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***WITH EXCHANGE
CONTROL IN FULL
FORCE, CAPITAL
FLIGHT IS FROM THE
PUBLIC SECTOR***

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THE CLIENT

The BCV has published its balance of payment figures for the first half of 2006. Three important things are obvious: firstly, the balance of payments for the first half of 2006 shows a deficit of US\$187 million; secondly, capital outflow from the public sector is equivalent to 83% of the total capital account, and lastly, that direct foreign investment for the first half of the year recorded a deficit of US\$ 1.427 billion. Thus the external accounts show how vulnerable the current situation really is.

**US\$1,231 billion balance
of payments deficit for
Q206**

According to the BCV data, the balance of payments for 2Q06 recorded a surplus of US\$8.265 billion in current account. However, the capital account deficit was US\$9.496 billion, resulting in an overall deficit of US\$1.231 billion in the country's balance of payments. It is important to bear in mind that a deficit in the balance of payments signifies a reduction in international reserves of an equivalent amount.

Year-on-year, the Venezuelan oil basket increased 42.1% in 2Q06, but in 2Q05 the balance of payments showed a surplus of US\$9.298 billion.

Non-oil exports decline

Another point that must be emphasized is that non-oil exports declined 10.7% in 2Q06 against last year's similar period, in the midst of a period of economic growth. However, the decline in non-oil exports is explained mainly by the real appreciation in the (official) exchange rate which was around 20% at the end of the first half of the year, and this is occurring together with an increase in imports of 34.2% in 2Q06, year-on-year.

BALANCE OF PAYMENTS (US\$ Millions) (General Summary)						
Sources: BCV and Ecoanalítica						
	IIQ 2006	IIQ 2005	Var (%)	1S06	1S05	Var (%)
Current Account	8,265	6,193	33.5%	15,053	10,882	38.3%
Goods	10,448	7,588	37.7%	19,759	14,094	40.2%
Oil Exports	16,619	11,558	43.8%	30,515	21,363	42.8%
Non-Oil Exports	1,678	1,879	-10.7%	3,316	3,600	-7.9%
Import of goods F.O.B	(7,849)	(5,849)	34.2%	(14,072)	(10,869)	29.5%
Services	(1,131)	(983)	15.1%	(2,033)	(1,756)	15.8%
Others	(1,052)	(412)	155.3%	(2,673)	(1,456)	83.6%
Capital Account	(9,496)	3,105	-405.8%	(15,240)	(6,057)	151.6%
Public Sector	(8,294)	4,471	-285.5%	(12,573)	(2,717)	362.8%
Private Sector	(1,202)	(1,366)	-12.0%	(2,667)	(3,340)	-20.1%
Reserves Variation	(1,231)	9,298	-113.2%	(187)	4,825	-103.9%

Capital flight of the private sector declines

In 2Q06, the private sector reduced its deficit in the capital account, explained mainly by the fall in capital flight of 44% when compared to last year. The numbers are even more significant if we analyze the whole semester, when reduction in private sector capital flight reached 80.5%, passing from US\$3.704 billion in the first half of 2005 to US\$722 million during the same period this year. The reasons behind this dramatic reduction are to be found in the Exchange Crimes Law which significantly reduced outflows of currency through private agents, and also in the fact that the government has not carried out any new Bolivar - Dollar operations so far this year.

Foreign investment in Venezuela practically non-existent

The other salient point of the private sector balance of payments refers to direct foreign investment, given its significance as a component of the sustainable growth of an economy. So, we find that during 2Q06, direct foreign investment was only US\$65 million, signifying a drop of 90.3% with respect to the same period last year when it amounted to US\$620 million. For the first half, the private sector had a disinvestment of US\$1.427 billion, generated mainly in the private oil sector and caused by the legal changes produced by the migration from operating agreements to joint-venture companies.

It is obvious that a stable legal framework and transparent rules are indispensable conditions if direct private investment is sought. Apart from that, and something which has been shown by countless studies, foreign investment is a factor that has a positive effect on a country's economic growth.

