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IS VENEZUELA GOING THROUGH AN ADJUSTMENT PROGRAM?

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During the last few weeks, a number of economic analysts have pointed out that the Venezuelan Government, since the beginning of 2008, has been implementing an adjustment program much like the famous adjustment package forced on countries in problem by the IMF during the 90s, which also included Venezuela. It's true that the Government has introduced some changes to its economic policies during the first five months of the year, but these "changes" can't really be classified as an adjustment or a structural change in the way the it pretends to solve the problems that are currently affecting our economy or that they will lead us on the path to sustainable growth.

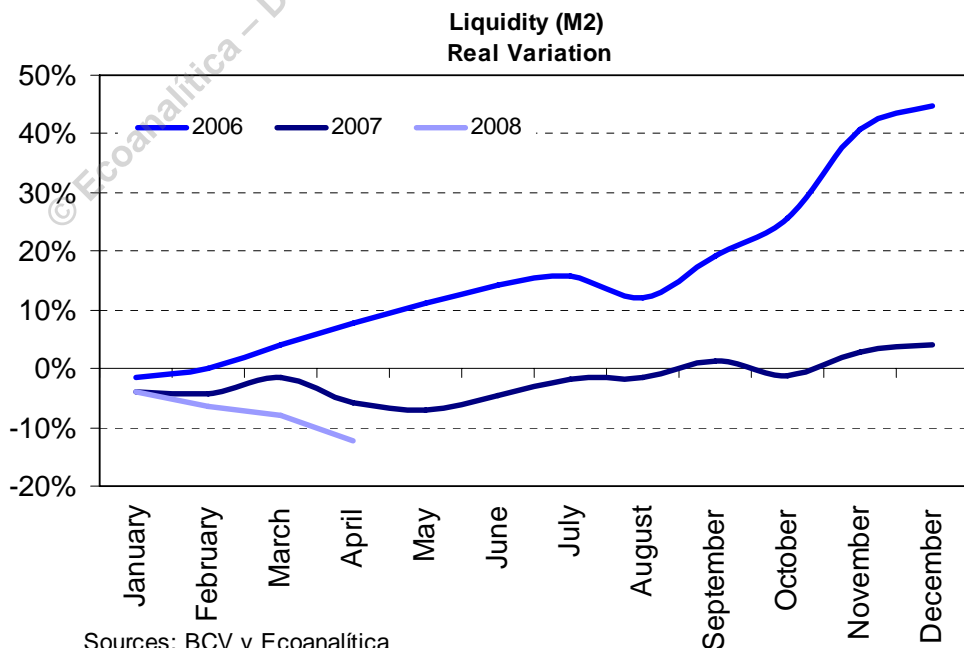
A more pragmatic Minister

Many analysts though that by appointing Rafael Isea, who was the president of BANDES, to the office of Minister of Finance, that this signaled a future of very little change in the way things were being done and that significant changes were not to be expected. However, Isea and his group understood that there were two main things that had to be dealt with right from the start: the high inflation and the instability of the foreign currency parallel market.

The economic package” has been successful at containing the foreign currency swap-market

First, we’re going to refer to the issue of the foreign currency swap-market. At *Ecoanalítica*, we have always thought that a successful strategy for dealing with this market was to take into account the corporate sector and to manage the expectations concerning the permanent offer of instruments. Isea and his team seem to have understood this, and contrary to their predecessors, they have not only designed issues of significant quantities (Republic and EDC), but they have also permanently offered structured notes in US-dollars which have significantly appreciated the unofficial foreign currency exchange market.

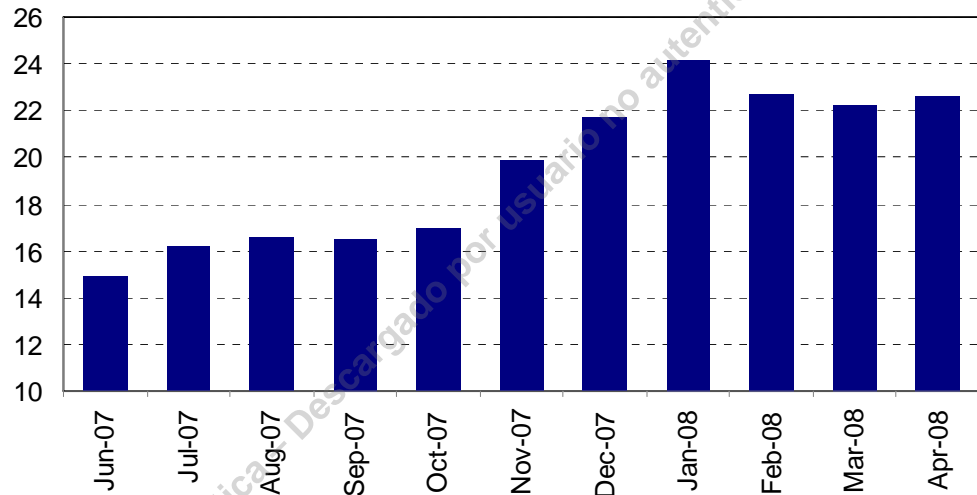
It would be naïve to think that other mechanisms haven’t also been put into effect so that this new exchange strategy would be successful. Among those mechanisms that have been launched, in our opinion, fiscal and monetary policies which have been introduced since the end of last year standout. Specially, those which have to do with the more efficient managing of public funds by private banks which has translated to the transfer of said funds from the private financing system to State-run banks. Additionally, the National Treasury has searched for a way to establish a reordering of the payment orders which has had a lot to do with the very moderate growth reflected by monetary aggregates.



