Economic Outlook

Report

13 – June 2022

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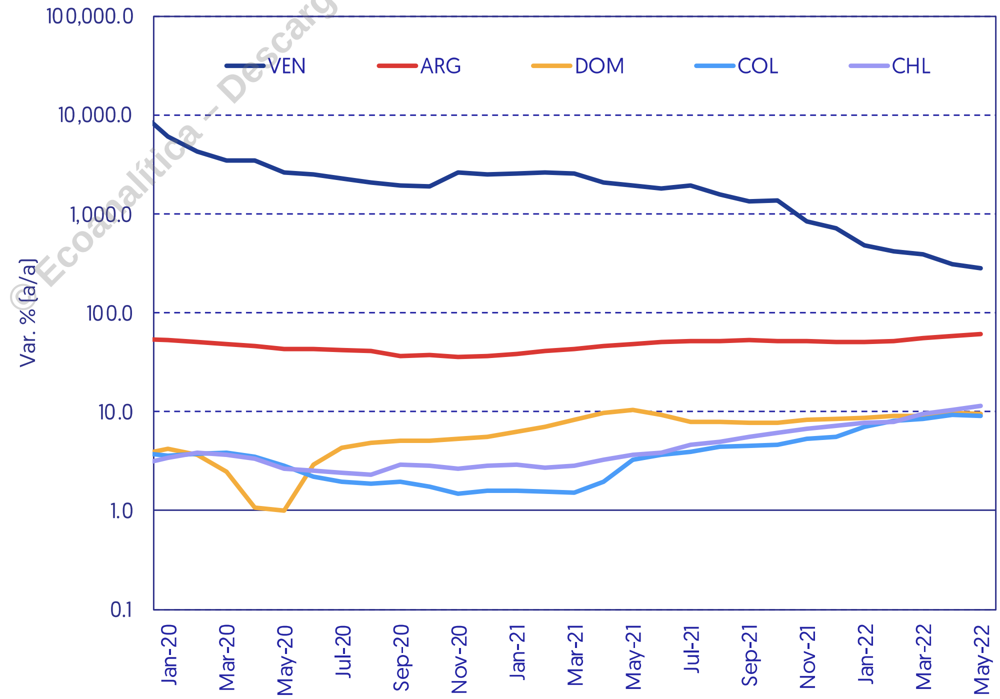
Content

Three faces of inflation ***in Venezuela***

The persistent inflationary slowdown in Venezuela since February 2019 has constituted a considerable reduction in the volatility of price dynamics faced by firms and households. The combined effect of a policy focused on monetary and exchange rate containment supported on the reduction of the fiscal deficit, of a credit restriction through reserve requirement hikes and of a *de facto* extension of a partial dollarization propitiated the end of the hyperinflationary episode started in 2016-2017.

At the end of the first half of 2022, price trends in Venezuela are paradoxical within the international context. On the one hand, it is decelerating "against the tide" while the rest of the world is experiencing record highs not seen in decades. On the other hand, Venezuelan inflation remains orders of magnitude above its regional neighbors, registering monthly what other countries reach in a year. At this juncture, the rising cost of living continues to be one of the main challenges for the financial planning of firms and households.

Year-on-year inflation in Latin America



Note: Graph in logarithmic scale.
Source: Central banks of each country and Ecoanalítica.

What is behind the post-hyperinflation price hike?

Inflation in Venezuela can be attributed to the confluence of three types of pressures. The first, and main one, is of a *monetary* nature and corresponds to the distortions and imbalances of a partially dollarized environment where transactional frictions persist and asymmetries prevail between the preferences of agents who wish to hedge in dollars and the policy of the authorities who try to encourage the use of bolivars, a currency that is sensitive to the growth of its aggregates[1] and whose real demand for extended horizons is minimal due to its low capacity to retain value.

The second type of pressure is of a *real nature*. There are imbalances between a demand reactivated by an increase in "post-pandemic" consumption and a local supply that faces frictions in supply capacity, interruptions or service coverage deficits, low productivity and a limited range of financing[2] .

The third type of pressure is *external.* Rising raw material, fuel and transportation costs in international markets raise the costs of imported goods, although not to such an extent as to neutralize their advantage over local industry.

Although the general effect of these forces is summarized in higher prices, the effect of these forces is not uniform throughout a *bimonetary* economy, in which the disorderly interaction between different monetary signs and means of payment gives rise to more than one inflation metric by which economic agents can be guided.

More than one inflation

Traditionally, inflation in Venezuela is captured by price variations denominated in local currency (INPC); however, the worsening of the hyperinflationary episode and the inherent difficulties in making calculations in a volatile environment made this metric less useful in the value measurements made by firms and households, who opted to anchor their expectations in markers expressed in foreign currency.

At **Ecoanalítica**, we try to approximate the evolution of the cost of living in dollars by measuring the exchange rate appreciation[3] , with the lag of the exchange rate with respect to inflation in bolivars and reporting the loss of purchasing power of foreign currency when these are used to acquire goods in the local economy.

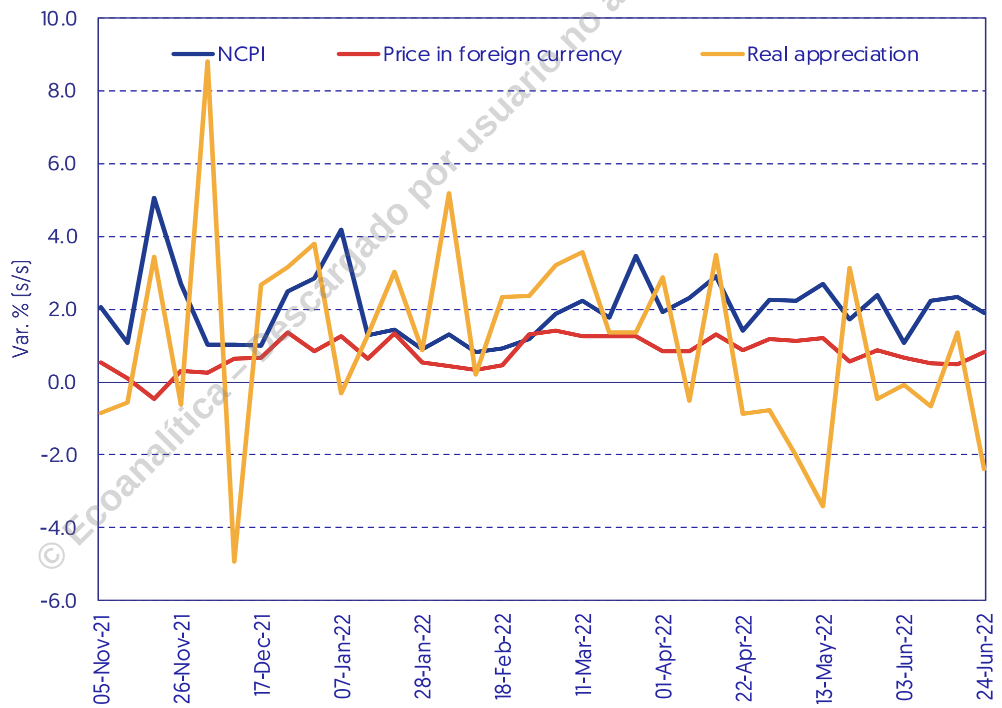
Initially for informative purposes, this measurement faces the limitation of not being able to capture the dynamics restricted to channels managed only in foreign

