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ECUADOR WEEKLY REPORT®

KEY INDICATORS

For the week of May 23 – May 26, 2016

Rough Seas

Still avoiding the term “crisis,” President Rafael Correa sought to present his term’s final state of the nation speech – called “Accountability Rendition” locally – as a show of modesty. In contrast to the pomp of previous years, when he rode atop a Tiuna, an open Hummer-type car made in Venezuela, he walked to the congressional building, thronged by many dozen supporters, flanked by two Amazon and two Andean indigenous people on each side (his wife and son arrived separately). The squadron of Tarqui grenadiers, in their 1829 attire, rode in front of him, rather than flanking the Tiuna. Yet austerity has its limits: the speech, complete with floral and straw decorations and folkloric singers who roused officials and their supporters to a brief dance to the tune of Argentine singer Diego Torres’s *Color Esperanza* (Hope Color), cost \$60,000 to produce, down from \$88,100 a year earlier. The display appropriately accompanied the speeches’ verbose contents.

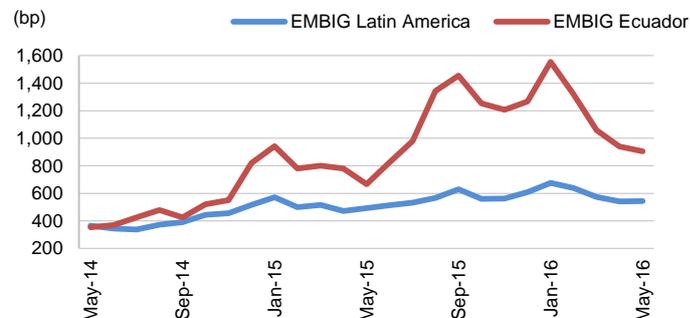
Overall, four speakers treated listeners to their analysis of the past years, aptly summarized in the latest official slogan, “the decade gained” (cut and pasted from Cristina Fernández, the Peronist former president of Argentina): Gabriela Rivadeneira, the president of congress; planning secretary Sandra Naranjo; vice president Jorge Glas; and the president himself, with two speeches. Though hardly acknowledged officially, the challenges Correa will face in what’s left of his term loom large. “Before handing over the government, it will be a very tough, very tough year humanly, economically, politically,

Ecuador's Global Bond Prices

Bond	Last Price				
	26-May	Apr-16	Mar-16	Feb-16	Jan-16
Global 2020	99.09	95.21	90.54	79.08	74.92
Global 2024	88.03	88.04	82.88	72.81	69.63

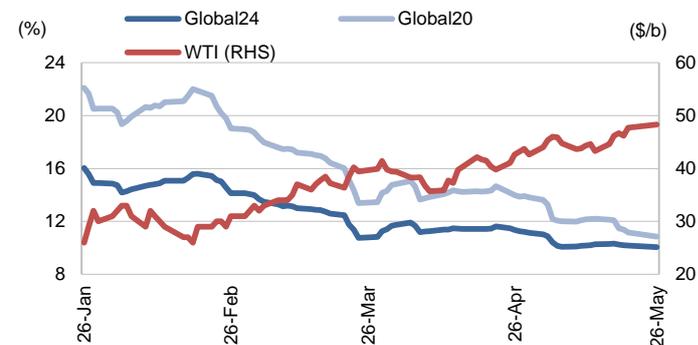
Source: Bloomberg and Analytica

EMBIG Spread



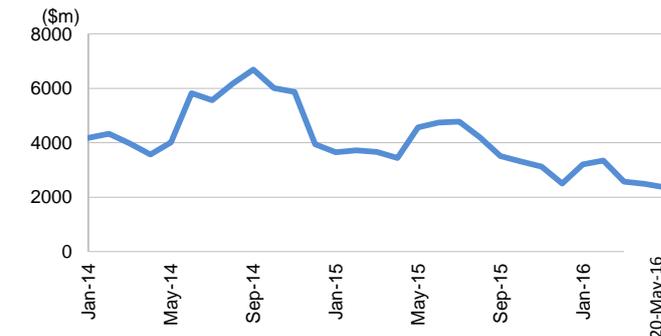
Source: JP Morgan and Analytica

Bond Yields vs. WTI in 2016



Source: Bloomberg and Analytica

International Reserves



Source: BCE and Analytica

internationally”, the self-styled 21st century socialist said. Along with the defensive nature of the slogan, the speeches highlighted real or imagined achievements that close watchers of Ecuador’s political and economic scene could link to recent months’ developments. Correa continued his repetition of real and imagined opposition from corporate interests and “so-called independent media,” including a moment in which he said he had been shot at by these interests while campaigning as a student leader in Guayaquil in the 1980s. Rivadeneira addressed the political situation slightly more concretely, warning the 70% pro-Correa majority to stay the course by attacking the handful of the bloc’s dissenters, particularly the breakaway Avanza party. Without naming them directly, she also attacked the congresses of Venezuela and Brazil for their role in seeking the removal of the presidents of those countries – the lone relevant foreign policy statements of the near five-hour event.

Naranjo’s and Glas’s speeches ended up being superfluous; Glas got some involuntary laughs on social media by portraying the country as a complete wasteland before Correa first took office in 2006. The country had hydroelectricity (false) and roads leading nowhere that now lead to places like the Coca – Codo Sinclair power plant (actually, that road always led to the main oilfields near Lago Agrio). He touted the increase of rural electrification to 97% coverage from 94% over nine years as proof of the extraordinary achievements of the Correa administration, where he leads economic efforts as a quasi super-minister for energy, resources, and infrastructure. He thus stuck to so far illusory and long overdue projects like superhighways and a 200,000 barrel-a-day refinery near Manta. “Where some see a road, an aqueduct, and a lot, I see the Refinery of the Pacific,” he said, referring to the vast empty terrain. Perhaps Correa summarized the situation best when he reiterated that “The country needs to take a break from me, and,

sincerely, I also have to take a break from the country.”