In order to reduce inflation, a way to slow down consumption has been sought.

It's true that if one looks at the foreign currency swap-market right now it looks pretty much under control and leveling off, "for now." But, when it comes to the issue of inflation, the Government has yet to make any significant positive strides. As part of some of the new measures being introduced, the Central Bank of Venezuela (BCV) has increased interest rates in order to slow down consumption. However, given Venezuela's current economy's growth dynamics, these measures have had a very limited effect.

Average Active Interest Rates
%



Sources: BCV and Ecoanalítica

Though most of the economic indicators point to the Venezuelan economy as one that is beginning to cool down, it grew by 5.5% during the first quarter of this year compared to last year. Consequently, this reflects the limited effect that policies have had on slowing down consumption.

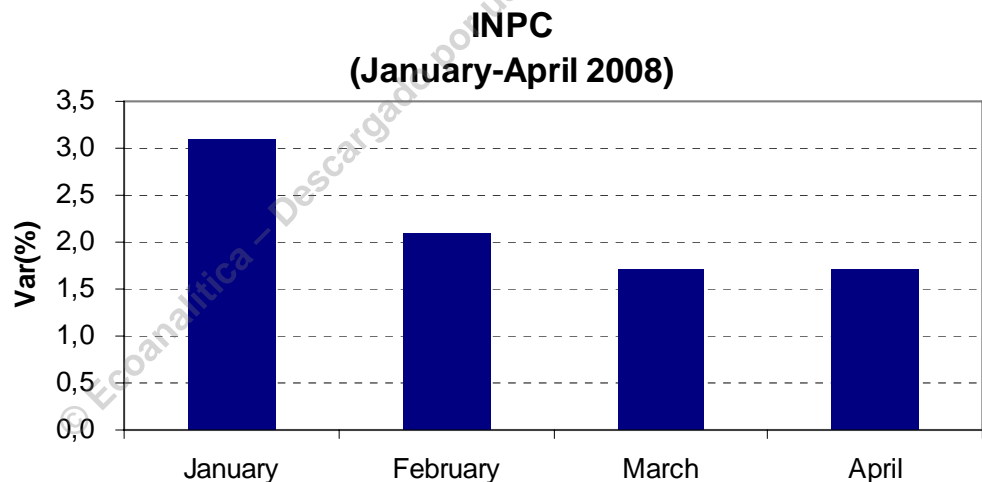
The Government has begun to recognize the failure of price controls

In order to avoid problems with shortages getting worse, the Administration has begun to recognize the increase in prices in some items, especially food items. Furthermore, it has increased its subsidy policies through MERCAL and PDVAL, mainly with imports. In other words, a typically orthodox program which recognizes that prices are increasing and awards subsidy to certain items in order to soften the impact of shortages.

Inflation continues to rise

The question that one has to ask is: why is inflation still so high? For us it is quite clear, the main cause of inflation is still intact and it's non other than the imbalance between supply and demand. This is not only explained by the economies recent expansion, but by the fact that there is virtually no private investment and the official posture which is quite aggressive and creates a lot of doubt as to what the Government may have in mind with future measures and actions.

It's important to note that the Government has been aware that inflation was one of its biggest problems for over two years now. It has not been solved nor gone down, not necessarily for a lack of measures being implemented. Even the more traditional signs of increasing inflation have not been checked like price increases, fiscal restrictions, and increasing interest rates. As long as the Economic Cabinet doesn't become aware of these issues, inflation will continue to rise and be the Achilles' Heel of the current Administration.



Sources: BCV y Ecoanalítica

Why can one expect in the future?

