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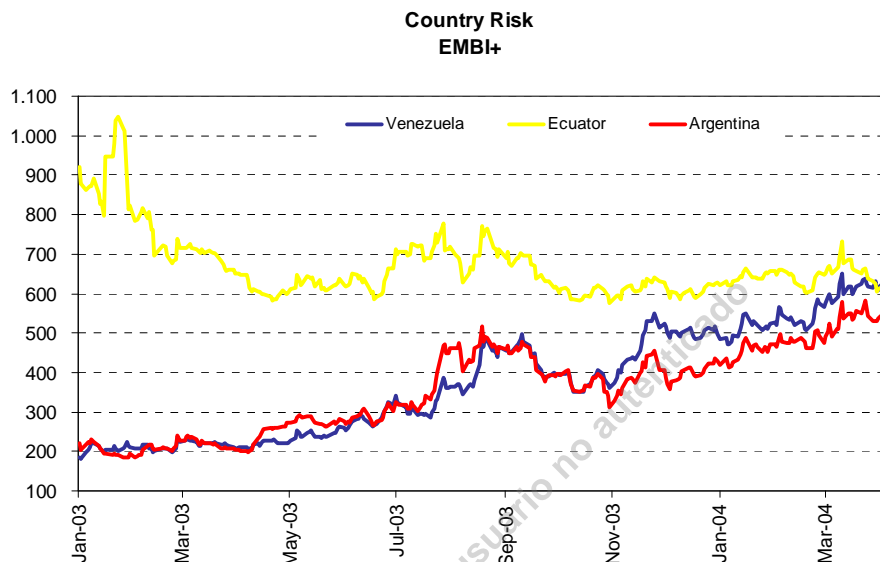
John Holden

*The paper storm is
increasing the country risk*

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After a period in which Venezuela's credit risk was improving along the lines of the same improvements Brazil was showing, during the middle of 2006, Brazil's behavior began to unravel and it began to reflect a much more volatile and risk taking course of action much like that taken by Argentina, and more recently by Ecuador. In other words, markets went from seeing Venezuela and Brazil as representing similar risks to comparing us to Ecuador, a country that after President Rafael Correa announced the "illegitimacy" of its foreign debt, was the country with the highest country-risk rating in Latin America.

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Sources: Cbonds and Ecoanalítica

With oil prices increasing from day to day, Venezuela's increase in country risk seems to reflect the market's concern about the considerable amount of public debt paper being issued which is substantially greater than the limited demand and a considerable increase of negative news combined with unsubstantiated rumors of liquidity problems. Due to the fact that the main economic objective Minister of Finance Rafael Isea has is to reduce the differential between the official and non-official exchange rate, everything seems to point out that the Government will continue to sell paper, thereby deteriorating its credit. Furthermore, one would have expected that the Administration would have put its radical agenda aside for a bit after the constitutional reform referendum defeat last December, but as one can see, that's not the case. And lastly, for those investors that are still looking for high yield low risk bonds to invest in, issued by a Latin American oil producing country, they should begin to start thinking about Ecuador.

Obviously, it's the paper's issue.

The sale of short term structured notes by Fonden¹, which are an unrevealed combination of risk from Argentina, Brazil, Ecuador, and

¹ This week we have decided to focus on the technical implications of the sale of structured notes and not on the collateral benefits that they produce for some people because of their lack of transparency.

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Venezuela, caused a very abrupt expansion and leveling of Venezuela and Argentina's credit curve. At different times the Minister of Finance has announced that the country sells structured notes to the financial system as an indirect vehicle to inject US-dollars into the non-official foreign currency market. At **Ecoanalítica**, we believe that the only clear objective that the Administration's new economic team has is to reduce the differential between the official and non-official exchange rate. The effects these sales are having on the international credit market is simply a "collateral" price that the country, or more specifically, those issuing the bonds, have suffered and will continue to suffer. Now, in order to keep the non-official exchange rate in check it will be necessary to issue a significant amount of papers, so it wouldn't be a bad idea to calculate approximately how much the private sector demand for US-dollars is in this market.

