



Weekly Report

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*Looking beyond the devaluation:
what to expect regarding the
exchange*

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The Administration kicked-off the year with a devaluation of the official exchange rate which it heralded not as a devaluation, but as a unification of the exchange rate at Bs.F 4.30/US\$. The Administration also backtracked on the implementation of a previously announced tax-package. In this first Report of the year, we will look at what the Administration is evaluating with respect to exchange matters.

**Politically, the
most costly
option**

As we have mentioned in previous Reports, the Administration has been evaluating options as to how to go about devaluing the official exchange rate. A number of options were being considered with the Ministry of Planning and Finance, the Central Bank of Venezuela (BCV), and PDVSA, all having a different opinion as to how to make the adjustment. In the end, the Administration chose to devalue via a unification of the exchange rates. At *Ecoanalítica*, we believe that this option, compared to all the others being considered, is the one that will have the greatest impact on inflation throughout the year, given that all the government's subsidy programs were financed at the Bs.F 2.60/US\$ exchange rate, as well as



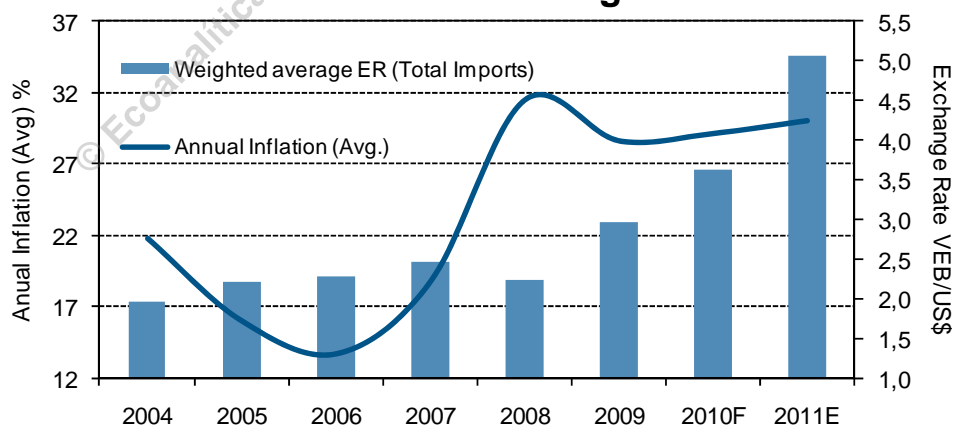
price controls on basic food items and medicines. So it will be a real challenge for the Administration to control inflation this year and it will be interesting to see how the BCV will decide to tackle this serious problem.

The dilemma

Facing this scenario of inflationary pressures, the Administration has already defined the path it will follow: fight against price gouging, expand price controls, and increase public subsidies. A number of spokespersons for the Administration have already come forward with a number of different proposals including everything from a complete freeze on prices to stricter price controls on all goods of mass consumption and medicines being imported.

The dilemma in 2011 will be: if the Administration continues to corral the private sector, accusing it of price gouging, what we will see is an increase in shortages of many items. And, the only way to not lose control of inflation is to insure that the market is not plagued by shortages. But, and here is the dilemma, the only way to ensure that the market isn't plagued by shortages is for the Administration to seriously reconsider its price control policies, which in turn will lead to higher inflation. In this context, inflation will be at around 30%.

Inflation Vs. Exchange Rate



Sources: BCV and Ecoanalítica

Was the devaluation enough?

In Venezuela, the devaluation of the official exchange rate has a direct and significant impact on fiscal revenues, and this time is not the exception. As a direct result of the devaluation, the Administration stands to collect in bolivars the equivalent of US\$ 7.0 billion in extra revenue into its fiscal coffers (fiscal oil revenues calculated at Bs.F 4.30/US\$ instead of Bs.F 2.60/US\$ = US\$ 3.02 billion; an adjustment to the SITME exchange rate



from Bs.F 5.30/US\$ to Bs.F 6.5/US\$ = US\$ 2.09 billion; and the BCV exchange profits = US\$ 1.90 billion). In bolivars this is equivalent to VEB30.17 billion, which in turn is equivalent to 14,8% of total spending budgeted in the 2011 National Budget. This explains part of the reason why the Administration decided to hold off on the tax-package it was planning on implementing which included increasing the VAT and re-implementing the Bank Debt Tax. These two measures would have generated US\$ 5.30 billion (VEB 22.80 billion) in fiscal revenue, assuming that the increase of the VAT would have been two percentage points.

But, at *Ecoanalítica*, we believe that given the country's current situation, the devaluation isn't enough. There is no doubt that the devaluation has generated a significant amount of extra fiscal revenue, but it doesn't solve the main problem: the restricted flow of foreign currency towards the private sector. The reason for this has to do with PDVSA. The Venezuelan oil industry is in the midst of a serious decline in production. Between 2007 and 2010, the drop in crude oil production has averaged 290.000 bpd. This means that using the estimated price of a barrel of crude oil in 2011, Venezuela will not take in around US\$ 9.2 billion.

On top of this, PDVSA has to honor its agreements with PETROCARIBE and China, both cutting into the number of barrels it will be able to sell on the open market and which in turn will affect the amount of cash the Republic will receive via oil revenues. And, given that we are just one year away from a crucial presidential election year, the fiscal pressures brought to bear on PDVSA have increased, earmarking US\$ 3.0 billion of the company's revenues for building houses and improving shelters.

**More
adjustments
likely to come**

In this context, the flow of foreign currency coming from PDVSA will be very limited. We estimate that in 2011, PDVSA will turn over to the BCV around US\$ 27.41 billion which will clearly limit the BCV's role as foreign currency supplier via CADIVI. Consequently, we don't expect an increase in the liquidation of foreign currency from the official market. In fact, we estimate that the liquidation of foreign currency for imports via CADIVI will go from US\$ 19.30 billion to US\$ 15.0 billion, down by 22.3% compared to last year. On the other hand, we expect an 8.8% increase in public sector imports. But this is assuming a conservative average price of the Venezuelan oil basket of 76.6 US\$/b for 2011, in the probable case of a more bullish oil market, the Cadivi liquidations could be higher.





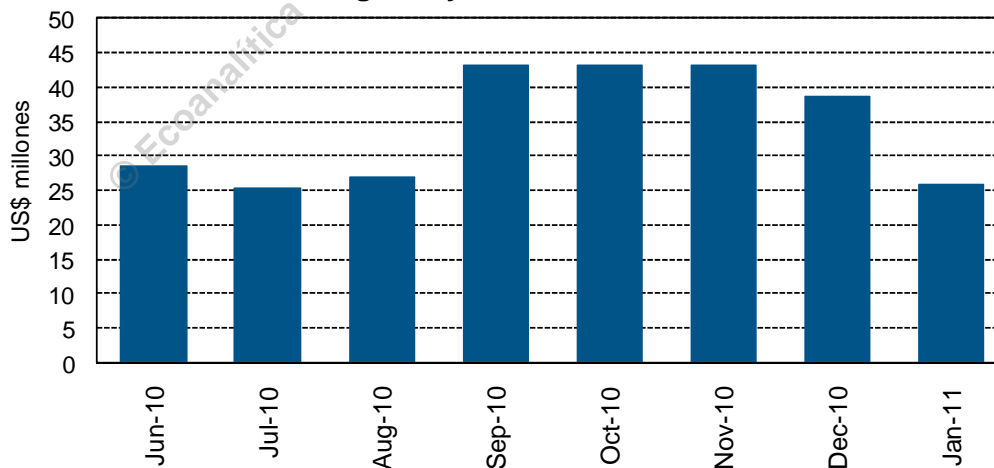
	Imports by exchange rate							
	2004	2005	2006	2007	2008	2009	2010E	2011P
Cadivi	81%	68%	60%	68%	75%	55%	51%	38%
Cadivi 2.6							23%	
Cadivi 4.3							28%	
Public imports	10%	15%	18%	19%	21%	24%	34%	35%
Swap/black market	9%	17%	22%	13%	4%	21%	5%	8%
Sitme							10%	20%

Sources: BCV, Cadivi and Ecoanalítica

And the SITME?

