ANALYTICA INVESTMENTS

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Risky Appetite

After defaulting on $3.2b in sovereign bonds in 2008, government officials boasted of the billions of dollars the politically motivated move would save the country going ahead. Less than a decade later, the government has now issued $4.5b in bonds and may yet go for more after placing another $1b tranche this week. Amid the low-interest environment extended by the US Federal Reserve at least past the US elections, Ecuador took quick advantage, doubling the $1b amount the central government budget had allotted for debt issuance this year. As *Bloomberg* noted, the yield had fallen to 9.54% on Monday, the lowest since June of 2015.

The sale came as a reopening of the bonds sold in July, due 2022. For the administration, including its dependency, the Central Bank of Ecuador (BCE), plenty of room remains for raising debt. BCE chief executive Diego Martínez has lately insisted the 40% of GDP legal debt ceiling applies only to "consolidated" debt net of money the government owes other public-sector entities like Ecuador's Social Security Institute (IESS). While signs of liquidity problems at IESS abound and users complain about the long lines and lack of medicines, analysts dispute this view of government debt, which whittles down the debt ratio to around 25% of GDP from the close to the 38.3% gross level, which institutions like the International Monetary Fund use as their reference. Additionally, some already see debt around 44% of GDP, including short-term notes, central bank financing to the treasury, and "pre-sales" of oil, all of

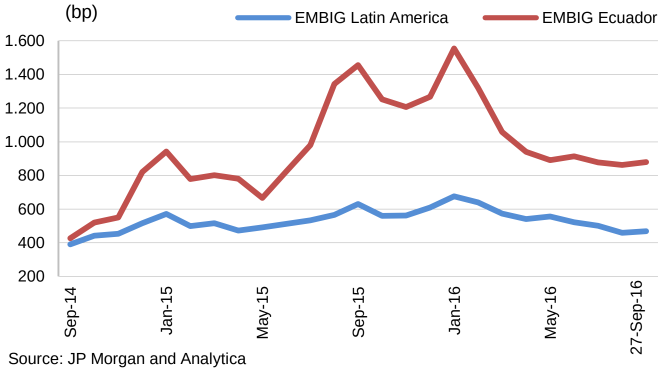
KEY INDICATORS

Ecuador's Global Bond Prices

Bond	Last Price								
	23/09/2016	Aug-16	Jul-16	Jun-16	May-16	Apr-16	Mar-16	Feb-16	Jan-16
Global 2020	102.55	102.30	100.49	99.38	100.28	95.21	90.54	79.08	74.92
Global 2022	102.66	102.89	100.03	N/A	N/A	N/A	N/A	N/A	N/A
Global 2024	90.19	88.05	87.49	87.64	89.44	88.04	82.88	72.81	69.63

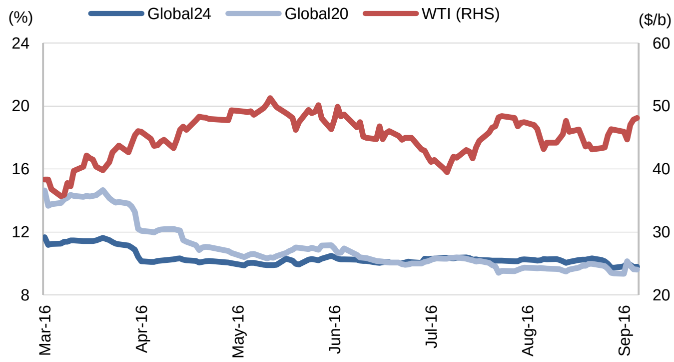
Source: Bloomberg and Analytica

EMBIG Spread



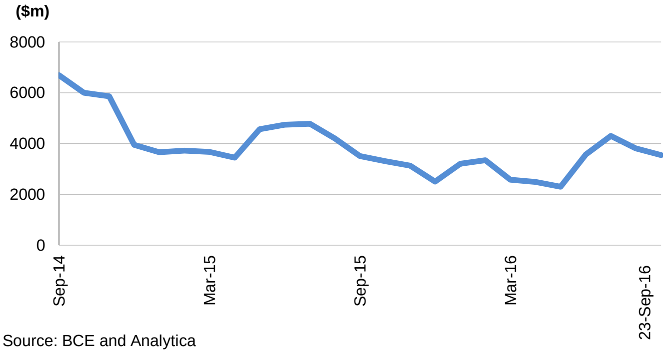
Source: JP Morgan and Analytica

Bond Yields vs. WTI in 2016



Source: Bloomberg and Analytica

International Reserves



Source: BCE and Analytica

which carry interest but which the government disingenuously uses legal terms to deny they are actually debt.

