

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

ECUADOR WEEKLY REPORT®

KEY INDICATORS

For the week of Jan 23 – Jan 27, 2017

Imagine

On January 15, president Rafael Correa celebrated the tenth anniversary of his administration in typical fashion: he appeared at a rally in Guayaquil, arriving on a white, open light truck wearing one of his indigenous-modern white collarless shirts with embroidery, the truck emblazoned with one of the innumerable logos his propaganda machine continually spurt out, in this case 10RC - which in this case can mean both Rafael Correa and his “Citizens’ Revolution” - and the “Victorious Decade” slogan copied from Argentina’s then-president Cristina Fernández de Kirchner. Even for government newspaper El Telégrafo, the event was worth just 252 words. Aerial photos showed police outnumbering revelers along Guayaquil’s central Av. 9 de Octubre, despite newspaper reports of some 850 buses ferrying in supporters. While these had a capacity to carry around 34,000 passengers, the number looked small in the vast avenue, and the event had no lasting impact other than demonstrating popular apathy regarding the regime.

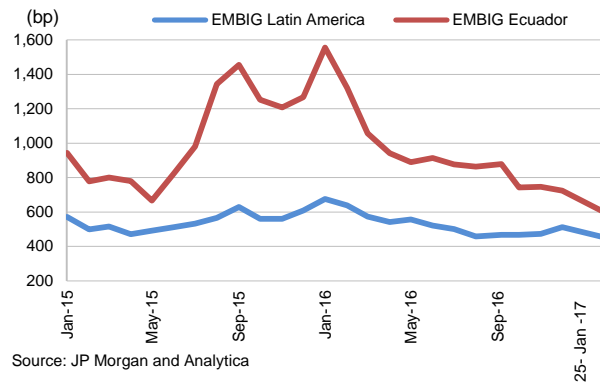
Despite his record-breaking stint in office, Correa has relatively little to boast about. Correa once nervously acknowledged that things were not going quickly and extraordinarily well, as he normally insists. This is one of the truths of his decade in power marked by redone policies and constant rotation of high-level officials (more than 200 cabinet changes). Compared with earlier regimes, his ambitious infrastructure construction plans have left the country littered with white elephants (underserved

Ecuador’s Global Bond Prices

| Bond | 27/01/2017 | Last Price (end of the month) | | | | | |
|-------------|------------|-------------------------------|--------|--------|--------|--------|--------|
| | | Dec | Nov | Oct | Sep | Aug | Jul |
| Global 2020 | 108.56 | 107.89 | 105.54 | 106.13 | 102.51 | 102.30 | 100.49 |
| Global 2022 | 111.58 | 108.81 | 104.94 | 106.11 | 102.47 | 102.89 | 100.03 |
| Global 2024 | 98.16 | 95.92 | 92.15 | 94.55 | 90.25 | 88.05 | 87.49 |
| Global 2026 | 104.50 | 102.50 | N/A | N/A | N/A | N/A | N/A |

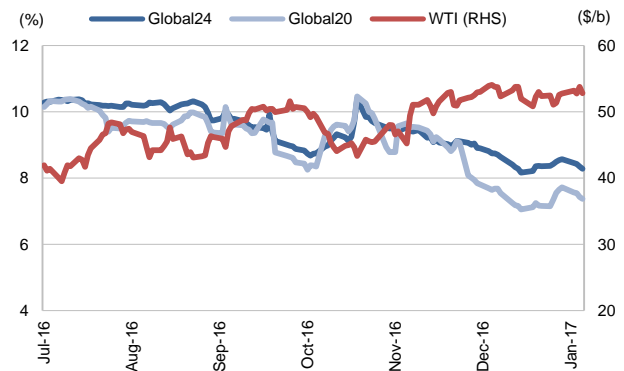
Source: Bloomberg and Analytica

EMBIG Spread



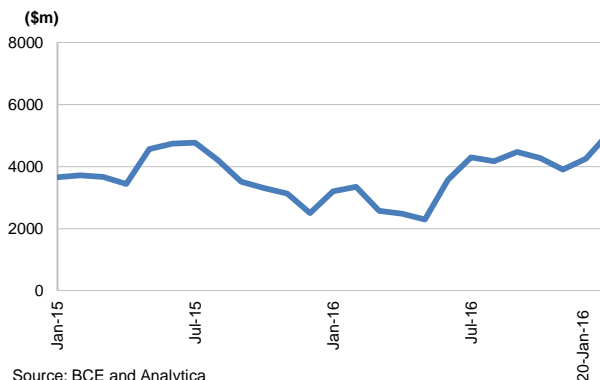
Source: JP Morgan and Analytica

Bond Yields vs. WTI in 2017



Source: Bloomberg and Analytica

International Reserves



Source: BCE and Analytica

or abandoned new airports in Tena, Macas, Salinas, Santa Rosa, Latacunga), haphazard road construction (every time it rains hard, there's a risk the fragile roads between the Andes and Pacific Lowlands might be cut off), and provided little proof of improved education and none at all regarding the judiciary, as continued scandals reveal, most recently through the government's scramble to keep a lid on the Odebrecht and Petroecuador corruption scandals. Out of the touted eight "emblematic" hydroelectric plants the government was to inaugurate in 2016, three are actually up and running, two (Coca - Codo Sinclair and Manduriacu) providing about half the electricity they were supposed to generate, as critics had warned.

