



Volume 2, Number 44
November 17, 2006

By:
Alejandro Grisanti
Asdrúbal Oliveros

Edited by:
Gabriel Dobson

**DESPITE SOARING
EXPENDITURE, THE
PUBLIC SECTOR IS IN
SURPLUS**

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

The Ministry of Finance has published the figures for the Consolidated Public Sector for 2004 and 2005. The most outstanding result is that the public sector ended 2005 with a significant surplus of over four points of GDP. Additionally, PDVSA is playing a fundamental role in the trend in public finances in Venezuela. **Ecoanalítica** expects the public sector surplus to be down to 2.5% of GDP at the end of 2006.

**With a delay, the Finance
Ministry presents CPS
figures**

Just a week ago, the government announced very discreetly the fiscal figures for the Consolidated Public Sector (CPS) for 2004 and 2005. The CPS fiscal accounts give a more complete view of the fiscal management of the Chavez administration in recent years. The reason for this is that they include not only the central government but also PDVSA, non-financial public companies, Social Security and FOGADE. In future years they will also include FONDEN but this only began to operations in 2006.

Four key results in the 2001-2005 period.

An analysis of the CPS figures highlights four aspects:

1. A strong 11.7 point increase in total revenue mainly due to oil revenue. The PDVSA surplus increased 7.8% percentage points, which is 67% of the total increase.
2. Total expenditure apparently grew only 2.7 points from 31.9 to 34.6 points of GDP; however, these figures have a hidden trap so public expenditure could be higher.
3. The CPS moved from an overall deficit of 4.6 points of GDP in 2001 to a surplus of 4.4 points of GDP in 2005.
4. The extrabudgetary expenditure of the central government is irrelevant, representing only 0.5% of GDP in 2005. What the economists call "extrabudgetary expenditure" is being included in other items, especially concerning PDVSA and the non-financial public companies.

Consolidated Public Sector (CPS) (% GDP)					
	2001	2002	2003	2004	2005
Consolidated Public Sector					
Total Revenues	27,3%	29,5%	32,4%	36,1%	39,0%
Tax Revenues	9,6%	10,0%	10,3%	11,7%	12,5%
Non-Tax Revenues	17,7%	19,5%	22,0%	24,4%	26,5%
Central Government	0,0%	0,0%	0,0%	0,0%	0,0%
PDVSA Operating Surplus	12,5%	14,3%	17,7%	19,3%	20,3%
FIV (BANDES) Interest and Dividend Income	0,0%	0,0%	0,0%	0,0%	0,0%
Non-financial Public Enterprises	0,5%	1,1%	0,8%	1,0%	0,7%
Capital Revenues	0,0%	0,0%	0,0%	0,0%	0,0%
Other	4,7%	4,1%	3,6%	4,1%	5,4%
Total Expenditures	31,9%	31,0%	32,2%	32,8%	34,6%
Current Expenditures	20,9%	20,7%	22,2%	22,9%	22,2%
Salaries, etc.	5,1%	4,7%	4,9%	4,6%	4,2%
Purchases of Goods and Services	1,6%	1,9%	1,9%	1,6%	1,6%
Interest Payments	3,4%	5,2%	5,2%	4,1%	3,1%
Transfers to Private Sector	2,1%	1,5%	1,8%	2,9%	2,9%
Central Government Transfers to Unconsolidated Entities	8,6%	7,1%	8,1%	9,3%	10,2%
Other (2)	0,1%	0,3%	0,3%	0,4%	0,2%
Central Government (Extra-Budgetary)	1,0%	1,1%	1,0%	0,6%	0,5%
Capital Expenditures	10,0%	9,2%	9,0%	9,3%	11,9%
Capital Formation	5,9%	5,6%	5,2%	3,7%	3,8%
Other (Including Transfers to Unconsolidated Entities)	4,1%	3,7%	3,8%	5,7%	8,1%
Overall Surplus (Deficit)	-4,6%	-1,5%	0,2%	3,3%	4,4%

Sources: Finance Ministry and Ecoanalítica

The CPS figures do not necessarily reveal total expenditure

The CPS figures seem to pour a bucket of cold water over our thesis that the government has been significantly increasing its expenditure in recent years. Public sector expenditure totaled only 34.6 points of GDP in 2005. However, this figure may not be reflecting the real extent of public expenditure.

