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THE PRIVATE SECTOR SHOULD FOLLOW THE PUBLIC SECTOR'S EXAMPLE AND REDUCE ITS LARGELY EXTERNAL DEBT

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THE CLIENT

In the current situation CADIVI needs to urgently issue regulations to enable the private sector to join the efforts of the public sector and reduce its external liabilities. A reduction of the external private debt would help control the monetary aggregates and ease pressure on prices. The possibility of exchanging external private debt for new issues on the local market would also deepen the stock market and create new sources of domestic savings needed for the low-income population.

A positive aspect of exchange controls is the deepening of our knowledge of the foreign private sector

Although exchange controls have created significant distortions in the Venezuelan economy, they have also supplied more detailed information on the Venezuelan private sector's relations with the rest of the world, especially the quantification of the external private debt and the nature of imports.

Using information from the National Foreign Currency Commission (CADIVI), **Ecoanalítica** has found that:

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1) CADIVI could be financing 70% of ordinary imports. The other 30% must be financed with foreign currency from other sources. So the government's concern about the trend in the parallel exchange market is understandable.

2) Registered external private debt totals US\$8.77 billion, including some payments up to 2017. Currently the average cost of debt service is between US\$500 and US\$600 million a year.

3) 57% of the foreign currency liquidated relates to domestic consumption, 26% to capital goods, and 17% to final consumption. This confirms the idea that the import sector is the most dynamic in Venezuela.

The public-sector debt repurchase has been positive

Exchange controls and high oil prices have improved the profile and costs of the external public debt. As part of this strategy, the repurchase of external public debt in the first half of 2006 has reduced pressure on liquidity and inflation. For these debt operations, the central government placed bonds and other paper on the domestic market which mopped up surplus liquidity in the financial system. This reduction of liquidity should moderate the cost of Central Bank monetary policy and dampen inflationary pressures. Since May the government has issued almost VEB4.0 trillion (US\$1.86 billion) in domestic public debt bonds at fixed interest (TIF).

CADIVI should let the private sector follow this example

Ecoanalítica strongly believes that the private sector should follow this example and reduce its foreign liabilities. The impact of a fall in the amount of external private debt (approximately US\$8.80 billion) would be more limited than the reduction of the public sector debt but equally positive. A lower external private debt would help control the monetary aggregates and ease pressure on prices, especially in view of the spiraling inflation of the last three months. When the private sector issues a variety of instruments on the local market to raise funds and pay its external debt, it deepens the stock market and creates new sources of the long-term domestic savings needed for the low-income population.

The plan has an impact on surplus liquidity

If the private sector repurchased 50% of its debt, liquidity surpluses would be cut by VEB9.5 trillion, a saving of VEB1.0 trillion a year in the cost of monetary policy. The Central Bank figures on absorption operations show that the cost of monetary policy in the first eight

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months of the year was VEB2.0 trillion, generated by the interest paid by the Bank on the certificates of deposit (CD) that it issues to take out part of the surplus liquidity in the system.

Repurchase also reduces inflation

Another effect would be to soften the pressure of the monetary surpluses on inflation. Like the public sector, the private sector could improve its external debt profile and make considerable savings in its service payments in the near future. In the example given, a 50% repurchase of external debt would produce foreign currency savings of over US\$400 million. This would improve the external accounts

Democratization of capital

In recent months, the national government through the National Securities Commission (CNV) has been promoting "democratization of capital" under the citizen participation program and the program for trading shares of state companies (especially mining), private companies and small and medium-sized enterprises (SMEs) on the Caracas Stock Exchange. In essence, the project encourages workers and small investors to become shareholders, and creates incentives for public and private companies to use the market as an alternative means of finance and saving.

The fact that part of the amount of the private debt repurchase program has to be financed through the stock market (equity and bond issues, etc) with new financial instruments deepens the market and creates incentives for long-term domestic private saving, a fundamental component for the sustained and socially responsible growth that the country needs.

The private sector can also gain from the current situation.

The current economic situation is not only advantageous for the public sector, the private sector should also use the opportunity to reduce its external debt. A program has to be designed to replace costly debt for debt on better financial conditions, given the advantages that exchange control can offer in this respect. The resources used to reduce liabilities would release funds in future years which could be invested in physical capital leading to higher growth for companies and for the nation.

