



Volume 4, Number 13
Week II, April 2008

IS THE DUAL EXCHANGE SYSTEM COMING?

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Since the beginning of the year, the rumor that a dual exchange system was about to be introduced has been steadily growing. Today, most people are convinced that this system will be introduced this year. The issue is very complicated and at **Ecoanalítica** we don't believe that it will be introduced as soon as many others are saying.

In Venezuela, any kind of exchange control implies that a dual exchange exists

By introducing an exchange control in Venezuela, given the structural characteristics of the country, it immediately implies that a parallel or "black" exchange exists. Economic agents use the parallel (not official) exchange rate as the reference base or the "market" exchange base. Therefore, the differential between the parallel exchange rate and the official rate becomes a kind of subsidy for the import sector.

So, when an exchange control system is introduced, it works like a dual exchange system. On the one hand, preferential foreign currency rates are granted (official exchange rate) in order to finance certain sectors through a Government foreign currency regulatory entity (RECADI, OTAC, or CADIVI); and on the other hand, economic agents use the "black" exchange rate (parallel rate) in order to finance a

portion of imports that can't be done through CADIVI and for outgoing capital.

Of course, all this, during the current exchange control, has been going on under the table without any "official" recognition by the Administration. So, in fact, what could be being considered at this moment is whether the Government wants to go from an unrecognized dual system to a dual exchange mechanism sponsored by the State.

Last year's results set off alarms in the Government

2007 was not a bad year for the Venezuelan economy. Economic growth was high, there was no fiscal stress, and the reserves were at acceptable levels, among other things. However, distortions were exacerbated, especially those having to do with exchange controls and prices. Regarding the first case, according to information gathered by **Ecoanalítica**, the Administration was extremely concerned about the significant increase in imports last year, the fraudulent use of the Internet purchases foreign currency quota and traveler's quota, and the pressure coming from the unofficial exchange rate.

2008 started with a number of economic changes

Faced with the above mentioned situation, the Government decided to, among other things:

1. Restrict liquidity, by delaying payment to Public Administration suppliers and using the state-run banks to better coordinate this matter.
2. Grant FONDEN greater liquidity, which led to an order to reduce the minimum levels of structured note positions. Up until now, a little more than US\$1.50 billion have been auctioned.
3. Establish priorities for CADIVI, focusing on three sectors: food, medicines, and capital goods for domestic industry. Furthermore, import ceilings were established in some sectors and for some goods; automobiles being a good case in point.
4. Establish foreign currency liquidation limits through the ALDI agreement.
5. Pay contractors in foreign currency, a procedure that has been used for awhile now but that has become even more prevalent during this first quarter. According to Ministry of Finance sources, around 15% of primary spending is being carried out in US-dollars.

With CADIVI being selective now, the other sectors are beginning to get desperate

As a result of decisions made by the BCV regarding monetary policies, the unofficial exchange rate has dropped substantially, but the private sector has become much more nervous because CADIVI shown significant delays in the approval and liquidation of foreign currency. In fact, of CADIVI's total budget for imports, around half of it is earmarked for the three main priority sectors that we have already mentioned, and the rest to be distributed among all the other sectors. So, as it stands now, most companies are receiving any official rate foreign currency, or the amount that has been approved is less than what was requested.

Chávez doesn't like the dual system

Currently, what's being considered is that CADIVI continue to distribute official exchange rate foreign currency to those priority sectors mentioned and then there will be another intermediate exchange rate for the other sectors and credit card foreign currency quotas, and then there would be a free exchange rate (black), which would be the same parallel exchange rate that has always been around. At **Ecoanalítica** we know for a fact that President Chávez is not sold on this idea of a dual exchange rate. His hesitancy has to do with corruption and general collapse of the system that RECADIVI unleashed with former President Pérez's famous "*paquetico*" in 1989. The dual system idea is also not very popular with all the ministers in the Economic Cabinet, the Ministers of MILCO, Environment, and MIBAN have expressed their concerns and pointed out that the exchange regimen will remain the same.

So, what's likely to be introduced is an intermediate system, a scenario that we at **Ecoanalítica** have described as a "politically correct devaluation."

