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**ECUADOR WEEKLY REPORT®**

**KEY INDICATORS**

**For the week of Jun 25 – Jun 29, 2018**

**Glass Half Full**

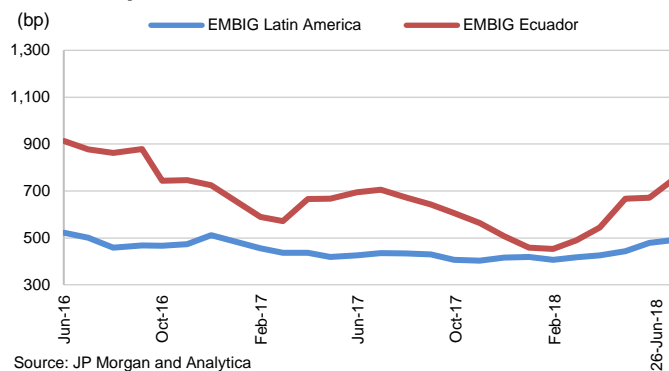
After being passed by congress last week, the fast-track economic bill is now in the hands of president Lenin Moreno, in practice in those of finance minister Richard Martínez. Thanks to the 2008 constitution, the president has a massive line-item right to veto the bill that basically would allow him to rewrite it completely, with legislators then having to create a two-thirds majority to overrule him. We don't expect either to happen, with relatively few corrections and no two-thirds majority likely from congress. The congressional debate and its outcome was an example of legal sausage-making that Ecuador at this stage can live with.

As we reported previously, the law seeks to tempt companies to invest in the near term as well as to allow the government to receive additional funding this year from a tax amnesty. Shortly before the congressional debate on the law, the government celebrated a commitment by dozens of companies to invest a combined \$9.5b over the coming three years. The law also bans the central bank from lending to the government and strengthens shareholders' rights. Otherwise, the law eases some regulations for the construction of low-income housing, with legislators piling on tax breaks here and there in exchange for their votes, as reported in his refined prose by Roberto Aguilar in *Expreso*. It passed with the Morenista bloc in congress supported by its tacit allies, the Social Christian Party and SUMA, the political vehicle of embattled Quito mayor Mauricio Rodas (EWR896).

Bond	Last Price (end of the month)						
	29-Jun	May	Apr	2018	Feb	Jan	2017
Global 2020	102.24	104.12	103.10	108.42	108.75	109.98	110.94
Global 2022	102.55	105.36	105.54	111.06	113.07	116.32	117.48
Global 2023	93.71	97.75	97.89	104.68	106.64	110.12	110.67
Global 2024	89.25	94.06	94.11	100.70	102.06	106.04	106.60
Global 2026	93.58	99.08	98.50	107.37	110.44	114.40	115.03
Global Jun 2027	93.33	98.70	98.11	107.08	110.35	113.76	114.73
Global Oct 2027	89.16	94.49	94.36	102.19	105.58	109.17	109.90
Global 2028	84.02	88.66	88.53	96.76	99.23	102.04	-