The next few months are of vital importance to the Government, not only because of the upcoming regional elections in November, but also because of the challenge that keeping the parallel market foreign exchange rate in check presents and the efforts to lower inflation.

There are a lot of rumors circulating about Ministers being replaced, new bond issues, new structured note policies, and CADIVI paper, among others. But only one thing is certain: fiscal injection of resources will be very substantial, especially with oil prices being so high.

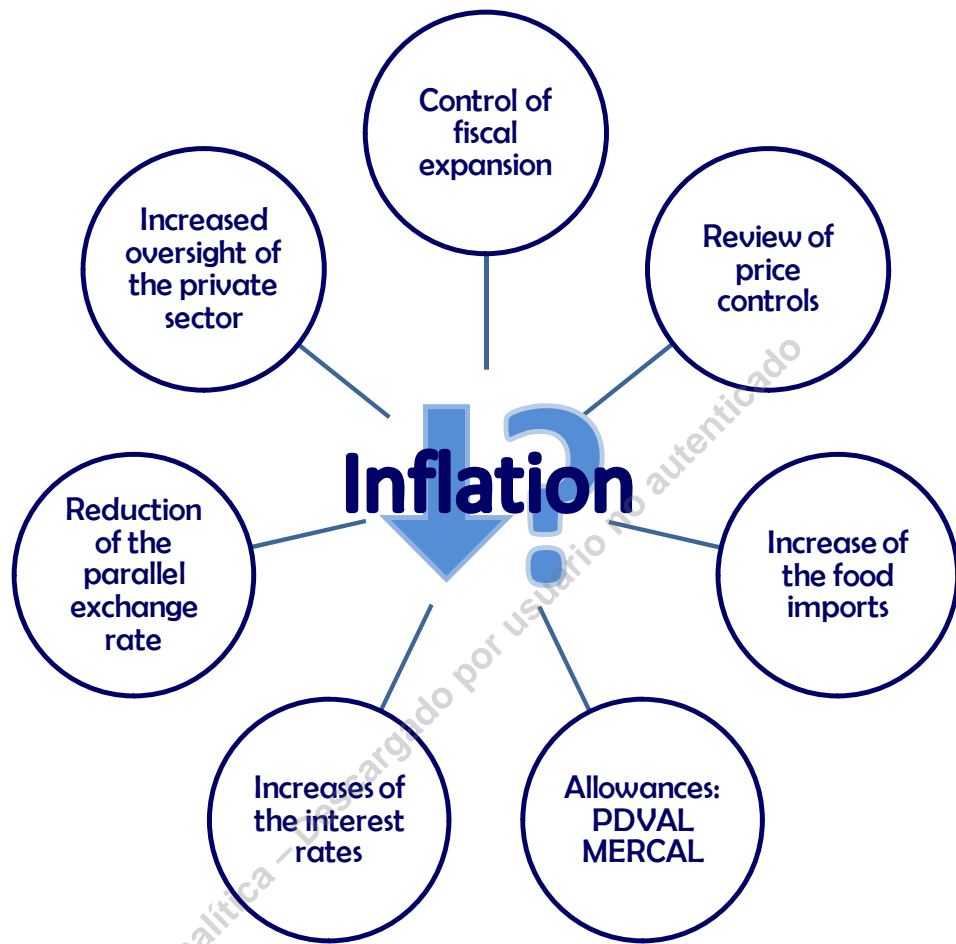
A lot of strategies to deal with the parallel market

So, any anti-inflationary policies or exchange control policies that are in the works will have to deal with this fact which will make it more difficult to achieve positive results. With regard to the foreign currency swap-market, the Government must maintain the basic fundamental premises, a steady secure supply of foreign currency issued through bonds or structured notes, and to not neglect the corporate. How can it do this? With Argentinean bonds (US\$ 1.0 billion in stock and it very likely that another US\$ 2.0 billion more may be acquired), with structured notes (US\$ 500 million, plus a new design is being proposed, a new modality of the type of instrument where the risk isn't Venezuelan) and with the National Treasury and PDVSA (in the management of their payments). So it's not impossible, though it will be difficult, to keep the foreign currency swap-market in check.

Not so many to attack inflation

On the other hand, with regard to inflation, the situation is much more difficult and we don't see how the Government will be able to get a handle on this situation. Even if it intensifies its subsidy policies, the aggressive posture being reflected by the Administration with its nationalizations and expropriations, and attacks aimed at recognized and respected corporations, among other things, all point to domestic supply continuing to lag significantly behind local demand, and the pressure on prices will continue.