The era of "CADIVI for everyone" is all over

We don't rule out that in the medium term the Government introduces a differentiated exchange system as a mechanism to oxygenate and guarantee the survival of the exchange control regimen. However, for what's left of 2008 what we are going to see is a very simple scheme. First, CADIVI will be liquidating foreign currency at a rate of US\$2.0 billion a month for imports, distributing first and foremost to the priority sectors. The other sectors, and even some food and medicine companies which are suffering serious delays, will receive bonds and/or notes at a higher exchange rate. This is a devaluation, as simple as that, because they will not continue to receive foreign currency at the official rate of VEF2.15 per dollar.

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Of course, this is the Bolivarian Republic and the Government will never admit that in fact, a devaluation has taken place. Isea and El Troudi, the Ministers of Finance and Planning respectively, will always be there to remind us that CADIVI still authorizes foreign currency at the official exchange rate.

This system can't be sustained indefinitely

For many companies, this situation that we have just described isn't all that bad, because between not receiving foreign currency from CADIVI and being able to buy them a little more expensive but from the Government, the latter is not such a bad deal. However, the Government can't continue to issue debt indefinitely, and more so when the fiscal situation the Government is in doesn't allow for it. That's why we believe that this is a transitory situation that companies can take advantage of, taking all the necessary precautions, and not forgetting to continue with their coverage operations.

At Ecoanalítica, we continue to insist that the best thing would be to dismantle the exchange control

High oil prices, solid international reserves and extraordinary resources, low expectation that the official exchange will devalue, these are all positive key indicators that the time is right for dismantling the exchange control and at the same time minimizing any possible negative after effects.

Dismantling the exchange control could take around a year and a half, in other words up until the second semester of 2009, Venezuela would have another exchange regimen. The first stage would last six months. The Government could use two instruments, weekly auctions of around US\$250 million in short term notes with an average daily liquidation from CADIVI of around US\$200 million, this would create a stable exchange environment. The second stage would last approximately a year and would be focused on the gradual dismantling of the exchange control.

But we don't expect much to happen. The exchange control gives the Government two very important advantages for them: first it's a very effective political weapon; and second, it allows them to improvise at will with regard to fiscal matters. We don't think the Government is ready to give this up.

Economic Tips

March NCPI in 1.7%. The National Consumer Price Index registered a 1.7% variation in March, 3.1% in January and 2.1% in February. With these results, NCPI accrues a 7.1% variation for the first quarter of 2008. Price behavior in March resulted from minor growth levels both in price-controlled items (from 2.0% to 1.8%) and in non-controlled items (from 2.1% to 1.7%). The items that increased the most were alcoholic beverages (4.5%) and footwear and apparel (1.5%).

Broken down results. When the results are broken down into goods and services, it can be observed that the first ones registered a 1.6% variation, like in the previous period (1.5%), whereas services slowed down (from 2.9% to 2.0%)

Core inflation at 2.2%. National core inflation, a measure of inflation that excludes the effect of certain items which face volatile price movements or which prices are controlled, changed 2.2% in March. This is basically explained due to increases in processed foods (2.7%) and not-administered services (2.4%).

Bonds for importers. According to Minister Isea, this month the Ministry of Finance will issue corporate notes denominated in dollars and payable in bolivars, which will be mainly purchased by importers of foodstuffs, medicines and machinery, in particular, which are being affected by the backlogs in the allocation of foreign currency by CADIVI. The conditions under which the issue will be placed haven't been disclosed, but its amount is expected to be US\$ 1.8 billion. Large corporations and natural persons would also take part in the issue.

Another issue. Isea also announced that the issue of the Venezolano III bond will take place in mid April. The issue will be like the prior ones, i.e. a bond denominated in Bolivar and another in dollars (both payable in bolivars), with a face value of US\$ 1,500 and maturing in 2038. However, the bonds will most probably mature in the mid term and not necessarily will be issued in April.

Treasury bills in the making. The Finance Ministry informed in a press statement that the President of the Republic approved Treasury Bill issues for the national financial market; therefore, ordinary auctions will soon be carried out during the entire 2008 fiscal year. The announcement will be published on the FM and the BCV web pages and auctions will be carried out every Tuesday through the BCV electronic platform.

Highly positive. Treasury Bills auctions are useful because they help fix the cost of the country's domestic debt, since they serve as a reference for the calculation of the interests paid by the Vebonos. They also help stabilize the management of day-to-day cash flows of the National Treasury Office (NTO), because they provide more maneuver margin to address and finance short-term cash flows. These auctions are also a benchmark to measure money cost on the local finance markets, since the issue and placement of these titles allow the Venezuelan short-time yield curve to be drawn and provide information on the fixing and appraisal of interest rates on the local markets.

