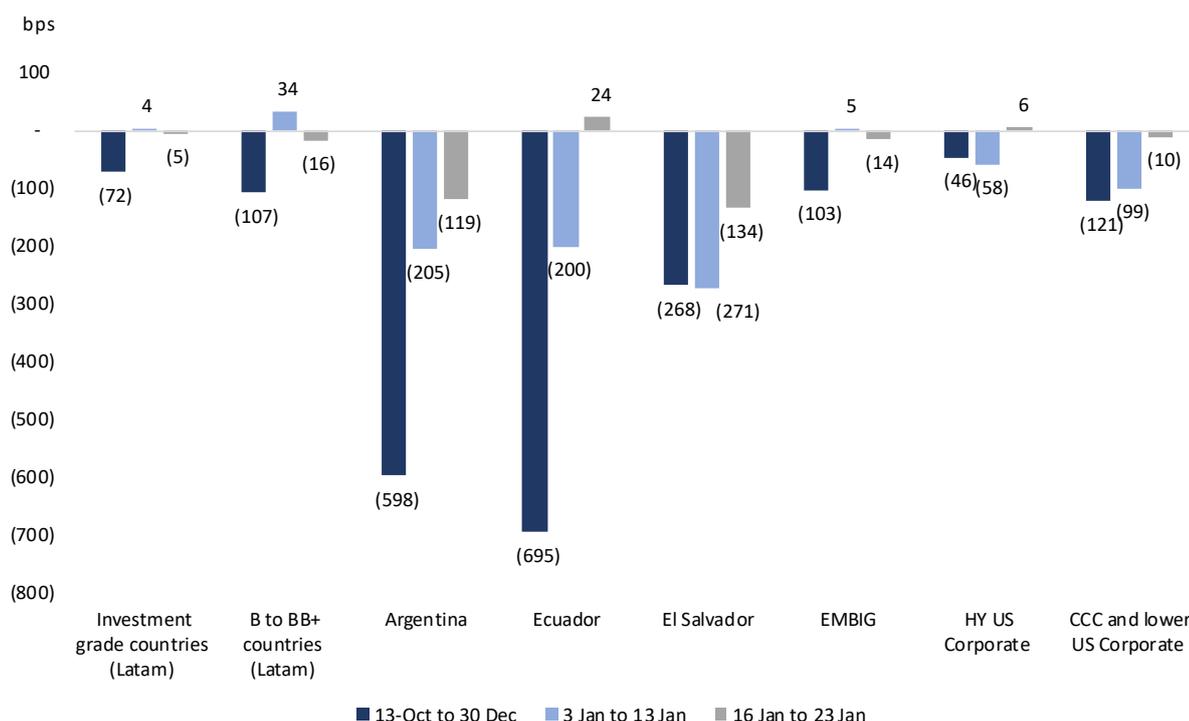


Political risk back to the spotlight

- Spread compression to lose momentum; we place our OW recommendation in negative watch
- Conflicts with indigenous groups seem manageable
- Corruption investigations could take a toll on the government’s popularity
- The referendum could provide short-term relief, but downside risks persist

Spread compression to lose momentum along weaker governability. Bonds continued the rally that began in mid-October, boosted by more lenient external conditions and positive news on the domestic front that we described in Ecuador Economics and Strategy: [“We prefer short-term bonds to capture impact of positive news”](#), 18 October. After the conclusion of negotiations with the indigenous groups and the announcement of the potential Blue bond issuance in mid-October bonds picked up by 52.8% on average until the end of 2022, recovering partially from the drop triggered by the indigenous protests in June 2022. Bonds continued overperforming most EM credits at the onset of 2023, along with the recovery of risk appetite that benefitted distressed credits, such as Ecuador, El Salvador and Argentina. Nevertheless, threats of new strikes of the indigenous groups and the revelation of a potential corruption scheme involving top government officials and President Lasso’s relatives, have prevented Ecuadorean spreads from continuing to profit from higher risk appetite since 16 January as shown in Chart 1. As a matter of fact, since 24 January bonds have lost on average 4.4% compared to the 0.4% gain recorded by the JPMorgan USD EM Sovereign Bonds ETF. With this in mind, **we place our OVERWEIGHT recommendation in negative watch** based on heightened political risk.

