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**ECUADOR WEEKLY REPORT<sup>®</sup>**

**KEY INDICATORS**

**For the week of Aug 7 – Aug 10, 2017**

**Oily Sovereignty**

On the sidelines of a few protocol meetings with oil companies including Repsol and Baker Hughes, Carlos Pérez, the oil minister, briefly spoke about the elephant in the room: China. While Chinese companies didn't participate in the sitdowns with Pérez and president Lenín Moreno, Pérez said that the review of oil-backed loan agreements had allowed the ministry to determine that Ecuador has paid back about half of the oil it needs to deliver to Chinese oil companies to repay loans: around 550 million barrels out of a total 1.1 billion. Thus it still needs to ship around 550 million more. At output of around 540,000 barrels a day, if Ecuador were to dedicate itself solely to this task of meeting the terms of the Chinese deal, it would take it two years and nine months delivering all of its oil to the Chinese companies to repay the debt. For oil policy, the Chinese deals are a weight that constrains it foreseeably over the duration of the Moreno administration, which ends in 2021.

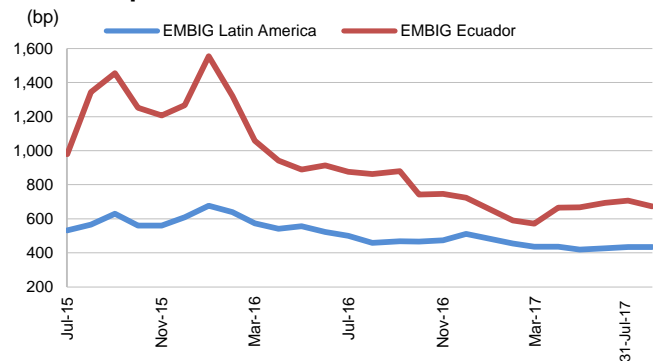
Moreno's predecessor, Rafael Correa, had started contracting the Chinese debt after cutting links with international financial markets through his politically-motivated default on \$3.2b in bonds in December 2008, bought back at a significant haircut for bondholders the next year. While he boasted about the savings in the long run, in fact he forced himself to come up with a lot of cash for bondholders that would have been better spent to boost the economy just as Ecuador needed a fiscal impulse to deal with the Great Recession of 2009. Oil policy, too, reflected Correa's missteps: By threatening nationalization,

**Ecuador's Global Bond Prices**

Bond	Last Price (end of the month)						
	10-Aug	Jul	Jun	May	Apr	Mar	Feb
Global 2020	107.36	106.12	105.83	105.58	107.50	106.65	110.18
Global 2022	109.92	108.20	106.83	107.41	108.63	106.66	111.82
Global 2023	12.51	100.12	98.55	-	-	-	-
Global 2024	98.51	95.60	93.52	95.05	95.58	94.57	100.41
Global 2026	105.18	102.56	100.71	101.11	102.29	103.92	108.65
Global 2027	104.93	102.19	100.30	-	-	-	-

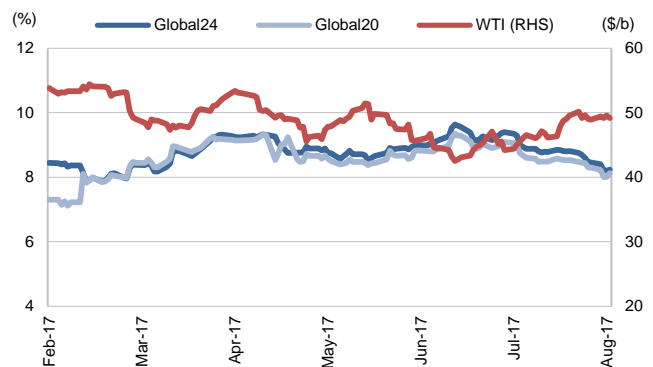
Source: Bloomberg and Analytica

**EMBIG Spread**



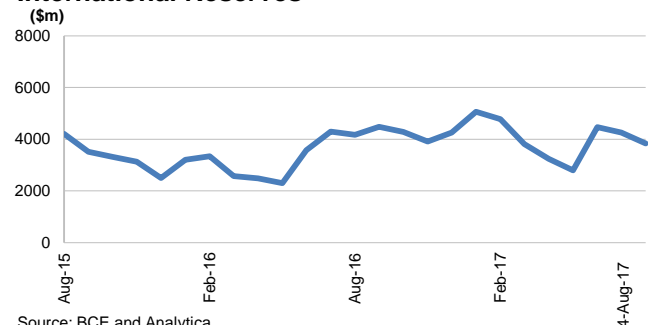
Source: JP Morgan and Analytica

**Bond Yields vs. WTI in 2017**



Source: Bloomberg and Analytica

**International Reserves**



Source: BCE and Analytica

jerking windfall taxes to 99% yet failing to present a contract model, he pushed private oil producers to reduce production even as prices were near record high levels. Before he took office, Ecuador and Colombia produced a similar amount of oil around 560,000 barrels per day. Now, while both are off peaks, Colombia extracts far more.