Data from the Ministry for Planning and Development (MPD) reveal a positive growth during IQ-08. Preliminary data from the MPD were disclosed by the Minister, Haiman El Troudi, who informed that GDP grew between 6% and 7% at the end of the first quarter of 2008.

Unemployment also drops. El Troudi also announced that the country's unemployment index is at 7.6% at the closing of February 2008. The Minister pointed out that compared to the index released in January 1999, when unemployment reached 16.6%, the trend has dropped by approximately 9%.

The goal has to be reviewed. Haiman El Troudi pointed out that the inflation goal the Government had set for this year of 11% has to be reviewed, as a result of the inflation rate registered during the first months of the year. El Troudi stressed that the economic cabinet won't set a new goal until the corrective measures required to control prices have been applied. However, in another interview he pointed out that inflation should close this year at around 19.5%.

More resources for FONDEN. FONDEN received US\$ 3.16 billion worth of resources during the first quarter of the year to execute 182 projects nationwide. It's important to highlight that out of the 182 projects estimated for this year, 37 are already consolidated and 27 new projects were launched during the first quarter of 2008. These projects include an investment of US\$ 194 million for the Valencia Subway, US\$ 255 million for the Maracaibo Subway, and US\$ 335 million for the Caracas Subway line 4, the stretch between Capuchinos and Plaza Venezuela.

Supplementary appropriations increase budget by 14%. To date in 2008, the National Assembly has authorized VEF 19.4 billion worth of supplementary appropriations from the surpluses that have been deposited since last year in the Fondo Miranda IV and the Ministry of Finance's trust fund. Including this amount, the initial spending budget of VEF 137.5 million has now increased to VEF 157 million. Most of the supplementary appropriations have been allocated to governorships and

major offices, to the National Community Council Fund and to the Ministries of the Interior and Justice, and Housing.

Deficit in January. The Central Government received VEF 9.028 billion worth of revenues during the month of January, thus increasing 8% in real terms in comparison to January 2007. Of this amount, non-oil revenues amounted to VEF 5.323 billion (59%) and oil revenues, VEF 3.70 billion (41%). Spending totaled VEF 9.88 billion, resulting the period in a VEF 857 million deficit. Financing requirement for January was VEF 1.86 billion.

FISCAL BALANCE CENTRAL GOVERNMENT (VEB Billions)	January- December 2007	January- December 2006	Nominal Variation	Real Variation
Total Revenue	9.028	6.738	34,0%	7,9%
Non-Oil Revenue	5.323	4.805	10,8%	-10,8%
Oil Revenue	3.705	1.932	91,7%	54,5%
Total Expenditure	9.885	8.429	17,3%	-5,5%
Fiscal Balance	-857	-1.692		
Primary Balance	-326	-1.209		
Non Oil Balance	-4.563	-3.624		
Debt Amortization	1.003	1.250		
Financing Requirements	1.860	2.942		

Sources: BCV and Ecoanalítica

Interest rates. Lending rates of the country's six major banks increased by 3.03% on the last week of March with respect to the previous week, thus reaching 22.44%. Time deposits lost 2.5% to fall to their legal minimum of 14%.

International Reserves. International Reserves increased by US\$ 389 million, to US\$ 30.956 billion, on the last week of March.

Monetary liquidity. Monetary liquidity increased 1%, to VEF 152.15 billion, on the fourth week of March, following the behavior it had over the prior weeks.

OIL TIPS

Windfall tax approved by the NA. The National Assembly at its plenary session approved in the first discussion the draft Law of Tax on Extraordinary Prices on the International Hydrocarbon Markets. Now that it has been approved, the Law should be submitted to the Commission on Energy and Mining of the NA where a report will be prepared that will be the basis for the Law's second discussion. If the Assembly approves the new Law this month, it will enter into force on May 1st.

Community power to receive the proceeds of this new tax. The draft law provides for that the proceeds from this tax will be earmarked by the National Executive to the execution of projects for the development of infrastructure, social production, and strengthening of the community power. Vis-à-vis this decision, community councils would have another financing source available.

Exxon case will be submitted to ICSID. The US oil major will submit the conflict to the International Centre for Settlement of Investment Disputes (ICSID) following a recommendation of a Dutch court. According to the current international agreements, Venezuela must accept the ICSID's jurisdiction, although according to the Venezuelan President, the country always loses at international courts.

