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ECUADOR WEEKLY REPORT®

KEY INDICATORS

For the week of Feb 13 – Feb 17, 2017

Down to the Wire

With polls more than a week old and conflicting down to the wire, little more than hearsay and the latest scandals have been there to guide voters down to the final minutes of the decision on who gets to succeed president Rafael Correa in late May. Amid the sadly large field of eight candidates, most of whom hardly stand a chance at getting elected, they get to choose between an illiberal, populist, state-oriented worldview and another much more trusting in guaranteeing individual rights and freedoms, albeit split among three candidates with important ideological differences among them.

Guillermo Lasso (CREO), a conservative former banker, has emerged as something of a favorite to end up winning the presidency in analyst reports, including our *Ecuador Weekly Report*. Correa's chosen successor, Lenin Moreno (vice president 2007-2013), still has very strong chances of winning. His success appears more to hinge on whether he can hold on to enough popularity to win in the first round by capturing at least 40% of valid votes than on whether Lasso or one of the other candidates, including conservative rival Cynthia Viteri (Partido Social Cristiano) and retired general Paco Moncayo at the head of a broad left-of-center coalition, can obtain at least 30%.

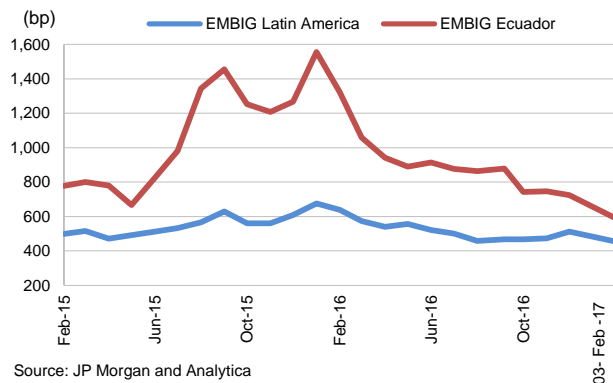
Moreno's candidacy and the government have pulled all possible strings. Nightly brigades have been filmed pulling down opposition campaign advertising, replacing it with that of the correísta Alianza Pais (sic) movement's. A new television

Ecuador's Global Bond Prices

| Bond | Last Price (end of the month) | | | | | | |
|-------------|-------------------------------|--------|--------|--------|--------|--------|--------|
| | 10/02/2017 | Jan | Dec | Nov | Oct | Sep | Aug |
| Global 2020 | 108.91 | 109.52 | 107.89 | 105.54 | 106.13 | 102.51 | 102.30 |
| Global 2022 | 109.33 | 112.25 | 108.81 | 104.94 | 106.11 | 102.47 | 102.89 |
| Global 2024 | 97.77 | 99.07 | 95.92 | 92.15 | 94.55 | 90.25 | 88.05 |
| Global 2026 | 105.79 | 105.96 | 102.50 | N/A | N/A | N/A | N/A |

