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ECUADOR WEEKLY REPORT®

KEY INDICATORS

For the week of Oct 3 – Oct 7, 2016

Correadämmerung

As expected, delegates to a conference held in a soccer stadium in southern Quito on Oct. 1 rubber-stamped former vice president Lenin Moreno (2007-2013) as the official candidate of the Alianza Pais (sic) political movement to succeed Rafael Correa next year. How much independence Moreno will actually have if he wins the election is unclear. Correa has already indicated he wants nothing more than a cosmetic change in power. The political and economic cycles indicate that he won't get his wish, but Ecuador faces a trail of tears before recovering from Correa's record consecutive more than 10 years in power.

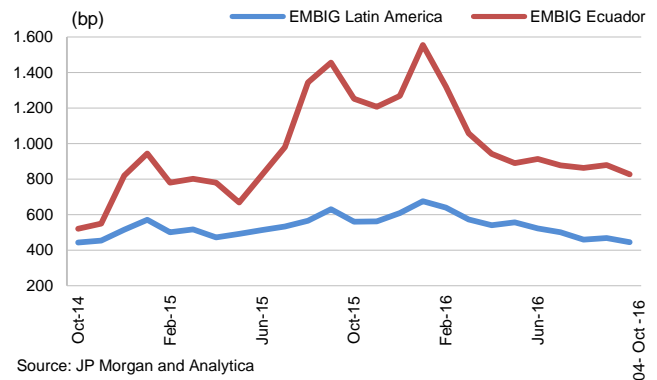
To say AP is the ruling political movement (legally and in real terms, it's not a full-fledged party) is an exaggeration. The organization, according to internal critics, is an electoral vehicle that never managed to consolidate the center-left ideology with which it captivated a majority of Ecuadorians in late 2006. And the problems it faces in getting Moreno elected with his running mate, the current vice president, Jorge Glas, showed from day one. Moreno arrived from Switzerland, where he spent three years as a United Nations Special Envoy on Disability and Accessibility with a nominal \$1 annual salary, to an organized welcome last week designed to showcase his candidacy as a triumphal march. Yet AP organizers only managed to draw less than 5,000 people to his welcome rally, and the seats of the 20,000 capacity Aucas soccer club stadium also remained mostly empty for the AP rally on October

Ecuador's Global Bond Prices

Bond	Last Price									
	07/10/2016	Sep-16	Aug-16	Jul-16	Jun-16	May-16	Apr-16	Mar-16	Feb-16	Jan-16
Global 2020	103.28	102.51	102.30	100.49	99.38	100.28	95.21	90.54	79.08	74.92
Global 2022	103.87	102.47	102.89	100.03	N/A	N/A	N/A	N/A	N/A	N/A
Global 2024	91.48	90.25	88.05	87.49	87.64	89.44	88.04	82.88	72.81	69.63

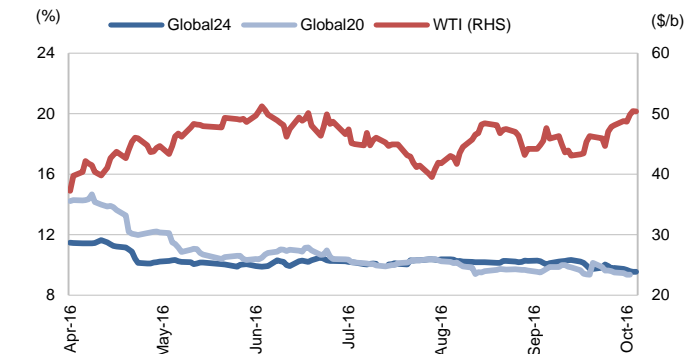
Source: Bloomberg and Analytica

EMBIG Spread



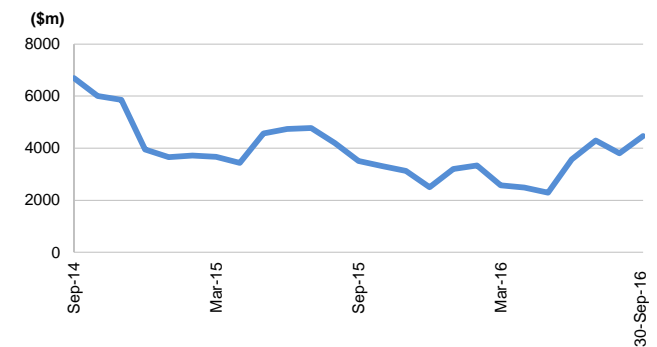
Source: JP Morgan and Analytica

Bond Yields vs. WTI in 2016



Source: Bloomberg and Analytica

International Reserves



Source: BCE and Analytica

1, as photos show, notwithstanding Correa's claim of a full house and AP's even more ridiculous statement that more than 40,000 had attended.

Despite his popularity, which makes him the obvious frontrunner in the field of seven current potential candidates, Moreno faces a political minefield, which his cautious initial speeches have reflected. When he was Correa's vice president, he was able to play "good cop" to the angry president's attacks on real or imagined rivals in politics and the business world, which Correa continues to attack as the "poderes fácticos" (powers that be). Drawing on his smiling persona and tendency to crack jokes, despite his wheelchair-bound condition, he became even more popular than the president. There are nagging doubts regarding his physical abilities that Moreno faces, which sparked demands that he present a clean bill of health; "I'm perfectly healthy," he said in an interview with Gama TV, a television broadcaster confiscated in 2009 that has yet to be privatized.