Fonden still has structured notes

In order to put the problem in perspective, it's important to point out that at the beginning of 2008, Fonden had US\$4.50 billion in notes in its possession, of which US\$1.70 billion (38%) have been sold directly to financial institutions so far this year and US\$1.20 billion will mature this year and won't be sold. The US\$1.60 billion that is left, in our opinion, will be sold when the Government considers that there are pressures in the non-official market that merit it. During this period, the non-official exchange rate has appreciated significantly. We can't get into specific figures due to the new law that exists which prohibits such matters. Furthermore, *Electricidad de Caracas* (electric power company) sold US\$650 million in bonds at the beginning of April and a new issue of US\$2.20 billion is expected during the second half of the month of April.

How many US-dollars does the private sector need?

In the Balance of Payment figures, the capital account shows a deficit of US\$23.30 billion. Of this amount, US\$17.40 billion correspond to the private sector and only US\$5.90 billion to the public sector. Outgoing capital from the public sector is nothing more than foreign savings that the sector has accumulated in different foreign funds. One of the big contradictions of the economic policies of this Government is that it allows the public sector to put its savings in US-dollars but doesn't expect the private sector to do the same.

The exchange controls stimulate private sector outgoing capital

Of the US\$17.40 billion in outgoing capital that corresponds to the private sector, approximately 65% or US\$11.20 billion was financed by the public sector through issues of PDVSA bonds, *bonos del sur*

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bonds, 2038 bonds, and structured notes. Keeping these figures in mind, at **Ecoanalítica**, we believe that in order for the Ministry of Finance to maintain, or even further strengthen the non-official exchange rate, it will have to sell between US\$10.00 billion to US\$15.00 billion in paper.

In the end, the people will end up severely paying for the outgoing capital

We don't understand, considering these figures, how the President could have said that "we can make the exchange controls more flexible, but the exchange control is here to stay. We can't continue to allow the Oligarchy to continue to take all the people's US-dollars out of the country." What makes it all a bit nostalgic, to say the least, is that these speeches make it absolutely clear that for the second time, the great opportunity to develop the country considering all that could be financed with the recent historically high oil prices, will be missed. We've mentioned it a number of times in previous reports that in a not to distant future the exchange control will require an adjustment like what the country has already been through in 1989 and 1996; an adjustment that will be more severely felt and paid for by those who are poorest; an adjustment that is coming, but that the high oil prices have been able to postpone.

New foreign debt issue could reach US\$6.50 billion

By analyzing how the Administration has been managing the debt during the first quarter, one can imagine that the Government's most probable strategy will be to push all foreign as well as domestic debt payments into new issues on the international market. During the first quarter of this year, domestic debt payments equaled US\$632 million and foreign debt payments equaled US\$678 million for a total of US\$1.31 billion. These payments will be more than compensate for by the next foreign issue, which as we already mentioned, will be around US\$2.0 billion. Without considering the possibility of buying back debt on the international market, and given the fact that the restricted public sector has a surplus which allows it to continue saving, we will assume that the total Venezuela public debt will remain at US\$60.0 billion, which is equal to the level it was at the close of 2007. In this scenario, the US\$6.50 billion of debt that is due to be paid this year (US\$4.20 billion in the domestic market and US\$2.30 in the international market) could be issued in the foreign market in US-dollar denominated bonds that can be paid for in bolivars when issued. This will allow for a greater supply of had currency in the non-official market. In other words, assuming these suppositions are correct, we would be expecting new issues for the sum of US\$6.50 billion during 2008. It's

important to point out that these issues wouldn't be made out of necessity, but in order to create foreign currency flows to feed the non-official foreign currency market. In this scenario, we aren't considering a new PDVSA issue.

The nationalizations and other news coming from the President's office are not sitting well in the market

One of the main problems for Venezuelan assets is **Headline Risk**. This type of risk started in 2008 with the freezing of PDVSA's assets and continued with the nationalization of the cement industry and more recently, SIDOR.

How much are the nationalizations costing?

