



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

ECUADOR WEEKLY REPORT®

KEY INDICATORS

For the week of Jul 31 – Aug 4, 2017

Lonesome George

President Lenin Moreno this week dramatically isolated his running mate, Jorge Glas, by stripping him of his remaining government functions. Glas had forced his hand as the ever-growing evidence of his personal corruption triggered a major political crisis. Erstwhile, Moreno appears to have the upper hand. Alianza Pais (AP), the amorphous political vehicle that Rafael Correa used to rule Ecuador from 2007 to 2017 and on whose ticket Moreno and Glas were elected, now faces a possible rupture or, conceivably, even extinction.

Peruvian investigative news site *IDL-Reporteros* unleashed the storm by publishing an audio recording of a conversation between Carlos Pólit and José Conceição dos Santos, at the time the comptroller general and a representative of Brazilian construction firm Odebrecht, respectively. In their conversation, according to *IDL* gleaned from testimony by Conceição, who took advantage of the opportunity to a plea bargain, Conceição said that via Glas’s uncle, Ricardo Rivera, now under house arrest under suspicion of taking bribes, “Jorge Glas had asked me for money for all contracts ... He told me it was an obligation because the Chinese were already paying.” Glas said that this was all part of Odebrecht’s smear campaign against him for having been tough on the company in a 2008-2010 dispute over a badly built power plant.

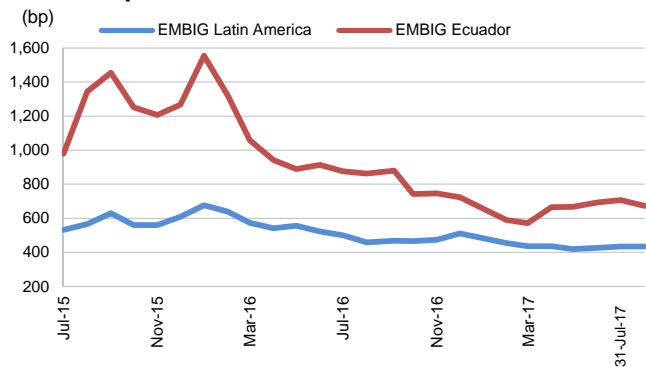
Since the audio was part of a conversation, Glas’s claims look weak. On Thursday, he received more bad news on the legal front as prosecutor general

Ecuador’s Global Bond Prices

Bond	Last Price (end of the month)						
	4-Aug	Jul	Jun	May	Apr	Mar	Feb
Global 2020	106.94	106.12	105.83	105.58	107.50	106.65	110.18
Global 2022	109.22	108.20	106.83	107.41	108.63	106.66	111.82
Global 2023	101.29	100.12	98.55	-	-	-	-
Global 2024	97.37	95.60	93.52	95.05	95.58	94.57	100.41
Global 2026	104.07	102.56	100.71	101.11	102.29	103.92	108.65
Global 2027	103.93	102.19	100.30	-	-	-	-