The level of foreign investment is laughable and is only compensated by the gigantic inflow of foreign currency coming from the oil sector. This situation contrasts starkly with that of other Latin American countries, which in the first quarter of 2006 alone received foreign investments equivalent to: US\$3.957 billion (Brazil), US\$3.438 billion (Chile), US\$3.005 billion (Mexico) and US\$978 million (Colombia).

BALANCE OF PAYMENTS						
PRIVATE SECTOR						
(US\$ Millions)						
(General Summary)						
Sources: BCV and Ecoanalítica						
	IIQ 2006	IIQ 2005	Var (%)	1S06	1S05	Var (%)
Current Account	(7,841)	(5,012)	56.4%	(14,403)	(9,668)	49.0%
Goods	(5,677)	(3,648)	55.6%	(9,781)	(6,571)	48.9%
Non-Oil Exports	1,678	1,879	-10.7%	3,316	3,600	-7.9%
Import of goods F.O.B	(7,355)	(5,527)	33.1%	(13,097)	(10,171)	28.8%
Services	(1,119)	(971)	15.2%	(1,982)	(1,725)	14.9%
Others	(1,045)	(393)	165.9%	(2,640)	(1,372)	92.4%
Capital Account	(1,202)	(1,366)	-12.0%	(2,667)	(3,340)	-20.1%
Private Sector	(1,202)	(1,366)	-12.0%	(2,667)	(3,340)	-20.1%
External Debt Service	(128)	(217)	-41.0%	(518)	(651)	-20.4%
Foreign Direct Investment	65	670	-90.3%	(1,427)	1,015	-240.6%
Private Outflow Capital	(1,139)	(2,033)	-44.0%	(722)	(3,704)	-80.5%

Weekly Report

The strength of the external indicators of the public sector comes almost exclusively from the public oil sector (i.e., PDVSA)

For the first half of the year, it may be seen that the current account of the public sector reflects a surplus of US\$29.456 billion, 43.3% above the first half figure for 2005. This high surplus is due in 42.9% to the increase in oil exports over the same period of last year, in spite of an increase of public sector imports of 39.7%.

Public sector capital account deficit almost five times that of the private sector

Another fact that should be emphasized is that there has been a significant increase in the public sector capital account deficit, which is now almost five times greater than that of the first half of 2005 and also five times greater than the capital account deficit of the private sector for the first half of 2006.

Debt servicing equivalent to half of the public capital account deficit

It is important to note that in the past this amount was generally associated with the servicing of the public external debt which, according to the BCV stood at US\$6.560 billion at the end of the first half, that is, 52% of the total deficit in the public sector capital account. The remaining amount is explained by the transfers to FONDEN by PDVSA and the offshore securities operations that the BCV records in the capital account and which would be US\$6.013 billion.

BALANCE OF PAYMENTS						
PUBLIC SECTOR						
(US\$ Millions)						
(General Summary)						
	IIQ 2006	IIQ 2005	Var (%)	1S06	1S05	Var (%)
Sources: BCV and Ecoanalítica						
Current Account	16,106	11,205	43.7%	29,456	20,550	43.3%
Goods	16,125	11,236	43.5%	29,540	20,665	42.9%
Oil Exports	16,619	11,558	43.8%	30,515	21,363	42.8%
Import of goods F.O.B	(494)	(322)	53.4%	(975)	(698)	39.7%
Services	(12)	(12)	0.0%	(51)	(31)	64.5%
Others	(7)	(19)	-63.2%	(33)	(84)	-60.7%
Capital Account	(8,294)	4,471	-285.5%	(12,573)	(2,717)	362.8%
Public Sector	(8,294)	4,471	-285.5%	(12,573)	(2,717)	362.8%
Reserves Variation	7,812	15,676	-50.2%	16,883	17,833	-5.3%

As with the fiscal accounts, our external sector is vulnerable to any change in the oil scene. However, under present conditions, the structural reforms necessary to reduce such debt could easily be made. The government could be more aggressive in its foreign debt buy-back plan, as well as accumulating surplus resources in a stabilization fund that would serve as our buffer or support if oil prices were to fall. The worst thing about all of the above is that the more time the government spends inflating such distortions, the bigger the bang will be when they explode.