PDVSA's production costs increased. The production cost per barrel, according to finance statements of the state-owned company, increased 13.6% to US\$ 4.93. This indicator reveals the outlays made by the company in activities directly related to oil production. However, although the production cost is the highest over the last five years, it is in agreement with the global exploitation cost increases.

Only half of oil agreements were complied with. According to the management report of Petróleos de Venezuela, less than half the oil supplies to countries signatory of the cooperation agreements were met. Furthermore, countries like Barbados, Guatemala and Panama didn't receive any shipments at all.

Gas stations on the border restricted. The Domestic Marketing Division of the Ministry of Energy and Petroleum notified the Safec member gas stations in Táchira state that they will be allowed to operate only from Mondays to Saturdays between 6 am and 10 pm and that cannot receive supplies from heavy load trucks with Colombian plates.

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Petroandina will start operations. The bi-national company, owned by the Bolivian State-owned oil company and PDVSA, will start hydrocarbon exploration and exploitation activities in six regions of the country. Two contracts were already signed by Bolivia's YPFB and Petroandina presidents before President Evo Morales. 50% of the production will benefit Petroandina and the other 50% the Bolivian State and producing regions.

Drilling ship for the Mariscal Sucre project will arrive in May. Minister Rafael Ramírez pointed out that the drilling ship "Neptune Discoverer" will arrive in Venezuelan waters the first week of May. This ship will make off-shore drilling works for the Mariscal Sucre project, which is 70% completed.

PDVSA will sign with Indian oil company. The India's state-owned oil company ONGC will invest US\$ 450 million in an oil field in which it will have a 40% stake. The field is located in the Orinoco River basin and has reserves of around 250 million tons.

OPEC won't increase production. OPEC's chairman, Chakib Khelil, doesn't believe that a production increase is necessary because, in his opinion, the dollar fall will continue to influence oil price increase.

BUSINESS SECTOR TIPS

Possible cement industry nationalization. On national TV network, President Chávez announced his intention of nationalizing cement industry and ordered the required legal actions to be started in order to implement this decision, claiming as reasons the national cement shortages and the pollution produced by some cement plants. Companies to be nationalized are those that previously belonged to the State and the later were sold to private companies.

Authorities from Mexico, Switzerland and France demand explanations. Authorities from Mexico, Switzerland and France reacted to the nationalization announcement made by President Chávez, describing this decision as improper and disrespectful to property rights. They claimed that the affected parties should receive compensation for a possible nationalization.

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Cemex shares dropped in Mexico and New York. After the decision, Cemex share price dropped. The contrary happened in the Caracas Stock Exchange, where Vencemos shares increased their value.

The State expects to be the controlling partner. Although Chávez said that only the companies that had been privatized were going to be taken by the State, PDVSA president indicated that negotiations will be held with the major cement companies, to which end the National Executive appointed a special commission made up by PDVSA and the ministries of Housing, Basic Industries and Mining, and Light Industries and Commerce. According to this information, the State expects to be the controlling partner in the three cement companies that are owned by transnationals.

CEMEX, the most affected. CEMEX is the main producer of cement, premix and aggregated in Venezuela, with 4.6 mm mt of cement production capacity and 32 premix plants. According to data, the company has a consolidated basis that generated US\$ 301 million EBITDA in 2007 (approximately 6% of total CEMEX EBITDA.) However, Venezuela only contributed 55.5%, or around US\$ 165 million, of the total assets (international affiliates in the Dominican Republic and Panama generated the other 44.5%.)

Negotiation will prevail. We at *Ecoanalítica* believe that this new nationalization process will be like the one applied in the case of CANTV and EDC. Therefore, in the case of CEMEX we think that it will keep the control of its operations in the Dominican Republic and Panama. CEMEX Venezuela capitalization is in the order of US\$ 550 million, and around US\$ 300 million only including its assets in Venezuela. We don't believe that compensation will reach this amount; therefore a likely result is that a compensation of around US\$ 820 million will be paid. International markets perceive as a positive fact that CEMEX can apply these resources to pay off debt.

It shouldn't be PDVSA. The process can take at least three months and we believe that the global cost of the nationalization of the cement industry would be of the order of US\$ 2.0 billion. Up until now it would appear as if PDVSA would be making these payments. This makes no sense. Ideally, these payments should come from the FONDEN resources.

EDC to issue debt. La Electricidad de Caracas issued bonds denominated in dollars and payable in bolivars for US\$ 650 million. The issue is earmarked for businesses and banks only.

