

WALTER R. SPURRIER
Guayaquil, 25 January 2011
20H00 – 21H00

Scenarios for 2011



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Análisis Semanal

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- 1.0 Economic Scenario.
- 2.0 Legal Environment.
- 3.0 Where is the Ecuadoran political economy going?

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Análisis Semanal

Programa

- 1.0 Economic Scenario.
 - 1.1 Inflation.
 - 1.2 Financial system.
 - 1.3 Exchange rate.
 - 1.4 Foreign trade.
 - 1.5 Possible trade restrictions.
 - 1.6 Economic growth.
 - 1.7 Winner Sectors.
 - 1.8 Loser Sectors.

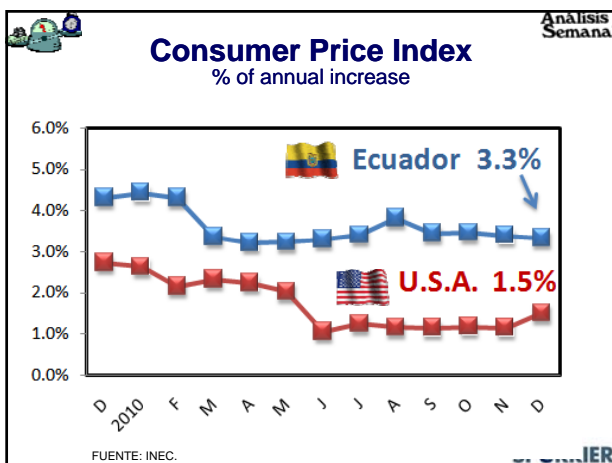
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1.1 Inflation.



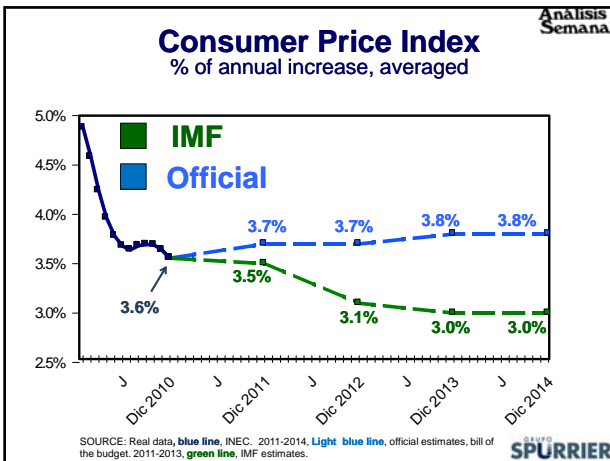
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The average consumer inflation would be 3.5% - 3.7% in 2011.

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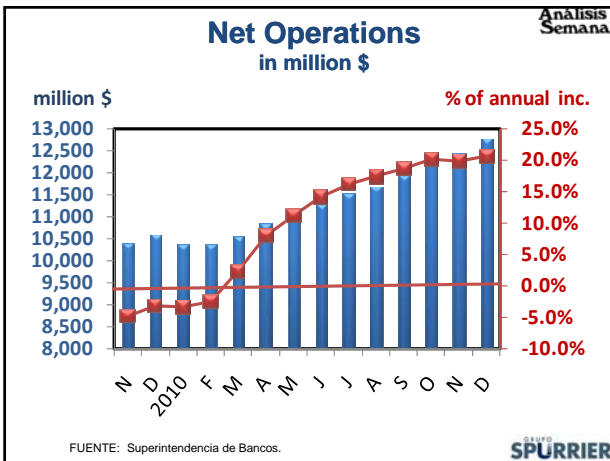


But risks for higher inflation come for three sources:

- Falling dollar, rising commodity prices
- When U.S. economy recovers, U.S. inflation is expected to rise, and would be imported by Ecuador
- A potential reduction in fuel subsidies.

1.2 Financial System.

As long as the economy is liquid, there will be plenty credit available.



Presently credit is plentiful. Some corporations have opted for contracting loans instead of issuing commercial paper.