Economic Tips

A first look at the 2007 budget. On a visit to the National Assembly Finance Committee, Finance Minister Nelson Merentes announced the preliminary estimates used by the government in the design of the 2007 budget. Economic growth is projected at between 5% and 6% of GDP with non-oil fiscal receipts (by SENIAT) of 16.3% of GDP, in line with our estimate. *Ecoanalítica* sees the growth estimate as conservative compared with our projection of over 7.0% growth.

Very conservative oil scenario. The preliminary estimates are based on three scenarios for crude prices: US\$28, US\$30 and US\$35 per barrel. Two foreign exchange scenarios are analyzed, which are still being reviewed by the economic cabinet. Evidently, the government is continuing its practice of underestimating the oil price in order to manage the surpluses at its discretion.

Bond of the South for October but market expects issue in 2007. In another development, Merentes said that the Bond of the South issue was almost ready and that placement would be at the right time in early October with a first tranche of US\$1.00 billion of Venezuelan fixed-interest bonds (TIF); however, according to market rumors, the first issue of the bond will not be until 2007. The Argentine instrument has not been defined.

The TIF get credit rating. Standard & Poor's agency granted a "BB" grade to the TIF bonds (fixed-interest paper) in local currency maturing between 2018 and 2020.

Non-oil receipts up 30% in August. According to SENIAT, non-oil tax collections in August totaled VEB4.2 trillion, a 30.4% year-on-year increase. These higher levels relate to VAT and customs with VEB1.4 trillion each. This year, SENIAT has collected VEB33.6 trillion, up 39.3% from the same period last year. Income tax supplies VEB13.3 trillion of this total.

VAT cut on standby. Tax Superintendent José Vielma said that the cut in the VAT rate to 13% on October 1 (would not be easy) and was even unlikely this year, although the date does not depend on SENIAT. The government may have realized that the measure would have little political impact, and that cutting non-oil revenue in a context of falling crude prices would be unwise.

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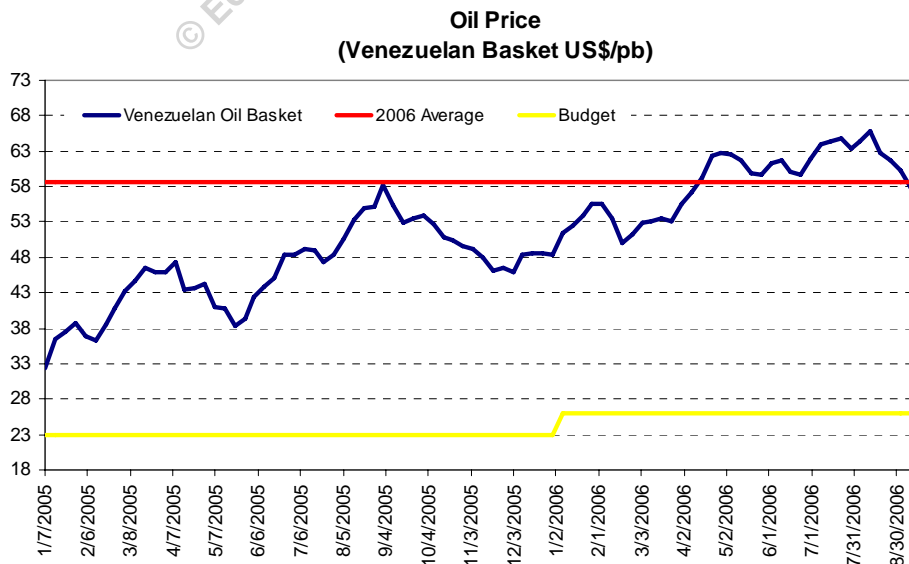
NATIONAL TAX COLLECTION		AUGUST		
(Bs. Billions)	2006	2005	Var %	Var % Real
TOTAL	4,234	3,248	30.4%	13.5%
Income TAX	1,286	742	73.3%	50.8%
Tax	1,402	1,174	19.5%	4.0%
Customs	1,399	970	44.3%	25.6%
Others Incomes	146	116	26.7%	10.3%
Debit Tax	0	246	-100.0%	-100.0%