INDECU sets a deadline for shortages. Without further details, the new president of the National Institute for the Defense and Education of Consumers and Users

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(INDECU for its initials in Spanish), Eduardo Samán, informed that with the implementation of a number of supervision strategies, the Institute expects to put an end to hoarding and profiteering before next May 31st.

Banks to face lack of liquidity. The EDC bond sale and the Income Tax payment period resulted in a lack of liquidity in part of the banks in Venezuela late last week, which forced BCV to purchase bonds and deposit certificates from them. As a result of this lack of funds, overnight interest rate hit a maximum of 28% last Monday and averaged 22%.

Actions taken to renew industrial park. The Venezuelan Association of Heavy Machinery and Empresarios por Venezuela (Empreven) signed an agreement to renew equipment and machineries of the domestic industrial park, which is 25 year obsolete. The agreement consists of a trust fund of US\$ 50 million at the Banco del Tesoro, which will issue credit lines to import equipment. Those businesses that are interested in renewing their machinery have to ask the Association.

New Social Production Company. President Chávez announced the organization of the Empresa Nacional Almacenadora de Alimentos and a Sino-Venezuelan joint fund over the next months, with the aim to advance the Socialist model.

Agro-alimentary alliance between Venezuela and Nicaragua. The government of Venezuela and Nicaragua closed a strategic alliance for agro-alimentary cooperation, signing a number of bi-national agreements to supply Venezuela with beef and powder milk.

Fishing industry profits will be regulated. The new Law on Fishing and Aquiculture activities entitles the ministries of Agriculture and Lands, Light Industries and Commerce, and Food to regulate profits produced by the domestic fishing activities. The president of INSOPESCA pointed out that once the law is enacted "fish prices will be fair," and assured that the marketing chain is going to be readjusted.

US\$ 17 million to be invested in artisanal fishing. President Hugo Chávez announced that the State will launch a program which will be implemented by INSOPESCA, which contemplates the investment of US\$ 17 million, to be financed by the Sino-Venezuelan joint fund, for the construction of collection centers, refrigeration networks, and tool supplies for domestic fishermen.

Food basket at VEF 1,220. The food basket for workers cost VEF 1,220 in March, according to data provided by CENDA, which would account for an increase of 0.8% from February. The most significant price rises were observed in cereals and derived

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products (13.2%), fish (6.9%), and fruits and vegetables (5.9%). Pasta, rice, and bread increased between 6% and 20%. The current minimum wage covers 50.4% of the basket.

Basic basket increased 2%. According to data from CENDA, the cost of the basic basket for the month of March was at VEF 2,551, i.e a 2% increase from the value in February. The most significant increase was registered in utilities, with a 22% rise in public urban transportation and 84% increase in refuse collection. According to the report, average income is enough to buy only 48.2% of the basket.

Car sales down in March. 23,705 new cars were sold in March, down 36.4% from March last year, informed CAVENEZ. Meanwhile, between January and March 2008 79,894 cars were sold, down 19.7% from the figure corresponding to the previous year, when 99,489 cars were sold.

Aerpostal suspended international flights. Aerpostal suspended its international routes until further notice, due to the low season and the reduced number of bookings. The company is endorsing with other airlines the tickets that were already sold.

Political Tips

Government hits the brake concerning the Bolivarian curriculum. Due to the multiple complaints, protests, and teachers' meetings against the implementation of the Bolivarian curriculum, last week, President Chávez announced that the implementation of the new national educational program will be postponed until next year.

And it would possibly be put up for a referendum. The President of the Republic pointed out that there isn't any rush in his governmental team to implement the Bolivarian curriculum, therefore, he considered appropriate that its contents be submitted to widespread discussion over the next months, with the participation of those who are putting forward the proposal and those who are questioning it. The proposal would possibly be put up for a referendum in 2009.

IVAD survey evaluates as positive Chávez's government, but lack of personal security is still an issue. A survey by IVAD shows that 66.5% of the population describes Hugo Chávez's performance in the presidency as positive. However, 69.5%

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of the respondents identified lack of personal security as the main problem in Venezuela, followed by shortages (38.8%), unemployment (28.3%), and political instability (23%).