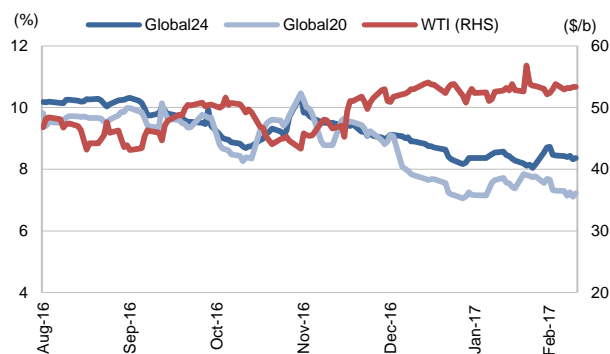
Source: Bloomberg and Analytica

EMBIG Spread



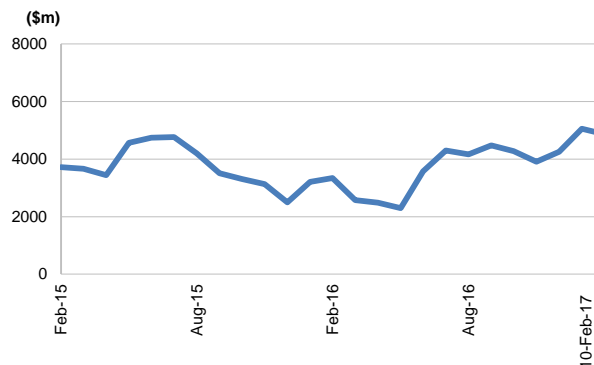
Source: JP Morgan and Analytica

Bond Yields vs. WTI in 2017



Source: Bloomberg and Analytica

International Reserves (\$m)



Source: BCE and Analytica

segment ordered by the communications secretariat, “*Siete días en siete minutos*” (Seven Days in Seven Minutes), offers a daily prime-time advertorial highlighting “positive news,” i.e. propaganda of government achievements with supportive comments from local beneficiaries of new clinics, schools, and other investment, as well as from friendly experts. Campaign handouts have included prepaid phone cards and flyers offering people to register people for free or nearly free public housing that Moreno has pledged for his presidency, amid a cornucopia of populist goodies like \$150 monthly cash payments to poor households, triple the current amount, and 40 new technical universities. Critics scoff at the prospect of Moreno being able to provide these, and the candidate has given no details on how he believes he might prove them wrong amid a dire fiscal situation. This isn’t the point however. Moreno needs only to convince perhaps three or four percent of voters to prefer to bet on some part of this largesse to reach them to win in the first round.

Other voters see the last-minute AP tactics as evidence of desperation and, much as it occurred in the 2014 local elections, when it undertook a similar campaign, as proof that opposition candidates have made similar gains. The latest news about corruption scandals may be pulling undecideds to vote for an opposition candidate, in many cases for Lasso, according to anecdotal evidence, in the hopes that Moreno will fail to win in the first round. So might concerns about fraud related to the numerous cases of deceased people and non-resident foreigners discovered to be on the electoral roll and the roll’s large size as well: there are 1.6m more voting age people on the roll than the statistics agency calculates actually exist. The relationship between the telecommunications company hired by the electoral council to transmit the data from the voting precincts and vice-presidential candidate Jorge Glas has also raised eyebrows. A very narrow Moreno victory therefore also raises a possibility of protests. People

may be angered by allegations of fraud but also by the corruption issue, much of it aimed at Glas in recent weeks. Glas has denied any wrongdoing, but has largely disappeared from the campaign trail, also skipping Moreno’s final election rally in Quito.

Election runoffs are supposed to give the victor legitimacy and a mandate to lead a country by having had more than half of the voters behind her or him. This has often worked poorly, not just in Ecuador, as voters have been forced to align behind a figure little to their taste, only to avoid an even worse prospect. It may be fair to say that, a decade ago, faced with the option of the goofy banana billionaire Alvaro Noboa, many opted for Correa instead. Now, a similar situation may go against Moreno.

Another Boondoggle

Last December, the Yachay public university, touted as world-class by president Correa, presented lettuce and two radishes as proof of success of an urban agriculture project. While not intended to provide evidence of global education leadership, the tweet triggered widespread ridicule. Now, Yachay did far worse: its claim this week that it had managed to attract a huge investment in cutting-edge technology was quickly revealed to be an empty propaganda trick. Secretary of higher education René Ramírez and Yachay chief executive Hector Rodríguez presided over a ceremony in which a company called Red Tech NikteslaCORP agreed to invest \$3 billion in a factory to produce electric cars, motors, and graphene semiconductors in a new factory near the university, located in a balmy Andean valley not far from the northern city of Ibarra.

One of Correa’s long-term promises was to transform Ecuador from a resource-based economy into one of new industry, centered on biotechnology and driven by clean energy. While he managed to build fewer than half the promised hydroelectric plants in his decade in office, the situation regarding industrialization has been even worse, as the share of

industry in gross domestic product has declined, despite protectionist efforts. Car and mobile phone assembly plants have shut down amid the economic crisis. A major deal to build a future-proof factory would have helped dispel that criticism.

