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ECUADOR WEEKLY REPORT[®]

KEY INDICATORS

For the week of Jan 30 – Feb 3, 2017

Looks Like Lasso

When he left office in 2013 after six years as Rafael Correa’s vice president, Lenin Moreno was wildly popular. With an approval rating of around 80%, he was even more popular than Correa, and looked like a powerful candidate to preserve the president’s legacy past the end of his term on May 24. But things went south since the middle of 2016 amid a problematic economic climate, a poorly run electoral campaign, and mounting corruption allegations. A growing number of careful analysts therefore now say that Guillermo Lasso, a career banker and the center-right CREO party’s runner-up to Correa in 2013, is now likely to win the presidential race even though he trails Moreno in all polls.

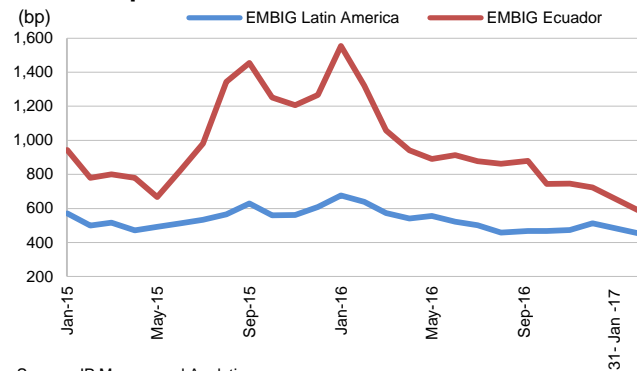
Moreno’s campaign is in serious trouble. Correa’s long hinting that he could, in the end, seek reelection delayed clarity about the Moreno candidacy until November, while corruption allegations began to undermine his popularity from the middle of the year. Not just his personal integrity has been questioned; the giant corruption scandals regarding billions of dollars in contracts of state downstream oil company Petroecuador and Brazilian construction company Odebrecht have put the administration severely on the defensive. Additionally, the beating of socialist opposition candidate Enrique Ayala Mora in Ibarra that left the eminent, 66-year old historian and Correa critic hospitalized is likely to earn sympathies for opposition candidates (police have not arrested suspects in the incident, but the two men who smashed him into an iron gate were spraying slogans

Ecuador's Global Bond Prices

Bond	03/02/2017	Last Price (end of the month)					
		Jan	Dec	Nov	Oct	Sep	Aug
Global 2020	110.56	109.52	107.89	105.54	106.13	102.51	102.30
Global 2022	112.37	112.25	108.81	104.94	106.11	102.47	102.89
Global 2024	98.88	99.07	95.92	92.15	94.55	90.25	88.05
Global 2026	106.58	105.96	102.50	N/A	N/A	N/A	N/A

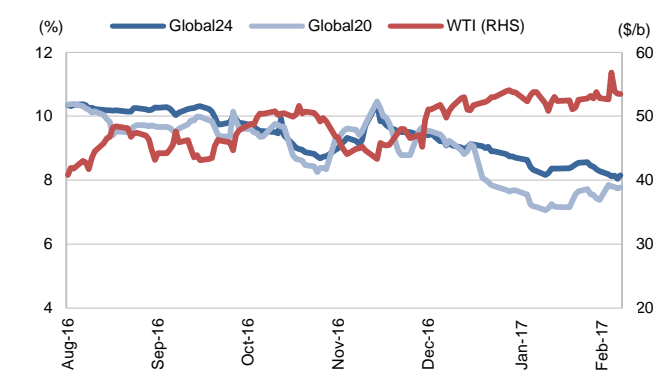
Source: Bloomberg and Analytica

EMBIG Spread



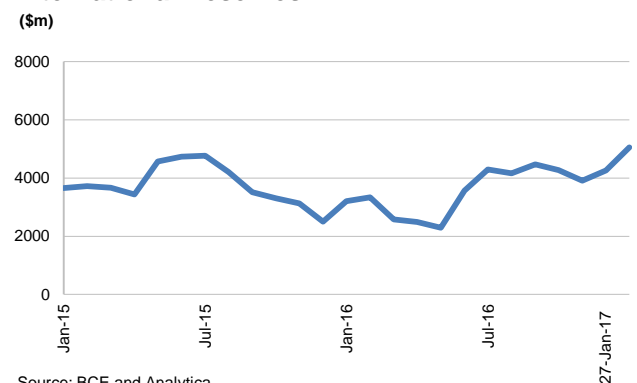
Source: JP Morgan and Analytica

Bond Yields vs. WTI in 2017



Source: Bloomberg and Analytica

International Reserves



Source: BCE and Analytica

against him on the walls of a family home).

Moreno has tried to present himself as both a champion of change and the guarantor of continuity in social progress that correísmo claims it has achieved in its decade in power. This balancing act between two conflicting positions has been impossible to keep up. Thanks to the candidate's complete inability to step out of Correa's shadow, his bid to show solutions to Ecuadorian's most pressing problems has been lackluster given he has been forbidden from criticizing the incumbent and forced to keep on the unpopular present vice president, Jorge Glas, as his running mate. He also committed a serious gaffe regarding the job market, calling Lasso's pledge to create a million jobs in the next term demagoguery, only to pledge 250,000 new jobs annually. In desperation, he has now pledged to triple the monthly cash transfer to low-income families to \$150, promising to thereby eradicate extreme poverty in 2019 and to provide full employment and "housing for all."