In 2011, the SITME will be alive and kicking. However, important changes to the system are expected. Minister Giordani is planning to enhance the SITME by including public bond trading and PDVSA bond trading from the recently created Public Securities Exchange into its system. The reason for this is that the Minister wishes to minimize the BCV's control over SITME operations. This would imply that SITME import operations would go from US\$ 3.81 billion to US\$ 8.0 billion, in other words, an increase of 110.0%. It's important to point out that a number of businesses that have been managing their operations through CADIVI up until now will have to migrate to the SITME.

Average daily traded securities in the Sitme



We would also like to mention that we consider it a fact that the SITME's exchange band ceiling will be adjusted from Bs.F 5.30/US\$ to Bs.F 6.50/US\$. And we are also still waiting for the reform that will allow PDVSA and FONDEN to sell their surplus foreign currency via the SITME system. This would significantly increase the amount of foreign currency liquidated through the SITME and ease the pressure on CADIVI.



**What about
issuances and
dividends?**

The first thing we want to point out is that the Economic Cabinet has pushed back the issuance of any debt until the end of the first quarter, due to the fact that in their opinion market conditions are currently adverse. Nonetheless, we stand beside our estimates in terms of the amount that will be issued in 2011. In order for the current exchange system to be maintained, it is necessary for the Republic and for PDVSA to continue issuing foreign debt, keeping in mind the financing needs in both cases. In the case of the Republic, we estimate the fiscal deficit to be at 4.1% of GDP in 2011, that is, around US\$11.24 billion, of which US\$4.0 or US\$5.0 billion will be financed by the issuing of sovereign bonds. This year PDVSA is planning to issue US\$6.6 billion in foreign debt, and they will be distributed in this way: US\$3.1 billion will be sold directly to the BCV, and for the local investors they will be US\$2.5 billion in the second quarter and a billion more in the last quarter of the year, leaving room in the third quarter for the Republic bond issue.

With respect to dividends for foreign companies doing business in Venezuela, the delays in liquidating foreign currency is such that it could lead to many companies stopping operations. The Administration is considering a couple of options, among them that CADIVI partially liquidated dividends owed to companies tied to the food and pharmaceutical industries, as long as they agree to strictly comply with price control policies; to establish additional regulations in the SITME system so that companies may request foreign currency for this purpose.

**Nothing has
been solved**

Besides devaluating the official currency, or unifying it if you will, and deciding to hold off on the tax-package it was planning to implement, the Administration has not addressed any of the fundamental problems besieging the Venezuelan economy. The issues that have emerged in the last few years will continue, compounded by others that have emerged along the way. The basic problem in Venezuela is related to two elements, that we consider difficult to solve: the perception of mutual distrust between the public and private sectors; and the implementation of a non-viable, inefficient and a costly economic model based in the increasing size of an unefficient public sector with an absurd exchange rate control. These two factors negatively affect our economic performance and limit our potential in the future. Venezuela basically lost the opportunity to take advantage of the expansion and influx of capital that Latin America has enjoyed during the last years.





... But keep in mind

As we pointed out in our last Outlook Report, the two areas of opportunities which stand out for 2011: sovereign debt operations, which afford us a legal means of obtaining foreign currency; and the changes being introduced to the SITME, specifically with the incorporation of the Public Securities Exchange. These are factors to keep in mind while planning this year's strategies.

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Economic Tips

CPI 2010: 27.2%. According to BCV figures, the Consumer Price Index (CPI) closed at 27.2% in 2010; up two percentage points from 2009. However, with these results, the BCV claims that a deceleration trend starts in the second half of the year, when prices increased 9.3%; that is, under the 16.3% recorded in the same period in 2009.

NCPI closes 2010 at 26.2%. According to preliminary figures, the yearly variation of the National Consumer Price Index (NCPI) was 26.9% at the close of 2010, with a month-to-month rate of 1.8% being estimated for December. In accordance with the BCV Year End Address (YEA), the annual result was particularly influenced by month-to-month variation rates recorded in March, April and May (2.4%, 5.2% and 2.6%, respectively), when food prices increased significantly due to seasonal factors.

... Core Inflation declines. The Year End Address of the Central Bank of Venezuela estates that, according to preliminary figures, core inflation significantly decelerated in 2010, with an annual variation of 27.4%, down 2.5 percentage points from 2009 (29.9%).

Increased shortages. As per figures published by the BCV, product shortages increased in December. In the last month of 2010, of every 100 products, 13.3 were not found on supermarkets' shelves throughout the country. The variety of products offered on the market has reduced; the index measuring the diversity of brands dropped from 173.2 to 149.5, which can worsen as a result of the devaluation implemented in early 2011.

Food basket rises up to 27,2%, In November 2009 and 2010, food prices increased 27.2%, as per figures of the National Statistics Institute (INE). The institute reported that an average Venezuelan family, in that month, had to spend VEB 1,359.37 to buy food, that is, VEB 136 over the minimum wage. The INE also reported the variation in the food basket price per city, highlighting that this indicator fell in two cities (San Cristóbal and Maracay with 0.19 and 0.645, respectively), with the highest variation being recorded in Maracaibo (1.01%). This resulted in the basic food basket price growing up to VEB 1,478.24.

Another year with negative figures. The Year End Address of the President of the Central Bank of Venezuela presented the preliminary macroeconomic results of the Venezuelan economy for 2010. It's worth highlighting that 2010 could close with GDP contracting 1.9% and with a US\$ 10.18 billion deficit in the Balance of Payments.



According to the BCV, oil activity recorded a 2.2% drop, even as non-oil activity lost 1.8%.

Income tax collection falls in 2010. Tax collection in 2010 was impacted by the recession in the economic activity. This fact is reflected in income tax collection which amounted to VEB 27.8 billion in 2010 and VEB 26.0 billion in 2009, for an increase in nominal terms of 7%; however, when the inflationary factor is included, income tax collection records a 19.9% drop. Income tax collection, in turn, is estimated at VEB 30.0 billion in 2011's budget.

VAT collection totals VEB 45.6 billion. The Value Added Tax (VAT) was the tax that contributed the most to the national treasury in 2010, according to the tax authority, SENIAT, with VEB 45.6 billion. The Tax Superintendent José David Cabello reported that this tax accounted for almost 50% of the total, over the goal set for 2010, recording additional revenues for VEB 9.0 billion. In general, tax revenues totaled VEB 102.0 billion.

