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**ECUADOR WEEKLY REPORT®**

**KEY INDICATORS**

**For the week of Aug 20 – Aug 24, 2018**

**Testing, 1, 2, 3...**

President Lenín Moreno this week presented a plan to restructure the administration, state-owned companies, and subsidies to shave \$1bn annually off the central government budget. It also wants to shore up the balance sheet of the Central Bank of Ecuador, which Moreno’s predecessor, Rafael Correa, stripped of its independence and forced to lend to the government. The measures include increasing the price of premium gasoline and that of industrial diesel in a show of moderate bravery as, for both the government and society, even this gradual change poses a test of Ecuador’s ability to reform. Reactions against the plan have so far been relatively subdued, hopefully confirming that society is ready to drop its resistance to an economy driven by the private sector.

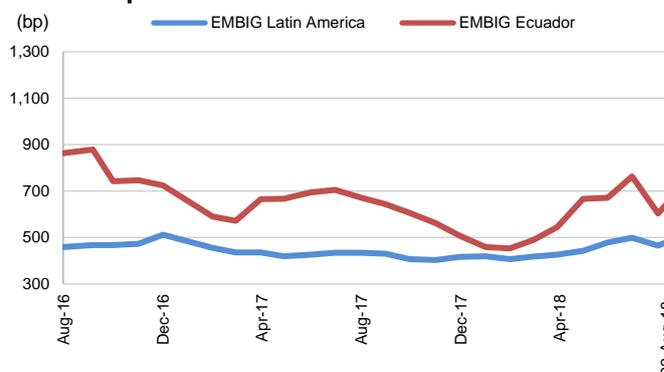
The administration unveiled the plan in the week that the latest changes to economic legislation came into effect. The law includes major tax breaks for new investment, hinging on industry and region, of eight to 20 years. It also allows the government to continue to issue debt amid a drive to stabilize the overall debt load and reduce the deficit before interest payments to zero by the end of Moreno’s term in 2021. Now, the government says it will do its homework, eliminating perks like free gasoline and mobile phone usage by top-level officials and reducing the size of the state. The number of ministries will drop to a more reasonable 20, from the 40 the government started off with last year. A series of institutions will be shut down, including obscure entities like the Ecuadorean

**Ecuador’s Global Bond Prices**

Bond	Last Price (end of the month)						
	2018						
	24-Aug	31-Jul	29-Jun	May	Apr	Mar	Feb
Global 2020	103.87	105.54	102.24	104.12	103.10	108.42	108.75
Global 2022	105.21	108.28	102.55	105.36	105.54	111.06	113.07
Global 2023	97.43	100.21	93.71	97.75	97.89	104.68	106.64
Global 2024	92.72	96.56	89.25	94.06	94.11	100.70	102.06
Global 2026	97.70	100.99	93.58	99.08	98.50	107.37	110.44
Global Jun 2027	97.24	100.61	93.33	98.70	98.11	107.08	110.35
Global Oct 2027	93.06	96.60	89.16	94.49	94.36	102.19	105.58
Global 2028	88.27	91.40	84.02	88.66	88.53	96.76	99.23

