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By:
Alejandro Grisanti
Asdrúbal Oliveros

***DRIVEN BY THE
CONSUMPTION BOOM,
THE VENEZUELAN
ECONOMY GOES ON
GROWING***

Edited by:
Gabriel Dobson

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THE CLIENT

12 quarters of non-stop growth

In the third quarter, the Venezuelan economy grew 10% compared with the same quarter last year. This trend is due to 18.9% growth in final private consumption spending, 7.6% in government expenditure, and 42.8% in investment in fixed assets. In external demand, exports decreased 9.1%. As long as oil prices remain at high levels, the Venezuelan economy will continue to show acceptable growth rates.

The Central Bank published growth figures for the economy measured by the change in gross domestic product (GDP). With no great surprise, economic activity grew significantly accumulating 12 quarters in a row of growth. According to the Central Bank, the economy expanded 10.2% in the third quarter year-on-year. This growth was the result of an 11.7% expansion of non-oil activities and a 1.8% fall in the oil sector compared with the third quarter of 2005.

These results were in line with **Ecoanalítica's** forecasts of 10.1% overall growth with 10.9% expansion for the non-oil sector and a 1.0% fall in oil activity.

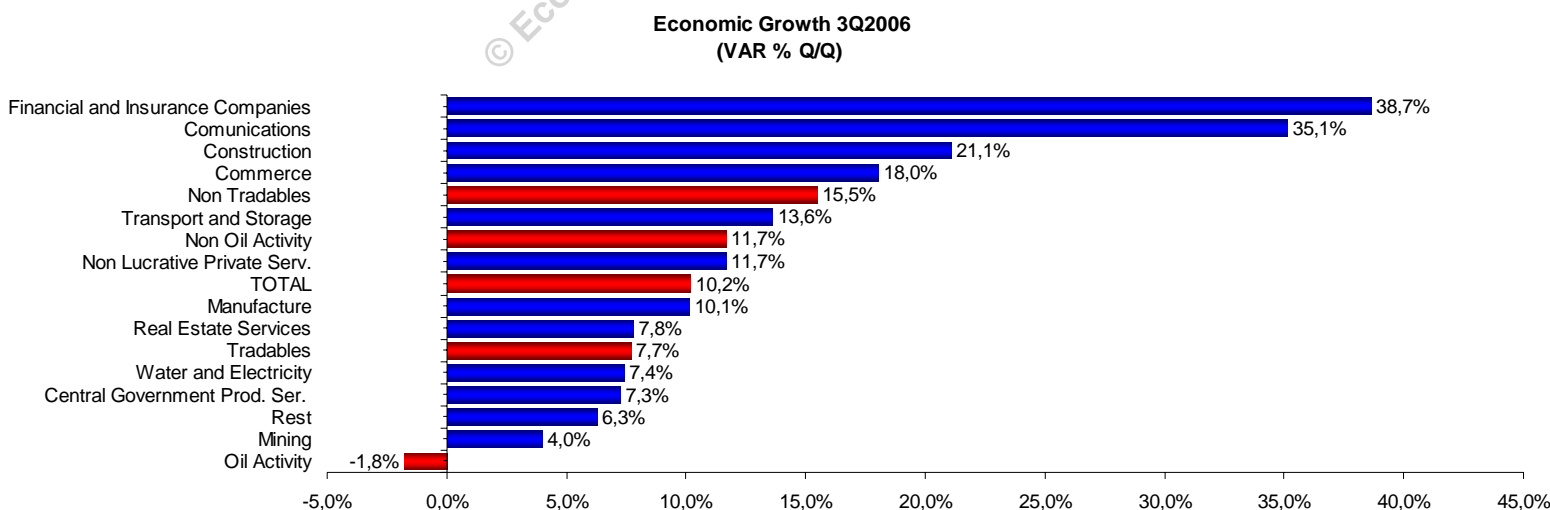
The fall in oil activity is due to the contraction of the private oil sector

According to the Central Bank, public non-oil activity expanded only 0.9% in 3Q06 compared with 3Q05. Private hydrocarbon activity slumped 11.4% so the overall oil sector contracted 1.8%. The private sector plays a very important role in the oil sector which the government has recently tried to minimize. In fact, the private oil sector has become even more important since the 2002-2003 oil strike.