Banks: Net Operations as of 31 December 2010, in million \$

	December 2010	% inc. Dec. 2010 / Dec. 2009
Net operations	12,760	20.6%
Portfolio	11,044	21.1%
- Commercial	5,049	18.0%
- Consumption	3,585	30.7%
- Housing	1,440	11.9%
- Micro-business	969	19.6%
Restructured	62	-2.8%
Past due + non performing portfolio	255	-6.2%
Acceptances	34	-12.2%
Net contingents	1,366	25.3%

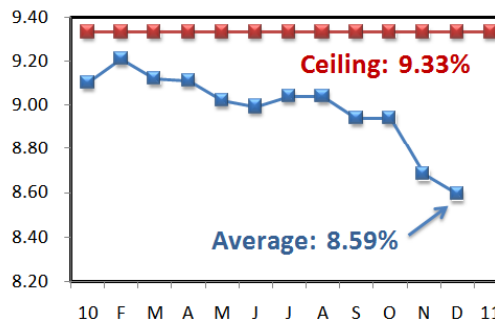
SOURCE: Bank Superintendence.

Interest Rates.



Stable interest rates. Authorities have not exerting downward pressure on rate ceilings.

Corporate Loan Rate in \$



FUENTE: BCE.

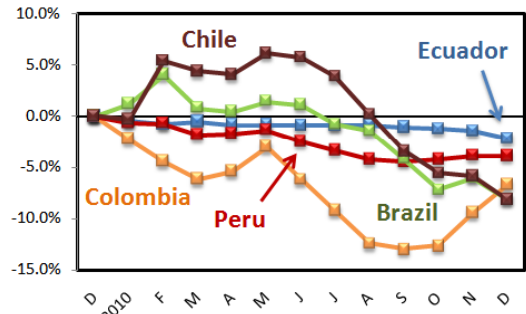
In 2011, if inflation continues low, interest rate ceilings may be lowered.

1.3 Exchange Rate.

With December 2009 as base, Brazil's prices have risen 8.2% in relation to U.S. prices, those of Chile in 8.1%, Colombia 6.8%, Peru 3.9% and Ecuador 2.2%.

Real Exchange Rate

December 2009 = 0



1.4 Foreign Trade.

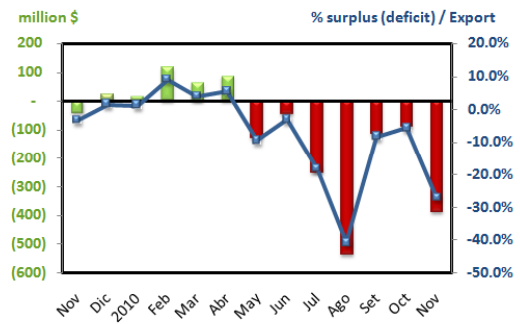


In 2011, if inflation continues low, interest rate ceilings may be lowered.

A \$387 mn trade deficit is reported for November, equivalent to 27% of total exports. This is the seventh month in a row with a trade deficit, and second highest of the year.

Trade Balance FOB

Per month



FUENTE: BCE.

1.4.1 Exports

2011

Oil exports would grow about 27%, non-oil 11%.

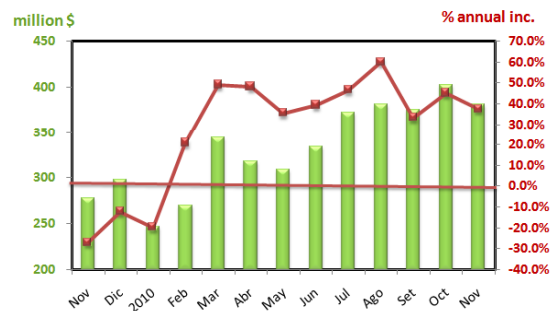
1.4.2 Imports

The recovery of internal demand may most clearly be seen in import data, which since march must important rates of year-on-year growth.

In November **consumer imports** fall -5.2% from October but rise 37.5% year-on-year.

Imports of durables are up 45% year-on-year, nondurables up a less steep 32%.

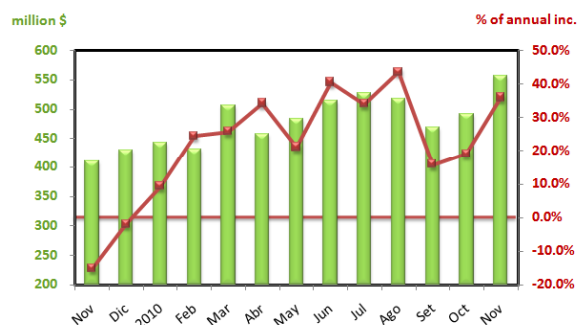
Consumer Imports



Input imports are up 13.5% in November in relation to October and 36% year-on-year.

