



Year 2, Number 33
September 01, 2006

Redaction:
Alejandro Grisanti
Asdrúbal Oliveros

Editors:
Gabriel Dobson

INSATIABLE: THE STATE'S VORACIOUS FISCAL APPETITE POSES A PROBLEM FOR VENEZUELA'S PUBLIC FINANCES

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

THE CLIENT

The fiscal figures corresponding to the month of June show that state expenditure grew 97% year-on-year. The first half shows a 61% increase in expenditure in real terms with respect to H105, while total income only grew 15%. In the midst of this oil bonanza, the central government's fiscal administration shows a deficit of VEB 3.3 trillion for the first half of the year. This fiscal policy is unsustainable over the long term, since the increase in expenditure is being financed with non-recurring income: oil income.

Primary expenditure grows 110% during the month of June

Data published by the BCV show that public expenditure increased 97.1% interannually, with an increase in primary expenditure (i.e., excluding interest payments) of 109.6% in respect of June 2005. This increase in expenditure has been mainly financed by an increase of 74.9% in oil income, while non-oil income has only increased 33.5% year-on-year. June figures show a fiscal surplus of VEB 2.6 trillion against a deficit the month before (VEB 5.5 trillion).

Weekly Report

A huge and unjustified deficit

Upon analyzing the fiscal figures for the first half, we find a fiscal deficit of VEB 3.3 trillion, which contrasts with a surplus of VEB 9.1 trillion for S105. More representative is the deterioration of the non-oil fiscal result which passes from a deficit of VEB 13.5 trillion (US\$ 6.273 billion) to VEB 28.9 trillion (US\$ 13.455 billion). In other words, the current expansion of expenditure is only supported by high oil revenue, since the increase of non-oil collections is clearly insufficient to maintain the current levels of public expenditure. The expansion of primary expenditure in the first half was 73.2% in real terms, when compared with the same period last year.

FISCAL BALANCE CENTRAL GOVERNMENT (VEB Billions)	June	June	Nominal	January-June	January-June	Nominal	Real
	2006	2005	Variation	2006	2005	Variation	Variation
Total Revenue	11,722	7,401	58.4%	49,496	38,569	28.3%	14.7%
Non-Oil Revenue	3,943	2,954	33.5%	23,895	15,887	50.4%	34.5%
Oil Revenue	7,779	4,448	74.9%	24,977	19,100	30.8%	16.9%
Central Bank Earnings	-	-		624	3,582	-82.6%	-84.4%
Total Expenditure	9,114	4,623	97.1%	52,825	29,374	79.8%	60.8%
Primary Expenditure	8,707	4,153	109.6%	49,977	25,799	93.7%	73.2%
Interest Payments	407	470	-13.5%	2,847	3,576	-20.4%	-28.8%
Domestic Debt	296	321	-7.6%	1,832	2,365	-22.5%	-30.8%
Foreign Debt	110	150	-26.3%	1,015	1,210	-16.1%	-25.0%
Quasifiscal Expenditure	-	-		-	-		
Fiscal Balance	2,609	2,778		(3,329)	9,194		
Primary Balance	3,015	3,248		(481)	12,770		
Non Oil Balance	(5,171)	(1,670)		(28,929)	(13,487)		
Debt Amortization	631	468		5,288	2,689		
Net Monetary Injection	5,802	2,510		34,217	17,462		
Financing Requirements	(1,977)	(2,310)		8,617	(6,505)		
Foreign Debt	23	8		154	63		
Domestic Debt	-	1,308		-	6,142		
Treasury Bonds	-	811		-	5,218		
Treasury Debt	-	496		-	924		
Others	(2,001)	(3,626)		8,462	(12,711)		

Sources: BCV and Ecoanalítica

The level of indebtedness declines, as does the accumulation of resources in the financial system

During the first half of the year, the government needed to finance around VEB 8.6 trillion (US\$ 4.008 billion). Net indebtedness was VEB 154 billion (US\$ 71.6 million), exclusively external, which contrasts with the gross indebtedness for H105, which was VEB 6.2 trillion (US\$ 2.886 billion). However, in order to cover a shortage of resources, the Government sought alternative financing methods during H106 for

Weekly Report

about VEB 8.5 trillion. This means that the Government had to draw on its assets (Government accounts with the BCV and the financial system) for an equivalent amount.

