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ECUADOR WEEKLY REPORT®

KEY INDICATORS

For the week of Jul 18 – Jul 22, 2016

Reeling

Ecuador’s central bank (BCE) last week released national accounts figures showing a 3% on the year (y/y) fall in GDP, the worst decline since the introduction of the dollar. From the previous quarter, October – December 2015, the economy shrank 1.9%. With a third straight quarterly decline, the recession is impossible to hide, but president Rafael Correa, who may yet seek reelection next February, still refuses to use the term. A two-week delay past the BCE’s regularly scheduled publication date led to suspicions that the administration was attempting to conjure a positive spin to the data. Those thoughts were not disappointed as, during his Saturday radio and television show, president Rafael Correa said Ecuadorians have already left the worst behind them. “We’re not going to decrease (sic) like the IMF says (4.5% y/y for the whole of 2016),” Correa said. “With a bit of luck, we’d grow in 2016, despite all manner of things having happened to us,” he added. “I’m very optimistic in this second semester (sic).”

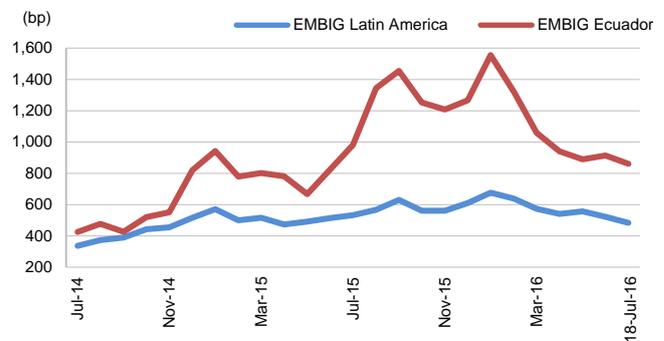
On the downside, he was referring to the plunge in the price of oil and massive strengthening of the dollar; the 7.8-magnitude earthquake in April and its continuing aftershocks, which caused at least \$3.3bn in damage, according to the government; as well as the lost Occidental Petroleum arbitration suit, saddling Ecuador with close to \$1bn that it had to pay the US oil company (avoidable, had its assets not been confiscated with his political support in 2006). “It has been a very hard semester, I hope we understand the gaps, the restrictions that we confront, but that’s

Ecuador's Global Bond Prices

Bond	Last Price						
	22/07/2016	Jun-16	May-16	Apr-16	Mar-16	Feb-16	Jan-16
Global 2020	101.50	99.38	100.28	95.21	90.54	79.08	74.92
Global 2024	88.53	87.64	89.44	88.04	82.88	72.81	69.63

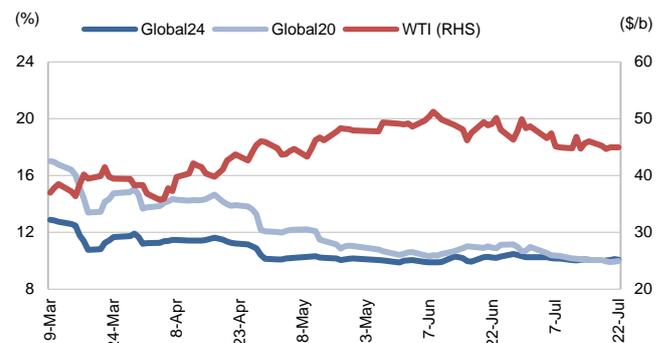
Source: Bloomberg and Analytica

EMBIG Spread



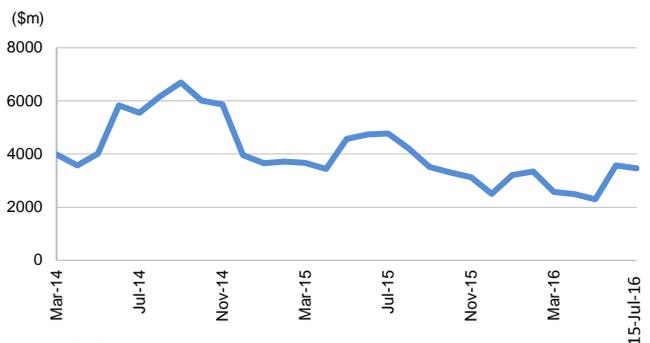
Source: JP Morgan and Analytica

Bond Yields vs. WTI in 2016



Source: Bloomberg and Analytica

International Reserves



Source: BCE and Analytica

where the art of governing is, and a bit also the art of the economy too: to do the best of what's possible with all these restrictions," he said in an economics presentation at ESPOL university in Guayaquil, a presentation widely spoofed given the large number of formulas he drew on a marker board which, in the end, emptied into tautologies, leading to a fair amount of jokes on social networks.