NATIONAL TAX COLLECTION		JANUARY-AUGUST		
(Bs. Billions)	2006	2005	Var %	Var % Real
TOTAL	33,623	24,139	39.3%	23.8%
Income TAX	13,254	7,366	79.9%	60.0%
Tax	10,484	8,064	30.0%	15.6%
Customs	8,579	6,334	35.4%	20.4%
Others Incomes	984	787	25.0%	11.1%
Debit Tax	324	1,589	-79.6%	-81.9%

Sources: SENIAT and Ecoanalítica

Oil Tips

Oil basket falls for 7th month in a row. The Venezuelan crude basket fell US\$3.52 last week to average US\$54.23 a barrel. This is the seventh week running that the price of the basket has dropped, a total fall of US\$10.6 per barrel since July 29. So far this year, the Venezuelan oil basket has averaged US\$58.59 per barrel.



Source: MEM and Ecoanalítica

PDVSA represses foreign currency to control liquidity surplus. Merentes announced that PDVSA was holding its windfall petrodollars in an account in the National Treasury and that the funds would be sold when required for additional credits. This mechanism will receive deposits of US\$4.00 billion to US\$5.00 billion for four months. In addition to this scheme, a change will be made in the flow of funds from official bodies and agencies, along with the planning of the disbursement of the additional credits. However, given the entry into force of Foreign Exchange Agreement No. 9, which governs the flow of dollars from PDVSA to the Central Bank, the state oil company has already deposited part of its dollars in foreign accounts, along with a part in FONDEN.

Oil investment too little. According to the IMF, Venezuela should invest more of its public expenditure in the oil sector. "Venezuela has a tremendous opportunity with current crude prices to use the resources from oil to reduce poverty and make the investments needed in the oil sector to maintain competitiveness in the future."

Ramírez confirms issue of PDVSA bonds. According to PDVSA President Rafael Ramírez, the company plans to have a bond issue for US\$3.50 billion ready before the end of the year. The paper to finance energy projects and control liquidity will be placed on the local market. The operation will take place without audited financial statements, which will mean a higher financial cost.

Sectoral Tips

Financial system results. Net lending grew 4.2% in August from the month before. This year lending has grown 26.4%. Investments in securities grew to VEB36.9 trillion, up 43.2% growth this year. Deposits rose 2.2% month-on-month in August with 34.3% growth in the first eight months of the year.

Trusts on the rise. In August, assets held in trusts in the financial system totaled VEB71.0 trillion. The Treasury leads with VEB28.8 trillion (40.6% of the total). Official deposits rose to VEB20.2 trillion, a 44.1% increase in the first eight months of the year. The simple loan-to-deposit ratio in August was 39%, while the ROE was 28.0%, higher than in the same month last year (25.4%).

Franchises a key sector. The franchise sector in Venezuela is composed of 332 brands and operates 6,755 establishments which generate over 35,000 direct jobs and double the number of indirect jobs. Its economic impact is around 5% of non-oil GDP,

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resulting in sales revenue of VEB480 billion (US\$224 million) monthly. Profranquicia, the association that represents businesses in the sector, estimates that 65% of the brands in the country are of Venezuelan origin.

Venezuela seen as threat. According to the Business Climate in Latin America survey, 78% of the executives interviewed believe that their companies in the region performed better this year than in 2005, while 19% say there was no change. The remaining 3% say their businesses were worse off in 2006. Lastly, 71% see Venezuela as a threat in the region.

Growth in insurance sector. According to the Insurance Superintendency premiums in July rose to VEB5.2 trillion, 41.4% growth from the same period last year.

Political Tips

New man at the ministry. The Ministry for the Popular Economy (MINEP), after almost two years of operations, receives its third minister following the announcement in the Official Gazette of the appointment of Deputy Pedro Morejón Carrillo (MVR-Miranda) who will replace Oly Millán. Morejón was also named President of the National Institute of Education Training (INCE) to replace Ángel Custodio Velásquez.

16 million on voter roll. According to the National Electoral Council (CNE), the voter roll totals 16,081,971 voters; however only 15,919,261 citizens are Venezuelan and can participate in the presidential elections this December.