This is not in fact completely negative, since for this same period last year, the Government accumulated resources of around VEB 12.7 trillion, but, at the same time and for no reason, it issued debt for around VEB 6.2 trillion. There is no logical reason at all for getting into debt over and above one's financial needs.

A good point: Greater debt amortization

On the other hand, the Government amortized VEB 5.3 trillion (US\$ 2.460 billion) of debt (internal and external) during H106, which represents an increase of 96.7% over the same period last year. This is mainly driven by internal debt reshuffling (gradual substitution of VEBONOS for TIF) and the advanced repurchasing of foreign debt. Nevertheless, mainly in regard to the external market, the levels of debt amortization are superior to the amounts reported by the BCV, since they are close to US\$ 5 billion.

Fiscal policy, the Achilles heel

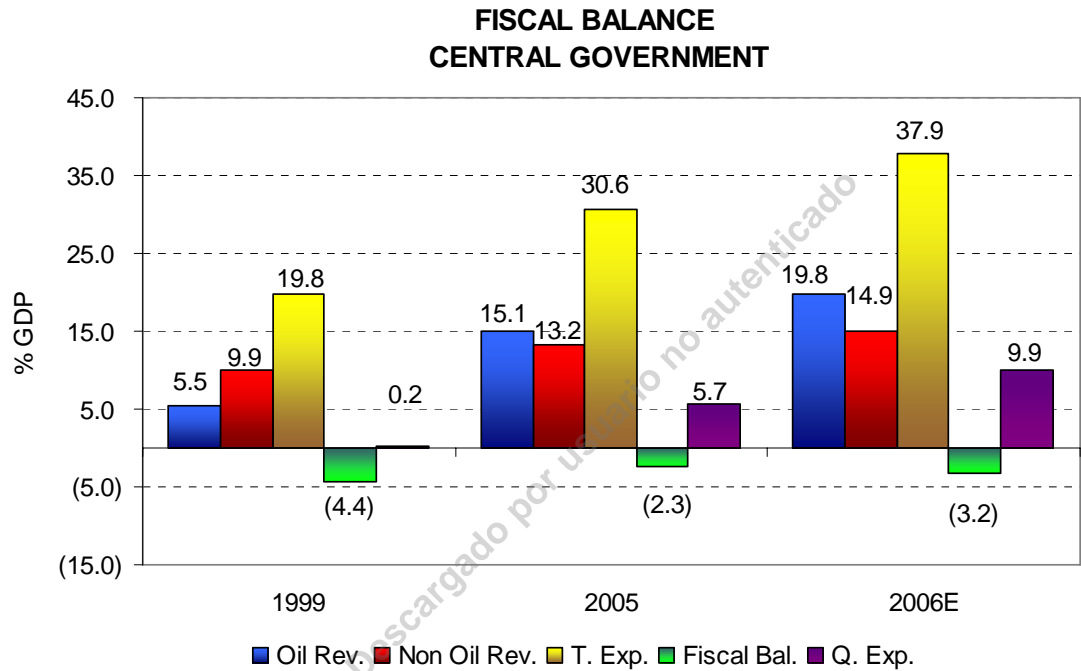
The main characteristics of Venezuela's fiscal policy over the last 7 years have been lack of transparency, disorder, the inclusion of extraordinary financing methods such as currency units and the transfer of international reserves, and the increase of cuasi-fiscal expenditure.

History repeats itself ... this time more dramatically

We at Ecoanalítica believe that the current administration not only needs high oil prices but that such prices continue to grow over time, because it is patently clear that the rhythm with which expenditure is growing bears no relationship at all to the growth in price of our oil basket - it is far more pronounced. This may not be new, but it has been made worse by significantly increasing the cuasi-fiscal debt and diminishing institutional control.

