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***The exchange rate:
Everything you have
always wanted to
know but were afraid
to ask***

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THE CLIENT

Despite the low volatility of the exchange market, we should watch the fundamentals that tend to move this sector: the oil price, fiscal policy, inflation, etc. It seems that the decision has already been taken not to devalue in 2006. However, we do not think that the calm in the parallel market in the first quarter of this year will continue into the second half. In fact, the political climate and rising expectations of devaluation will put pressure on the parallel market. So in 2007, we forecast a 16% devaluation of the official exchange rate to 2,500 VEB/US\$.

Devaluation of official exchange rate remote this year

Ecoanalítica did not rule out a devaluation in the first quarter of 2006. We explained this reasoning as a cost-benefit decision between additional revenue of VEB10 trillion which the central government would receive from the raising the exchange rate to 2,300VEB/US\$ versus the additional cost of two or three points of inflation. Although Planning Minister Giordani wants to use exchange policy as a tool to combat inflation, he has never advocated a fixed nominal exchange rate. We believe that Giordani, who is concerned about the competitiveness of the country and wants to avoid overvaluation, favors depreciating the exchange rate at a lower rate than inflation.

As elections approach, the benefits of devaluation decline and the political costs rise. Since President Chávez did not take the decision to devalue in the first three months of the year, we no longer expect a depreciation of the official exchange rate during the rest of the year.

**Not devaluing today,
simply means
devaluating more
tomorrow**

Ecoanalítica has no doubt that the administration will be forced to devalue in 2007. This conclusion is based on an analysis of the fiscal accounts. As we commented in the last report, the fixed exchange rate will cause a decrease in oil revenue in 2006 of 1.3 points of GDP, despite an expected 8% rise in the oil price. Exchange stability depends on fiscal discipline, and as we never tire of saying the main characteristic of Venezuelan fiscal policy in the last 35 years has been the exact opposite: spending until nothing is left. Until the administration understands the need for a very austere fiscal policy, Venezuelans will be condemned to macro-devaluations and general impoverishment. This debate is not about right or left. Brazil, Chile, Argentina and other countries considered as left leaning have understood that exchange and price stability depend on responsible public finances. We expect the administration to devalue the currency to around 2,500 VEB/US\$ in the first quarter of 2007.

**This does not mean a
calm exchange market**

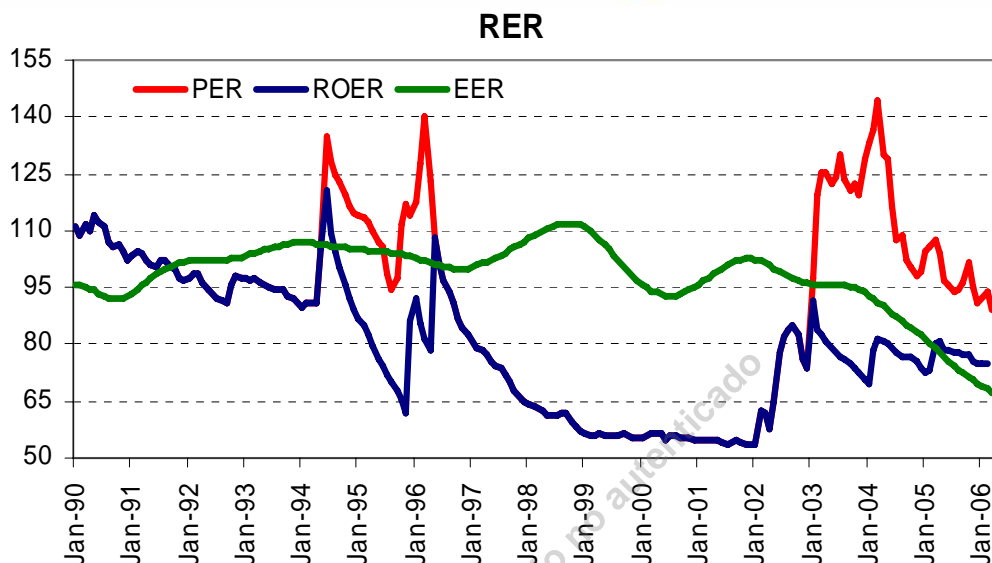
Maintaining the official exchange rate is not necessarily a recipe for low volatility on the parallel or bond swap market. In the second half the year, in the heat of the election campaign and with rising expectations of devaluation, the parallel market will come under increasing pressure. Its level at the end of the year will basically depend on how many debt operations involving Venezuela and other Latin American countries the Finance Ministry makes in the second half. If the Ministry sells US\$4.20 billion to US\$5.80 billion¹, our model shows that the parallel exchange rate will end the year at around 2,817 VEB/US\$.

