



Ramiro Crespo
 Chairman of the Editorial Board
 WEEKLYREPORT@ANALYTICAINVESTMENTS.COM

ECUADOR WEEKLY REPORT[®]

KEY INDICATORS

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The New Normal

In the aftermath of diplomatic normalization between Havana and Washington, signs of warmer relations have also extended to countries heavily influenced by Cuba: Venezuela and Ecuador. While Cuban and US diplomacy obviously differ strongly towards both of these, Washington’s détente overtures appear to be leading to a softer Obama administration approach towards both Caracas and Quito, who are responding in kind. For the US, the new policy may look like a promising way out of a dead end, at least in Venezuela. But human rights defenders worry that this will give weakened and dangerously illiberal regimes a breather and undermine opposition figures who have for years favored better ties with the US.

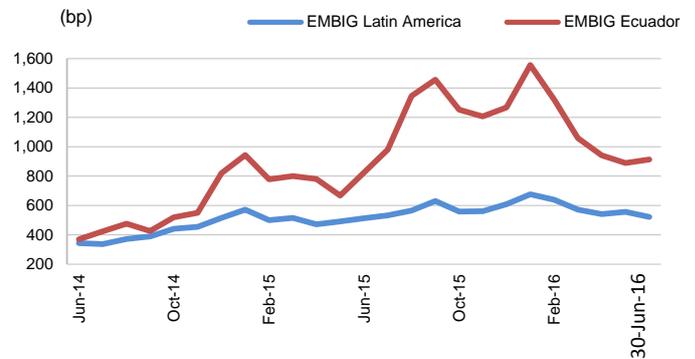
The similarities between Venezuela and Ecuador are obvious, and more than just superficial. Both have continued to maintain important commercial links with the US, principally through oil exports, despite their anti-US rhetoric inspired by both an unfortunate and petty belief in dependence theory and expediency (the need for an antagonist for their populist message). Both have seen diplomatic relations fall to historic lows under their present leadership. In 2011, president Rafael Correa expelled US ambassador Heather Hodges, resulting in a year-long suspension of diplomatic ties. In the case of Venezuela, the absence of ambassadors from the respective capitals has lasted even longer, since 2010. For all their rhetoric about “sovereignty,” both have felt more comfortable to await a green light from Havana to

Ecuador's Global Bond Prices

Bond	Last Price						
	08/07/2016	Jun-16	May-16	Apr-16	Mar-16	Feb-16	Jan-16
Global 2020	100.44	99.38	100.28	95.21	90.54	79.08	74.92
Global 2024	88.15	87.64	89.44	88.04	82.88	72.81	69.63

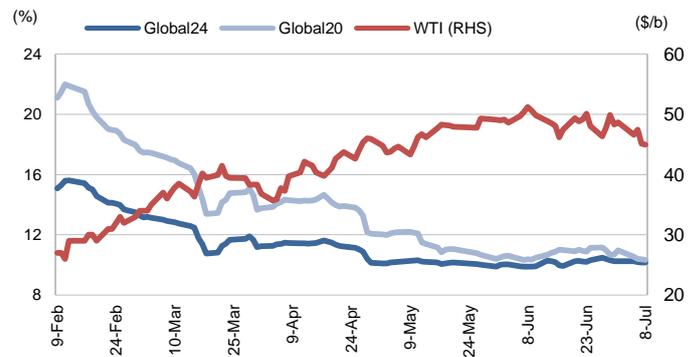
Source: Bloomberg and Analytica

EMBIG Spread



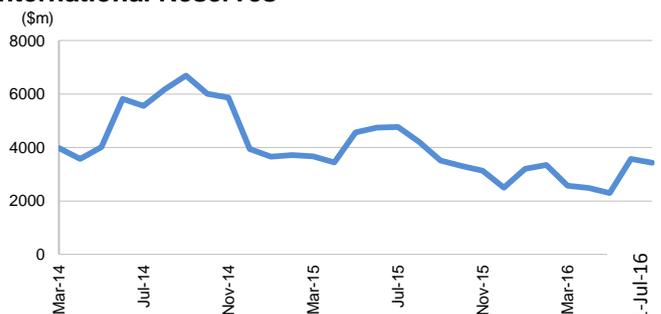
Source: JP Morgan and Analytica

Bond Yields vs. WTI in 2016



Source: Bloomberg and Analytica

International Reserves



Source: BCE and Analytica

approve of a more normal relationship with the US.

The thaw between Cuba and the US was, of course, overdue at least since the collapse of the Soviet Union. In the case of Venezuela, where president Nicolás Maduro has made a habit of accusing the US of planning to murder him and has also blamed the death of his mentor and predecessor, Hugo Chávez, on a cancer “inoculated by enemies,” the US may be looking for a way out of dead end after six years of separation. As recently as May, Maduro had held one of Venezuela’s largest military maneuvers ever against potential US aggression, while the US had last year declared a series of officials as threats to US national security. Much of Latin America’s left joined Maduro in decrying this soft measure as old-style gringo jingoism. Now, Venezuela has swiftly warmed to normalization with the US. This has undermined the efforts of Organization of American States secretary general Luis Almagro to get the region to implement the Inter-American Democratic Charter, which would imply a suspension of Venezuela from the OAS for violation of its principles, to push the Maduro government to recognize the legal rights of the opposition to seek a recall vote against him this year and to become more actively involved in the face of the humanitarian crisis in the world’s biggest holder of oil reserves.

