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ECUADOR WEEKLY REPORT®

KEY INDICATORS

For the week of Aug 28 – Sep 1, 2017

Reality Bites

Finance minister Carlos de la Torre had already pledged to promote cashless payment forms to reduce Ecuadorians’ demand for expensive coins and notes. The hapless “economic money” scheme introduced by the Correa administration in early 2015 was now going to be opened to the private sector in earnest. A meeting between president Lenin Moreno and bankers this week led to agreement that the system would become fully privatized, but (of course) subject to regulatory oversight. In a few months, what many feared could become an instrument to destroy Ecuador’s dollar-based payments system will be what it always should have been: A debit-based payments method, nothing else.

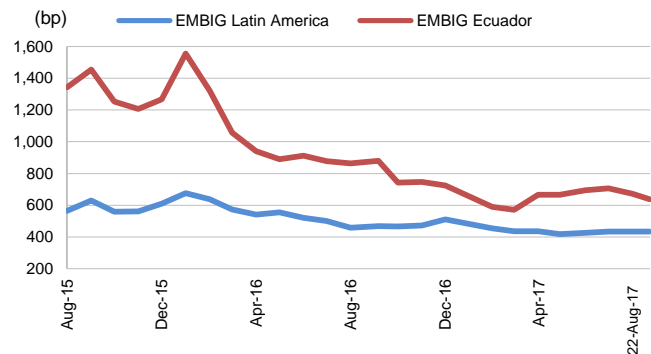
The Central Bank of Ecuador will now wind down its existing platform, pledging to return the money to the few individuals who trusted in the system. Lack of trust was what doomed it from the start. For all their potential susceptibility to populist politics, few Ecuadorians have nostalgia for the sucre, which collapsed in the late 1990s amid rampant inflation. Unfortunately, one of these, Rafael Correa, ran the country like a fief until late last May, who called Ecuador’s dollarization a “straight jacket.” Indeed, as one of the few remaining independent institutions in the country, it helped save Ecuador from the inflationary spiral that has contributed to the abysmal living conditions in Venezuela. But, pressed for cash despite the oil boom, Correa sought a new way to boost public spending. At the start, he and economists around him (including Diego Borja, briefly

Ecuador’s Global Bond Prices

Bond	1-Sep	31-Aug	Jul	Last Price (end of the month)			
				Jun	May	Apr	Mar
Global 2020	107.38	107.39	106.12	105.83	105.58	107.50	106.65
Global 2022	109.94	110.05	108.20	106.83	107.41	108.63	106.66
Global 2023	102.19	102.34	100.12	98.55	-	-	-
Global 2024	98.12	98.22	95.60	93.52	95.05	95.58	94.57
Global 2026	105.09	105.25	102.56	100.71	101.11	102.29	103.92
Global 2027	104.86	105.01	102.19	100.30	-	-	-

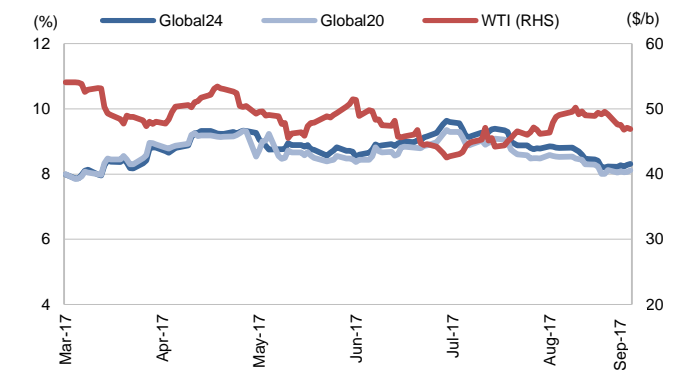
Source: Bloomberg and Analytica

EMBIG Spread



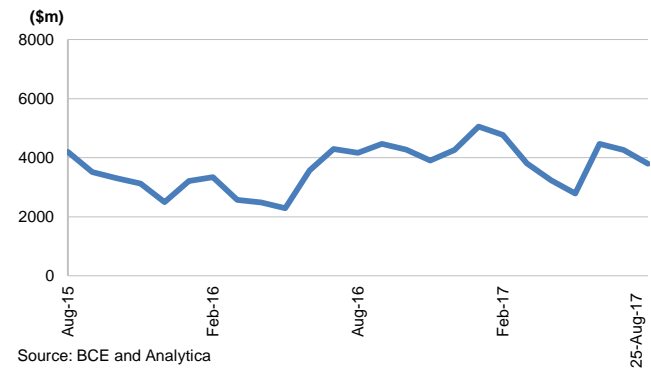
Source: JP Morgan and Analytica

Bond Yields vs. WTI in 2017



Source: Bloomberg and Analytica

International Reserves



Source: BCE and Analytica

head of the central bank) argued that the state had to have a monopoly over new “electronic money” lest the banks uncontrolledly issue private currency.