Recently, President Chávez gave the order to begin the nationalization process of all the companies working in the cement industry and of Sidor. The cement industry, which produces almost 10 million tons yearly with 90% of production controlled by three multinational companies could be valued at around US\$1.90 billion. And Sidor, 60% owned by the Argentinean Techint Group, with production at around 4 million tons of liquid steel a year could be valued at least at around US\$1.60 billion. In other words, both nationalizations could end up costing the Government US\$3.50 billion. However, the cost generated by these nationalizations isn't only measured by how much the Government will eventually have to pay in US-dollars, but also by how much it affects investment, or rather, the lack of investment, due to the uncertainty and the question of which sector is next.

Which sector will be next?

Many analysts believe that the next sector that will be nationalized will be the financial sector. At **Ecoanalítica**, we don't agree with this assessment, but we can't discard it as being a possibility. The public sector is spending millions of US-dollars in expanding and consolidating a public financing system. In fact, the State is currently the owner of 10 banks with approximately 400 agencies nationwide, which all together could control more than 25% of the financing system. But, they could want more.

Even though we do not believe that the Government will nationalize the financing sector in the near future, it is important to point out the distortions that this event could bring about among the main players in this sector. In a country with high aggregate monetary growth product of increased public spending and the exchange controls, the financing system has grown at an average yearly rate of 54% during the last five years. In the current environment of nationalizations and without

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guarantees regarding private property: What financing group would invest in order to maintain its capitalization coefficient? Just the thought of this, could cause the strength of the financing system to deteriorate rapidly.

Credit self-destructing

In this scenario, it's impossible to be optimistic with Venezuela's country risk, which we believe will continue to be pressured in the coming months. Though we thought that the Administration would have put its radical agenda aside for a bit after the constitutional reform referendum defeat, clearly one can see that is not the case. Furthermore, increased negative sentiments in the international markets, has led to unfounded rumors being spread, a subject we will take up in our next report. All of this could change, unfortunately, the Government shows no evidence of wanting to change.

Economic Tips

Here to stay... Last Sunday, the President once again said that "*the exchange control is here to stay.*" Furthermore, the President assured that it's because of the exchange control that an "economic coup" that is his opinion the Venezuelan Oligarchy and the U.S. "Empire" have been organizing has been avoided. However, he also mentioned that the exchange control could be made more flexible.

Unemployment down. According to figures released by the National Statistics Institute, unemployment dropped to 7.6% at the close of the month of February, which reflects a drop of 3.3% compared to February 2007, when it was at 10.9%. January also showed a drop of 2.6%.

Informal sector too. The National Statistics Institute 2008 February figures also show that 43.7% of the working population belongs to the informal sector of the economy while 56.3% belong to the formal sector. In February 2007, the formal sector was at 56% and the informal sector was at 44%.

BANDES lost US\$3.12 million. The headquarters of the Social and Economic Development Bank (BANDES) in Uruguay reported losses for US\$3.12 million during the first two months of the year. BANDES Uruguay had total assets equaling US\$ 38.3 million, losses for US\$ 15.2 million, and 55,373 clients in December 2007. The headquarters expects to make investments in technology for US\$10.0 million this year.

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Rising. During the month of March, the CPI variation for the Metropolitan area of Caracas was 2.31%. The accumulated variation for the first three months of the year is at 8.2%, and the annualized variation for the period is at 31.6%.

Non-oil tax collection drops. Tax collection for the month of March totaled VEF8.19 billion, down 18.8% in real terms compared to the same month last year. The Income Tax collection period generated revenue for VEF4.09 billion, down 35% in real terms compared to march 2007. Tax collection for the first quarter is at VEF18.06 billion, down 12% in a year.