Chart 1. Spread compression of different issuers and issuer types.



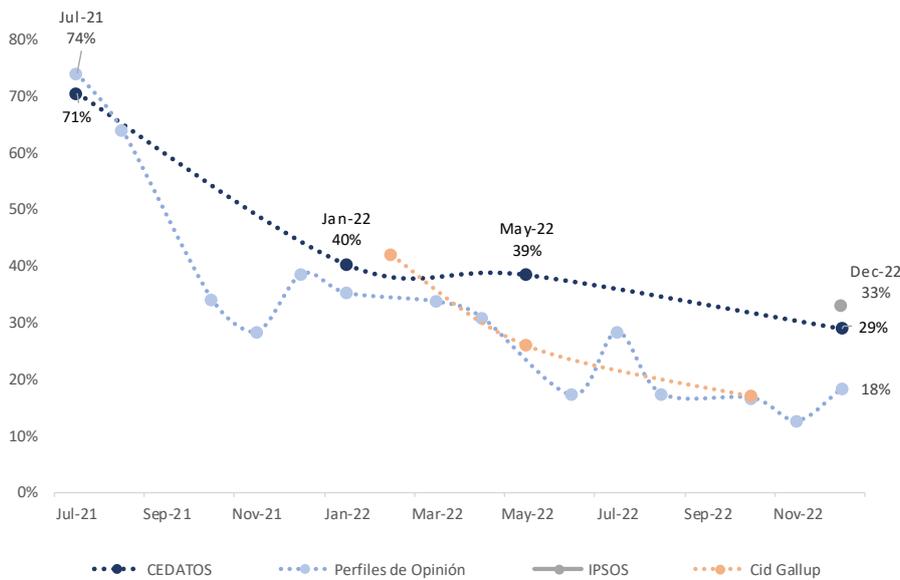
Source: BancTrust & Co. estimates based on JP Morgan and Federal Reserve Bank of St. Louis

Conflicts with indigenous groups seem manageable. Ecuador's Natives Communities Federation (CONAIE) claim the government has not complied with deals made after last year's demonstrations. In particular, they stressed the government signed two new mining investment agreements in December, breaching the moratorium on mining in ancestral indigenous territories the government pledged to place until the legislature approves a law to outline community consultation rules for extractive projects. Authorities denied they have breached the agreement, arguing no new concessions have been granted, but did not provide explanations regarding these two projects. For that reason, on 12 January, indigenous groups decided to gradually "prepare conditions of territorial defence" in the areas where these mining companies were present. **We have reasons to believe that a new wave of mobilisations will not take place in the short term.** On the one hand, the government would likely be keen on preventing protests, based on the consequences the June 2022 indigenous protest had on activity and governability prospects. With this in mind, we expect authorities will engage in negotiations with the indigenous groups and clarify the situation of the before-mentioned projects. Talks could accelerate the drafting of a new regulation on community consultations, which would be key to appeasing the indigenous groups in our view. On the other hand, indigenous groups have incentives to avoid mobilisations before the 5 February local elections, as it could harm the prospects of indigenous candidates.

The "Great Godfather" investigation has acquired significant relevance. Although the first disclosures made of the "Great Godfather" on 9 January were belittled by the government, the wide repercussion of accusations forced authorities to make bold moves to save face. As a reminder, the investigation alleges that President Lasso's brother-in-law and mentor figure, Danilo Carrera heads an illegal organisation that manages public companies' procurements to obtain bribes or favour certain suppliers. Even though public officials denied emphatically these accusations, the government began an audit of the state-owned companies and requested heads of the companies to be ready to submit their resignation if needed to emphasise their commitment to transparency. They also announced they will cooperate with the Prosecutor General's Office, which started an investigation named "Encuentro" (which translates to "Encounter") inspired by the government's slogan "The government of encounter". The Prosecutor General's Office already raided nine houses as part of its investigation on 19 January, and it was confirmed that one of the main suspects, former head of Ecuador's Public Companies Coordination Enterprise (EMCO) Hernán Luque, left the country. The former events enhance the seriousness of the investigation and make it a more relevant issue for the political scenario.

