ANALYTICA INVESTMENTS

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Don't Show Me the Money

To tackle the ongoing economic malaise has meant trying to keep spending as high as possible despite plunging tax returns and the virtual disappearance of oil revenue. As a result, Ecuador's central government debt has soared to 38.7% of GDP, or $36.99bn, as of the end of September, according to the finance ministry's monthly debt report. No, it didn't, the government argued in recent weeks, setting up the sleight of hand produced via decree by president Rafael Correa last week. After leading a chorus of officials in saying the 40% debt ceiling introduced in a law only two years old (the "Organic Monetary and Financial Code") failed to meet International Monetary Fund debt accounting guidelines (a false claim), Correa signed an official decree earlier this month that said that the ceiling applies only to "consolidated debt." This eliminates the debt the government owes the Ecuadorian Institute of Social Security (IESS), among other public institutions. Currently, the government owes IESS around $8bn, economy minister Patricio Rivera said in an interview with El Telégrafo on October 28. Money owed private contractors adds another 1.5% to 2% of GDP to debt, he added. All told, the decree leaves more than $11bn (or close to 11% of GDP) outside the amount considered relevant for further borrowing.

Of course, the 40% debt limit was a political choice aimed at bridging the gap between the government's free-wheeling ways and the 2006 electoral platform, when Correa campaigned in favor

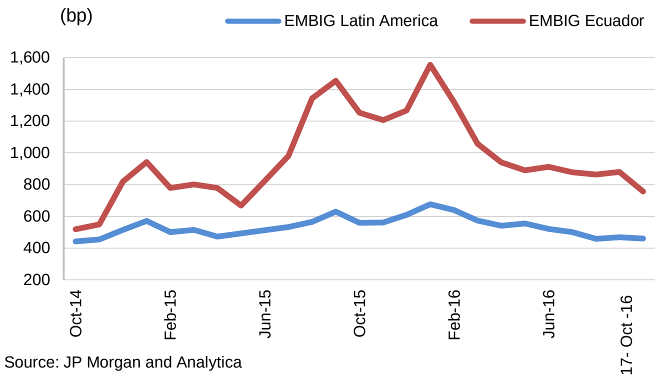
KEY INDICATORS

Ecuador's Global Bond Prices

Bond	Last Price									
	28/10/2016	Sep-16	Aug-16	Jul-16	Jun-16	May-16	Apr-16	Mar-16	Feb-16	Jan-16
Global 2020	106.94	102.51	102.30	100.49	99.38	100.28	95.21	90.54	79.08	74.92
Global 2022	106.50	102.47	102.89	100.03	N/A	N/A	N/A	N/A	N/A	N/A
Global 2024	95.64	90.25	88.05	87.49	87.64	89.44	88.04	82.88	72.81	69.63

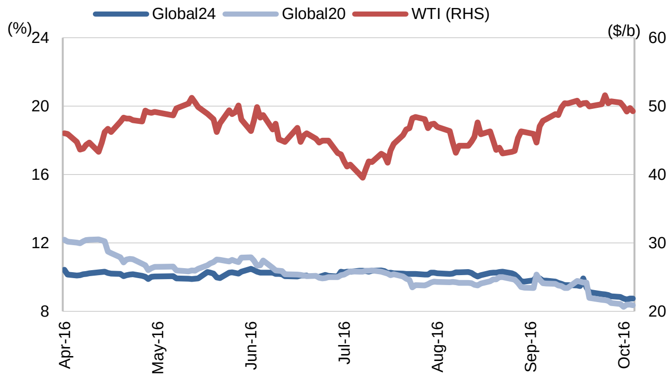
Source: Bloomberg and Analytica

EMBIG Spread



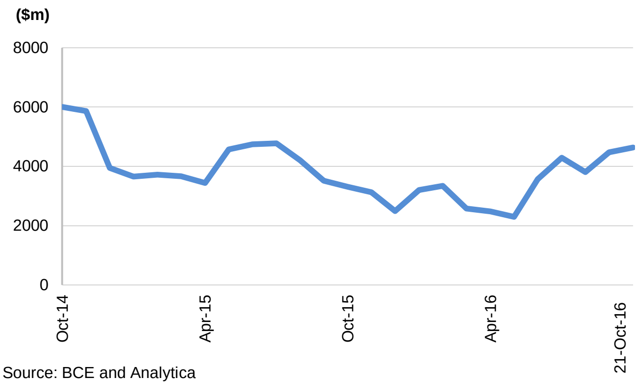
Source: JP Morgan and Analytica

Bond Yields vs. WTI in 2016



Source: Bloomberg and Analytica

International Reserves



Source: BCE and Analytica

of debt relief that came in the form of his politically motivated default on $3.2bn in sovereign bonds that left the government with debt of just 20% of GDP at the time. Failing to hedge for the fall in the price of oil, Correa was caught in a bind and returned to the debt market, besides accumulating debt primarily with China. To go back to the legislature only a few months before the February 2017 elections however would have allowed opposition parties, despite their small minorities in congress, at least to make noise about the raising of the debt ceiling that could have cost votes. This would have also limited the type of additional spending the government could use to finance with debt as the existing code limits it to investments in "strategic-sector" projects. Going this way, it can spend the money discretionally. While slashing spending also risks alienating voters amid rising unemployment, the president opted for the less painful way of fiddling with an arcane body of regulations governing the financial code. Opposition legislators say the move was illegal as a subordinate decree may not change a superior law, but the president has done this kind of thing before, notably to limit freedom of association.

