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**ECUADOR WEEKLY REPORT®**

**KEY INDICATORS**

**For the week of Nov 6 – Nov 10, 2017**

**Explosive Package**

Even president Lenin Moreno appears to be having second thoughts about a series of changes to tax and other economic rules he submitted to the congress last week under fast-track "emergency" rules. "Some measures have had to be a bit hard," Moreno this week told business leaders in Quito. "It's possible we may have erred." The congress now has 30 days to rubber-stamp, reform, or strike down the law, otherwise it will go into effect automatically.

Moreno had announced the measures as a "reform package" last month, including measures to boost employment and attract capital held overseas. An increase in the corporate income tax by three points to 25% (28% if a company is headquartered in a constituency Ecuador's tax authority considers a tax haven) and a confusing announcement to set up a new import duty regime overshadowed it. Moreno's economic team defended it as a boost for the overwhelming majority of companies, whose minimum income taxes were to fall. Rafael Correa, Moreno's predecessor, imposed minimum income taxes, which Moreno questioned on the campaign trail. Nonetheless, it remains intact for larger companies and is now be extended to high-income professionals earning at least \$300,000 a year. The tax and duty increases aim to increase government revenue by \$1.4b annual and are necessary to keep schools and hospitals open and the fault of the economic mismanagement of his predecessor, Moreno said.

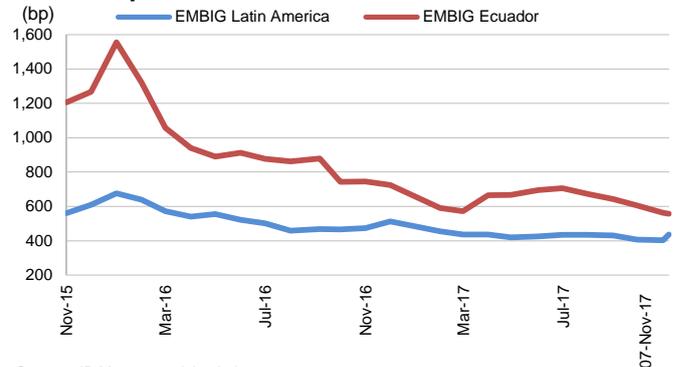
But the final wording reads like a wish list of

**Ecuador's Global Bond Prices**

Bond	Last Price (end of the month)					
	10-Nov	Oct	Sep	Aug	Jul	Jun
Global 2020	108.04	109.10	108.03	107.39	106.12	105.83
Global 2022	113.34	113.13	111.77	110.05	108.20	106.83
Global 2023	105.93	104.90	103.39	102.34	100.12	98.55
Global 2024	100.83	100.89	99.14	98.22	95.60	93.52
Global 2026	108.63	108.04	105.60	105.25	102.56	100.71
Global Jun 2027	102.36	102.00	105.04	105.01	102.60	100.30
Global Oct 2027	107.18	107.18	-	-	-	-

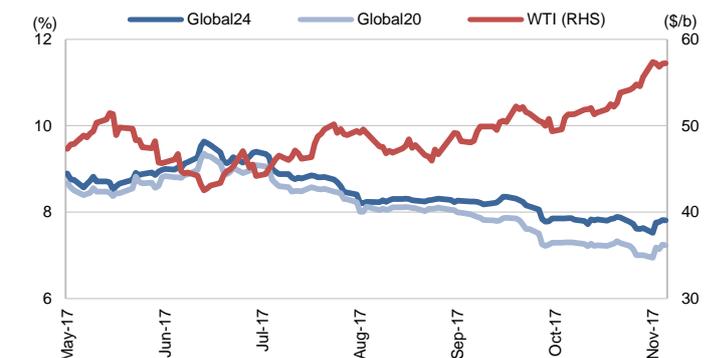
Source: Bloomberg and Analytica

**EMBIG Spread**



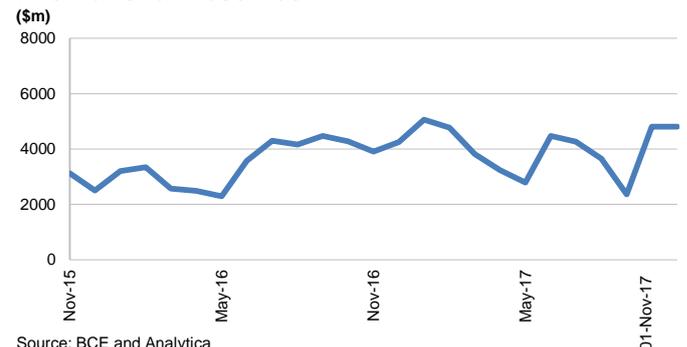
Source: JP Morgan and Analytica

**Bond Yields vs. WTI in 2017**



Source: Bloomberg and Analytica

**International Reserves**



Source: BCE and Analytica

correísta anti-capitalist bias. Beyond the previously unannounced minimum taxes for high earners, it includes an income tax increase of up to \$6,774 per year for people who earn more than \$3000 a month – hence, more than two full salaries – if they are childless. Every payment of more than \$1000 must be made via a bank. Monthly cash withdrawals of more than \$4000 will be taxed and the monetary board, the top monetary regulator, will have the right to restrict them altogether. Mining companies, too, will be affected by the income tax increase unless they sign new investment contracts through 2019. Shareholders are to become legally responsible for their share of ownership of a company in cases of tax fines. Regarding the issue of public health, thanks to the new duty regime, imported syringes will get a 50% duty, with similar surges affecting all kinds of goods in time for the Christmas retail season.