Isaías Rodríguez was elected associate judge to the Constitutional Chamber. The Plenary Chamber of the Venezuelan High Supreme Court decided to appoint the former Attorney General, Isaías Rodríguez, as associate judge to the Constitutional Chamber. Rodríguez's appointment was proposed by the president of the Court and the Constitutional Chamber, justice Luisa Estella Morales.

Court Martial renewed. The Plenary Chamber elected new Court Martial members. The Army's Brigadier General Francisco Rivas Rodríguez was appointed president; Army's Colonel Rafael Martínez Gavidia was appointed chancellor, and Commodore José Vivas Sáenz as rapporteur.

Attorney General's Office closed case against Nicolás Maduro. The Attorney General's Office requested charges brought by Paciano Padrón in 2004 against Nicolás Maduro, for illicit enrichment during his tenure as president of the National Assembly, be withdrawn. The ruling accepted the Attorney General's Office allegations as valid; this entity checked Maduro's bank accounts and his sworn declaration of assets, finding an increase of only 2%.

A mixed university entrance system was agreed upon. Rectors of the commission appointed by the National University Council agreed along with OPSU (the higher education planning office) the establishment of a mixed university entrance system for 2008. The system will be transitory and places will be allocated by means of entrance tests made by the different universities, the mechanism approved by OPSU, and Special Agreements. The new process will be implemented in 2009.

Other Tips

More Petrocasas for Cuba. Houses built with materials extracted from crude oil are becoming an alternative system to address housing problem in Cuba. Cuban authorities announced that the construction work of this kind of houses has begun in Santiago de Cuba, this being the second residential community in Cuba with this kind of houses.

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The IDB's statistics report that poverty has decreased in Latin America. IDB's annual report reveals that the number of poor inhabitants in Latin America and the Caribbean decreased from 194 to 190 million in 2007, meaning a 36.5% decrease in poverty rate in 2006 and 35.1% in 2007. Concerning the number of indigents and people in extreme poverty, the rate dropped from 13.4% to 12.7%.

WB claims it's necessary to face recent increases in foodstuff prices. The World Bank pointed out that a new agreement on global food policies is required, since the increase in agricultural products is increasingly affecting poor countries. According to the WB, 33 countries are currently threatened with political destabilization and social disturbances due to price increases.

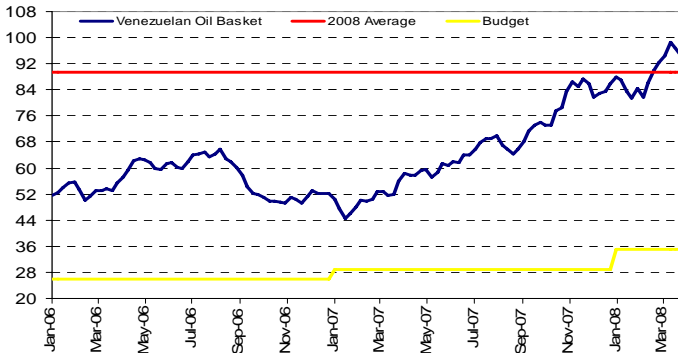
US: GDP could fall. Ben Bernanke, president of the US Federal Reserve warned the Congress, without making any direct reference to recession, that US GDP will grow less and even could fall during the first half of the year. However, Bernanke expects the economy to recover for the second half of the year as a consequence of the economic stimulus plan that is being applied by the US Government.

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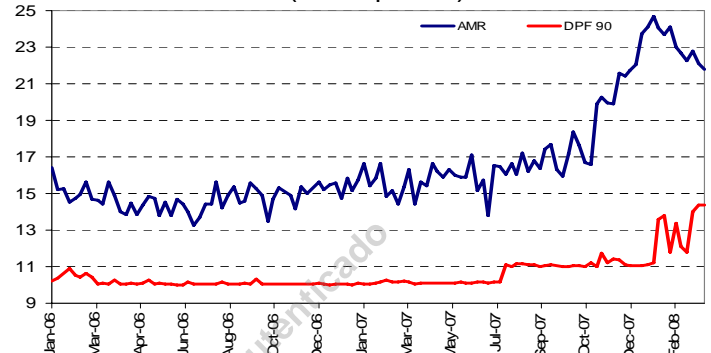
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ECONOMIC OVERVIEW