In fact, for the first year of government of President Chavez, the cuasi-fiscal deficit amounted to 4.6 points of the GDP and, at that time, cuasi-fiscal expenditure was almost non-existent, amounting to 0.2 points of the GDP. Last year, cuasi-fiscal expenditure stood at 5.7 points of the GDP. The most significant fact is that over 6 years, the cuasi-fiscal deficit has increased by 3.4 GDP points to stand at 8 GDP points. For this year, Ecoanalítica estimates that the cuasi-fiscal deficit will rise to 13.1 GDP points, which would mean an

increase equivalent to 8.5 GDP points, when compared to the year 1999.

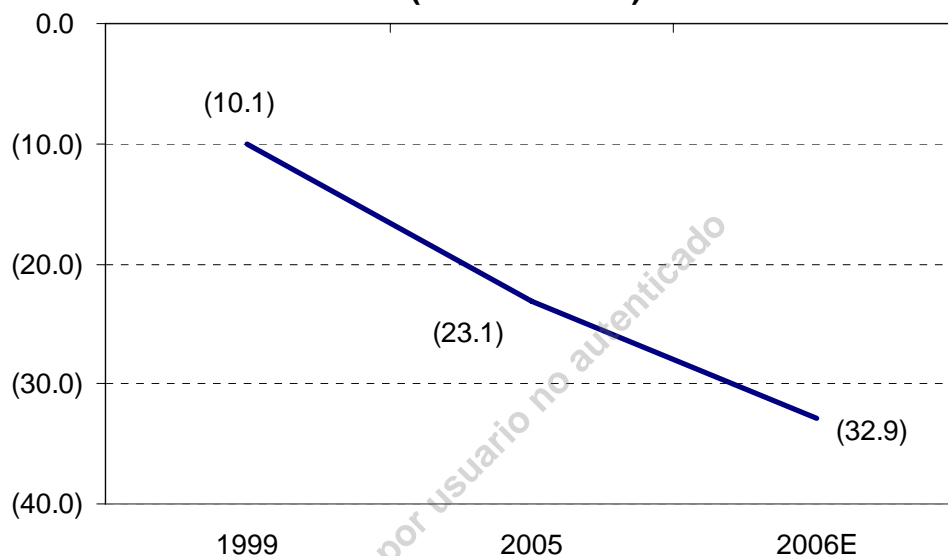


Source: MF and Ecoanalítica

The non-oil cuasi-fiscal deficit has tripled in 7 years

Upon analysis, the non-oil cuasi-fiscal deficit is more worrying. This indicator measures the fraction of total expenditure that has to be financed by oil and debt. For the year 1999, this amounted to 10.1 GDP points, or approximately US\$ 8.4 billion, 50.5% of total expenditure. This year, the non-oil cuasi-fiscal deficit will reach 32.9 GDP points or US\$ 51 billion. This means that of the total of public expenditure for this year, oil will have to finance US\$ 51 billion, or 68.8% of total expenditure expected for the year. Thus the fiscal accounts are now far more dependent on oil revenue than they were in 1999. What is more, the voracious fiscal appetite is now so gigantic that when faced with the positive shock of rising oil prices, we have spent all the extra income and gotten ourselves into debt on top of that.