[1] Between the week of January 7 and June 17, the monetary base grew 147% and liquidity (M2) 93%.
[2] A reactivation of demand in the face of a relatively more inelastic supply is at the epicenter of global inflation. One thing in which Venezuela differs from its contemporaries is that local productive capacity was already compromised before the COVID-19 pandemic.
[3] Weekly link(s) on cost of living in dollars for July 2021.

currency[4] and, also, the distortions in the calculations introduced by the strategy of the Central Bank of Venezuela (BCV) to contain the exchange rate; this increases its volatility and makes common situations in which, counterintuitively, the cost of living in dollars exceeded by far the CPI inflation for those weeks in which the exchange rate contracted. Subsequently, the metric registers very sharp reversals when the exchange rate experiences eventual corrections[5] .

In order to expand our repertoire of inflationary measurements, **Ecoanalítica** has incorporated the weekly monitoring of prices in foreign currencies. After more than a semester of information gathering, we can make some initial observations about the data.

Appreciation of the cost of living in bolivars and foreign currencies



Sources: Ecoanalitica.

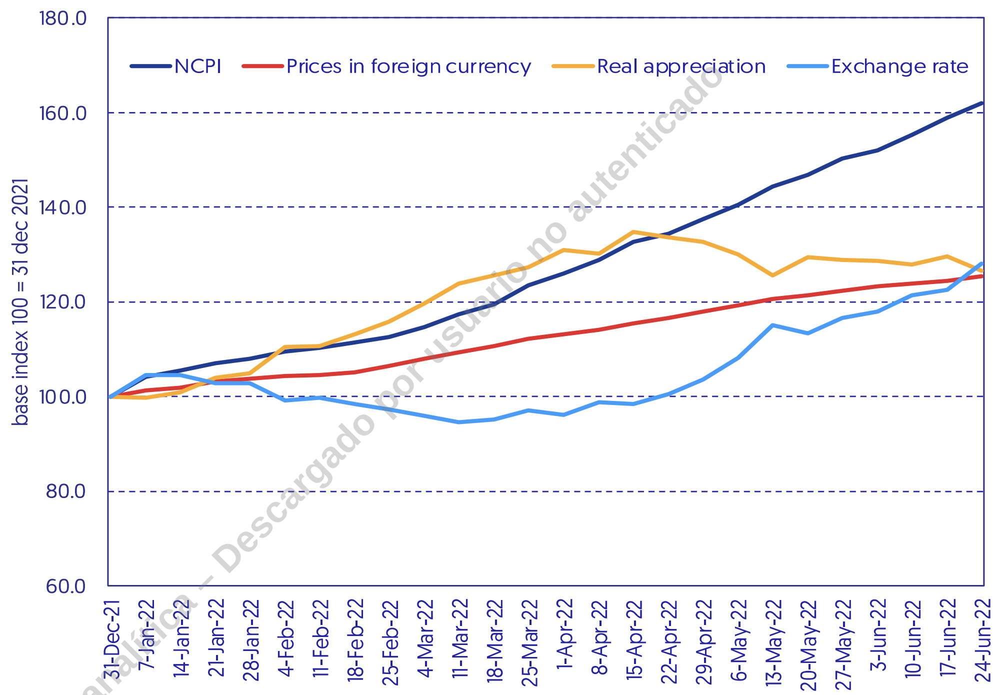
First, price variations in foreign currency are persistently lower and less volatile than price variations in bolivars, with respective averages of 0.80% and 2.00%, and standard deviations of 0.44 percentage points (pp.) and 0.96 pp, which is consistent with

[4] They became progressively more common as the bolivar underwent an inertial demonetization and its liquidity was surpassed in terms of value by the cash circulation of foreign currency.
[5] For longer time horizons, lags and exchange rate corrections tend to be *netted out* and appreciation is tempered.

greater stability associated with the nominal anchoring of expectations using a monetary sign in which economic agents have greater confidence.

In cumulative terms, between the beginning of the year and the week of June 24, inflation in bolivars was 62.0%, while the increase in prices in foreign currency was 25.5%. In the same period, the exchange rate rose 28.0%, which translates into a real accumulated appreciation of 26.6%[6] ,

Cost of living increase (first half 2022)



Sources: Ecoanalitica.

From these differences and similarities, as inflation metrics, some considerations can be drawn about price dynamics and their setting and modification in Venezuela:

- Expectations are mainly anchored to foreign exchange[7] , but it is not a perfect anchor that makes prices in bolivars simply residual of the current market exchange rate; otherwise, inflation in bolivars would be entirely explained by exchange rate variations[8] .
- Inflation in bolivars continues to be conditioned to monetary pressures beyond the exchange market. Prices in bolivars tend to continue to grow

[6] The exchange rate is a component of the appreciation calculation, so they go in opposite directions for a given level of inflation in bolivars.
[7] Venezuelan Observatory of Finance. (2022). *At least 99% of prices are dollarized in Caracas and 49% of payments are made in bolivars.*
[8] A full *pass-through* effect by controlling for price increases in foreign currencies, which would act as the basis for reference prices.

even in weeks when the exchange rate remains stable. Firms' and households' preference for bolivar use is concentrated in shorter time horizons.

- The variation in foreign currency prices may be more representative of the real dynamics mentioned at the beginning of this report, as it can be explained by the evolution in cost structures and demand intensity rather than by a drop in confidence in the monetary sign.
- If we assume that the anchoring to foreign currency references is quite deep, the observed market exchange rate[9] is insufficient to explain the existing differences between inflation in bolivars and inflation in foreign currency in the country. This opens the possibility that, in the internal dynamics of firms and households, the "implicit" exchange rates are heterogeneous and divergent from the ranges targeted by the BCV's exchange rate policy.
- A representative "implicit" exchange rate[10] consistent between both inflations could shed light on underlying exchange rate dynamics that anticipate the possible evolution of the market exchange rate.
- Preliminary evidence indicates that, if the cost of living in dollars measured by appreciation exceeds that measured by foreign currency prices, there is pressure for the exchange rate to undergo corrections to reduce its lag with respect to dollar prices.

