

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

ECUADOR WEEKLY REPORT®

KEY INDICATORS

For the week of May 14 – May 18, 2018

Tectonic Test

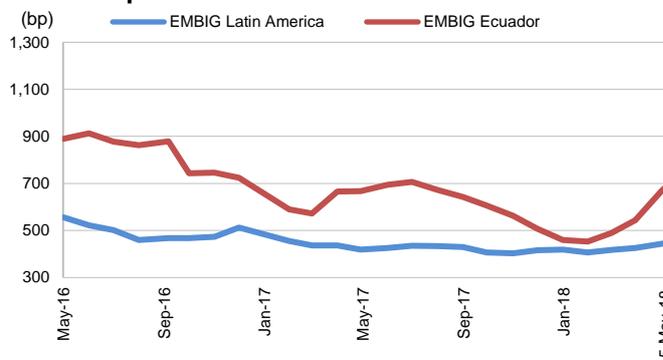
With debt woes mounting and his poll ratings diving, President Lenin Moreno has made a bid for a 37-year old economist to guide Ecuador out of its government-created fiscal and economic quagmire. In his first few hours in office, Richard Martínez, who has spent more than a decade working in high-level position for business associations, immediately said the right words to calm bond markets. He nonetheless faces high hurdles towards getting Ecuador's economy, derailed for more than a decade, to rekindle the pre-2007 growth that would be essential to getting poverty reduction on a sustainable footing. Moreno's surprise decision also marks an unexpected shift towards the political center, sadly still without including foreign policy, which remains tilted towards supporting dictatorships in Nicaragua and Venezuela.

Martínez firstly pledged that Ecuador would keep current on its debt, both in terms of its amounts and of its maturities. While this welcome statement repeated what Carlos de la Torre, Moreno's initial finance minister, said before being replaced in March, Martínez also pledged a gradual pruning of the state that de la Torre refused to consider and an aggressive effort to reduce country risk. He added that the finance ministry will provide transparent data and immediately began to publish debt reports suspended in January. Eighteen recommendations regarding debt made by the comptroller general in a special examination of debt will be fulfilled within the near term. Martínez replaces María Elsa Viteri, whose stay in the office was only two months, but long

Bond	Last Price (end of the month)						
	2018				2017		
	18-May	Apr	Mar	Feb	Jan	Dec	Nov
Global 2020	102.10	103.10	108.42	108.75	109.98	110.94	109.64
Global 2022	103.05	105.54	111.06	113.07	116.32	117.48	115.86
Global 2023	95.80	97.89	104.68	106.64	110.12	110.67	108.46
Global 2024	92.02	94.11	100.70	102.06	106.04	106.60	104.42
Global 2026	97.02	98.50	107.37	110.44	114.40	115.03	112.45
Global Jun 2027	96.91	98.11	107.08	110.35	113.76	114.73	111.66
Global Oct 2027	93.02	94.36	102.19	105.58	109.17	109.90	106.82
Global 2028	87.69	88.53	96.76	99.23	102.04	-	-

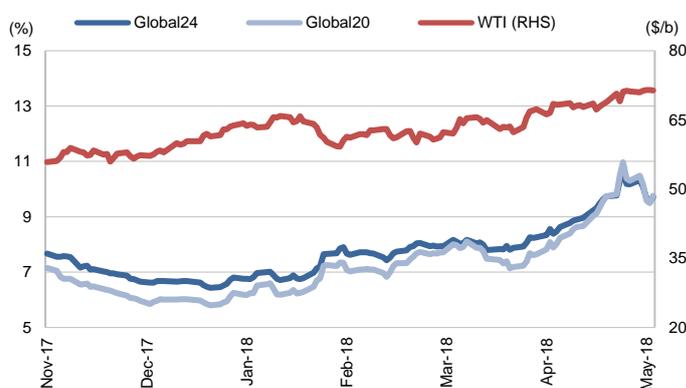
Source: Bloomberg and Analytica

EMBIG Spread



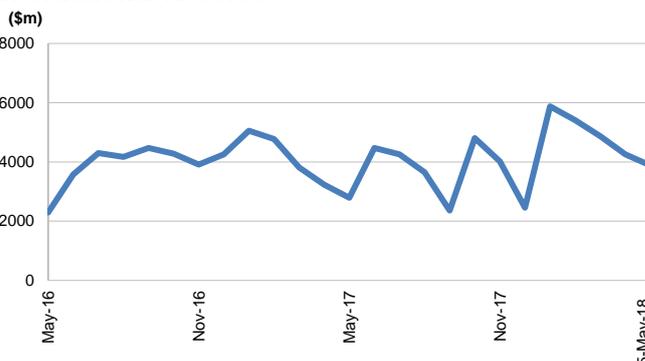
Source: JP Morgan and Analytica

Bond Yields vs. WTI



Source: Bloomberg and Analytica

International Reserves



Source: BCE and Analytica

enough to make Ecuador's bonds the worst among emerging markets. Hopefully, her abysmal performance has served to wean Moreno from continuing the failed socialist-populist economic ideas he couldn't let go of during his first 11 months in office.