**In the last three years,
the exchange rate has
appreciated in real
terms; however given
the higher oil prices this
exchange rate is
sustainable**

The next chart shows the real official, parallel and equilibrium exchange rates, taking into account the effect of oil prices on the latter. A fall in the index represents an exchange appreciation and a rise a real depreciation. Since the implementation of exchange controls, the official exchange rate has appreciated in real terms 18.5%, while the parallel exchange rate has appreciated only 6.5%.

¹ This number comes from the sale of Latin American bonds at US\$60 million a week and from one or two debt operations (open to the public) totaling US\$1.60 billion.

Weekly Report



This exchange appreciation has taken place amidst a record increase in oil prices, which can maintain the real exchange rate at these levels and even at levels of undervaluation. If current oil prices are maintained, the equilibrium dollar would be around 1,940 VEB/US\$ in March this year. However, if oil prices fall to their real average of the last 15 months (24.62US\$/bl), overvaluation of the official rate would be 25%, giving an equilibrium exchange of 2,687.5VEB/US\$. Prepare your own oil scenario, and make your own conclusions. **Ecoanalítica** continues to recommend a very conservative projection of oil prices.

Economic Tips

March inflation at 0.9%. According to the Central Bank, in March the CPI gained 0.9%, more than in February (-0.4%) but less than in March 2005 (1.2%). Total inflation in the first quarter was 1.3%, less than in the first quarter of 2005 (3.3%) and 12.1% year-on-year, down from the same period last year (15.8%).

Controlled prices rise most. The inflation of controlled goods and services increased 1.0% while non-controlled prices rose only 0.8%, moderated by the low impact of the food and non-alcoholic beverages group (0.3%), which continued to be favorably affected by falling farm prices (-1.6%).

Home building is the key. The increase in the month-on-month rate of the CPI from minus 0.4% to plus 0.9% was largely due to the housing services group, which recorded the highest increase in the month from 0.5% and 3.8% following the hike in electricity charges. Education services also grew significantly (1.5%).

Chaos. The Ministry announced that the government was planning early repayment of US\$200 million in debt with the World Bank. The World Bank announced that it would disburse four new loans in the next two years for an estimated US\$200 million.

Jobs freeze extended, but only for the private sector. Labor Minister Ricardo Dorado said the job freeze would be extended until September 30. The decree protects workers who earn under VEB633,600 a month. This type of measure is incomprehensible in the midst of an expanding economy. The freeze does not apply to employees in positions of trust, public-sector workers, and workers who have been under three months in a job.

Income tax receipts. Seniat forecasts that income tax collections in March will top VEB2.0 trillion, with total receipts of VEB5.7 trillion, which is 143% of the target. *Ecoanalítica* believes that low targets can always be overshoot.

Oil Tips

Joint ventures get the go-ahead. Just before the deadline, the National Assembly approved a model joint venture that lays down the legal basis for the formation of these new companies.

Orinoco Oil Belt next. After concluding the chapter on the operating agreements, it is now the turn of the companies in the Belt, which still enjoy preferential conditions in relation to the legislation in force. Marketing will also be subject to changes.

Not everything is defined. The conditions for the formal start-up of these new companies are not entirely clear. Valuation of assets has not been completed and there is no agreement on the amounts that PDVSA will recognize for calculating each partner's equity interest. While the Ministry says that it will present the individual model agreements to the National Assembly in the next few days, the companies are asking questions about their future protection amidst a constantly changing legal framework; about the adequacy of the valuations of the assets to

be transferred to the joint ventures; and about the scope of the heated political debate that the changes have provoked.

Strong differences. The gap between the valuations made by CVP and the private companies is very wide so there is no agreement on the net present value of the concessions. Moreover, it has not been possible to agree on an equity interest of around 40%. Lastly, although the process has been granted some legal certainty, the memorandums of understanding are not binding on the final conditions for migration to joint ventures.