Another trademark of the government is massive spending that practically doubled the public sector's weight in the economy to around 45% of GDP before edging lower in the past two years as it became unsustainable once the price of oil fell back, just as independent analysts had always warned. This has been countered by massive debt issuance. Ecuador was well on its way to healthy public finance in the midst of supposedly "odious" and "illegitimate" debt, quickly slashing the post-crisis debt level of near 77% of GDP to under 30% when Correa took office. Much as they did in Venezuela, the high-spending years did produce fast growth and high corporate earnings, but public spending crowded out private-sector investment, the worst of which may have been the billions dumped in dubious refining projects, above all the Manta refinery project that has cost at least \$1.5bn, including the tab for an aqueduct built by Brazilian construction company Odebrecht, which also leveled the land on which the plant is supposed to be built.

Meanwhile, Correa's propaganda machinery has managed to retain significant core support with around a quarter of voters. While international leaders and media are stunned to hear US president Donald Trump call the media public enemy number one,

many, particularly on the center-left, have turned a blind eye to this kind of abuse as a kind of tolerable tropicalism for more than a decade in South America, believing that improvement in social spending was the trade off for the noise. Here, too, performance has not proven any justification. Malnutrition continues to affect one in four children. Economic growth has averaged 3.3% under Correa, only minimally better than the 3.2% of the decade that preceded him and even included a severe systemic economic crisis that almost led to hyperinflation. Poverty has continued to fall largely on the trajectory established amid the difficult reconstruction of the economy that started with the introduction of the US dollar in 2000.

To a moderate extent, Correa has held off from repeating some of the horrid economic mistakes perpetrated by the Venezuelan political elite. Above all, despite time and again criticizing Ecuador's use of the dollar, he has held on to it, aware that any short-term currency reform could have triggered his political downfall even though it might have provided short-term benefits. Without the dollar, Ecuador would economically much more closely mirrored the Venezuela of today, with hyperinflation and scarcity, quite possibly accompanied by severe unrest. The economic handbrake turn of 2000 saved Ecuadorians from this plight. But to soften the blow, Ecuador has issued massive debt (see below) that, while perhaps relatively low, must be repaid within a worryingly short time of just a decade.

Meanwhile, the administration has spent some \$300bn in its decade in power. Adjusted for inflation, this is more than twice the Marshall Plan that rebuilt much of Europe after World War II for \$130bn, in a country the size of the UK and with just 16m inhabitants. It wouldn't have required an ideal world like the one dreamed up by John Lennon to have dramatically changed Ecuador's fate over the past decade. To have saved just some of the oil windfall would have contributed to fiscal discipline, reducing country risk, interest rates, and consequently

improving investor confidence. This would probably have been offset by higher oil revenues than those that Correa obtained in his misguided push to increase the state's share of that income source: While oil prices were at historic highs, output fell back to around 460,000 barrels a day in 2010, down 16% from the pre-Correa peak in 2006 (it later climbed back but has been unable to be pushed significantly higher than under his predecessors). And Ecuador actually did have an oil savings fund, which Correa misrepresented as a fund to guarantee debt payments in lieu of expanding social services. He spent it in 2007 to accelerate growth. Thanks to his surge in debt issuance to kick the problems his mismanagement has caused to his successor, debt payments now already top those for health and education. The recent oil boom was a historic opportunity for Ecuador that won't repeat itself. It will have to go through a long, hard slog to repair the damage and find the elusive path to development.

The Price of Honor

Verónica Saráuz, wife of investigative journalist Fernando Villavicencio, this week provided a Quito court proof of another \$44,301.60 deposit, on top of a previous \$3006. The payment order stemmed from a suit against him, then-legislator Cléver Jiménez, and medical union leader Carlos Figueroa for libeling president Correa. According to the court, they insulted him by demanding an investigation into Correa's responsibility in the September 30, 2010 police mutiny, which left around a half-dozen people dead after a violent standoff at the police hospital in Quito and amid scenes of anarchy elsewhere. The three avoided the sentence, which included 18 months in jail and a joint \$141,000 indemnity to the president; Figueroa served out his sentence after a neighbor reported he was visiting his mother, who was dying of cancer (he was barred from attending her death bed). Jiménez and Villavicencio reappeared in public after the statute of limitation on the sentence ran out, but a

judge subsequently ordered the payment of the fine. According to Saráuz, the family raised the money through debt and donations. On his part, Jiménez, whose parliamentary immunity the congress never lifted ahead of the trial, via Twitter said he would refuse to pay up.

Besides resuscitating the indemnity payment after the end of the statute of limitation, the case violates the protection extended towards the men by the Inter-American Human Rights Commission, which argues that their human rights have been violated in this case and sought information on the situation from the Correa administration again earlier this month. Villavicencio and Jiménez, who also has a family, remain in hiding because the government alleges they hacked of the president's e-mails. Their defense says that the government has failed to produce any evidence of such hacking, while the president has publicly shown e-mails obtained by the prosecution in other cases to attack conservative rival Jaime Nebot and the Social Christian Party and Quito mayor Mauricio Rodas, currently allied with conservative presidential candidate Guillermo Lasso, and government newspaper *El Telégrafo* published in 2014 e-mails illegally obtained from Martha Roldós, a center-left former legislator and staunch critic of the administration, without any reaction from prosecutors.

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.