Non Oil Quasi Fiscal Balance (% of the GDP)



Source: Ecoanalítica

If this dynamic continues, the fall to earth will not be far behind

In this current oil bonanza, and if the non-oil revenues continue at their expected level, the Government will be able to maintain its projected level of expenditure for one-and-a-half years. But this is not a recommendable policy and would be counterproductive over the medium and long term, given the monetary implications that it represents. If the Government keeps up its expenditure levels for 18 months and spends all its reserves, the adjustment to be suffered by the economy would be extremely severe and impoverishing. In such a scenario, it would be difficult for the Government to sell debt and it would have to reduce its primary expenditure, net of interest, by at least one half. Quite a different scenario would be one where the Government plans its expenditure in advance, and, if faced with a drop in oil prices, seeks a soft landing so that the adjustment is less severe. In a year of elections, however, the scenario will unfortunately be more akin to the first than the second

Economic Tips

FONDEN presents its results. Among the numbers presented, two stand out: firstly, that its assets amount to US\$ 8.826 billion, and secondly, that 40% of the resources meant for infrastructure (US\$ 3.228 billion) have yet to be distributed.

Distribution does not equal execution. It is important to emphasize that although FONDEN has distributed US\$ 5.382 billion among different projects, this does not mean that the resources have been executed in their entirety, but rather that this happens gradually.

The numbers do not square up. According to the numbers announced by the MF, FONDEN's assets do not tally with the contributions made by the BCV and PDVSA. According to MF calculations, these assets should amount to around US\$ 15 billion. This means that the MF is not explaining where a total of US\$ 6.174 billion was spent. For *Ecoanalítica*, a proportion of such resources has been used by the aforementioned Ministry to buy back foreign debt during the first half of the year (about US\$1 billion). The remaining US\$5.174 billion has probably been used to finance certain infrastructure projects or even to cover current expenditure. Nevertheless, it would be useful if the MF could explain what use was given to the resources.

New judicial instance. SENIAT has suggested the constitution of an instance to review violations of the legal tax framework. The new instance would be the Supreme Criminal Tax Tribunal before the TSJ.

SENIAT estimates. To date, the SENIAT has collected VEB 31 trillion and estimates that non-oil collections for the year will amount to VEB 50 trillion. At *Ecoanalítica*, however, we calculate that this figure could be over VEB 55 trillion.

Oil Tips

Down again. The barrel of Venezuelan oil went down US\$ 1.03 last week to end at a weekly average of US\$ 61.79 per barrel, putting the August average at US\$ 63.73 and the year-to-date average at US\$ 58.68 per barrel.

Weekly Report

An uphill target. According to PDVSA calculations, our crude production will increase by 75% over the 2006 - 2012 business plan period. Using official numbers this translates into 2.5 million barrels on top of the current figure which, according to PDVSA is 3.3 million barrels per day. However, in our opinion, current production is nearer 2.6 million barrels per day and seems to be stuck there, since the average over the last three years has been 2.63 million barrels per day, therefore the company's targeted production looks unlikely.

No transition period. Unlike the migration from operating agreements to joint-venture companies, which has taken more than a year, the migration of strategic associations will not take into account a similar transition period, since such businesses are not considered illegal, having been approved by the former Congress, according to sources at PDVSA. It is also foreseen that the four associations will be separated into two stages: upstream (extra-heavy crude extraction) and upgrading. For the first stage, the State, through CVP, will keep a majority shareholding, but this will not be the case for the second stage, where the partners will be allowed to keep their majority participation.

Sectoral Tips

No longer the BCV. The National Intendant of Internal Tributes at the SENIAT, Noel Gonzalez, has indicated that two officials from the Special Taxpayers Management and two from the Audit Office will be assigned to calculate CANTV's debt with its retirees and pensioners. Although it has not been said whether this new calculation eliminates the one made by the BCV experts, we think this is indeed the case, whereupon the case of CANTV's debt with its ex-workers is back to square one. According to our calculations, the maximum amount to be paid by CANTV would be US\$ 650 million.

Good year for the BVC. During the first 8 months of the year, the BVC Index has grown 74% and company earnings for H106 were VEB 1.9 trillion (US\$ 860 million), representing an increase of 69% over the previous year.

The financial system is in the lead. Of the total earnings obtained by the companies listed in the BVC, 61% corresponds to banks, 23% to companies in the services area, and 16% to the industrial sector.