With the change, the amount of debt the government will count towards the ceiling falls to 25.7% of GDP. Not only does it make it unlikely that the government will repay the IESS debt in the near term, it means that the government will continue to attempt to tap markets and other sources for loans. Debt was over the legal limit anyway given that interest-bearing "pre-sales" of oil to China and Thailand as well as domestic notes with maturities under 360 days (CETES), both of which the government refuses to consider as debt. Recently, the US State Department for the first time since starting a list of countries lacking government budget transparency in 2012 included Ecuador among them (belatedly, we find). Among reasons to do so, it cited the above case of the lack of public access to details of the oil-backed loans. On its part, Ecuador's foreign ministry rebutted the comment and telling it to "act on jurisdictions with opaque fiscal practices that are within its own territories." Ecuador's drive against tax havens continues, but looks increasingly thin as revelations of offshore accounts by allegedly corrupt former government oil officials widen. Meanwhile, the government has increased its own spending assessment by 9.6% over the budgeted level to $32.7bn due mainly to reconstruction costs in the aftermath of April's heavy earthquake along the Pacific Coast, from an originally budgeted $29.84bn (an increase up to 15% without asking for legislative approval is legal in Ecuador), a finance ministry official told congress this week. All of this may not lead bondholders to refuse to buy more Ecuadorian government debt, but it will serve to keep yields higher than need be. It also keeps Ecuador firmly on track to require debt restructuring in the medium term, which conservative candidates have demanded (foolishly, center-left candidate Paco Moncayo, a retired general, has chimed in with the government mantra of saying that debt in industrialized countries is much higher). Of course it has lower debt than other countries; with its commercial debt carrying a 10.75% interest rate and that of comparable countries much lower, it's clear other countries can afford to acquire much more debt given that it costs them far less.

Media Mayhem

While touting an investment portfolio of more than $40bn in glitzy events like one held at the otherwise normally empty UNASUR-headquarters on the Equator this week, the government has kept silent about a complete overhaul of broadcast television and radio frequencies due to conclude over the coming weeks. From an investment standpoint, such a move could even be considered a compelling move to change a major industry, akin to the auctioning of major mobile spectrum. But, as is the general rule for Ecuador, the reshuffle has stark political overtones.

For freedom of expression NGO Fundamedios, the tender of 1,472 frequencies – possibly among the biggest anywhere since the privatizations that followed the fall of the Berlin Wall – pose a huge threat to free speech.

The procedure stems from the controversial 2013 media law, which has drawn widespread criticism from journalism advocacy groups and human rights organizations for its imposition of a repressive media control regime in a series of political bodies that are generally judge and jury when deciding whether to dole out fines. The law also calls for a redistribution of radio frequencies to leave 33% in the private sector and ensure 33% for the public and 34% for the "community" sector, implying radio for low-income urban and rural community groups. Arcotel, the telecommunications industry regulator, in April called the process a "historic milestone because it is a transparent process that aims to give voice to all citizens by facilitating the creation and strengthening private and community media." Yet to date, courts have failed to overturn the refusal by Arcotel to allow Fundamedios to closely monitor the process, which is every citizen's right. Together with media content regulator Cordicom, Arcotel is leading the tender process. Both have shown themselves as extensions of the Correa administration, being led by officials close to the government, rather than independent regulators. "With its history of granting temporary irregular frequencies to an economic group that collects media outlets of all kinds, Arcotel shows clear favoritism for certain companies," referring to the Mexican media mogul Angel Gonzalez, whose Albavisión media empire in Ecuador includes radio stations and newspaper El Comercio, the legality of whose new television broadcast frequency Fundamedios questions (Guatemalan prosecutors allege Albavisión broadcasters there laundered funds and provided illegal campaign donations and issued an arrest warrant for his wife Alba Elvira Lorenzana). On October 21, Fundamedios warned that more than 300 radio stations risk losing their frequencies after Arcotel said they had received their licenses from a body that lacked the competence to do so: none other than Arcotel's predecessor, thus applying the law retroactively to strip many broadcasters of their licenses. This could take many off the air, including some that have braved president Correa's crusade against independent media like morning talk show hosts Diego Oquendo (Radio Visión) and Gonzalo Rosero (Radio Democracia). The flexible rules of the tender will allow the regulators to exert discretional influence to choose holders of the new frequencies, Fundamedios has warned.

It may well be that the massive procedure will flop, given the scale of the project, Ecuador's poor track record of drawing in foreign investment, and the lack of available private and government funding (the media law calls for advertising from municipal governments to fund community broadcasters). But the scheduling of the procedure is almost certainly no coincidence, and cause for major concern. Already, the Constitutional Court has refused to grant Fundamedios the right any citizen group theoretically has under the 2008 constitution to be granted access to oversee the tender as undertaken by Arcotel. Ahead of the elections, the government may instead simply want to use the threat of a loss of frequencies for decades old-concession holders like the radio stations named above or private television broadcaster Teleamazonas and Ecuavisa to cajole them into submission amid the election campaign. As Fundamedios noted, "without a free press, there are no free elections."