Perhaps even more critically, Correa has already publicly attempted to block him from establishing his own power base. Moreno carefully spoke of a "stalemate on taxes" and of "an outstretched hand," and said "I'm not bothered by the word 'crisis'" in his Gama TV interview. During the AP conference in the Aucas stadium, he wore a white shirt, unlike the rest of the movement's top brass, which wore its standard 1980s neon green. For Correa, even this has been a threat to his legacy. The word "crisis" is anathema to him. While he has acknowledged that the economy is in a recession, he has blasted critics' claims of a crisis, insisting that despite budget cutbacks and shortfalls it is doing relatively well. After Social Christian presidential candidate Cynthia Viteri criticized the state of the economy, Correa told her to speak about makeup, rather than economics. And in his speech at the AP conference at the Aucas stadium, he ominously issued orders that ran completely to the contrary to Moreno's initial

comments, which had poked some more holes into Correa's view that all's well. "We won't permit that out of alleged campaign strategies our candidates separate themselves from Alianza Pais (sic) or the government," he said. "This wouldn't just be disloyal, it would be clumsy."

Correa will find it personally difficult to extricate himself from the ongoing campaign. In 2014, this was a recipe for disaster. The president violated electoral law by campaigning in favor of the incumbent AP mayor of Quito, Augusto Barrera, only to witness his loss in a landslide to the center-right candidate Mauricio Rodas (SUMA). Moreno has already lost substantial credibility not only for his role in the Correa administration in general, but also in particular for the lack of income tax payments and accountability for his spending in Geneva, which investigative news site *Milhojas.is* reported as being budgeted at \$1.6m annually. His poll ratings have dropped to below 40%, potentially putting a victory in the first round at risk, also considering the hard left and center-left opposition has surprisingly largely rallied around retired general and former mayor of Quito Paco Moncayo, who could draw away votes from AP's leftwing support base. At the same time, the center and center-right remains divided in a deeply personal dispute between Guayaquil mayor Jaime Nebot, Viteri's mentor, and Guillermo Lasso, a self-made millionaire former banker who came in second to Correa in 2013 as the candidate of the CREO party. This conflict strengthens Moreno's bid. Lasso has not yet announced a running mate; the highly-regarded former finance minister Mauricio Pozo, meanwhile, told Guayaquil daily *Expreso* that if asked to be on Viteri's ticket, he would "assume it with humility and commitment" but that "there has been nothing to take a decision at this time."

Meanwhile, Correa will stay on the scene at least until late May, while the first round of the elections will go ahead February 19. Depending on the

performance of the economy, fresh corruption scandals, and the result of the election, this could be a very long time for him, but also provide an early taste of potential political instability. With AP looking to be much diminished in congress from the middle of next year, if Moreno were to win, Ecuador faces a risk of conflicts between the executive branch and the just as its politicians need to take action to deal with a prolonged period of economic weakness.

A Danger and Opportunity

A research paper published last month updates the risks the immediacies of the Cotopaxi and Ecuador in general faces from an eruption. With the volcano's activity much more subdued than in 2015, the report gives public officials information on what remains to be done to mitigate destructive risks from what the researchers call "one of the most dangerous volcanoes of the world."

The authors of the report, published in *Natural Hazard* under the title *Economic risk assessment of Cotopaxi volcano, Ecuador, in case of a future lahar emplacement*, include Fabián Rodríguez from the armed forces' university ESPE, Theofilos Toulkeridis from Quito's PUCE Catholic university, and Fernando Mata from Universidad de Cuenca. Risks they discussed, many of whom have been mentioned amid the critical situation that emerged when Cotopaxi's eruptive activity sharply increased last year, are led by "its ability to generate far-reaching lahars, which are able to destroy infrastructure and endanger a high amount of population living close to the main fluvial drainages of this volcano."

At 5,897 meters, Cotopaxi is one of the world's highest active volcanoes. In the event of a catastrophic eruption, the risk for nearby cities – Latacunga and Quito's southern and eastern suburban areas including Machachi and Sangolquí – stem mostly from the "lahars," avalanches of mud

and water bursting forth as the vast glacier would suddenly be melted by magma. This happened four times in the historic past, around every 150 years from 1757 to 1880, meaning that the mountain might be due for an eruption near the present. Of course, this is impossible to predict. Although it continues to emit steam periodically, the telltale signs of an eruption have decreased enough for authorities to drop the "yellow" alert and reopen the national park (although people may not go up to the edge of the glacier, which is a useless limit giving an eruption would reach the parking lot to which they are allowed after a few more seconds).

Around 350,00 people live in the potential high risk area. Government efforts included the protection pipelines carrying fuels like oil, as well as water, and installing speaker systems to warn people to evacuate. A more substantial problem remains in the houses, farms, businesses, schools, and roads, among the infrastructure of the area. Despite warnings, the Correa administration built a major jail straight in the way of a potential major lahar. A destruction of these assets would cost a staggering \$17b, approaching 20% of the country's GDP, including secondary losses inflicted by the "losses in revenues in water, food, energy and gasoline supply among others." But these aren't inevitable, the study concludes. "The construction of mitigation structures able to retain lahars is calculated to be of about \$150m." Considering the opportunity for construction that Cotopaxi's decline in activity presents and the weakness of the economy, to secure multilateral loans at low long-term rates should therefore become an urgent policy priority for local and national authorities.

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