Corruption investigations could take a toll on the government's popularity. Given that the probe is still ongoing, it will take time to determine its potential consequences in the mid-term. If the accusations are confirmed, it could have severe implications for governability. In the short term, we expect the corruption scandal would encourage opposition forces to begin a war of attrition against the government, as happened in previous scandals. For instance, lawmakers have already created a commission to investigate the "Great Godfather" case, as they did after the "Pandora Papers" scandal in October 2021. We expect the indigenous group will also replicate their strategy at that time and raise their tone against the government to wear down its popularity. Although the "Pandora Papers" case was dismissed by the competent authorities, the scandal and the opposition pressure contributed significantly to eroding President Lasso's popularity after the successful vaccination campaign in the first months of his mandate (see Chart 2). If a similar result repeats with the "Great Godfather" investigation, this could be detrimental to the government's already weak approval ratings, which hovers around 18% to 33% according to different pollsters.

Chart 2. President Lasso' approval ratings



Source: BancTrust & Co. based on CEDATOS, IPSOS, Cid Gallup and Perfiles de Opinión

The referendum could provide short-term relief, but downside risks persist. As we mentioned in our 2023 Year Ahead Outlook: [“Lingering challenges”](#) 16 December 2022, the referendum scheduled on 5 February could be a booster for the government’s weak popularity. Polls carried out before the spread of the “Great Godfather” scandal, suggest that most questions of the referendum are endorsed by the population (see Table 1). The least popular question was the one seeking to strip the Citizens’ Participation and Social Control Council (CPCCS) of its right to appoint top officials, which was not endorsed by most of the people surveyed by Clima Social pollster. We expect a positive outcome for the referendum despite the negative impact of the scandal, as support for the most question is significantly above the 50% required to be approved.

Table 1. Approval to each question of the referendum

Question	Clima Social (6-Jan)	IPSOS (21-Dec)	CEDATOS (15-Dec)	Average
1) Do you agree with allowing the extradition of Ecuadorians who have committed crimes related to transnational organised crime?	69.3%	68.0%	61.3%	66.2%
2) Do you agree with guaranteeing the autonomy of the Attorney General's Office, so that it may select, evaluate, promote, train and sanction its employees?	61.9%	72.0%	64.1%	66.0%
3) Do you agree with reducing the number of lawmakers?	82.3%	86.0%	73.3%	80.5%
4) Do you agree with requiring political movements to have a minimum number of members equivalent to 1.5% of the electoral registry of their jurisdiction and requiring them to keep a record of their members periodically audited by the National Electoral Council?	79.9%	82.0%	65.1%	75.7%
5) Do you agree with transferring the power of the CPCCS to appoint authorities to the National Assembly?	49.4%	69.0%	58.5%	59.0%
6) Do you agree with modifying the appointment process for CPCCS members, so that they are elected by the National Assembly?	54.8%	76.0%	54.9%	61.9%
7) Do you agree with the incorporation of a water protection sub-system into the National System of Protected Areas?	79.9%	88.0%	71.1%	79.7%
8) Do you agree that individuals, communities and indigenous peoples should receive compensation from the state for their contribution to preserving the environment?	77.8%	84.0%	69.2%	77.0%
Average endorsement	69.4%	78.1%	64.7%	70.7%

Source: BancTrust & Co. based on CEDATOS, IPSOS and Clima Social

With this in mind, we would expect Lasso' popularity to benefit from this political victory, as happened after April 2007 and September 2008 referendums carried by former President Rafael Correa (see Table 2). Nevertheless, we cannot rule out that this victory could be overshadowed by the political scandals and pressure from the opposition. This was the case of the February 2018 referendum, which did not translate into a spike in former President Lenin Moreno's popularity.