Alas, even for a startup, Red Tech has a short pedigree. The company which supposedly would provide billions was registered less than 24 hours before the deal was signed. The company's chief executive, as reported, above all Martín Pallares of news web site 4Pelagatos researched within hours, is a twenty-something named Justin Perry, who as recently as December 22 on his Facebook page said he was in the jobs market "looking for anything I might remotely be able to do." As recently as January 20, US technology blog *Engadget* reported that researchers at Cambridge University were hopeful that they might have discovered a feasible way to create graphene superconductors. "Like so many graphene projects, it's still early days," *Engadget* reported. Three weeks later, Ecuador's government announced a factory for this non-existent technology would be built. Newspaper *El Comercio* reported that the agreement includes a 90-year lease that, at 25 cents per square meter, will provide a \$1m monthly rent for the 400 hectares. This makes the whole thing look more like an obscure real estate deal. Land around Yachay now appears to have been expropriated with taxpayers' money to benefit dubious investors.

On his part, Ramírez days earlier tweeted an electoral survey predicting a first-round victory by candidate Moreno falsely attributed to Georgetown University's Center for Latin American Studies. The university took the trouble to tweet a denial. It's not the first time the government has used empty propaganda to create an illusion of modernity. In 2014, Correa had two useless micro-satellites sent up as proof of the country's entry into the space age. One might be able to take this as humorous third-worldliness along the lines of the magic realism

described in Latin American literature, or the brilliantly described world of a 20th-century Latin dictator of Cuban novelist Alejo Carpentier's 1974 *Recurso del Método* (translated as *Reasons of State*). For Ecuador's claim to seriousness as an investment partner, the event will hopefully linger in memory only as one of the final farcical episodes of a dying regime.

Too Complicated

Ecuadorians aged 16 and over will head to the polls on February 19. Precincts will be open from 7 a.m. to 5 p.m., an hour later in the 30,000-resident Galápagos Islands. Those aged between 18 and 65 must vote or face a \$45.50 fine; proof of voting is also required for numerous bureaucratic procedures like car registration and opening a bank account. Two quick counts will report samples drawn from several thousand votes at 8 p.m., one by non-governmental organization Participación Ciudadana, the other by the National Electoral Council itself, which has drawn criticism from political scientists given a potential conflict of interest.

In this election, voters will receive ballots to pick a presidential ticket; "national" legislators representing parties on a nationwide basis; and legislators representing local districts, 137 in all, and 5 representatives to the Andean Parliament. The split of opposition candidacies into numerous party and movement lists will favor AP given the incumbent organization's large number of candidates and nationwide presence, risking to undermine an eventual opposition presidency. Redistricting and the introduction of the D'Hondt method of distributing congressional seats increased this risk. While in a country with large districts, the D'Hondt method creates little distortion, in the small districts gerrymandered here in 2012, this has favored the biggest party. As a result, in 2013, AP obtained more than 70% of the seats with less than 55% of the votes – enough to change the constitution and any other law without fearing serious opposition.

Additionally, voters get to pick and choose individual candidates on ballots. While this permits people to more clearly express their preference for candidates over parties, this has made counting the votes highly complicated, and in past elections, it has taken weeks for a final result to be made public. Also, historically since the 1990s, political parties have become weakened, favoring populism.

Voters will this time around also decide whether to prohibit civil servants, both elected and unelected, from owning assets in tax havens. President Correa, who had this referendum included in the election principally to attack candidate Lasso, has done little to promote it in recent weeks as the corruption debate has increased. Correa originally came up with the idea of the ban after the Panama Papers scandal broke. But with numerous officials at state-owned oil company Petroecuador facing trial in the days before the election, he has gone largely quiet on the matter. Still campaign jingles ask voters to favor the ban in order to combat corruption. It remains to be seen what the complex question with limited exposure leads to. In any case, an elected official with assets in this kind of jurisdiction will have a year to sell it to be able to stay in office.

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