The reason is that the ministry prepares these figures following the directives of the International Monetary Fund (IMF). According to the IMF manual, PDVSA, which is the country's leading public company, and the public financial companies must present their net financial results, that is the net profit for the period.

So for example 2005 shows that the net result of PDVSA is equivalent to 20.3 points of GDP. This figure includes a part of the public expenditure made by PDVSA which is not recorded in total expenditure. The same occurs, although to a lesser extent, with the non-financial public companies.

However, the CPS is in surplus

Obviously if the IMF methodology underestimates expenditure, it also underestimates revenue, so the deficit and/or surplus is the same either way. In the midst of the current oil bonanza, the public sector as a whole has been slowly improving its overall result from a deficit of 4.6 points of GDP in 2001 to 1.5 points in 2002, and to balance in 2003 (0.2%). In 2004 the sector ended with a surplus of 3.3 points of GDP which deepened in 2005.

The role of BANDES

Ecoanalítica is surprised by the fact that the BANDES item in revenue does not represent any value despite the preponderant role which BANDES has played in the last two years handling a significant volume of funds. The most logical explanation is that the funds were transferred to BANDES after the period in question and as they come from the oil surpluses they are included in the PDVSA financial results.

The heart of the matter is PDVSA

On this basis, **Ecoanalítica** can only conclude that the trend in Venezuelan public finances can only really be understood by including an in-depth study of the financial results of PDVSA and the new expenditure structure, especially the financing of the missions (social expenditure) and transfers to FONDEN and other public sector bodies. However, PDVSA still has to file its 2004 financial statements with the US Securities and Exchange Commission (SEC).

The 2006 results will show the impact of the presence of FONDEN and the Bank of the Treasury

2006 is a special year, not only because of a presidential election in which the incumbent president can run for reelection but also because of the start of operations of FONDEN which has total resources of around US\$18.00 billion, equivalent to 10.8 points of GDP, along with the Bank of the Treasury, which is leader in the trust area in the public sector. So the total expenditure disbursed by the public sector will be significant. Clearly when the ministry presents the 2006 results FONDEN will be shown net and the figures will continue the trend of past years. The Bank of the Treasury will not appear in the fiscal accounts of the CPS because as a public financial company it is not included in the CPS accounts.

CPS will have a 2.5% surplus

The CPS expenditure in 2006 will be around 38.5 points of GDP, following the methodology of the ministry and the IMF, with the net results for PDVSA, other non-financial public companies, and FONDEN. This is an increase of 3.9 points of GDP in only one year and 6.6 points of GDP compared with 2001. On these results, CPS will end this year with a surplus of 2.5 points of GDP.

The good health of the public sector is linked to the trend in oil prices

Obviously these are positive figures for the public sector. However, they are strongly linked to the high oil price of recent years. The oil surplus (PDVSA) is the revenue item which grows most, unlike tax revenue (via SENIAT) which only rose only 2.9 points. Capital formation (associated with public investment) fell between 2001 and 2005 from 5.9% of GDP to 3.8% of GDP.

Economic Tips

Economy picks up 2.2% in Q306. According to the Central Bank, economic activity grew 10.2% in Q306 year-on-year in line with our forecast of 10.1%. The non-oil sector expanded 11.7%, similar to our estimate while the oil sector fell 1.8% (*Ecoanalítica* forecast a fall of 1.0%). In the first nine months of the year, cumulative growth was 10.2%. On this result, we confirm our forecast of 9.8% economic growth this year. We will look at these results in more detail in our report next week.

SENIAT receipts down in October. According to the figures issued by SENIAT, during October collections totaled VEB4.0 trillion, down 9.4% from October 2005, due to the 13.6% drop in VAT collections and 10.6% in customs. Income tax maintained its growth

Weekly Report

rate, rising 29.8% year-on-year. The fall in customs receipts is extremely unusual because the September-November period is when receipts from this source are highest as companies prepare for the arrival of the Christmas season.

Good numbers this year. Between January and October, non-oil tax revenue increased to VEB41.9 trillion, 35% growth compared with the same period last year. In 2006, income tax overtook VAT as the main source of non-oil receipts. Income tax represents 36.9% of total collections, followed by VAT with 32.3% and customs with 27.0%. These three taxes provide 96.2% of total SENIAT receipts.