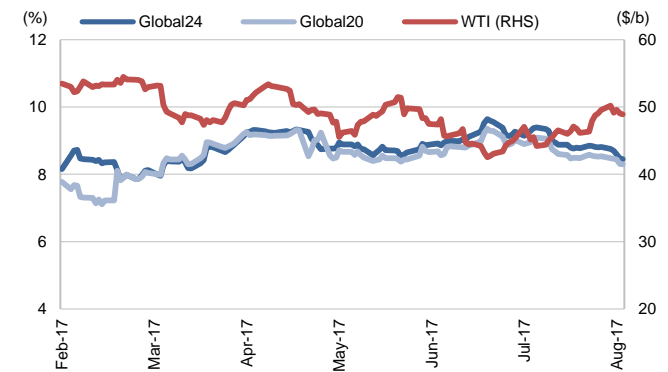
Source: Bloomberg and Analytica

EMBIG Spread



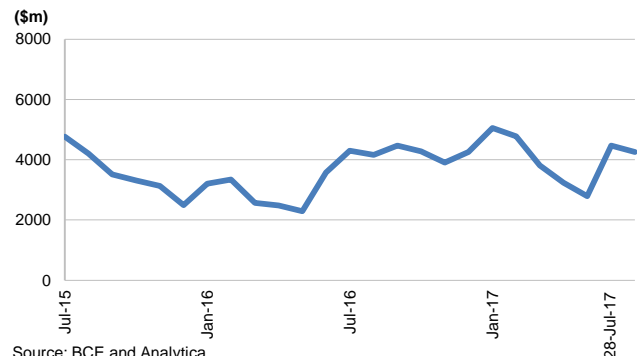
Source: JP Morgan and Analytica

Bond Yields vs. WTI in 2017



Source: Bloomberg and Analytica

International Reserves



Source: BCE and Analytica

Carlos Baca, formerly considered a *correísta* hardliner, confirmed that he had included the vice president in a criminal investigation into a deal for Singue, an oilfield, after the comptroller general's office had found evidence of criminal activity that could include embezzlement. Glas decided to go on the offensive to victimize himself and, along with once again denying any corruption, accused Moreno of trying to roll back the political changes Correa established in his uninterrupted decade in office (a record) in order to impose a supposedly unnecessary economic structural adjustment plan on Ecuador.

In a four-page public letter, he claimed that Moreno had handed control over state-owned electricity distributor CNEL, to the family of Abdalá Bucaram, as part of an alleged deal for the latter's return from Panama after 20 years in self-imposed exile; accused Moreno of "perverse" interpretation of economic figures by revealing that Ecuador's foreign and domestic debt is well above the 40% legal ceiling (see below); by appointing an independent career journalist to run newspaper *El Telégrafo*, under Correa a government mouthpiece; and by discussing the entry of private banks in the running of the troubled mobile payments scheme (also see below).

Moreno refused to comment in public and said that he would never interfere in the judiciary's activities. He also didn't respond to Glas's attacks, instead accusing him of disloyalty on his part. Already stripped of much of his power compared with his role under Correa, when he oversaw a major part of the economy including oil, electricity, and telecommunications, he removed him from his remaining administrative roles, though he can't fire him altogether. Glas thus no longer has any government-sponsored way to try to shore up his public image. Less than 100 days into office, Moreno has amputated *correísmo's* leading representative from the government.

Some analysts say that Correa continues to wield major power. This remains to be seen as Moreno now

holds the most essential power: the purse strings upon which loyalty largely depends. AP's legislators made a lukewarm call on both leaders to compromise, but given the insults heaped upon Moreno by Correa and Glas, along with the latter's undignified public whining about being barred from using the presidential plane, reconciliation is very unlikely. Aware that Moreno will likely not pick him as vice president once Glas is forced out, as he eventually will be, José Serrano, the president of the congress, appears to be throwing his political weight around as the manager of AP. Serrano positioned himself as the holder of Correa's legacy, overshadowing Glas, by disputing Moreno's comments on debt, just like Correa did via Twitter. Serrano also warned Moreno against tampering too much with the real estate windfall tax (see below), setting him up for a battle in congress. This will provide another test of survival for AP.

Taking Stock

Thankfully, president Lenin Moreno has dropped his predecessor's compulsive habit of forcing radio and television stations nationwide to broadcast what he actually had for breakfast or attack foreign correspondents for tongue-in-cheek tweets in so-called *cadena nacionales* (national emergency broadcasts). In one of his first such broadcasts, Moreno late on July 28 instead told the public how much domestic and foreign debt he had inherited from Rafael Correa: up to \$58b, around 60% of GDP, including money owed the state-run Social Security Institute and potential losses in international arbitration courts. The confession of debt way beyond the legal 40% ceiling is positive, paving the way for realistic fiscal planning and refinancing. During the campaign, he had stuck to Correa's claim that debt was just 27% of GDP. Moreno also acknowledged that Ecuador's economy is in dire straits: "The situation is critical, it is true; we need to improve financing conditions, generate higher inflows,

increase our exports, bring dollars into our economy and encourage private investment." Regarding the way out of the economic problems, the message however falls sadly short.