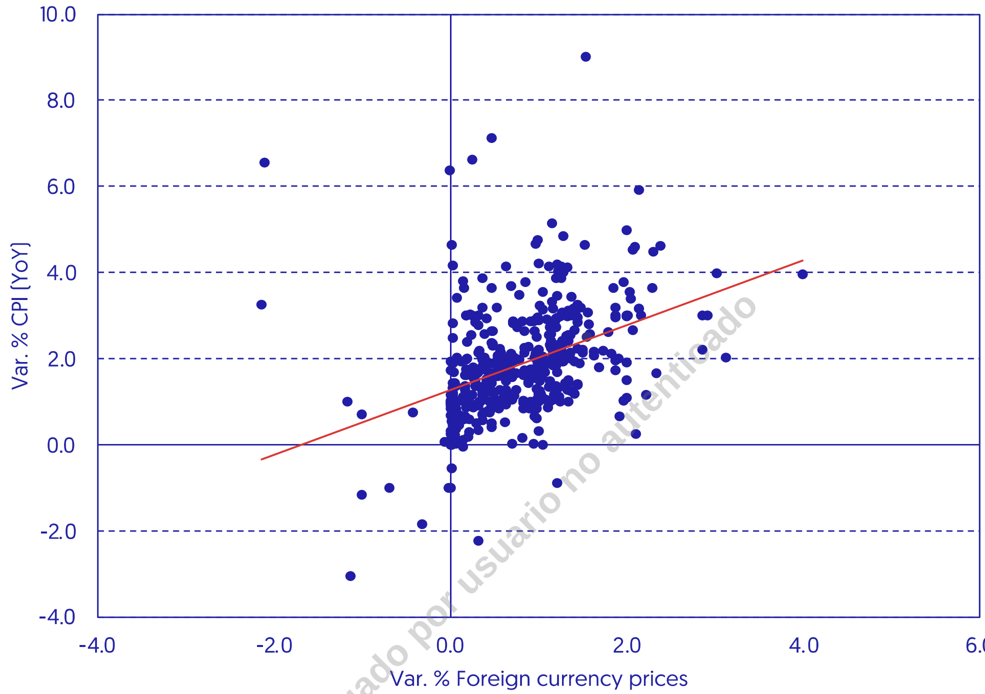
Looking at items with more reservations

Seen from a general price perspective, the relationship between bolivar inflation and foreign currency price variation is not very strong, with a coefficient of 0.07. An effect attributable to occasions when bolivar inflation accelerated compared to weeks when foreign currency price changes remained relatively constant.

Viewed in a more granular way, by item, the relationship between both inflation rates becomes stronger, with the entire sample[11] growing at a correlation coefficient of 0.43, but with varying degrees of heterogeneity among items. A higher correlation is observed in the categories of Leisure and Culture (0.6), Housing Rentals (0.5) and Transportation (0.5), and a lower one in Miscellaneous Goods and Services (0.2) and Housing Services except telephone (0.2) and the only one with a negative relationship in Food and Non-Alcoholic Beverages (-0.2).[12]

[9] And by extension the official exchange rate reported by the BCV.
[10] Exchange rate variations that make the increase in the cost of living in dollars equivalent to the increase in the cost of living in dollars, seen from the perspective of prices in foreign currencies as a result of real appreciation.
[11] 34 pairs of observations for 13 categories for a total of 442 observations.
[12] This explains the low relationship between headline inflation and general currency prices when the highest weighted category acts "counter-current".

Correlation between weekly price variation in bolivars and foreign currencies



Note: Data by item for a 34-week period between 05/11/2021 and 06/24/2022.
Source: Ecoanalítica.

Different flows for the same river

At **Ecoanalítica** we believe that the structural conditions of the Venezuelan economy make it inherently prone to high inflation rates, even outside a hyperinflationary range, and such pressures may manifest themselves differently in a fractioned ecosystem in terms of the use of monetary signs and respective payment systems. In this regard, we believe that firms and households should consider the following:

- Different collection-payment channels may be exposed to different inflationary dynamics prevailing in the short term. Bolivar-only transactions will be affected by currency imbalances better captured by **CPI inflation**.
- Operations that require frequent exchanges between foreign currencies and bolivars, especially those motivated by the implementation of the Large Financial Transaction Tax (IGTF) are more exposed to exchange rate imbalances captured by **real appreciation** measurements.
- Transactions restricted to the exclusive use of foreign currencies are subject to real pressures captured by the **variation of prices in foreign currencies**.
- The high probability that firms and households must interact simultaneously among these three channels opens the possibility that a particular metric is perfectly representative of the aggregate inflation that the economic agent faces.

- As a consequence, it is important to identify the extent to which firms' activities are involved in the aforementioned channels, especially in the short term, when misalignments between inflation in bolivars, appreciation and prices in foreign currency may lead to different, and even contradictory, assessments of the dimensions of the cost-of-living increases faced.

Giorgio Cunto Morales

Weekly ***Indicators***

	5th Week June	*Weekly chg. [%]*	*Depre/Apre [pp]*[1]
FX Boards [VES/USD][2]	5.5	0.8	0.8
	3rd Week June	Weekly chg. [pp]	Annual chg. [pp]
Lending Interest Rate [%]	56.6	-2.0	-0.2
	5th Week June	Weekly chg. [pp]	Annual chg. [pp]
Overnight Interest Rate [%]	113.9	53.1	-15.2
	4th Week June	Weekly chg. [%]	Annual chg. [%]
International Reserves [USD Bn]	10.3	-0.15	65.7
	3rd Week June	Weekly chg. [%]	Annual chg. [%]
Monetary Liquidity [MM VES]**	7,705.6	-0.4	331.2

Price of International Oil Baskets [USD/bl]

	4th Week June	Weekly chg. [%]	Annual chg. [%]
WTI	107.9	-7.4	52.0
Brent	116.8	-6.6	60.8