NATIONAL TAX COLLECTION (VEF Millions)				
MARCH				
	2008	2007	Var %	Real Var %
TOTAL	8.185	8.051	1,7%	-21,2%
Income TAX	4.086	5.038	-18,9%	-37,2%
Tax	1.533	1.526	0,5%	-22,2%
Customs	1.229	1.349	-8,9%	-29,5%
Others Incomes	281	138	104,5%	58,4%
ITF	1.056	0	-	-
JANUARY- MARCH				
	2008	2007	Var %	Real Var %
TOTAL	18.062	16.517	9,4%	-13,3%
Income TAX	5.757	7.356	-21,7%	-38,0%
Tax	4.640	4.907	-5,4%	-25,1%
Customs	3.591	3.915	-8,3%	-27,3%
Others Incomes	917	339	170,6%	114,5%
ITF	3.158	-	-	-

Sources: SENIAT and Ecoanalitica

China put in its part. The Ministry of Planning, Haiman El Troudi, announced that the Government of China delivered the US\$4.0 billion corresponding to its part of the joint fund it has with Venezuela which are earmarked for productive investments and big infrastructure projects in the country, among them agriculture road systems, irrigations systems, and the construction of the first 10 universities of the Alma Mater Mission program.

International reserves. For the first wee of the month of April, international reserves were at US\$ 30.96 billion, up 1.32% compared to the previous week.

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Interest rates. Loan interest rates for the six main banks in the country closed the first week of the month of April at 22.23%. The term deposit rate remained at 14%.

Monetary liquidity. For the first week of April, monetary liquidity was at VEF147.63 billion, down 2.95% compared to the previous week.

OIL TIPS

Venezuelan oil basket continues to rise. The Venezuelan crude oil and oil by-products basket averaged US\$97.34 per barrel this week, up 4.6% compared to the previous week.

New record. The price for a barrel of oil hit new record levels on the international market. Brent oil reached US\$111.31 per barrel. The barrel of light crude oil for May delivery reached US\$115.54 and the price of OPEC crude oil reached US\$104.02 per barrel. Recent price increases are attributed to the close of Mexican terminals and the disturbances around Nigerian oil installations which could affect supply in the coming weeks.

PDVSA paid bond holder interest payments. On April 14th, PDVSA proceeded to pay the interest due on the bonds maturing in 2017, 2027, and 2037, according to the conditions established on the paper.

Recognize difficulties. PDVSA Management Report recognizes that the natural gas conversion of the public transport system has become difficult since only 77 new GNV (natural gas for vehicle) distribution points were incorporated around the country by the close of 2007, and there is a certain amount of incompatibility when it comes to the conversion of diesel engines. It's planning to launch a program this coming July to solve that problem.

More resources. After the scolding that was handed out by the President Hugo Chávez on Sunday, the National Assembly approved a law that would tax windfall revenues earned by public and private oil companies due to the high oil prices. The regulation has 8 articles, which were totally modified by the mixed commission that studied the project.

Significant changes. With respect to the project approved during its first discussion, the main changes were: the name of the regulation which previously had been called "Tax Law on the Extraordinary Prices of the International Hydrocarbons Market" and was changed to "The Special Contribution Law...." The fact that it was called a "Tax" before didn't allow the funds to be specifically earmarked for FONDEN, as it states in the Organic Law for the Financial Administration of the Public Sector. Article 3 was also modified in order to correct the contradiction that was evident in the first project which stated that the revenue collected would go to fiscal coffers and then later stated that they would go to FONDEN.

In foreign currency. Furthermore, it was pointed out that the liquidation of the Tax, now called, "contribution" will not be made in bolivars but at the current exchange rate, but in foreign currency. The sixth article, which was the one which caused a certain amount of confrontation during the second discussion of the law, changed the word "deductible" for "accounted for as costs," when referring to the discount regarding Income Tax payment.

Increase Tax collection. According to Minister Ramírez, this new fiscal "contribution" will bring in around US\$9.0 billion that will be deposited in FONDEN, and managed at the Administrations discretion. However, the net increase in fiscal tax revenue is estimated at around US\$1.20 billion considering that the special contribution on windfall revenues will affect the Oil sector Income Tax contribution. What the Administration gains is that now they will be able to have greater control over the resources being able to dispose of them out-of-budget.

Minister Ramírez clarifies. The Minister of Energy and Petroleum went before the National Assembly Energy and Mines Commission to clarify any doubts concerning the Windfall Tax Law. The Minister explained that it would be deductible from the Income Tax and that it would not affect fiscal tax revenues. According to the Minister, the tax will allow the State to collect more than 90% of the windfall value of a barrel of oil when the price per barrel is over US\$70.