This week, the finance ministry will hand the president a draft to rescind a decree by Moreno's predecessor (and Viteri's mentor), Rafael Correa, that in 2016 artificially raised the debt ceiling by refusing to acknowledge debt owed other public-sector institutions like social security. The arbitrary existing limit on debt – 40% of GDP – should be replaced in due course by a technical one guided by Ecuador's capacity to repay its debts. Ecuador will have to continue to raise debt given the ingrained structural deficit, Martínez has also indicated. That will mean obtaining a total \$8.2-\$8.3b this year and possibly more. If he manages to keep debt to new issuance to that level, this will be legally covered by the current budget. If more, then he will seek parliamentary approval, which will demand a debt sustainability plan he should already be working on anyway, as well as more friendly lenders, who have yet to be won over given the large amount of bonds Ecuador has sold since returning to the markets in 2014.

Before Moreno gives his state-of-the-nation speech on May 24, the government will also submit its long overdue economic reform plan. Critics have mentioned Martínez's youth and lack of public-sector experience as potential issues undermining his ability to tackle his mammoth job. Under Correa, Martínez was among the more restrained, low-key leaders of public enterprise, and he understands regulatory requirements well, as well as the over-regulation that hamstringing entrepreneurship of all scales. His negotiating skills will likely be tested by Ecuador's congress, which lacks a clear structure as Moreno's Alianza PAIS (AP) has no outright majority and continues to vote with its self-declared strongest opponents, the AP faction that supports Correa. The

Morenista group has voted with the opposition in cases where the president has vocally stated certain policy objectives, such as unwavering support for the temporary Citizens' Participation and Social Control Council that is rooting Correísmo out of the judiciary. In the few days remaining before the speech, Martínez will also have to advance on building the technical team he has promised to bring to the ministry. To pledge to comply with the comptroller's debt audit seems like a no-brainer as it will bring transparency long overdue to public data. Politically, it will put the Correístas on the defensive and might well provide embarrassing information the administration could leverage to help push the nominally left-wing Morenistas to support economic reform.

Moreno's move reaches out radically towards the business sector to help get Ecuador out of the mess statism got the economy into. Martínez speaks a language that will finally allow the dialogue that Moreno insists is the hallmark of his government to go forward. For all the meetings held during the president's first year in office, the refusal to call debt and other fruitless grandstanding particularly by Viteri made it impossible to bridge conceptual gaps. It may also allow him to enlist the private sector, whose most influential voices, contrary to Correísta claims, have refrained from calling for extreme austerity measures that will hurt the economically weakest and reinforce economic problems if applied too swiftly. Martínez knows their positions by heart. He is also readying conversations with multilateral lenders, credit ratings agencies and bondholders to improve communications practically frozen for a decade. He is in fact the first economically "orthodox" minister since at least 2005.

Of course, Ecuador hasn't had a non-populist administration in 15 years. Martínez's arrival won't necessarily change that. He continues to build his economic team, and, along with oil minister Carlos Pérez and foreign trade minister Pablo Campana and, perhaps, tourism minister Enrique Ponce, still forms

something of a centrist-conservative minority in the 26-member cabinet. Moreno and Martínez have both spoken of national unity to fix the economy. Notably, when he swore in his new cabinet – little-changed except for Martínez's entry – Moreno didn't promise to avoid austerity measures for which he has used the bugbear term "*Paquetazo*." Yet for all the approval he has won by the simple fact of accepting one of Ecuador's most difficult public-sector jobs, Martínez faces ingrained left-wing challenges to substantive change and a potential backlash if the economy falters or adjustment fails to provide results quick enough for the impatience and short memories of Ecuadorians.

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The protracted case of Wikileaks founder Julian Assange showed a few new twists in recent days through a series of articles published by Ecuadorian investigative news sites *Milhojas*, *PlanV*, and British newspaper *The Guardian*. Much of the information was largely known earlier, but the reports added relevant information regarding how Assange turned the embassy into a focal point of international espionage. In a first reaction to news that Ecuador under president Correa spent at least \$5m to protect but also to spy on Assange in "*Operation Hotel*," president Moreno ordered security for the embassy to be downscaled to no more than the security at any embassy worldwide. The reports said that they found additional evidence that Russia provided hacked e-mails from the US Democratic Party that Wikileaks subsequently published, undermining the presidential bid of Hillary Clinton. *The Guardian* notes that the most likely intermediary to pass the information from Russian spies to Assange was UK populist Nigel Farage, one of the leading proponents of Britain's exit from the European Union. Spanish security contractor UC Global meanwhile had the espionage contract to provide surveillance on Assange.

According to the media reports, Assange hacked the embassy's communications, which is a crime in Ecuador. This again complicates the situation: Assange is wanted in the UK for skipping bail. Now Ecuador, which granted him citizenship in 2017, could want him for a separate crime (one of the reporters, Fernando Villavicencio, was falsely accused by president Correa of having hacked his e-mails). A trio of Quito-based actors – Pablo Aguirre, Christoph Baumann, and Alfredo Espinosa – are currently spoofing the situation in a political satire show, with the tall, German-born Baumann playing the Australian hacker (who refuses to be called a hacker). Other authors will undoubtedly someday have a field day with this equally serious and farcical espionage episode. It was previously already odd for Assange to be enjoying asylum as an Ecuadorian citizen inside an Ecuadorian embassy. If he really is as ill as the Ecuadorian side purports, he might not even serve time in a British jail if he were to leave the embassy in the first place. But as things now stand, it looks like Ecuador should be asking the UK for safe passage to extradite him to stand trial here for hacking the foreign ministry's communications.

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