Mutual funds doing well. Resources handled through mutual funds have grown 22% in the first 7 months of the year, compared with the same period of 2005. The best performance has been that of the mixed Bolivar funds, i.e., where money is invested in

Weekly Report

BVC shares and bonds, with earnings through July of 16.58%. On the other hand, mutual funds investing only in bonds or commercial paper, known in the market as fixed-return instruments, have earned an average of 5.92%.

Control of commissions. The board of the BCV issued a resolution prohibiting financial institutions from increasing their service commissions and rates. Banks are now obliged to freeze the rates and commissions that they had in force on August 23, and future adjustments have to be authorized by the BCV. Neither are they allowed to create new charges, unless they receive the go-ahead from the BCV. In our opinion this measure should not be a permanent one, since the ideal is that the market itself imposes competition and that the users can choose the financial services that they deem most convenient. In this regard, we think that the BCV's initiative of publishing on its website the different commissions charged by each bank is a positive step.

Sales rising. According to the BCV, the sales volume index rose by 35.3% in May, compared with last year. The strong 59.8% increase in wholesale sales is the highest of the year, while retail sales rose 25.1%. For the January - May period, sales have increased 32.5% year-on-year.

Meager gains in manufacturing. As opposed to the commercial sector, manufacturing showed a modest growth of 13.7% in May, against May last year. Nevertheless, year-on-year growth reached 9.4% for the first 5 months. The manufacturing sector is the one most affected by the over-valuation of the exchange rate. The timber sector is the hardest hit with a drop of 20.6% during the same period in question.

Labor legislation changes. The Government will submit for public consultation a draft resolution extending the breast-feeding period to nine months, counted as of the date of birth, in order for the mother to enjoy the necessary paid leave for correctly breast-feeding her children. Also under study is the extension of this period to 12 months, when the employer does not have a child-care center, or in cases where the mother or her child have an apparently abnormal health condition.

Another change in the housing target. The Housing Minister, Ramón Carrizalez, has indicated that by the close of Q306 he will have 60,000 housing solutions ready. This target looks to be far removed from the Government's established goal for this year of 150,000 dwellings. If the latter is to be respected, it would mean the construction of 90,000 homes during the last half, at an average of 978 homes per day. We see this as technically unfeasible.

Living an "illusion of harmony". According to the 2006 Pulse of the Nation prepared by Datos, the perception held by all Venezuelans of their economy has not varied since

Weekly Report

2005, with 45% considering that it is the same or better, and 54% thinking it is the same or worse than before. In fact, for Q106, 56% of those polled are satisfied with the current state of well-being, however, they insist on urgent attention to problems that are deep-rooted in society, such as insecurity, high prices and unemployment.

The missions are well considered. According to this study, the missions that have been most successful in achieving the satisfaction of the populace have been those related to food and health, whilst those dedicated to education have suffered a decline in level of interest. For Q105 the Mercal mission had accomplished a 35% penetration in the population, while for the same period this year the figure had risen to 46%. As far as Barrio Adentro, level of acceptance rose from 17% to 20% in one year. The Sucre and Ribas education missions, however, had a penetration level of 25% in Q105, which fell to 23% in Q106.

Increase in electricity generation. According to CAVEINEL, the country's accumulated electricity generation rose by 5.7% through July compared with the same period of last year.

A new bank. SUDEBAN is studying the creation of a new State bank to attend the needs of the tourism sector. It is hoped that it will be operative by the beginning of next year.

Ford sales rising. During the first half of the year, Ford's sales increased by 77% over the same period last year. The company also increased its market share by 3.5%.

Political Tips

One more. Roberto Smith, of the Venezuela de Primera Party, announced the withdrawal of his presidential candidacy and passed over to the sole opposition formula headed by Manuel Rosales. Smith will form part of the campaign team, probably in the strategic area alongside Teodoro Petkoff. This is a positive step for the opposition and at Ecoanalítica we do not rule out the possibility that Benjamin Rausseo will also set aside his aspirations over the next month or so.

