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ECUADOR WEEKLY REPORT®

KEY INDICATORS

For the week of Dec 12 – Dic 16, 2016

Monopoly Money

This week, the antitrust regulator or "Superintendency of Control of Market Power" unleashed a tide of controversy when it said that private banks had treated the government-run mobile banking scheme unfairly. In a bizarre and problematically vaguely worded move, it insinuated that banks had blocked people and companies from opening accounts, ordering them to stop this activity and to stop criticizing the system. After controversy boiled over on social networks, the banking junta whistled back the antitrust regulator, which is led by staunch Marxist economist Pedro Páez. Yet the event struck a double blow, further diminishing the reputation of the regulator but also hitting trust in the government's economic management.

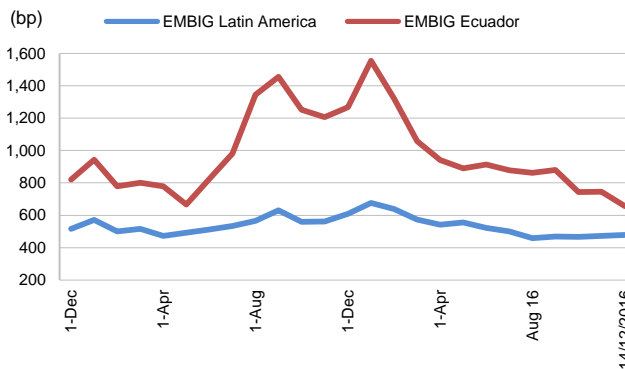
The regulator had most recently ruffled feathers by ordering the sale of Cervecería Nacional's Club brand of beer, the second-most popular in the country, to clear the Ecuadorian part of the merger between brewing giants SABMiller, the owner of Cervecería Nacional, and InBev. Per se, the sale is reasonable, and similar to other conditions imposed by antitrust regulators elsewhere (Japanese brewer Asahi will buy Pilsner Urquell and other Central and Eastern European beer brands from InBev and Molson Coors will buy SABMiller's majority in MillerCoors, among other examples). Yet while on the face of it understandable considering the near-monopoly Cervecería Nacional currently enjoys in the local beer market, the regulator first cleared the deal in July, then later changed the decision to include Club. The

Ecuador's Global Bond Prices

Bond	Last Price									
	16/12/2016	1-Nov	1-Oct	1-Sep	1-Aug	1-Jul	1-Jun	1-May	1-Apr	1-Mar
Global 2020	106.66	105.54	106.13	102.51	102.30	100.49	99.38	100.28	95.21	90.54
Global 2022	106.85	104.94	106.11	102.47	102.89	100.03	N/A	N/A	N/A	N/A
Global 2024	93.81	92.15	94.55	90.25	88.05	87.49	87.64	89.44	88.04	82.88

