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ECUADOR WEEKLY REPORT[®]

KEY INDICATORS

For the week of Sep 5 – Sep 9, 2016

Pumping Biodiversity

Ecuador’s oil production reached a record above 565,000 barrels a day this week as a well at Tiputini, the first part of the Ishpingo-Tambococha-Tiputini oil field, officially went online. Production at ITT, renamed “Block 43” after a major campaign to keep its oil underground flopped, will be instrumental in keeping Ecuador’s output up over the coming years. But many fear the earnings, especially considering the crisis in the oil industry, will pale compared with the environmental costs of drilling and pumping in one of the world’s most biodiverse habitats.

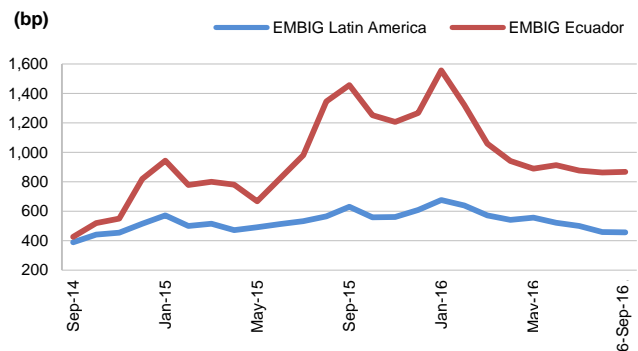
In July, the government announced that the field, stretching north-south from about the Napo River deep into the eastern part of the Yasuní National Park, holds 1.67b barrels of crude oil, citing a review of reserves by US consultancy Ryder Scott, close to double the previous amount, even surpassing previous estimates of possible reserves by about 400m barrels. Output has already reached 23,000 barrels a day and will climb to 40,000 b/d by the end of the year, as well as averaging 50,000 b/d in 2017, officials said this week. The increased reserves and production support the government view that ITT development, started in earnest after president Rafael Correa pulled the plug on an environmental plan to keep the oil underground in exchange for mostly foreign funding. “Income” from the production, which started in the Tiputini area outside the Yasuní National Park, will total around \$100m this year and \$750m-\$800m in 2017, vice president Jorge Glas said during the ceremony.

Ecuador’s Global Bond Prices

Bond	Last Price									
	09/09/2016	Aug-16	Jul-16	Jun-16	May-16	Apr-16	Mar-16	Feb-16	Jan-16	
Global 2020	102.60	102.30	100.49	99.38	100.28	95.21	90.54	79.08	74.92	
Global 2022	103.16	102.89	100.03	N/A	N/A	N/A	N/A	N/A	N/A	
Global 2024	88.54	88.05	87.49	87.64	89.44	88.04	82.88	72.81	69.63	

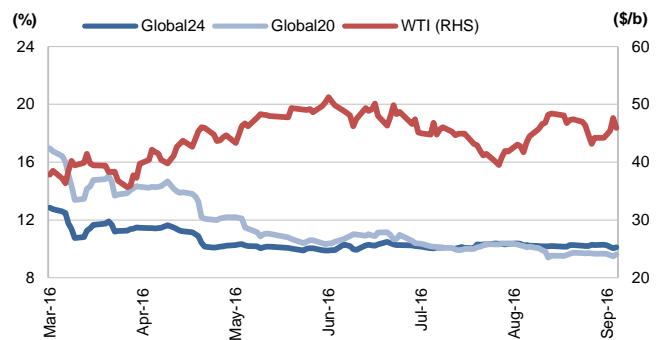
Source: Bloomberg and Analytica

EMBIG Spread



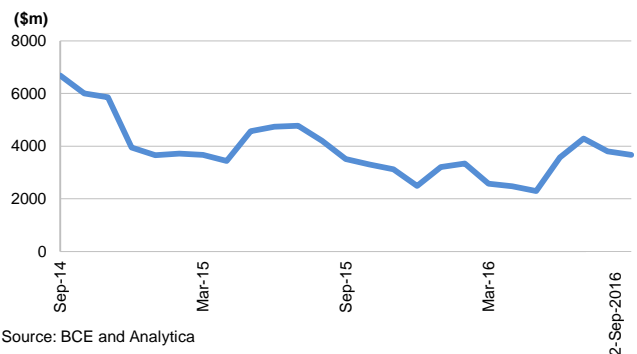
Source: JP Morgan and Analytica

Bond Yields vs. WTI in 2016



Source: Bloomberg and Analytica

International Reserves



Source: BCE and Analytica

Among conventional fields, ITT holds 41% of the country's reserves around 4bn barrels. In the near-decade that Correa has held office, the oil industry, under ever-increased government control has failed to find significant new reserves through exploration. The greater output horizon that ITT's additional reserves imply go a long way to providing evidence in the final months of his administration that his energy policy has worked, including the pursuit of a controversial, non-existent new refinery near Manta on which it has already spent \$1.2bn. By announcing new reserves, the administration says that the country does in fact have enough oil to supply the Manta refinery (aside from the issue of the weak profitability of the refining industry). Originally, the government estimated the field's production to end in 2039, with a peak output of 200,000 b/d in 2018 or 2019.