Two did not sign. Total and Eni were the two companies that did not sign the memorandum of understanding that marks the start of the migration to joint ventures. Even so, they have not expressed any intention of leaving their other investments in Venezuela. Total operates the Jusepín field which produces 33,000 barrels a day, and ENI the Dación field which pumps 50,000 barrels a day. Both firms have presented expansion projects. According to the published information, a group of 16 operators signed the agreements.

Venezuelan oil goes on rising. The Venezuelan basket of crudes and products rose to \$55.49/bl, ending March with an average of US\$53.74/bl and \$53.24/bl in the first quarter.

Sectoral Tips

VERIZON sells CANTV. Teléfonos de México and América Móvil announced Monday they had signed an agreement, in the form of an integrated strategic alliance, with Verizon Communications Inc (“Verizon”) to acquire its equity interest in CANTV for US\$676.6 million. The acquisition price represents US\$3.01 per ordinary share or US\$21.10 per ADS. The alliance will acquire the CANTV shares indirectly through the purchase of a subsidiary of VERIZON. The Verizon interest in CANTV is approximately 28.51% of total shares in circulation. CANTV is the leading provider of telecommunications services in Venezuela with over 3.1 million fixed-line customers and over 5.1 million cellular customers as of December 31, 2005. The operation is subject to regulatory approval. After concluding the acquisition of the equity interest of Verizon in CANTV, the alliance will make an offer for the remaining shares for the equivalent in bolivars (at the official exchange rate) of the price paid to Verizon.

Three comments and a first recommendation. This operation is taking place at the same time as the sale of Verizon's interest in the providers in the Dominican Republic and Puerto Rico. So they could be paying over the price for these assets, undervaluing the Venezuela assets and leaving the buyers in a better position in relation to the Venezuelan takeover bid and the Securities Commission (CNV). The second comment concerns the indirect purchase of the block of shares. Telmex and América Móvil are acquiring a company that holds the shares. As far as we are concerned, this is no coincidence and should bring advantages to the buyer. Lastly, the commitment is to buy all the shares in bolivars at the official exchange rate, so you will receive a discount equivalent to 20% of your share position, except for those of you who are able to buy dollars at the official exchange rate. Based on these comments, we do not recommend our clients to be very conservative with respect to this transaction.

CANTV dividend approved. The CANTV shareholders' meeting approved a dividend of VEB700 per share to be paid on April 27. The meeting also reelected Gustavo Roosen as president of the corporation, and BANDES President Edgar Hernández Behrens entered as principal director representing the shares of the State.

More pressure on the banks. The government is promoting co-management in private companies. FONCREI President William Fariñas said that the executive will provide VEB500 billion to finance companies that adopt this model. The government has designed an incentives structure in which businesses that maintain a traditional equity structure can opt for loans at interest between 6% and 12%, but those that handover of at least 30% of their shares to workers will obtain financing on much more favorable terms between 0% and 4% interest.

Bill to regulate plastic cards scrapped. The good news for the financial system is that the National Assembly, on the recommendation of the Finance Ministry, will include a special chapter in the Bank Law for credit and debit cards and other electronic forms of payment.

Demand for electricity continues growing. In the first two months of the year, generation by the national electricity system grew 6.9% from the same period of 2005. Power availability for the 12 months to February increased 8.2% from the same period of 2005.

Housing regulation ready. If approved, the new regulations will place a VEB100 million ceiling on real estate values in 26 parishes in Libertador Municipality. The measure, which covers apartments built over 15 years ago with an area of 60 to

90 square meters, is expected to be in force for six months, depending on the rate of execution of the government home building plans. This year, the government plans to build 15,000 units in Caracas at a price of VEB65 million. The application of price bands by parish and suburbs is still being analyzed. Econanalítica believes the only way to stabilize prices in the real estate market is by building low-cost homes to compete with higher priced apartments.