The Government has always been willing to sacrifice inflation over for growth because it feels that it gains more political points this way. However, the way things are looking, we are not so sure that this is true.



A lesson to be learned

In 2002, the drop in oil prices, and fixing the exchange rate in order to contain inflation, forced the Government to cutback on public spending, to stop saving in the Stabilization Fund, and to abandon the exchange bands system which devaluated the currency and establish a system of auctions. This was followed by the paralyzing of the private and oil sector. Within this framework, the Government persisted in acquiring debt as a mechanism to obtain resources and withdraws more than US\$ 6.0 billion from the Stabilization Fund. It also increases the VAT rate and reintroduces the IDB (Bank withdrawal tax).

These adjustments were all very orthodox and followed the IMF playbook right down the line, the same IMF which is so hated by President Chávez. In view of the changes recently being introduced, it seems like President Chávez becomes very pragmatic when it's time to make

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economic decisions that could be considered very orthodox. The measures that have been introduced since November of last year makes us think that economic policies are subordinate to political survival strategies. So, it looks like President Chávez will continue to introduce measures of an orthodox nature (IMF-like) in order to avoid any serious collapse that may put his political future and hold on power in jeopardy

Economic Tips

New supplementary appropriations approved. The National Assembly approved six new supplementary appropriations for VEF 856.5 million with most of the funds earmarked for back-wages and retirement benefits owed by Cadafe, Edelca, Enelven, and Enelbar (VEF 400 million) and to the national vaccination plan (VEF 244.9 million). The rest will be distributed among the Governor's Office of the state of Barinas and the Ministries of Social Participation and Protection, Finance, and Housing. Added on to this is extraordinary spending (through supplementary appropriations) which is at VEF 21.90 billion which increases the Budget by 14% in three months.

SENIAT has collected 35% of the taxes estimated for this year. According to the SENIAT, taxes collected for the month of April reached VEF 8.13 billion which totals VEF 26.19 billion for the first four months of the year in taxes collected. The total estimated taxes to be collected for the year are VEF 73.00 billion. Accumulated tax collection registered a real negative variation (-15.9%) compared to the same period in 2007. The category of tax most collected is Income Tax (35% of the total collected).

NATIONAL TAX COLLECTION
(VEF Millions)

APRIL				
	2008	2007	Var %	Real Var %
TOTAL	8.127	8.023	1,3%	-21,7%
Income TAX	3.393	5.245	-35,3%	-50,0%
Tax	1.594	1.398	14,0%	-11,8%
Customs	1.425	1.244	14,5%	-11,4%
Others Incomes	386	135	186,1%	121,2%
ITF	1.329	0	-	-

JANUARY- APRIL				
	2008	2007	Var %	Real Var %
TOTAL	26.189	24.542	6,7%	-15,9%
Income TAX	9.150	12.603	-27,4%	-42,8%
Tax	6.234	6.307	-1,2%	-22,1%
Customs	5.015	5.159	-2,8%	-23,4%
Others Incomes	1.303	474	175,2%	116,7%
ITF	4.486	0	-	-

Sources: SENIAT and Ecoanalitica

BCV must approve public sector foreign accounts. The BCV reminded the public sector that in order to have foreign accounts they must request authorization from its board.

FONDEN has a new source of financing. Part of these new supplementary appropriations will be financed with last year's surplus resources deposited in the Miranda Fund. They will be transferred to FONDEN which used to only receive resources from the BCV and PDVSA.

30% of the Budget used. Preliminary figures from the Ministry of Finance show that at the close of first quarter 2008, public spending is at VEF 157.00 billion which equals 30% of the year's Budget.

Worldwide crisis won't affect Venezuela. The Government estimated that the worldwide food crisis which international organizations are warning about won't affect Venezuela. The Minister of Food, Félix Osorio, pointed out that the Government has been introducing a series of agro-food measures in order to add

incentives for domestic food production so as to not have to depend on imports in the future.

International reserves. For the second week of the month of May, international reserves are at US\$ 30.13 billion, down by 2.29 percentage points compared to the previous week.

Interest rates. The lending interest rates for the six main banks in the country for the first week in May was at 24.66%, up 2.01% compared to the previous week. The savings interest rate was up 2.31% to settle at 17.10%.

Monetary liquidity. Monetary liquidity (M2) was at VEF 151.28 billion during the first week of May, down 2.73% compared to the last week in April.

OIL TIPS

The Venezuelan oil basket continues to rise. The Venezuelan crude oil and oil by-products basket increased by US\$ 4.67 (4.3%) to settle at an average price of US\$ 112.27 per barrel. This mid-week price pushed the accumulate price for May up to US\$ 108.32, up more than US\$ 8 than the April average. The 2008 accumulate price is at US\$ 93.96, up US\$ 29.22 more than the price was last year.