Inputs for agriculture grow the most year-on-year, 46%; those of manufacturing 37% and inputs for construction materials 10%.

Imports of Inputs



Capital goods imports drop -1.7% in November in relation to October but rise 40% year-on-year.

Capital goods for **industry** are up 42%, **transportation equipment** 39%, while capital goods for **agriculture** only increase 4.0%.

Imports of Capital Goods



If for 2011 the government is not able to secure all the external funding it is after, import growth will slow down considerably.

Imports in million \$ FOB

	2009	2010 Estimate	2011 Estimate	inc. 2011/ 2010
Imports	(14,269)	(18,923)	(20,769)	9.8%
Consumer goods	(3,096)	(4,294)	(4,568)	6.4%
Fuels and lubricants	(2,334)	(3,476)	(4,088)	17.6%
Inputs	(4,675)	(5,883)	(6,398)	8.8%
Capital goods	(3,927)	(5,017)	(5,458)	8.8%
Other	(238)	(253)	(257)	1.6%

1.6 Economic Growth.



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Official forecast:

2011: 5.06% (too optimistic).

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IMF economic growth estimates:

2011: 2.25%.

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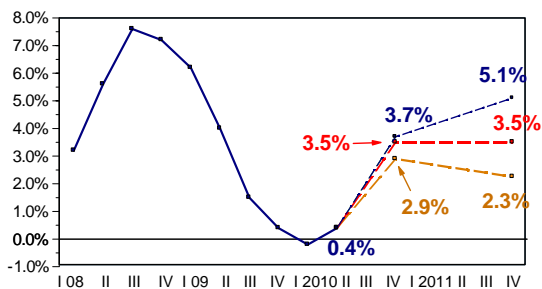


NACIONES UNIDAS
CEPAL

Cepal: 3.5%

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Gross Domestic Product % of increase, 12-month rolling period



SOURCE: Blue line: BCE, "Previsiones Económica"; Green line 2011-2013: BCE, "Tabla de Indicadores Macroeconómicos, Bill of the Budget 2011. Orange line: IMF estimates. Red line: Cepal.

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2011 – Opportunities

The government may authorize the operation of new mining companies. The key is the contract with Ecuacorriente.

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2.0 Legal Environment.

2.1 Production Code.

In force since before year-end (RO 351-S).

Production Code

It includes:

- Payment of “dignified salary”.
- A new **Customs Law**.
- Rules to **manage trade**.
- A set of measures to boost **micro-petty-and mid-sized businesses**.
- A section for the **corporate sector**.

2.1.1 Dignified Salary.



There is a double minimum salary system:

- The legal minimum, currently \$264. All businesses must pay it.

- The dignified salary: all businesses must destine profits to complete a “dignified remuneration”: to workers.
- Only when every worker earns at least a dignified salary may stockholders have access to their profits.

This dignified salary must be linked to:

- A family basket of goods and services;
- Number of minimum-salary earners per family

The definition of dignified salary includes the reserve fund and the proportional rate of the two additional salaries. With that, at the current minimum salary, the minimum remuneration is \$330.

To reach the dignified salary of \$343 from January 2011, a worker earning the minimum should receive at least \$10 a month additional on average through profit-sharing, bonuses, commissions, etc.

2.1.2 Customs law Reforms.

- Red tape is considerably reduced.
- Sanctions are rendered much stiffer

2.1.3 Possible restrictions to trade.



- The law lists all the possible restrictions, tariff and non-tariff alike, the authorities may recur to.
- Expect the authorities to recur more to sanitary rules, or rules-of origin dispositions, among others, so as to restrict unwanted imports.

2.1.4 Incentives for the corporate sector.

There is to be an industrial policy built around import substitution.

Since before the Code was approved, the tariff has been moved to favor some industries. They have been moved in both directions:

i) Higher tariff rates for finished goods so as to protect local output

- TV equipment;
- Textiles and garments;
- Shoes;
- Tires;
- Refrigerators.

ii) Elimination of tariffs for imported inputs for domestic industries:

- a) Telephone assembly;
- b) Fishmeal;
- c) Toiletries;
- d) Software.