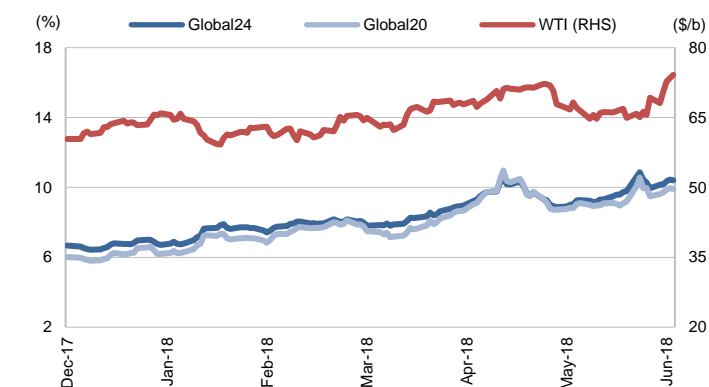
Source: Bloomberg and Analytica

**EMBIG Spread**



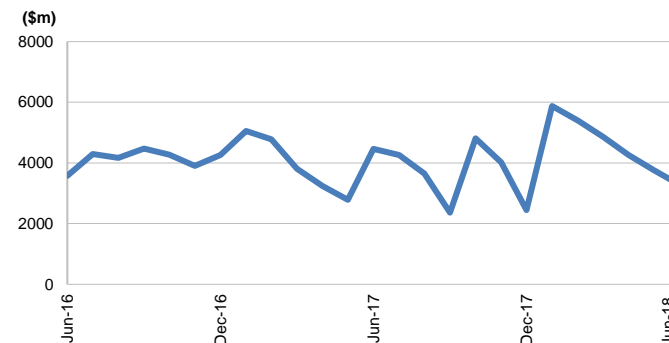
Source: JP Morgan and Analytica

**Bond Yields vs. WTI**



Source: Bloomberg and Analytica

**International Reserves**



Source: BCE and Analytica

Noise came from opposition party CREO. It abstained from voting for the bill because it lacks clarity on how to fix the ceiling broken by massive debt issuance and bilateral debt with China, which has taken the ratio of debt to GDP way above the 40% legal limit. The law allows the government to continue to issue debt to remain liquid, while in the long term leaving the limit in place. There is some murkiness regarding the legal situation now. After recognizing that debt tops the limit, the government is supposed to have the legislature approve a debt stabilization and reduction plan. A detailed plan on how to do this will probably have to wait until Martínez works out the budget for next year over coming months.

Worries meanwhile abound. Country risk has increased in the wake of US interest rate hikes, as it has for all emerging market bonds. Fortunately for Ecuador, it has no exchange risk for bond repayments, but the pace of inflexible public spending continues to threaten the government's ability to put off bond issuance until at least late this year. This has led to recommendations that Ecuador seek help from the International Monetary Fund, currently in Quito reviewing the books in the regular Article IV consultations. The plight of Argentina, despite its currency and inflation issues, deserves a look. Previous IMF assistance has done little to spur that country to reforms, some economists argue; whether it would do so in Ecuador is therefore an open question that will depend on both Fund staffers and the finance ministry team.

The doubts and on occasion harsh debate within the conservative political and economic scene led to reactions. Ecuador's Entrepreneurial Committee, the umbrella business interest group, issued a press release lauding the law as a step forward. It also warned against excessive, Argentina-style "gradualism" to reform the economy. Indeed, Argentina serves as an argument in favor of faster cutting rather than slower. Martínez, who headed the

committee before being named finance minister, followed up with a television interview in which he acknowledged the crisis but put forward some clearer financial goals: The primary deficit before interest payments is to drop to \$1.1b this year, narrowing to \$500m to \$600m next year "and so on until 2021, when we expect to reach a balance and even a primary surplus." That estimate is also based on expectations of higher oil revenue, above all from increased output. This, however, is optimistic as the state oil company is underfunded and the private oil industry is hesitating to invest. Still, Martínez's statement does finally put some numbers on the expected budget cuts.

### **Trouble in the 'hood**

After restoring relations with Rafael Correa, president Moreno's predecessor, Colombian president Juan Manuel Santos leaves office amid a notably cooler bilateral climate. Mostly, this is due to the trouble he has had in administering the peace deal with the Marxist rebel group FARC, which contributed to the deteriorating security situation along the border with Ecuador. But much of the deterioration has been completely unnecessary and stems, above all, from his disregard for local sensitivity. How ironic that he ended up getting along better with Correa after having bombed a FARC camp inside Ecuador in 2008 than with the peace-loving Moreno.

