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ECUADOR WEEKLY REPORT®

KEY INDICATORS

For the week of Sep 3 – Sep 7, 2018

Treading Water

The finance ministry has surprised markets by obtaining \$500m from Goldman Sachs in the form of a bond repurchase (“repo”) agreement. For the government, the deal has two main benefits: It provides liquidity at a substantial discount to market rates and it avoids injecting more issuance in the market. At the same time, the size of the guarantee has raised eyebrows: \$1.2bn, more than twice the amount of liquidity provided. At this point in time, the risks associated with the guarantee look limited. The fiscal situation remains serious however.

Under the terms of the deal, Ecuador will pay an interest rate currently near 6.5%, composed of 90-day LIBOR plus 425 basis points. At the time the deal closed late August, that was close to 30% lower than the yield on the 2022 bond. Ecuador reopened the 2020 and 2022 bond series, and the repo matures in 48 months. Goldman agreed to keep the \$1.2bn collateral off the market as long as Ecuador remains current on the repayment. The deal led to mixed reactions among bond analysts. Some applaud the move as creative, while others would prefer the government approach the International Monetary Fund sooner rather than later, to stop putting off painful decisions to cut spending faster.

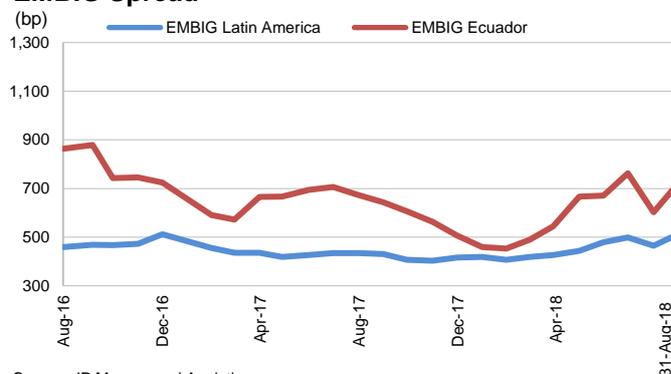
For the finance ministry, the deal provides evidence that it still has access to the market and can raise funding at cheaper rates. This will be important down the road as it tries to shovel out of the deep, heavy dung heap of debt left by the previous administration under Rafael Correa. Correa

Ecuador's Global Bond Prices

Bond	Last Price (end of the month)						
	7-Sep	31-Aug	31-Jul	29-Jun	May	Apr	Mar
Global 2020	102.18	103.02	105.54	102.24	104.12	103.10	108.42
Global 2022	102.92	104.12	108.28	102.55	105.36	105.54	111.06
Global 2023	95.38	96.29	100.21	93.71	97.75	97.89	104.68
Global 2024	90.74	91.56	96.56	89.25	94.06	94.11	100.70
Global 2026	95.59	96.87	100.99	93.58	99.08	98.50	107.37
Global Jun 2027	95.31	95.94	100.61	93.33	98.70	98.11	107.08
Global Oct 2027	91.17	91.23	96.60	89.16	94.49	94.36	102.19
Global 2028	85.77	86.79	91.40	84.02	88.66	88.53	96.76

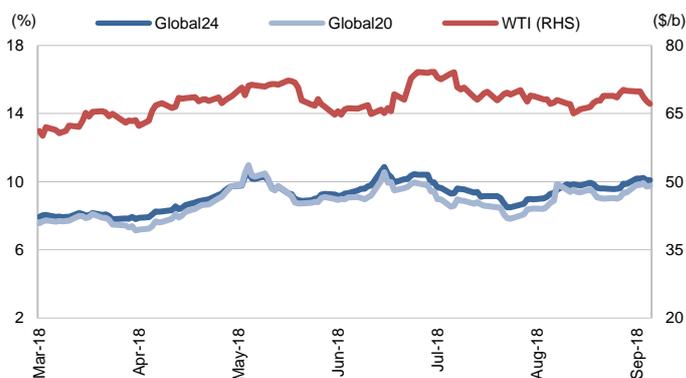
Source: Bloomberg and Analytica

EMBIG Spread



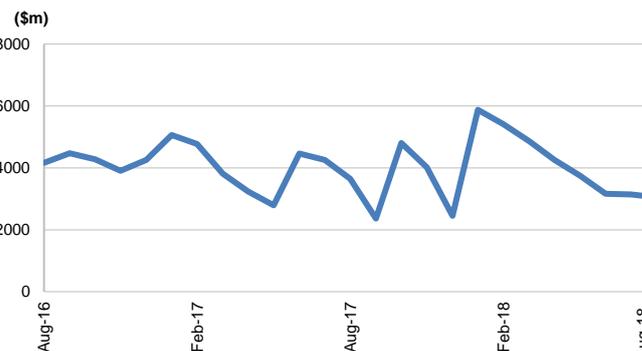
Source: JP Morgan and Analytica

Bond Yields vs. WTI 2018



Source: Bloomberg and Analytica

International Reserves



Source: BCE and Analytica

unnecessarily embarked on a frivolous, corrupt orgy of fiscal spending that has saddled the government with debt above the legal limit of 40% of GDP. It is also important given the poor market conditions for emerging markets. In this region, the plight of Argentina, which is having little success with a \$50bn assistance package from the International Monetary Fund has raised fears of a similar situation down the road for Ecuador given the parallel of “gradualist” fiscal and economic reform.