WTI breaks another record. International oil prices closed last Monday, May 19th at US\$ 127.05, up 76 cents from last Friday's price.

Financing through agreements. According to President Chávez, PDVSA supplied around 500,000 b/d of crude oil and oil by-products to those that benefited from the energy agreements that were active in 2007, among which are: Petrocaribe, Caracas Energy Agreement, and Integral Cooperation Agreements with Cuba and Argentina, which implies financing for US\$ 3.0 billion.

A lot of help to Nicaragua. Since 2007, Venezuela has sent Nicaragua 10 million barrels of crude oil a year with a very lax payment schedule. Profits from the business are managed by the mixed company Albanisa, made-up by both countries. According to Daniel Ortega, President of Nicaragua, the oil that the country receives from Venezuela has generated around US\$ 520 million in revenues which have already been spent on energy projects, building roads, and fighting poverty.

ALBA will finance fuel in Nicaragua. After a strike which started last May 5th in Nicaragua, the Government of that country agreed with transportation workers to introduce a subsidy of US\$1.3 a gallon for diesel. The Minister of Interior of Nicaragua announced that the funds for said subsidy will come from the ALBA countries, authorized by President Chávez.

Venezuela recognized for its low gasoline prices. Venezuela is known around the world for having the cheapest gasoline prices in the world. A liter of the most expensive gasoline in Venezuela costs US\$ 0.04, while in Alaska, the same liter of gasoline costs US\$1.06. It's been 10 years since the country has increased its gasoline prices.

And it will remain the same. Even though in January 2007, President Chávez publicly ordered the Minister of Energy and Petroleum, Rafael Ramírez, to study the possibility of increasing gasoline prices, this course of action was discarded, as the President himself admitted just a few weeks ago, in the middle of one of the biggest jumps in international oil prices ever recorded.

Energy pact expanded. The Agreement to Exchange Crude Oil for oil By-products between Petroecuador and PDVSA will be expanded to an agreement whereby both companies will be able to exchange oil and other hydrocarbons for up to 100,000 b/d. The aim is to diversify the basket of by-products exchanged.

"Meritocracia" bonus hasn't been paid. According to Savariego, one of the directors of the United Federation of Power Workers of Venezuela (Futev), PDVSA workers haven't received their Electronic Food Card increase which was supposed to kick in last April, according to the collective bargaining agreement signed last year.

Venezuela dropped to fifth place. According to figures from the Energy Information Administration, Venezuelan crude oil exports went from 945,000 b/d in February to 858,000 b/d in March. This reflects a drop of 87,000 b/d (9.2%) which dropped Venezuela from fourth to fifth among U.S. oil suppliers after Canada, Saudi Arabia, Mexico, and Nigeria.

Subsidy inflates. With the increase in oil prices, the subsidy given to gasoline, which is the difference between foreign gasoline prices and domestic gasoline prices, continues to inflate. The subsidy is slightly more than US\$ 10.0 billion a year, without counting the subsidy for diesel and natural gas for vehicles.

Compared to last year the drop in shipments is even greater. If you compare crude oil shipments from last March with those from March of 2007 you'll notice that the drop is even greater, around 178,000 b/d. While during the first quarter of 2007, Venezuela shipped an average of 1.03 million b/d to the U.S. During the same quarter in 2008, it shipped 980,000 b/d, a difference of 5% or 53,000 b/d.

Oil by-products also drop. The average shipment of Venezuelan oil by-products to the U.S. was at 157,000 b/d, down by 29,000 b/d compared to February. Between January and March of this year, Venezuela sold 166,000 b/d in oil by-products to the U.S., down by 78,000 b/d compared to what was shipped during the same period last year.

PDVSA getting a new loan. In the next few days, PDVSA expects to sign an agreement which will allow it to receive a loan for US\$ 3.50 billion granted by the Japanese companies Sumitomo and Itachu Corporation. According to unofficial sources, the agreement establishes that the loan will be paid with Venezuelan crude oil, just like what was done last year with Marubeni and Mitsui, two other Japanese companies. The funds are expected to be used in the Oil Seeding Plan, more specifically, in the modernization of the El Palito and Puerto La Cruz refineries.

PDVSA. PDVSA and its subsidiaries total debt is at US\$ 16.01 billion at the close of 2007. Of the total debt, more than US\$ 13.0 billion was acquired in 2007 through public and private debt with banks and foreign companies. If the agreement with the Japanese companies goes through, the company's total consolidated debt could reach US\$ 19.50 billion, not including the US\$ 4.0 billion loan it requested by the Republic of Venezuela from the Chinese at the end of last year, guaranteed by PDVSA through an agreement to supply 100,000 b/d of fuel oil.

