



Year 2, Number 22
June 16th, 2006

Redaction:
Alejandro Grisanti

Editors:
Gabriel Dobson

***Dropping the zeros
from the bolivar is
not a monetary
reform but a non-
event.***

Reproduction and distribution prohibited out of the
terms between ECOANALITICA C.A. and

THE CLIENT

Last week the National Assembly debated the possibility of dropping three zeros from the bolivar, something we refuse to call a "monetary reform." One of the things that we noticed is the unity of criteria among the members of the AN Finance Committee, the Finance Ministry, and Bank of the Treasury. This coincidence makes us think that President Chávez has given the green light for the change.

**History of the bolivar:
our legal tender for over
125 years**

It was during the administration of General Antonio Guzman Blanco when coins were minted for the first time with the effigy of liberator Simon Bolivar on the face and the coat of arms of the Republic of Venezuela on the reverse. This design has remained on Venezuelan coins until today. In 1879 a Coin Law was passed which created a new monetary unit: the silver bolivar.

The change from a hard currency to a worthless one

In the late 19th and early 20th centuries money in circulation escalated. The bolivar was one of the world's strongest currencies. In 1913 the Venezuelan currency was 5.3VEB/US\$. It appreciated 18.4% over the next 70 years to 4.3VEB/US\$ in February 1983. Since then in all administrations the trend reversed with an average 31.0% annual depreciation, totaling 50.000%, until the current official exchange rate of 2,150VEB/US\$. The average annual rate of depreciation from 1983 to 1998 was 35.6% rising from 4.3VEB/US\$ to 565VEB/US\$. The calculation for the last seven years already totals a not insignificant 21.0%.

What happened? The government got caught short

The big difference between the stability of our currency during the first 70 years and the last 23 years is fiscal policy. From 1913 to 1973, the government simply spent all its revenue, with a very stable external sector. Over the next 10 years fiscal expenditure expanded strongly based on "the strengths of the economy" and "in a country that has the strength of oil revenue."¹ While oil prices remained high, the economy withstood the rise in expenditure but when prices fell, devaluation and the infamous Black Friday were inevitable.

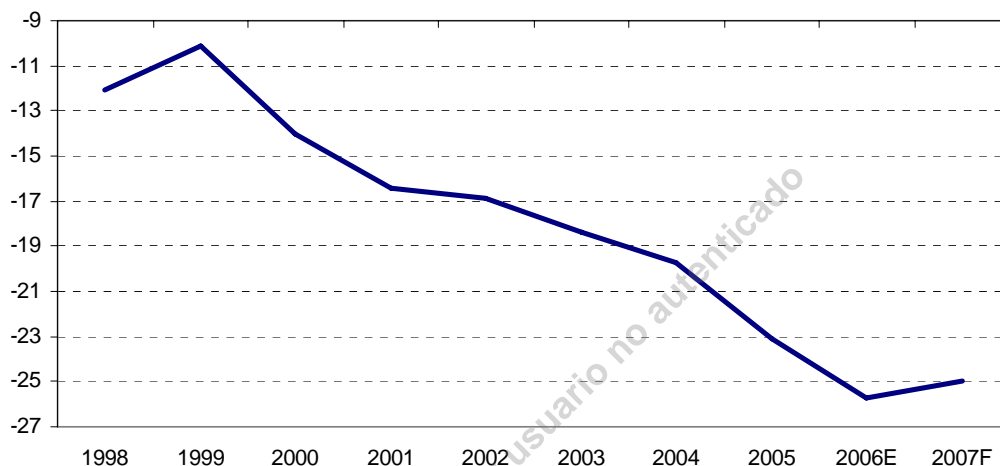
Since then, governments have committed the same mistake over and over again: overestimating oil prices and oil revenue, then having to devalue and return to a period of high inflation in which prices readjust. The saddest thing is that despite the 2002 devaluation this government, like all the others, has not learned the lesson. A monetary reform that drops zeros from the bolivar should be the last link in a reform package.

A really effective monetary reform would include a deep fiscal adjustment to moderate the vulnerability of the fiscal accounts to oil revenue

This is the key. However, the non-oil deficit, which is the part of the expenditure that has to be financed from oil revenue, has grown from 10.1 points of GDP (US\$10.40 billion) in 1999 to 23.1 points (US\$30.70 billion) in 2005. Moreover, the transfer of reserves and the "unreal exchange profits" do not help stabilize our monetary unit. Clearly with a fiscal policy like this, a monetary reform to stabilize the currency is impossible.