The war of the polls. The latest opinion poll taken by the firm PS & B Associates reveals that President Chavez has a voting intention of 50% and Manuel Rosales 37%. The results also show that most Venezuelans rate Chavez' performance as either fair or bad: for example, 73% give the thumbs down on street crime and fighting corruption, and 62% on combating poverty.

A novel methodology. To obtain the data, the firm used a methodology that is not usual in Venezuela. To reduce the incidence of "political fear" among interviewees, the survey was made by telephone. This is an important innovation because, according to the experts, the "fear" variable could be a decisive factor for the opposition vote.

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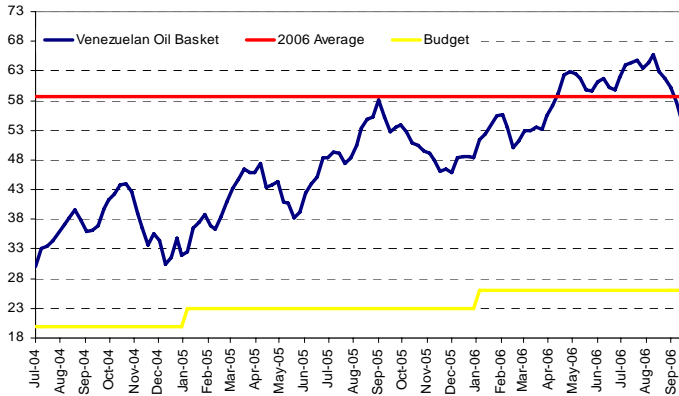
Another poll. According to the Hinterlaces poll, Chavez has a 40% voting intention, while Manuel Rosales has 30% of voter preferences, having grown 11% monthly from 7% in June. The poll was taken from August 24 to September 3 in 18 states.

Most difficult stage. According to Hinterlaces, the most intense and difficult stage of the campaign is now beginning: conquering the 20% undecided who have the capacity to define the outcome on December 3. All the other candidates combined total only 2%. The poll also reveals a very balanced election market: 20% define themselves as opposition, 34% as Chavez supporters, and 46% as neutral or independent.

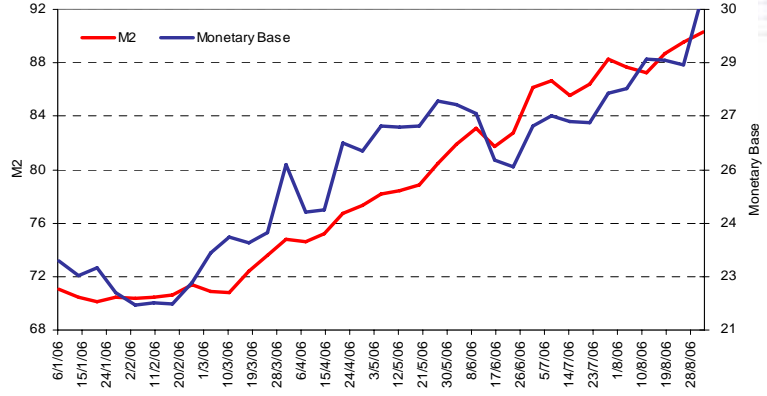
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ECONOMIC OVERVIEW

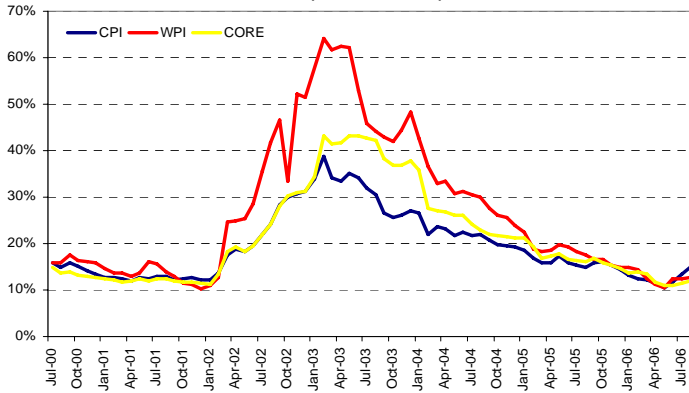
Oil Price
(Venezuelan Basket US\$/pb)