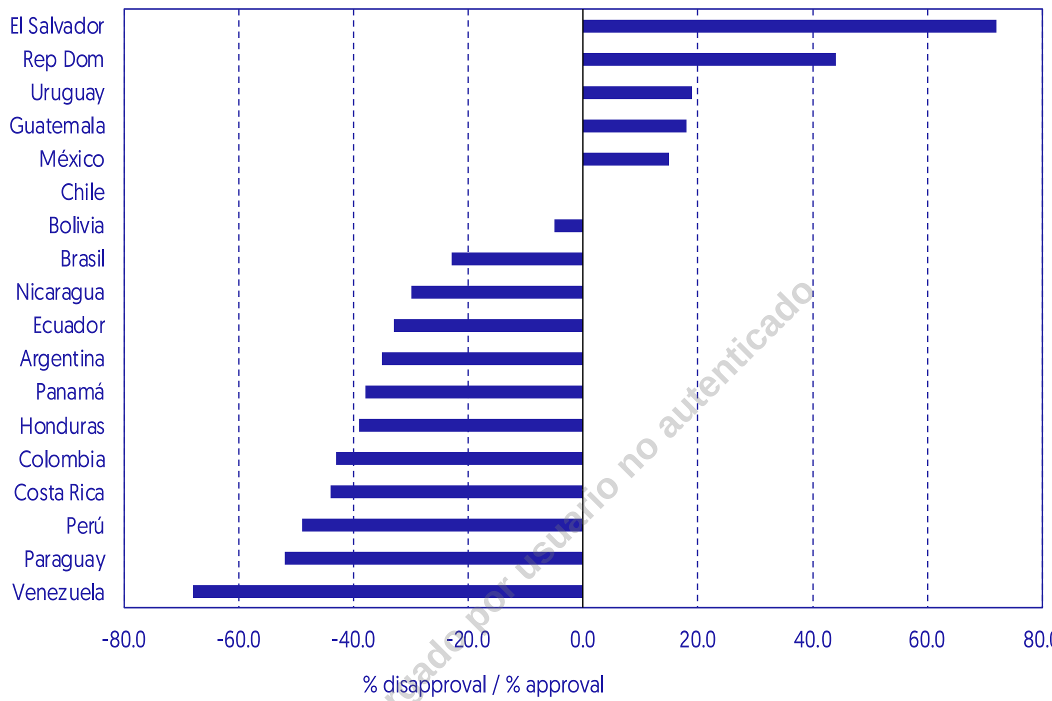
Price of the Venezuelan oil basket [USD/bl]

	5th Week July [2020]	Weekly chg. [%]	Annual chg. [%]
Weekly Average	22.4	0.0	-61.9
Annual Average	28.8	-0.7	-51.7

Sources: BCV, MENPET, ONT and Ecoanalítica.
****Annual variation of accumulated expenditure.***
*****Reconverted amounts.***
[1]Depreciation [+]/Apreciation [-]
[2]FX Borads' average exchange rate.

Graphic of the week
Unpopular presidencies

Approval level of the region's presidencies



****Colombia takes into account the outgoing government.***
****The last survey for Venezuela was conducted in November-December 2020.***
Sources: NGO Directorio Legislativo and Ecoanalítica.

A study called "Image of Power" by the Argentinean non-governmental organization Directorio Legislativo, shows, through bimonthly public opinion surveys, the levels of approval of the citizens of the countries of the region towards their governments. Thus, according to the latest monitoring in the period March-April of this year, the presidential approval net (% approval - % disapproval) was negative in most of the governments of the region except for El Salvador, which registered the highest approval (72%), followed by the Dominican Republic (44%), Uruguay (19%), Guatemala (18%) and Mexico (15%). On the other hand, among the governments whose administrations were most disapproved of were those of: Paraguay (-52%), Peru (-49%), Costa Rica (-44%), Colombia (the outgoing government with 43%) and Honduras (39%).

Given the historical evolution of these surveys; according to Mario Riorda of the Legislative Directory, we can observe a solid trend evidenced with high disapprovals (above the approval levels) of the passing governments of the region, which represents a novelty with respect to the 2002-2009 period when government approvals increased from 36% to 60% for the 18 presidents of the region. It is from 2010 onwards that approval begins to decrease. Riorda also points out that there are two new elements: rapid drops in approval shortly after the beginning of the terms of office and disapprovals consolidated in aggravated and hyper-aggravated formats.

Tips
Economic, oil, sectorial and political

ECONOMIC TIPS

COVID-19 in Venezuela. According to government figures as of June 29, 2022, the country accumulated 525,929 registered cases of coronavirus and 5,730 deaths. In turn, according to OurWorldInData, it is estimated that 79.19% of the population has received at least one dose of some vaccine as of March 25, 2022.

May inflation (I). The BCV reported that May inflation was 6.5% inter-monthly, which is the highest monthly inflation since January of this year. With this figure, the accumulated inflation for 2022 amounts to 23.9%, while the interannual inflation stands at 167.2%.

May inflation (II). When broken down by items, the highest monthly inflation was observed in Education services at 15.7%, followed by "Food and non-alcoholic beverages" and "Recreation and culture" with 8.6% and 8.5%, respectively. On the other hand, the items with the lowest price increases in May were "Alcoholic beverages and tobacco" with 2.8% and "Transportation" with 2.9%.

Food is becoming more expensive. It is worth noting that inflation in "Food and non-alcoholic beverages" has accelerated in the last two months, after being below general inflation in the first quarter of the year. Thus, in April, monthly inflation in this category was 1.2 percentage points (pp) higher than general inflation, and in May this difference rose to 2.1 pp.

Interventions continue... In the last two weeks of June, the BCV carried out two foreign exchange interventions, each for an amount of USD 120 million. With these two operations, the BCV has injected USD 2,235 million into the financial system so far this year. As a result, in 2022 the average per intervention is USD 86.0 million.

... and the increase. The selling price of the first intervention was VES 5.72/EUR, equivalent to VES 5.47/USD, while the second intervention was placed at a rate of VES 5.80/EUR or VES 5.51/USD. Thus, the exchange rate continues to rise in the official market.

Change of hands. The Superintendency of Banking Sector Institutions (Sudeban) announced that Banco Nacional de Crédito (BNC) completed the acquisition of the assets and liabilities in Venezuela of Banco Occidental de Descuento (BOD), after the latter institution was in a crisis in recent months due to insolvency problems.

High expectations. Jesús Faría, president of the Permanent Commission of Economy, Finance and National Development of the National Assembly (AN), indicated that the Venezuelan economy will grow by 20% this year as a consequence of the progressive increase of the country's oil revenues. He also added that oil generates 95% of the foreign currency for the productive sector and the 70% necessary to comply with the social agenda.

Money tables. For the last week of June, the average money desk rate was VES 5.5/USD, representing a 0.8% depreciation from the previous week.

OIL TIPS

Investment in clean energy. The International Energy Agency (IEA) projects that global investment in the energy sector will grow 8% in 2022, reaching a total of USD 2.4 trillion. Of this amount, approximately 60% will be allocated to the development and implementation of clean energies.

It's cheap, give me two. In May, China imported 8.41 million tons of crude oil from Russia, an increase of 54.8% compared to May 2021. With this Russia displaces Saudi Arabia as China's top oil supplier. In recent months, Chinese state-owned companies have increased their purchases of Russian oil encouraged by heavy discounts due to the sanctions that some countries have imposed on the country.

Moderate increase. Monomers applied to the U.S. Office of Foreign Assets Control (OFAC) for an extension of its license to conduct transactions, including those related to dividends. These transactions were not permitted due to U.S. sanctions on the country. The license will be in effect until June 2023, but is subject to the Colombian government recognizing opposition leader Juan Guaidó as president of the country, which could change with the new president-elect, Gustavo Petro.

