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Falling country risk but investments stalled

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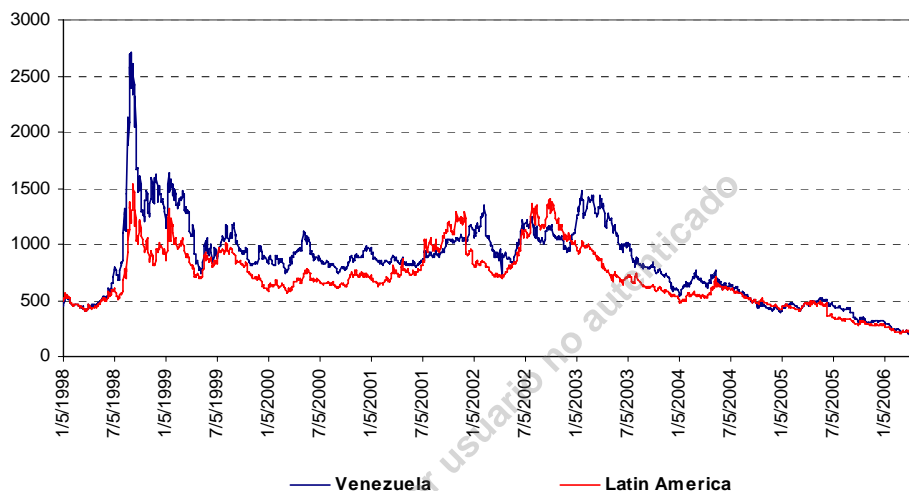
EL CLIENTE

At various times the government has announced that Venezuela has the lowest level of country risk in its history. The yield differential between Venezuelan bonds and US Treasury bonds averaged 180 basis points (bp) on April 19, 2006. This means that on average Venezuelan bonds are now yielding only two percentage points less than US bonds. Despite this positive development, the question is: Why has this not resulted in more and better investments? What is this indicator really telling us?

The fall in the Venezuelan country risk index is the most marked in Latin America

In 1998, the country risk index averaged 969.4 basis points. The Venezuelan risk has fallen 514.9 bp to average 414.5 bp in 2005, a steeper fall than the Latin American average, which fell 325.3 basis points in the same period from 700 to 374.7 bp.

SOBERING RISK (EMBI)



The fall in country risk does not necessarily imply greater confidence or an increase in investments

During the same period, according to Central Bank figures, investment in real terms in 2005 was 3.2% down from 1998. Unfortunately, the Central Bank does not separate public from private investment so this figure includes both. **Ecoanalítica** believes that the figures for private investment have contracted more than the overall figure.

What does the country risk index reflect then?

In Venezuela this index simply reflects oil prices. In 1998 the Venezuelan oil basket averaged only US\$10.7/bl. Recalling that the best estimator of the future oil price is the current price, at that time, the government not only had temporary liquidity problems but was would have had to declare a suspension of payments simply insolvent. Given the expectation that oil prices would remain very low, the government had no capacity to pay its foreign debt and if the price had remained at that level. I was US\$45.3/bl rising to US\$54.4/bl in the first quarter of 2006. In this situation we have an immensely rich government with little risk of insolvency. It's as simple as that. Country risk in a mono-producing economy like Venezuela simply reflects the fluctuations in the oil market.

Rich state. Weak private sector. Poor people

This is the Venezuelan paradox: an immensely rich state, with huge flows of foreign currency, which is incapable of strengthening and stimulating the private sector. The constant threats to property rights, legal instability, indirect expropriations, increased uncertainty, and total unpredictability simply frighten investments away. Without investments no jobs are created, labor productivity stagnates and the purchasing power of wages along with it. Without investments, our population is condemned to poverty. All the countries that have enjoyed sustained economic growth, with appreciable reduction of poverty, have been capable of attracting investments. To do this, the important thing was not the debate between left and right but choosing a direction; and even more important, the maturity to maintain it over time. Unfortunately, Venezuela is a long way from this goal.

Economic Tips

This government has cut social spending. According to data published by the Integrated System of Social Indicators for Venezuela (SISOV), investment in social development is below the 1996-1999 level when the share of this area in total expenditure averaged 25%.

The weight of the missions. According to SISOV, expenditure on social development, which goes into the special programs (missions), last year represented only 8.9% of total social expenditure. In 2005 the funds earmarked for the social area totaled VEB 32.9 trillion, of which VEB 2.9 trillion went to the missions. These figures do not include the funds allocated by PDVSA, FONDESPA and BANDES to the central government social programs. For the restricted public sector, this figure is around VEB 9.2 trillion.