The crisis along the border revealed poor coordination between Bogota and Quito. A lot of politicking went ahead on *Twitter*, to the chagrin of the families of the reporting team from newspaper *El Comercio*, who became witnesses to the Colombian government's lack of sensitivity. Santos repeated that this week, announcing that their bodies had probably been found without bothering to wait from a green light from Quito first. He got a protest note from foreign minister José Valencia, to which Bogota responded with "surprise," saying that Valencia and

other Ecuadorian officials had been notified (but without explaining the tweet). For his tough stance, Valencia logged some important support among Ecuadorians. How that will fly with the newly elected Iván Duque is unclear. As the favored candidate of Santos's estranged predecessor, Álvaro Uribe, Duque is known best for his criticism of the peace deal. Regarding FARC dissidents and numerous other criminal gangs, he can be expected to pursue a more militaristic agenda. This will put pressure on Ecuador's strategy to pacify the border and, more broadly, its changing role in the narcotics trade.

Both countries need to deal with two primary problems that will affect the bilateral relationship: the Venezuelan regime and the exodus of citizens it has caused, as well as Colombia's unsolved domestic violence, which regularly spills over into Ecuador. Regarding the former issue, Moreno and Valencia have moved policy away from the Cuban-Venezuelan zone of influence, exemplified by Ecuador's protest this week against the killing of protestors by the Nicaraguan regime, making it easier to find common ground. The visit of US vice president Mike Pence, also this week (which we will discuss in the next issue), will support increased US police and military aid for the border zone. At the same time, Moreno has outlined a border security plan that, wisely, includes a significant local development component. His administration nonetheless faces a very large challenge in pacifying the area after years of negligence and even complicity by Ecuadorian public officials with criminal gangs. Whether Moreno can avoid Ecuador becoming a target for Colombian rebels again is still unclear. Colombia has historically ignored its border area, and Duque is unlikely to change this in a way that will contribute to peace. At the very least, the shift back to professional foreign policy under Moreno can help his administration to earn some respect in Bogota's eyes.

### **The Castle Crumbles**

Loja, a provincial capital in southern Ecuador with close to 250,000 residents, last weekend recalled mayor José Bolívar Castillo, whose first of four terms began in 1998. His erstwhile fall from power is an interesting case of local resistance to authoritarianism. More than 70% of voters had enough of his abrasive style, which was particularly directed against journalists and opposition politicians. A protest by cabbies against what they considered excessive fines doled out by camera traps led to the recall vote. Beyond this immediate reason, the strength of the opposition to him reflects deep-seated anger at the way he ran the mayors' office, despite some success.

As a *correísta* legislator, Castillo gained notoriety nationwide as a leading proponent of the 2013 media law, criticized by human rights organizations as one of the most repressive in Latin America. Thanks to that law, which is being reformed, he had newspaper *La Hora* fined for failing to cover one of his speeches. Opposition legislator Jeannine Cruz (CREO) has been among his strongest critics, accusing him of corruption. Castillo won a libel case against her as a city councilwoman and she had to spend a month in jail in 2016. Unaware a microphone was on, ahead of the February 2018 referendum that has helped restore institutional independence and remove authoritarianism imposed by president Rafael Correa, whom Castillo supported, the mayor was recorded admitting that he was against it, while he officially supported it out what thus was proven to be pure opportunism.

Amid the storm of criticism against him, Castillo's has been able to chalk up some administrative success. Urban renewal lately has had a comprehensive quality far surpassing that of the silly, Disneyesque city gate he had built during his first administration. The works caused considerable temporary discomfort, but central Loja is now free of

aerial cables, repaved, and boasts a great number of freshly restored façades of historic churches and mansions (the nightly illumination turned out a bit on the gaudy side). All of this obviously failed to offset the anger of the locals with their intolerant mayor. Yet his political machine remains in place. Piedad Pineda, Castillo's deputy and a member of his political vehicle, ARE, succeeds him. Castillo won support from close to a third of the electorate and is not barred from running for mayor again next year. Cruz has said she might resign from congress to make her own bid for that office.

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