European destination resumes. After authorization from the US State Department, Venezuelan oil exports to Europe are resumed with a shipment of 650,000 barrels of oil. The Italian energy company Eni is the recipient of the shipment and is doing so as a form of payment to settle the unpaid debt and outstanding dividends owed. PDVSA is expected to send a second shipment of 2 million barrels in the following months.

90-day suspension. After the price of a gallon of gasoline hit a record $5, Biden announces that he will ask the country's Congress to eliminate the federal tax of $0.18 per gallon of gasoline until September. In addition, together with the $0.24 per gallon diesel tax, this measure is expected to stop generating $10 billion in tax revenues for the country's federal government.

Invitation to Venezuelan soil. Given the oil embargo of the US, Canada and other countries on Russia, Emmanuel Macron, President of France, stated at the annual G7 summit that Venezuela and Iran should be re-incorporated to the oil market in view of the increase in the price of crude oil. In response, Venezuelan President Nicolas Maduro commented that the country is "ready to receive all French companies that want to produce oil and gas".

SECTORIAL TIPS

Hopeful expectations (I). The president of the board of directors of the Venezuelan-Colombian Chamber of Economic Integration (Cavecol), Luis Alberto Russián, explained that after Gustavo Petro's victory in the Colombian presidency, there are positive expectations for trade relations between the two countries.

Hopeful expectations (II). He stated that if relations between the two countries were to be resumed after Petro's arrival to power, the revenue from trade relations between the two countries could be USD 800 million and in a positive scenario, it would reach up to USD 1.2 billion.

Successful projections for vacations. Leudo González, president of the Superior Council of Tourism (Conseturismo), stated that there are positive expectations for the beginning of the vacation season. He explained that the enthusiasm is due to the sustained growth that the sector has presented in the last seasons due to the participation of mayors' and governors' offices to promote tourism.

Food security in danger... Celso Fantinel, president of the Confederación de Asociaciones de Productores Agropecuarios de Venezuela (Fedeagro), explained that the country's agricultural production is affected by transportation problems caused by the unavailability of diesel, the lack of financing in the sector and the shortage of fertilizers.

...for other people's reasons. He pointed out that fertilizer procurement has become more expensive as a result of Russia's invasion of Ukraine, which has affected the primary sector. In addition, he commented that due to the unavailability of diesel, the transportation sector has not been able to move the final product in an efficient manner, causing crops to be lost.

Reactivation of companies (I). Giovanni Celano, president of the Chamber of Entrepreneurs of Guarenas-Guatire, commented that a series of proposals were presented with the objective of reactivating paralyzed companies in the area. He explained that among the proposals are "plans for the adaptation and updating of all the documentation necessary for these companies in order to have access to long-term financing".

Reactivation of companies (I). He also commented on the existence of unfair competition experienced by Venezuelan businessmen, explaining that sectors such as textiles and footwear were affected by imported products. He specified that "Industrialists from other countries are practically being helped with credits, with tax incentives that lower prices and when they arrive to our market, they compete unfairly with the national sector".

POLITICAL TIPS

Are we heard (I)? The Spanish transnational Telefónica revealed requests for the tapping of more than 1.5 million of its telephone lines and Internet accesses in Venezuela in 2021, which human rights defenders considered as a sign of the advance of a program of "massive surveillance" by the State.

Are we heard (II)? According to a report by Telefónica, present in Venezuela since 2005, legal interventions of telephone lines and internet accesses of the company jumped from 380,250 in 2016 to 861,004 in 2021, with more than 1.5 million accesses affected in that last year.

Border opening... Nicolás Maduro informed that he spoke with Gustavo Petro, president elect of Colombia, about the willingness to reestablish normality in the borders. The opening of the border is one of Petro's campaign promises, who assured that, if elected, he would take this step.

and respect for Venezuelans. On the other hand, Petro affirmed that his government will respect the rights of Venezuelans who went into exile in his country fleeing Nicolás Maduro's regime. Regarding the resumption of diplomatic relations between the two countries, broken since 2019, Petro stressed that it is a complex issue that will not be resolved quickly.

No freedom of expression (I). Michelle Bachelet, United Nations High Commissioner for Human Rights, denounced the stigmatization and criminalization of journalists, media workers, discredited since the government of Nicolás Maduro.

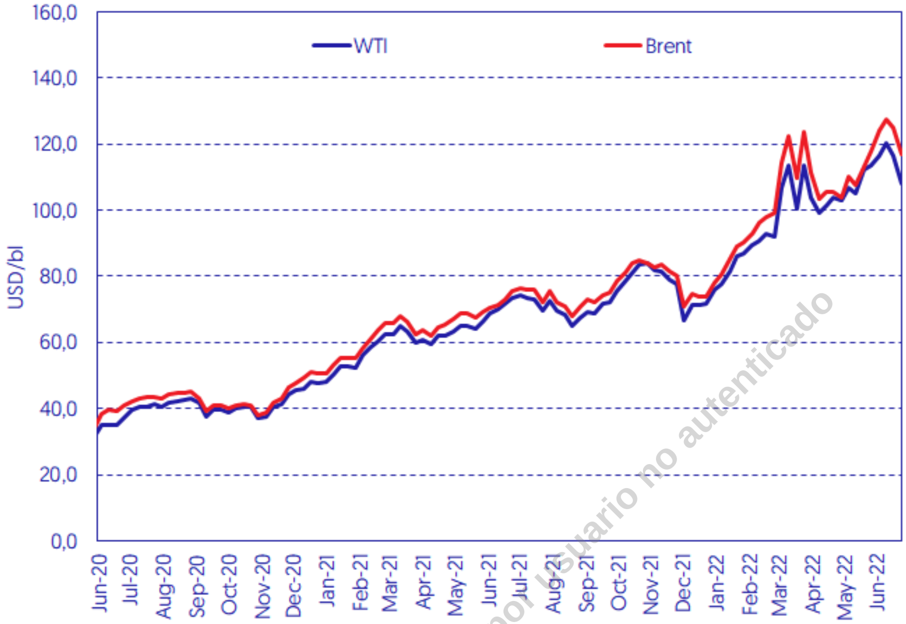
No freedom of expression (II). Bachelet will present the update of her report, which covers the period between May 1, 2021 and April 30, 2022, to the United Nations Human Rights Council.

No freedom of expression (III). Similarly, Bachelet reported that she documented 34 cases of violations against the press, including harassment, censorship and confiscation of equipment, as well as self-censorship for fear of reprisals. The report also noted that there are at least 11 journalists and media workers under judicial restrictions.

Opposition primaries... The executive secretary of the Unitary Platform, Omar Barboza, informed that next year primary elections will be held in the democratic opposition to elect a candidate to face Nicolás Maduro in the presidential elections of 2024.