Amid the dire straits that Ecuador is in, the president walked a fine line with voters mentioning budget cutbacks (forced by the plunge in tax and oil revenue) and rejecting austerity packages (he says the rise in value added tax to 14% from 12% next month will go to reconstruct the areas hardest hit by the April 16 earthquake). To defend his record as frugal, he calculated the money received by his administration in net terms of \$169.28 billion over his first nine years as president. Around \$85 billion, almost half, went to satisfying what Correa called “basic public services,” contrasting with private-sector allegations of wasteful, overblown current spending. For many observers, the marginal announcements – adding two small hydropower plants to the list of assets for sale, the merger of a few public media outlets, and the closing of 6 public entities and 12 deputy ministries) don’t add up to the confidence-building effort anxious investors require. Yet some analysts see his comments as a tacit signal to the International Monetary Fund that his administration indeed is committed to an austerity package by raising consumption taxes, seeking privatizations, and reducing the civil service.

Politically, much ado has been made of the presence of popular former vice president Lenín Moreno, celebrated far more than Glas in the congressional hemicycle. Coupled with Correa’s insistence that he would hand over government to another president in a year, the scheduled date for the next inaugural, the display showed that Moreno will be the presidential candidate, with Glas again running as vice president, or vice versa. Others however doubt that Correa, despite looking tired, will in the end acquiesce to relinquishing another bid for power.

Petroecuador's Pain

Recently published annual earnings data from Petroecuador, the state oil refining and sales company ("downstream", in industry lingo) reflect the plummeting revenue from oil, even if partially offset by the corresponding decline in prices for imported fuels like high-octane gasoline and diesel. The most important figure, net profit, plummeted almost 85% on the year (see chart). Nonetheless, the company did register a \$752m net profit (in 2015, it reported full-year net profit for 2014 at \$5.17bn; it didn't explain the significant, 7% correction in this year's presentation).

Year	2015	2014	Change
Sales	\$9.28bn	\$15.74bn	-41%
Operating costs	\$8.21bn	\$10.65bn	-22.9%
Earnings before interest, taxes, depreciation, appreciation	\$1.08bn	\$5.09bn	-78.8%
Operating profit	\$971m	\$5bn	-80.6%
Net profit	\$752m	\$4.81bn	-84.4%

The beneficiary of the net profit is the central government; at least in downstream operations, the administration has managed to continue to earn from oil operations (it says that the fall in the price of oil has erased any earnings from "upstream" oil extraction).

Petroecuador transports Ecuador's oil for sale in foreign and domestic markets. Domestically, it sells through its own network of gas stations and affiliate stations, as well as others for the distribution of other fuels used for aviation or the fishing industry. Among the explanations the company has given for details of its earnings, it mentions the fall of sales due to the plunge of international oil sales by \$6.46bn, while operating costs declined \$2.44bn amid the corresponding fall of prices for imported derivatives of crude oil. Ecuador continues to require imports of fuels from overseas, despite a decades-old dream still pursued by government officials of weaning Ecuador

off the need to spend these dollars. The premise might seem logical but fails to take into account the low margins of the refining business, particularly in the current environment, as well as the capital expenditure required for new refining infrastructure. The administration has sunk more than \$2.4bn in refining capacity in the past nine years, approximately half going to the nonexistent Manta refinery, the other mostly for the Esmeraldas refinery, without presently showing an improvement justifying the scale of the spending, which ballooned to an official \$1.2bn from \$187m.

The refining affair has led to turmoil in corporate leadership. Successive chief executives have all come from the refining operations, even before the government reorganized Ecuador's state oil industry: Petroamazonas, created in 2006 from assets confiscated from Occidental Petroleum (for which the government promises to finish paying \$980m next month after losing an arbitration suit; the original deadline had been the end of April), now runs the entire upstream business, and Petroecuador the downstream business. Alex Bravo, appointed in November, had to resign in April under a cloud of suspicions linked to his ties to offshore companies unveiled under the "Panama Papers" scandal (EWR801). For this year, the management aims to carry out an "entrepreneurial restructuring," according to its annual report summary, without further explanation. Ideally, beyond president Correa's recent statement that he would welcome private capital in the state telephone corporation CNT and oil shipping company FLOPEC, the administration would use the restructuring to prepare Petroecuador for a partial sale. This would require fundamental change as the company lacks independence in numerous business segments. It is a signatory of the oil-backed loans with China, the latest of which was signed in January, yet it has only limited influence there: of a \$1bn loan from Noble Energy last September, the government

handed it just \$328m, according to Petroecuador's report. While the present government changed fiscal accounting to book oil sales and derivatives imports directly, instead of hiding it in Petroecuador's balance sheet, it would be better to make this a competitive industry as free of political influence as possible.

Beyond the vague idea of restructuring, it's business as usual: Petroecuador says that it will complete ongoing projects, including finishing a multipurpose pipeline between Guayaquil's Pascuales suburb and Cuenca, continue to try to fix the Bajo Alto liquefaction plant, another problematic infrastructure project, "optimize" the \$600m Monteverde gas terminal inaugurated in 2014, remodel – yet again – the company's service stations, and "rehabilitate" the La Libertad refinery near Salinas. Quietly, it has dropped goals mentioned in recent months, including a bid to import 30 million barrels of light, low sulfur crude to improve refining at Esmeraldas and the privatization of its gas stations.

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