SENIAT starts to collect Income Tax. Starting in February 1st, SENIAT will implement mechanisms to facilitate tax payers (individuals or businesses), the preparation of the tax return and the payment of income tax. The deadline will be March 31st of this year. Individuals are offered the possibility of paying the income tax in three installments: the first before March 31st, the second before April 25th and the third before May 16th, according to the law.

About US\$ 25.0 billion were allocated by Cadivi for importers. The Minister of Planning and Finance, Jorge Giordani, informed that resources earmarked for imports in 2010 substantially increased in comparison to the 2009 level. Minister Giordani explained that in last year, Cadivi allocated US\$ 24.95 billion to the import sector, *"an amount that is in line with the economic strategies implemented by the national government so as to overcome recession and be able to attain a progressive increase in national finance"*.

Cadivi and BCV reassess applications. Applications for foreign currency submitted up until December 31, 2010, for products imported at a VEB2.60/\$ rate will be reassessed by both the Central Bank of Venezuela (BCV) and Cadivi. This measure is intended to guarantee transition toward the new scheme for the import of goods and services, the exchange rate of which was unified by the Administration at VEB4.30/\$, by determining which applications are truly a priority for the Venezuelan population, as stated Manuel Barroso, Cadivi's President.

Unemployment down by 6.5% in December. According to official numbers published by the National Institute of Statistics (INE), unemployment reached 6.5% in December,



0.1 percent points (pp) less than the unemployment reading of December 2009, and 1.2 percent points more than in November of 2011 when it reached 7.7%.

In 2010 reached 8.8%. With number registered in December, the average unemployment rate for 2010 was 8.8%, 0.9 percent points (pp) more than the unemployment reading of 2009, when it reached 7.8%.

Interest rate. The lending rate for the fourth week in December was at 16.7%, down by 0.9 percentage points compared to the previous week. Time deposits and savings rates were steady at 14.5% and 12.6%, respectively.

International reserves. International reserves increased 1.6% going from US\$30.33 billion during the fourth week in December to US\$30.80 billion during the first week of January. Compared to the same period last year, international reserves have dropped by 13.4%.

Monetary liquidity. Monetary liquidity for the first week in December was up by 0.3%, compared to the previous week settling at VEF 279.1 billion. Year-to-date the M2 has increased 18.4% and 19.6% year-on-year.

Sitme figures. To date, US\$4,790 million have been negotiated through the Integrated System for Foreign Currency Transactions (Sitme), averaging US\$35.8 million a day, with an implicit exchange rate of VEF 5.3/US\$. Last week the traded amount reached US\$223.2 million, US\$13 million less than last week when braided US\$209.9 million.

Oil Tips

2010 Oil GDP was the lowest since 2003. According to the preliminary results published in the BCV Year End Address, oil GDP lost 2.2% in 2010 (vs. a 1.9% contraction of the entire economy), after having shrank 7.2% in 2009 with regard to the prior year. Even worse is the fact that measured in term of constant bolivars (1997), the oil GDP in 2010 is even 2.2% below that of 2003 during the oil strike.

Crude oil and gas production dropped in 2010 but the refining activity increased. Preliminary figures presented in the Year End Address of the BCV show a 2,8% drop in oil and gas production in comparison to 2009, whereas refining activity grew by 1.3%.



Lower sea exports for OPEC. Statistics on future shipments reveal that OPEC's maritime oil exports, excluding Angola and Ecuador, could drop by 410 kb/d over the first four week of January. According to Britain's Oil Movements, OPEC's exports over the first four weeks of past December decreased by 410 kb/d, from 23.11 mb/b to 22.7 mb/d.

Oil exports to the US are unstable and show a downward trend. Venezuela's oil exports to the US in the last week of 2010 dropped 40% with regard to the prior week, averaging just 650 kb/d (the second lowest figure throughout 2010), as compared to 1090 kb/d exported in the week ending on December 24, 2010; however, the average of the last four weeks of 2010 was 840 kb/d, which is still significantly under the average figure of around one mb/d reached in September and higher than August mb/d.

A progressive process. Venezuela's oil exports to the US have been registering a decreasing trend since October 1997, when they recorded a daily average of 1.600 kb; however, this trend was more marked since the oil strike, dropping from 1515 kb/d in August 2002 to the current level of less than 900 kb/d. It's worth stressing that these exports have been compensated for, albeit only partially, by an increase in exports to other destinations, especially to China.

The government asks PDVSA US\$ 3.0 billion to build homes. Given the behavior of oil revenues, the government continues to demand more resources from PDVSA. In less than two months, the state-owned company has channeled US\$3.0 billion for the construction of homes and the rehabilitation of shelters.

Argentina will pay debt for US\$1.26 billion to PDVSA before 2010. The Argentinean government announced the issuance of new government promissory notes to pay off the US\$1.26 billion debt corresponding to the import of liquid fuels according to the Refinancing Agreement signed within the framework of the Integral Cooperation Agreement between Argentina and Venezuela, since May 15, 2009. The notes will be issued by Argentina's Compañía Administradora del Mercado Mayorista Eléctrico S.A. (Cammesa) and Energía de Argentina S.A. (Enarsa). The Argentinean government pledged to pay principal and interests of this debt before May 2012, according to the conditions set forth in the bilateral agreement.

Venezuela will buy crude oil from Azerbaijan to supply Belarus. Venezuela closed an agreement with Azerbaijan to purchase crude oil to be sold to Belarus. The agreement was reached to enforce a previous bilateral agreement according to which Venezuela was committed to supplying 30 million tons of crude oil per year (about 210



kb/d) between 2011 and 2013. The oil will be transported through a pipeline between those both countries and Belarus will assume transportation costs.

The US warns PDVSA about businesses with Iran. On September 24, 2010, the US Congress sent a letter addressed to PDVSA's president Rafael Ramirez, expressing their concern about "reports according to which, PDVSA continues to do businesses with Iran that could be in violation of two US laws, namely the US Iran Sanctions Act (ISA) and the Comprehensive Iran Sanctions, Accountability and Divestment Act (CISADA). The letter warns that if a satisfactory response is not offered by the Venezuelan government, the US Congress will be forced to enforce these acts, that is, US companies, and their technologies. could be banned from continuing to do businesses with PDVSA.

High oil prices threaten global recovery. According to Fatih Birol, Chief Economist of the International Energy Agency (IEA), the global economy stability is being threatened by the growing oil prices that are entering into a dangerous zone. As per the IEA calculations, the increase in oil prices in 2010 is equivalent to a 0.5% drop in the combined GDP income of all OECD countries. In the European Union alone, the oil import bill grew US\$ 70.0 billion the past year, which is equivalent to the deficit of Greece and Portugal together. According to the IEA, these high oil prices could weaken developed economies to such an extent that it would be inconvenient even for oil exporting countries.

International oil baskets. At the close of the New York market last Thursday, December 23, the WTI was at US\$89.7/bl, showing a 1.7% increase compared to the US\$88.2/bl of the previous Thursday. The Brent decreased by 0.2% to reach US\$91.3/bl, compared to US\$91.1/bl of Thursday, December 23th.

Local oil basket price. The Venezuelan oil basket price increased last week, to close at US\$83.7/bl on Friday, December 24, up by US\$1.5 or 1.8% from the US\$82.2/bl registered the previous week. Meanwhile, the basket's annual average is at US\$71.0/bl.