PETROCEDENO shutdown ready. With over 4,500 men and women involved in the shutdown operation to be able to perform maintenance and improvements, the operation was pronounced a complete success by the president of PDVSA Rafael since it is scheduled to be completed within the time allotted.

Now India. PDVSA board members and the Indian transnational company ONGC signed a contract yesterday for the constitution, administration, and registration of the constituent acts and the statutes of a mixed Indo-Venezuelan oil company with 60% Venezuelan shareholding and remaining 40% going to ONGC. After the direct

assignment is approved, this mixed company will operate the San Cristóbal (Anzoátegui state) field, aiming to duplicate its current production of 30 thousand b/d to 60 thousand b/d of crude with an investment of around US\$400 million. The defined parameters of this 160 Km² (99.4 mile²) field, has already been authorized and appeared published in the Gaceta Oficial number 38.878 and the company agreed to pay US\$173 million as an entrance bonus.

It's not OPEC's fault. The high oil prices can't be attributed to OPEC since it kept its part of the deal and maintained a balance in the oil market. A member of the International Monetary Fund (IMF) attributes the record prices to *"the dynamic of the financing markets."*

Fuel leaving the country. The Ministry of Energy and Petroleum is continuing with its plan to stem the flow of fuel out of the country over the Colombian border which is estimated at 29,000 barrels daily. Among the measures being considered is to reduce the supply of fuel to the area by 20%.

PDVSA looks for an operations partner. According to the president of Petróleos de Venezuela, the company is looking for a partner to operate the Chalmette refinery in Louisiana, since currently this function is being carried out by Exxon Mobil. The companies are equal partners of said refinery.

Exxon must be paid its indemnity. According to the treaty with Holland, the expropriation or nationalization process can only be carried out once a "just compensation" has been finalized. This type of treaty places Venezuela in a very complicated situation that it can't get out of by simply filing charges.

BUSINESS SECTOR TIPS

Ternium willing to negotiate. According to a press release, the executive president of Ternium Sidor announced his willingness to proceed with the Government's proposal that would allow the definite signing of the collective bargaining which has still not been defined.

Imports from Colombia increased by 31%. The Venezuelan-Colombian Economic Integration Chamber announced that during the first quarter of 2007, imports coming from Colombia equaled US\$858 million, compared to the US\$1.13 billion registered in

the same period in 2008. This represents an increase of 31% spearheaded mainly by the automobile and food sector.

Construction materials increase. According to the latest statistics released by the BCV, the construction material price index during the last 12 months has increased by 19% at the wholesale level while at the production level it's at 20.7%. Construction sector representatives point out that it's difficult to find products like ceramic, rock, and sand.

Cement export has been dropping in the last few years. Cement export from the main companies working in Venezuela, Cemex, Lafarge, Holcim, have been dropping for the last three years going from 4.1 million tons in 2004 to 720,000 tons in 2007. Sector figures indicate that during the first quarter of 2008, foreign sales were at 32,000 tons and during the month of March no product was sent abroad. Representatives of the cement industry have repeatedly stated that due to increased domestic demands, they have been forced to sell almost all their product domestically.

MMC reaches an agreement to solve the conflict. Representatives from the Ministry of Labor approved the signing of an agreement between MMC Automotriz, Metal Press, and the unions of the two companies and thereby putting an end to the recent labor conflict that has paralyzed the company. According to the agreement, the company will reinstate 21 of the 40 workers that had declared themselves on strike, while the rest would receive help to find jobs similar to those they were losing.

Ford estimates car market at 350,000 units. According to preliminary calculations, Ford Motors of Venezuela estimates that car sales in Venezuela in 2008 will be around 350,000 units, down more than 100,000 units compared to 2007. According to Ford, this is due to the new automotive sector policies.

Banesco coming out with more preferred stock. On April 10th, Banesco finished its successful placement of 1.25 billion of Banesco Preferred Stock. Given the high demand, the bank will carry out a second issue for the same amount which will begin on April 17 and close on May 8th, 2008.