The missions in 2006. According to Finance Minister Nelson Merentes, the missions this year will receive an appropriation of US\$4.50 billion (VEB9.6 trillion). With the increase in revenue this year, the government should be able to increase specific appropriations. In this case the total budget for the special plans will increase the programmed amount by over 70%. The other factor that the minister does not mention is that 2006 is an election year.

Government continues in debt to social security. According to SISOV, public spending on social security fell to 24.5% as a proportion of total social expenditure in

2005, similar to 2002 levels. In per capita terms, this figure was VEB119,109 (US\$55) in 2005, clearly insufficient for all the Social Security subsystems.

Social security reform stalled. The long delay in setting up and applying the Social Security subsystems has generated large losses, the hardest hit being the Venezuelan population. The core social security regimes (pensions and health) have not yet been approved. The laws passed, although not effectively applied, which form the framework for social security are the Labor Prevention, Conditions and Environment Organic Law (LOPCYMAT), the Social Services Law, the Housing and Habitat Law, and the Employment Law.

Leaving the Andean Community of Nations. According to President Chávez, the withdrawal has to do with the signing of the free-trade agreements by Colombia and Peru with the United States.

Not yet possible to assess the repercussions. It is not yet possible to measure the repercussions that this decision could have. Although the president announced Venezuelan withdrawal from the Andean Community at a press conference, Foreign Minister Rodríguez Arraque and Minister Iglesias said that this action "does not cause any change in trade policy with these nations." For *Ecoanalítica*, Andean integration was the most convenient scheme because the economies had similar asymmetries. Integrating with Brazil or Argentina could be more traumatic because of their powerful industrial sectors.

Negotiations must be in bloc. The free trade treaties of member nations of a trade bloc with third parties should be negotiated multilaterally and not bilaterally as in the case of Peru and Colombia. We cannot ignore the fact that the Andean Community represents one third of South American trade, with intraregional exports totaling almost US\$9.00 billion in 2005 and attracting an annual foreign investment flow of over US\$8.00 billion.

Withdrawal will not be immediate. Experts consulted said that Venezuela would not lose all its rights and obligations under the Cartagena agreement immediately. The free trade area and common external tariff should remain in force for five years, unless the countries agree to shorten the period. In the long term, this measure will mean fewer bolivars and pesos in Venezuelan Colombian pocketbooks.

Employment continues falling. According to INE, unemployment fell to 10.1% at the end of March, down 3.4 percentage points from March 2005. The monthly INE report said that the formal sector employed 53.9% of Venezuelan workers (5.9 million), expanding by 573,386 workers last year.

Economically active population (EAP) grows weakly. The EAP totaled 12.1 million against 12.0 million workers in the same month last year. The unemployment rate in March was 34.3%, an increase from 33.2% a year ago. In the last 12 months, the Venezuelan economy has created 542,468 new jobs.

Oil Tips

Venezuelan basket sky high. The Venezuelan oil basket gained US\$2.96 last week to average US\$62.27 per barrel. The average price in 2006 is US\$54.44 per barrel, up US\$9.05 against the 2005 average.

IMF concerned. According to researchers in the organization, soaring crude prices have had less impact than expected on the world economy, partly because inflation is under control and the increases have been backed by stronger world demand. But looking to the future, the IMF is concerned that the rise is beginning to look permanent instead of temporary. The increase in "geopolitical uncertainty" in the Middle East, and the data on financial operations with options suggest that the price is likely to rise to US\$80/bl by around mid-2006.

Interesting suggestions. In the opinion of *Ecoanalítica*, the IMF has often been mistaken in energy matters. However, its recommendations in the current oil situation seem interesting: the IMF suggests that producer countries relax obstacles to investment. They also recommend a more equitable distribution of petrodollars to create a protection network for the poorest sectors in the nations with oil wealth. Lastly they propose an improvement in information on oil markets and more conservation.

Brasken arrives. The government announced that the Brazilian company Braskem signed two agreements with Pequiven to expand the El Tablazo polypropylene plant and study the technical and economic feasibility of the Jose olefin plant, which had originally been negotiated with ExxonMobil. The olefin project, which was dissolved only a month ago for operational and strategic reasons, has been restructured to create a more ambitious plan to cover the Jose and El Tablazo complexes. Braskem will participate with Pequiven in both production centers with equal shares for a total of US\$3.40 billion.

