ANALYTICA INVESTMENTS

Ramiro Crespo
Chairman of the Editorial Board
WEEKLYREPORT@ANALYTICAINVESTMENTS.COM

ECUADOR WEEKLY REPORT®

For the week of Apr 2 – Apr 6, 2018

Clutching at Straws

Late Monday, president Lenín Moreno outlined his long awaited economic reform plan, promising to scrap ministries and secretariats, eliminate red tape, and to cut spending by $1b annually without increasing taxes. He said Ecuador was willing to speak with creditors including unspecified multilaterals. Domestic analysts saw important positive steps forward, notably, a pledge to phase out the hated currency export tax and easing of problematic labor market rules. Conservative opposition leader Guillermo Lasso welcomed the message as an acknowledgement that economic policy can't continue to follow the populist past decade's path any longer and must unshackle the private sector to rekindle growth. Foreign analysts however unanimously said the plan falls short of creating conditions the bond market and other foreign investors will embrace. A wordy press briefing by finance minister María Elsa Viteri did little if anything to clarify the government's intent. The plan ends up leaving people wondering whether the glass is half full or half empty.

Moreno in fact was less optimistic than in the past regarding his administration's ability to get the titanic deficit spending of his predecessor under control. Last year's deficit was near 6%, well above the 4.7% target, and will hit 5.64% this year, according to Moreno's new goal. At 2.47%, his new deficit target for 2021 is also less ambitious than the sub-2% goal of the past. The spending side is also the least clear part of the plan. Seven of 22 public companies are to

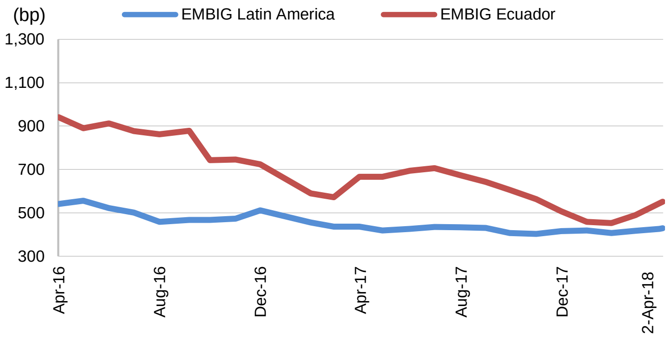
KEY INDICATORS

Ecuador's Global Bond Prices

Bond	Last Price (end of the month)						
	2018				2017		
	6-Apr	Mar	Feb	Jan	Dec	Nov	Oct
Global 2020	108.68	108.42	108.75	109.98	110.94	109.64	109.10
Global 2022	112.11	111.06	113.07	116.32	117.48	115.86	113.13
Global 2023	104.33	104.68	106.64	110.12	110.67	108.46	104.90
Global 2024	100.40	100.70	102.06	106.04	106.60	104.42	100.89
Global 2026	106.32	107.37	110.44	114.40	115.03	112.45	108.04
Global Jun 2027	105.72	107.08	110.35	113.76	114.73	111.66	107.57
Global Oct 2027	100.64	102.19	105.58	109.17	109.90	106.82	102.40
Global 2028	94.73	96.76	99.23	102.04	-	-	-

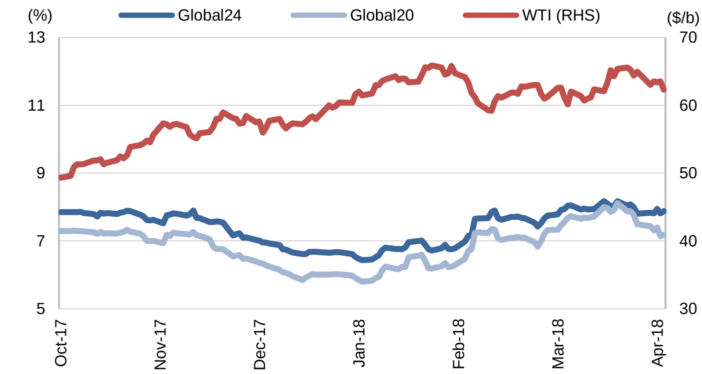
Source: Bloomberg and Analytica

EMBIG Spread



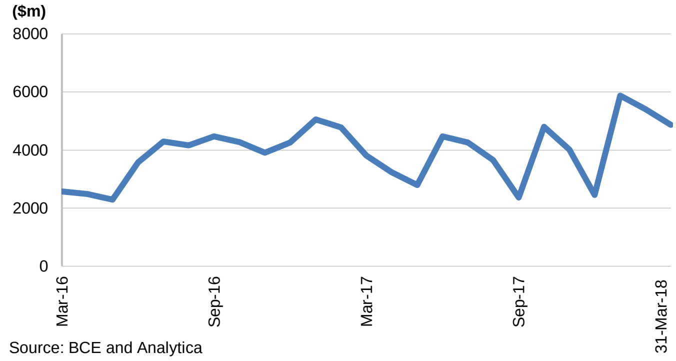
Source: JP Morgan and Analytica

Bond Yields vs. WTI



Source: Bloomberg and Analytica

International Reserves



Source: BCE and Analytica

be shuttered, but these are most likely to be some of the economically insignificant ones like ENAMI, the fledgling national mining company, or FABREC, a manufacturing company best known for producing shoddy police uniforms. Similarly, Moreno this week replaced the IEPI intellectual property office (a necessary function) with a new secretariat doing the same job. Closing public offices will have no impact if it simply means maintaining current staffing – in fact, that kind of reorganization would cost money. A clear number on the headcount reduction and corresponding savings (after compensation for layoffs) would provide a much-needed signal to the market. Unfortunately, that appears to remain a work in progress. More details of the plan are due to be released over the coming two weeks, once again asking markets for patience (please see our *Ecuador Monthly Report* for further information).