Economic Tips

Losses again. The BCV's Balance Sheet to July once again showed losses for around VEB98.166 billion (US\$45.7 million). These losses are incurred in order to meet the more important objective of the Central Bank: to keep inflation in hand. Nevertheless, it would seem that the government does not provide much help to the BCV, since it appears set on increasing public expenditure. This generates increased liquidity which the Bank has later to sop up by issuing certificates of deposit. These deposits stood at VEB39.4 trillion (US\$18.320 billion) at the close of July.

Unemployment at 9.6%. According to INE figures, unemployment stood at 9.6% in July this year, three percentage points lower than July 2005, equivalent to 327,497 jobs, for a total of unemployed of 1,181,981.

10% salary increase. As of September 1 this year the second salary increase of 10% comes into force. With such increase the minimum salary is now VEB512,325 (US\$238.3) both for city and rural workers.

And the government prepares. The government will ask the National Assembly (AN) for additional funds for about VEB 2 trillion through extra credits over the next few weeks to cover the cost of the new minimum salary and part of the end-of-year bonuses (aguinaldos) for Public Administration workers.

Income Tax reform ready. Within not more than two weeks the AN calculates that it will approve reforms to the Income Tax, which contemplates an adjustment to the rate paid by the Orinoco Oil Belt associations. Three provisions will be modified. The first article to be revised is the one covering the taxing rate for the oil area, in such a way

Weekly Report

that companies dedicated to the production of extra-heavy crude will file their returns based on a 50% rate, which will also apply to joint-venture companies (empresas mixtas). In the current text the strategic associations are subject to a 34% rate. The draft indicates that the 34% rate will continue only for companies dedicated to the exploration and production of natural gas and to the processing, transportation, distribution and storage of gas or the refining of hydrocarbons or upgrading of heavy crudes.

Other changes. The changes will not only affect the Orinoco Oil Belt, since the reform establishes the elimination of the discounts granted to the sector for investments. Article 56, which contemplated a discount of 8% over amounts of new investments and an additional 4% discount over the total cost of investment in exploration, drilling, transportation and storage of hydrocarbons, is to be repealed. In the case of Article 57, only the section allowing an additional 10% discount over the amount of investments in assets and programs aimed at environmental conservation and improvement in hydrocarbons and gas exploration and production areas was removed.

Extra income. According to government estimates, the adjustment of the association rates will generate extra income to the tune of US\$905 million per year.

Oil Tips

Down US\$3. The Venezuelan basket of crudes retreated US\$3 per barril to US\$62.82 per barrel, the lowest quote registered since the end of June. In spite of this reduction, the August average continues to be the highest of the year, climbing to US\$64.42 per barrel. So far this year, the average of the basket stands at US\$58.59 per barrel.

PDVSA waits for the Finance Ministry. According to the President of PDVSA, Rafael Ramirez, the company has not abandoned the idea of issuing debt paper on the internal market and is awaiting a reply from the Finance Ministry saying when the operation can be effected. In our opinion PDVSA's issue could be during the third quarter of the year, since the government will first issue the Southern Bond.

Exports of crude to the USA are on the way down. According to IEA figures, Venezuelan crude exports to the USA continue their downward trend. The most significant of these figures has been a reduction in June exports of crude of 21.9% when compared to June 2005. Derivatives exports also fell by 311,000 barrels per day with respect to June last year. During the first half of 2006, an average of 135,000 less bpd has been exported to the USA compared with the same period of 2005.

But increased exports to China are sought. PDVSA anticipates upping its exports to China by a substantial margin this year, taking the oil supply to this country to an average of 150,000 bpd, almost 90,000 bpd more than the 2005 average. For 2007 it is hoped that this average will reach 200,000 bpd.

Joint-venture companies' production down. According to numbers published by MENPET, the production of the recently formed joint-venture companies fell by 7,800 bpd between April 26 and August 15, going from 341,800 to 334,000 bpd. Therefore PDVSA's proposed target of increasing production from these agreements by 100,000 bpd looks unattainable for this year.

Production also down. In regard to the strategic associations of the Orinoco Oil Belt, production averaged 542,000 bpd around the beginning of August, way down on 2005's average of 601,700 bpd.