Another company for the State. Pequiven became the new owner of the multinational firm Monómeros Colombo Venezolanos acquiring 47.24% equity interest from the Colombian government. According to Colombian officials, the transaction topped US\$43.5 million.

More on the oil joint ventures. According to CVP President Eulogio Del Pino, the Ministry of Energy and Oil (MEP) and PDVSA are evaluating the reassignment to private firms of the areas separated from the joint ventures after eliminating the operating agreements. The 27,700 kilometers which were returned to PDVSA can now be reassigned to the same oil companies that participated in the joint ventures, particularly those that received credits from MEP for a total of US\$913 million, as reimbursement for part of their investment. The private sector and the administration agreed that the credits would be exchangeable in future opening processes.

Sectoral Tips

Strong growth of non-traditional exports. According to INE, in January this year non-traditional exports grew to US\$1.24 billion, up 142% from the same month last year. The main destination is the United States with 62.6% of the total, followed far behind by the Netherlands and Colombia with 6.1% and 5.6%, respectively. Our main export items continue to be commodities, which represent 83% of the total.

Falling imports. In contrast imports in January dropped a slight 1.8% from January 2005 to US\$1.63 billion. The main countries of origin are the United States 33.9%; Colombia and Brazil 9.3% each, and Mexico 6.3%. The main economic sectors are electrical materials with US\$577 million (35.5%), followed by transport material (mainly vehicles) (14.6%), and chemical products (13.8%).

Small shareholders ready to fight CANTV. Former president of the National Securities Commission (CNV) Aida Lamus called on the CANTV minority shareholders to organize a group to exert pressure during the takeover attempt by Carlos Slim. Lamus said that the authorities should not permit Slim to buy 28.5% of CANTV in a first step, and then make an offer for the rest of the shares. This gives him a sufficiently large advantage to dissuade a possible competitor. "The shares on offer should go into a trust to make a public offering for 100% of the company. If a competitor emerges, good, there will be a fight," Lamus said. She also asked for a review of the valuation criteria used to launch the takeover and the earlier DIGITEL and TELCEL processes.

CVG Telecom moves ahead. The Venezuelan state telecommunications company, CVC Telecom, obtained approval from CONATEL for a nationwide international long-distance telephone service. The company president said that the costs of international calls would be 70% less than the traditional market cost.

Regulation of commissions on the way. The Central Bank board issued a resolution which compiles all the provisions related to charging of commissions, tariffs and

surcharges by financial institutions. However, Banking Superintendent SUDEBAN Trino Alcides Díaz said that the rules that regulate commissions would not be ready until May. **Ecoanalítica** believes that more and better information is the best way to deal with this problem, which would improve competition and enable the users to take the decisions themselves.

SUDEBAN asks National Assembly for powers to regulate commissions under the new Bank Law. Trino Alcides Díaz explained that, although this power is proper to the Central Bank, the agency that he heads could oversee that banks charge users fairly, without speculation, and apply sanctions for violation or non-compliance with the established parameters.

SUDEBAN suggests that it audit the new community banks and that they submit balance sheets. These banks will be responsible for granting finance to communities through the community councils. **Ecoanalítica** considers the suggestion positive and necessary. SUDEBAN should apply supervision criteria to these new banks to avoid a repetition of the very bad experiences with BIV, the People's Bank, and the Women's Bank, among others.

Moving up to category 1. The US Federal Aviation Agency decided to raise the Venezuelan operational safety classification to Category One which means that national airlines will be able to fly north using their own equipment and crews. This decision eliminates the INAC threat to suspend or reduce flights by foreign airlines.

Political Tips

Teodoro decides to run. After a long period of "reflection," Teodoro Petkoff, veteran political leader and editor of the afternoon daily *Tal Cual*, took the plunge and announced his presidential candidacy. Petkoff has to overcome a series of obstacles: low support in the polls, and an image associated with the old political class. **Ecoanalítica** sees this launch as very positive because it has given new dynamism to the opposition.

Primaries dilemma. SUMATE announced its interest in organizing primary elections to pick the single opposition candidate. Behind the NGO's proposal is the idea of synchronizing the presidential campaign with the fight for fair electoral conditions, with a view to a possible withdrawal if they are not achieved. So far, although no candidate has opposed the primaries, not all are keen on the idea.