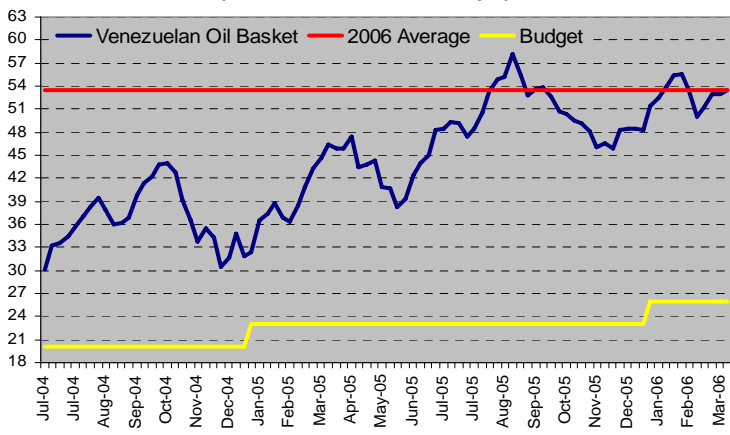
Decision postponed. The Venezuelan National Civil Aeronautics Institute (INAC) decided to extend the deadline for suspending the flights of US airlines for the second time (until April 25). The intention is to give the US Federal Aviation Administration time to raise Venezuela to category 1.

Deteriorating business climate. According to an index prepared by the analysis division of the British publishing group The Economist based on 82 countries, Venezuela is one of the countries with the worst business climate. The country has dropped from 70 to 77 since the last ranking. In fact, most Latin American countries analyzed have moved down the ranking, which is based on over 90 factors, including the attractiveness of the business climate, the political and economic context and macroeconomic stability. The top Latin American country classified is Brazil which moved from 20 to 22 in the ranking. Other countries that lost position were Mexico, Costa Rica, Colombia, while Argentina and the Dominican Republic maintained their positions

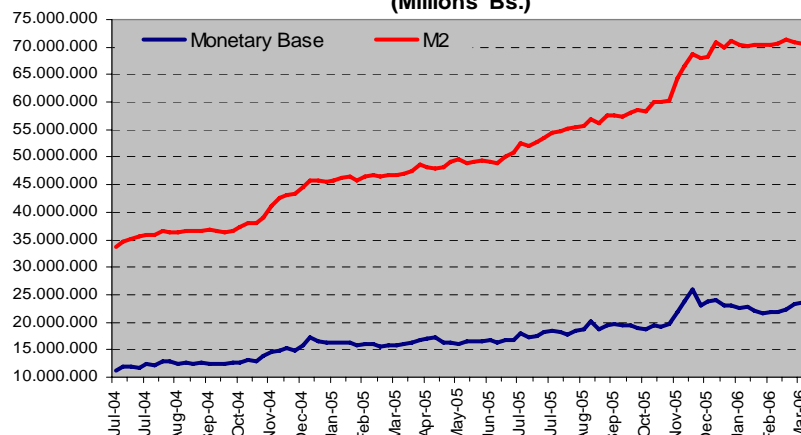
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ECONOMIC OVERVIEW

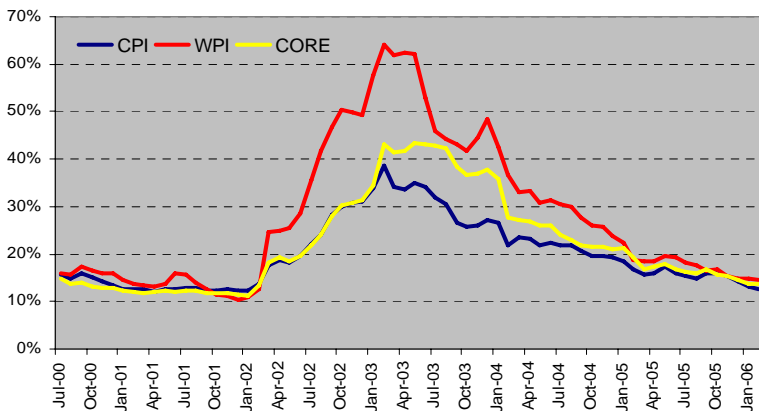
Oil Price
(Venezuelan Basket US\$pb)



