

ECUADOR WEEKLY REPORT®

KEY INDICATORS

For the week of Jul 3 – Jul 7, 2017

Oil's Return

Carlos Pérez, Ecuador's oil minister, this week spoke at length to the media in his first individual press conference. As he had implied in earlier interview, Pérez, a longtime executive at the Ecuadorian operations of oil services company Halliburton, has launched an oil policy that marks a significant rollback from the past decade, while maintaining some recent financial successes in the state oil sector. Using a careful wording bent on avoiding potentially polemic discrepancies, nonetheless the difference may lead to something of a near-term renaissance of the local industry. Critics have said that Ecuador's reserves dwindled thanks to the lack of exploration under president Lenin Moreno's predecessor coupled with the desperation to produce as much as possible to pay back oil-backed debt mostly owed China. The soft-spoken Pérez however said reserves remained around their long-term average above 4b barrels of crude oil and that he believed Ecuador continues to have a production horizon of around 20 years.

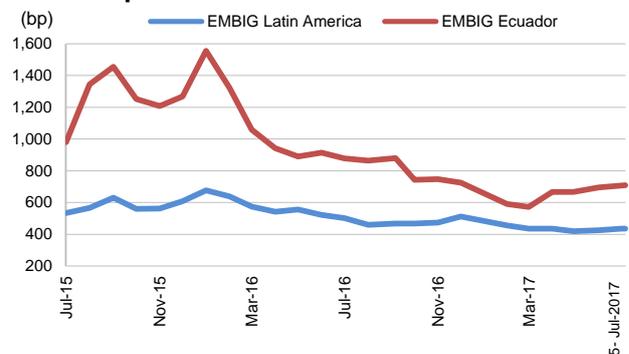
Beyond that basis, the main reason for optimism stems from the recent ability of upstream (exploration and extraction) state company Petroamazonas to cut costs, the leading factor which led chief executive Alex Galárraga, appointed last September, to keep his job under Moreno. Production costs at the company now average around just \$16.96 per barrel, pointing to a healthy profitability even at present crude prices in the mid-forties per barrel. In recent years, the cost was nearly twice as high, although its

Ecuador's Global Bond Prices

Bond	Last Price (end of the month)					
	Jun	May	Apr	Mar	Feb	Jan
Global 2020	104.46	150.58	107.50	106.65	110.18	109.52
Global 2022	106.23	107.41	108.63	106.66	111.82	112.25
Global 2023	97.89	-	-	-	-	-
Global 2024	92.75	95.05	95.58	94.57	100.41	99.07
Global 2026	99.43	101.11	102.29	103.92	108.65	105.96
Global 2027	99.17	-	-	-	-	-

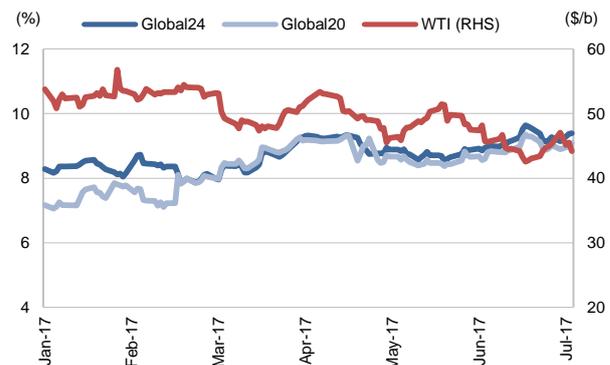
Source: Bloomberg and Analytica

EMBIG Spread



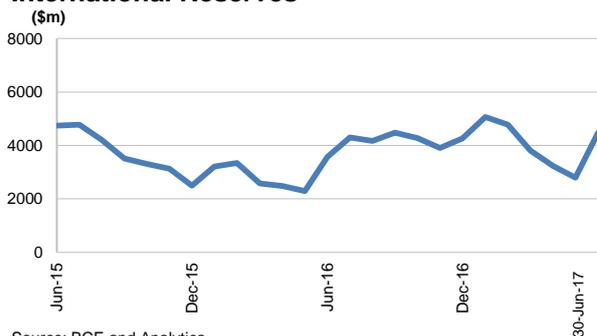
Source: JP Morgan and Analytica

Bond Yields vs. WTI in 2017



Source: Bloomberg and Analytica

International Reserves



Source: BCE and Analytica

components were never satisfactorily made public under the preceding administration. Pérez said the emphasis on cost-cutting will continue, targeting \$15/barrel, strongly geared at reducing Petroamazonas's own energy costs, largely for diesel fuel. The company will replace that fuel with used natural gas associated with its own production as well as with electricity from the Coca – Codo Sinclair hydroelectric plant, Pérez said. At the new field, Ishpingo-Tambococha-Tiputini, production costs are significantly lower. Current output there, which has started in the Tiputini area, is 50,000 barrels per day, with peak production estimated for 2023 at around 300,000 b/d in the Yasuní national park, an Amazon rainforest nature preserve.