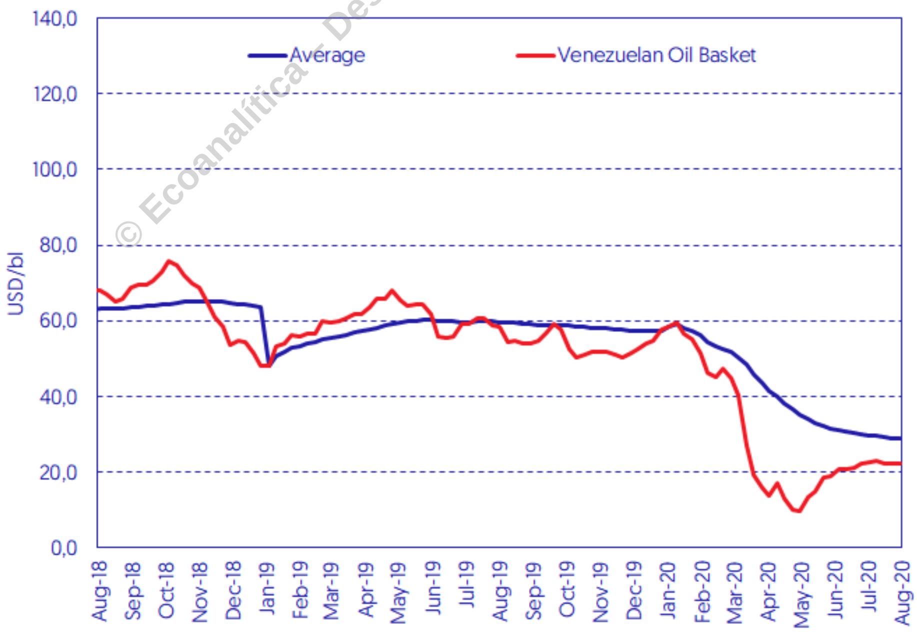
detached from the CNE. Likewise, Barboza informed that the direction of the process will be in charge of a National Primary Commission, clearing the possibility of the participation of the National Electoral Council (CNE), which is, precisely, one of the demands made by different leaders.

Oil prices (WTI and Brent)



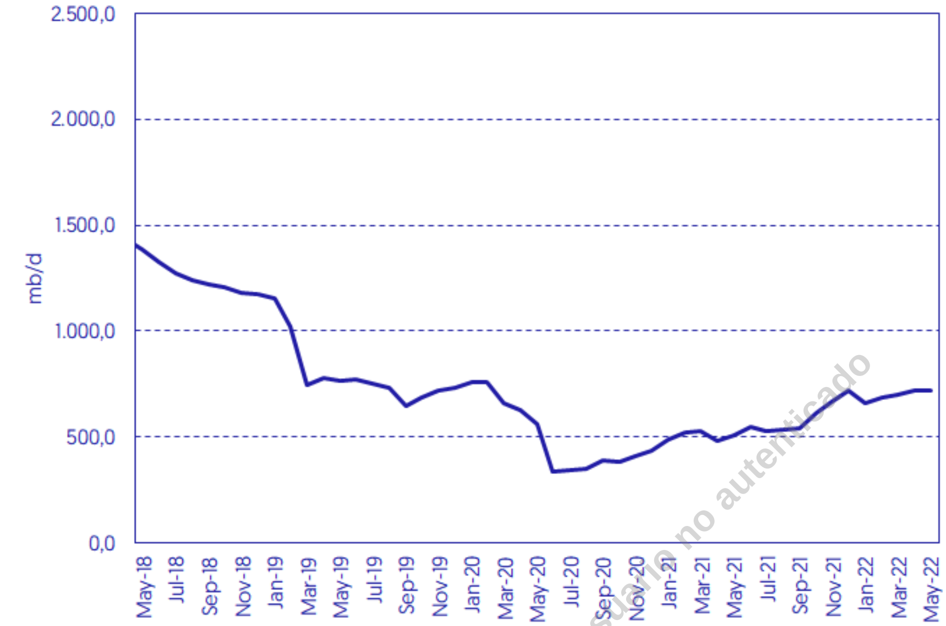
Sources: Menpet and Ecoanalitica.

Oil prices (Venezuelan basket)



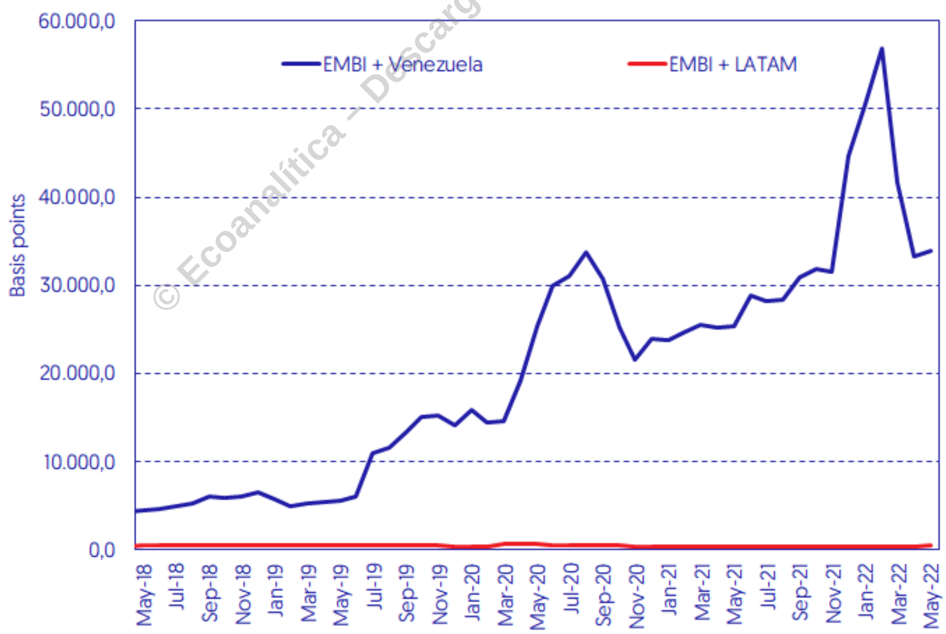
Sources: Menpet and Ecoanalitica.