¹ These are the reasons that deputy Cabezas used when he proposed the monetary reform.

Non Oil Quasi Fiscal Balance
(% GDP)



Source: Ecoanalítica

Although the proposed “monetary reform” will be ineffective, we are not against it because it is an economic non-event.

The “reform” could bring the benefits of simplifying accounting and reducing the average number of bills in the hands of the public. The costs include adaptation to the new monetary unit, the rounding-up effect, and the cost of printing the new bills. There is also a possible “psychological effect” but we have no idea which way this works. For **Ecoanalítica** none of these costs or benefits is significant so the non-event will be soon forgotten.

The reform originally included a 30% revaluation.

The first time that **Ecoanalítica** heard about the plan to drop zeros from the currency it included a 30% revaluation which would have revalued the current official exchange rate of 2,150VEB/US\$ to 1,500VEB/US\$. This change was prepared by the association of defenders of the bolivar. Since the revaluation rumor began circulating, we have repeatedly said that we do not expect the bolivar to be revalued. Moreover, in the current fiscal situation, a revaluation would simply speed up the failure of the “monetary reform” under discussion.

Economic Tips

More debt The National Assembly Finance Committee authorized the administration to issue debt (domestic and/or foreign) for VEB6.6 trillion (US\$3.07 billion). The prospectus states that the new funds will be used to pay debt service. As is the norm with this type of approval, the administration can do whatever it likes: issue new debt in bolivars, dollars or euros at virtually any level of fixed or variable rates that it likes. With such broad conditions, this approval procedure has become a mere formality and the opinion of the Finance Committee is hardly necessary if the operation takes place under the Borrowing Law 2006. *Ecoanalítica* believes that the entire issue will be placed on the local market (through TIF bonds). We do not expect another issue of the famous bonds in dollars payable in bolivars. In fact, PDVSA will probably make the issue².

More Argentine bonds. According to Argentine sources, Venezuela may buy another US\$200 million of that country's bonds (Boden12). *Ecoanalítica* has no doubt that Venezuela will continue supporting this type of operation with other countries in the region and even African countries.

The Assembly should mind its own business. Last week the members of the Finance Committee met with the Central Bank Board to propose a package of measures which, Committee Chairman Rodrigo Cabezas believes, would help to reduce the bank's losses, cut the cost of bank charges in the financial system, and permanently guarantee price stability. It seems Cabezas is teaching the Central Bank how to do its job. He also advised the Bank to cut its deposit interest rate. However, the directors did not agree. We celebrate that fact that deputy Cabezas has recognized that the main cause of the Central Bank's losses was the transfer of international reserves, initially approved by the National Assembly, which the administration, in violation of the law, seems to have taken as normal practice.

The Central Bank gets it right. In response to the National Assembly's advice, the Central Bank board insisted on the need for macroeconomic and financial coordination between the administration and the Bank, because the surplus liquidity has a fiscal origin and the State has a joint responsibility in the deposits of the government and other public institutions.

² See Oil Tips.

The role of the state banks. As part of the coordination of monetary policy, the Finance Ministry and the Central Bank are considering ending the purchase of certificates of deposit by state financial institutions. The government wants them to use these funds to finance productive sectors.

Bank charges come up again. In their recommendations to the Central Bank, the deputies insisted on the need to control bank charges but with no tangible results. The Central Bank directors said they were studying the matter with the Banking Superintendency.

Government needs more money. Despite the monetary problem and the transfer of international reserves to the administration, it seems that President Chávez needs even more money. Sudeban is insisting that the Central Bank declare foreign exchange profits this half year. Central Bank director Domingo Maza Zavala said there were no exchange profits to declare. No bets on who will win this contest?

Chávez proposes social security fund. The fund would be financed by national, state and local governments, the private sector and the retirees themselves. According to President Chávez, the management of the fund would be decided by its members and the resources used for investments. In practice, this would be a pension fund regime, which the administration has always rejected.

New CADIVI head. President Chávez appointed Manuel Barroso, president of Bank of the People and director of Bank of the Treasury, as the new president of the Foreign Currency Administration Commission (CADIVI) to replace Mary Espinoza de Robles who resigned for unknown reasons. Manuel Barroso has held various positions in the Chávez administration: assistant to the Minister of the Secretariat, assistant to the vice president of Republic, director general of the Infrastructure Ministry, and director of the Office of the Presidency of the Republic.