All of the above raises country risk, and makes debt even more onerous to repay. For buyers of the debt, previously derided by the government as “speculators” and now applauded as investors, the annual, double-digit interest rate of 10.75% offers an attractive deal, considering that countries with credit ratings similar to Ecuador’s can place debt much more cheaply. This also dispels the government’s claim of ample liquidity and running the economy very well amid the impact of the low price of oil, the OPEC member’s leading export and source of income. In fact, according to the finance ministry’s budget execution report this week, debt raised so far this year totaled $7.09b, more than oil and tax income combined.

The government insists the level of debt is low compared with the very high levels of industrialized countries. This is true, but it belies the fact that the scale of the rise of debt has been enormous, interest rates are high, and the maturities are short. It has become increasingly clear that president Rafael Correa’s successor will have to deal with a situation he has lacked the political courage and economic competence to avoid. Ecuador is staring at an Argentina-type situation, in which it will have to offer a restructuring deal to extend maturities. In any event, with interest payments on foreign debt topping health and education budgets, Correa’s claim of a government where the interests of the people top that of “capital” ring hollow.

Na Zdorovie!*

After US presidential candidate Hilary Clinton’s surprise bout with pneumonia, Juan Carlos Solines, himself a center-right vice presidential candidate in 2013, requested that Lenín Moreno, widely expected to be anointed the Alianza Pais (sic) presidential candidate this weekend with president Correa’s blessing, inform the public of his own medical condition. In a radio interview this week, Solines said that “independent doctors should certify his physical condition to be able to govern a country.” After all, Moreno, left quadriplegic by a robber’s gunshot in 1998, as vice president 2007-2013 suffered a several serious medical episodes.

In 2008, he was interned in the Quito military hospital’s intensive care unit with lung and urinary problems. This led him to make public assurances that he was in sufficiently good health to be on the presidential ticket in the early elections of 2009. Yet later that year, he was hospitalized due to a hemorrhage during a visit to Peru. Privately, he has said in past years that back pains associated with his disability make it impossible for him to complete a full day of the workload he would have to deal with as president.

All of this makes Solines’ demand understandable. In typical fashion, leading figures of correísmo however blasted him for it. Defense minister Ricardo Patiño on Twitter asked if Solines had gone insane. Correa called him "human misery." The government's handicapped council attacked him for discriminatory remarks. So did conservative legislator María Cristina Kronfle, also confined to a wheelchair, who asked whether all candidates should have to confirm they wouldn’t die while in office (she is a legislator for the Social Christian Party, which is competing with the CREO party for which Solines was the vice-presidential candidate in 2013). Solines’s criticism however had no discriminatory background, nor did it question Moreno’s mental ability (his ethics have been widely questioned after revelations this summer that he has received a huge salary from the government, despite having been promoted as receiving just a symbolic, $1 annual salary as a United Nations representative for the handicapped in Geneva).

Moreover, the issue of Moreno's health raises raises questions about who will finally run the country if he should become elected on February 19, or in a second round. The inaugural is May 24, 2017. His likely running mate, Jorge Glas, would take on a leading role even beyond the strong administrative task overseeing infrastructure and extractive industries he has had as Correa's vice president since 2013. Or, some speculate, he could simply take over the presidency within months should Moreno indeed prove physically unable to run the government. This, however, would pose yet another problem: congress would have to elect another vice president. Should an opposition majority control the legislature next year, that would set the country up for renewed conflict of the nature that plagued it during the 1979-2005 democracy.

Unhealthy Insurance

President Correa this week used his line-item veto power to increase the level of health coverage private insurers need to guarantee that they will match any required service up to ceilings established by either IESS or the public, catch-all health system, whichever the higher. Private health insurers said Correa based his decision on faulty data that gives an impression of a profitability of the industry that is, they say, in fact much smaller. The move could lead numerous people to opt back into the public system because of price increases, they added.

According to a letter industry representatives sent legislators this week with the support of Ecuador's Entrepreneurial Committee, a business association, IESS reported that the private industry had booked a net profit of $221m in 2014, while, according to the government-controlled Superintendency of Companies, it was just $12.8m. IESS simply mistook income, or sales, for profit, as a result estimating that the private health industry could comfortably assume medical services worth $71m annually that IESS would otherwise need to provide. Given the tight liquidity at IESS, it can safely be assumed that this is an imminent threat to health insurers.

Only some 400,000 of Ecuador's 16m residents have private health insurance. A cost increase by the amount the law aims to create would force them to raise premiums by 50%, amid a situation where unemployment and the worsening economy has already begun to erode margins that still existed in 2014. But as close to three quarters of legislators want Correa to put them back on the ballot, they will hardly overrule the veto. Yet according to the industry, the public health system will find itself unable to obtain the calculated $71m. Instead, by driving people back into the already strained public health system, it "will only see health services costs rise amid an overflowing demand that will multiply exponentially," according to the industry's statement.