

ECUADOR WEEKLY REPORT[®]

KEY INDICATORS

For the week of Mar 06 – Mar 10, 2017

The Trooper

In the military academy’s parking lot because they were denied access to an auditorium, four lieutenant generals removed from the army by president Rafael Correa spoke to reporters late on March 6. “We reached this situation thanks to the vicissitudes of politics,” said Gustavo Egüez. The most senior, Luis Castro, confirmed what many critics had feared: the armed forces, custodians by law of the ballots, didn’t have full control of them during the entirety of the February 19 first round of the elections. Correa didn’t explain the staffing changes. Guillermo Lasso (CREO), the conservative candidate facing the president’s former vice president Lenin Moreno in the April 2 runoff, said that they undermine the military’s institutional structure and come at a negative time due to the sensitivity of the upcoming, pivotal vote. Thirty-eight years after the fall of the last military dictatorship, Correa’s running of things has pushed it back into the center of politics, much to its chagrin.

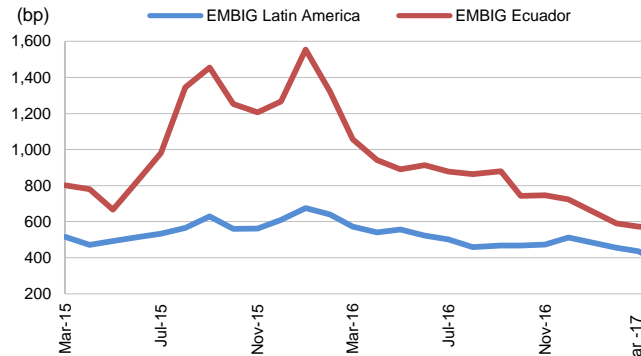
The latest change to the high command puts lieutenant general Edison Narváez, a 35-year career officer, at the head of the army. Correa first had to issue a weekend decree to replace Castro with Egüez before replacing the latter with Narváez, resulting in the turnover at the top. In recent years, Narváez commanded the North Andean and Amazon troops along the border with Colombia, militarily a particularly sensitive area due to operations by Colombian rebels and other criminal networks. According to opinion site *4Pelagatos*, Narváez, most recently undersecretary of defense under defense

Ecuador’s Global Bond Prices

Bond	Last Price (end of the month)						
	10-Mar	Feb	Jan	Dec	Nov	Oct	Sep
Global 2020	108.46	110.18	109.52	107.89	105.54	106.13	102.51
Global 2022	109.19	111.82	112.25	108.81	104.94	106.11	102.47
Global 2024	97.68	100.41	99.07	95.92	92.15	94.55	90.25
Global 2026	105.88	108.65	105.96	102.50	N/A	N/A	N/A

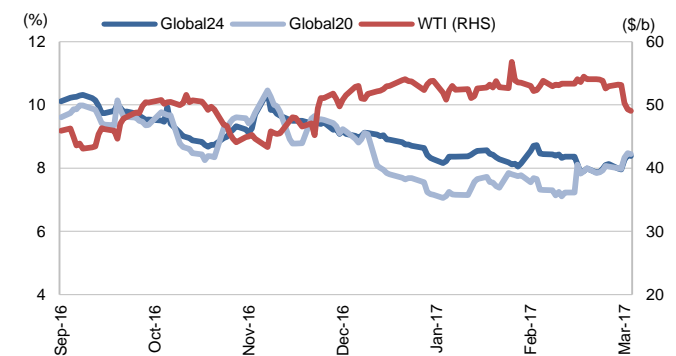
Source: Bloomberg and Analytica

EMBIG Spread



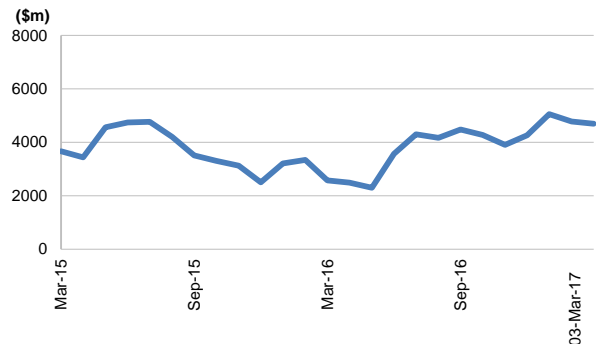
Source: JP Morgan and Analytica

Bond Yields vs. WTI in 2017



Source: Bloomberg and Analytica

International Reserves



Source: BCE and Analytica

minister Ricardo Patiño, was also the lone army general who didn't sign a generals' letter calling for the National Electoral Council (CNE) to ensure respect for the actual electoral results. While the government touted a poll that said Moreno had obtained 42%, pollster CEDATOS reported 39% for him, which left him short of a threshold to win without facing the runoff against Lasso.

