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ECUADOR WEEKLY REPORT®

KEY INDICATORS

For the week of Aug 14 – Aug 18, 2017

Lenin Strikes Back

The week before Ecuador’s Independence Day holiday, observed August 11, looked bad for president Lenin Moreno. After having frozen vice president Jorge Glas out of the government, Moreno appeared to lose ground: The presidency circulated a document signed by chief of staff Eduardo Mangas that put into writing that Gustavo Larrea, a longtime friend and key behind-the-scenes advisor to Moreno, holds no official position in the government. Also, Antonio Intriago became the first higher-ranking official in the administration to resign, quitting as chief executive of electrical utility CNEL. Intriago noted that he had worked for the administration of Moreno’s predecessor, Rafael Correa, for eight years, only to be slandered as a supposed ally of populist president Abdalá Bucaram by a group of correísta hardliners (Bucaram recently returned to Ecuador after as president fleeing to Panama to avoid corruption charges in 1997 after the statute of limitations in his cases ran out). With that, the correístas appeared to have successfully flexed their muscles, as both Larrea and Intriago were objects of their recent claims that Moreno had “betrayed” the legacy of Correa’s administration. Then the bomb exploded: While thousands of Ecuadorians headed to the beach for the holiday weekend, the presidency said that Carlos Pareja Yannuzelli, a former oil minister now largely known by his “Capaya” acronym and who had fled to Miami amid corruption charges, had turned himself in.

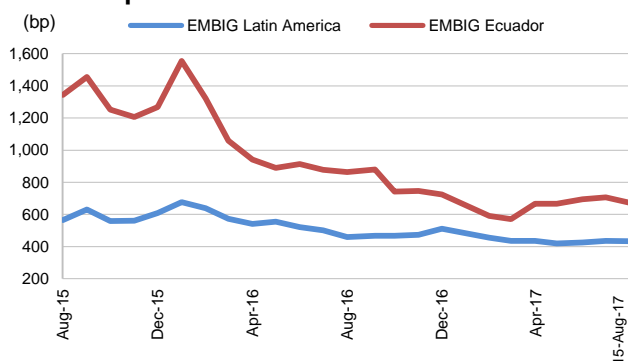
Later that evening, Capaya arrived in Ecuador. Police transferred him to a jail in Quito (before his

Ecuador’s Global Bond Prices

Bond	Last Price (end of the month)						
	18-Aug	Jul	Jun	May	Apr	Mar	Feb
Global 2020	107.17	106.12	105.83	105.58	107.50	106.65	110.18
Global 2022	109.79	108.20	106.83	107.41	108.63	106.66	111.82
Global 2023	102.24	100.12	98.55	-	-	-	-
Global 2024	98.18	95.60	93.52	95.05	95.58	94.57	100.41
Global 2026	105.10	102.56	100.71	101.11	102.29	103.92	108.65
Global 2027	104.91	102.19	100.30	-	-	-	-

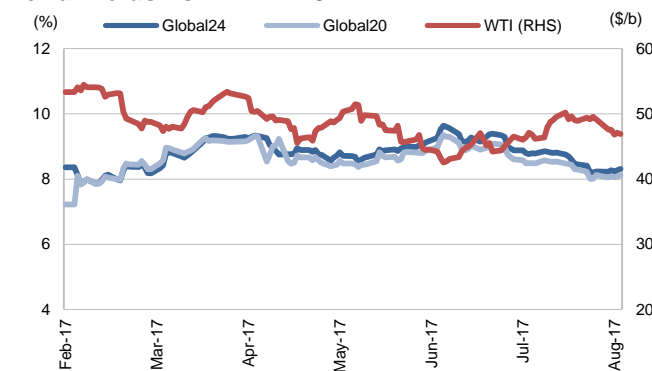
Source: Bloomberg and Analytica

EMBIG Spread



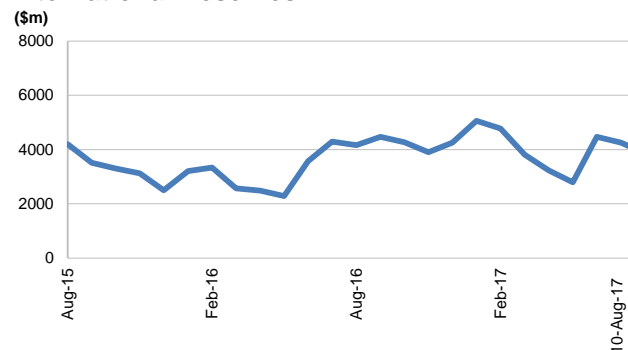
Source: JP Morgan and Analytica

Bond Yields vs. WTI in 2017



Source: Bloomberg and Analytica

International Reserves



Source: BCE and Analytica

departure in 2016, Capaya had resigned for health reasons, saying the capital's altitude was harming his health). He becomes the first former top official in living memory to return to the country to face justice; unlike Bucaram, he says he is willing to face the music. The situation compounds the pressure on Glas: During the electoral campaign, Capaya said that Glas had controlled the corrupt dealings at state refining and oil sales company Petroecuador in cases where dozens have already been tried and many others have fled the country. On his part, Glas has sought to portray Capaya as the mastermind behind corruption at the company. The complications won't end there: Correa in the past inadvertently mentioned his own involvement in potential cover-ups on social networks as he sought to undermine Capaya's credibility, and, according to Christian Viteri, a former legislator of Correa's Alianza Pais (sic) political movement, Carlos Baca, at the time a legal aide of Correa, had sought to stop AP legislators from questioning Capaya in congress. Baca is now the prosecutor general and is due to question Capaya.