Import of rice up. The head Minal announced that 70,000 tons of rice will be imported in order to guarantee its supply during the winter season, when the sector usually suffers shortages.

Domestic production also to increase. Elías Jaua, Minister of Agriculture and Lands announced that he expects a 20% increase in the rice harvest in 2008 which would represent a 126,000 surplus of this product.

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MERCAL trying to cutback on imports. The Minister of Food, Félix Osorio, announced that products purchased from domestic suppliers makes up 55% of the total merchandise distributed through the network. This means that of the 134,000 tons of food that Mercal sells monthly, 77,000 tons is purchased domestically. These figures reflect 2008 first quarter totals.

But imports still rule. Osorio, assured that shortages have been reduced, though there are some current problems with supplying powdered milk in some areas. Current supply of food to public and private distribution networks depend on receiving 55% of their products through imports and 45% through domestic suppliers and producers.

Bread production down. Representatives from the sector report that increases in the price of wheat flour and regulations are not allowing the industry to cover production costs like for example worker wages on Sunday. The bread sector has been forced to close down on Sundays in order to make materials last for the rest of the week.

Ships in port. More than 260 industrial fishing boats (trawlers) remained in port because fishermen refused to work because they feel the new Fishing Law offers them very few guarantees, despite the fact that Insopesca has already issued more than 70 fishing licenses.

Propose to increase cereal production. Aiming to reduce imports, Fedeaagro proposes to increase cereal production by 20% nationwide, specifically sorghum and corn, for which it will be necessary to adjust prices according to the international market as well as increase the area planted.

Río Turbio property converted into UPS. The president of the INTI, announced that the 2,400 hectares (5,930.5 acres) recovered from the Río Turbio valley property will be converted into a Socialist Production Unit (UPS) which will be focused on agro-ecological developments. The president assured that the sugar cane production will remain because it is an essential product for the country.

The INTI constantly revising. The president of the INTI denied that the Government is interested in expropriating or recovering the property of certain union leaders. It assured that the organism has inspected more than 100 properties located in Táchira, Lara, and Yaracuy state. The INTI's goal for 2008, is to recover one million hectares (2,471,054 acres).

More resources for coffee production. The vice-minister of Agriculture and Lands (MAT), gave two checks for the amount of VEF1 million each to the Café Venezuela and CVA Café companies in order to open a line of credit so that they can support

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coffee growers around the country. An agreement was also signed to open a line of credit through the *Banco Agrícola de Venezuela*, to the same two companies for VEF10 million.

Expropriation risk increases. The vice-president of the Republic assured that all private companies that maintain hostile relations with their workers will be monitored by the Government which will take the necessary steps to correct any anomalies.

Producers will be granted “combos.” The *Banco Agrícola de Venezuela* will grant “combos” for the amount of VEF600,000 to producers that include tractors, materials, and trucks to transport what they are producing. The “combos” will be earmarked for especially for small producers located around the zamoranos area.

Political Tips

A question of efficiency. During a gathering along the Urdaneta avenue, the President of the Republic questioned the efficiency of his Government when it came time to deal with the more practical problems of the people, and he called for more efficiency.

Propose to create a Single Center for Workers. The Minister of Labor plans to present to the Administration a proposal to create a Single Center for Workers that will substitute the current National Union of Workers, UNT, because “there are sectors that are not supported or represented in the UNT or in the CTV.” He added that the UNT could be a part of this new structure if it wanted to.

Minister change. The President of the Republic, Hugo Chávez Frías, named National Assembly representative, Roberto Manuel Hernández, as Minister of the People’s Power for Labor and Social Security. His appointment was published in the *Gaceta Oficial* dated Tuesday, April 15, 2008. Hernández will replace José Ramón Rivero, who has been there since 2006.

Change of ambassadors. The National Assembly agreed to appoint Jorge Valero as Venezuela’s ambassador to the United Nations (U.N.), and Roy Chaderton Matos as ambassador to the Organization of American States (OAS). Valero has been Venezuela’s permanent representative before the OAS in Washington D.C. for the last five years, and Chaderton comes from being Venezuela’s ambassador to Mexico, an

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office he was appointed to in August 2007. The National Assembly approved the appointment of Germán Mundaraín, former ombudsman, as Venezuela's ambassador to the International Organizations of the U.N. based in Geneva, Switzerland. No mention was made of who would replace Chaderton in Mexico.

