ANALYTICA INVESTMENTS

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

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The IMF's Slow Return

The International Monetary Fund last week approved the long-awaited, earthquake prompted resumption of lending to Ecuador via a $364m "Rapid Financing Instrument." Just days after the April 16, 7.8-magnitude quake and amid continued aftershocks (two 5.9- and 6.2-magnitude quakes caused further damage and one death), president Rafael Correa had announced his intent to seek a no-strings attached IMF loan. While the amount falls short of the touted $400m, the IMF cash, which should be made available practically immediately, is the full amount available according to the country's share of Special Drawing Rights at the Fund: 37.5% of $970m.

Terms of the deal match those available for other IMF members, including a low interest rate of 1.1%, a five-year maturity of the loan, along with a 3.25-year grace period. The IMF agreed with Ecuador that the quake had created an urgent balance of payments need given demands for reconstruction. According to local media reports, Ecuador recently provided the funds to be able to close to double its total available funding to the near-billion-dollar level. Further borrowing, the IMF made clear, will only be available if Ecuador decides to carry out a macroeconomic adjustment plan.

That looks more feasible now than at any time in the recent past. Last week's RFI marks the return of borrowing from the IMF after a 13-year hiatus. In 2003, president Lucio Gutiérrez obtained $200m in exchange for a fiscal consolidation plan decried by the hard left at the time as a symbol of submission to

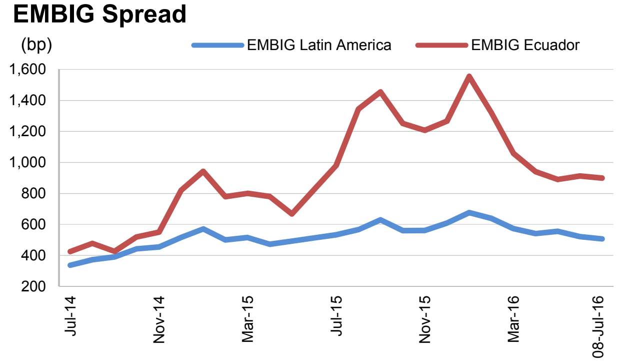
KEY INDICATORS

Ecuador's Global Bond Prices

Bond	Last Price						
	15/07/2016	Jun-16	May-16	Apr-16	Mar-16	Feb-16	Jan-16
Global 2020	101.31	99.38	100.28	95.21	90.54	79.08	74.92
Global 2024	88.57	87.64	89.44	88.04	82.88	72.81	69.63

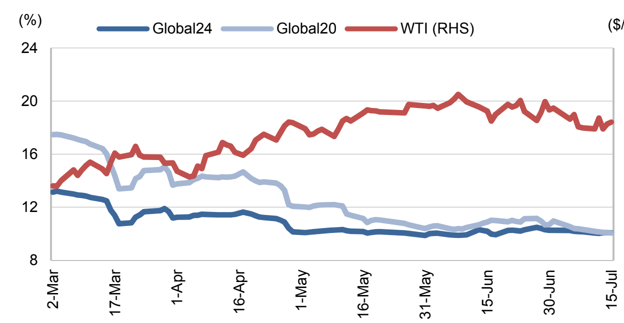
Source: Bloomberg and Analytica

EMBIG Spread



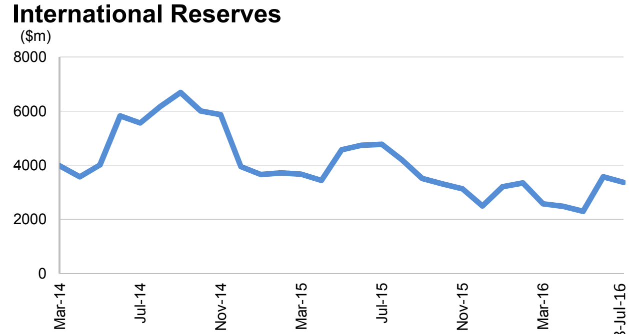
Source: JP Morgan and Analytica

Bond Yields vs. WTI in 2016



Source: Bloomberg and Analytica

International Reserves



Source: BCE and Analytica

the Fund's "neo-liberal" program, which called for slashing of subsidies and tax reform. To all, the exit from the IMF formed part of Correa's political platform from his very beginnings. Of course, the predictable fiscal pressures have forced him to grudgingly return to its doors, first by resuming "Article IV" fiscal and economic reviews in 2014.

The Fund gave the government some credit for policy changes implemented over the past year, including the latest tax package and the postponement of some "non-essential" government infrastructure investments. At the same time, the government is pressing forward in its goal of raising around $12b for an ill-conceived new refinery in Manabí. In its comments following the approval of the loan, the IMF said that Ecuadorian officials have told it that they would be willing to consider additional tax increases and budget cuts, which would be hard to console with new borrowing for the refinery. While the Fund did agree with Ecuador that the economy is reeling because of the fall in the price of oil and the global strengthening of the dollar, it added that a lack of international financing is part of the problem. And one must remember that the low levels of confidence-building reserves stem from the government's misspending during its decade in power, when it wasted the unprecedented twin benefits from historically high oil prices and a weak dollar.

Grexit, Brexit, "Excit"?

