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ECUADOR WEEKLY REPORT®

KEY INDICATORS

For the week of Nov 21 – Nov 25, 2016

Hey Big Lender

Thirty-two years after the establishment of formal diplomatic ties between the two countries, Xi Jinping became the first president of China to come to Ecuador on an official visit, staying for around 24 hours November 17 and 18. Xi spoke of experiencing a warm welcome from Ecuadorians, but police completely emptied Independence Square in the center of Quito, with the presidential palace on its western side, of people, a highly unusual event that had not happened even with visitors of the likes of the presidents of Belarus, Iran, and Turkey. While the presidents made a show of officially inaugurating the (actually long overdue) \$2.3bn Coca – Codo Sinclair hydroelectric power plant remotely by pressing buttons together, what the visit actually achieved is a mystery given that the parties haven't made the accords signed late November 17 public. For now, the visit appears to have provided little more than a public-relations boost as president Rafael Correa heads into the final months of his term. Not even the highly-awaited loan for the Refinery of the Pacific, currently a \$1.2bn empty plot near Manta, was announced.

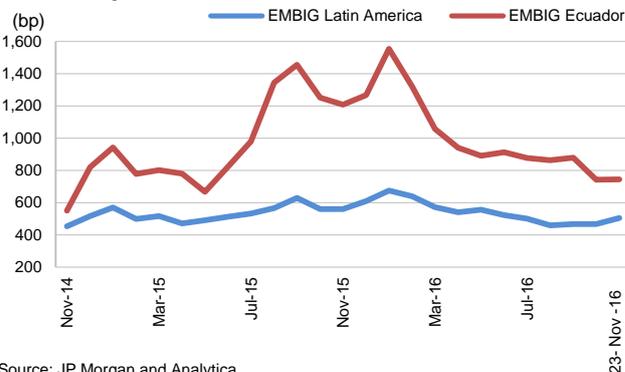
According to their joint statement, China will provide Ecuador with a \$150m donation for the reconstruction of two hospitals destroyed in the April 16, 7.8-magnitude earthquake and for public housing projects in the affected area. Additionally, the two sides agreed to an “integral strategic association,” calling for stronger ties in numerous industries. Xi offered preferential loans and Correa said the Chinese had “expressed their disposition” to finally

Ecuador's Global Bond Prices

Bond	25/11/2016	Oct-16	Sep-16	Last Price						
				Aug-16	Jul-16	Jun-16	May-16	Apr-16	Mar-16	
Global 2020	104.83	106.13	102.51	102.30	100.49	99.38	100.28	95.21	90.54	
Global 2022	104.56	106.11	102.47	102.89	100.03	N/A	N/A	N/A	N/A	
Global 2024	91.76	94.55	90.25	88.05	87.49	87.64	89.44	88.04	82.88	

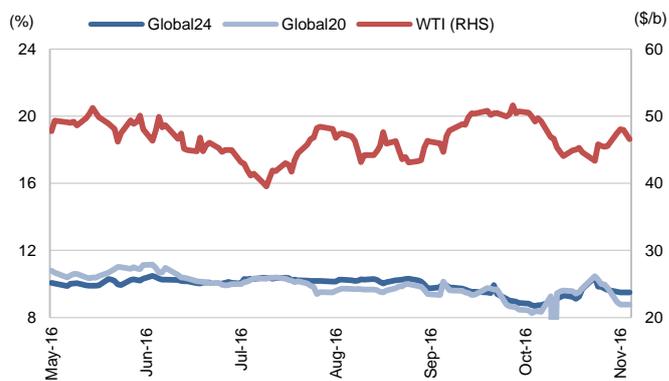
Source: Bloomberg and Analytica

EMBIG Spread



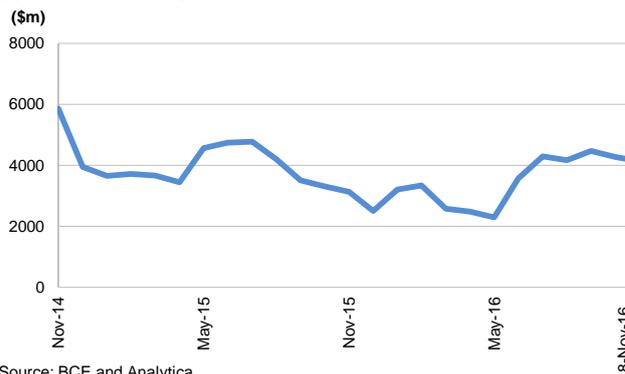
Source: JP Morgan and Analytica

Bond Yields vs. WTI in 2016



Source: Bloomberg and Analytica

International Reserves



Source: BCE and Analytica

lend money for the new, 200,000 barrel-per-day, \$13.5bn Manta refinery (In comparison, the latest expansion of the Panama Canal cost just \$5.45bn). Hyundai Engineering formally said on November 6 that it was in the final stages of negotiating a deal to build the plant for \$10bn with Chinese companies Tianchen Engineering and China Machinery Industry. Hyundai said that the final announcement was to coincide with Xi's visit. But the company likely jumped the gun. No final confirmation of the loan came. Instead, the joint communiqué said that "Both Parties encourage and support the companies and financial institutions of the two countries to negotiate (joint industrial) projects, in accordance with commercial principles and customary international practices, such as the Refinery of the Pacific." Ecuador's banks can't provide funding of this scale and have long been vilified by the government. Neither they nor Chinese companies and banks can be expected to bear the economic risks of the project. It thus looks no closer to completion than it did when the first stone was laid in 2008, although the *correísta* presidential candidate Lenín Moreno has pledged to pursue it.