Beyond the small fields which it recently began to present to potential investors, and where the flexibility in upcoming contracts reflects a shift from the strict fee-based payments scheme introduced in 2010, Pérez announced a tender for additional fields with reserves between 50m and 610m barrels towards the end of the year. Regarding the large Sacha field, which the previous administration unsuccessfully sought to lease to a private company like Schlumberger or Halliburton, the government still faces the hurdle of dissolving the Río Napo joint venture with Venezuelan state oil company PdVSA. Pérez said he would not sign off on the deal with PdVSA before completion of an environmental review (there was a significant oil spill there while the joint venture existed). Overall, the Moreno administration did inherit a series of problems from that of his predecessor, Rafael Correa. As hinted at above, exploration faltered while Correa mortgaged significant amounts of crude to the Chinese and, to a far lesser extent, Thailand. While Colombian output now tops Ecuador's by a third, a decade ago, when Correa took office, both produced around the same, more than 530,000 b/d.

Ecuador's output first fell despite the global oil boom as Correa rattled the industry with demands for

contract renegotiations that took some four years to even complete. Since then, output for some time slightly topped those of the first years of the century, but has since dropped slightly to around 530,000 b/d, irrespective of the cuts agreed by oil cartel OPEC and other significant oil producers to help shore up prices. Pérez said he aims to increase output once OPEC ends the limits on production, a more dovish position compared with the previous administration. At the same time, the financial woes inherited by Moreno also mean that the pre-sale mechanism might yet be repeated to help fund the government's strained budget. Talks are underway with other potential providers of this kind of funding, Pérez said.

The politically charged issue of corruption has also had an impact on Petroecuador, the downstream (transportation, refining, and sales) state company where dozens of former officials have been found guilty of crimes like bribery and embezzlement. Under a new manager from outside the industry, numerous contracts at the Esmeraldas refinery, one of the main focal points of corruption, Byron Ojeda, have been canceled. On his part, Moreno this week reinstated financial controls by the finance ministry and comptroller general's office before contracts for public works can be signed; "supplementary" contracts now linked to suspected corruption often ballooned the price of power plants and other infrastructure under Correa.

While potential cleanup costs left over from the Río Napo episode worry Pérez, he appeared less sensitive to some environmental questions than critics would like to hear, particularly given the potential impact of production in the Yasuní park and a vast area south of the park on intact forestland part of indigenous territories. Pérez repeated the previous government's insistence that, were it not for the presence of a company like Petroamazonas, small local communities would be bereft of public services like electricity. As cases in the Amazon southeast demonstrate, this is untrue. Also, Pérez insisted that

recently documented illegal trade in tropical woods and other contraband to Peru from an area so sensitive that any outside activity is prohibited, was up to the environment ministry. Technically this is true, but it's also true that provision of services that he touted for local communities is also not up to oil companies. A much more proactive position will be necessary to avoid conflict with indigenous communities and environmentalists who, given the industry's troubled early environmental track record in Ecuador, will be adamantly against the expansion of the oil frontier and with whom Moreno very publicly started a dialogue this week as well.

Correa's Departure

Former president Rafael Correa this week announced that he will leave Ecuador on July 10 to live with his family in Belgium (his wife is from there). His departure will do much to calm the political situation in the country and strengthen the Moreno administration, but, paradoxically, also may enable the opposition. For all the safeguards and defensive trenches Correa and his allies have dug against losing power, they do appear to be fighting a retreating battle. Despite the continued presence of correístas in the government, Ecuador is beginning to resemble that of the years before Correa, and that's a good thing.

Among the signs of a return to normalcy, Correa for the first time since 2007 lost a case in court this week. In yet another suit against a journalist, he had accused Martín Pallares of libeling him in an article for opinion web site 4Pelagatos. Correa's lawyer Caupolicán Ochoa, said that an article, in which Pallares hypothesized about Correa's potential arrest, caricaturing the then-president as a potential jewel thief, had injured Correa's "honor" and "dignity." Correa failed to appear at the court. His key witness, a woman who said that she had received the article via social networks, denied that the article had in any way altered her (positive) perception of the president.

While this pulverized Ochoa's arguments, it remained up to the judge to actually apply the law, and, given the track record of manipulation of justice and lack of independence in the past decade, this was not necessarily to be expected. Yet judge Fabricio Carrasco indeed declared Pallares innocent. Beyond protecting freedom of expression, the decision is also a potent signal of independence to judges and potential investors.

Correa hasn't commented on his loss, preferring to take to Twitter to voice his displeasure at decisions taken by Moreno, his vice president 2006-2013, such as guaranteeing umbrella indigenous group CONAIE its Quito headquarters (Correa had unsuccessfully attempted to close it). He called this decision "disloyal and mediocre." Moreno responded that he will continue "determined to reconcile the country. For hate, don't expect me" to be a part of it. Among Ecuadorians, Moreno appears to have the upper hand over his former job. As of June 15, he enjoyed an approval rating of 66%, some 25% above his electoral results, according to pollster Cedatos, which has also for the moment at least apparently survived Correa's attempts to have it shuttered during the dying days of his administration (he accused it of masterminding a quasi-coup attempt by publishing an exit poll on the day of the vote that said most of the around 36,000 polled had voted for conservative Guillermo Lasso). While Correa may well be planning a return in triumph, at the moment, a rupture between him and Moreno and a breakup of his political organization, Alianza Pais (sic), looks like a more near-term likelihood, and a reflection of how Correa's power has dwindled.

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