Meanwhile Correa, who had already dissolved government savings funds, wanted to spend even more. China, which in parallel was also lending significant amounts to Venezuela, stepped up and the first deal was announced in 2010. Correa always denied these deals constituted loans and thus kept them off the official debt register; we have always called them loans since they carry interest. In total, according to Pérez, Ecuador will receive around \$14b in disbursements, with some \$2b yet to be provided. The country has meanwhile repaid around \$9-10b (each loan carried an interest rate around 6%), including some \$3b in interest and commissions; the latter above all have raised doubts regarding their legality and, hence, suspicions of massive corruption. Moreno finally included them in his statement regarding the true state of debt late July.

He had already said that he would like to renegotiate the deals, and Pérez has said that even another loan from another source might be preferable to continue the agreements under current terms. After all, there are serious indications that corruption was involved here, particularly regarding intermediation. Yet the investigation into public debt ordered July 31 by the acting comptroller general, Pablo Celi, doesn't include all the oil-backed loans, despite the years of controversy surrounding them, because the review will only go back to 2012. The oil deliveries meanwhile never made it to China, instead being exported to the US, where they have always gone; the Chinese companies inserted themselves as intermediaries, while the spot market would always have been the most efficient way to sell Ecuador's crude. While Pérez has announced that Ecuador's oil

will finally once again be sold in the spot market, meanwhile, he still has to solve the troublesome legacy of owing China years of this country's production. Given the impossibility of jerking production higher quickly without major foreign investment, this situation will likely take some time to fix. At least the lenders have indicated willingness to renegotiate, Pérez says.

### **Bad Relationships**

In Germany's medieval national epos, the Song of the Nibelungs, Burgundian royalty put their loyalty to an ally above obligations to serve justice. This appears to be the course the Moreno administration is pursuing with Ecuador's decade-long nominal ally, Venezuela. This week, 17 Latin American foreign ministers gathered in Lima to discuss the situation in Venezuela, where delegates elected in an election so fraudulent that even the makers of the vote-counting computers questioned the results have started to work on a new constitution. Ecuador's foreign minister, María Fernanda Espinoza, rumored to be shortlisted as a potential replacement for current vice president Jorge Glas engulfed in corruption allegations, however chose to travel to Caracas in a counter-summit of the Bolivarian faithful. In her comments there, she said "We condemn the unilateral sanctions that are to be imposed on the Bolivarian Republic of Venezuela, which only affect the Venezuelan people and damage its right to development," ignoring that said sanctions have thus far only targeted high-level Venezuelan officials. In a public statement after the so-called election, her ministry protested against the decision by customs union Mercosur to suspend Venezuela, and, unlike many other countries, recognizes the plan to change Venezuela's constitution: "No foreign will can force the government of Venezuela to take decisions opposed to its legitimate interests, nor to fail to recognize the general will of its people, which at the

polls has expressed its will in favor of installing a Constituent Power.”

Espinoza’s foreign policy is perhaps not surprising given that her Nicaraguan partner, Eduardo Mangas, who formerly worked for Daniel Ortega, the leftwing authoritarian ruler of his home country, as chief of staff is a key advisor to president Moreno. But it is foolish. The alliance with the regime of Hugo Chávez early on certainly helped Rafael Correa reach for power, amid dubious financial dealings that must eventually be investigated. Other Venezuela-sponsored initiatives in Ecuador ended in debacles, such as the plan to build a new refinery near Manta on which Ecuador wasted more than \$1.5b, the failed Río Napo oil joint venture and handover of Venezuelan oilfields to Petroecuador, or a joint mining company. Politically, regardless of the loyalty Espinoza is offering, the alliance with the regime of Nicolás Maduro is a domestic liability – even many leftwing voters have no sympathy for Maduro, according to a local poll – and internationally. Espinoza’s support for Caracas even runs counter to the Moreno administration’s stated goal of reaching a commercial deal with Ecuador’s biggest trading partner, the US, which will hardly find this amusing, and Moreno’s initial rapprochement with both Colombia and Peru. In the end, this raises questions regarding what Moreno’s foreign policy goals actually are and why Ecuador is so desperate to protect the relationship with Maduro.

This is all the more troubling given the easy way out of the Venezuelan swamp that has been charted before it. Moreno has already broken with several of his predecessor’s most cherished policies. He could have ordered Espinoza to ride the Vatican’s coattails and tell the Venezuelans, as their small but still biggest remaining ally, that the new constitution was a step too far. To have gone to Lima would have been to Ecuador’s benefit, demonstrating its willingness to work more closely with its most important neighbors. It might even have credibly positioned itself as a

sensible intermediary if Espinoza had been willing to pursue a more neutral stance. All of this has been wasted, and provided a gratuitous domestic and international blow to the prestige of Ecuador’s young administration. Espinoza would do well to read up on what followed from the blind, unjust Nibelung loyalty: annihilation by the Huns.

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