On the year, the declines showed crisis levels in a number of segments. Imports plunged 11%, gross capital formation (including both the private and public sectors) 8.9%, household consumption 3.9%. Government consumption declined 3.2%, still achieving a high level considering the amount of spending in the record budgets of previous years. On the upside, and from the industry perspective, the BCE reported strengthening of agriculture, electrical output, and the oil sector. Financial services were almost flat and Correa claimed that government administrative measures have been responsible for the banking industry to be liquid and sound, thus taking part of the credit for banks being able to announce they will be able to lend \$10b in the second half. Net of debt payments to banks, the increase may amount to around 10% on the year, nonetheless an important signal. Hopefully, this will not reduce the quality of credit portfolios and maintain solid credit standards. But to say Ecuador is on the cusp of recovery is unrealistically optimistic.

The Rodas Touch

As he enters the second half of his five-year term as mayor of Quito, Mauricio Rodas of the center-right SUMA party is facing headwinds. Failing to keep up popular enthusiasm of the type his experienced conservative populist peer Jaime Nebot manages to consistently generate in Guayaquil, he appears to be falling into the Ecuadorian political trap of linking his legacy with major construction projects, even though Quiteños have been slow to embrace them. A damning interview several weeks ago by a former

political advisor may have been unfair, but it helped to undermine his image as a capable presidential alternative for Ecuador after a decade of correísmo. Despite some positive measures, Rodas has yet to show voters what he's about, and continues to experience in-house troubles.

In his interview with an Argentine newspaper, Ecuadorian Jaime Durán, one of Latin America's top campaign advisors, boasted of how he helped Rodas win the mayoralty; he described the young political scientist as a boy who didn't know the city he sought to run. True to Durán's political advise, although the two have parted ways, Rodas has avoided aggressiveness and entering the political fray. Yet while the more conciliatory position has indeed been a welcome break from the confrontational president's abrasiveness, he has appeared dithering in the face of Quito's discontent.

Notwithstanding a brief appearance before a large anti-Correa protest last year, he has been unable to ensure some civil rights, notably the right to peaceful protests. Meanwhile, while facing a slim pro-Correa government in the municipal council, he has also suffered sniping from inside his supposed group of backers in the municipal government, including Antonio Ricaurte, who suffered a political blow of his own triggered by the confession of his unfaithfulness to his wife in a sexual affair with a young SUMA councilwoman that became widely viewed on YouTube.

More seriously, deputy mayor Daniela Córdova, a thirty-something lawyer (thus even younger than Rodas) has emerged as more finely attuned at least to the political interests of the middle and upper-middle class voters in north-central Quito. She joined marchers in the streets last year and, most recently, became one of the critics of a massive, \$131m bridge and road program Rodas wants to build to speed traffic between the suburbs of Cumbayá and Tumbaco and the downtown areas. In an editorial for opinion portal 4Pelagatos, she confirmed the harsh

criticism that architects and journalists have put forward against the project, on which work has already started: that it will push the morning and evening traffic jams into the already saturated area around the capital's quasi-central park, La Carolina, a problem the municipality's urban planners hadn't even considered. Additionally, the builder, China Road and Bridge, is controversial due to the company's past corruption, which led the World Bank to blacklist it in 2009.

From an electoral standpoint, the project is a huge mistake. It will potentially divide the anti-Correa electorate that supported Rodas; perhaps he will retain support in the suburbs, but in north-central Quito, which is far larger, voters will hardly forget who worsened traffic, already one of the biggest local issues, as well as pulling down property values. One need only to observe the plight of areas where previous mayors made the mistake of putting up overpasses or digging underpasses, which are now some of the city's most hideous. Rodas has pledged to discuss the project publicly, a wise concession, but which will cost him prestige nonetheless. Elsewhere, his plans to integrate cable cars into the public transportation system have literally been very slow to get off the ground. These may indeed prove to be a cost-effective and clean alternative to the bus system that neither he nor his predecessors have been able to fully reorganize into a clean, fast, and safe public transport option. He pulled the trigger too soon here too, as he hasn't been able to finance the cable cars he announced first (ticket prices will be an issue: in the Russian city of Nizhni Novgorod, low-income residents hesitate to use the cable car that crosses the Volga as the 100-ruble ticket, while less than \$2, still costs five times more than the much slower buses).

The biggest infrastructure project, of course, is the subway, or metro. The project, inherited from his petty correísta predecessor, Augusto Barrera, is still slated to cost "just" \$1.9bn, an unrealistically low budget

considering prices elsewhere. Rodas has acknowledged that the final price cannot be guaranteed. While public officials involved mean well and the city may indeed be suitable for this type of transport, the public remains unconvinced that the project will indeed solve the capital's traffic problems. A seminar held to prove its safety still disregarded the negative examples of Cologne, where a subway tunnel collapsed, destroying Germany's oldest public archives (going back to the 10th century) and setting back that metro line by a decade, or of Sao Paulo, where the builder, Odebrecht, also had a major negative incident in the form of a massive sinkhole during subway construction. Of course, a cloud of suspicion hangs over the Brazilian company given its own history of corruption demonstrated in courts in its home country. Much like his peer in Cuenca, Marcelo Cabrera, fighting to finish a tram, Rodas at time appears to be a hostage to the central government's funding pledge to fund a part of the metro, and therefore too close to Correa for voters' liking. With the huge United Nations Habitat III project scheduled for October, Rodas does still have time to think things over and improve his administration, but time flies.

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