NATIONAL TAX COLLECTION		OCTOBER		
(VEB Billions)	2006	2005	Var %	Var % Real
TOTAL	4.006	4.420	-9,4%	-21,5%
Income TAX	902	695	29,8%	12,4%
Tax	1.497	1.731	-13,6%	-25,1%
Customs	1.475	1.650	-10,6%	-22,6%
Others Incomes	132	107	24,0%	7,4%
Debit Tax	0	238	-100,0%	-100,0%

NATIONAL TAX COLLECTION		JANUARY-OCTOBER		
(VEB Billions)	2006	2005	Var %	Var % Real
TOTAL	41.890	30.972	35,3%	19,6%
Income TAX	15.465	8.983	72,2%	52,3%
Tax	13.545	10.649	27,2%	12,5%
Customs	11.302	8.233	37,3%	21,4%
Others Incomes	1.255	1.016	23,4%	9,2%
Debit Tax	324	2.091	-84,5%	-86,3%

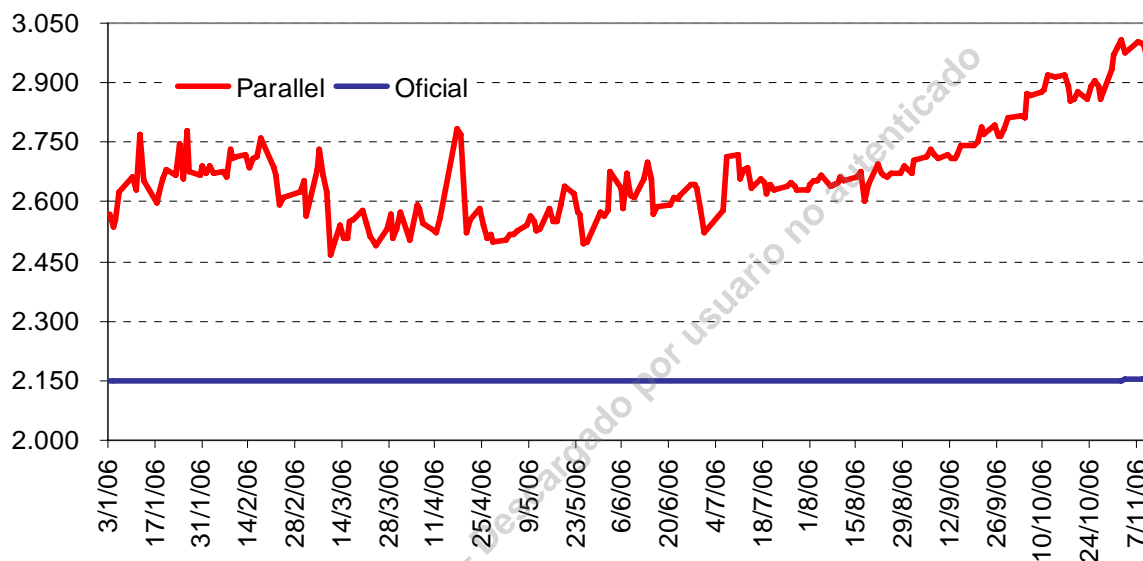
Sources: SENIAT and Ecoanalitica

Successful placement. The placement of the "Bond of the South" was a complete success both for the national government and for the privileged investors who were lucky enough to buy it. However, the amount was insufficient and revealed an almost insatiable demand for foreign currency in Venezuela. The Finance Ministry said they received over 59,000 purchase orders totaling US\$12.00 billion, a record for this type of operation. The ministry followed the tested pattern of previous placements: the more the amount applied for, the less the amount assigned. Large investors will receive only 1% to 2% of what they wanted. The maximum assigned by the ministry was US\$27,000 to buyers who applied for over US\$10 million.

Weekly Report

Parallel market rises Given that the bond issue totaled only US\$1 billion, excess demand caused the parallel exchange market through ADR operations and bond swaps to shoot up to VEB3,350 a dollar; a value that reflects market jitters but which are likely to be short-lived.

**Exchange Rate
(VEB/US\$)**



Sources: Reuters and Ecoanalítica

Pandora's Box With the Bond of the South, the government opened Pandora's Box in a market with high levels of liquidity avid to get its hands on foreign currency. The government will have to redesign its strategy to prevent the parallel market from reaching abusive levels and brake the unusual growth in surplus liquidity, especially in this season of the year. *Ecoanalítica* believes that the government will not make another issue this year. In the rest of 2006 the government will attack the problem through high liquidations of foreign currency by CADIVI, sales of structured notes, and placement of indexed bonds. However this formula is only short term and the strategy will have to be redesigned in 2007.