Business Sector Tips

Industrial Production plummets by 10.2%. The Central Bank's statistics reported a 10.2% drop in industrial production over the past two years, its lowest level since



2006. This drop reflects that public expenditure is not longer enough and that investment has to be expanded to improve machinery and technology in this sector.

Authorities intervene Cedel Casa de Bolsa. The National Securities Superintendent's Office intervened Cedel Casa de Bolsa, which was chaired by Eligio Cedeño. This organization was inactive since 2007 and it was presently used to operate as a social foundation to benefit people living in extreme poverty.

Specific reforms in the Organic Labor Law are implemented through the Special Powers Law. According to a recent statement by the Administration, the Special Power Law will be used to legislate in areas related to the Organic Labor Law. The Administration also referred to the possibility of eliminating several articles that would be temporarily replaced with special laws.

Paralysis of consumption credit renders bank environment tougher. Venezuelan banking system has proven to be capable of adjusting to tough environments, after six quarters of recession in a row and a package of controls that leaves to the state fixing interest rates, fees and commissions for bank services and the destination of 50% of bank credits; however the margin of maneuver will be further reduced in 2011, because the National Assembly recently passed a reform of the Bank Law that prevents banks from earmarking more than 20% of the total loans for credit cards, the most rentable niche of banks.

Banvalor is intervened behind closed doors. The Bank Superintendent's Office decided to intervene Banvalor Banco Comercial, through the modality of "cessation of financial intermediation." The measurement means that Banvalor's offices will be closed and authorities will have 60 days to decide if the bank should be liquidated or rehabilitated. With this decision, the number of small banks intervened since February 2009 is now 16.

Cemex is allowed to take the conflict with the Venezuelan government to Dutch courts. The World Bank's International Center for Settlement of Investment Disputes (ICSID) authorized two companies that are incorporated in Holland and belong to Mexico's Cemex (cement manufacturing company) to claim the breaching of the investment protection agreement signed between Venezuela and Holland in 1991. This decision implies that the case of the expropriation of Cemex' assets in Venezuela could be heard by a Dutch court.

...However, the government announced an amicable settlement with Cemex. Recently, the Ministry of Science and Technology and Intermediate Industries informed that they are talking with Cemex to achieve an amicable settlement that would imply compensation for the Mexican group after 2008 expropriation.



The exchange rate of VEB 2.6/\$ will be recognized only for outstanding priority imports. Cadivi's president Manue Barroso pointed out that they are reviewing along with the Central Bank the situation of foreign currency applications at the VEB 2.60/\$ exchange rate that were submitted before December 31st for their eventual approval. Both entities will assess and determine the applications that are truly a priority and as such may receive the approval to be allocated dollars at this preferential rate.

Plans to increase controls to stop price increase. The Administration expects to minimize the eventual impact of devaluation on prices of goods and services, especially basic ones; for this purpose, they have "undusted" the "fight against price gouging," which is a program implemented every year by the Institute for the Defense of Citizens in the Access to Goods and Services (Indepabis) to try to stop inflation from increasing.

Liquid steel production drops by 41.4% in 2010. Siderúrgica del Orinoco "Alfredo Maneiro" (Sidor) liquid steel production fell 41.4% in 2010, when the steel mill managed to produce 1.8 million tons, in comparison to the 3 million tons produced in 2009. This is the lowest production level reported for the steel and iron processing company over the past three decades.

The price of iron bars and aggregates grew in 2010. According to BCV figures, the construction price index for producers recorded a lower variation last year with respect to 2009, when variation was 21.4%; however, the behavior with regard to several products was different: prices of steel and iron products (including iron bars, mess, flat products) in 2010, increased by 23.6%, whereas prices of steel and iron aggregates increased 22.7%, attributable to a lower raw material production along with distribution products due to the high transportation costs.

Massive imports of drug products by the government. The government has planned massive imports of drug products in 2011, which would be distributed free of charge or at a very low cost among patients of the national public health system.

Devaluation will affect costs for the automotive sector. The automotive industry will also feel the devaluation impact, both car assembly plants and part manufacturers that imported raw materials for their production. The former exchange rate for imports by these sectors was VEB 2.60/\$; but now they will have to import at VEB 4.30/\$, thus implying an impact of about 33-38% on costs of cars, depending on the percentage of local and imported parts of each model.

The Minister of Agriculture and Lands states that 72% of expropriated lands "are active". The Minister of Agriculture and Lands Juan Carlos Loyola reported the



achievements made with expropriation of farm lands. According to his statement, 72% of about 3 million hectares that have been “rescued” by the government are active. The private production sector, for its part, has a much different opinion, since according to the President of the Venezuela’s National Federation of Cattle Raisers (Cofagan) José Agustín Campos only 30% of these lands would be productive.

The electric power system exhibits a deficit of VEB 11.39 billion. Authorities of the electric power sector asked president Hugo Chávez at the Ministerial Council to approve financial resources to cover operational expenses of the National Electric System (SEN) and comply with the Single Collective Bargaining Contract of the sector, given the “recurring deficit situation” of this industrial activity.

Rates won’t be increased. The Minister of Electric Power Alí Rodríguez Araque assured that the government won’t rise electric service rates for the time being. This announcement is related to the set of measurements taken by president Hugo Chávez at the first ministerial council of 2011. The President stressed the inconvenience of increasing these rates without first considering the quality of the service and thoroughly studying its cost structure, Rodríguez added. The Minister reiterated that according to studies conducted by the ministry, 1.2 million users are not formally subscribed to the National Electric System; he added that there are 2.2 million subscribers that don’t have a consumption measurement system.

World Economy Tips

The price of foods is fueling global inflation. JP Morgan has pointed out that the higher food prices are stoking global inflation, since many markets of agricultural commodities are being driven by the bad weather in key producing countries. Will Shropshire, a senior trader at JP Morgan, pointed out that breaking down the inflation numbers then the impact of food has been extremely significant. *“It’s food that is driving inflation rather than inflationary expectations driving people to invest in food,”* pointed out the analyst.

Improvements in the US labor market. Decrease in US unemployment rate last month was lower than expected. From 9.8% in November, unemployment declined to 9.4% in December, much better than 9.7% reported by market consensus. The decline accounted for an increase of 297,000 new jobs, which translates into a year-to-year increase of 0.9% in employment, after dropping for two months in a row.



It'll be difficult to come back to prior levels. Additional to the drop in unemployment rate, labor force fell by 260,000 people, for the third monthly drop in a row. These declines may be related to the completion of the population census, which generated about 1,200,000 new jobs in the US during the past year. Comparing the unemployment rate of the last year (9.6%) to levels before the crisis (5.8%), we can see that the drop to those levels poses a challenge for economic policy makers in the largest economy of the world.

However, small business employment is driving the adjustment. Small business employment in the US has been growing since September, 2009. That's the indication from Intuit's Small Business Employment Index for December, which is based on online employment data from small business employers that use Intuit Online Payroll. Since the 2009 low, the index has risen 4.5%. These smallest employers comprise about 88 percent of the total U.S. private employer base and employ nearly 20 million people.