The administration is still sticking to its initial estimate, going back to August 2013, that production costs at ITT will average less than \$12 per barrel. A quiet reassessment has gone ahead in recent months after Correa surprisingly disclosed last year that Ecuador's production costs were around \$30/b, when only a few months earlier state-owned oil company Petroamazonas had said they were around \$8/b, which however were operating costs, not including other elements like depreciation. Now, the company web site says output costs averaged \$7.32/b in July (the company has yet to publish a press release on this week's inauguration at Tiputini). Industry analysts question the cost estimate given the need to mix lighter crude with the field's own heavy crude around 14 degrees API to transport it in pipelines for processing and to the Pacific Coast for export, all of which raise production costs. The company estimated the transportation cost at \$1.46/b in 2013. While Petroamazonas remains the nominal head of the operation, government officials acknowledged a number of contractors are working there, namely Schlumberger and Sinopec, as well as "Azul" ("Blue"), a company associated with the corruption scandal

that has hit Petroecuador, the Petroamazonas's sister company that handles fuel transport and exports and import. Petroamazonas has gone ahead with developing ITT despite the low-price environment for oil out of necessity, considering the need to fulfill debt commitments to China after the government obtained a series of loans from that country at an interest rate of around 7% in exchange for oil shipments. Oil has rebounded to around \$50/b from lows below \$30 in January, but the price still remains a far cry from levels around \$100/b from which the economy – and government spending – benefitted as late as mid-2014.

Environmentalists, meanwhile, bristle against development of the field. Petroamazonas has pledged to use the highest environmental standards to safeguard the rainforest environment, but its track record shows continued oil spills and numerous delays in cleanups. Besides demanding congressional approval for oil production and mining in protected areas, Ecuador's constitution bans any such activity in the territories of its two remaining isolated Amazon indigenous tribes. While it promoted the environmental option to leave the ITT undeveloped, the government said that these tribes inhabited the ITT/Block 43 area, some 40% of which is outside the park to the north and in a strip along the border with Peru. In the documents submitted to congress however, the justice ministry denied any evidence of their presence in the areas slated for development. Additionally, the Ishpingo deposit's southern end juts into an "intangible" area of the Yasuní park officially set aside in which any economic activity is banned. Yasuní has more species of trees in a single hectare than all of the US and Canada combined and has more species per hectare of birds, amphibians, mammals, shrubs, and insects than anywhere else in the world, says US environmentalist organization Amazon Watch.

The NGO, close to the group of plaintiffs seeking \$9.5b from US oil company Chevron for its

responsibility in contaminating part of the jungle northeast in the 1970s and 1980s, has called for a boycott of Ecuadorian crude in Californian refineries. While such a measure is highly unlikely to proceed, there is some consensus between economists and environmentalists that the income from oil production at the biologically tremendously important site won't provide the financial benefits the government is touting. After all, more than 40 years after starting to produce oil, Ecuador is still far away from the original promise of wealth for all.

Citizen Correa

Since first taking office in January 2017, president Correa has won six cases in court, all of them linked to alleged offenses against his honor. In 2010, a court awarded him \$600,000 – he had sought \$1m – from Banco Pichincha after the bank had kept him on a list of bad debtors in a dispute over a \$169 credit card bill amid a portfolio of debts that it had acquired in the wake of the 1998-2000 financial and economic crisis. Correa used around half of this money to buy an apartment in Belgium, from where his wife is. Indirectly mentioning this case may now send Eduardo del Pozo, the 30-year old deputy mayor of Quito from the conservative Creo party, to jail for two weeks.

In a radio interview in July, del Pozo had ridiculed Correa's demand for an "ethical pact" that would keep politicians with assets in overseas tax havens from holding office. Del Pozo said that "it's incredible that those who speak to us about an ethical pact are those who through certain pressures have been able to win lawsuits and take out their assets without paying taxes ... and to take these assets to Belgium." Offended, Correa sent his personal lawyer, Caupolicán Ochoa, "to safeguard his honor" in a civil suit against del Pozo. Del Pozo's comments "are a discredit and dishonor to a human being who has a right to a good name, honor, and dignity," he added. Judge Máximo Ortega agreed, sentencing del Pozo to

15 days in jail, a \$90 fine, and ordered him to apologize publicly in the same radio station which aired the offending interview.

Del Pozo said that he never mentioned the president's name, which is true, but somewhat disingenuous given the background of the case Correa won against Banco Pichincha. The original case, however, also holds enough controversy to merit judicial review, not to mention the president's failure to pay income tax on the win. Most glaringly, the judge sentenced del Pozo to jail time in a civil case linked to the right to freedom of expression. The \$90 fine would have led to less controversy, albeit also to jokes about the president's honor being worth only a few dozen greenbacks.

Six months before the general elections, the case has made del Pozo much better known. Perhaps the government is weighing the impact on the media and polls of the case to gauge what will happen should Creo leader and presidential candidate Guillermo Lasso, the runner-up to Correa in the 2013 elections, also be sentenced to jail in a similar suit filed by higher education secretary René Ramírez for quoting media reports that said that his wife drew two salaries at the IAEN postgraduate university she runs (a rather clear case of potential conflict of interest). To lock up Lasso, even briefly, could make him a martyr amid a lackluster presidential campaign. Still, del Pozo, who will appeal, has had somewhat less of an enthusiastic reception among the anti-Correa audience than might be expected. In what might just be botched circumstances, Gonzalo Ruiz, a journalist, failed to give him a moment to speak at a conference hosted by business chambers in Quito this week.

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