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ECUADOR WEEKLY REPORT®

For the week of January 28 – February 1, 2013

Now Rate This

Since mid 2012, all three major credit ratings agencies have upgraded Ecuador, even if the debt remains notches below investment grade. Despite the politically motivated 2008 default on most of its commercial debt, the government has been able to secure major loans from China, each agency argued, meriting the modest upgrade. But they may have been won over too easily by the government, which is seeking to return to the international debt markets, despite qualifying Ecuador's debt well below investment grade given the terms of the debt deals with China.

Ecuador entered the "long-term" crude oil and fuel oil delivery deal after defaulting on most of its foreign commercial debt, $3.2 billion, in December 2008, despite being financially able to meet credit payments. Populist president Rafael Correa called the debt "illegal" and "illegitimate" following an audit of the debt drawn up by a committee. The default cut off Ecuador's access to the foreign credit market, leading Correa, who has a PHD in economics from the University of Illinois, to proudly turn to China for loans to fund major infrastructure projects. Ecuador thus was able to start construc-

ECONOMIC INDICATORS

Ecuadorian Global Bonds (February 1, 2012)

	BID	ASK
Global 2015	103.06	104.99
Global 2030	28.13	32.13

BCE International Reserves
In million US$

Apr 2012	3.787,39	12.20%
June 2012	3.930,92	3.79%
Aug 2012	4.218,81	7.32%
Oct 2012	4.033,19	-4,40%
18 Jan 2013	3.698,05	-38.44%

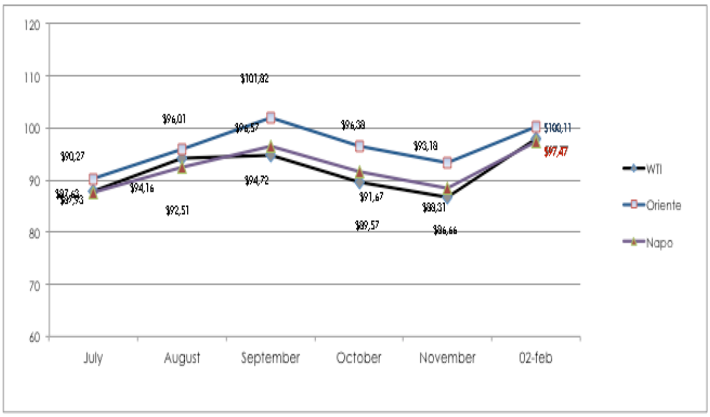
Inflation

December 2012	-0.19%
Year to Date	4.16%
Year on Year	4.16%

Banks – Short and long term Deposits
In million US$

Aug 2012	11.795,0	2.41%
Sep 2012	11.705,9	-0.75%
Oct 2012	11.855,7	1.28%
Nov 2012	11.684,9	-1.44%
Dic 2012	11.924,5	2.36%

Ecuadorian Oil Export Prices (US$ per barrel)



tion on hydropower plants like Coca-Codo Sinclair whose $2 billion price tags run well above the loan amounts multilateral banks including the Inter-American Development Bank and the Andean Finance Corporation could be willing to finance given their already high exposure to Ecuador.

Ever since the framework agreement governing the credit was signed, critics have called the terms onerous given that the interest rates have run between 6% and 7.5%. Additionally, the populist government of president Rafael Correa adopted a "just trust me" attitude, declaring the base deal confidential. It was revealed this week however by political activist Fernando Villavicencio, a former Petroecuador employee, in a book called *Ecuador Made in China,* in which he reveals the handover of Ecuadorian crude for cash advances.

Finance Minister Patricio Rivera has steadfastly denied that two loans were actually loans, calling them "advance sales," even though Ecuador has had to pay interest on them. This has kept them from being registered as foreign debt, artificially reducing the debt level Ecuador has to pay off. The four-party agreement between the finance ministry, Petroecuador, and China's Development Bank (CDP) and Petrochina, respectively, however is called "the loan" throughout. The terms have led critics to doubt the legality and the transparency of these transactions.