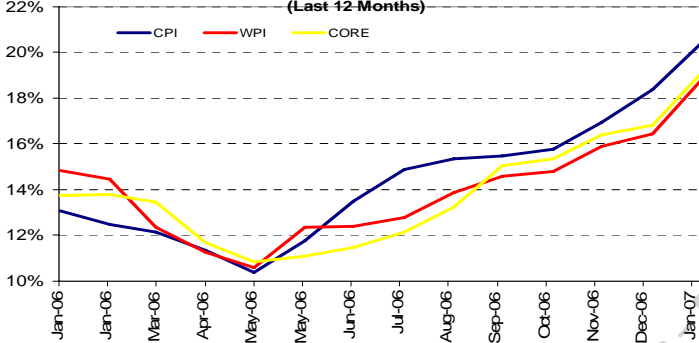
Oil Price
(Venezuelan Oil Basket US\$/pb)



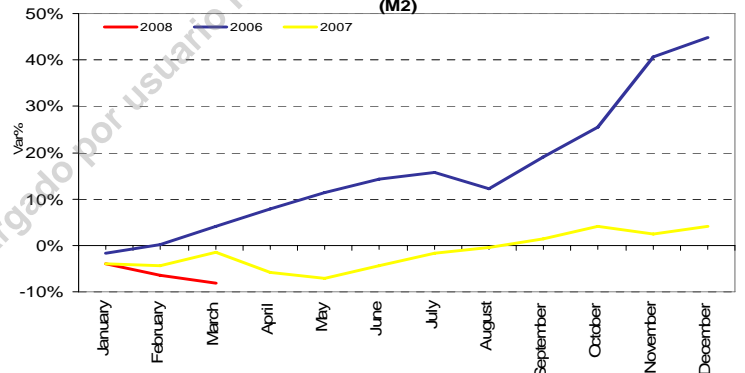
Interest Rate
(Six Principal Banks)



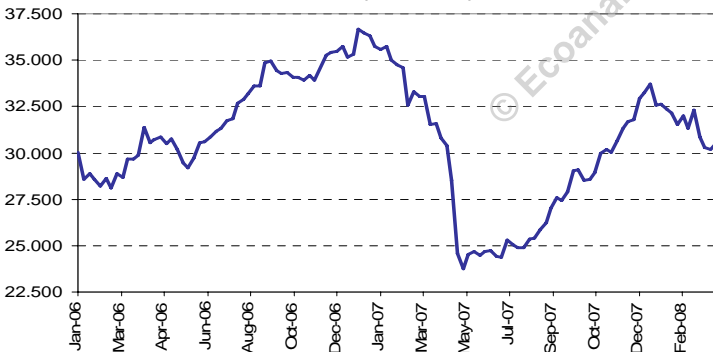
Inflation
(Last 12 Months)



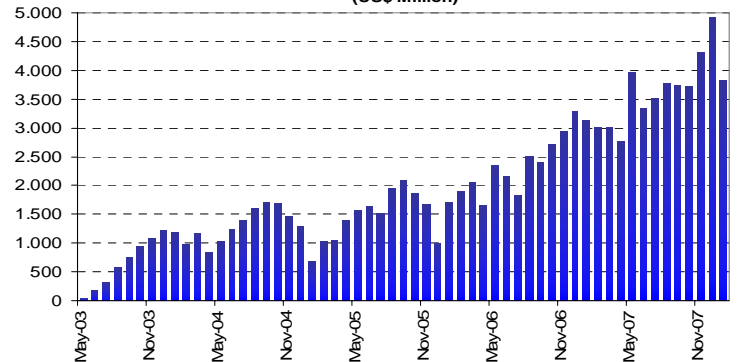
Real Expansion
(M2)



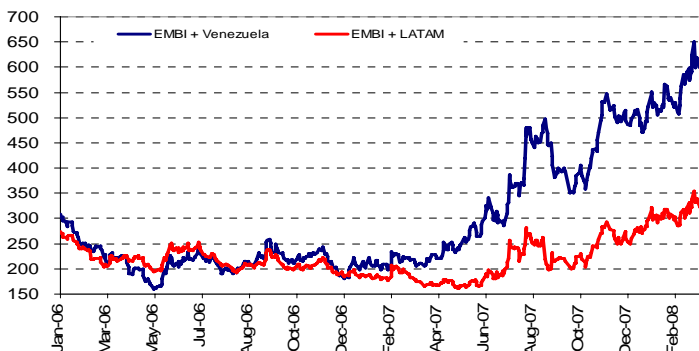
Fx Reserves - BCV
(US\$ Million)



Disbursement
(US\$ Million)



EMBI



Central Government
(VEB Billion)