Table 2. Previous referendums results and impact on popularity.

Date	President	Average votes in favour	Approval rating before the referendum	Approval rating after the referendum	Difference
Apr-07	Rafael Correa	81.7%	69%	76%	7%
Sep-08	Rafael Correa	63.9%	61%	72%	11%
May-11	Rafael Correa	47.7%	57%	54%	-3%
Feb-18	Lenin Moreno	68.6%	69%	65%	-4%

Source: BancTrust & Co. based on CEDATOS and National Electoral Council (CNE)

DISCLAIMER

This report has been prepared by the research and strategy division of BancTrust & Co. Investment Bank and/or one or more of its Affiliated Companies (collectively referred hereinafter as "BancTrust & Co."). This report is distributed in the United Kingdom and the European Economic Area by BancTrust Investment Bank Limited d/b/a BancTrust & Co. Investment Bank, which is authorised and regulated in the United Kingdom by the Financial Conduct Authority ("FCA") with Firm Reference Number 580379, with main address at 110 Bishopsgate, Level 24, London EC2N 4AY, United Kingdom. This report is distributed in the United States to major U.S. institutional investors under SEC Rule 15a-6 by BTCO Securities LLC, an affiliated broker-dealer registered with the SEC and a Member of FINRA, with main address at 1230 Ave of the Americas, New York, NY 10020. This report is distributed in Argentina by Noreste Bursátil Sociedad de Bolsa, S.A. d/b/a BancTrust Securities Argentina, which is regulated in the Republic of Argentina by the Comisión Nacional de Valores ("CNV") and is a member of ByMA and MAE. This report is distributed in Venezuela by BancTrust Securities Casa de Bolsa C.A., which is regulated in the Bolivarian Republic of Venezuela by the Superintendencia Nacional de Valores ("SUNAVAL") and is a member of the Caracas Stock Exchange. This report is otherwise distributed by BancTrust International Inc. The issuance and distribution of this report is being made only to, or directed only to, "Professional Clients" and "Eligible Counterparties" as defined by the FCA in the FCA Handbook COBS 3.5 and COBS 3.6 respectively. It is not suitable or directed to any other party, nor is it directed to you should you reside in a jurisdiction that BancTrust & Co. cannot provide its services to. BancTrust & Co. will not treat unauthorised recipients of this report as its clients and accepts no liability for use by them of the contents which may not be suitable for personal use.

This report is a financial promotion and does not constitute an investment advice. BancTrust & Co. makes no representation or warranty in relation to the accuracy, completeness or reliability of information contained in its research. Research is not intended to be an exhaustive statement on the financial instruments, issuers, markets or developments referred to in its research. Any opinions expressed in this research are subject to change without notice. The analysis contained in the research is based on numerous assumptions. Different assumptions could result in materially different results. Save as otherwise disclosed on this page, or any other financial promotions, BancTrust & Co. is not aware of any relationships or circumstances relating to it, its Affiliated Companies, its investment analysis, or its other employees, which could reasonably be expected to impair the objectivity of its research.

Nothing in this report constitutes a representation that any investment strategy or recommendation contained in the research is suitable or appropriate to a recipient's individual circumstances. Neither the information provided in this report or information on which such reports are based, nor the opinions expressed in any other communications, should be considered or construed by any client or prospective client as an offer or invitation or other solicitation or recommendation to enter into or attempt to enter into a transaction to buy or sell a security.

BancTrust & Co. does not represent or undertake that recipients of its research reports will obtain profits, nor will it share with such recipients any investment profits, nor accept any liability for any investment losses or tax consequences that they may suffer. Investments in any financial instruments involve risks, and recipients of the research should exercise prudence in making their investment decisions. The research should not be regarded by recipients as a substitute for obtaining investment advice and/or the exercise of their own judgement and is not to be relied upon by recipients. Neither BancTrust & Co. nor any of its Affiliated Companies, nor any of their members, directors, employees or agents accept any liability for any loss or damage arising out of the use of all or any part of the research.

