



ECUADOR WEEKLY REPORT®

KEY INDICATORS

For the week of May 16 – May 20, 2016

Hands in the Cookie Jar

On Monday, police arrested Alex Bravo, a former chief executive of state-owned Petroecuador. The prosecution accuses him of the crime of influence trafficking when he managed the refurbishment of Ecuador’s main refinery, Esmeraldas, with an official capacity of 110,000 barrels a day – a project whose projected costs ballooned from \$187m to \$1.2bn and counting. While Bravo denies the charges, president Rafael Correa and his chief legal advisor, Alexis Mera, have sought to distance themselves from him. By attending Bravo’s arraignment, Mera and the head of the Internal Revenue Service, Leonardo Orlando, did reveal the government’s particular interest in the case.

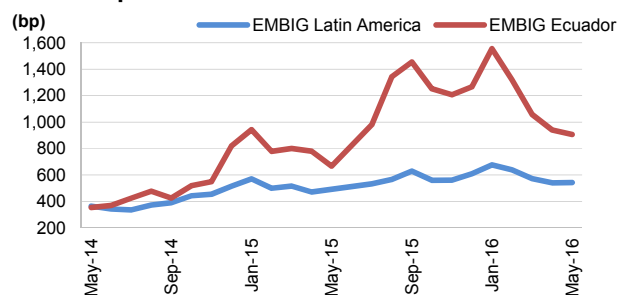
According to the prosecution, at Petroecuador, Bravo directly benefited companies in which family members and friends are shareholders or employees. Three companies in which he is a shareholder directly obtained well over a 100 contracts, including one for more than \$35m in a services company. Since Bravo worked for the company from 2006, Mera said he might also be guilty of bribery and embezzlement. Mera denied that Bravo’s was “a political official of this government,” which can hardly be since Petroecuador’s supervisory board, which consists only of the oil minister, the planning minister, and a representative of the presidency, appointed him last November. President Rafael Correa denied knowing him and that he needed to pay for his crimes, if he committed them; this is also disingenuous as Bravo frequently attended the president’s Saturday

Ecuador's Global Bond Prices

Bond	Last Price				
	20-May	Apr-16	Mar-16	Feb-16	Jan-16
Global 2020	98.30	95.21	90.54	79.08	74.92
Global 2024	88.03	88.04	82.88	72.81	69.63

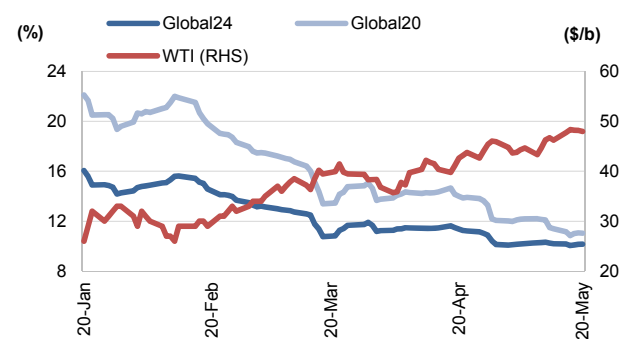
Source: Bloomberg and Analytica

EMBIG Spread



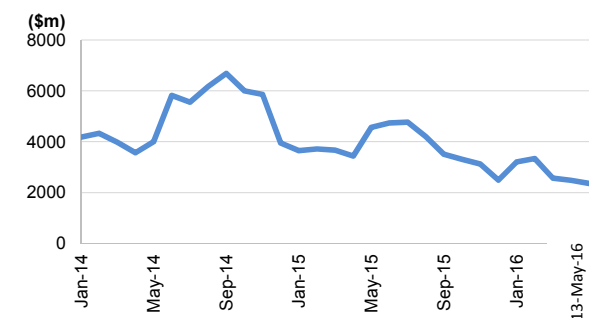
Source: JP Morgan and Analytica

Bond Yields vs. WTI in 2016



Source: Bloomberg and Analytica

International Reserves



Source: BCE and Analytica

propaganda broadcasts and given Correa's style of micromanagement. In a video in March, he referred to him as "my dear Alex," and numerous recent photos of the two have emerged.

Bravo's lawyer during the arraignment said that the sheer scale of the alleged crimes implies that he couldn't have acted alone. Investigative journalist Fernando Villavicencio agrees; in a report for investigative news site Focus, Villavicencio writes that his meteoric rise as a local Esmeraldeño to lead the oil refining, transportation and gas station company at just 35 needed support from political leadership. While Correa said that he had been fired, Bravo said that he had resigned after his name had emerged tied to the massive "Panama Papers" data leak. Indeed, he and oil minister Carlos Pareja, whom Correa says is an honest man, resigned after El Universo and Focus revealed his offshore links. According to El Universo, his personal assets rose to \$670,000 as of last December from just \$19,000 as recently as 2012. Bravo acknowledges having created Panamanian companies but denies using them to commit crimes.