PDVSA off target. The figures given by PDVSA also reveal that its own extraction in the west continues to be below its target of 963,000 bpd for this year, reaching 936,000 bpd on Tuesday, a gap of 27,000 bpd. On the other hand, the eastern and south-central divisions beat their 2006 targets, registering an average of 1.31 million bpd and 90,000 bpd respectively. In total, national production was 3.21 million bpd, 240,000 bpd below the year's target.

Sectoral Tips

We'll let you know. The reform of the General Banking Law was postponed for the second period of sessions of the AN which starts in September. The discussion was put off because the question of banking commissions and rate regulation is still being reviewed.

Threat after threat. During his Sunday program number 260, the President of the Republic reminded CANTV that he had given the company a deadline for paying its labor liabilities, and announced that if it did not meet its obligations towards the retired employees he would re-nationalize the company, a threat he had first launched the week before. The news has had a negative effect on CANTV, bringing down its share price last week, with Bolivar-denominated shares falling 0.3% and the ADRs 0.8%.

Telecommunications sector performs well. According to CONATEL, mobile phone penetration stood at 58.5% at the close of Q206, while fixed-line penetration was

14.3%. In the case of cellular phones, Movistar remains ahead with a 44.7% share, followed by Movilnet with 41.6% and Digitel with 13.7%. In the Internet business, subscribers grew by 33.3% year-on-year, with broad-band use expanding 62.3%. It is estimated that Internet penetration in Venezuela is now 13.8%. During the first half, investment in this sector was US\$344 million.

Interesting data. According to data published by the investigation firm Pyramid Research, the growth of the mobile phone industry in Venezuela is double the growth registered for Latin America, which was between 28 and 30% for the same period under study.

The State moves ahead in telecommunications. CVG Telecom activated the first multi-satellite platform of Latin America, which will allow it to offer Internet and telephone access services, with the intention of providing telecommunications services to the least populated areas of the country. Its investment amounted to US\$3 million. However, CANTV, our main telecommunications company plans to invest more than US\$600 million this year.

Capital increase. The CNV reports that the stock market accumulated earnings of around VEB91.124 billion over the first half, a figure that is already higher than the VEB66.000 billion for the whole of 2005. The CNV also considers that the time has come to demand more capital, and it is therefore studying the implementation of new minimum equity levels. There are now 82 stock exchange and brokerage houses operating in the market.

Who's winning? According to INE numbers, trade between Venezuela and Brazil grew to US\$1.1 billion, an increase of 39.2% over the same period last year. However, it should be noted that the quantity of products sold by Brazil to Venezuela grew by 43.7% to US\$1.046 billion, while trade in the other direction was actually 7% lower, standing at US\$64 million.

With Chile on the other hand ... According to data provided by the Chilean Embassy in Venezuela, first half trade between the two countries grew by 36% with respect to the same period last year, reaching US\$306.3 million. Chilean exports to Venezuela grew by 14%, whilst exports from Venezuela to Chile grew by 40%, mainly consisting of products such as hydrocarbons, ammonia, rum and aluminum, among others.

Colombia another good client. Venezuela's sales to Colombia grew by 40.8% year-on-year in the first half of 2006, to stand at US\$756 million. Venezuela is the fifth-highest supplier of goods to Colombia, behind the USA, Mexico, Japan and Brazil.

Weekly Report

Productivity way down. In spite of eleven consecutive quarters of economic growth, there are no signs of this translating into increased employment and productivity. According to FEDECAMARAS estimates, productivity as measured by the relationship GDP / Employed Population, is declining and has fallen 27% over the last 20 years, meaning that each person is producing 73% of what she or he did in 1985.

Tourism takes off. According to data provided by the Ministry of Tourism, 32 million national tourists moved around throughout the country during the first half of this year, which represents an increase of 10.2% over the same period last year. There were also 5.3% more foreign tourists, with a total of 348,000 foreign visitors. In monetary terms these variations represent income of around VEB5.2 trillion, an increase of 18.9% over the amount registered for the first half of 2005.