Oil production (secondary sources)



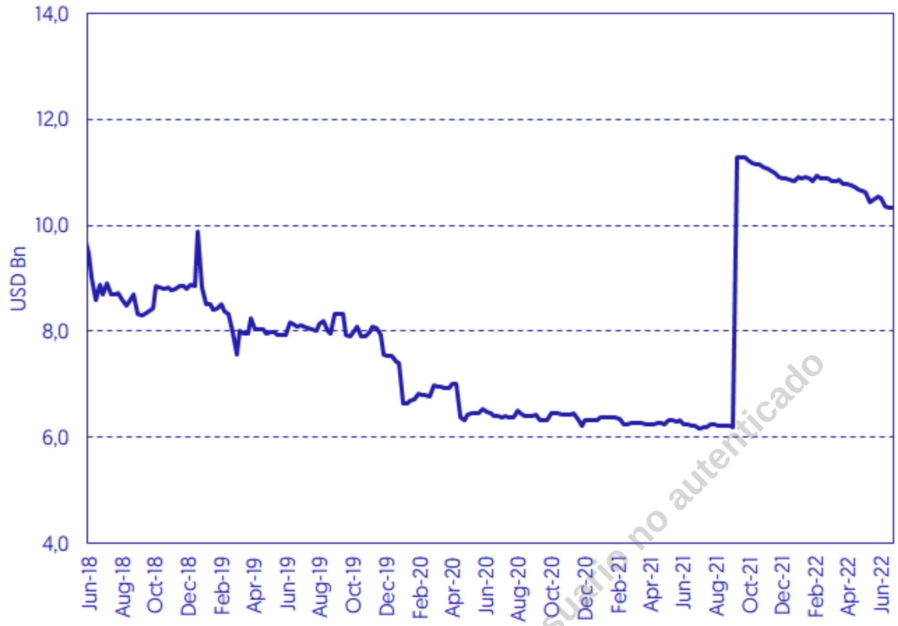
Sources: OPEC and Ecoanalitica.

EMBI



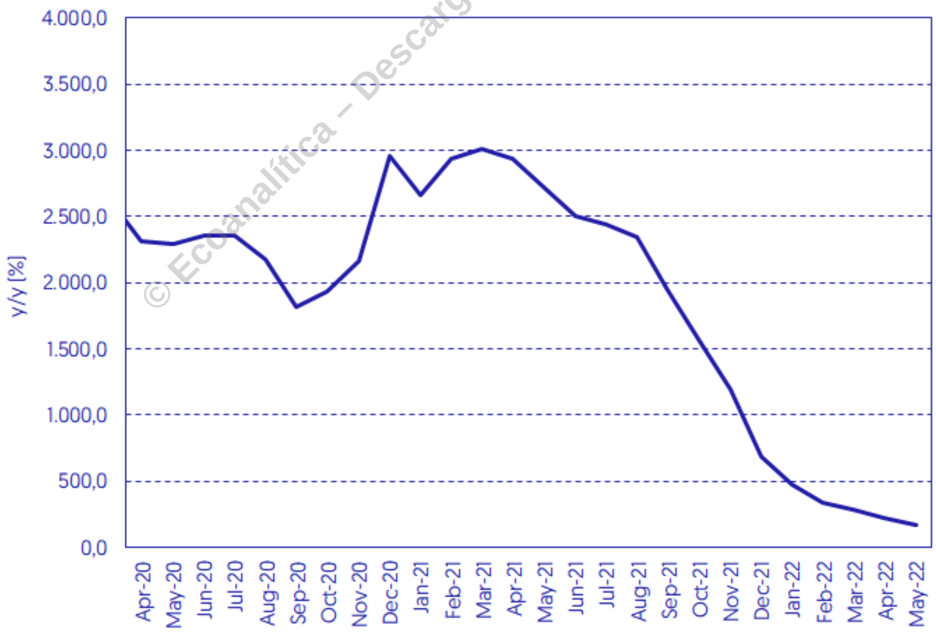
Sources: BCRP and Ecoanalitica.

International reserves (BCV)



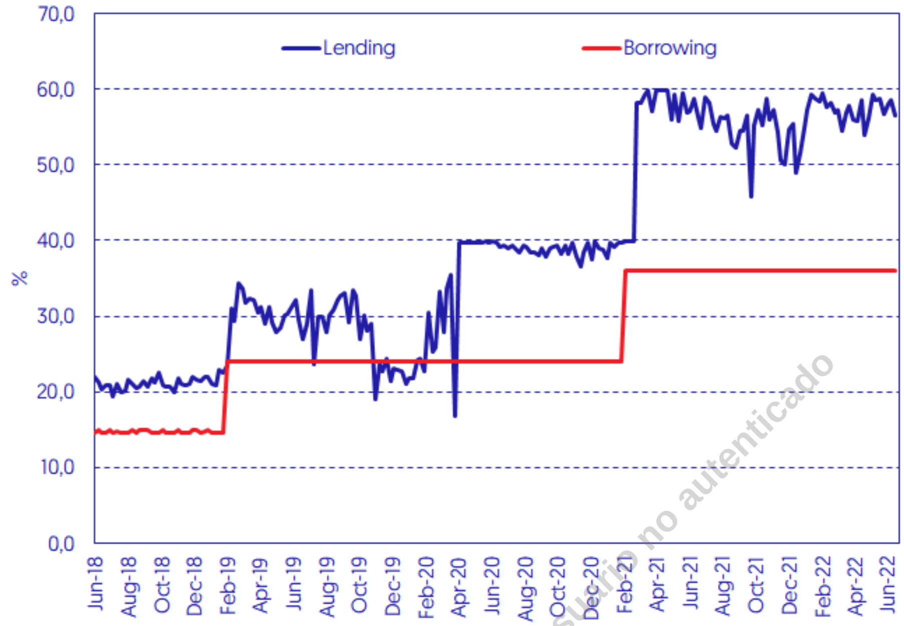
Sources: BCV and Ecoanalitica.

Inflation (BCV)



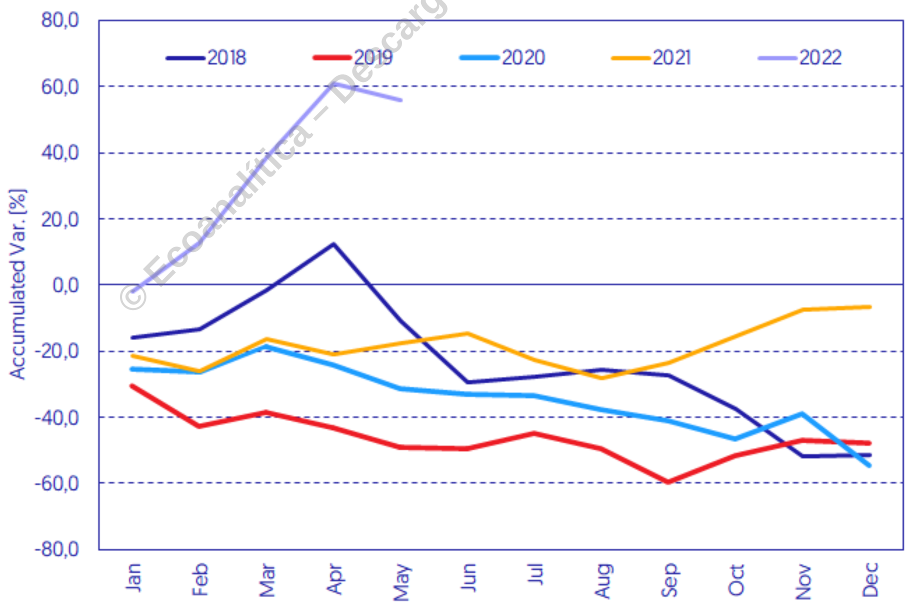
Sources: BCV and Ecoanalitica.