The first regulations issued by the government indeed aimed at creating a new currency, an ability the BCE lost in 2000 when the dollar replaced the sucre. Monetary experts cried out in protest, and the rules subsequently changed, saying that the BCE would back electronic money in liquid assets. This was still too ambiguous as government bonds with no demand in the financial market could also be included as this kind of an asset, thus risking exponential growth of the money. Fortunately, the BCE platform included a very narrow distribution channel: Individuals could only receive the money if they agreed to it by setting up an account. Few did. The government, including the non-independent BCE, switched tack, insisting it was only a mobile debit-based payments scheme (which it should have been from the start), and dropping the name that had already become a liability as a risky alternative to the dollar. Memes had already circled in social networks offering government officials virtual sandwiches in exchange for the unwanted electronic cash.

Now, the system will belatedly pass to the private financial sector. It will be able to offer benefits beyond those desired by de la Torre, which are increased speed of monetary circulation to boost economic growth and to reduce the drain on government resources that cash imports from the U.S. mint demand. Among them, paying via mobile saves people time from having to head to banks and automatic teller machines, and improves safety - a corner store open late at night can switch to mobile payments only to avoid having cash on the premises, and people can reduce the amount of money in their wallets. More people can be drawn into the formal banking system, and the risk of money laundering is reduced, a major factor in a society as strongly subject to the illegal narcotics trade as Ecuador's. Of course, there are drawbacks, including the risk to

privacy by allowing even minor transactions to potentially be traced, and Moreno has yet to wind down the domestic spying agency SENAIN set up by his predecessor.

It remains to be seen whether the skeptical public accepts the new payment option. International experiences vary starkly: In both Sub-Saharan Africa and Scandinavia, the system is wildly popular. In Germany, it isn't. And while some may continue to fear the scheme for the reasons it failed to gain traction, now, correísta hardliners like vice president Jorge Glas and Guayaquil legislator Marcela Aguiñaga and leftwing economists like Alberto Acosta are already blasting banks for wanting to manage the system, repeating all the nonsensical arguments that they used to argue to impose a state monopoly in the first place. At the moment, it seems unlikely that this will become a stumbling block for Moreno, but it does pose something of a risk for the Alianza Pais (sic) political movement. If the correísta hardliners make the mobile payments scheme into a major political issue to weaken him, they could seek to oppose the legal changes in the congress. That would be an interesting test for AP unity.

Evil Soup

On August 13, Ecuador's navy captured the Fu Yuan Yu Leng 999 deep inside the Galápagos Islands Marine Preserve. The Chinese ship carried some 300 tons of fish, including 6,623 sharks of the hammerhead and silky species. The judiciary acted swiftly, and on Sunday, August 27, the crew members received jail sentences; subsequently, the air force flew them to the mainland to serve their terms in the Manta jail. Fines totaled \$5.9m. The event however scandalized Ecuador in defense, foreign, and environmental policy.

While the seizure itself and the speedy resolution of the case showed a certain degree of efficiency and even efficacy, the Chinese ship acted surprisingly brazenly in simply crossing the archipelago's waters

in a straight line, suggesting the Ecuadorian navy doesn't exactly have a reputation as a fearsome protector of the preserve. It wasn't a fishing boat, but a ship used to receive catches from other ships. The navy via satellite detected a vast fleet as large as 300 Chinese fishing boats just outside territorial waters, between the islands 1000km off the coast and the mainland. First, the navy argued it didn't have enough ships to patrol the area, which is several times the size of the country on land, then it sent a submarine to help patrol the preserve. Memories of the US air base in Manta returned, whose lease the Correa administration failed to extend past its 2009 expiration. While it's unclear how the U.S. military presence might have deterred Chinese fishing, the six Israeli drones which Correa had purchased for \$23m to replace the U.S. surveillance flights have long since stopped operating due to lack of maintenance and other issues already described three years ago by online magazine *PlanV*.

Meanwhile, Foreign minister María Fernanda Espinosa called in the Chinese ambassador to protest. Ecuadorian media scoffed at the Chinese insistence that Ecuador respect the Chinese fishermen's human rights, pointing at China's own dubious domestic human rights record. While the fleet appears to be heading southeast to Peruvian fishing grounds, which from an environmental point of view is just as problematic, Ecuador's financial reliance on China has led to doubts regarding the government's ability to stand up to the Asian power. As a case in point, the AP majority in congress refused to name China in a resolution in protest against the environmental destruction wreaked by its fleet. But conservative opposition legislator Fabricio Villamar managed to have two points included that could lead to headaches for AP: the congress voted to question cabinet ministers on the matter and to investigate how the ships were being refueled, implying a possible relationship between the fleet and domestic businesses. The *New Yorker* once suggested

Ecuador's navy was on the take in the entire sordid business of the depredation of the seas. Perhaps more proof of this will emerge in the coming weeks.

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