New foreign currency directives? At Barroso's swearing in, President Chávez said that "it has been a mistake of the revolution that several years have gone by and we continue handing over dollars to a group of "paper" companies to import food from the United States and Europe, over invoicing and making large profits ... But now we're going to make triple play. We can't go on giving the people's dollars to the oligarchy for whisky imports which the people do not drink." Let's wait and see the reaction of the "new CADIVI" to the president's words. As CADIVI becomes more restrictive, the economic distortions will increase, and the parallel exchange rate will depreciate.

Oil Tips

Another week of oil hikes. The Venezuelan basket of crudes and products averaged US\$61.7 per barrel. This year Venezuelan crude has averaged US\$56.6 per barrel.

PDVSA goes to market. PDVSA may be structuring a US\$3.50 billion debt issue, which would almost double the total amount of the oil company's debt. The placement would be structured by European banks with various types of placement: bonds on international markets or bolivar-dollar (or bolivar-euro) paper on the local market, which **Ecoanalítica** sees as the most probable. At US\$56.6 per barrel, we cannot see why PDVSA needs to issue debt. We hope these funds will be used to invest in refining and exploration activities.

PDVSA plans to invest only US\$3.00 billion in operations this year. In contrast the figure for social investment is around US\$9.50 billion (including transfers to Funden). The corporation will also have to deal with the migration of the operating agreements and possibly the strategic associations to joint ventures.

PDVSA Occidente below target. According to the Exploration and Production Division of PDVSA Occidente, crude extraction dropped to 1.2 million barrels day in April, including the joint ventures. This figure is 95,000 b/d and 320,000 b/d below the June 2003 and January 2002 totals. According to PDVSA Occidente, the 2006 production target is 974,000 b/d from its own fields plus 285,000 b/d from the joint ventures, which gives an overall production of 1.26 million b/d.

New ships. PDV Marina will shortly sign an agreement with the Brazilian shipbuilder Eisa Mauá Jurong for eight Panamax-type ships and two others for transport of oil products. PDVSA plans to invest US\$2.60 billion between 2006 and 2012 in building 42 ships. About 80% of the investment is likely to come from external financing.

Sectoral Tips

Retroactive list for CANTV. At the end of May the Central Bank issued a supplement to the Supreme Court decision of July last year in favor of former CANTV workers. The Court asked the Central Bank to calculate the retroactive since 1993 (date the suit was filed) for each pensioner to determine the total amount that the telephone company must pay to its pensioners.

The amount still a mystery. We don't know yet how much is involved. In our opinion, it should be in line with the amount programmed by CANTV (almost US\$400 million). However, the main problem is no longer the amount that the telephone company will have to pay to its pensioners but the possibility of a significant increase in the number of pensioners favored. A group of CANTV pensioners protested the exclusion of over 3,000 former workers from the retroactive payment for back pensions, and the fact that the Central Bank did not include back interest in the calculation of the amount owed. The Supreme Court decision could favor about 6,000 workers. The inclusion of over 3,000 extra workers would have a significant impact on the amount of the debt payment.

More on CANTV. The telephone company contracted the services of Goldman Sachs to evaluate the takeover bid of Telmex-América Móvil (companies controlled by Carlos Slim). CANTV President Gustavo Roosen said that they would do "whatever necessary to maximize the value of the shareholders." According to unofficial information, the government may have suggested, through its director, Banesa President Edgar Hernandez Behrens, the contracting of experts to value the company. The state holds 6.6% of CANTV shares.

Longer interbank loans. This week, the Central Bank included new repurchase periods in the interbank market in a new version of the Electronic Transfer System (SET). The financial system can now make placements at terms of 1, 7, 10, 14, 20, 30 and 60 days. The previous version allowed only overnight interbank loans. With this system, the Central Bank is facilitating the daily transfers of funds between financial institutions to optimize liquidity levels.

Credit reference system ready. The Banking Superintendency authorized the financial institutions to reactivate the system of credit references which records customers in default. The system will provide less detail than the former Central Risk Information System (SICRI). The new system can only include "information on customers who have breached loan, service or any other type of agreement, when the breach is certain, and the obligation is enforceable and overdue."

Little spare capacity Planning and Development Minister Jorge Giordani said that in view of the pick up in economic activity, some companies were operating with less than 10% spare capacity. According to INE statistics, capacity utilization is almost 88%, and 58% of companies are working at full capacity. These figures are higher than expected. In view of the steady increase in demand, coupled with limitations on production, pressure on prices could begin to build up.

Weekly Report

Vehicle sales go on climbing According to the Venezuelan Automotive Chamber (CAVENEZ), vehicle sales increased 74% in May from the same month last year. This year car sales have grown 46% from the same period of 2005.