On the income side, the government had somewhat more to say. A new tax amnesty, the second since 2016, aims to provide the government with short-term one-offs, along with an acceleration of tax cases in the courts. Piecemeal measures including charging the value-added-tax on energy-saving bulbs and insurance and reinsurance and slowing depreciation of vehicles, will combine for a small $100m in added annual income, while once again kicking the insurance industry. In total however, the added income aims to more than offset the near-billion in cost savings. While this begs the question whether there will be any savings at the bottom line, an additional factor Viteri mentioned only in passing was the reinstatement starting in 2019 of the 40% subsidy for the Ecuadorian Social Security Institute, which will cost another $1b annually, doubling the pressure on the spending side from the $1b Moreno pledged. The budget is currently close to $35b.

Regarding the issue of debt, the situation remains overshadowed by the debt audit being carried out by the comptroller general's, whose findings will be announced at 10 am Quito time on April 9. In her press conference, Viteri said the country needs to acquire another $4.5b this year. A major part of that will certainly have to come from bond markets. Tantalizingly, the plan includes “multilaterals” and a debt negotiation with China, while Viteri said that she had few options particularly with the bond market. She refused to repeat the sensible pledge of her predecessor, Carlos de la Torre, who spoke of full compliance with commitments and gradually improving Ecuador's debt profile with longer maturities and lower rates. While de la Torre never got spending under control, Viteri at least said constant monitoring would let her step in if targets aren't met. But her unnecessary statements on wanting to reduce the weight of the commercial debt load while failing to explain measures beyond “liability management” have not contributed to building confidence among bondholders. This may well translate into investors demanding higher rates when she moves to sell more bonds in the near term. Viteri also said that she thinks that the audit being undertaken by the comptroller general's office is wrong to book the oil-backed loans from Asia (mostly China) as debt rather than as “commercial operations,” as they were called when they were started in 2010. The preliminary audit report in detail explained the potentially illegal nature of offloading this interest-bearing debt of at least $8.2b.

For the economy in general, Moreno offered some welcome signals. After insisting late last year that the currency export tax, one of the biggest hurdles to foreign direct investment, would remain in place, he said it would be phased out. Viteri however made it clear that this was contingent on the “private sector balance of payments” and stressed the need for temporarily higher duties on a group of up to 375 goods to push the trade balance into the black. This makes it unlikely for the ISD to end soon, if ever, under Moreno. Another problem with her message was that she insisted that the private sector, which according to the self-declared socialist regime of the past decade was finally made to pay taxes, do its part to exit a crisis entirely of government making. For the plan to become a core of economic recovery, it needs fixing in congress. That will include the promised capital markets reform and restoration of shareholders' rights, a key step to integrate Ecuador's capital market with the Alliance of the Pacific group of countries stretching from Mexico to Chile (Moreno also promised other trade accords). If this plan is really all the Moreno administration can conjure up, it should be flanked with a major shift in foreign policy away from its support of hardline socialist and authoritarian governments like Belarus, Cuba, and Venezuela towards reliable ties with longtime real commercial partners. A first step would be to show Julian Assange to the door of Ecuador's embassy in London.

Cutting the String

The new, temporary "Citizens' Participation and Social Control Council" has begun to flex its muscles. Since voters and congress installed independent new leadership there under jurist Julio César Trujillo, it has removed two controversial regulators. First, it fired Carlos Ochoa, the media regulator. This week, it fired former finance minister Patricio Rivera, a key figure in public finances in the past decade. Rivera had treated his most recent appointment, to be superintendent of the "popular and solidarity" part of the economy, as his personal decision, flaunting a deadline to officially take on the position. It cost him the job and removed his protection from prosecution. The CPCCS now is taking on the powerful Gustavo Jalkh, head of the Judicial Council, which oversees the courts, and will move on to the National Electoral Council and Constitutional Court (CC) in due course.

According to non-governmental organizations specializing in law, Jalkh played a key role in imposing control over the courts by president Rafael Correa (2007 – 2017). The council fired dozens of judges using a figure called "inexcusable error" as a discretional tool. As demonstrated in leaked e-mails, Jalkh systematically carried out Correa's orders to influence the judiciary. On April 4, the CPCCS gave Jalkh, along with the prosecutor general, Carlos Baca (currently facing his impeachment trial in congress), banking regulator Christian Cruz, and the members of the National Electoral Council a week to submit performance reports. It postponed a last-ditch effort by the Judicial Council to name dozens of new judges and prosecutors and hundreds of new administrative officials. "The cheating contests that no one trusts, least among them qualified people, are over," said Trujillo, supported by the revelation of comptroller general's report that provided concrete evidence of how Jalkh's office had manipulated contests in the past. Jalkh protested, calling it a "de-facto" measure.

Indeed, the CPCCS's swift moves have led to debate amid legal experts. Fundación Ciudadanía y Desarrollo, an NGO, has strongly criticized the rules the CPCCS has issued to govern its evaluation of officials. It says the CPCCS may not judge the heads of organizations such as the CC since this wasn't specified in the February 4 referendum that lead to the overhaul of the body and its temporary right to review recent appointments. It also says the rules allow the panel to make highly discretional decisions. Other lawyers however argue that the public intended for a wholescale review of top officials, both legal and regulatory, to cut through the legal web spun by Correa to guarantee impunity for graft and other crimes committed by officials during his regime. Under this perspective, the imperfect CPCCS looks rather unlikely to do worse than its predecessor.