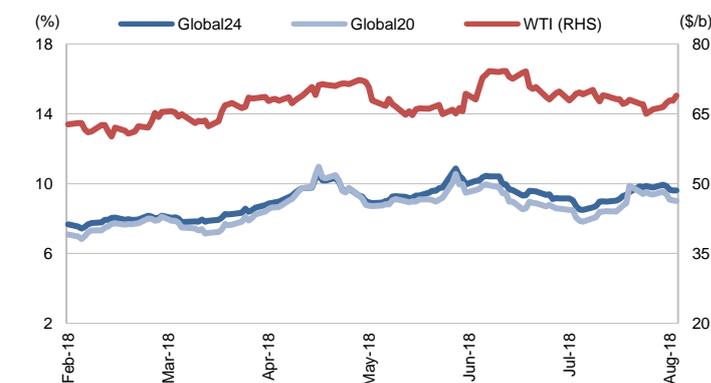
Source: Bloomberg and Analytica

**EMBIG Spread**



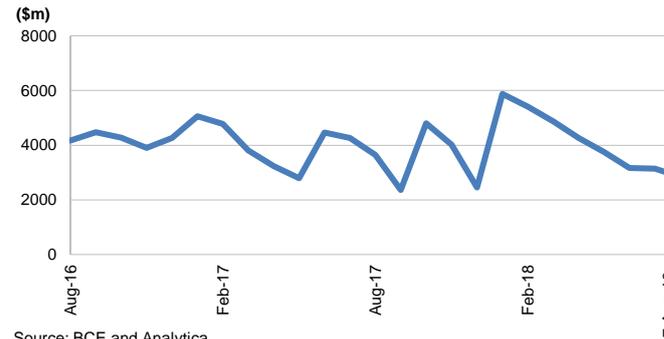
Source: JP Morgan and Analytica

**Bond Yields vs. WTI 2018**



Source: Bloomberg and Analytica

**International Reserves**



Source: BCE and Analytica

Space Institute, the Institute to Develop the Arts, Innovation, and Creativities and the Postal Regulation and Control Agency. It will also stop the abuse in the public procurement system's online platform. Combined, this should save close to \$600m a year, two thirds of it by cleaning up the manipulation of procurement.

The changes to the fuel subsidies will reduce spending by some \$200m annually, perhaps 5% of the total wasted on this largesse. Fuel subsidies have created a vehement sense of entitlement in oil-producing nations like Ecuador. This has also instilled a similarly strong sense of political paranoia regarding the impacts of tampering with these regressive expenses. The increase in the price of premium fuel to \$2.98 a gallon, along with a delivery of 92 rather than 90 octane gasoline, will go ahead next week. The measure officially targets high-income owners of relatively new cars, although automotive companies recommend new small cars also use this kind of fuel. According to the government, 84% of the fuel subsidy benefits people with above-average income. In the case of diesel, "industrial" diesel will go up. Much of this is diesel is consumed by state-owned thermoelectric plants, so the social impact here too is limited. The government is thus testing the rejection of the measures by society. FEUE, a left-wing student organization, called a demonstration against them that failed to attract many people. Further discussions on reducing fuel subsidies are to follow from roundtable discussions in the coming months.

Another taboo broken by the government in these plans is the offer of numerous state-owned companies to the private sector. While the oil companies are still off the table, practically all the others in some way will be opened to investor participation, via public-private partnerships, concessions, or privatization, from the tiny railway and near-bankrupt airline to the almost entirely state-owned electrical industry, telecommunications company CNT, and the road system. This could lead

to transformative change in the economy, but again could face challenges from the same hard-left political sector that derailed practically all privatization attempts in recent decades. One argument that Moreno could use against this claim is that initial, and failed, attempts at attracting private investment in state-owned companies stemmed not from Richard Martínez, the finance minister who switched to the public sector from the presidency of Ecuador's Entrepreneurial Committee, but from Correa himself. To help the privatization plan finally go ahead this time, Ecuador is receiving advice from the Inter-American Development Bank and the Andean Development Corporation.

Little-mentioned by the press but important nonetheless, the plan also includes restoring the balance sheet of the central bank. The government argues that this will ultimately support economic growth by easing the liquidity needs of the private sector whose funds were partially syphoned off to feed the Correa administration's insatiable appetite for cash. This will however weigh on the financial requirements of the government: it will require the return of the illiquid shares in assets of state-owned banks scandalously transferred to the central bank last year, booked as \$2.14bn, in lieu of real payment of the government's debt. This will have to be covered by new domestic debt.

Some of the savings on fuel will go to fund expanded social service for recipients of a small subsidy for low-income households. The bulk of \$1.3bn in assistance to low-income Ecuadorians will however come in the form of loans from public-sector banks to small companies working in handicrafts and small industry, agriculture, and construction. This will keep current spending from rising. To also help convince citizens they aren't tightening their belts while the corrupt officials that caused the fiscal distress go free, Moreno is promising to step up the fight against corruption. Overall, while still timid

regarding fuel subsidies, the plan points entirely in the right direction.