Costly subsidy. According to Nervis Villalobos, Cadafe president and vice minister of Energy, the government is planning to invest US\$1.00 billion this year in electricity generation, transmission and distribution which joins the US\$1.50 billion disbursed in the 2004-2005 period. The aim is to reverse the disinvestment of the last twenty years. The funds will be provided by FONDESPA and FONDEN. However, Villalobos recognizes that the amount is insufficient to cover short- and medium-term needs. He also confirmed that the administration would increase electricity rates this year.

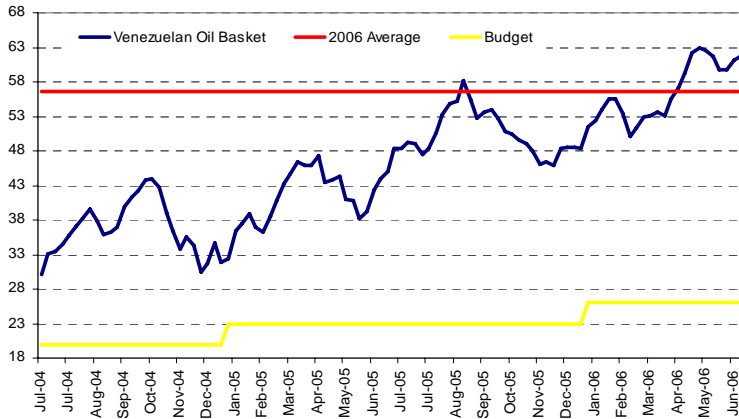
Political Tips

Presidential hopefuls meet. Last weekend, presidential candidates Julio Borges (Primero Justicia), Teodoro Petkoff (independent) and Manuel Rosales (Nuevo Tiempo) met with other contenders. All present confirmed their willingness to register a single candidate with the Electoral Council for the December elections. Representatives of NGOs Súmate, La Colina and Queremos Elegir were also at the meeting.

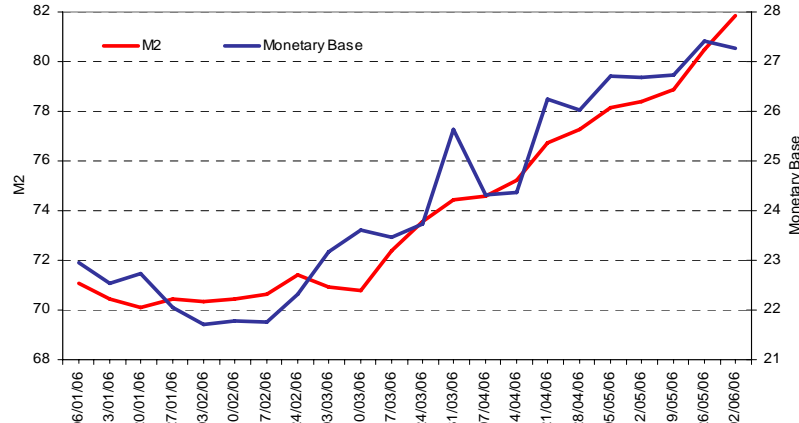
Government bid to maintain unity. With the upcoming December election, President Chávez and Executive Vice President Rangel have intensified calls for unity among pro-government groups (MVR and others). Rangel said that not only were the votes important but also the political and ideological definitions. In other words: quality counts as well as numbers.

ECONOMIC OVERVIEW

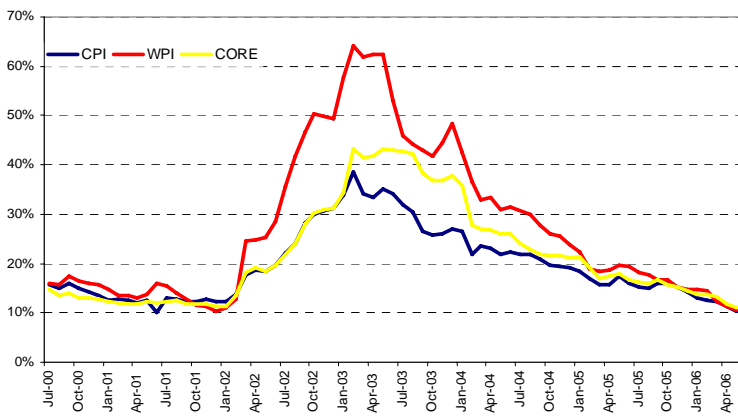
Oil Price
(Venezuelan Basket US\$/pb)