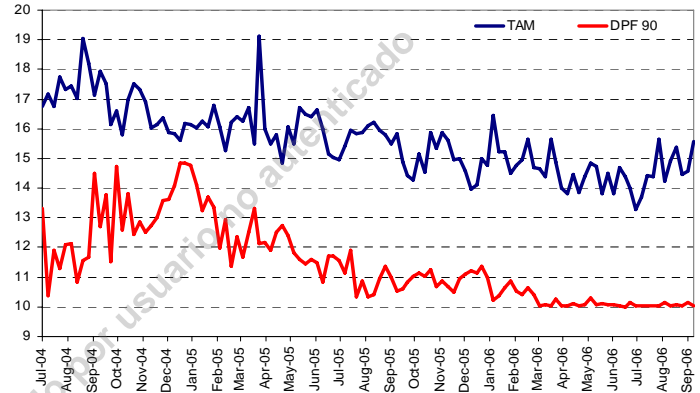
Monetary Base & M2
(VEB Billions)



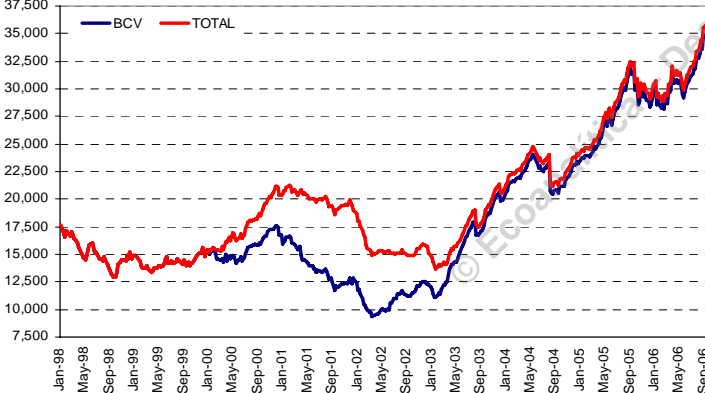
Inflation
(Last 12 Months)



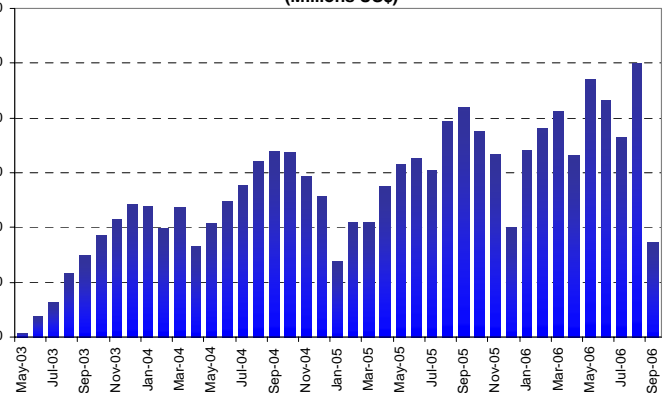
Interest Rate
(Six Principal Banks)



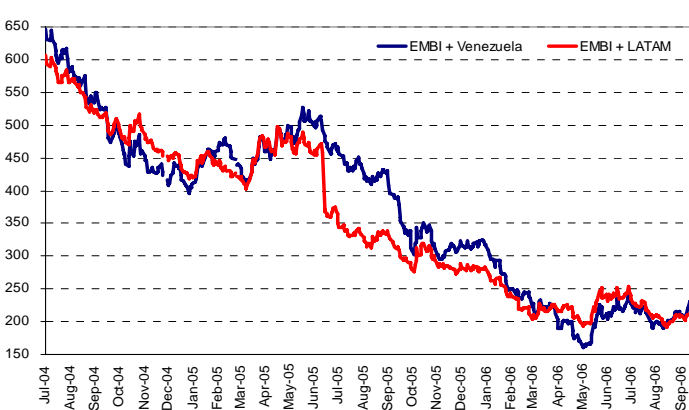
Fx Reserves
(Millions US\$)



Disbursement
(Millions US\$)



EMBI



Central Government
(VEB Billions)