On his part, Xi in an editorial for government newspaper *El Telégrafo* said that China's investment and financing in Ecuador exceeds \$10bn. "Chinese investment to Ecuador (sic) hit \$6.03bn in 2015," said state television CCTV; the *New York Times* in July 2015 reported that China had "invested billions in Ecuador." These figures however don't add up. Unlike other countries in the region, Ecuador has received almost no Chinese investment. According to central bank data, Chinese companies invested just \$685m in Ecuador from 2007 through 2015, with investment in the oil industry growing but originally beginning under Correa's predecessors. The lone relevant new investment was by Tongling Nonferrous Metals, which bought the Ecuacorriente copper and gold mining project in southeast Ecuador, where violent incidents with the native Shuar people have been frequent. Beyond the interest in oil and metals, the Chinese

have become Ecuador's largest individual creditor, or, as president Correa says, financier, currently with around \$8.6bn in loans, not counting the loans provided in exchange for collateral in the form of oil deliveries.

It hasn't necessarily come easy either. Correa in December 2009 called China "worse than the IMF" due to its financial conditions. In contrast, in front of Xi last week, he applauded what he called the lack of strings attached to Chinese lending. "In granting funding, China prioritizes non-interference and non-conditionality towards beneficiary countries," Correa said. But this policy has included plenty of terms and conditions, namely high interest rates – at close to 7% around double those that multilaterals would charge for similar projects – as well as the hiring of Chinese companies, including staff and other workers. To fund the Correa administration's ambitious infrastructure spending plans, particularly dams for hydroelectric and irrigation projects but also roads, bridges, and even police stations, record high oil prices provided bountiful spending opportunities before 2015 (with the exception of the short-lived slump of 2008-2009). But this wasn't enough for Correa: he attempted to accelerate growth further by raising government debt. Yet by defaulting on \$3.2bn in foreign loans in December 2008, Correa got only short-lived financial relief at a time when Ecuador's debt burden was already low, at around 20% of GDP (additionally, spending needed to complete the debt restructuring buyback in 2009 topped what Ecuador would have had to pay creditors, reducing the level of public spending available for the local economy amid a recession). Even in the medium term, he shot himself in the foot by severing ties with international capital markets, and only China, at a significant premium, was willing to step in to provide funding. Ecuador's debt to China is now 2.5 times greater than the amount on which Correa defaulted, and overall debt-to-GDP at least double the level at the time. Investment implies willingness to buy into Ecuador.

China didn't do this. Correa handed it over on a plate.

Bad Apple Justice

Public opinion in Ecuador got more proof of the precarious state of the judiciary in recent days when videos of public misbehavior of judges went viral through social networks. In the most public case, police arrested Lorena Collantes in an altercation at a restaurant in Guayaquil's middle-class Urdesa neighborhood after she refused to pay a \$126 bill, arguing that she was a judge and civil servant. Videos showed her showering police with expletives in a drunken stupor, interspersed with severe threats including "if you want to die, I can make a (telephone) call and you'll die in 30 minutes," apparently claiming to have the power to hire a hitman. The Judiciary Council, a nominally autonomous body led by former interior minister Gustavo Jalkh, said that she had been fired as a judge a few days earlier for unspecified "manifest negligence." Photographs of her with Viviana Bonilla and Marcela Aguiñaga, both leading members of the correísta political movement, Alianza Pais (sic), quickly found their way onto social networks.

President Correa denied she had anything to do with AP, but a photo showed her at an AP rally, holding a campaign poster in favor of Bonilla and wearing a bright, short orange dress similar if not identical to the one she wore during her public fracas. News opinion site *4Pelagatos* reported that the photos had been taken just hours before the scandal. She said she had been drugged to provoke the incident. Government newspaper *El Telégrafo* however cited several anonymous sources saying that she did, in fact, have issues with abusive language and alcohol, and audio recordings of telephone calls in which she made death threats in the midst of disputes over sexual relations in the court also made their rounds through social networks. According to the government, she received her appointment at court in May 2015, having gone

through the new judiciary training system. Correa said officials at the judicial council told him no third parties had attempted to protect her from being fired. "This speaks well of the cleanliness with which the judicial system is now being run," he told reporters this week. Meanwhile, the interior ministry launched an investigation into who had leaked the videos of Collantes to the public.

Another judge in Guayaquil, Josafat Mendoza, was also filmed in an incident in public. After three women, including a former partner of his, called police, he pushed and slapped the officers. He threatened to kill one of them and, handcuffed, broke a window of the police car while being held inside it, *El Universo* reported, citing the police report of the 12-hour scandal. The initial prosecutor called by police to review the case refused to do so, saying he wouldn't harm him given that Mendoza was a friend and had four children. The next prosecutor however ordered his detention given his aggressive attitude, but at the end of the day, a judge allowed him to go free with the order of presenting himself before the court once a week ahead of his trial. In an interview with the newspaper, Pedro Ortega, the president of the Guayas district court, said that the violent judges were the lone cases he knew of in the most recent three years. He said that the procedures to nominate judges in place since the judicial reforms begun in 2011 were an improvement compared with the past, and that constant evaluations ensure that judges showing a lack of propriety are being removed. On his part, Jalkh vaguely said that the process for the appointment of judges may be reviewed. Nonetheless, long before these incidents happened, the Latin American Foundation for Due Process in 2014, reported that the removal of judges by the Judiciary Council has lacked transparency. "In practice, there is a line of action of the executive power aimed at interfering in judges' decisions on matters of political relevance, severely weakening the division of powers proper to any democratic regime,"

according to the report. With skepticism regarding the independence of the courts mounting, even if they are isolated incidents, these latest events have further undermined the judiciary's prestige, and serve as evidence of a climate of arrogance and abuse of power that has permeated Ecuador's public sector in the past decade.

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