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ECUADOR WEEKLY REPORT®

KEY INDICATORS

For the week of Aug 21 – Aug 25, 2017

Glas Cracks

It finally happened: Ecuador’s prosecutor general Carlos Baca this week said he would include vice president Jorge Glas in a criminal case after the prosecution uncovered what it called “convincing” evidence of his having committed acts of criminal conspiracy linked to acts of bribery acknowledged by Brazilian construction firm Odebrecht. Glas continues to insist that he is innocent and that he is a victim, blaming the media, opposition, and even some in the administration of his running mate, president Lenin Moreno, of having pressured the prosecution to take this step. But it is getting lonelier around him.

Glas’s formal inclusion in the case comes after the return to Ecuador of Carlos Pareja, a former oil minister who had fled corruption charges by escaping to Miami and who from his temporary exile accused Glas of masterminding widespread corruption in the state-run oil industry that court cases have proven in recent months (Pareja however has so far reportedly remained silent pending a plea bargain with the prosecution). Glas said that he had nothing to fear and that he welcomed the chance to clear his name once and for all in court. He even asked Alianza Pais (sic), the political movement on whose ticket he and Moreno ran and which has an absolute majority of 74 seats in congress, to approve the trial. Glas doesn’t have immunity, but the 2008 constitution requires approval by two thirds of the congress for the trial.

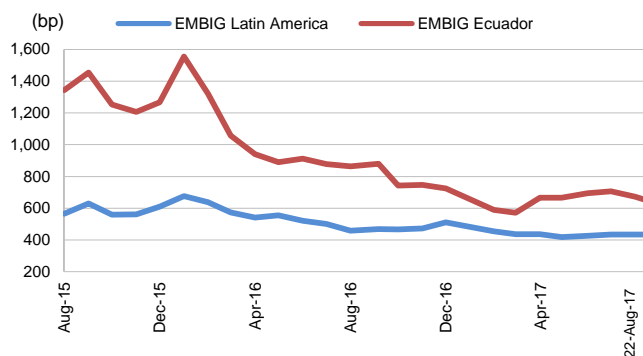
Legal scholars debate whether the proper procedure has been followed, but the National Court, the top instance which would handle the trial, has had

Ecuador’s Global Bond Prices

Bond	Last Price (end of the month)						
	25-Aug	Jul	Jun	May	Apr	Mar	Feb
Global 2020	107.29	106.12	105.83	105.58	107.50	106.65	110.18
Global 2022	110.06	108.20	106.83	107.41	108.63	106.66	111.82
Global 2023	102.45	100.12	98.55	-	-	-	-
Global 2024	98.36	95.60	93.52	95.05	95.58	94.57	100.41
Global 2026	105.31	102.56	100.71	101.11	102.29	103.92	108.65
Global 2027	105.09	102.19	100.30	-	-	-	-

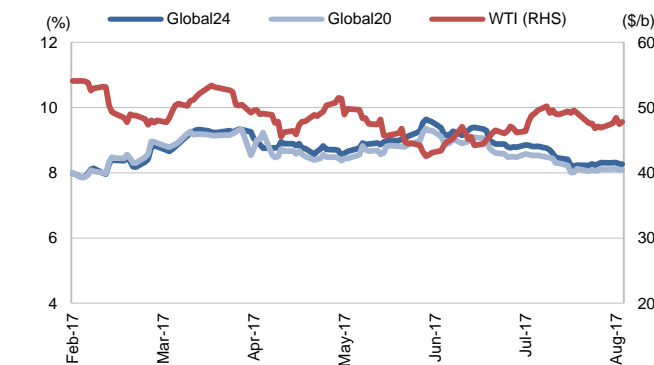
Source: Bloomberg and Analytica

EMBIG Spread



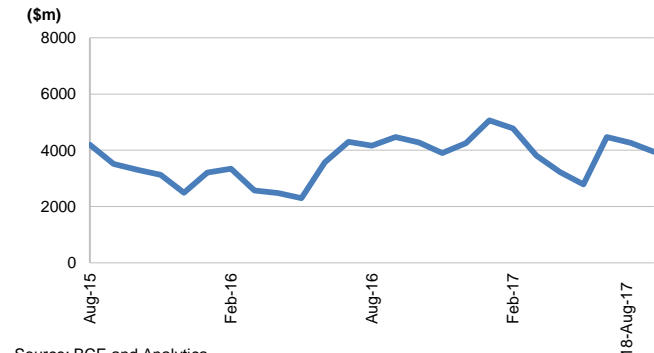
Source: JP Morgan and Analytica

Bond Yields vs. WTI in 2017



Source: Bloomberg and Analytica

International Reserves



Source: BCE and Analytica

no doubts and duly submitted the prosecution's request to the congress for approval. This will likely follow shortly after the close of this edition for the *Weekly Report* as, with some qualms, enough opposition legislators will vote in favor, as will AP. The procedure on the face of it looks illegal because Baca seeks to "link" Glas to the Odebrecht case, but the constitution says congress needs to approve the trial itself, not for a procedural pre-indictment collection of evidence for a specific crime. This could mean that, under a new precedent thus established, congress could be called in to vote on every procedural step, delaying the actual trial.