Better sentiment of US economic agents. The US consumer held onto the "good" mood adopted since this past summer. During December, the Index of Consumer Sentiment regarding current economic conditions increased to 85.3 which was its highest since January 2008. The rally was led by another jump in attitudes about conditions for buying large household goods such as furniture or appliances. Sentiment concerning personal finances dropped on an m/m basis, but remained improved from 2009's low. The index of consumer expectations gained to 67,5 which was its highest in six months. The change expected in personal finances was slightly improved but the m/m increase wasn't enough to surpass 2010's high recorded in June.

Estonia switches to the Euro. As 2011 begins, the Baltic nation of Estonia will join the Euro Area, becoming the 17th country to use the euro currency. The last country to adopt the currency was Slovakia at the beginning of 2009. This event marks the retirement of the Estonian crown, with an exchange rate of 15.6466 crown/euro. During the recent worldwide recession, Estonia's GDP contracted 5.1% in 2008 and 13.9% in 2009. This contraction resulted in a jump in unemployment from 4.1% in 2008Q1 to 19.1% in 2010Q1; this rate has since fallen back to 16.2%.

Germany: producing isn't everything. Capital goods growth rates in Germany are more or less stable at a still very accelerated pace. Capital goods output in December grew by 17.3% on a year-to-year basis and at 16.5% pace over the last three months. The production of consumption goods and intermediate goods is still showing signs of deceleration. However, German retail sales haven't bounced back to the levels desired and consumer confidence in the Euro Area exhibits a quite uneven behavior.



Therefore, stimulus to capital spending in the region seems a difficult task, especially with the implementation of austerity programs.

France will grow... a little. The growth rates for GDP and for private consumption have converged in France. This means that private consumption, which has been leading French economy's recovery since the crisis began to be mitigated in 2009Q2, will no longer carry the load of accelerating France's growth. Public spending has diminished its year-to-year growth rate, while the French government is implementing an austerity program, holding its impact on GDP. While import growth has hold back growth a little, exports have released this brake. However, balance-of-trade growth seems to be in tandem with imports. In this regard, the following question is in order for Europe in 2011: Will austerity be the road to prosperity?

Portugal's deficit better than expected? According to the online edition of the Portugal Economic Journal, that country's fiscal deficit could be at about 6.9-7.1% of GDP for 2010. If this is confirmed, the result would be better than expected. Until recently the government has remained faithful to its budget goal that deficit wouldn't get up to 7,8% of GDP. In this regard, a budget result close to 7 points of GDP would suggest that some sector of the government will reflect improvements in the last quarter of the year, which is good news. Therefore, in 2011, Portugal could implement a more aggressive fiscal adjustment (about 4% of GDP) in order to mitigate market concerns about the sustainability of its long-term debt. However, the impact of this measure on the economic growth might prove to be a relevant issue.

Political Tips

The Caracas-Brasilia axis gets stronger. The Venezuelan president Hugo Chávez, at his arrival in Brazil on the occasion of Dilma Rousseff's swearing as in ceremony, has announced that he will strive to continue to *"build the Caracas-Brasilia axis,"* in a statement broadcasted by the official TV channel. *"We are convinced that with Dilma Rousseff, who is a determined fighter, we will continue to build the Caracas-Brasilia axis,"* he stated. Chávez underscored the role of the outgoing president Luis Inacio Lula da Silva. Lula *"will always remain in the pages of South America's history,"* Chávez assured.

US: Palmer sticks with choice of Ambassador to Venezuela. The US is still considering Larry Palmer as its proposed Ambassador to Venezuela and is determined to maintain his nomination indefinitely, Philip Crowley, spokesperson of the



US Department of State informed. Washington believes that it's important to have an ambassador in Venezuela, but decries the *"increasingly authoritarian trends"* in that country, the spokesperson warned. *"We haven't stepped back from our support of Palmer even though his nomination technically expired.... We supported him before the end of the last Congress in December and we are sticking with our choice and deeply regret that Venezuela's withdrawing its approval, but the fact is that we aren't looking for another candidate,"* he added. When asked about what would happen if the current situation continues, which has resulted in both countries not having ambassadors in the respective capital cities, Crowley said, in his words, *"the administration is prepared to stay where we are, with no full ambassador in Caracas for an indefinite period."*

Colombia is not worried about the use of nuclear energy in Venezuela. The government of Colombia assures that they are not worried about the use of nuclear energy in Venezuela for electric power generation, stated Colombia's Ministry of Foreign Affairs, María Ángela Holguín, who pointed out that as a signatory of the Nuclear Non- Proliferation Treaty (NPT), her country is against *"any attempt of nuclear development for military purposes."* *"I don't know what's beyond that decision, but it's clear that the UN International Atomic Energy Agency (IAEA)'s role is to see to it that countries may opt to use nuclear energy without this implying a war threat,"* Holguín added. The Minister recalled that France obtains 80% of its electric power from nuclear plants and Brazil also has its nuclear plant.

OAS Secretary General criticizes the Special Powers Law. José Miguel Insulza stated that president Chávez's Special Powers Law is contrary to the Inter-American Democratic Charter: *"I don't believe that the fact that an outgoing congress prevents the incoming lawmakers from doing their task is something democratic, because what is the sense of having people legally electing a congress that won't be allowed to speak later because the president is going to rule by decree for 18 months?"*

The OAS will analyze the Special Powers Law. The Special Powers Law denounced by the opposition parties as the last evidence of the institutional imbalance in Venezuela will be discussed and analyzed tomorrow at the Permanent Council of the OAS. Ramón José Medina explained that the Permanent Council was convened by OAS Secretary General José Miguel Insulza, who recently criticized the Law that the former National Assembly granted to president Chávez for 18 months. Medina, along with Omar Barboza (Un Nuevo Tiempo), Ismael García (Podemos) and Luis Aquiles Moreno (Acción Democrática) are the members of a commission of the Democratic Unity Table (MUD) that is promoting the OAS intervention vis-à-vis the alleged violations of the Inter-American Democratic Charter by Hugo Chávez's government.



The government has expropriated only 10% of productive lands. President Hugo Chávez's government has intervened a total of 3 million hectares, which accounts for 10% of potentially productive lands in the country, the Minister of Agriculture and Lands, Juan Carlos Loyo, assured. The minister explained that there are "450,000 small, medium and large farms in Venezuela that comprise close to 30 million hectares" that can be used for agriculture, livestock and forestry. *"Of these lands, the State has recovered three million hectares, which represents 10%. This means that the largest part of lands in the country are in hands of private producers and farmers,"* Loyo stated.

Who manages these lands? Minister Loyo assured that 72% of the expropriated land is in the hands of farmers and is fully productive and that its output will grow by 19% (cattle rising) and 30% (vegetables) over the coming years. In 2004, the Administration declare war to big landowners and since has expropriated lands because they aren't productive, are being underused or property titles on them are dubious, promising to hand them over to poor farmers for them to work on the lands.

PSUV: 2012 is the target. PSUV is already preparing to face future eventual challenges. The order is clear: to have Hugo Chávez reelected in 2012 presidential election. For this purpose, the PSUV is preparing to approve its political action plan for 2011-2012 over the upcoming days. *"This is the tactical and strategic design that will guide the Venezuelan socialists throughout this year and 2012,"* Rodrigo Cabezas, head of the Venezuelan group to the Latin American Parliament, explained yesterday.

