



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

ECUADOR WEEKLY REPORT®

KEY INDICATORS

For the week of Jul 23 – Jul 27, 2018

End the Absurd

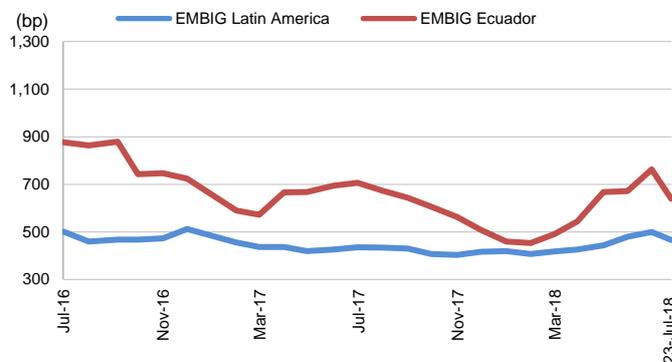
A small herd of sacred cows has become central to Ecuadorian politics since the country became an oil exporter in the 1970s. None are financially directly more onerous than those for the consumption of liquefied petroleum gas (LPG), diesel fuel, and gasoline. And none strike deeper fear into the heart of individuals in power than these as an attempt to change them triggered the downfall of Abdalá Bucaram, the populist president whose brief, scandalous government kicked of a decade of political instability in 1997. In 2010, after Bolivian protestors derailed a proposal by populist-socialist president Evo Morales, an ally of Rafael Correa (president, 2007 - 2017), to increase gasoline prices, Correa was frightened into leaving things as they are. Yet there are signs that, after tens of billions of wasted dollars, the current administration might leverage their modification, if not elimination, thanks to the dire state of public finances. Finance minister Richard Martínez has carefully spoken of the need to focalize these subsidies on the needy.

According to data presented by oil minister Carlos Pérez earlier this year, Ecuador will spend \$1.7b in 2018, or about 1.5% of GDP, on these fossil fuels, a figure that looks low. It amounts to about half of all subsidies inside the \$35b budget and is less than the average. In comparison, the Moreno administration budgeted \$3.85b for public education, and the fuel subsidies top public spending on housing or clean water. And the poor only benefit indirectly from them as lower diesel prices contribute to lower public bus

Bond	Last Price (end of the month) 2018						
	27-Jul	29-Jun	May	Apr	Mar	Feb	Jan
Global 2020	106.42	102.24	104.12	103.10	108.42	108.75	109.98
Global 2022	109.15	102.55	105.36	105.54	111.06	113.07	116.32
Global 2023	101.32	93.71	97.75	97.89	104.68	106.64	110.12
Global 2024	97.50	89.25	94.06	94.11	100.70	102.06	106.04
Global 2026	102.13	93.58	99.08	98.50	107.37	110.44	114.40
Global Jun 2027	101.75	93.33	98.70	98.11	107.08	110.35	113.76
Global Oct 2027	97.79	89.16	94.49	94.36	102.19	105.58	109.17
Global 2028	92.49	84.02	88.66	88.53	96.76	99.23	102.04

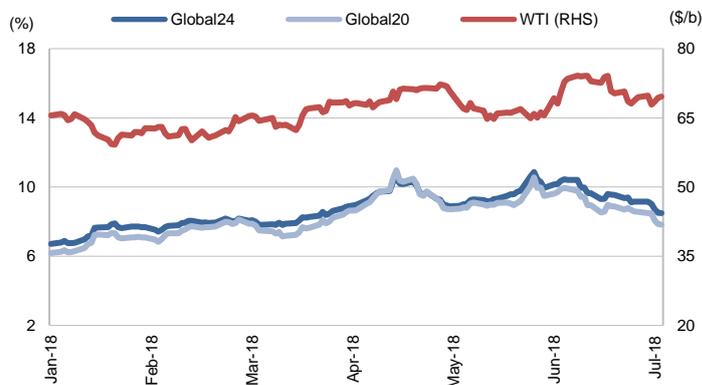
Source: Bloomberg and Analytica

EMBIG Spread



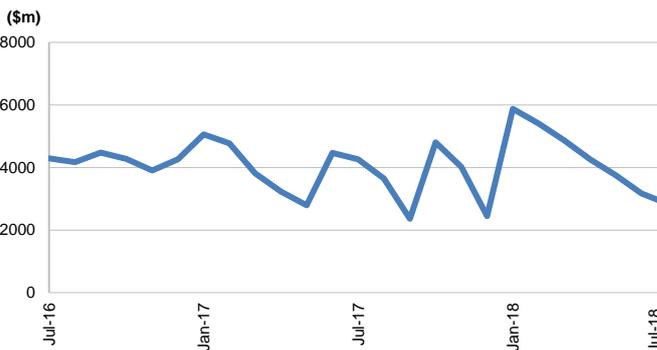
Source: JP Morgan and Analytica

Bond Yields vs. WTI 2018



Source: Bloomberg and Analytica

International Reserves



Source: BCE and Analytica

fares (which are set by local governments) and transportation costs for food (which, on the other hand, are inflated by Ecuador's protectionist import duties and currency export taxes). As articles for years have repeated, the real beneficiaries include middle- and upper class Ecuadorians; the bigger the car or hot tub, the greater the subsidy. Correa introduced a "green tax" on cars based on engine displacement; the bigger, the higher the tax. Perversely, this creates an incentive to drive more to avoid the sunk cost of the tax, along with undercutting the resale value of the car. Other beneficiaries are smugglers. Economist Luis Fierro in 2013 estimated that half a billion dollars worth of the subsidies are lost to neighboring Colombia and Peru, where fuel prices are set by markets. One could even argue that Ecuador also subsidizes narcotics traffickers, both on the mainland and on the Pacific Ocean. Ecuador's refineries, despite some \$4b in alleged investment under Correa (much of it lost to corruption), continue to be abject failures or, in the case of the Manabí refinery, a \$1.5b mirage. According to economist Gabriela Calderón, Ecuador between 1989 and 2017 spent a whopping \$54.9b (in current dollars), \$41.94b just in the past 11 years. Even left-of-center analysts like Henry Llanes bemoan the wasteful subsidies, which also serve to generate urban sprawl, congested traffic exacerbated by the country's difficult topography, and pollution.