A New Cold War

Governments love to start verbal foreign policy adventures when things are difficult, and the governments of Brazil and the region's remaining nominally leftwing "Bolivarian" countries – Bolivia, Cuba, Ecuador, El Salvador, Nicaragua, and Venezuela – all have plenty of reasons to distract citizens from domestic economic woes. The Bolivarians have rejected the removal of Brazilian president Dilma Rousseff as part of impeachment proceedings; they call the procedure a coup, as they did when Fernando Lugo was impeached in Paraguay in 2012 (the two cases are very different however). Ecuador followed suit after both El Salvador and Venezuela recalled their ambassadors to Brasilia for consultations.

Brazil's new foreign minister, José Serra, rejected their criticism for "allowing themselves to opine and propagate falsehoods over the internal political process of Brazil," he said. The impeachment "is going ahead in a framework of absolute respect for democratic institutions and the federal constitution," according to Serra, who lost his bid to become president in 2010 to Rousseff.

The governments of Brazil as well as most of its critics look shaky. Michel Temer, the vice president who now has succeeded Rousseff, needs to fear that he, too, could fall given the numerous corruption allegations against his political party, the PMDB. The Brazilian situation will remain complicated and the economy is in its worst shape since the Great Depression. To look tough against the Bolivarians is an easy move for Temer's government thanks to their wholehearted support for Rousseff, whose approval ratings had plunged to single digits. The return of a more traditional foreign policy could please the career diplomats in Brasilia, although some found the tough response to the Bolivarians according to the BBC too undiplomatic. Perhaps the change in Brasilia also emboldened Luis Almagro, secretary general of the Organization of American States, to decry the authoritarian regime of Nicolás Maduro in a scathing open letter.

The fall of Rousseff meanwhile means a huge loss to the Bolivarians, already hit by the exit of Argentina from their alliance. Now, they have been practically reduced to some of the smallest countries in the region. The independence shown by Brazil's judiciary justifiably worries politicians in countries where Brazilian companies like Odebrecht and Petrobras linked to massive corruption have been active; this includes Ecuador. Opponents of the Correa administration will hope that revelations, as in the case of the Panama Papers, emerge to further weaken the government's reputation during the upcoming electoral campaign. To pick a fight with

Brazil could therefore be a risky bet for the Correa administration.

Honey Trap

The final wording of the latest changes to the tax regime, passed last week, include last-minute modifications that worry many economic analysts. For a year, coinciding almost to the day with the end of president Correa's term, the Central Bank of Ecuador (BCE) "will not be subject to the limits and restrictions established in the Monetary and Financial Code" to pursue widespread adoption of the government's mobile payments scheme, dubbed "electronic money." The law says that the BCE will promote the plan by subsidizing or providing free of charge the mobile payments platform so that banks can distribute them to the public. A new advertising campaign even removes any mention of the BCE, and the tax law includes a tax break of 4 percentage points for those people who sign up for and use the system; for people who pay with credit or debit cards, the discount will be returned in electronic money. As a final incentive, the BCE will allow account holders to keep their electronic money accounts at the financial institution where the account was opened instead of at the central bank.

Nonetheless, the system will remain state-controlled, and the government rejected an offer by Ecuador's private banking association to buy the whole system. In particular, the loosening of restrictions that the BCE previously had to observe raises fears of irresponsible issuance; already, analysts have worried about the true nature of the promised backing of the currency by "liquid" assets. In a radio interview this week, BCE chief executive Diego Martínez gave an unrealistically positive situation report on overall liquidity by mentioning all cash reserves in the economy as a measure of liquidity, rather than government reserves – a problematic view in light of the government's

difficulties raising funding, exemplified by its widespread arrears with providers. The latest measure creates additional uncertainty, warned Guillermo Lasso, a conservative former banker who aims to succeed Correa next year. Fidel Egas, main shareholder of Banco Pichincha, the country's biggest bank, per Twitter said that the bank will not participate in the system. Opposition legislator Ramiro Aguilar in an opinion column for 4Pelagatos wrote that he welcomed the bank's position. "I think it's healthy that Banco Pichincha has publicly refused to participate in this mad and suicidal adventure that aims to flood the economy of the nation with electronic money," he said. With just 60,000 existing accounts, Ecuadorians have failed to embrace the new payments option. But with the economy pinching pocketbooks and consumption taxes rising, many may be tempted to join up.

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