Fitch confirms The Fitch rating agency confirmed a "BB-" rating for Venezuelan long-term foreign currency debt. At the same time, Fitch confirmed the "B" rating for short-term foreign currency debt and the country ceiling of "BB -". The rating outlook remains stable.

HDI improves. Venezuela is in position 72 out all a total of 177 countries in the Human Development Index (HDI) prepared by UNDP, up from 75 in the previous report.

Income per capita is the key. The improvement is mostly explained by the increase in GDP per capita, which was US\$4,919 in the study last year on 2003 data. This year with data from 2004, the figure has risen to US\$6,043. The UNDP reports that Venezuela has reduced the number of people under the poverty line. With data for all of 2004, 8.3% of Venezuelans live on less than a dollar a day and 27.6% on less than two dollars. Last year these figures were respectively 15% and 32%. In the next few years, Venezuela should continue to improve its HDI ranking, given the economic recovery in 2005 and 2006.

Some key indicators. According to the UNDP, in Venezuela, public expenditure on health represents only 2% of GDP, below 3.4% in Brazil and one third of the allocation in Colombia. For each person, the Chavez administration spends US\$522 compared with US\$597 in Brazil. In contrast, Venezuela has more doctors than some of its neighbors, 194 for every 100,000 people (unchanged from last year), while Brazil has 115 and Colombia 135. The report also finds that 68% of Venezuelans have access to a sanitation network and 83% have drinking water. The rate of HIV infection in Venezuela is 0.7% in the 15-49 age group.

More regulations. The government will apply a 15% surcharge on the import of 205 tariff items categorized as luxury or with sufficient national production, President Chávez announced to a group of businessmen. He said that one of the items affected will be whisky. In addition to so-called luxury consumption, the tariff surcharge will also apply to items that have sufficient national production, including cigarettes, statuettes, and picture frames.

Yet more subsidies. President Chávez also announced that a list of 3,682 products will receive tariff benefits. The items affected are capital goods, inputs and raw materials needed to increase the production of cooperatives, SMEs and social production enterprises. All these items can be imported without prior application for a certificate of non-national production at the time of applying to CADIVI for the foreign currency.

Oil Tips

Oil basket up last week. The Venezuelan basket of oil and products gained US\$1.66 last week reaching US\$51.04 a barrel. This year the cumulative average is US\$57.19 per barrel.

Weekly Report

Oil production at a standstill. According to the US Energy Information Administration (EIA), national crude production was unchanged last month. In its monthly report on the short-term outlook, the EIA attributed Venezuela with total production of 2.45 million barrels a day, exactly the same as in the last two months. The agency also reported that Venezuela, Nigeria and Indonesia will be the only OPEC members that will not make any cuts in their current crude production as part of the global reduction of 1.2 million b/d which the cartel announced for November.

ENI goes to arbitration. In a statement, the Italian oil company ENI said that it considered the non-migration of the Dacion operating agreement to the joint venture model established in the Hydrocarbon Organic Law a "violation of its rights." The company will begin arbitration proceedings against Venezuela in the International Center for the Settlement of Investment Disputes. ENI recalled that there was an investment protection treaty between Venezuela and Holland, the country where ENI Dacion, the subsidiary that operated the Dacion field until April, is registered.

Sectoral Tips

EDC results. According to data from Electricidad de Caracas (EDC) for Q306, operating income grew to VEB403.20 billion, up only 2.5% year-on-year. This disappointing increase is mainly due to the tariff regulation imposed by the national government. Operating expenses (including depreciation) increased to VEB207.30 billion, up 12.2% from the same quarter last year. According to EDC this increase is mainly explained by the wage hikes in the Collective Agreement 2004-2006.

EBITDA falls but debt profile improves. For the third quarter, EBITDA dropped to VEB95.80 billion, 6.0% down from the same period last year. Net profit fell 58.0% year-on-year to VEB43.00 billion. At the end of Q306, EDC held debt of US\$283 million, down US\$135 million from Q305.

Domínguez y Cía IPO. Domínguez y Cía. and Econoinvest Casa de Bolsa announced the results of the recent IPO. A total of 2,924 bids were received for shares in the issue from October 3 to 13. The company satisfactorily placed 100% of the issue.