Interest rate (six major banks)



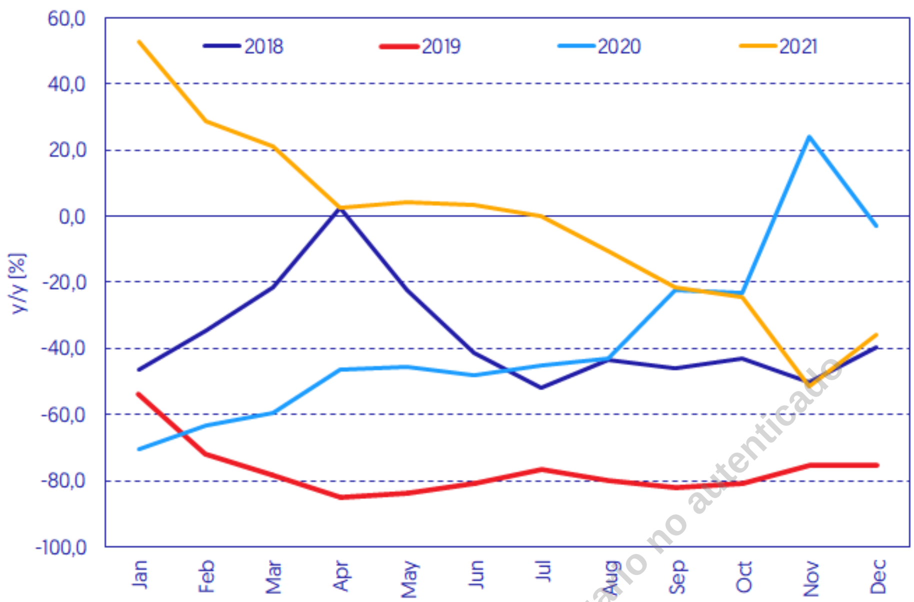
Sources: BCV and Ecoanalitica.

M2 Expansion (real)



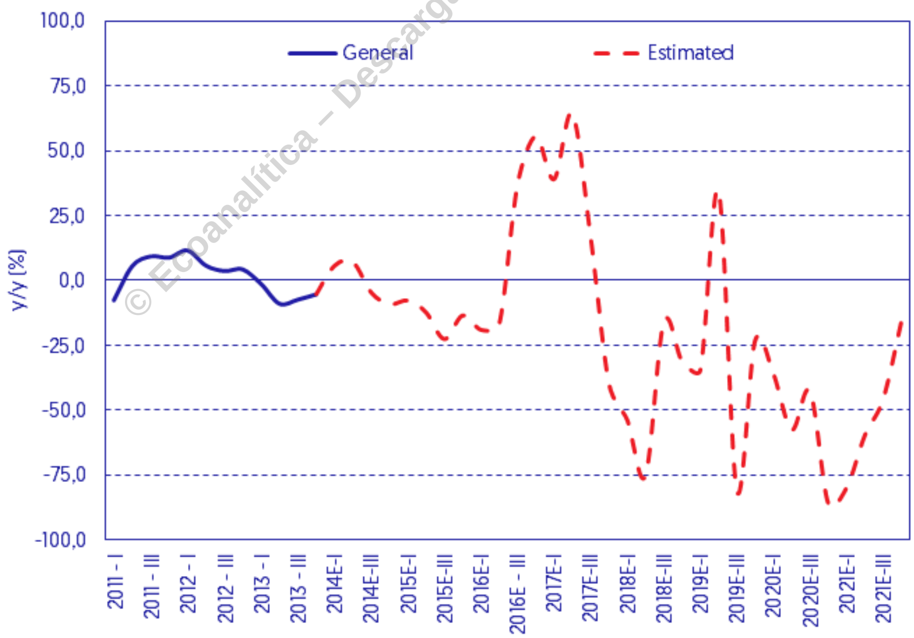
Sources: BCV and Ecoanalitica.

Loan Portfolio (real)



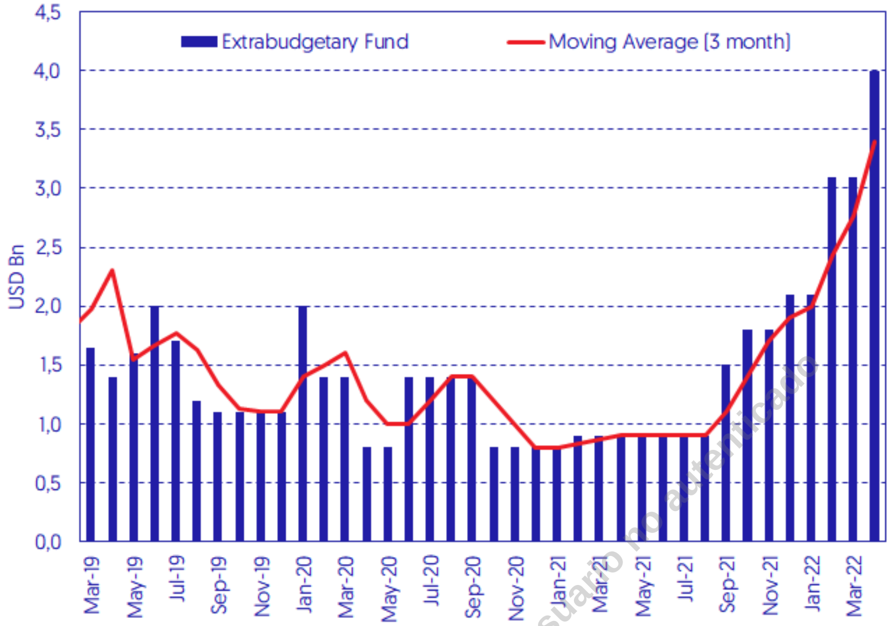
Sources: Sudeban and Ecoanalitica.

Real wage index



Sources: BCV and Ecoanalitica.

State extrabudgetary resources



Source: Ecoanalitica.

Directors
Alejandro Grisanti, Pedro Palma, Asdrúbal Oliveros,
Armando Grisanti, Reinaldo Planchart.

Research Team
Luis Arturo Bárcenas, Giorgio Cunto Morales, Jesús Palacios Chacín,
Jhoan F. Castellano, Diego Santana Fombona, Carlos Penfold.

Research Assistants
Mariana Fernández, José Antonio Medina, Pablo De Sousa.

Venezuela
C.C. Mata de Coco, 5th floor, office 5-E, La Castellana,
Caracas 1060, Venezuela.
J-31130403-7
+58 212-266.9080

República Dominicana
Torre Da Silva IV, 19th floor, La Esperilla,
Santo Domingo 10107, Dominican Republic.
RNC 132303352
+1 809-895.0227