ANALYTICA INVESTMENTS

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Loan Acceleration

In a recent meeting with well-known media editors, president Lenin Moreno complained that the acceleration of Ecuador's government borrowing on the campaign trail was such that he feared it was designed to lead him to fail politically, triggering a return of Rafael Correa, his predecessor, to the presidency. Yet rather than curtail borrowing, his economic team is putting their foot down even harder. This month alone, new issuance and other financial deals have totaled a whopping $4.24bn, including a record $2.5b sovereign bond.

Aside from the bond, in order of size, the borrowing included $640m from the Latin America Reserve Fund, a regional multilateral current accounts lender; $500m in a transaction signed with Goldman Sachs just days before the bond issue and included in the fine print of the bond prospectus; $400m as a loan by the Central Bank of Ecuador (BCE) to state-owned BanEcuador to help fund the president's public housing scheme; and $200m from the Bank for International Settlement as a short-term liquidity loan. Under Moreno, debt has thus swelled by around $6bn.

While under markedly different political circumstances – Moreno appears to be pushing for an exit from his predecessor's authoritarian regime – much like Correa, he appears bent on not losing credit with voters by seeking money from creditors, keeping the spending machine going with only token cutbacks. Just four people accompanied him to the

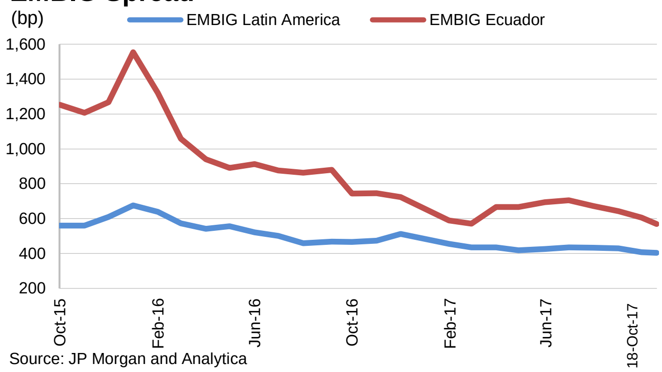
KEY INDICATORS

Ecuador's Global Bond Prices

Bond	Last Price (end of the month) 20-Oct	Sep	Aug	Jul	Jun	May	Apr
Global 2020	109.06	108.03	107.39	106.12	105.83	105.58	107.50
Global 2022	113.13	111.77	110.05	108.20	106.83	107.41	108.63
Global 2023	104.72	103.39	102.34	100.12	98.55	-	-
Global 2024	100.79	99.14	98.22	95.60	93.52	95.05	95.58
Global 2026	107.92	105.60	105.25	102.56	100.71	101.11	102.29
Global Jun 2027	107.02	105.04	105.01	102.60	100.30	-	-
Global Oct 2027	101.77	-	-	-	-	-	-

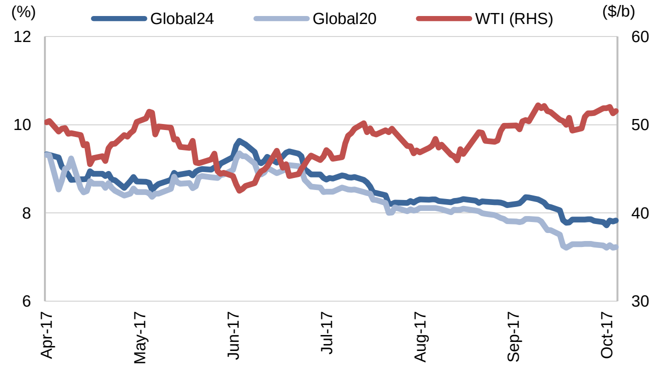
Source: Bloomberg and Analytica

EMBIG Spread



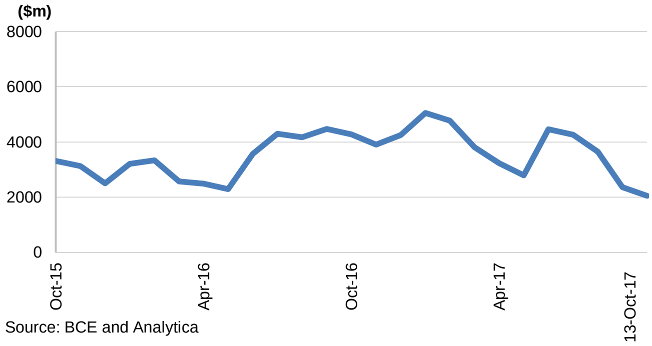
Source: JP Morgan and Analytica

Bond Yields vs. WTI in 2017



Source: Bloomberg and Analytica

International Reserves



Source: BCE and Analytica

United Nations' General Assembly, compared with the dozens Correa would ferry to overseas stints, often in more than one plane, as an example of austerity, but cutbacks he has announced in the recent past will amount to only about $500m. Indeed, the electoral campaign for Moreno's referendum, aimed at legally blocking Correa's eventual return, has started de facto.