The investments discussed in this report may fluctuate in price or value. Investors may get back less than what they invested. Past performance is not necessarily indicative of future results. Foreign currency rates or exchange may adversely affect the value, price or income of any security or related investment mentioned in this research. This report does not contain an exhaustive statement of the risks associated with the investments or types of investments referred to in the research.

Any prices stated in this report are for information purposes only and do not represent valuations for individual securities or other financial instruments. There is no representation that any transaction can or could have been effected at those prices. In line with its compliance procedures, BancTrust & Co. undertakes every effort to avoid, mitigate and manage conflicts of interest, both between itself and its clients as well as between a client and another client. Disclosure of BancTrust & Co.'s Conflicts of Interest policy can be requested from our compliance department.

Subject to BancTrust & Co.'s compliance rules and all applicable laws and regulations, the directors and employees of BancTrust & Co. may have long positions in, or may buy and sell any of the securities, derivative instruments or other instruments mentioned or described in this report, either as agent or as principal for their own account. However, BancTrust & Co. has a strict personal account dealing policy in place, in line with its compliance policies.

BancTrust & Co. may, to the extent permitted by law, participate or invest in financing transactions with the issuer(s) of the securities referred to in this report, perform services for or solicit business from such issuers, and/or have a position of holding, or other material interest, or effect transactions, in such securities or options thereon, or other investments related thereto. In addition, it may make markets in the securities mentioned in the material presented in its research. BancTrust & Co. may have, within the last three years, served as financial advisor or placement agent of a private or public offering of securities for, or currently may make a primary market in issues of, any or all of the entities mentioned in this report or may be providing, or have provided within the previous 12 months, significant advice or investment services in relation to the investment concerned or a related investment.

In the production of its research, BancTrust & Co. makes numerous calculations based on various assumptions, including a diverse range of valuation methodologies including, inter alia, analysis of earnings multiples, discounted cash flow and sum-of-the-past calculations as well as net asset value assessments, which when adjusted could result in materially different outcomes. The authors of our investment research and research analysts are not compensated for any investment banking transactions undertaken by BancTrust & Co. and/or its Affiliated Companies.

BancTrust & Co. issues the following recommendation ratings for fixed income financial instruments over a three-month period:

OVERWEIGHT: Spreads and/or excess returns are expected to overperform the benchmark market index.

NEUTRAL: Spreads and/or excess returns are expected to post a similar performance relative to the benchmark market index.

UNDERWEIGHT: Spreads and/or excess returns are expected to disappoint relative to the benchmark market index.

BancTrust & Co. targets the J.P. Morgan Emerging Market Bond Index (EMBI) Global Total Return as its benchmark index (Bloomberg ticker JPEIGLBL Index). The J.P. Morgan EMBI Global Index is a more comprehensive version of the EMBI+ Index, as it selects countries based on the World Bank's per capita income brackets and the country's debt-restructuring history.

BancTrust & Co. targets the J.P. Morgan Corporate Emerging Market Bond Index Broad Diversified (CEMBI) Total Return as its benchmark index (Bloomberg ticker JBCDCOMP Index). By covering a larger universe of EM corporate bonds that includes smaller and shorter-dated notes, it provides wide issuer coverage and risk diversification.

This report is distributed on a confidential basis. Neither the report, nor its content, nor any copy of it, may be altered in any way, transmitted to, copied or distributed to any other party, without the prior express written permission of BancTrust & Co. (except to the recipient's advisers, who must be informed of its confidentiality) and the recipient and its advisers must keep it confidential. If this report is distributed by a financial institution other than BancTrust & Co. or its affiliates, that financial institution is solely responsible for distribution. Clients of that institution should contact that institution to effect a transaction in the securities mentioned in this report or require further information.

For more information, please visit <https://www.bancstrust.com>