For the ruling bloc, the risk of a split over the matter and loss of further prestige helped to outweigh the instinctive reflex to vote against Baca's request, as it did when it stopped the opposition's attempt to start the impeachment of Glas in July. Additionally, the president of the congress, José Serrano, widely understood to have been an ally of his and their former boss, Rafael Correa (president 2007-2017), appears to have sided with Moreno by playing a leading role in bringing Pareja to stand trial in Ecuador.

Skeptics point to the lack of judicial independence and potential loyalty of the judges of the top court to Correa as a risk of a proper trial. Moreno has insisted that he will not interfere. But the judges face issues of their own. While some of them proved their loyalty to Correa in friendly rulings in the past, the change in the political reality may lead to a different outcome in this case, under which they will face public scrutiny like never before in their careers. Correa has had difficulty in retaining the loyalty of former allies beyond Serrano. Also, even Correa appears to be distancing himself from Glas, his vice president in his final term and closest ally in the Moreno administration until the current president removed him from any political role in the government this month. Correa's legal secretary, Alexis Mera, last week put full responsibility of the management of the state oil

industry on Glas. And even if the case goes to trial and the court finds him innocent, numerous other cases exist that mean that even if he refuses to resign, Glas will likely find himself under fire for much of his term.

Please Come Home

According to finance minister Carlos de la Torre, Ecuadorian assets held overseas total at least \$10bn and perhaps even as much as \$30bn, or, at the top end, around a third of GDP. For the government, the repatriation of these funds would be a highly welcome economic shot in the arm. De la Torre has announced plans for a repatriation law to attract this money back into the country. Under president Correa, banks were twice forced to bring back deposits held overseas following certain obligatory domestic liquidity ratios. This however is different.

De la Torre has pledged to refrain from taxing the owners of these funds should they bring them back or imposing any other kind of fee. Further details unfortunately remain unknown; taxes are currently only leveled on currency outflows, not inflows. At least verbally, the plan seems aimed at injecting liquidity into the economy, rather than funding for the public sector. This appears positive. The approach taken by Argentina under president Mauricio Marci has been different; there, owners of overseas funds faced stiff taxes should they fail to report these holdings in a bid to boost government revenues.

Some analysts however fear that a "no-questions-asked" policy might attract the wrong kind of funds, i.e. open the doors to money laundering. This was a critique leveled by vice president Glas (ironically, a business associate of his uncle Ricardo Rivera, accused of receiving Odebrecht bribes, recently acknowledged reception of \$2.7m from an "unknown source," which also raises doubts regarding the exact nature of the financial transaction and compliance with anti-laundering rules). But awareness of this risk is strong, in particular inside a government whose

officials still remember the problems it faced in recent years with the Financial Action Task Force, a global anti-laundering watchdog, for attempting to undertake financial dealings with Iran. Laundering issues will foreseeably be part of the congressional debate, as will discussion of how to avoid the laundering of funds obtained through corruption in the past decade through this new channel. While an overall positive signal to the economy, Moreno and de la Torre above all have to prove to potential investors that the country is indeed open for business. There, signals remain mixed.

OPEC Breather

As part of last week's presentation of the state of the oil industry, Carlos Pérez, the career private-sector oilman and personal friend that president Moreno tapped as oil minister, said that in compliance with OPEC, Ecuador, one of its smallest members, will cap oil output at the present level, i.e. 541,000 barrels a day, through the end of this year. On the face of it, this looks like a diplomatic bid to placate the cartel. Pérez shocked it last month by saying Ecuador's fiscal problems forced it to abandon its pledge to reduce output in line with the oil producers' deal to slash production to stabilize the price of crude oil. But there's more to it.

Local oil analysts previously had said that Ecuador was too generous when, still under president Correa, it promised to limit production to 522,000 barrels per day (b/d) - a cut of 26,000 barrels. Some said that this was closer to the real level of output at the time. Pérez however noted that Ecuador has substantially greater potential, telling *Reuters* in a post-inaugural interview that the country could produce as much as 700,000 b/d in the medium term, by far topping the previous record around 570,000 b/d. For the foreseeable future, this hinges on the continued development of the Ishpingo-Tambococha-Tiputini (ITT) oilfield. While questioning numerous other bullish statements of the previous administration,

Pérez hasn't cast doubt on increased reserve estimates for the field, which rose to 1.7bn barrels in a review a year ago, double the previous amount.

Firstly, the field is wildly controversial given that it is inside the Yasuní national park, an Amazon rain forest nature preserve with extraordinary biodiversity. Opposition to its development was strong and conservative opposition leader Guillermo Lasso during the election campaign said he was against expanding the oil frontier there. But it now looks like a key economic factor as without it, production has faltered from a record around 560,000 b/d mid-2014. After inaugurating the Tiputini area over the past year, Tambococha further south was the next part of the field's production scheduled to go online by the end of this year. This is particularly worrying since the added production from Tiputini has outweighed declining output in mature fields both at those run by state-owned Petroamazonas and at those in the hands of foreign oil companies under service contracts. With the pledge to OPEC to cap overall oil production, it looks like this has had to be postponed - a further industry problem for Pérez to deal with.

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