New charge against Empresas Polar. President Hugo Chávez ordered the seizure of a number of plots of land in which are property of Empresas Polar in Antímamo. The measure was taken upon request of the collective Nueva Comunidad Socialista Amatina, which in recent days occupied the plot, before the presidential announcement. President Chávez informed that this property will be used for the construction of houses. The plot, with an area of 9,113 square meters, is the seat of the Center for Children Nutritional Care of Antímamo (Cania), operated by Empresas Polar. President Chávez assured that the government will pay for the plot of land, but before, Polar must demonstrate its title on the property. Furthermore, the President approved VEB 39.4 billion to begin the construction of homes for the group Nueva Comunidad Socialista Amatina.

States will receive less resources this year. Governor of Carabobo State Henrique Fernando Salas Feo expressed his concerned about the new exchange model which, in his opinion, will affect all social programs implemented by his office in the areas of education, school food plans, among others. Salas Feo believes that reconsidering budgetary allocation for the states this year is a priority. *"If president Chávez admitted that the oil barrel is selling at \$85 and is going to be sold at \$100, in 2011, states*



would receive less than a half of the budget they are entitled to. Carabobo was allocated VEB 1.8 billion instead of the corresponding VEB 3.9 billion.”

The Ministry of Finance has issued 170 firing orders. Despite workers’ protests, the Ministry of Finance continued the personnel reduction process as part of the ministry’s reorganization. Union representatives point out that 710 firing orders have been already issued. The ministry has more than 3,000 workers and payroll is expected to be cut by 40%.

More labor conflicts are expected in the country in 2011. Vis-à-vis the firings taking place in the public administration, laws passed in a rush, undelivered promises and the package of economic measures, the union leader Manuel Cova believes that labor conflicts will intensify this year as a consequence of improvisation and incompetence, which in his opinion has brought about lack of productivity, inflation, devaluation, shortages, lack of personal security, unemployment, exclusion and submission of powers.

Legislatives Tips

Results of five years of work. Between 2006 and 2010, the PSUV controlled the National Assembly and passed a total of 191 laws. Of this amount, 61 were approved in the past year, and of these, 26 were passed in December. Comparing this five-year congressional period controlled by the government to the prior one (2001-2006), we observe that 140 laws were passed. A new stage has begun and the PSUV five-year reign has come to an end, but we’ll have to wait and see how the new National Assembly will look like, also with a majority of the government party.

A new stage begins. On Wednesday January 5, 2011, the new National Assembly was installed in Venezuela, with 67 opposition representatives (65 from the MUD and 2 from Patria Para Todos, PPT) and the government party has 98 representatives. Notwithstanding the PSUV clear majority, the party will not be able to pass new laws easily. However, president Chávez has been granted a Special Powers Law that will allow him to rule by decree until mid-2011. The opposition comes back to the National Assembly after five years of absence.

A new Special Powers Law. On December 17, 2010, the former National Assembly passed a new Special Powers Law which grants president Chávez with special powers to issue decree-laws. However, thanks to this new version of the Special Power law,



president Chávez will rule for 18 months instead of the 12 months he had planned originally.

The new board of the National Assembly. In the session of January 5th, 2011, the new members of the National Assembly board were elected. Fernando Soto Rojas was elected president of the parliament and he will be accompanied with Aristóbulo Istúriz (first Vice President) and Blanca Eeckhout (second Vice President). The representatives elected to the board are members of the socialist PSUV. The new board was made official in the Official Gazette No. 39587, published on January 6, 2011.

The committees are defined. The 15 committees of the new AN have been defined, 11 chairs and vice chairs are going to be held by representatives of the ruling party, while the remaining 4 chairs and vice chairs will be in the hands of the opposition. The opposition will chair the committees of Science and Technology, Environment, Culture and Recreation and Family and will handle the vice chair in the committees of Services Management, Indigenous Peoples, Worship and Prisons and Energy and Petroleum. For his part, the committee chair of Psuv will be in Domestic Policy, Foreign Policy, Comptroller, Finance, Energy and Petroleum, Defence and Security, Social Development, Religion, Indigenous Peoples, Participation and Natural Resources.

Irregularities in the former National Assembly. Podemos' Juan José Medina reported that 80% of the laws that were passed by the former National Assembly show signs of irregularities. In this regard, he stated that his party will submit a series of resources before the Supreme Court of Justice, apart from taking the case to the Organization of American States (OAS) and Mercosur.

Vetoed...for now... President Chávez decided to veto the new Law for University Education that had been passed in its second discussion by the National Assembly on December 23, 2010. According to the President, the decision to veto the law was made after reviewing messages on Twitter, confidential letters and reports with remarks on the inconvenience of applying the law. President Chávez said: *"I veto the law and urge the National Assembly that is being installed tomorrow to lift the passing of the law. Let's a new national debate be open. The country has to know that it counts on a democratic government that reasons and listens."* In addition to the President's statements, the representative Aristóbulo Istúriz stated that the population isn't still prepared to implement the new Law for University Education; therefore the veto is an opportunity to rethink and improve, with the aim of creating a new man and a new teacher-State.





Students are preparing to make proposals. On Monday January 10th, students started to meet so as to begin an open and plural discussion of the Law for University Education, which will serve to design a new proposal. With the motto “On the 10th at 10 o’clock,” university students called upon all the student communities to participate in this movement. Student leaders assured that they will not cease to fight for the defense of their rights and university independence.

The new Social Responsibility Law for Radio, TV and Electronic Media was passed. The draft reform of the Social Responsibility Law for Radio, TV and Electronic Media was approved on December 20, 2010 and the new Law was published in the Official Gazette No. 39579. This new version of the legal instrument is aimed at determining the social responsibility of providers of radio and TV services, electronic media, advertisers, national independent producers and users concerning the dissemination and reception of contents. The new law will be applied to every text, image and sound being issued in Venezuela. Penalizations include fines amounting to 10% of gross income realized in the fiscal year immediately prior to the one when the infraction was committed and 72 hours out of the air for broadcasting messages that promote alterations of the public order or incite crime, hatred, discrimination, are anonymous or disobey the authorities.

The Telecommunications Law was also approved. The new Telecommunications Organic Law was passed by the National Assembly on December 20, 2010, with the dissenting vote of the PPT representatives and the rejection by the representatives of Podemos and Frente Humanista. This new law changes the legal nature of telecommunications, which were before of general interest and now are a service of public interest. The law proposes to transfer in favor of the State the assets used to provide telecommunication services at the time of reviewing the license. Furthermore, the law provides for that administrative authorizations to provide telecommunication services and licenses to use the radio broadcasting spectrum will be granted to people domiciled in Venezuela and they will last a maximum of 15 years. Finally, it’s established that rights on the use of the radio broadcasting spectrum derived from a license are personal, therefore they cannot be inherited.

...as well as the Law against the “change of sides”. The reform of the Law for Political Parties, Public Meetings and Demonstrations, better known as the Law against the “change of sides,” was approved on December 23, 2010. This law provides for penalizations for representatives that abandon their party and change to another party while they are active in the National Assembly, because they have to respect the will of the citizens that elected them. In addition to this law, the Law for the Defense of the Political Sovereignty and National Self-determination was approved, which is aimed at “preventing the stability and operation of institutions from being jeopardized through economic aid or financial support provided to organizations for political



purposes, devoted to the defense of political rights, or individuals that conduct political activities,” President Chávez dixit.