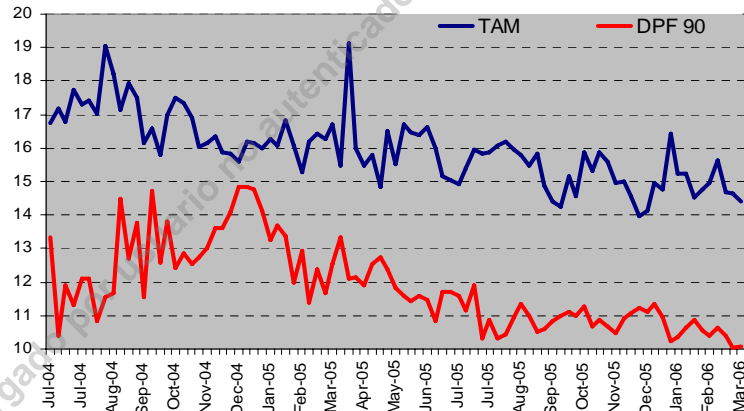
Monetary Base & M2
(Millions Bs.)



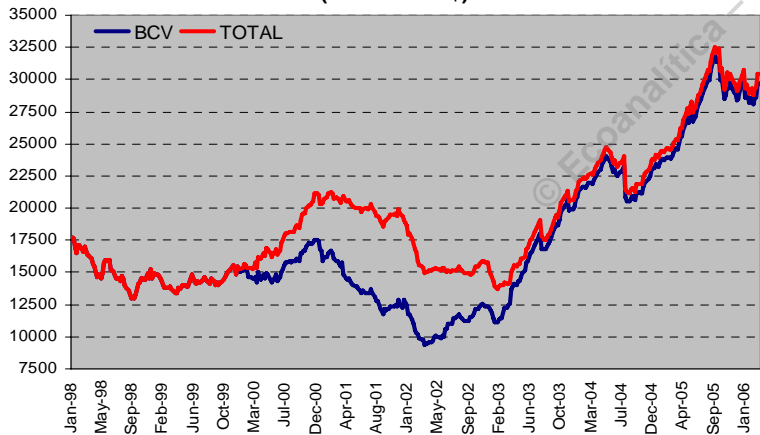
Inflation
(last 12 months)



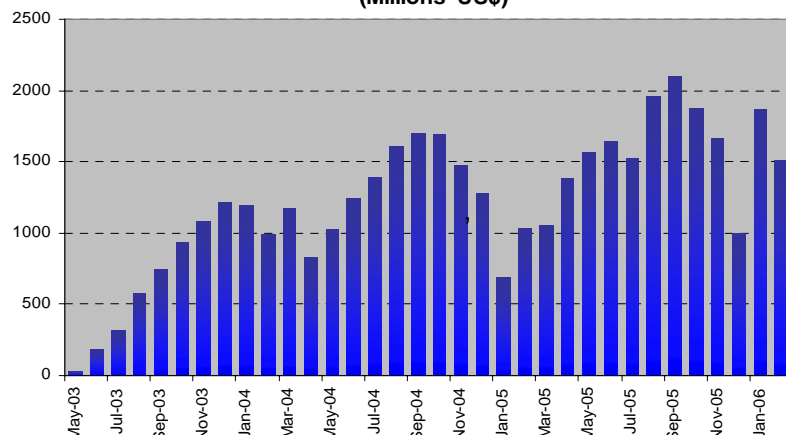
Interest Rate
(Six principal Banks)



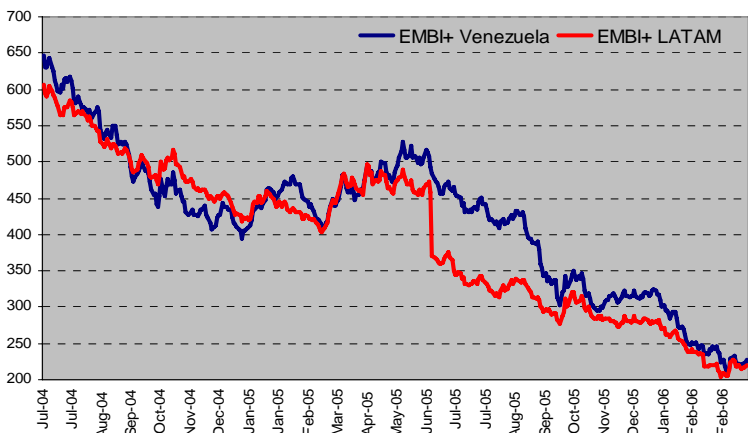
Fx Reserves
(Millions US\$)



Disbursement
(Millions US\$)



EMBI



Central Government
(Billions US\$)