Political Tips

Benjamín Rausseo drops out. Presidential candidate Benjamín Rausseo announced the withdrawal of his presidential candidacy after unfavorable poll results (voting intention under 2%). The former presidential hopeful said that he would grant freedom

Weekly Report

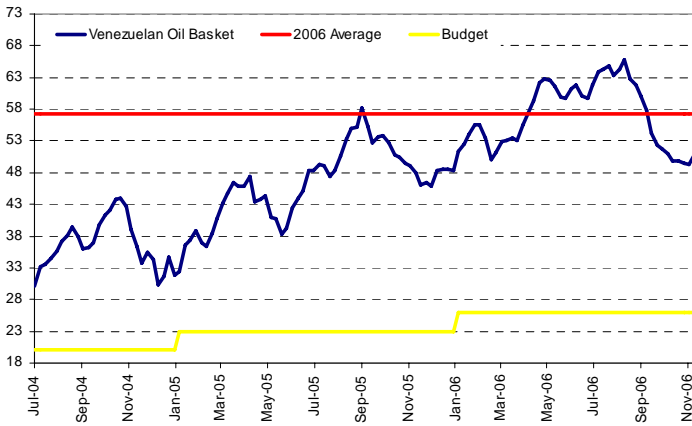
of conscience to his supporters to decide who they would vote for. Rausseo had been expected to withdraw for some time. The surprise was that he did not directly offer to support national unity candidate Manuel Rosales, although given his low poll rating this will not affect Rosales' chances.

EU to observe election. The European Union (EU) and the Electoral Council (CNE) signed a memorandum of understanding under which the EU will be an official international observer of the presidential election along with the OAS. The CNE also hopes to sign a similar agreement with the Carter Center and the Mercosur election observers. This agreement is positive given the technical expertise of the EU in similar election processes.

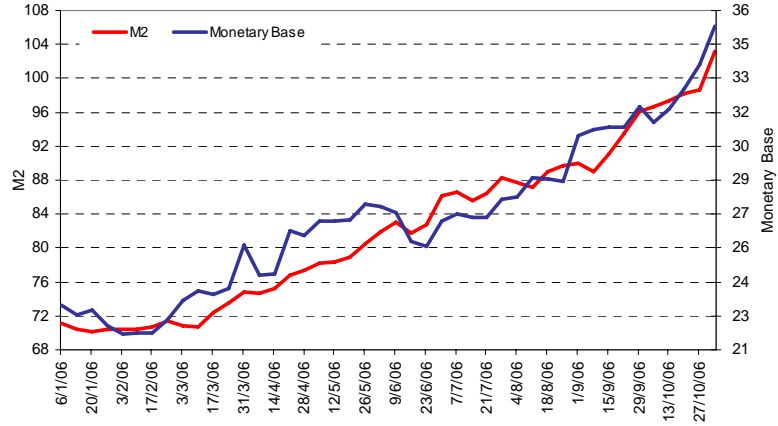
© Ecoanalítica – Descargado por usuario no autenticado

ECONOMIC OVERVIEW

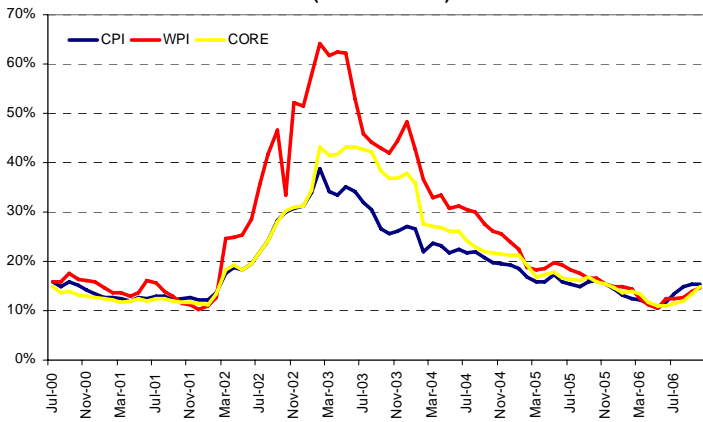
Oil Price
(Venezuelan Basket US\$/pb)