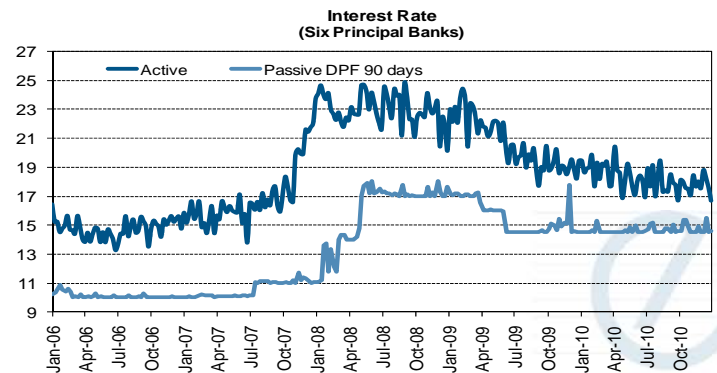
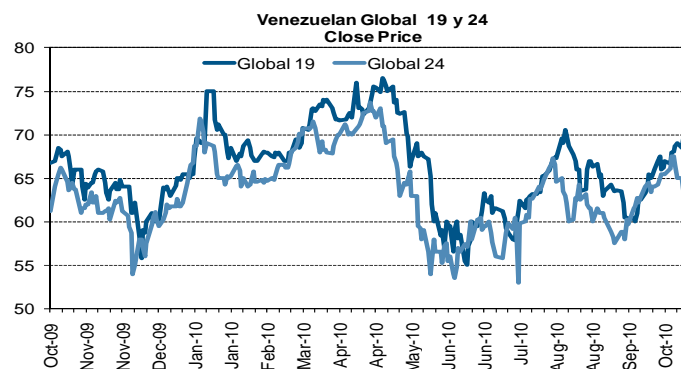
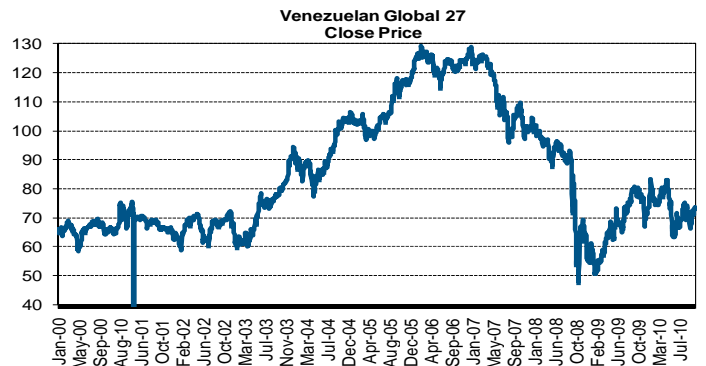
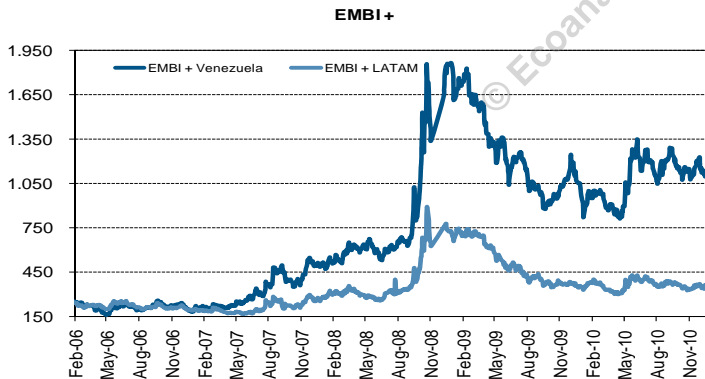
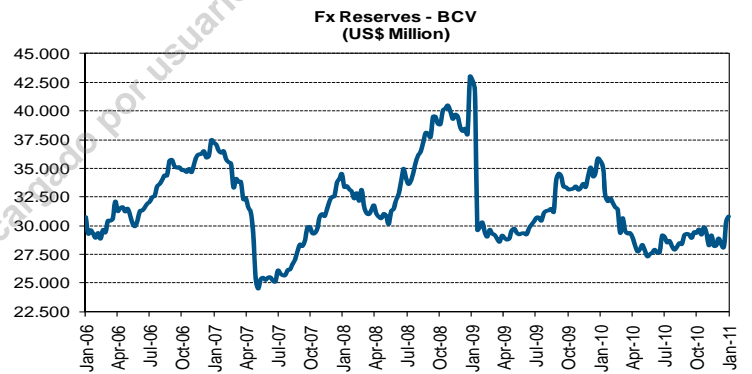
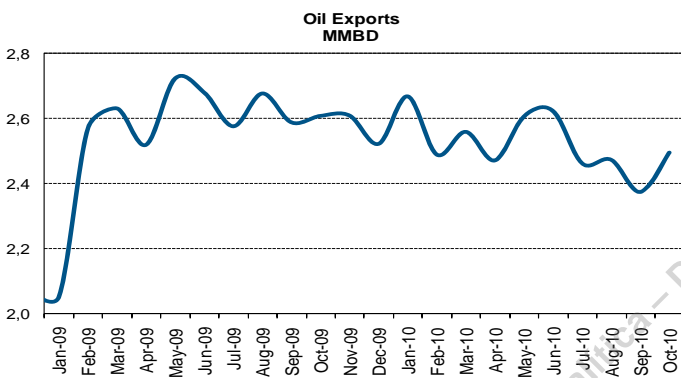
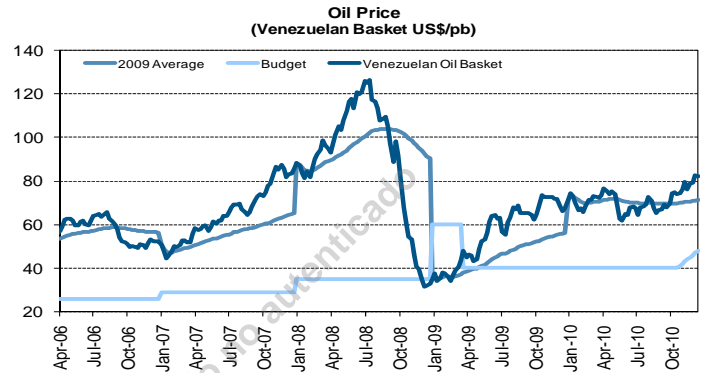
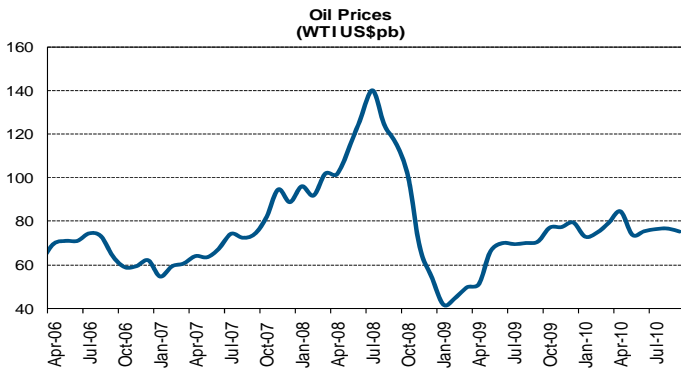
Another one: the Law of the Communal Economic System. The new Law was approved on December 23, 2010 and published in the Extraordinary Official Gazette No. 6011. This law was approved at an special session by the National Assembly and provide the regulatory framework for the new social-productive organizations, and tax benefits and privileges in contracting with public entities. Furthermore, the law establishes that public entities, “at their different political-territorial levels, will take measures for social-productive organizations of social-communal property, to have priority and preference in the contracting process with public entities for the acquisition of goods, rendering of services and execution of works.”

