



ECUADOR WEEKLY REPORT[®]

KEY INDICATORS

For the week of May 30 – Jun 03, 2016

Taking Toll

Ecuador’s planning ministry this week presented its assessment of the damages from the April 16 earthquake and subsequent aftershocks, with a cutoff date of May 28. Beyond the 663 official dead, 12 still missing, and 4,859 injured, 80,000 remain homeless. As a country, Ecuador will need to spend at least \$3.34bn to recover from the physical destruction to homes, stores, hospitals, schools, roads, water supply and other infrastructure. Out of the total, \$2.25bn will require state funding, the remaining \$1.09bn expected to come from the private sector. The whole damage represents a 0.7%, or \$465m, drag on growth, according to officials at the presentation. Planning secretary Sandra Naranjo said that the required funding for the government’s requirement has been practically secured, making it unnecessary to consider for the sake of reconstruction bond issuance or additional tax increases. The government used approved United Nations/European Union/World Bank methodology to assess the damage from the earthquake, she told reporters.

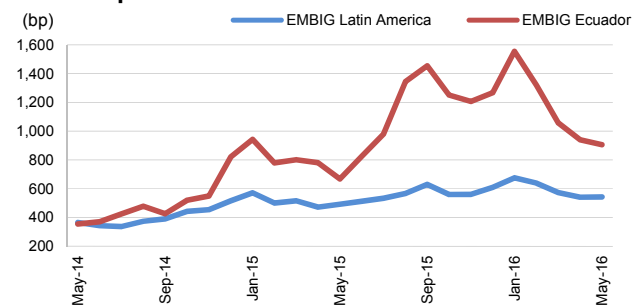
The administration calculates that multilateral lenders will provide around \$1.06bn in funding, including the Inter-American Development Bank, Andean Finance Corporation, and the International Monetary Fund. Another \$1bn is to come through the higher taxes approved last month; a 2-point increase in the value added tax went into effect this week, which, the government expects, will provide another \$1bn. Budget reallocation will help fund the

Ecuador's Global Bond Prices

Bond	Last Price				
	01-jun	May-16	Apr-16	Mar-16	Feb-16
Global 2020	99.65	100.28	95.21	90.54	79.08
Global 2024	88.66	89.44	88.04	82.88	72.81

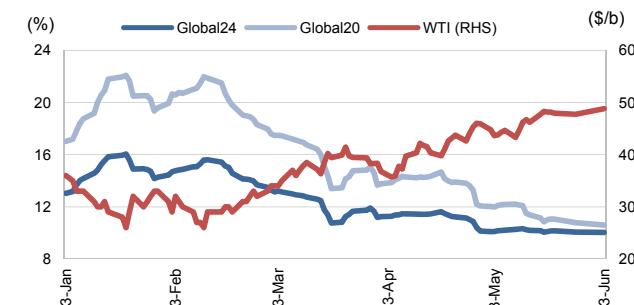
Source: Bloomberg and Analytica

EMBIG Spread



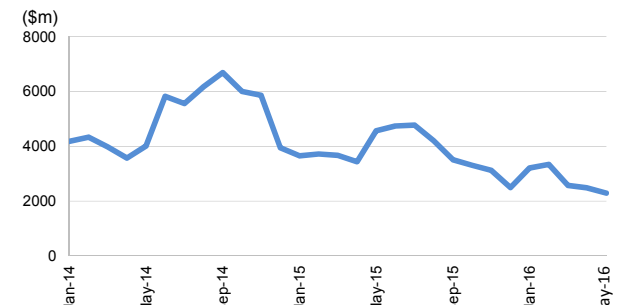
Source: JP Morgan and Analytica

Bond Yields vs. WTI in 2016



Source: Bloomberg and Analytica

International Reserves



Source: BCE and Analytica

remainder. Naranjo said that the challenge is “an issue of state, not a government,” and take years. “A new government will take office next year,” and the present administration will provide the appropriate documentation, including a separate account, to ensure transparency in reconstruction spending. The government argues that the VAT increase will be temporary and that its proceeds will go to reconstruction, though of course one of money’s principal benefits is its fungibility.

Among required repairs, the planning office noted 83 kilometers of roads, repairs to ports, and to the Manta airport, whose control tower collapsed. For the public sector, the data collected by the government-run statistics agency INEC showed a poor track record in recent construction. A total 875 schools and 51 clinics and hospitals were severely damaged, leaving 120,000 students with limited access to education and 593,000 people with limited access to health services. Investigative news site Milhojas reported that a Potemkin tent city went up briefly near Mompiche in Esmeraldas to impress president Rafael Correa, only to be dismantled after his visit.

