ANALYTICA INVESTMENTS

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ECUADOR WEEKLY REPORT®

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Just in Time

On November 11, Ecuador and the European Union finally signed off on the former's accession to a free trade agreement (FTA) that was originally slated to include the whole of the Andean Community of Nations (CAN). By closing the deal on that date and setting up a fast-track ratification procedure, the government barely managed to avoid the expiration of free-trade access of numerous goods to the country's biggest non-oil export market at the end of this year. The occasion also marks another step in president Rafael Correa's grudging crawl back from economic isolation back into the mainstream.

Before the advent of the economically heterodox, largely protectionist wave of governments in Latin America, the EU sought to negotiate trade deals with other trade blocs rather than individual countries to obtain greater scale. Yet while even hard-left governments in Central America went ahead with this plan, it floundered in South America as the regional trading blocs – CAN and Mercosur – remained mired in internal problems. Ecuador and Bolivia opted out, leaving Peru and Colombia, by far bigger economies, to complete the EU deals. While the administration insists it hasn't abandoned its anti-free trade policies, denying that the deal is an FTA, Ecuador's multi-year abstention from the negotiations with the rump-CAN reduced its chances at influencing their outcome.

At the same time, the change of economic fortunes as the price of oil collapsed and the dollar revalued globally forced the Ecuadorians back to the negotiating table. Additionally, plummeting Ecuadorian

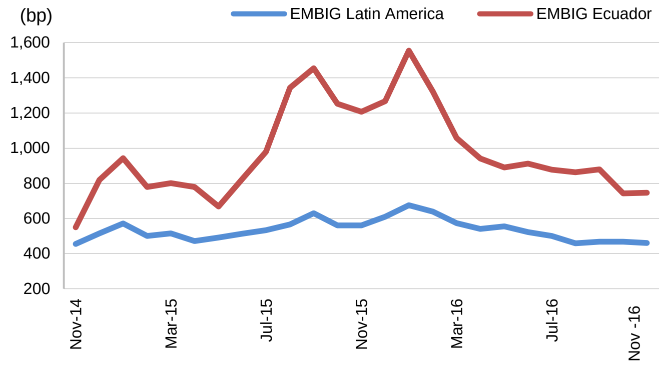
KEY INDICATORS

Ecuador's Global Bond Prices

Bond	Last Price										
	10/11/2016	Oct-16	Sep-16	Aug-16	Jul-16	Jun-16	May-16	Apr-16	Mar-16	Feb-16	Jan-16
Global 2020	103.45	106.13	102.51	102.30	100.49	99.38	100.28	95.21	90.54	79.08	74.92
Global 2022	103.04	106.11	102.47	102.89	100.03	N/A	N/A	N/A	N/A	N/A	N/A
Global 2024	90.73	94.55	90.25	88.05	87.49	87.64	89.44	88.04	82.88	72.81	69.63

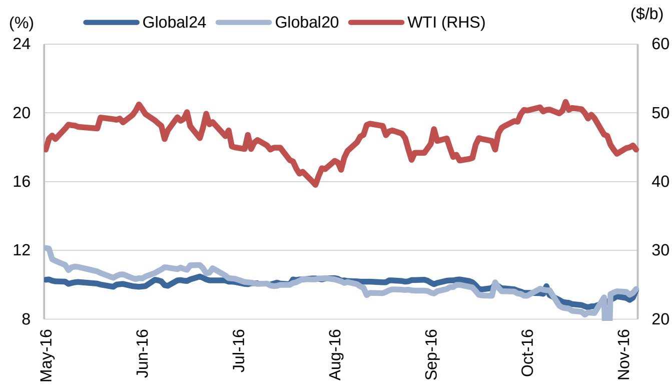
Source: Bloomberg and Analytica

EMBIG Spread



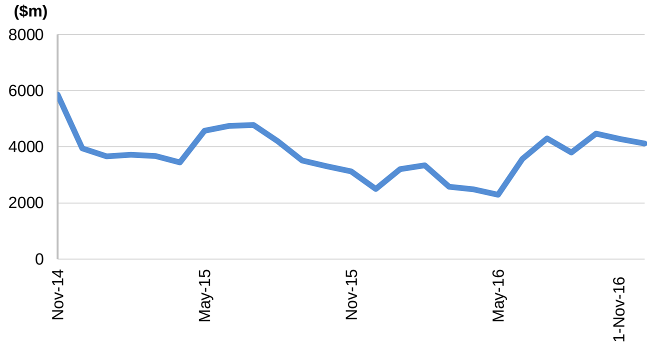
Source: JP Morgan and Analytica

Bond Yields vs. WTI in 2016



Source: Bloomberg and Analytica

International Reserves



Source: BCE and Analytica

demand helped to soothe the government's fears of a hemorrhage of dollars overseas: According to central bank data, exports to the EU shrank by 2.6% on the year to $1.91bn from $1.96bn January through August, but imports plummeted 33.7% to $1.12bn from $1.69bn over the same periods. According to the trade ministry, led through the final stages of the talks by Juan Carlos Cassinelli, a longtime associate of Correa, the deal protects 41,000 jobs that otherwise would have likely been lost as duties would have surged from zero to 23% on tuna or to 30%-34% for canned goods. Among individual product groups, Ecuador excluded imports of milk and fresh cheeses as well as rice and corn from liberalization, while duties on crucial exports like bananas and shrimp will fall (in the case of the former to €97 euros from €104 per ton and to zero from 3.6% for the latter).