Considering Ecuador's limited options for free trade, the integration with Colombia and Peru in the Andean Community of Nations (CAN) is among the key options for manufacturing exports (trade with Bolivia is low). Yet once again, president Correa has warned that he might take the country out of the bloc should Ecuador continue to register major trade deficits with its neighbors. "Ecuador must seriously think about the convenience of continuing in the CAN because the trade imbalance is terrible and what we have are only restrictions," he said, complaining that he needed to "ask for permission and forgiveness" when aiming to implement trade restrictions against them. Trade minister Juan Carlos Cassinelli said he would seek a balance of payments mechanism to be activated when the neighbors "devalue" their currencies. Newspaper *El Telégrafo* reported that an "Ecxit" from the CAN would take around five years (the current administration's term ends next May).

The government's leading arguments stem from its standard protectionist repertoire. Correa continues to pursue the illiberal belief that industrial development can be set by government. Again, he complained last week of Ecuador's inability to set exchange rates given its use of the dollar. The standard argument employed by government officials is that Ecuador needs to pursue a quasi-mercantilist policy to safeguard its internal liquidity since it doesn't print its own money. Aside from the simplistic nature of these arguments even after a decade in power, it appears the administration sees no risk of retaliation, while these have already had a negative impact on Ecuadorian exports in the past. Richard Martínez, president of the Ecuadorean Entrepreneurial Committee, criticized the fresh attack on Ecuador's CAN membership, noting that more than 80% of Ecuadorian exports to the CAN are industrial goods, the added-value products that the government purports to support.

An "Ecxit" might however not be the initial priority, not just given the little time the government still has in office. Trade minister Juan Carlos Cassinelli said that the Ecuadorian side is considering seeking a deal that would allow the government, "if there were to be a devaluation tomorrow, to have an automatic measure to protect our production." On the one hand, this repeats the government argument that Colombia and Peru are actively devaluing their currencies, which isn't the case as they enjoy a free-float FX regime with limited central bank intervention. On the other, such a mechanism would create a risk as the neighbors could logically ask for reciprocity in the case of a fall in the dollar. But that scenario would most likely be something a future government would have to deal with. Meanwhile, as Ecuador seeks ratification of its free trade agreement with the European Union by November 11, it continues to send out conflicting signals on its willingness to be a reliable partner.

Candidate Carrousel

As the date for next year's election – February 17 – approaches, president Correa finally gave a strong hint that he may run after all, as analysts including ourselves have long said was likely. Expressing annoyance over criticism, he said that should this not stop, he would run for president again "in 2021 and if the Constitutional Court (CC) doesn't approve the transitional (change to the constitution, approved by congress last September), I'll present myself in October" as an official candidate. Correa was referring to the final wording of the reform that last year scrapped term limits for all elected officials. While a group of *correístas* is officially seeking signatures for a referendum to get him back onto the ballot, the CC had never sanctioned the inclusion of the "transitional" rule in effect only for the next election into the package of last year's changes to the constitution. Now, to be on the ballot, Correa would only need for the friendly court to rule in his favor should a supporter ask the CC to declare that detail unconstitutional.

The statement came as the government's favored candidate, Lenín Moreno, has faced scandal in absentia after foreign minister Guillaume Long had to admit that the government has been paying him a handsome salary in Geneva, where he is the United Nations' special envoy for the handicapped. While other special envoys don't receive a salary, in the case of Ecuador, taxpayers foot the unspecified bill; lacking better arguments, Long could only argue that "Ecuadorians should be proud" of the role of the former vice president (2007-2013) at the UN. Ecuador's ambassador to the UN's Geneva body, María Fernanda Espinosa, added to the scandal by saying in an *El Comercio* interview that Moreno had "taken the decision not to adhere to the administrative financial parameters of the UN, although he is an official of the system, but he adheres to those of … the whole administrative financial management of the foreign ministry." While she said that the scandal stems from "ill faith" with which critics blast the matter, taxpayers still don't know what Moreno actually earns on top of his pension as a former vice president, a double income which Correa has harshly criticized in the past. Current vice president Jorge Glas meanwhile appears to be getting a lukewarm reception from voters, leading other top officials to unofficially put themselves into play, including Gabriela Rivadeneira, the president of congress, and interior minister José Serrano, whose ministry has funded an action thriller featuring the national police, *Tierra de Serpientes* (Serpent Lands); he denies it cost the $4m reported by opinion blog *4Pelagatos* but hasn't given the official figure.

This situation, along with some worries about conservative candidate Guillermo Lasso's potential, may have prompted Correa's statement last week. Additionally, Moreno is too popular on his own for the president to be able to rest assured that, should his former VP be elected, Correa would be able to control him. But the opposition, too, is in bad shape, split not just ideologically into a hard left and centrist and conservative groups (after their implosion a decade ago, political parties have almost ceased to exist). Efforts to join hands in favor of democracy have most recently been hit by personal interests, with a large number of potential presidential candidates. That kind of fragmentation could allow Alianza Pais (sic), Correa's political victory, to walk away with a first-round victory should the candidate win at least 40% of the vote with a 10-point advantage over the runner-up. In 2013, Correa won with 57.7%, compared with Lasso's 22.7%. Correa looks far less popular at present. Correa has recently said that the (poor) quality of opposition candidates would help AP, perhaps the shock of Correa’s potential return to the ballot may galvanize the opposition into taking the question of candidacies more seriously.

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