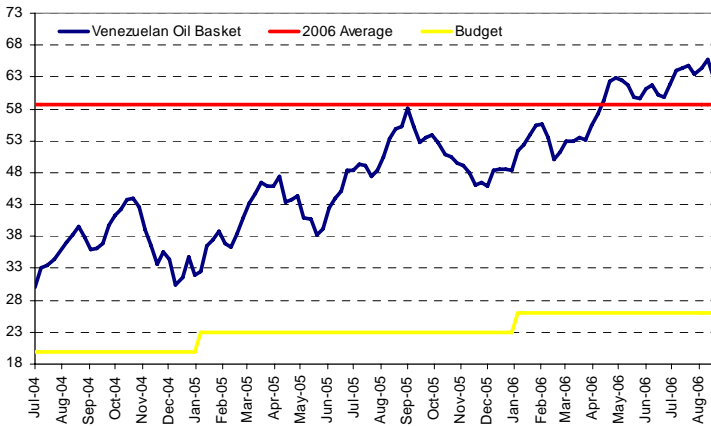
Political Tips

Giordani wants socialism. According to the Planning and Development Minister, Jorge Giordani, Venezuela needs "an extensive reform of its constitutional text to adapt it to the growing socialist process being lived by the country." He added that constitutional reform will be "the final consolidating element of change from an extreme individualistic and consumerist society to a territory whose development is always oriented towards the common wellbeing of its countrymen."

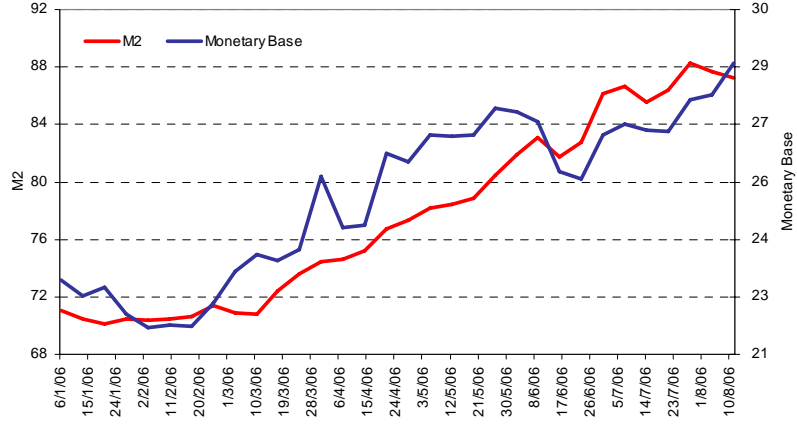
Temporary substitutes already sworn in. Presidential candidate Manuel Rosales has named Nelson Carrasqueño as the person who will take over the reins of Zulia State, and Pablo Perez as government secretary, while he dedicates himself to his electoral campaign.

ECONOMIC OVERVIEW

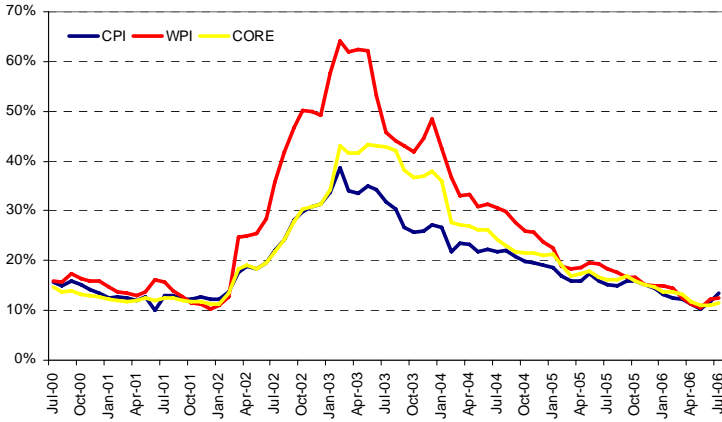
Oil Price
(Venezuelan Basket US\$/pb)