The former oil minister's arrival is a welcome contribution to fortifying the judiciary, continuing in the wake of the June 2 arrests of several individuals including Glas's alleged straw man, his uncle Ricardo Rivera. Yet the case is only inching forward. Baca this week says that "if indications against Jorge Glas appear, he will have to be prosecuted." Critics have pointed out that the prosecution has implicated other people, including relatives of Capaya, on much weaker evidence than that which has already been made public. Baca himself has also said there is more damning information than that provided in a leaked audio recording of Brazilian managers who said Glas was bribed. Baca did force his predecessor, Galo Chiriboga, into questioning this week as part of the investigation of Capaya, who was already sentenced to five years in jail and is being investigated in other corruption-related cases (Capaya says he bribed Chiriboga and Carlos Pólit, the impeached former

comptroller general who is also in Miami). Police detained Chiriboga at the Quito airport before taking him to the prosecution's head office (Chiriboga insulted Ecuadorians' intelligence by saying that, even though he was checked in to fly to Colombia, this didn't mean he was leaving).

Politically, while Moreno appears to have the upper hand and poured on more pressure this week on the Correa-Glas legacy (see below), he also appears to have won over José Serrano (AP), Correa's former interior minister and the president of the congress. It was Serrano who said that he brokered Capaya's surrender. Serrano this week also appears to have stopped his AP colleagues from attempting to impeach acting comptroller general Pablo Celi after the latter launched an investigation into Correa's post-2012 debt issuance. For the moment, Serrano perhaps avoided a schism within the bloc and AP in general. Yet from a procedural standpoint, his involvement in the Capaya case is troubling: Why wasn't it the prosecution that handled the matter in full? At least the plea bargain agreement remains up to the prosecution and Capaya and his lawyers to negotiate. But after Moreno already felt obligated to tell Baca he approved of an independent investigation into corruption related to Brazilian construction firm Odebrecht in June, Serrano's involvement in a top-profile legal case shows how strongly the judiciary still remains beholden to political influence.

Downstream Debacle

Voters love big public infrastructure: Under that assumption, president Rafael Correa (2007-2017) embarked on a spending spree that drove propaganda and, sadly, corruption, but failed miserably to meet its targets. None of this is necessarily news as intrepid reporters had dared to defy Correa on the matter, with some of them forced into exile because of this. Refreshingly, the new administration is demonstrating much more candor

regarding the legacy it inherited from Correa. After presenting more realistic debt data in July, showing much higher levels than acknowledged by Correa, Moreno and Carlos Pérez, the oil minister, during a tour of the Esmeraldas refinery confirmed just how badly Correa's government performed in the oil sector. Valuable for the record, the information also weakens the political position of vice president Glas.

The Esmeraldas refinery is the country's most important, with an official capacity of 110,000 barrels per day. Prone to accidents and shutdowns, Correa decided to refurbish the close to 40-year-old refinery early in his administration. The reconstruction cost ballooned to \$2.2bn, up from \$170m announced by Galo Chiriboga, oil minister (later prosecutor general, see above) in late 2007. In itself, the 13-fold price increase is scandalous. Still more shocking, even following the corruption-related arrests and convictions, is that the refurbishment, which aimed not to increase capacity, but simply to restore it, was an utter and complete failure, according to Pérez, who said that the refinery is in a "critical situation." The core of the project, the new fluid catalytic cracking unit, is prone to malfunction and will require an eventual 45-day shutdown for repairs. Other problematic areas include the electrical system, which needs new backup generators to avoid outages if there are fluctuations in the country's power grid (and there have been many in recent months), and the fuel storage tanks, which are in such bad shape that Petroecuador will need to put fuel into tanks at the facility of the nearby OCP heavy crude pipeline, which also exports crude through Esmeraldas. It also can't properly manage the sulfur treatment at the plant, worsening domestic fuel quality.

As the documents presented by the presidency show, Moreno could have picked a number of oil industry sites beyond Esmeraldas where spending by Correa and Glas ended in a debacle. The new president finally appears to have buried the Manta refinery project, which deforested an environmentally

sensitive dry forest near beach resorts for \$1.53b, including leveling of the ground and an aqueduct built by controversial Brazilian construction firm Odebrecht. This company also built a failed 215km multipurpose fuel pipeline between Guayaquil and Cuenca for \$623m: Its automated fuel dispensers don't work, among multiple parts suffering from premature ageing; industrial buyers will have to go back to receiving fuels trucked up from the Pacific Coast. The liquefied petroleum gas terminal at Monteverde meanwhile cost \$670m, but that failed to ensure that it had proper docking facilities, which are now rusting. Its reference cost in 2006 was less than \$100m. In total, in the last decade, during which Glas was responsible for the running of "strategic sectors" like electricity, telecommunications, and oil for the past four years, the government spent more than \$5b on what one can gently call ill-performing assets, amid massive corruption. Correa still boasts that his government did things quickly and very well, and Glas denies that the projects went sour. Hopefully, a majority of voters will understand who is telling the truth.

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