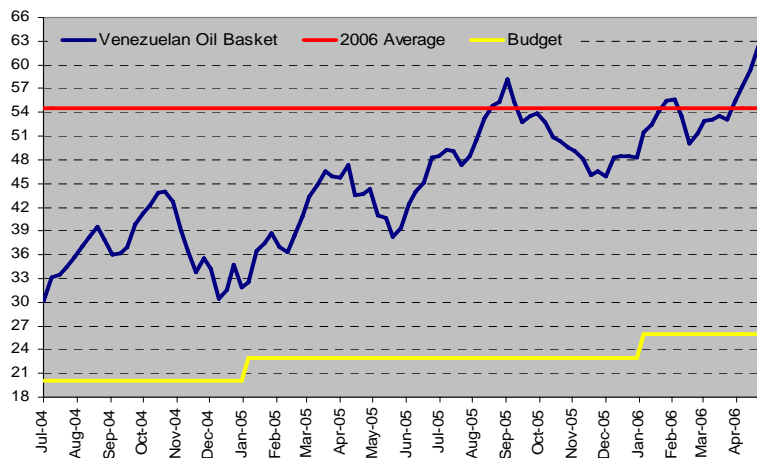
Weekly Report

Waiting for the new CNE. On the day this note is published, the National Assembly will probably announce the new principal members and alternates for the National Electoral Council. The selection and correlation of forces in the electoral body will be a starting point for evaluating the regime's willingness to allow the opposition to take part in the elections. Obviously, a new CNE board is a necessary but not a sufficient condition for guaranteeing transparent elections next December. Time will tell.

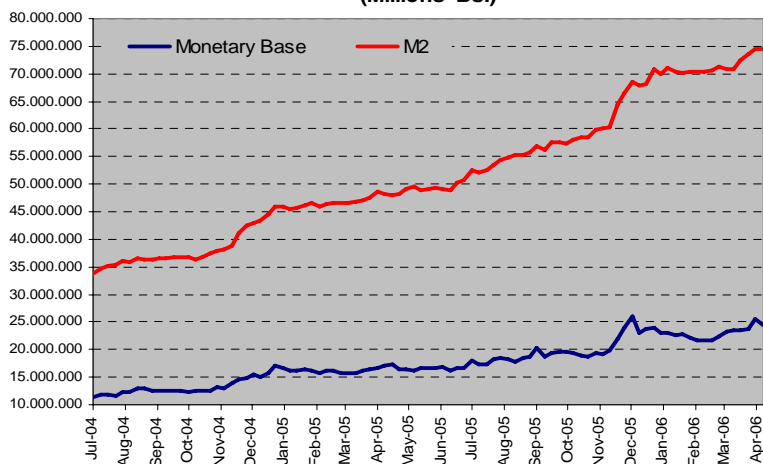
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ECONOMIC OVERVIEW

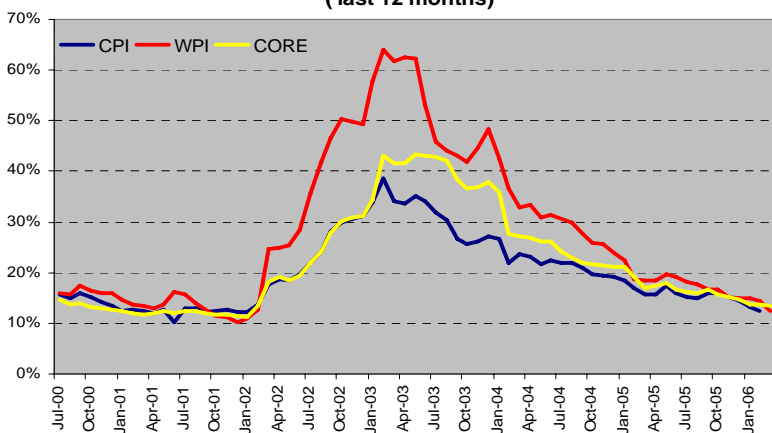
Oil Price
(Venezuelan Basket US\$pb)