A positive step. Despite the fact the current high oil prices would allow PDVSA to undertake its investment plans without getting debt (see our last report: For now... PDVSA doesn't have anything to worry about), at **Ecoanalítica** we believe that the agreement is positive, since it means halting the decline in production. In addition, it is important that PDVSA didn't decide to make bond issue, in which case the Venezuelan credit risk would be adversely affected.

BUSINESS SECTOR TIPS

Bandes buys bank in Bolivia. According to the Bolivian Stock Exchange, Bandes bought 94% shares of the private financial fund, Prodem de Bolivia, which specializes in micro-credits. Prodem has 90 agencies and services 25,000 clients.

INDECU following up on Plan Venezuela Móvil. The Institute for the Defense and education of the Consumer (Indecu) is making systematic visits to vehicle assembly plants in the state of Carabobo in order to monitor their progress with regard to complying with Plan Venezuela Móvil, due to the number of complaints its office has received.

INDECU warns of price gouging. The president of the Indecu, Eduardo Samán, maintains that there are strategies in play from the private sector which are hurting the poor sectors of the population around the country. It's been months since the Administration adjusted the price of chicken but distributors and merchants are still overpricing the product in order to create discontent and anguish among the population.

Shortage in some products persists. Despite the fact that the supply of many food items has improved, there are still structural problems that affect some items like tomato sauce, oatmeal, and oleaginous products. The Venezuelan Chamber of the Food Industry (Cavidea) pointed out that in the case of ketchup, for every kilo that is produced, 45% of the investment is lost since the fixed price to the public doesn't cover the cost of the raw material.

This situation affects family spending. A recent study carried out by Kerrygan shows how housewives have gone from having a purchasing strategy of supermarket products that was based on brand names and quality to one this based on availability which forces them to pay more for those products they can't find so easily.

Importing meat from Colombia drops. According to the Colombian vice-minister of Food, Rafael Coronado Patiño, its neighboring country and main trading partner unilaterally reduced the amount of meat Venezuela is importing. It went from importing 250,000 tons of meat a year to this year only importing 5,000 tons, according to official figures.

Confagan calls for a solution to the Cattle sector problem. The president of the Bolivarian Cattle and Agriculture Confederation of Venezuela (Confagan), José Agustín Campos, announced that prices have to be adjusted as well as investment

in roads and better technology. He said that accumulated inflation has had a very negative affect on the sector's profit margins.

Corn crop to increase. According to the vice-minister of Agro-Foods and Agro-Production Circuit Development of the MAT, María Fernanda Sandoval, the total area planted in corn for 2008 will increase by 45%.

Electrical appliances continue to increase in price. So far this year, electrical appliances have increased in price by between 15% and 20%. However, the supply doesn't compare to 2007 and merchants report that product turnaround has been minimal during the first quarter.

"Books" are on CADIVI's non-priority item list. The Venezuelan Chamber of Books and Venezuelan Editors warns that the free circulation of books is in danger since they have been catalogued as non-priority items by CADIVI. So, in order to import books, a certificate of non-domestic production or insufficient production issued by the MILCO is required.

Rent prices remain frozen. The *Gaceta Oficial* No. 38.931 dated May 15th, the Ministries of Infrastructure, housing, and Light industry published a resolution that established that rent prices will remain frozen for another 6 months.

Ciudad Guayana with power problems. People living in this area demand that the situation be solved quickly and that funds be invested to improve the electric power distribution system in Ciudad Guayana which on average is suffering 15 power outages a day.

Investment for the electric power sector. The Government expects to invest around US\$ 3.58 billion in the National Electric Power Sector (SEN) during the next four years (2008-2011) in order to satisfy the high energy demand and ease the current operative systems load.

Production promise. The Ministry of Basic Industry and Mining and the Brazilian group Andrade Gutiérrez signed a letter of intent to begin the construction of a social production National Steel Company that will be working out of Ciudad Piar and alongside Sidor. It would produce special steel for the military industry and construction. It's expected to begin operation during the last quarter of 2011.

Government expects to build block factory with Belarus. The National Assembly is about to declare as being in the interest of the people the appropriation

of land in the state of Miranda that include a number of clay mines. The Government aims to build a block factory there called Alfarería Belarús.

No definite plan. PDVSA, in charge of the negotiation of the cement company purchases has yet to define an acquisition scheme because two of the companies are open capital and their stocks are traded on the Caracas Exchange. This situation is much like it faced with the nationalization of Cantv and EDC last year.