Tax benefits are granted under different circumstances.

First, general incentives for investments made anywhere in the national territory:

Reinvestment:

The benefit of the deduction of 10 percentage points to the rate of the income tax, which companies can access in case they reinvest the profits of the fiscal year.

1.- The amount of profits reinvested must be used to purchase productive assets, consisting in new machinery or equipment, irrigation assets, plant material, plantings and all plant inputs for agricultural, forestry, cattle, and flower production, used in the productive activity of the company, as well as for the acquisition of goods related to research and technology to improve productivity, generate productive diversification, and increase the number of jobs; and

2.- The company must increase its capital in the amount of the profits that are reinvested.

Payments abroad.-

Amendment to the Law for Tax Equity in Ecuador exempting from the Tax on the International Movement of Capitals (ISD in Spanish) payments made abroad for the amortization of capital and interests accrued on loans granted by international financial institutions, with maturities longer than one year, destined to finance investments provided for in the Code.

Foreign Trade.-

Granting facilities for the payment of all taxes on foreign trade, for the importation of capital goods, according to the provisions contained in Art. 152 et seq. of the Tax Code.

The Advance payment.-

The costs of the advanced income tax payment (actually a tax on corporate activity that causes income tax credit) is reduced in some cases:

b) Taxpayers with exclusive activities related with productive agricultural agro forestry projects, with a growth stage exceeding 1 year, will be exempted from paying the advance on the income tax for the fiscal years during which they do not earn taxable income, which begin to flow during the main harvest stage.

d) For the purpose of calculating the advance on the income tax, the following amounts shall be excluded:

Incremental expenses for the creation of new jobs or improving the total wage bill.

Acquisition of new assets destined to improve productivity and technological innovation.

In general, investments and expenses actually made related with tax benefits for the payment of the income tax admitted by the Code for new investments.

Lower Income Tax Rate

Reduction from 25% to 22% of the corporate income tax, to be executed gradually over three years, as follows:

- During 2011 fiscal year 24%
- During 2012 fiscal year 23%
- During 2013 fiscal year and thereafter 22%

New investments:

5-year exemption of the anticipated payment of income tax for new businesses and new investment.

Total exemption from income tax for 5 years for sectors that make new investments in given sectors.

Proposed Sectors:

1. Production of fresh, frozen and processed foods;
2. Forestry and agro-forestry chain and by-products;
3. Metal-mechanics;
4. Petrochemical;
5. Pharmaceutical;

6. Tourism;
7. Renewable energies, including bio-energy o biomass energy;
8. Foreign trade logistics services;
9. Biotechnology and applied software; and
10. Sectors of strategic import substitution and promotion of exports, identified by the President of the Republic.

Incentives for deprived areas:

Additional to the general and sectoral incentives mentioned above:

Deduction of 100% of the cost of hiring new workers for 5 years in the case of new investment in economically depressed and border areas, provided they hire workers living in those areas.

2.2 Competition law.

There is to be a Competition law,
standard for this type of legislation.

Danger:

A company qualified as dominant in its
economic activity may be subject to
cumbersome controls geared to ascertain
that it will not abuse its dominant position.

**3.0 Where is the Ecuadoran political
economy going?**

On the one hand:

The government's policy fueling the
economy favors the sale growth we
currently enjoy.

On the other, there are investment risks.

- The aggressive fiscal policy turns
economic stability vulnerable to external
shocks.

- Expectations are created of ever-expanding social benefits.

- There is a continuous change in the rules of the game for business, particularly annual changes in tax legislation.

This strategy of growth based on growing government spending is not sustainable in the middle run. Liquidity may start to become scarce, perhaps not in 2011, but possibly in 2012.

There are two main scenarios:

Scenario 1: smokescreen

Some consider that the clashes between President and radicals in his entourage and erstwhile allies is a smokescreen, that we are on our way down a path similar to Venezuela's.

Scenario 2: President takes distance from radicals.

For his second inauguration, the president chose to lash the radicals and defend capital accumulation.

Crossroads:

The decisions the President takes this year may help determine whether one year hence:

- We are contemplating economic stagnation;
- Ecuador enters a stage of strong economic growth, in the context of setting aside demands from radicals such as the Indians and MPD (the Marxist teachers' union).