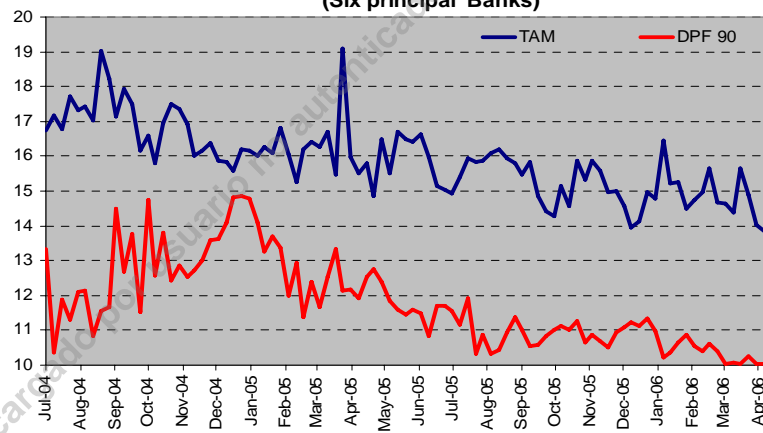
Monetary Base & M2
(Millions Bs.)



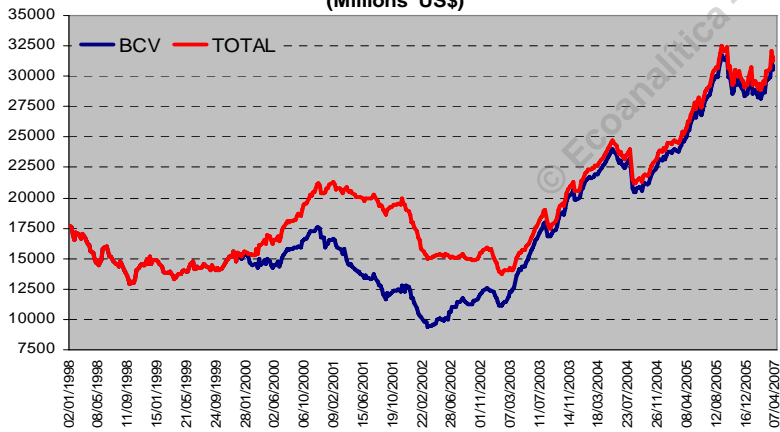
Inflation
(last 12 months)



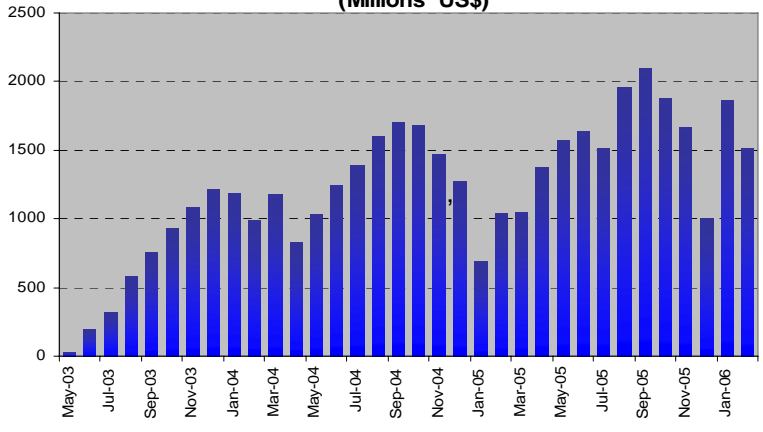
Interest Rate
(Six principal Banks)



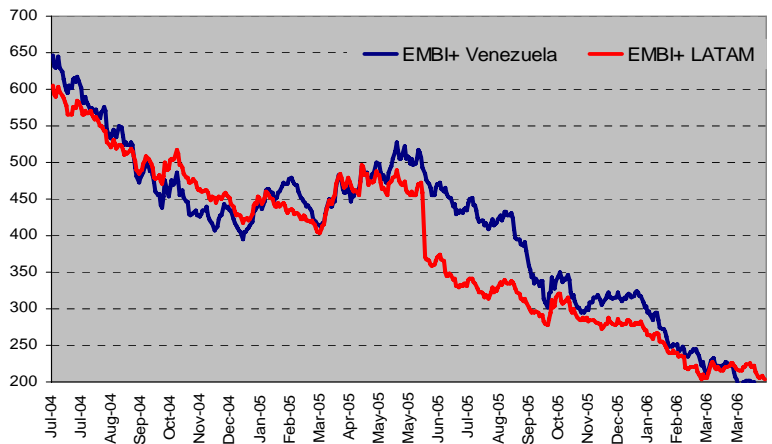
Fx Reserves
(Millions US\$)



Disbursement
(Millions US\$)



EMBI



Central Government
(Billions US\$)