On the positive side, Naranjo said that reconstruction won’t aim to restore the problematic status-quo-ante, where vast numbers of Manabí and Esmeraldas residents didn’t have direct access to potable water. The clarity of the assumptions that she presented carry some caveats: Government-run banks will provide subsidized loans, she said, hence private-sector involvement can expect additional help. At the same time, beyond VAT, the tax package increases taxes on assets, salaries, profits, and overseas investments, reducing private-sector capacity to fund reconstruction independently. Private commercial banks have meanwhile announced that they will condone millions of dollars in debts and refinance others. Banco Pichincha will create a \$100m fund to help finance reconstruction aside from government-led efforts. Meanwhile, of course the VAT

increase saps consumer purchasing power at a moment when unemployment is surging due to Ecuador’s economic woes (Japan has skipped such a move citing its fragile economy), and additional debts saddle future taxpayers with bills. Hopefully, the Cotopaxi volcano, which has issued only wisps of steam in recent weeks, will remain calm.

Saber Diving

Tensions over social security and other matters have created a crisis between the executive branch and the armed forces unprecedented since the end of the most recent military dictatorship in 1979. Eminent historian Enrique Ayala Mora, a potential socialist candidate for the 2017 elections, has likened it to an event back in 1935, when then-president José María Velasco Ibarra, the populist who overshadowed Ecuador’s politics from 1933 until his death in 1979, sought to make himself dictator, provoking a military uprising. Commenting on the event, the nonchalant leader in the early stages of a long career (that proved devastating for Ecuador) said that he had “thrown himself onto the bayonets.” Ayala notes the similarities with recent events confronting president Correa and the armed forces.

Even though military coups for more than a generation have not been de rigueur in the country since the two military dictatorships in the 1970s, civilian rule has failed to create a political system able to insulate the military from involvement in government affairs. Much like the Facebook relationship description “it’s complicated,” top brass, much to their discomfort, have had to take a stand or de-facto “pronounce” themselves amid severe political instability in 1997, 2000, and 2003, in which they removed support for a president and participated in a transition to a temporary successor, the president of congress Fabián Alarcón in the first case and the respective vice president in the latter cases. Through Correa’s provocations, he may be provoking a military

uprising, according to Ayala, one of the most prominent descriptor of such a scenario. In a brief incident in January 1987, airmen detained President León Febres Cordero to force the amnesty of air force Gen Frank Vargas, yet this was an isolated event unrelated to any interest in retaking power. The current situation is different.

Ecuador's current economic affliction has hit numerous public and private entities. Overdue payments have led to all sorts of complaints, from a Belarusian contractor to others who, lacking other means to pressure the government, have declared a hunger strike to get the administration, which continues to refuse to acknowledge the crisis, to finally pay up. The military has become engulfed in the economic crisis (as has the police) by the massive run-up in arrears to pension and other benefit funding. The president's arrogance in handling the problem has exacerbated the situation, perhaps, as Ayala and others say, to provoke a coup that would allow Correa to present himself as a victim of dark forces.

The 2008 constitution, like its immediate predecessors, says that the military has a "non-deliberative" role in policy. Correa interprets this as implying obedience in all circumstances, making him a de-facto commander in chief, and thus insulating him from the need to discuss with "underlings." The military however have had enough of this given the financial straits of its social security and pension institute (ISSFA). It refuses to obey an order to pay up \$41m because of a 2010 real estate deal gone bad (EWR 787). Instead, it demands a court rule in favor of the government before agreeing to pay back the disputed \$41m. Beyond the money, the military are angry about Correa's disparaging recent comments. Not only has he refused to deal with "underlings" like admiral Ángel Sarzosa, the head of the navy, who demanded Correa retract comments that navy high schools were "classist," or the complaint against his likening of ISSFA to pyramid schemes. According to

news web site 4Pelagatos, defense minister Ricardo Patiño, who has a track record of burning bridges and controversial tactics in the long list of portfolios he has held since 2007 (finance, a short-lived "ministry for the Pacific Coast," minister of political affairs, and foreign minister before getting his present cabinet position) has promoted Lenin Sánchez, the head of Ecuador's marine, seen as pro-Correa, to the rank of admiral, despite failing to meet the internal qualification rules. Along with toying to replace the joint command even though it has only been in office in February, a fresh attempt to supplant them will likely trigger a standoff. Additionally, in his latest letter to Patiño, general Juan Francisco Vivera, ISSFA's director, says that the fund is bleeding cash and, with \$52.78m on the books, doesn't have enough money to meet all pension payments in June; it needs close to \$57m a month. The defense ministry's 3,000 civilian workers meanwhile this week called a strike to protest overdue salaries.

Even if he seeks to make himself a victim, Correa is running a risk, considering that the military is more popular than he is. A poll by Cedatos published on May 23 put his approval rating at 35%, down from 51% a year earlier (considering that he has been in office for almost a decade, his support level is nonetheless significant). Ecuadorians may therefore not be too sad if he were to be unseated, and whether an early resignation would be preferable to an end to his term as scheduled next May is controversial among Correa opponents. Hopefully, the economy will not deteriorate too much to make this an acute question.

Note: Dear readers, like the Associated Press and Bloomberg, as of this week we are adjusting lower-case usage for words including "internet" and "web;" we continue to use lower-case spelling for personal titles like "president" and "admiral" as we consider

these to be temporary functions rather than permanent names.

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