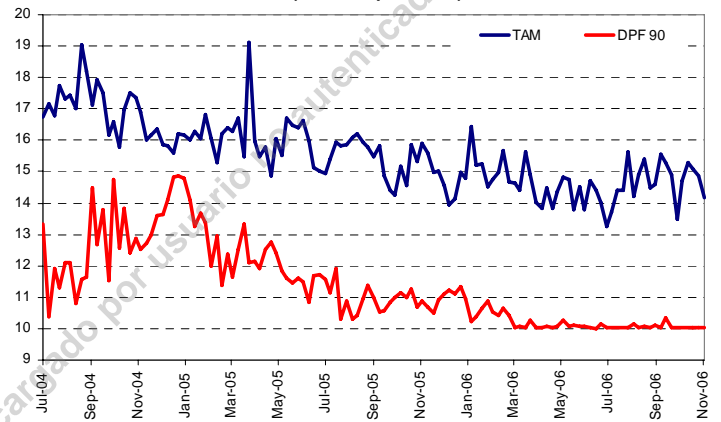
Monetary Base & M2
(VEB Billions)



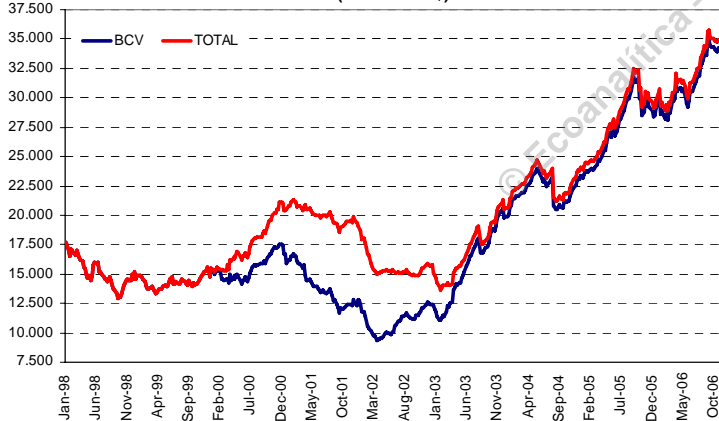
Inflation
(Last 12 Months)



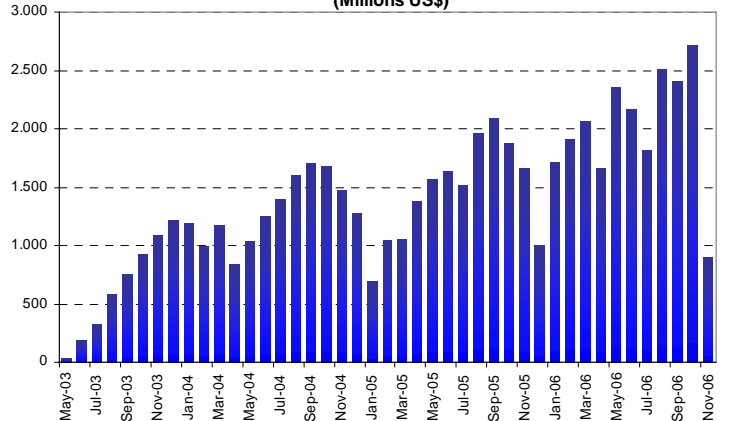
Interest Rate
(Six Principal Banks)



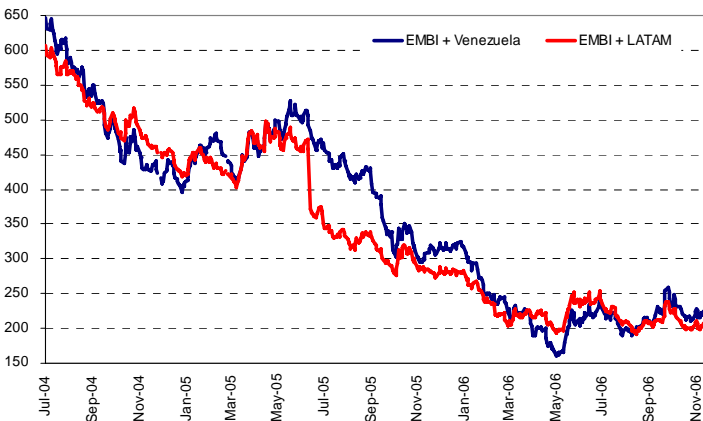
Fx Reserves
(Millions US\$)



Disbursement
(Millions US\$)



EMBI



Central Government
(VEB Billions)