Chávez announces birth of April 13th Mission. President Hugo Chávez announced the birth of the April 13th Mission aimed at improving the standard of living in communities and which will begin to work in 381 parishes, 74 municipalities, and will benefit 15 million people, among them 1.7 million in situations of poverty. The President explained that this Mission would be financed by the windfall tax collected from foreign energy companies.

New Laws coming via the Special Powers Law. The head of the Ministry of Planning announced that six new regulations will be published in Gaceta Oficial in the next few days which were approved via Special Powers Law. Among the legal instruments reformed are the Bank Law, the Communal Economy Law, the Indecu Law, the Public Financing System Law, the Income Tax law, and the investment promotion and protection treaty.

Next in line. The head of the MIBAM announced that in the coming days all operations and concessions granted international companies (Canadian Crystallex, U.S. Hecla, and *Promotora Minera Guayana*, of Goldfields from South Africa) which exploit gold will be reviewed in order to inspect their labor conditions and benefits and environmental management.

Other Tips

2008-2013 National Statistics Plan. The INE presented its 2008-2013 National Statistics Plan which aims at including all the necessary statistics required for national planning and that will also be a tool for regional economies.

Moderation. The director for the Western hemisphere for the IMF asked Latin American countries to be conservative with their public spending and protect recent fiscal gains before deteriorating foreign economic conditions and inflationary pressures.

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FAO warns of world crisis due to increase in cereal prices. The head of the Food and Agriculture Organization of the United Nations warned that if the price of certain cereals continues to increase protests in different countries will begin to increase. According to organization members, protests have already broken out and are increasing in a number of countries in Africa, and Indonesia, the Philippines, and Haiti due to increasing food prices and another 37 countries are facing food crises.

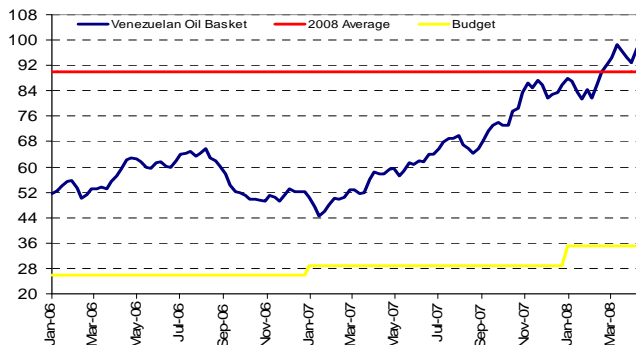
Latin America showing limited development. The 2007-2008 Worldwide Report on Technology released by Cisco Systems reflects that in terms of technological development, Latin American countries are ranked in the last places. Of the 127 countries studied, only four economies in the region (Chile, Barbados, Puerto Rico, Jamaica) rank among the first 50 places.

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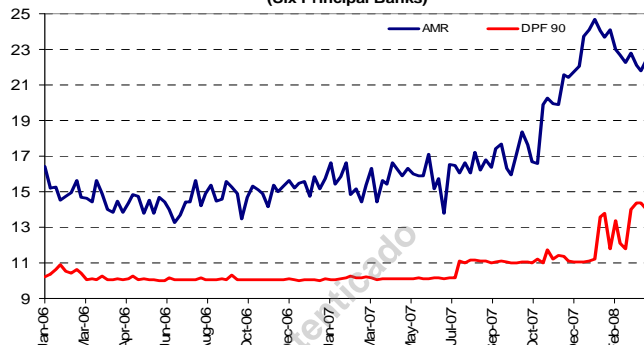
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ECONOMIC OVERVIEW

