policy for transactions with both the public and private sector, which is in part justified by the difficult business environment.

WHAT MIGHT CAUSE A CHANGE IN THE COUNTRY POLICY?

The policy may be made less restrictive in the event of

- The diversification of the economy, thus reducing vulnerability to oil price decreases
- Continuing steps toward increased pragmatism and market economy thinking

The policy may be made more restrictive in the event of

- Increased interventions in the form of price controls and import restrictions
- Inability to alleviate falling oil prices with adequate economic policies

EKN'S EXPOSURE AND EXPERIENCE

Mixed payment experience

EKN's exposure in Ecuador totals nearly SEK 150 million and is dominated by transactions in the paper sector.

Ecuador's transfer risk is balanced by the fact that the country is fully dollarised. The country's deficient operating environment has however resulted in certain payment problems, which has led to delays and claims to a limited extent.

COUNTRY ANALYST

EKN's country analyst for Ecuador:
Claes Nordström
Telephone: 08-788 00 06
Email: claes.nordstrom@ekn.se

Correa stays in power

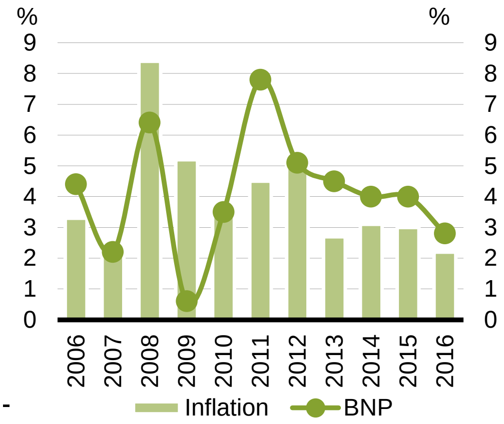
President Rafael Correa and his governing party Alianza Pais stand for a political movement characterised by populism, but also pragmatism to a certain extent. They get their support from the poorer sections of the population. Correa has been re-elected twice and is now in his third term of office, which lasts until 2017 – a complete change of scenery in comparison to the political turbulence the decade before Correa took power. With the help of favourable international commodity prices for oil, which rakes in major currency earnings, Correa has been able to make major public investments in health, infrastructure and education, which has reduced poverty, brought down unemployment and improved living conditions. On the other hand, Correa has increasingly limited the scope of civil society, the media and the judiciary. This has led to restrictions on the freedom of the press and freedom of speech. Under Correa, Ecuador's foreign policy has been oriented toward Venezuela and like-minded countries such as Bolivia and Nicaragua. In recent years, the country has broadened its focus and sought collaboration with neighbouring Colombia, Peru and Brazil. The country also signed a free trade agreement with the EU.

Correa's position of power is relatively unthreatened, especially given that the opposition is divided. A parliamentary process of changes to the constitution is going full speed ahead and will likely enable a further extension of Correa's reign. This is controversial for domestic policy and the risk of political turbulence has increased. However, it seems increasingly likely that the president's political movement will continue to set the agenda in the future.

High oil dependence

Oil dominates the Ecuadorian economy, accounting for 58% of exports, over 12% of GDP and approximately 40% of national budget revenues. The country is thus very sensitive to fluctuations in international commodity prices. The lower price levels expected in the future will therefore have a negative impact on the country's growth rate. To a certain extent, the price decrease has been counteracted by increased oil production in Ecuador, as a result of the investments that have been made. The economic trend has otherwise been relatively favourable over the past five years. In addition to solid growth, inflation has been under control, foreign trade has been balanced and debt has been moderate. However, due to the major public infrastructure investments, the public finances deficit has grown (the deficit currently amounts to over 4% of GDP), but is expected to be reduced as the investment programme is phased down.

Growth and inflation (source: *IMF, EKN)*



Ecuador's weak country risk categorisation and credit rating are related to its poor payment history. The country has suspended payments on bond loans on two occasions, 1999 and 2008. Ecuador has also had protracted conflicts with foreign investors, particularly mining companies, which has also contributed to the country's isolation from the international financial market. In recent years, the country has however

Kommentar [DF1]: Inflation GDP

changed course and attempted to improve relations with the international financial community. The government has attempted to solve its problems with its outstanding bond loans, its relations with multilateral institutions have improved, an IMF review has been conducted and the country has successfully launched a new bond loan on the international capital market. These measures should be seen in light of the need for increased foreign investment, not least in the commodity sector.

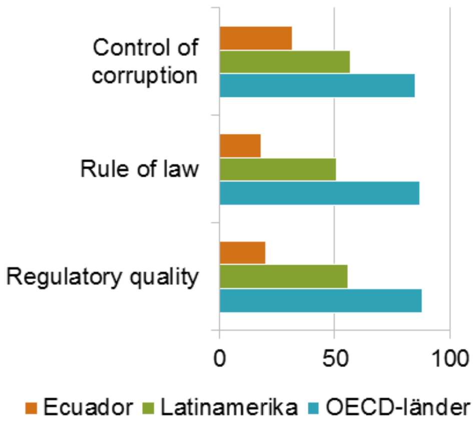
It is also beginning to become increasingly obvious that the dollarisation implemented in 2000 is here to stay. In practice, it is difficult to drop this policy, even though there are strong preferences for doing so, especially among the governing party. The dollarisation has taken from the government the ability to control its own monetary policies and in practice it puts a straitjacket on the country's economic policies. The government must be able to finance deficits and its ability to serve as a lender of last resort for the banking system is greatly limited.

It is therefore highly likely that the policies pursued, with strong state control and nationalist tendencies, will continue – although under stricter economic conditions. But the dollarisation and the government's ambitions for better relations with the international capital market put a sharp check on the government's room for manoeuvre, which is why the probability of orderly economic development without abrupt changes has increased.

The banking sector

The banking sector in Ecuador is relatively undeveloped and its assets are equal to 33% of the country's GDP, which is in line with other countries in the same country risk category. The banking system is almost entirely domestically owned. The banking sector is relatively well-capitalised and the proportion of bad loans is limited (around 3% of total loans). Profitability is falling, from acceptable levels, mainly due to various regulations such as interest rate ceilings and limitations on the ability to charge fees. Due to the fact that the central bank cannot serve as a lender of last resort, the central bank has instead ordered the banks to set aside 5% of their deposits as a special buffer against external shocks. business environment

Business environment (scale of 1 to 100)



Difficult business climate

The business climate in Ecuador is complicated, although it has improved in recent years. The country is now ranked number 115 (out of 189) in the World Bank's Doing Business Index and has a very low ranking in the World Bank's Governance indicators. The country has an extensive bureaucracy, and its legal system is occasionally deficient and time-consuming. As long as Rafael Correa is president, his interventionist policies will likely continue. Combined with the country's weak institutional environment, this constitutes an element of uncertainty in our risk assessment and places greater demands on companies to have safety margins to be able to manage various administrative and bureaucratic obstacles that may complicate business.

Source: World Bank

Kommentar [DF2]: Hör det här till diagramen? Ta bort om det inte hör till här.

Kommentar [DF3]: Ecuador
Latin America
OECD countries