For the ratings agencies, which need to analyze Ecuador's willingness and ability to repay debt, the four-party loan deal holds serious implications. Through the documents, it becomes clear that China has secured its hand on the purse strings, above the rights of other creditors of current and future loans, be they bilateral, multilateral, or commercial. In the deal, Ecuador agrees to a waiver of sovereign immunity, which allows China to seize almost any assets short of military equipment in the event that Ecuador falls into arrears with payments. Additionally, the money goes into a Petroecuador account at the CDB, which has to maintain a minimum $113 million balance - likely higher now following additional loans - for which it has to pay $300 a month, potentially allowing China to seize cash. The gravity of the situation becomes evident when considering that more than 80% of Ecuador's oil currently goes to Petrochina, and Ecuador's oil sales account for about 35% of the national budget. Finally, the loan sets London and Beijing as the locations for arbitration, going directly against the 2008 constitution Correa had championed. All of this happened without approval by the legislature, which is supposed to be informed of treaties "and other international instruments" so that it may ratify them. The deal also flies in the face of the public debt audit ordered by Correa early in his administration to legitimize his eventual default. For Villavicencio, the terms equal "letters of slavery in the 21st century." He said that he obtained the information from "conscientious" participants in negotiations and company officials, backing up his claims with documents in many cases obtained overseas. Much more than a simple one-off loan, the four-party agreement explicitly establishes an open-ended, "long-term" relationship that currently includes loans until 2019, thus ending two years after any currently constitutional additional presidential term for Correa.

Under the terms of the framework deal, followed since then by nine others, Ecuador agreed to supply China 36,000 barrels a day and two monthly shipments of 190,000 barrels of fuel oil, "notwithstanding the amount outstanding under the loan and/or … any reduction in OPEC production quotas," the contract says. With more than 80% of Ecuador's oil now secured by China outside of the spot market, one wonders why Correa ever insisted on Ecuador's return to OPEC in the first place.

A Divided Strategy

When Ecuadorians head to the polls on February 17 to elect a new president and congress, they will have 8 presidential candidates to choose from. The high number of candidates has been the norm for many years, but this year has an unusual generational component. Two candidates, Mauricio Rodas and Norman Wray, look like the youthful political versions of two older rivals, Guillermo Lasso and Alberto Acosta, creating a generational challenge on the center-right and the left, respectively. Foreign correspondents recently asked Rodas whether the numerous candidacies didn't favor the incumbent Correa, weakening the challengers. Rodas, a political scientist from his academic training, said that the wide field would lead Correa to lose votes because candidates like Acosta would appeal to leftwing voters who at least in the first round wouldn't vote for a conservative like Lasso.

Rodas himself has entered his SUMA movement into an alliance with the centrist Concertación, led by Quito legislator César Montúfar, and characterizes his political views as overcoming the traditional left-right divide. It is not obvious however how in which way he is very different from Lasso, or vice-versa. Rodas promotes a "responsible government" model as an alternative to the left-right schism. On his part, Lasso has pledged a "responsible budget." To some extent, Rodas appears to be more to the left of Lasso, offering a tax break and support in paying social security dues to employers who hire first-time workers. On his part, Lasso, who hasn't met the foreign media so far in the campaign nor spoken to Analytica, wants to cut taxes, including the currency export tax. Both he and Rodas pledge to scrap the land tax and to reduce the bureaucracy that Correa has inflated to create 40 ministries and secretariats. Lasso has also promised to make it possible for entrepreneurs to open a new business in a day for a maximum $20. He is pledging to create numerous different economic zones to ease certain kinds of businesses, including health, education, and technology. The presentation of his daily new proposal however remains short and vague, making it unclear how this form of special zone could reduce bureaucracy and attract new business. He has refrained from any reference to his ultra-conservative religious views as a member of the Catholic Opus Dei organization. Both pledge to restore diplomatic ties to traditional Western cooperation partners, and to guarantee freedom of expression and the independence of the courts, as has the rest of the opposition field.

Any of either's plans could feasibly be adopted or supported by the other. While this could eventually make it easier for Lasso's Creo movement and its allies, Guayaquil's "Madera de Guerrero" (Warrior Material) and the Social

Christian Party, to ally with Suma in the legislature, it's not clear that either alone will be popular enough to be the runner up in the first round. Correa has attempted to create an aura of invincibility, but opinion polls look linked to individual candidacies rather than trustworthy. Without reliable surveys to guide voters, anecdotal evidence points to a likelihood that voters will follow their hearts and vote for a candidate close to their ideological and personal interest. Whether that will be enough to keep Correa below the 40% minimum he needs to poll to avoid a runoff is another matter entirely.

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