Even the most favorable polls like that of Opinión Pública, which in 2011 predicted Correa would win a multi-issue referendum by two thirds only to see it barely scrape through (with serious indications of fraud), see Moreno's pull among voters declining. At this stage in the short campaign, about half of voters favored Correa in 2013; Moreno at best polls in the low 30s. The wide discrepancies among polls that show differences around eight percentage points have however confused voters and kept undecided levels at record level. Additionally, one pollster, Market, consistently shows Cynthia Viteri, the candidate of the conservative Social Christian Party (PSC), leading Lasso. The company's owner, Blasco Peñaherrera, has unfortunately lashed out vehemently both at Lasso and at Felipe Burbano, a left-of-center political scientist, to an extent unhelpful for Market's prestige. Lasso's popularity however has only slowly climbed higher in the polls than the 22.7% he won in 2013. Aside from Peñaherrera's jabs at critics, pollsters in general have low prestige among

voters. Political scientist and centrist congressional candidate César Montúfar (Concertación) has criticized them for confusing voters and failing at their patriotic duty to guide voters in a crucial election. He has even called the situation an unprecedented "survey war."

A further problem lies with voters' lack of trust in the National Electoral Council (CNE). Not only has the CNE turned a blind eye to government favoritism towards the Moreno campaign (and police completely ignore the lack of license plates on cars used in his campaign). An anti-corruption non-governmental organization complained to the electoral observers of the Organization of American States and the South American Union about "unprecedented control of executive power over institutions and electoral mechanisms" and the huge discrepancy between the electoral roll and the government-run INEC statistics institute's demographic projection. The CNE's electoral roll, compiled from the civic registry's issuance of identity cards, has 12.82m eligible voters 16 and older, but INEC estimates only 11.2m people in those age categories amid a total population around 16m, projected based on data from the 2010 census. The CNE has defended its roll, and INEC says the figures aren't comparable. The only factor inflating the roll is the inclusion of some 18,000 people who died since the electoral roll was completed in October, according to the CNE. But many people on social networks have complained about deceased relatives still eligible to vote, even decades after passing away. Fausto Camacho, a former CNE director, has warned of additional risks to distortions in the vote – and perhaps even of fraud – due to a lack of clarity regarding the voting records to be posted in each precinct; questions regarding the integrity of the chain of custody in the reporting of each precinct's results to the electoral authority; as well as doubts regarding the software the CNE will use to process the results. Others have worried that the telecommunications company on which the CNE

will rely to distribute the voting data has close ties to the administration and question that the CNE itself will also publish results in a quick count. While the CNE has denied the allegations, bizarrely, on social networks it shows voters how to annul or deposit blank ballots, which mathematically would favor the frontrunner.

Nonetheless, with a strong showing in last week's first presidential debate, most polls putting him in second place, and Moreno's downward trend, Lasso looks like he's likely to force a runoff (Moreno needs to win at least 40% of valid votes and top the runner-up by 10 points to win in the first round). Most voters would likely rally behind him in the April 2 runoff, setting the stage for a reversal of many policies and a return to orthodox macroeconomic policies. Still, the polls also show a solid center-conservative majority that could have won the election in the first round if ideological proximity and responsibility for leading Ecuador from the irresponsible policies of Correa had been more important than the personal rivalry between Guayaquil mayor Jaime Nebot, the PSC's hegemon, and Lasso.

Doubtful Debt Data

At the end of December, debt reached \$38.1bn, or 39.6% of GDP, the highest level under president Correa and since 2004, according to the most recent public debt report released by the finance ministry. It surged from \$32.8bn, or 32.7% of GDP, a year earlier as the government scrambled to raise funding and maintain public spending levels amid a prolonged recession. According to the administration, this swiftly led the economy out of a recession it never publicly acknowledged, all the while with overall debt levels relatively low, compared with industrialized countries. This however is only part of the story and solid evidence of its lack of understanding about finance and economics.

The entire increase in overall debt stems from overseas funding, which jumped to \$25.7bn, or 26.7%

of GDP, compared with \$20.2bn, or 20.2% of GDP, a year earlier (the ministry reported GDP for 2016 at \$96.2bn, 4% less than 2015's \$100.2bn). The ministry reported domestic debt of \$12.6bn, just \$100m higher than the \$12.5bn a year earlier, rising as a share of GDP to 12.9% from 12.5% because of the recession. With the \$1bn debt issuance of January in a retap of the bonds due 2026, officially reported debt tops the legal threshold of 40% of GDP. Correa last October however by decree raised the ceiling by stating that only consolidated debt net of money owed to public institutions like Ecuador's Social Security Institute (IESS) applies to this rule – instead of gross debt. In the ministry's report for December, consolidated debt totaled \$26.8bn, or 27.8% of GDP, in a jump from \$21.3bn, or 21.2% of GDP, within a year.

This however is still only part of the story, sadly. The government's struggle to remain current in domestic payments are reflected in its only partial ability to pay transfer funds to local and provincial governments and publicly funded universities (it still refuses to pay Universidad Andina, until last year led by professor Ayala). Significant debt remains unreported, including short-term CETES, debt owed to the Central Bank of Ecuador at \$4.8bn, and the oil and fuel-backed loans to China, Thailand, and Oman. It also magically disappears from the books: In September IESS stopped registering a \$2.51bn debt the government owed its health fund. In a statement this week issued after news portal *4Pelagatos* broke the news, IESS said that "the state never owed a debt for health services linked to retirees and victims of catastrophic illness," reflecting comments made in April 2014 by Correa, shortly before canceling a 40% annual government subsidy to the institute (almost a year later, he said IESS, not the state, shouldn't pay retirees' health services). Nonetheless, IESS's accounts continued to reflect the debt until the third quarter of last year.

Overall, not only does Ecuador face having to repay almost all of its debt in only a decade, a weight

compounded by a sluggish growth outlook. We also don't know how great that debt really is. This has led not just opposition candidates to speak of debt restructuring: Even Moreno this week spoke of replacing expensive debt with loans at lower rates. That, however, implies a restructuring of spending policy that is invisible in his electoral platform.

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