By and large, the CNE in the end appears to have confirmed results close to what voters picked. This doesn't mean the elections fully met standards for a democratic vote. Not only did Correa's electoral vehicle, Alianza Pais (sic) pick up 51% of the legislative seats with just 38% of the vote, thanks to the gerrymandering in 2012. Moreno and other AP candidates had indiscriminate use of the state to promote their campaigns. After the vote, numerous reports of irregularities have emerged, as well as practical problems that should have been solved after many decades of elections. Urns were uselessly split between those destined to hold ballots for the president and a referendum and those for legislators on local and district lists, confusing voters and providing discomfort since they were the lower half of the cardboard voting booth, only to be jumbled anyway to make sure all the ballots would be counted. A person who was depositing ballots often juggled the booth just as the next voter was standing behind it picking the candidates. More seriously, in a number of districts, the number of absentee votes was significantly and even dramatically lower than the average 18.4%, including Santa Elena (7.8%), Los Ríos (12.1%), and Manabí (13.7%), an indication of possible ballot stuffing (Moreno obtained a very wide margin over Lasso in those areas). A February 23 letter leaked on social networks shows admiral Darwin Jarrín requesting that César Merizalde, head of the chiefs of staff and brother of Petroecuador chief executive officer Pedro Merizalde, speak to Patiño and the CNE to make sure there was no break in the custody. The weak point, mentioned publicly by

Castro, was the handover of the precinct results to the aggregators of the tally.

On its part, the CNE said that "at no moment, reports or electoral material was without custody of the armed forces." Yet the irregularities reported included individuals attempting to enter the Guayaquil CNE offices with ballots in backpacks. Correa even indirectly confirmed this to foreign reporters when he complained about demonstrators having searched these people. Castro, previously not known as a critic of the president – he led Correa's extraction from the police hospital in which he had holed up after provoking mutinying police on September 30, 2010 – also warned against the potential for fraud on April 2, asking the military to hold steady in protecting the results. He also criticized Patiño for tweeting survey data on the elections before the polls had closed and said that a press release after the election denying that a council of generals had taken place was false (the chiefs of staff also published the same press release). Ahead of Lasso, Castro warned that the changes in the military were taking their toll on the institutional structure of the military.

Perhaps this is the point Correa and Patiño want to force onto the military, telling it that it needs to be subservient to the government to a situation similar to that of Venezuela, and that the shakeups will stop if it submits. This is unlikely to succeed. In a moment when voters get to pick between a model that led it straight into a crisis after an unprecedented bonanza and orthodox economics combined with a protection of civil liberties, the military has been forced into an extremely uncomfortable role. Patiño said the military had no role beyond safeguarding and transporting the ballots, but the fulfilment of this has pushed it not to turn a blind eye to the risks of manipulation. The situation is also a stark reminder for Lasso and his supporters, which now include even hard-left political organizations like Unidad Popular, as well as to foreign observers, of the risk of fraud. With its back to the wall, correísmo should be expected to try to pull

all the strings to ensure it doesn't lose power.

Struck a Nerve

At least since the introduction of the dollar in Ecuador, suspicions regarding the laundering of the US currency here have run high. In its recently released annual report on drug trafficking and money laundering, or "International Narcotics Control Strategy Report," the US State Department identifies Ecuador as a "major money laundering country" in the past year. It hadn't been listed as such in 2015, leading to significant media coverage and several days of hysterical retorts by public officials including interior minister Pedro Solines, justice minister Ledy Zúñiga, and foreign minister Guillaume Long. Fortunately, the political overtones aren't necessarily hampering efforts to fight laundering, although the report points its finger at the judiciary.

Ecuador's reactions approximated those of the Venezuelan regime when questioned regarding its humanitarian crisis, authoritarianism, or blood links of its leadership with accused drug traffickers. Certainly, the report presented an opportunity for the government to play the nationalist card amid the campaign, and was perhaps therefore stronger than in previous years. Solines, a loose-lipped former banking superintendent, said that Ecuador "has a legislation and financial control (among) the most advanced in the world to prevent and control laundering." The foreign ministry, led by Guillaume Long, a French-born UK national, blasted the report, saying that "on repeated occasions Ecuador has told the government of the USA that this practice of issuing judgement over third countries violates the principles of judicial equality of states and non-intervention in the internal affairs of sovereign countries." But the report is primarily directed at a US congressional audience rather than global media. Were it used in the sense that Long implies it would be a singular document aimed at alienating most of the world. As a UK passport holder, Long was

perhaps doubly stung given that the report also mentions London as a laundering center.

The report meanwhile does make points worth mention because of the country's inclusion into the highlight reel this year. Overall, the wording has hardly changed over the years. It continues to reflect Ecuador's twin problems as a transit country between the principal cocaine producing countries, Colombia and Peru, and the use of the dollar itself, the world's most liquid currency and therefore the most attractive for laundering. Importantly, the listing downgrade comes after the improvement in the fight against laundering recognized by the Financial Action Task Force, a global anti-laundering organization, in 2015. The report points to overall corruption and laundering through trade, retail, and cash couriers, mentioning a large yet indeterminate amount of money entering and exiting Ecuador. The picture is murkier still regarding banks, citing "some observers" noting "laundering is an important component in Ecuador's financial sector and authorities lack sufficient will to stamp out this activity." Despite the FATF approval of tightening of anti-laundering rules, the report finds that the penal code has "unclear wording (that) has led to confusion over the law's proper interpretation" and that specific criminalization of bulk cash smuggling is necessary as a "significant deterrent for this serious issue." At the same time, the document also mentions the Petroecuador corruption and gold smuggling scandals and says that government commitment needs to be improved. While it lauds the anti-laundering unit, it says that the top problem is the "widespread corruption and a lack of adequate training within the judiciary," which doesn't even report data on laundering and convictions. This is yet another severe indication for the vicissitudes of the control over the judiciary the government completed five years ago and is among the leading issues that the next president should resolve.

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