The above details are only a partial list of what Moreno has asked the congress to approve. It adds to the mass of red tape legal businesses have to deal with in Ecuador, worsening the climate in a country now at just number 118 out of 190 in the World Bank's "Doing Business" annual business ranking. Newspaper *El Universo* called on legislators to negotiate and to improve the text to salvage positive aspects, above all to end a tax on rural land. More and more however, Moreno appears to be following misguided economic advice of his predecessor – entrapped, as it were, in trying to solve the woes of correísmo by applying more correísmo. Prey as he appears to be to these advisors held over from Correa, he could easily put back anything legislators remove through his vast veto powers, and the National Assembly will be unlikely to be able to overrule him with a two-thirds majority. Under these circumstances, fixing it in the mix, as one might say in the recording industry, is unfortunately not an option.

### **Another Misfire**

It wouldn't be surprising if Petroecuador were to

install a revolving door at its executive offices. Carlos Tejada, the company's head of refining, this week succeeded Byron Ojeda, thus becoming the state-owned oil transportation and sales company's fourth chief executive since March. It's unclear why Ojeda left; state-owned newspaper *El Telégrafo* cited health reasons, but the company had originally called a press conference for the same morning that he departed, and he seemed in fine health, jovial and forthright (perhaps just a little too much so) during his remarkable recent press conferences. His departure is a clear setback.

Petroecuador has experienced a tumultuous decade. Thanks to Ecuador's deeply ingrained, economically ineffective statism, it has failed to go through the modernization that other state-owned companies in the region have pursued. It instead became mired in the corruption that accompanied the dismantlement of institutions under Rafael Correa. Alex Bravo, a youthful former chief executive, was found guilty of corruption; his successor, Pedro Merizalde, is also under investigation but left the country on January 29 (Correa kept him on as CEO until March 20, and Merizalde has yet to return to Ecuador). Under Correa, the company had 11 CEOs, including two navy admirals. It embarked on a series of pricey projects that resulted in disaster, as diagnosed in the half year that Moreno has been in office.

Ojeda, a trained engineer and former schoolmate of Moreno at Quito's Mejía school, came to the helm of the company as a complete outsider. Before taking on Petroecuador, he managed an audio company in Quito. He found running Petroecuador daunting, especially considering the company's importance for Ecuador's overall economy, once joking that the responsibility was so frightening that he had better quit. Indeed, the number and scale of problems is enormous. The company wasted some \$4b on infrastructure projects that have been exposed as wasteful shams. The 110,000 barrel-a-day

Esmeraldas refinery, refurbished for \$2.2b, is hardly, if at all, better than before, still producing 50% residue sold off at barrel-bottom prices as "fuel oil," as well as high-sulfur fuel. The storage tanks are in abysmal shape. Meanwhile, nothing came of the \$1.5b spent on a refinery near Manta except a vast empty lot and a pipeline, works now suspected to have been handed to Odebrecht, the Brazilian construction firm at the center of a major international corruption scandal, thanks to bribes. Under Ojeda, Petroecuador cancelled a contract with Odebrecht for a gas pipeline between Guayaquil suburb Pascuales and Cuenca due to more than 100 flaws, while costs more than doubled to \$600m. Petroecuador as majority shareholder in the Manta project also summarily fired the project's CEO, Bismark Andrade, and said it might sue him.

Beyond investigating misdeeds of the past decade, Ojeda's management undertook a review of the eight oil-backed loans from China and Thailand and other financial deals, finding that it even lacked the original document confirming a \$1b loan. It still owes them some 500m barrels of oil. The successful spot sale undertaken under his administration, the first since 2014, gave the company leverage to dispute the discounts agreed in deliveries. Petroecuador also says that technical changes in the contracts make them impossible to comply to the letter. These negotiations will continue, the oil ministry said in a statement following Ojeda's resignation. More generally, Ojeda was also trying to solve the basic question of its relationship with its state-owned upstream sister Petroamazonas. That company was born in 2006 out of the assets seized from US oil company Occidental Petroleum and later took over the oil production of Petroecuador and the Ecuadorian assets of Petrobras (the Occidental assets led to a \$1b loss before international arbitration tribunals Ecuador had to pay last year, while the Petrobras case remains in court). Ojeda had aimed to have clarity over the very basic question of

how oil deliveries and sales are booked between Petroamazonas and Petroecuador by the end of this year to allow the latter to seek independent financing.

Ojeda's management, with a combination of technical experts from inside the company and outsiders, along with that of oil minister Carlos Pérez, a career private-sector oilman, awakened hopes of serious change in the industry, which in an OPEC country of course has major exemplary impact. While this may yet go ahead at Petroamazonas, Ojeda's departure therefore casts doubt whether the downstream company can indeed gradually modernize, given the instability at the helm. Though he has a great sense of humor, it's not clear that Ojeda's successor, Carlos Tejada, will be able to run the company for a meaningful length of time. Tejada adamantly supports Petroecuador's refining operations (himself having previously run that part of the company) despite its total economic and environmental failure, while Pérez is a sceptic of the low-margin industry (we have previously also questioned refining in Ecuador). Even in the low-price environment, the government's economic officials have refused to consider reforming fuel subsidies, let alone scrapping them. Moreno this week authorized a fuel subsidy for airlines willing to fly to white elephant airports. And these same officials continue to force Petroecuador to bear the brunt of the previous administration's economic decisions: Asked by a correspondent this week about the renegotiation of the oil-backed loans, finance minister Carlos de la Torre bluntly responded that that wasn't "a state matter, it's a corporate matter up to Petroecuador," even though he was reminded by the journalist that Moreno himself said that he had raised the issue with Chinese president Xi Jinping a year ago. But the government has been happy enough to pocket the money the company provides – or the loans it is paying for.

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