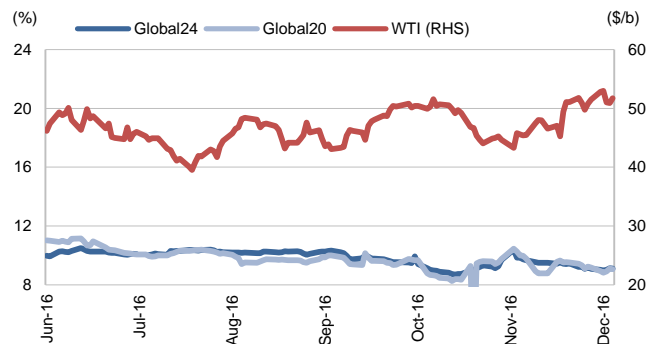
Source: Bloomberg and Analytica

EMBIG Spread



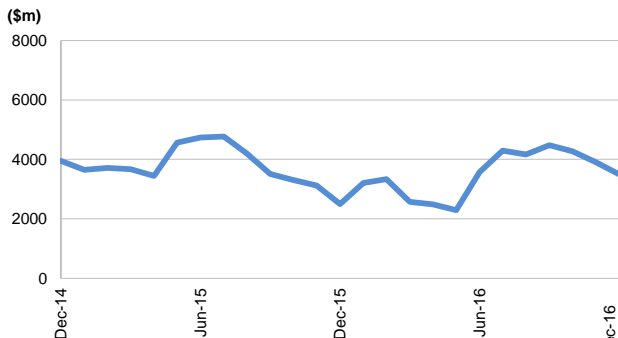
Source: JP Morgan and Analytica

Bond Yields vs. WTI in 2016



Source: Bloomberg and Analytica

International Reserves



Source: BCE and Analytica

matter remains under dispute, with a judge on December 4 ruling in favor of the company, while the antitrust body on December 14 said it had appealed the decision.

The same day, Páez's entity made public its resolution against the banking association and a series of private banks, including the largest, Pichincha and Guayaquil, but not state-owned Pacífico, the number two commercial bank. It said that they must "cease the suspected, disloyal, investigated practices (sic) ... immediately abstaining themselves from carrying out and distributing via whichever print, television, or social media degrading allusions towards the Electronic Money (sic) payments method." The regulator argued in favor of this blatant attempt at censorship to "seek market efficiency, fair trade and general well-being".

Furthermore, it gave the banks 30 days to "proceed to implement the creation of electronic money accounts to facilitate the transactions of users, consumers, or entities that have opted (for) electronic money as (a) payment method." It forbids the banks from "rejecting, denying or blocking transactions in electronic money," ordering the Central Bank of Ecuador to lend support. Taken literally, the resolution gives a contradictory impression; while the order to create accounts still reflects the voluntary nature of the mobile payments system, the second part appears to order banks to allow an influx of payments in what many consider a parallel currency. The latter interpretation took hold of social networks. Fidel Egas, lead shareholder of Banco Pichincha, tweeted that that bank wouldn't open electronic money accounts. Others noted the inconsistency between the government's threats to prosecute individuals for warning of risks to banks' solvency in the face of recent bank regulations under the penal code's definition of "financial panic" and the risks increased by regulators' anti-technical orders.

Páez clearly went too far in making himself a bank regulator. It took less than eight hours for the top

banking body, the Monetary and Financial Policy and Regulatory Junta, to issue a statement insisting that the Junta was the sole banking regulator. It added that it had established that banks could only voluntarily participate in the system and that this could not be changed by anyone other than the Junta (in itself something of a worrying statement given that it implies the possibility of change). Finally, between the lines it blasts the antitrust regulator for failing to work properly within the government system. Sadly, it doesn't address the issue of censorship and, as of the closing of this issue, Páez remained at his post, and the resolution at least formally continued in place.

Good, Bad, Ugly

On December 14, the administration signed its second major mining deal, completing the contracts necessary for Lundin Gold to begin to build and mine its Fruta del Norte project for gold and silver. While the first of these precious metals aren't scheduled to be extracted before 2021, the company will pay advance royalties, with \$25m to be paid near-term and \$20m due next year and in 2018, respectively. The deal comes after Lundin Gold's predecessor, Kinross, left the table and sold the project to the Toronto- and Stockholm-listed mining company in 2014 for \$240m. Company chairman Lukas Lundin called the exploitation agreement "a significant milestone" to develop a "world-class asset" holding an estimated 4.82 million ounces of gold and 6.34 million ounces of silver. Under the terms of the deal, the company will pay a 5% royalty of net smelter revenues from output, from which the \$65m advance royalties will be deducted. The deal allows Lundin Gold a 25-year renewable concession. If passed, the windfall real estate bill that includes a provision to suspend windfall taxes on mining "simplifies the application of the windfall tax with no material impact on the project," said company chairman and chief executive Ron Hochstein. The company has also signed an investment protection agreement. The

company plans to invest around \$1bn in the project, which is the second large-scale mining investment to go ahead after the end of the moratorium on open-pit mining in the country issued in 2009.