Rosales starts his campaign on the right foot. Rosales' campaign has started off much better than expected, attacking and reducing despair and increasing the possibility of bringing in those factors that were previously close to officialism.

Weekly Report

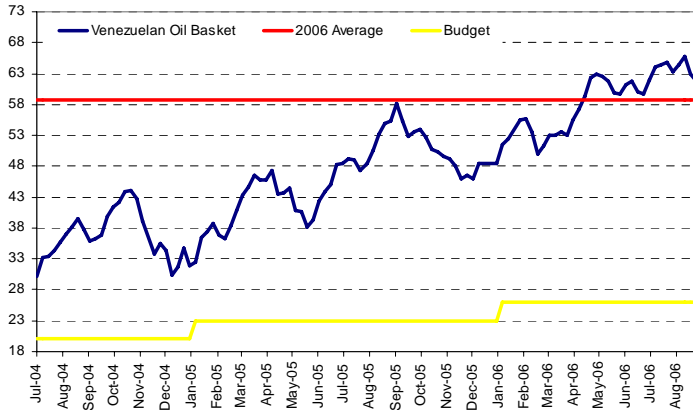
Unfortunately we have no poll results, but we believe that the numbers are getting closer.

CNE seeks 17 million. According to governor Sandra Oblitas, the CNE's goal is for the REP to have 17 million voters registered by September 4. However, by the month of June, which is the last total approved by the board, 15,572,000 voters were registered. In other words, in the two remaining months (July and August), the CNE needed to register a further 1.5 million voters to meet its target.

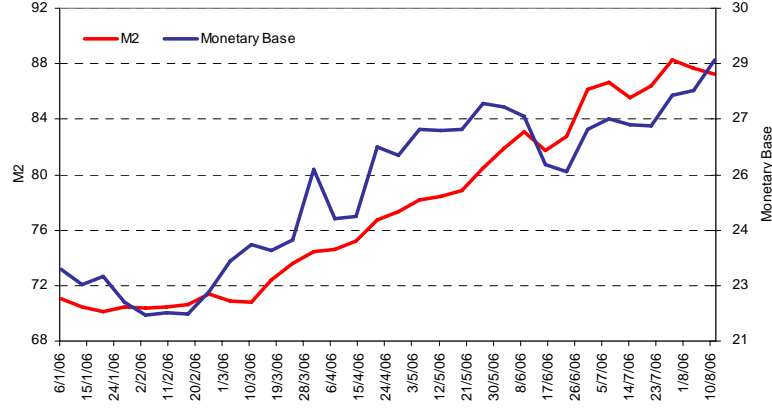
© Ecoanalítica – Descargado por usuario no autenticado

ECONOMIC OVERVIEW

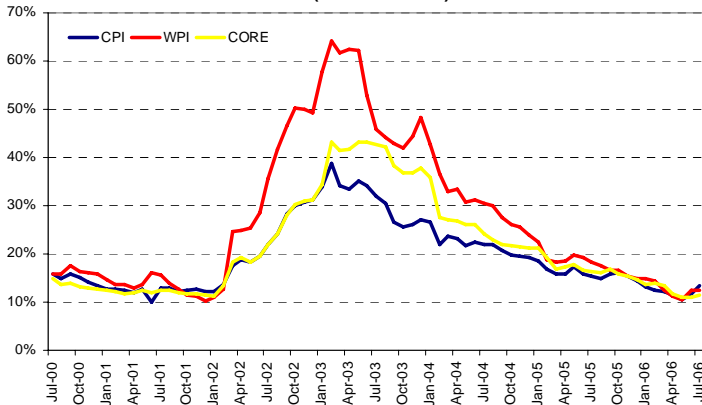
Oil Price
(Venezuelan Basket US\$/pb)