### **Finger in the Dike**

Ecuador, a country with hundreds of thousands of emigrants in the US and Europe, historically has had a relatively open policy regarding immigration. This has become strained this year by the surge in Venezuelan arrivals, with more than half a million entering Ecuador so far this year alone. The country made international news twice in recent days with policy decisions regarding them. First, it declared a humanitarian emergency in three provinces to rally resources. Then, it tried to close the door by saying all adults had to have passports to enter (children can travel with parents or other guardians). While Ecuador has said it wants a regional solution to the Venezuelan migration crisis, it has acted on its own, with some poorly thought-out consequences.

For one, Gina Benavides, the new public ombudswoman, and a group of human rights organizations filed for an injunction against the new rule, which they say violates Ecuador's migration law that says that South Americans have the right to enter Ecuador showing identity cards alone. Interior minister Mauro Toscanini argued that the decision, which he announced just after president Moreno met a group of Venezuelan economic refugees, stemmed from security issues because the poor state of Venezuelan identity documents, including worn copies of birth certificates, failed to allow Ecuadorian authorities to properly identify many of the 4,200 daily entrants. Both standpoints look reasonable.

Immigration is an area where Ecuadorian legislators and authorities have historically demonstrated incompetence. Ecuadorians long suffered a Stalinist rule requiring them to get exit permits before being allowed to travel abroad. The mass exodus in the years of the 1997-2000 economic crisis led to the creation of an illicit human trafficking industry. Despite claims to the contrary by Correa-era

officials, this continues to exist, with some people coming from as far away as Central Africa and China to try to travel to the US via established human smuggling routes. The complete open-door policy that then-president Correa launched in a bid to win over emigrant voters (it never helped tourism) had to be dropped after this compounded existing human trafficking. Occasionally, the tighter policy became harsh and arbitrary, with prominent expulsions of foreign regime critics and the low point being the forced return of Cubans fleeing the Castro regime being returned to Havana two years ago.

Currently, rules remain in place that are completely incomprehensible. With immigration officials swamped by Venezuelan arrivals, the interior and foreign ministries have issued amnesty after amnesty on the payment of fines for people overstaying 90-day tourism visas. It's supposed to be easy to get a one-year tourism visa, reinstated in the latest iteration of the migration law, but the situation is so poorly explained that not even immigration lawyers prove competent to know how to obtain it. Instead, many people can opt for work visas, simply getting an Ecuadorian employer to sign a work contract. Ludicrously, the foreign ministry then gets to work controlling whether the employer has fulfilled labor and social security rules, demanding minute paperwork and essentially replicating what other government offices do. Multiply this by the 250,000 Venezuelans who have immigrated in the past four years and one can begin to imagine the paper-pushing backlog.

Aside from the doubts regarding its legality, the passport requirement looks like a desperate short-term move, cynically sweetened by government spin doctors with Moreno's welcome of refugees in the Carondelet presidential palace. Peru quickly followed suit, meaning that, in theory, thousands of Venezuelans planning to travel south will be stuck in Ecuador (between 75% and 80% aimed to head to Peru or Chile, whose economies continue to grow far

faster than Ecuador's). Now, Ecuador is trying to bus people to the Peruvian border in time for them to enter in the few hours before the Peruvians demand passports too. Even though Moreno just met the new Colombian president, Iván Duque, and needs cooperation on the troubled border, the decision also strands thousands near Ipiales, the Colombian border town, and near San Miguel in the Amazon, historically an area with major rebel presence. Perhaps it is meant to pressure the Venezuelan regime, which is the main winner from the expulsion of its own people because their departure is an escape valve for the incompetent regime. But already, hundreds of desperate Venezuelans have simply walked across the border without any control.

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