Polar operations stopped. The National Institute for Prevention, Health and Job Security stopped operations on the nine lines of containers at the Polar Brewery located in Los Cortijos after it had inspected the premise. The company failed to comply with certain standards that are required. If the order to stop operation continues for an extended period, between 1 and 1.5 million liters of *malta* and beer will not be produced daily.

Central planning Commission created. According to what was published in the G.O., the commission will assume the control, administration, and supervision of the National Civil Aeronautic Institute (INAC) and the SATA. Ramón Carrizales, vice-president of the Republic will be president of the Commission.

Political Tips

Colombia denies troop incursion into Venezuela. Last Sunday, the Colombian Defense Minister, Juan Manuel Santos, denied that Colombian troops had crossed over into Venezuela in Apure state, as was stated by the Venezuelan Government which sent a diplomatic note of protest.

As if we were at war... The Government plans to acquire air and naval material for the Armed Forces from Russia for an amount of almost US\$ 2.0 billion. President Hugo Chávez is expected to arrive in Moscow for an official visit towards the end of May to sign the corresponding purchase agreements with Russian President Dmitri Medvédev.

“We’ll find the right moment to introduce the presidential reelection issue” were the words issued by Diosdado Cabello, Governor of the state of Miranda, who classified the defeat of the constitutional reform last December 2nd as a “mistake of an instant” in an interview in the El Universal newspaper.

They weren't altered. After finalizing their investigation of the computers captured in the FARC camp by the INTERPOL, it's concluded that the information on the computers was not altered by the Colombian Government.

Venezuela and the Interpol. The Minister of Interior and Justice, Rodríguez Chacín, announced that by order of President Hugo Chávez, the Government will analyze if it will continue to be a part of the Interpol, after they released their information verifying the contents of the computers found on guerilla leader Raúl Reyes which implicated the President with the FARC.

Other Tips

High fuel prices affect inflation of food item prices. The IMF announced that food prices have increased by 45% since the end of 2006. The main causes being the increase in fuel prices and fuel like ethanol being made out of agricultural products. According to the IMF, half of the price increase in 2007 was due to bio-fuel production.

Venezuela in last place. The study carried out by the Institute for Management Development of Switzerland which evaluates the country's economic performance, Government's efficiency, corporate efficiency, and the country's infrastructure placed Venezuela in last place.

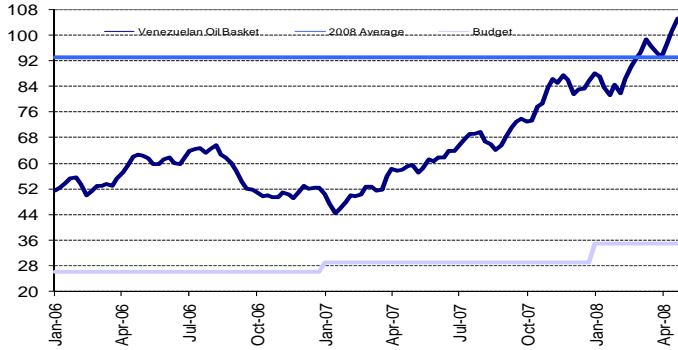
Almost in last place. The 2008 Global Peace Index which considers elements like military spending and human rights placed Venezuela at 123 out of a total of 140 countries.

UN expects less growth in Latin America. In the latest release of the report "Situation and Outlook for the 2008 World Economy," the UN adjusted its estimate of expected growth in Latin America and the Caribbean for 2008, going from 5.7% to 3.1%; the main reason for the adjustment being the slowdown of the U.S. and European economies.