Thanks to Correa's spendthrift ways, Moreno's predecessor, whose vice president he was from 2007 to 2013, "put the sustainability of our economy to the limit." As a result, growth this year would register a paltry 0.7% increase, slowing from the debt-driven bump of 2.6% reported by the central bank for the first quarter. After the book-cooking and -hiding of the past decade, data would be "truthful, precise, and publicly accessible," Moreno promised. Here, the trouble starts. He said the budget would increase 2% on the year this year to \$36.8b; but data reported for last year (if truthful) indicate the administration spent \$34.3b, 7.3% less. Estimates for this year also look doubtful: Moreno estimated that the government would collect \$14.8b in taxes, a wildly optimistic figure considering that this is 20% more than last year's tax intake. In the first half, the tax service collected 10.6% more than in the same period of 2016, i.e. \$6.87b, but with a 2% drop in value-added tax and even Moreno saying that growth will slow, it's doubtful the target will be met. On the one hand, this will make it more difficult for the deficit to drop to 4.7% of GDP given inertia in spending on public-sector salaries; on the other hand, it's unclear where new sources of funding will come from.

This issue could be countered by a credible economic reform plan. Moreno, and early this week finance minister Carlos de la Torre, mentioned boosting the construction industry, reduction of a demand for cash, repatriation of assets held overseas, and fiscal austerity, all of which would protect Ecuador's use of the dollar. To boost construction while reducing spending on public infrastructure, Moreno said he would reform the controversial real estate windfall tax, which Correa eventually imposed despite massive protests. To lower demand for cash, the government will end the

central bank's monopoly of mobile money, hamstrung by the misguided attempt to create a parallel currency under Correa. Ecuadoreans' foreign holdings, meanwhile, would be welcomed home tax-free, with the government hoping to attract much of the at least \$10b it estimates are held overseas.

Helpful as they may aim to be, in their present form, the proposals however have issues. Regarding austerity, there's no sign it's actually going forward. Electricity minister Medardo Cadena didn't get the memo, together with the electricity regulator holding a bash in Quito's planetarium before many dozens of bureaucrats to celebrate spending on the sector in 2016, during which just three of a promised eight hydroelectric plants were finished, and planned privatizations never went ahead. The presentation's data remains unavailable online. Mobile payments, meanwhile, face an uphill battle due to the poor reputation of the scheme and the misnomer of "electronic money" and the prejudice of trying to force banks to reduce fees as low as possible to ease access, while competition should instead do that trick. To attract a return of foreign-held assets, meanwhile, Moreno and de la Torre will have to present a more ambitious, clear set of reforms so that people will be confident that their money will gain acceptable returns; otherwise, the administration is prey to wishful thinking and will have to be careful that its efforts don't simply attract launderers. By themselves, the proposals can hardly spur the inflows and investments Ecuador desperately needs. De la Torre has however rejected plans going beyond the announcements and some administrative reshuffling.

Moreno and de la Torre may well have simply kicked the can down the road given that the 2018 budget is due within a matter of weeks. The need for clearer perspectives will only grow. There are some tantalizing hints at greater change however: oil policy is undergoing a reversal, and even an opening of Petroamazonas and Petroecuador along the lines of Colombia's Ecopetrol and Brazil's Petrobras may be

in the cards. The foreign trade minister, Pablo Campana, is starting to pitch a trade agreement with the US (but with a much less open administration in Washington), abandoned in 2007. Along with a more realistic view of debt, Moreno is overall showing a significantly greater willingness to work with the private sector in the open.

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