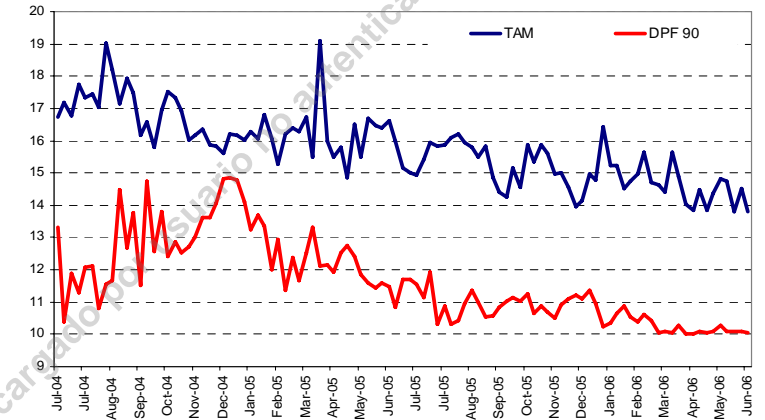
Monetary Base & M2
(VEB Billions)



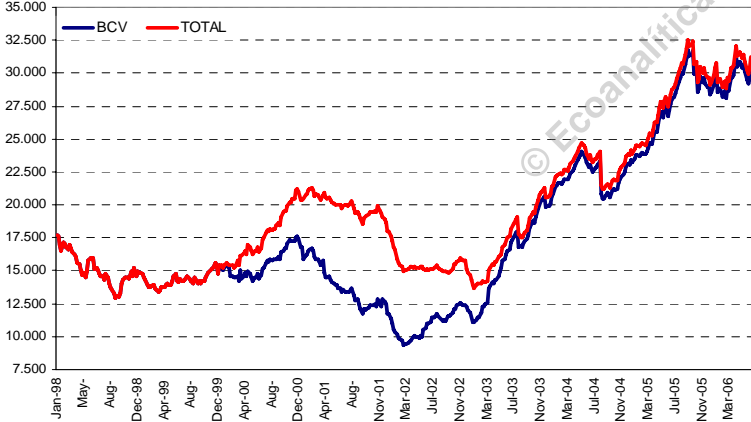
Inflation
(Last 12 Months)



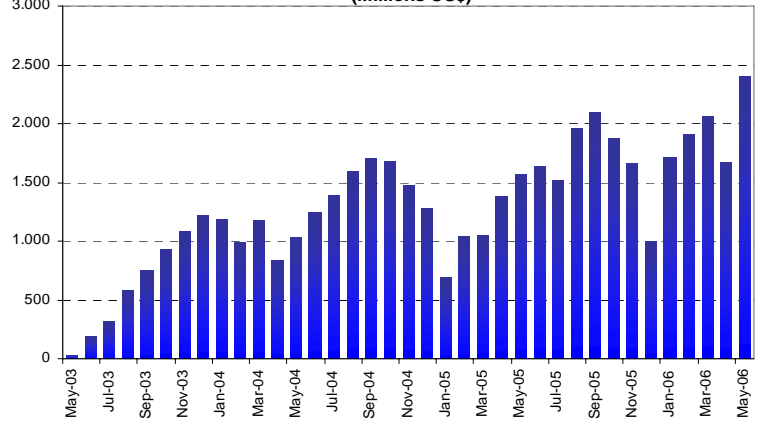
Interest Rate
(Six Principal Banks)



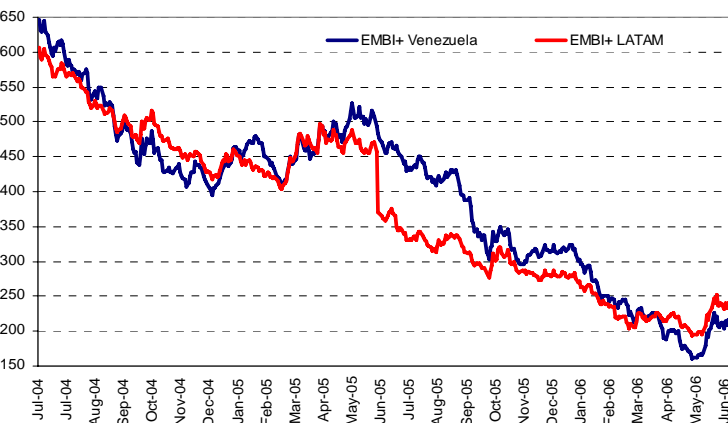
Fx Reserves
(Millions US\$)



Disbursement
(Millions US\$)



EMBI



Central Government
(VEB Billions)