The new ten-year bond issue obtained a single-digit interest rate of 8.875% and $500m more than announced in initial guidance. Domestic analysts tend to express surprise at the willingness of the external market to snap up Ecuadorian bonds given not only the country's track record as a "serial defaulter," but also given the lack of progress in economic reform. Some foreign analysts continue to be willing to give Moreno the benefit of the doubt, pointing to his apparent interest in combatting corruption, starkly exemplified by the jailing of vice president Jorge Glas amid the investigation into corruption by Brazilian construction firm Odebrecht. Also, Ecuador was willing to sweeten the offer given that the existing 2027 bond had a yield of 8.5% on October 17. Thus, 2027 will be an expensive year for whoever is in power then. The amount of debt maturing then will be around $7.7bn, with $3.9bn in domestic and $3.8bn in foreign debt.

On the positive side, the latest issue showed Ecuador able to extrict itself from its years of reliance on Citi for bond sales, instead working with three banks, JP Morgan, Deutsche, and Credit Suisse. It´s not clear however that we know the full extent of the financial terms, including commissions and fees. Ecuador was also able to take advantage of the window of opportunity presented by oil prices near $52 for West Texas Intermediate, the benchmark for Ecuadorian crude, their highest level since last April. Additionally, the market will appreciate Ecuador's willingness to operate as an OPEC maverick to obtain greater resources. This week, market-friendly oil minister Carlos Pérez said he will request OPEC to dispense Ecuador from fulfilling its obligations in the OPEC-non-OPEC deal to limit production, as other countries have in the past.

We could however be reaching the end of the flagpole. It's not clear that market conditions will exist next year to once again buy up some $5bn in Ecuadorian bonds next year. Unwinding of aggressive monetary policy by major international central banks poses uncertainty for the market. Even though the end result led to a bumper sale, there was some grumbling in the market about the amount of Ecuadorian bonds already trading. The latest gold deal with Goldman Sachs meanwhile compels Ecuador to pass more than $1b in assets to the bank as collateral, including 300,000 ounces of gold, in a three-year deal made all the more unusual given that the finance ministry and central bank had to carry out a foreign bond issue of close to $600m to provide the required bonds. The interest rate for the $500m obtained from Goldman Sachs is LIBOR 6.12%, finance minister Carlos de la Torre told *El Comercio*. Even with this week's bond sale, the ministry needed this deal to complete funding for the year, he added - a worrying statement considering the recent scale of borrowing and the complicated nature of the transaction, which will strengthen critics of economic policy. The central bank's involvement, with publications forcing it to belatedly explain swings in reported gold holdings, compound the skepticism among local analysts. The International Monetary Fund's team is set to have an interesting visit reviewing Ecuador's books in the coming weeks. Perhaps it will be able to tell Moreno who is setting him up to fail, and what he might do about it.

Goodbye to Bromance

Announced with a fanfare that is difficult to understand given the weakness of its content, last week's presidential economic policy package has led to frostier ties between the administration and the private sector. Disappointed that the months of talks and around 1,500 suggestions found so little reflection in the program has done some earnest damage because, for domestic businesses, the delay in coming to real grips with the economic situation is costly. But the political reality puts reform on the back burner. According to Richard Martínez, president of Ecuador's Entrepreneurial Committee, the failure to announce more after holding such extensive rounds of discussions has forced business leaders to rethink their relationship with the administration. The hard work was "in the end blurred by the economic team that wants to do more of the same, i.e. raise taxes and increase restrictions on commerce." The disappointment will lead them to speak to other instances, in particular legislators, to warn against measures that could inflict further damage on the economy, according to Martínez.

Hastily, the administration sought to patch up the blow this week with an event at the presidential palace in which a small business representative from Pichincha and one representing the labor sector, the so-called Labor Parliament, signed a "National Accord for Production and Employment" with industry minister Eva García. Here, again, details were vague, and Moreno leaned out of the window to dispute protests that the new commerce policy of setting a ten-cent duty on each imported unit would weigh heavily on wheat imports. Rodrigo Gómez de la Torre, a dairy farmer and president of an agricultural chamber, in a radio debate bluntly told finance minister Carlos de la Torre that the economic team is muddling the message, with some officials saying the duty would be per ton, but others saying per kilo, as just one example of the uncertainty businesses face.

But given that Moreno is facing a crucial election – the referendum he called will likely go ahead in January or February – potentially painful reforms have been put off. All things considered, Moreno's position is understandable, but he looks ill-advised at having put forward these so-called economic measures with such unwarranted ballyhoo. It's a shame that the depth of the crisis caused by a decade of rampant populism apparently needs another dose of politicking to solve. By playing to a hard-left audience in recent weeks, Moreno has lost prestige with political centrists and entrepreneurs. He will be at pains to repair the damage.