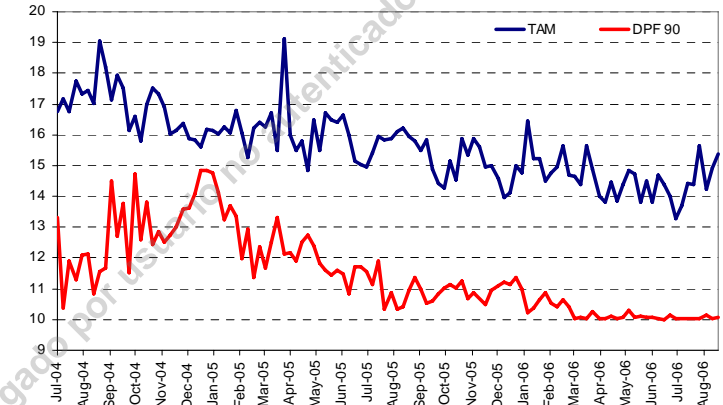
Monetary Base & M2
(VEB Billions)



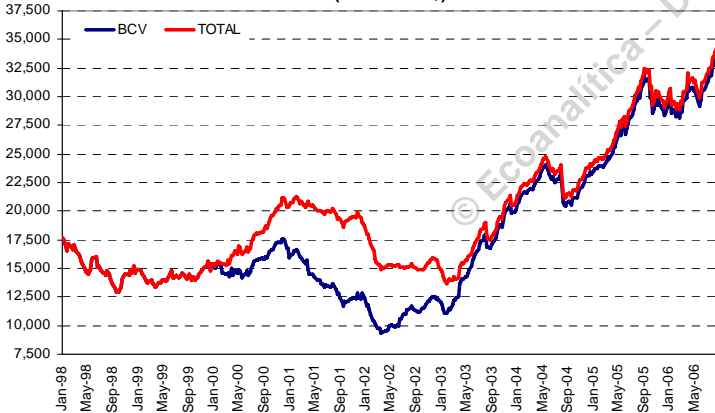
Inflation
(Last 12 Months)



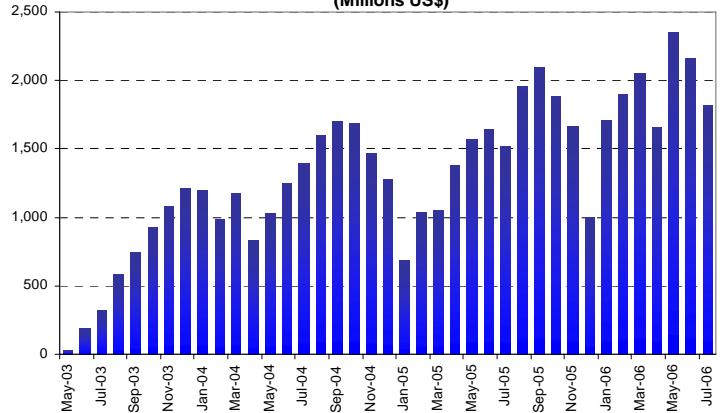
Interest Rate
(Six Principal Banks)



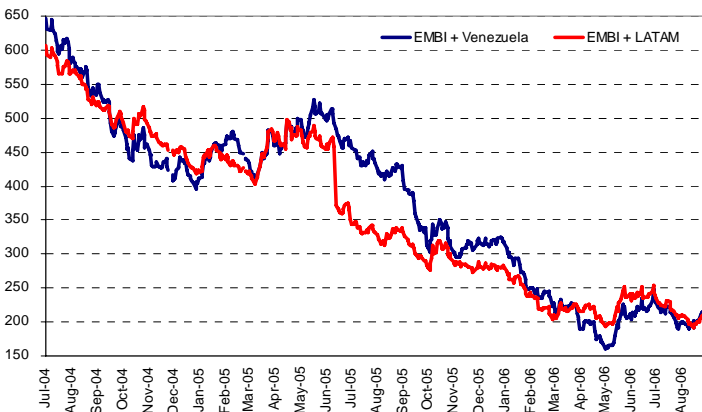
Fx Reserves
(Millions US\$)



Disbursement
(Millions US\$)



EMBI



Central Government
(VEB Billions)