The same day of this promising development, only a few kilometers to the north, a severe incident occurred at the Mirador project, owned by Chinese company Tongling Nonferrous Metals, where the final development and exploitation deal started to go ahead a year ago. The company, Explorcobre, China's lone non-oil investment in the country, lacks even the most basic web presence. The deposit holds an estimated 2.96m metric tons of copper as well as 26.1m ounces of silver and 3.22m ounces of gold. Local residents, mostly of the Shuar nationality, allege the company has forcibly evicted families from ancestral lands. In late November, some Shuar attempted to seize a company mining camp at Nankints. Expelled in an incident that left 17 injured, they returned while the Lundin Gold signing ceremony was going ahead separately in Quito. During the confrontation, one policeman was killed and another severely injured; four more soldiers and police also suffered injuries, according to the government. Two Shuar were injured and fled, according to Shuar legislator Pepe Acacho (Pachakutik). In response, the government declared a "state of exception" for the entire province of Morona-Santiago, one of the country's largest by territory, suspending a series of rights including freedom of assembly and speech, although the area of the violent incident is small (Fruta del Norte lies in the adjacent province of Zamora-Chinchipec and is thus unaffected).

The Correa administration vowed to impose the rule of law in the area, but also said it was willing to negotiate. Indigenous umbrella organization CONAIE called for mediation by the Catholic Church and international bodies but blamed the government for the escalation of violence; some said the government was defending Chinese business interests by expelling heronatives who in years past had helped

defend the area from Peruvian military encroachment. On its part, the Ecumenical Human Rights Commission noted several deaths among the Shuar related to the Mirador project and blamed the escalation of violence on increased police and military presence at the site. At 20 of 28, southern Ecuador's mining areas dominate among the number of people sentenced to jail for protesting in 2015. Ecuador's government has only itself to blame for missing out on the commodities supercycle of the recent past. Having failed at developing the country's mining potential, it has no reason to rush developments now. Running roughshod over legitimate local and indigenous interest in a bid to recover lost time only sets the stage for conflict, which can easily create further delays.

Radio Gaga

In the course of several decades, Diego Oquendo has made a small family business out of Radio Visión, centered on his morning news and interview show. Run out of a hillside one-family home, Radio Vision has survived amid a fast-changing media landscape. Similar to Exa - Radio Democracia's Gonzalo Rosero, the somewhat stodgy presenter has maintained an important audience through the depth of the leading opinion-makers invited to his show, including the former political unknown Rafael Correa. His son and daughter meanwhile attract a younger, nonetheless intellectual audience with high-quality music programs that stand out against the noise of trashy reggaeton and other extremely commercial forms of contemporary Latin music prevalent on the airwaves. Thanks to the wholesale change of the broadcast industry ordered by the presidency, he might be forced out of business, Oquendo, who while being soft-spoken and open to interviewing people from across the country's ideological spectrum has made no secret of his distaste for the current administration, warned in a plea this week. The government could simply argue that it obtained a better deal for society

for the 1,472 radio and television frequencies by raffling them off to the highest bidder, Oquendo said.

Indeed, Correa recently blasted critics for recommending the bidders become known to the public because that would expose them to undue pressure from allegedly existing media conglomerates (the largest however is in the hands of the government, while doubts linger regarding ties between the government and the radio and media conglomerate including newspaper *El Comercio* owned by Mexican media mogul Angel González). Media advocacy organization Fundamedios as well as the Ecuadorian Entrepreneurial Committee have for months warned of the lack of transparency surrounding the giant process. Fundamedios also reports that lesser known radio stations like Oasis and Antena Tres near Salinas continue to go off the air as government officials seize their equipment. Aside from the existential plight of these small stations, with only weeks to go before the February 19 vote, Ecuadorians risk losing access to independent thought at a crucial time.

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