Critics worry that the size of the guarantee will come back to haunt the administration. Both parties are betting that everything will go well. We feel that Goldman is obtaining considerable gains, while facing the risk that the collateral will plunge in value in the event of a default. While Ecuador is obtaining cash cheaply now, interest rates are going to rise, including LIBOR. Some critics also believe that more debt, rather than IMF support, is only postponing an adjustment. While the case of Argentina shows that the IMF may not provide a panacea, it's time for the financial team to move forward with economic reform and cut current spending at a faster clip to generate more confidence.

All in the Family

As the surge in people fleeing Venezuela has become global news, Ecuador's role in the crisis has attracted greater attention. When the foreign ministry called a summit in Quito to discuss the situation, interest flared as it appeared it might have invited other foreign ministers. In fact, it ended up being a summit of top immigration officials, which resulted in a refreshingly reasonable meeting. Hosting the meeting, Ecuador's foreign ministry regained prestige as a reliable member of the regional diplomatic theater.

In an 18-point statement, the group that also included Argentina, Brazil, Chile, Colombia, Costa Rica, Mexico, Panama, Peru, Paraguay, and Uruguay agreed that even expired Venezuelan travel

documents can be enough to permit Venezuelan migrants to enter. They also urged Venezuela to provide travel documents, which have become extremely difficult for its citizens to obtain not only due to the scarcity that has led to widespread malnourishment in the country but also due to the corruption that forces people to pay exorbitant bribes to speed the process of getting a passport. Additionally, Venezuela should allow humanitarian aid to enter. Bolivia participated in the meeting but, as Venezuela's lone remaining South American ally, refused to sign it. Venezuela didn't attend, denying the crisis. Vice president Delcy Rodríguez called the exodus, which according to the United Nations High Commission on Refugees has totaled 2.5m in the past four years, “a normal migration flow.”

The first Quito summit – another will follow in November – provided a necessary but only initial step. How to deal with the mass exodus remains, at least at this stage, an issue to be decided on by each country. Even though expired documents will be enough in theory to permit Venezuelans to continue to travel, countries will in practice likely seek methods to control the flow, which in essence means to constrict it to manageable numbers. A Chilean official at the meeting said that the situation is different from emigration to Europe and that quotas would fail to reflect the fact that the Venezuelans are not running from a war but seeking a better life elsewhere as migrants. In practice, however, the situation is very similar. Assimilation of Venezuelans of course is easier within Latin America given that they speak the same or similar language (in the case of Brazil), even with their own slangs, and share broadly the same religion.

While there is substantial empiric evidence that migration flows end up serving the destination countries, the immediate beneficiary of the situation is the corrupt and incompetent regime in Caracas. Like in Cuba, which used mass emigration to Miami as an escape valve on several occasions, departures help

to ease the pressure on the government of Nicolás Maduro. To point the finger at Maduro and constrict his regime alone is insufficient. Governments should also massively increase pressure on Cuba to relinquish its control of Venezuela. It almost certainly won't happen, but it would be very positive if one or more countries at the upcoming United Nations General Assembly were to demand an inclusion of Venezuela on the list of non self-governing territories.

Romo's Return

One of the problems in designing Venezuelan policy has been the poor coordination between the foreign and interior ministries. It was interior minister Mauro Toscanini who imposed the obligation to bear passports on Venezuelans. At the request of the public ombudswoman, Gina Benavides, a judge ruled this was illegal. Toscanini promptly replaced this with a rule requiring a Venezuelan apostille to validate travel documents, including identity cards and birth certificates. It won't be up to Toscanini to fight this out with courts. María Paula Romo, a lawyer and prominent member of the defunct leftist organization *Ruptura de los 25* has since replaced him.

An early stalwart ally of his regime, *Ruptura de los 25* broke with Rafael Correa in 2011 over the issue of judicial autonomy, which Correa had abolished. The move earned it the authoritarian president's enmity, and the National Electoral Council disbanded it in 2014. As the organization's most prominent leader, Romo to some extent might be granted more goodwill than president Lenin Moreno himself. After all, *Ruptura* broke with Correa six years before Moreno, and she is the third prominent member of the organization to enter the administration at a senior level. But though she was also a victim of Correísmo, *Ruptura's* missing mea culpa and the role it played in establishing that regime is galling to many. At the same time, the group is more genuinely social democratic than the amorphous electoral vehicle Alianza País (sic) that Moreno leads and whose

majority supports him in congress (a relevant minority still being Correísta).

Romo's initial agenda puts forward an interesting policy mix. She appears to want to combine human rights issue with an increase in domestic security, a welcomingly liberal goal. She identified some priority matters that have made headlines but for which there appear to be no credible policy initiatives including the non-stop casualties on Ecuadorian roads, led by crashing buses; the shocking violence against children and women, including numerous cases of rapes in public schools; and the level of crime in general. She risks sparking resistance among prominent interest groups including the quasi-mafia that runs public transit. While she has a reputation as a fighter for human rights and gender equality, her experience with law and order is limited to her training as a lawyer. Amid the restructuring of the ministry, which will include taking on parts of the ministry of justice that Moreno is dissolving, she will also have to deal with the criminal legacy of the Correa regime, risking trouble with her own erstwhile allies in government.

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