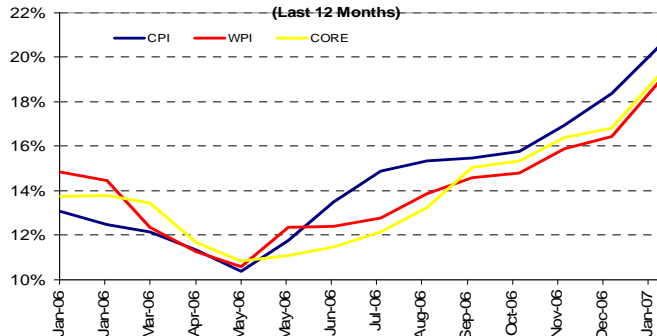
Oil Price
(Venezuelan Basket US\$/pb)



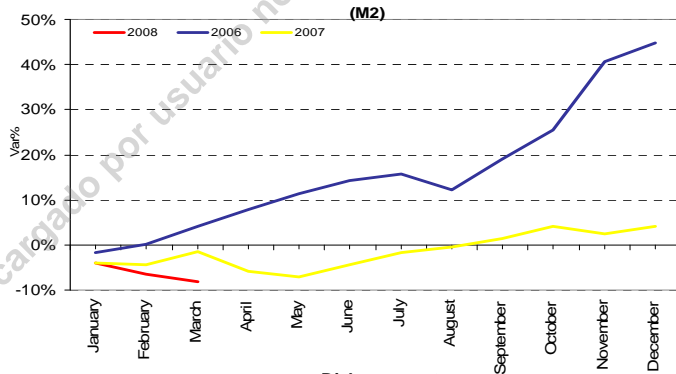
Interest Rate
(Six Principal Banks)



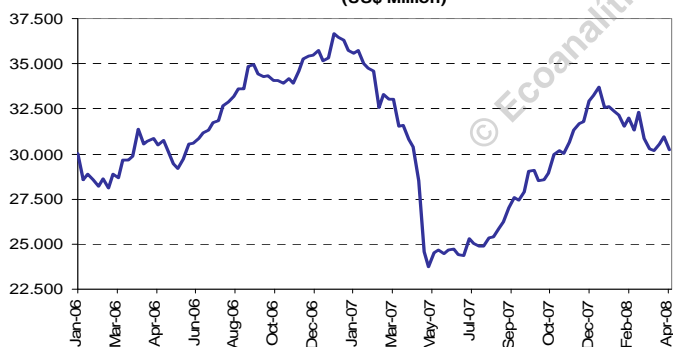
Inflation
(Last 12 Months)



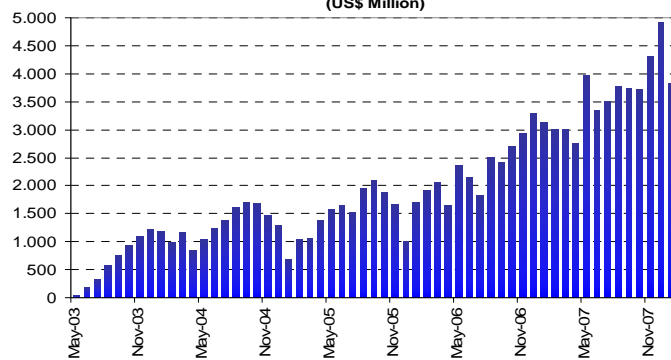
Real Expansion
(M2)



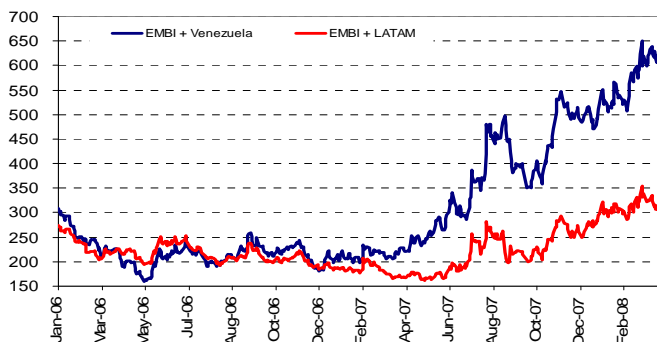
Fx Reserves - BCV
(US\$ Million)



Disbursement
(US\$ Million)



EMBI



Central Government
(VEB Billion)