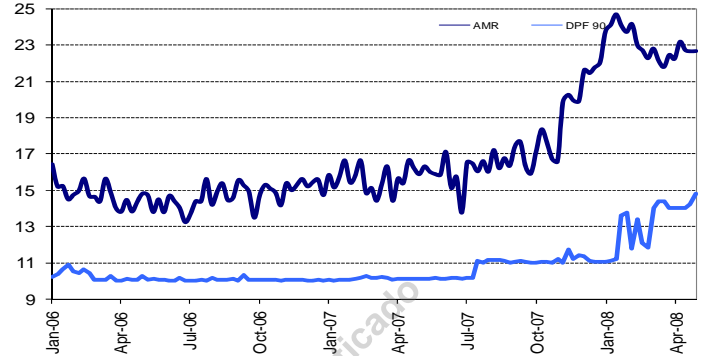
Weekly Report

ECONOMIC OVERVIEW

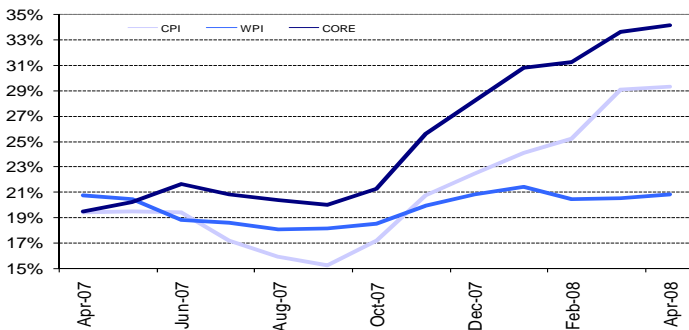
Oil Price
(Venezuelan Basket US\$/pb)



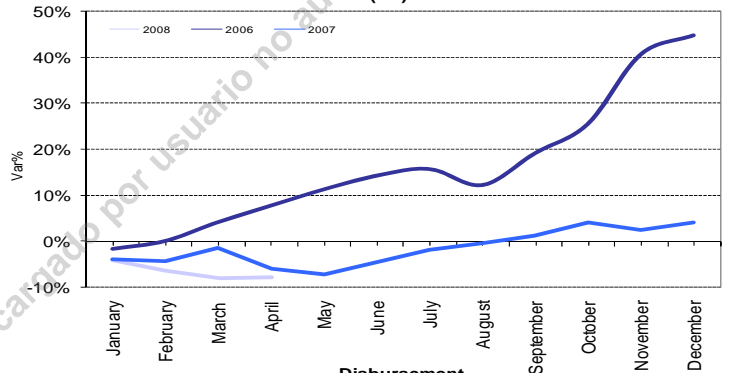
Interest Rate
(Six Principal Banks)



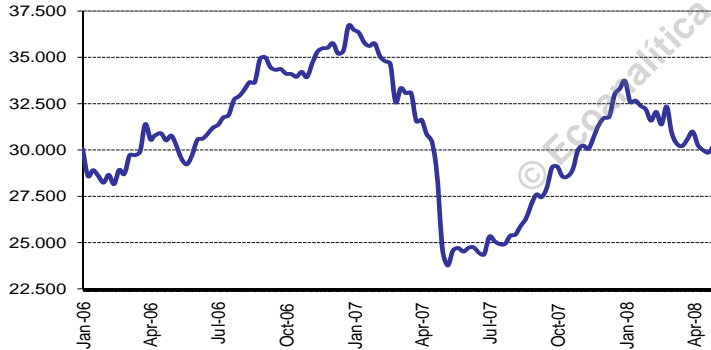
Inflation
(Last 12 Months)



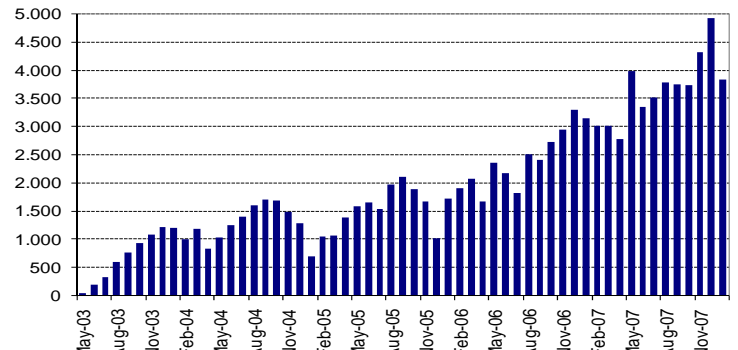
Real Expansion
(M2)



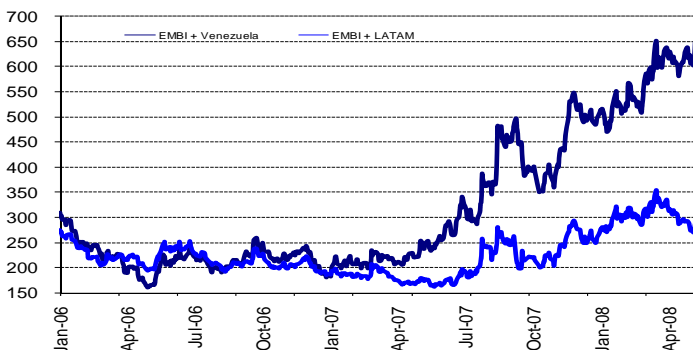
Fx Reserves - BCV
(US\$ Million)



Disbursement
(US\$ Million)



EMBI



Central Government
(VEB Billion)