But the myth of a benefit for the masses remains buried in the very marrow of social conscience. To modify or, worse still, abolish them, would be "neoliberal" or a so-called "paquetazo," a blow to the personal economy of the poorest amid rising poverty. Change could even risk a blowback so strong that it could return Correa to power, the argument goes. The political argument deserves some consideration. To change the regime could foreseeably provoke protests by the public transportation industry, which had strong links to the Correa regime. Disgruntled middle-class Ecuadorians, in particular the Quiteños

who will likely bear the brunt of public sector layoffs, might also take to the streets. Ricardo Patiño, a longtime Correa cabinet official who left a legacy of mismanagement wherever he went, told official Chinese newswire Xinhua that Correa's loyalists are betting on economic breakdown to return them to power even before 2021 via a new constitutional assembly. But Correísmo looks everywhere on the defensive. Vice president Jorge Glas is serving a six-year sentence for corruption. Correa himself faces a kidnapping indictment that promises to be only the first of his trials. More than a dozen former ministers, including Patiño, also risk criminal charges (see below). Thanks to the collapse of Correísta credibility, the voice of the hard left appears instead to be returning to the indigenous umbrella organization CONAIE and its allies, as well as parties close to trade unions.

The political and economic implications of changes to the fuel subsidy regime nonetheless demand a careful study because of the pivotal role of fuel in the economy. This obvious fact has also been repeated for years. Above all, the supply chain of the food market needs to be reviewed, but the risk of price increases is to some extent compensated by Ecuador's ongoing slight deflation. Focalization could imply that recipients of the "human development subsidy," a monthly financial support payment for low-income Ecuadorians get an additional amount of money that will allow them to buy a canister a month. This would be the simplest solution. Other ideas include mobile phone applications or chip cards allowing a limited allowance to be extended to private consumers. The impact on professional transportation companies could be at least partially offset by reducing duties on imported vehicles and parts, while local governments will play their role in establishing and subsidizing the price of bus tickets for low-income residents and/or students and seniors. Rationalization will also mean that the insane system of distribution of LPG to consumers will be fixed. Currently, small

trucks carrying subsidized LPG canisters careen through streets beeping or, in cities like Quito and Cuenca, blaring out annoying jingles from dawn to evening hours, fueled by subsidized diesel. Foreign investors will see that the government is serious about reducing fiscal waste, reducing country risk and, in consequence, interest rates, helping to stimulate the economy. Other positive impacts like cleaner air, and thus savings on public health costs, less traffic, and cheaper cars need to be made loud and clear to the public. We will continue to add our little grain of sand to the discussion.

Nine While Nine

The comptroller general's office shows no sign of letting off on investigating the corruption of the Correa decade. This week, it announced a 90-day examination of the flights of the presidential planes bought by president Correa and used extensively by him and his underlings. Correa had the planes, a \$28m Embraer Legacy 600 and a \$54m Dassault Falcon 7X, bought to replace the admittedly old presidential plane previously in service. After discovering that the Legacy, at 6,019 km, didn't have enough autonomy to take him overseas non-stop, he had the Falcon bought. According to news site *PlanV*, Correa didn't like the Legacy's onboard phone either, so it was replaced for \$280,000. And the planes were too small to transport the dozens of people Correa took on his international trips, contributing to the financial straits of state airline Tame, which was ordered to fly the committees and rarely, if ever, paid.

In addition to the controversy regarding the acquisitions, which apparently won't be part of this examination, the use of the planes has led to speculation of misuse, including smuggling. The comptroller general's office said it would investigate passenger lists and reason for use amid travels that cost around \$6.3m from 2012 to the end of Correa's term. Correa defended himself on Twitter by saying that the presidency was so concerned with saving

money that the food was cooked in Carondelet, the presidential palace, and eaten aboard from plastic terrines. Summarizing public sentiment, Pablo Arosemena, president of Guayaquil's chamber of commerce, tweeted that "They ate from terrines. They stole in planes."

Separately, Antonio López, a Quito-based corporate lawyer, has presented information to media regarding the Constitutional Court that he collected from publicly available data. Under the prosecution's investigation number 170101818061503, he obtained the numbers of identity cards involved in the case, which he found matched those of all nine members of the court. While legal officials haven't commented on the matter, this only adds to the controversies regarding the court, and provides more indications of the pervasiveness of corruption in Correa's Ecuador. It also puts more pressure on the Citizens' Participation Council to replace the members of the court.

The editorial board of Analytica Investment's Ecuador Weekly Report publishes information obtained from expert sources, public information and media reports, and documents. Anonymity of interviewed sources is protected.

Analytica has expertise in brokerage, debt and capital markets. It is recognized as one of the top Mergers & Acquisitions firms in Ecuador. It also has a fiduciary business, research department and other complementary financial services. The research department publishes a monthly report that analyzes the economic, political, and international situation of the country. We offer a variety of financial products and services that enable us to fulfill our main objective: helping our clients create value. For more information please visit www.analytica.ec