Correa still falsely claims that Colombia and Peru have devalued their currencies against the dollar and blasted shoppers for fleeing Ecuador's high-priced stores to places like Ipiales in Colombia and Tumbes in Peru (even though government officials including the president himself have been photographed shopping at luxury overseas stores). Yet with his presidency due to end next May, aside from the unsurprising protests by indigenous umbrella organization CONAIE (although indigenous fair-trade products stood to lose their biggest market), a pro-trade consensus does appear to have finally emerged in Ecuador.

Trade liberalization talks will start with the European Free Trade Association in the near term, and three rounds of negotiations have already gone ahead with South Korea. In a sad twist of irony however, the prospects of a deal with the US, scuttled in 2006 with the confiscation of US oil company Occidental Petroleum's assets here, have now been torpedoed from the US side by the election of Donald Trump, who resembles Correa in many ways beyond his visceral protectionism.

Lost Decade

Even considering its recent slump, Ecuador has shown that in soccer, it can play at least a second-tier role at the global stage; so has its production of top-notch, quality long-stemmed roses. But in many other areas, its competitiveness has hardly shown any of the trajectory the government claims, which is all the more troubling considering the giant splurge in public spending of the past decade. According to the World Economic Forum, Ecuador lost significant ground, falling to number 91 from 76 a year earlier, out of 138. And a world judicial ranking also put it down at 91, yet comparatively worse considering the survey included only 113 countries.

In the WEF ranking, Ecuador shares numerous problems with the remainder of Latin America, in particular lack of innovation and institutional weakness. It slightly outperforms the neighbors in health and education as well as infrastructure. But it has lost ground significantly even within the region. Its failings, according to the WEF, lie mostly in the very rigid labor market (rank 123), access to credit, taxes, and red tape. As we have also mentioned in previous reports, corruption and policy instability also spell trouble, although regarding the latter some problems are slowly receding (including trade policy, as mentioned above). The WEF has had a poor impression of the work of the new antitrust regulator considering that Ecuador is ranked only 124th in the efficiency of the goods market. After five years of "judicial reform," regarding judicial independence, Ecuador is a bottom dweller at 134th, topped even by the Democratic Republic of Congo.

The World Justice Project's 2016 Rule of Law Index notes a similar deterioration of the judiciary. It also compares Ecuador with its high-middle income and regional peers, showing that the legal system underperforms significantly even when viewed only against this theoretically easier background. While the review found the court system uniformly poor, particular drags on Ecuador's judiciary were the lack of constraints on government power, where Ecuador ranked just 103[d], andn “order and security,” where it ranked 97[th]. None of this should be surprising for longtime observers of the present administration. Sadly, president Correa will certainly not carry out significant changes to address these issues in the remaining months of his term. In a best-case scenario, his successor will gain the political mandate in the elections next February 19 to dismantle the institutional hurdles the Correa regime put in place that are contributing to the problems, as well as raising the yields for Ecuador’s debt by increasing country risk.

Pilot of the Airwaves

The massive restructuring of Ecuador’s broadcast market – perhaps unprecedented in the region – has raised fears of political manipulation of radio and television stations ahead of the February elections. President Correa has blasted requests for greater transparency as manipulation or worse; “they will call to threaten, to bribe, to anything, it’s an absurdity,” Correa said November 5. The government, i.e. the regulators Arcotel and Cordicom, will refuse to say who will bid for frequencies under a confidentiality agreement “precisely so that there can be no accord between them, so there is no corruption.” Yet a case of corruption has already made it into the courts, as announced by journalism activist organization Fundamedios this week. Prosecutor Hugo Carvajal late October accused three men, Marcos Miguel Párraga, Diego Arellano, and Tulio Odemar Muñoz, of asking bidders for $200,000 bribes in the name of vice president Jorge Glas and politics secretary Paola Pabón for the assignment of frequencies.

After media began picking up the story, Pabón’s office issued a statement denying any involvement by either official in the matter. In fact, she had already sued for libel given the mention of her name, according to the statement. The case casts even greater doubt over the entire procedure, which poses a threat to freedom of the press ahead of the vote. It’s highly unlikely that Correa, well-known for his micromanagement of government affairs, was unaware of the case before defending the industry reorganization. But the case also could have political repercussions. While Muñoz stems from the private sector, being registered by the corporate regulator as the chief executive of a Manabí province media conglomerate including radio, television, and a newspaper, after working as a CNN Español correspondent to Italy and the Vatican, Párraga worked with vice president Jorge Glas at the vice presidency until June, before moving on to Cordicom, where he resigned when the investigation into alleged influence trafficking began. With this latest scandal, Glas looks like an increasing drag on the electoral ticket (he is the running mate of presidential candidate Lenín Moreno, Correa’s vice president 2007-2013 and the incumbent’s bet for continuity of his legacy). Moreno this week issued a tepid statement in support of Glas, saying that accusations against him are just speculation, but that if hard proof were to emerge, “each of us knows which decision we have to make.”