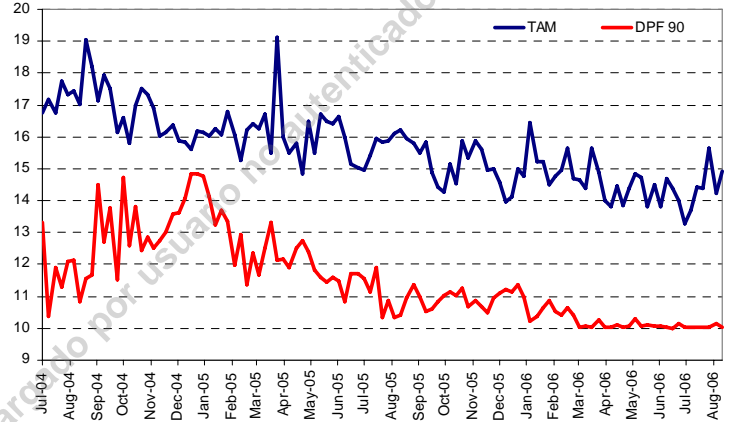
Monetary Base & M2
(VEB Billions)



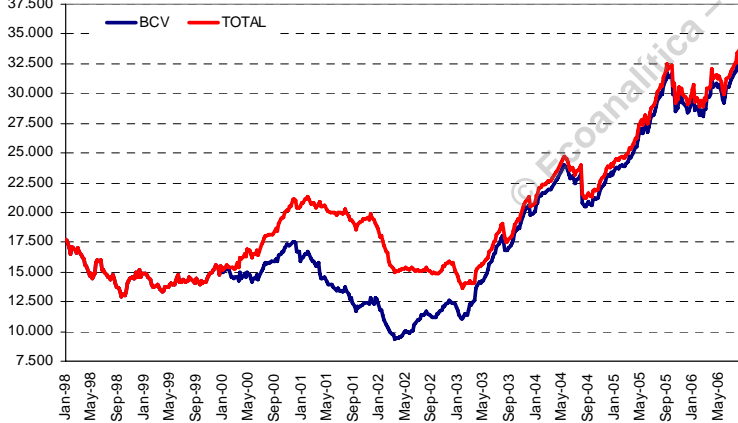
Inflation
(Last 12 Months)



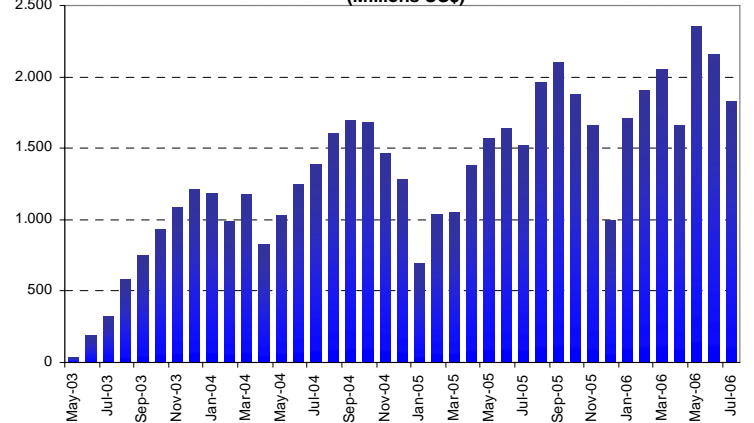
Interest Rate
(Six Principal Banks)



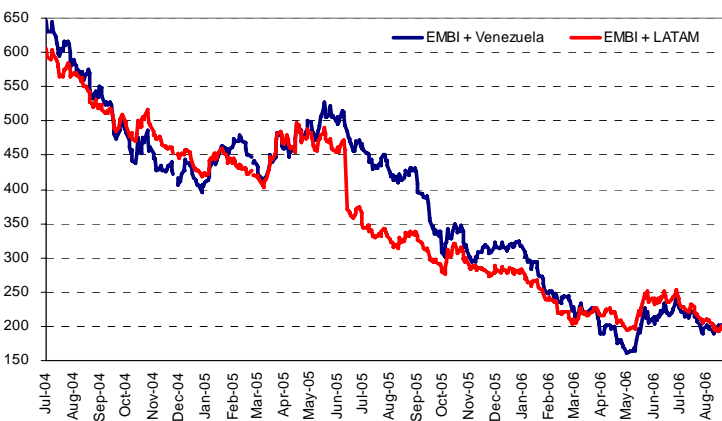
Fx Reserves
(Millions US\$)



Disbursement
(Millions US\$)



EMBI



Central Government
(VEB Billions)