This issue is also troubling to some in the Ecuadorian opposition. The economic weakness of Brazil and Venezuela as well as Argentina’s excision from the leftwing group has revealed the basic uselessness of UNASUR as a regional body, exemplified by the virtually empty \$43m headquarters Ecuador built for it alongside the Equator monument. Only with Almagro’s arrival at the OAS a year ago has the OAS reemerged as a meaningful regional body, with a particular emphasis on human rights welcomed by many activists bemoaning the slide back to authoritarianism suffered in many countries since the triumph of Chávez in 1999. In the view of critics, the US now appears to be appeasing discredited leaders

unnecessarily, dropping the pro-rights discourse with which it had publicly supported advocates of freedom of speech in particular, giving them essential backing to pursue their dangerous crusade for liberty.

Ecuador, in particular, required little of the approach seen towards Havana and Caracas. Nowhere else in South America are people more pro-US than Ecuador, according to a survey reported by *The Economist*. Diplomatic relations have appeared cordial, albeit with administration officials previously hesitant to appear all too friendly, such as attending the annual Independence Day reception at the US ambassador’s residence. Not this year. Only a few days after foreign minister Guillaume Long led a 14-person team to defend repression against critics before the United Nations’ human rights committee in Geneva with statements like “I’m not asking for relativism on the issue of human rights, as I know they are universal ... but they have to be placed in a historic context.” On this background, the new US ambassador, Todd Chapman, had tourism minister Fernando Alvarado, take the stand as guest of honor at this year’s reception. Diplomacy is one thing, but for the opposition, to have Alvarado, one of the officials with the darkest track records of abuses against freedom of speech amid other reasons to have resigned from the administration long ago – suspicious contracts and a doctorate written with his brother and parents – look like the ambassador’s new surfing buddy was galling for many. And perhaps even embarrassing for Alvarado: the article describing his presence at the reception mysteriously disappeared from newspaper *El Comercio*’s Web site. In the face of what will prove to be a crucial test for democracy over the coming months, culminating in next year’s elections that will likely again be unfair thanks to sophisticated rigging and abuse of public funding by Correa’s political vehicle, US apparent unwillingness to remain more clearly in the pro-rights camp is disheartening. But some of the critics of the US’s new approach are going too far by demanding

US president Barack Obama recall Chapman. Diplomacy has also included efforts to help earthquake victims in April that Ecuador dragged its feet on in the crucial first hours after the April 16 disaster. And Chapman has already met Correa and can be expected to use his own channels of communication to convey concerns over democracy and rights.

Less Accountability

Central bank chief executive Diego Martínez has made a patient round of visits to Quito media in the past few weeks seeking to promote the use of the government's "electronic currency," which continues to gain traction only slowly among the public. A campaign dubbing it the efficient cash option, has had strong success in recent weeks, according to officials. Still, the number of accounts is still under 100,000. As of mid June, just 450 stores accepted the mobile payments mechanism. From a technical standpoint, some of Martínez's most recent statements have been quite troubling however and indicate a deep, disingenuous shift in interpretation on how a central bank is supposed to work, particularly when using an external currency (Ecuador uses the US dollar).

The controversy regarding "electronic money" has focused on whether the transaction method is fully backed in cash assets. The government did tone down initial legal rules that pointed towards the goal of issuing a full-blown quasi-parallel currency. President Correa now insists that the system is no different from the usage of debit cards. Backpedalling from the mistake of calling the mobile payments system a currency, the Central Bank of Ecuador (BCE) is now rebranding it "efectivo," which in Spanish means both effective and cash, hence the campaign mentioned in the previous paragraph. In parallel however, the scale of BCE lending to the government has kept up concerns that amid a lack of liquidity, the government is dipping into private bank deposits at the BCE. Indeed, Martínez's recent

comments underscore that risk, which holds a potential for severe consequences.

In *Radio Democracia's* morning news show and in an interview with newspaper *La Hora*, Martínez provided an extensive interpretation of liquidity backing. In the radio interview, he went as far as to claim all of the economy's \$26b cash dollar reserves, including those held by bank emergency liquidity funds and in minimum reserves, could be understood as to be adequately backing dollar usage in the economy. In *La Hora*, he said that "every financial entity always has a partial backing, the important thing is that the BCE always have sufficient backing to attend the obligations of the demands that its clients require of it." As an example, he said that minus the \$900m reserve requirement, the BCE had close to \$2.2b left over to attend these requirements, or "an excess of approximately \$600m."

In his inaugural speech in 2007, Correa called central bank independence "corruption." After he had its independence squashed, Diego Borja, one of Correa's numerous appointees to head the BCE, sought to remake it into a development bank. Martínez now is claiming that it is a commercial bank like any other. While Ecuador's dollar usage makes it a marginal player in influencing monetary policy through the setting of domestic interest rate caps, the bank anchors the payments system. Before Correa, Ecuadoreans could trust that each dollar in the country was backed by a four-account system. Now, Martínez is saying that even private deposits held by commercial banks at the BCE as required by law may not be fully backed; in essence, he is equating the BCE with any private bank, refusing to acknowledge its role as an anchor of confidence in the financial system. Hobbled by a restrictive media law, Ecuador's financial press has kept mostly quiet about the seriousness of this interpretation. For others, the issue of whether after the end of *correísmo* Ecuador should even have a central bank or drop it like Panama is becoming more than just a theoretical

question. Additionally, delays in the release of macroeconomic statistics, including GDP figures for the first quarter expected for last week, also raise concerns about its role as a provider of public data.

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