Even the electric system was modified in December. Article 59 of the Electric System Law that entered into force on December 9 provides for an increase in the electric sector rates, which could exceed 20%/year, “with a view to maintaining its real values up to date and determined the pertinence of the application of mechanisms to adjust the rate scheme.” According to article 55, “the economic regime applicable to the national electric system activities for the rendering of the electric service is based on criteria of economic and financial sustainability of the service carrier and provider, the optimum use of resources for the benefit of users and the retribution of costs as determined by the ministry with competence in the electric energy area.” However, the Ministry of Electric Energy Ali Rodríguez stated that rate rise has been suspended for now.



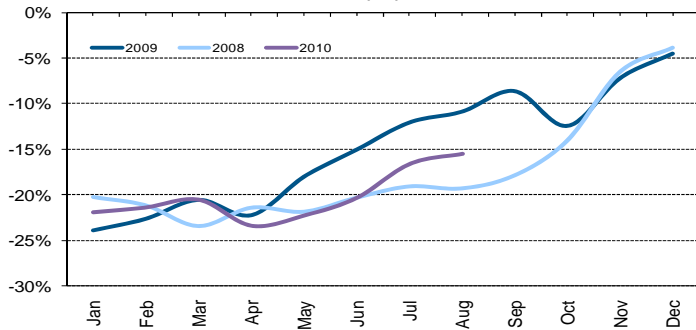


ECONOMIC OVERVIEW

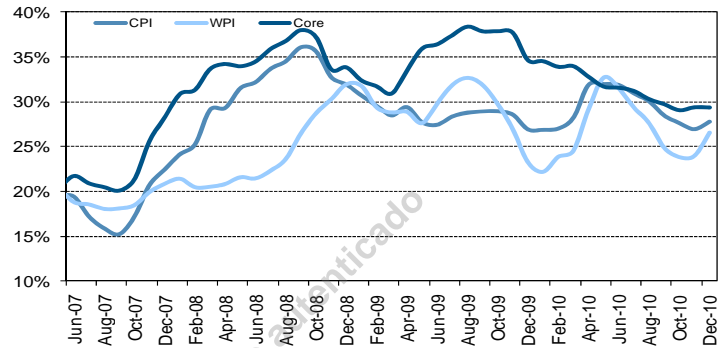




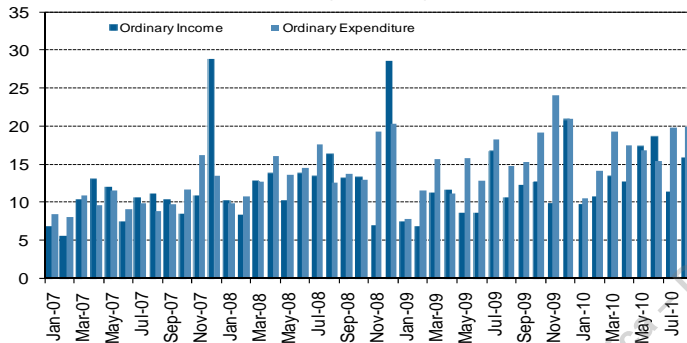
Real Expansion (M2)



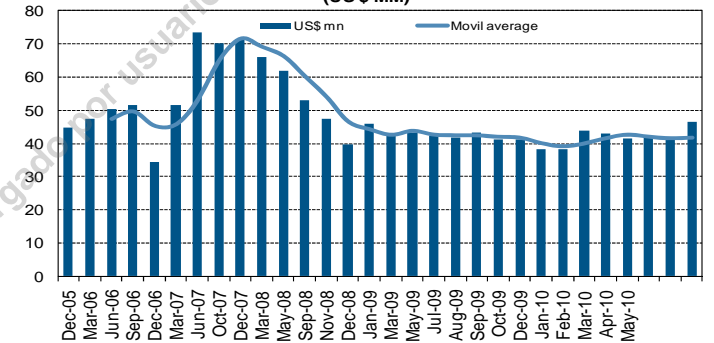
Inflation (Last 12 Months)



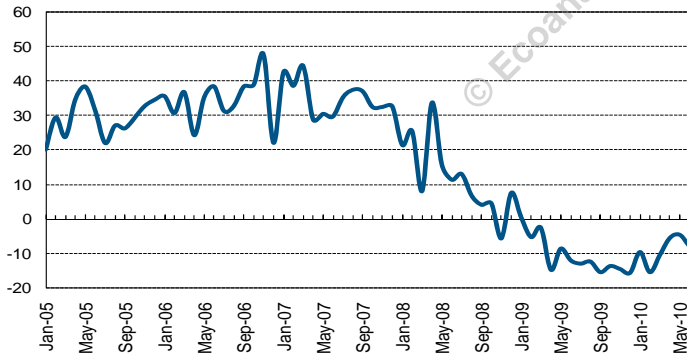
Central Government (VEB Billion)



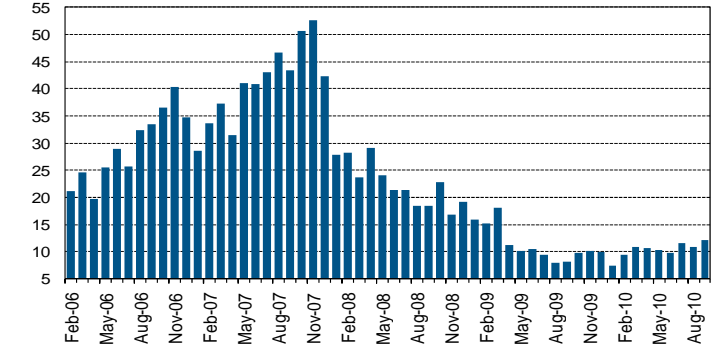
Resources of the State (US \$ MM)



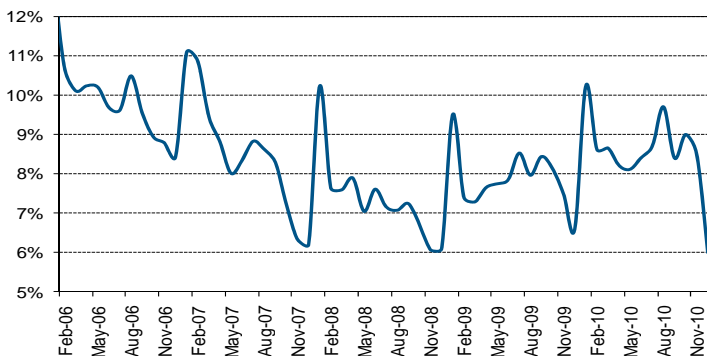
Volume of Sales (% Variation)



Sale of Vehicles (Thousands of Sold Units)



Rate of unemployment



Disbursement (US\$ Million)