According to the BCV, the decline in private oil activity was due to "preventative maintenance work in the plants of some crude upgrading companies in Orinoco Belt." Without discrediting the opinion of the Central Bank experts, we believe that the main reason for the fall in private oil activity has to do with the delays and disagreements that have arisen between the government and multinational companies about the migration of the operating agreements to joint ventures. In addition, the announcement by the Ministry of Energy and Oil (MENPET) that the Orinoco belt strategic associations would be transferred to joint ventures before the end of the year has also reduced investments in this area.

Growth of non-oil sector uneven

According to the Central Bank press statement, growth of non-oil activity was "significant, even and widespread" in 3Q06 year on year. **Ecoanalítica** does not entirely agree. Although growth of over 11% was significant it was not evenly spread. Some sectors expanded strongly such as financial institutions and insurance (38.7%), construction (35.1%), and communications (21.1%) but other sectors



Sources: BCV and Ecoanalítica

grew at very much lower rates such as mining (7.3%), electricity and water (7.7%), and manufacturing (10.1%).

Consumption driven

The highest growth sectors are evidently associated with the increase in aggregate domestic demand and private consumption. According to the Central Bank, aggregate domestic demand expanded 20.2% in 3Q06 year on year. In the same period, private consumption increased 18.9%, which explains the excellent performance of sectors such as financial institutions, communications, commerce, construction and transport.

The internationally tradable sectors grew weakly. The export sectors that did grow more strongly were mining with 7.3% and manufacturing with 10.1%. This dynamism is due to higher demand from consumption and investment, partly linked to the increase in demand for credit spurred by falling interest rates.

Investment grows strongly

In the third quarter of 2006 investment expanded 42.8% year on year, much more than in the second (28.2%) and first quarters (22.3%).

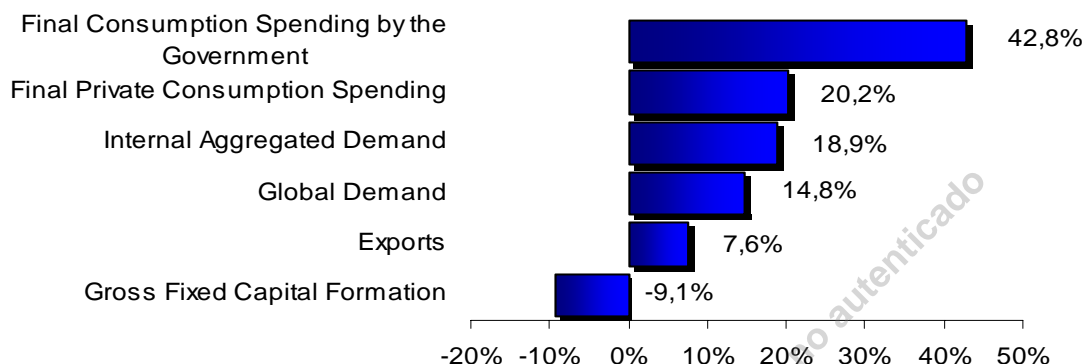
Regrettably the Central Bank does not distinguish between public and private investment. The industrial and business sectors talk about a suspension of private domestic investment, so it seems that new investment is being generated by the public sector, especially development of infrastructure works. In fact, construction by the public sector grew 33.2%, mainly financed with resources from the National Development Fund (FONDEN).

The Central Bank recognizes that this trend in investment was also stimulated by imports of vehicles and machinery for local industry.

Imports increase while exports decline

Using the demand and supply approach, imports grew 28.2% in Q306 compared with the same period last year. This increase is motivated by the exchange subsidy which results from the distortions created by exchange controls. In contrast, exports as a component GDP fell 9.1% in the same period. This confirms that in real terms oil production (91% of total exports are oil) fell from the third quarter of 2005, despite the rise in oil prices.

GLOBAL DEMAND 3Q2006 (Var% Q/Q)



Sources: BCV and Ecoanalítica

The growth will continue...

As long as the government can continue its strongly expansionary fiscal policy underpinned by high oil prices, the Venezuelan economy will maintain its rate of expansion. **Ecoanalítica** expects the Venezuelan economy to grow 9.9% in Q406 year-on-year so overall growth this year will be 9.8% in the non-oil sector 10.9% but only 1.3% in the oil sector.

... an unsustainable model

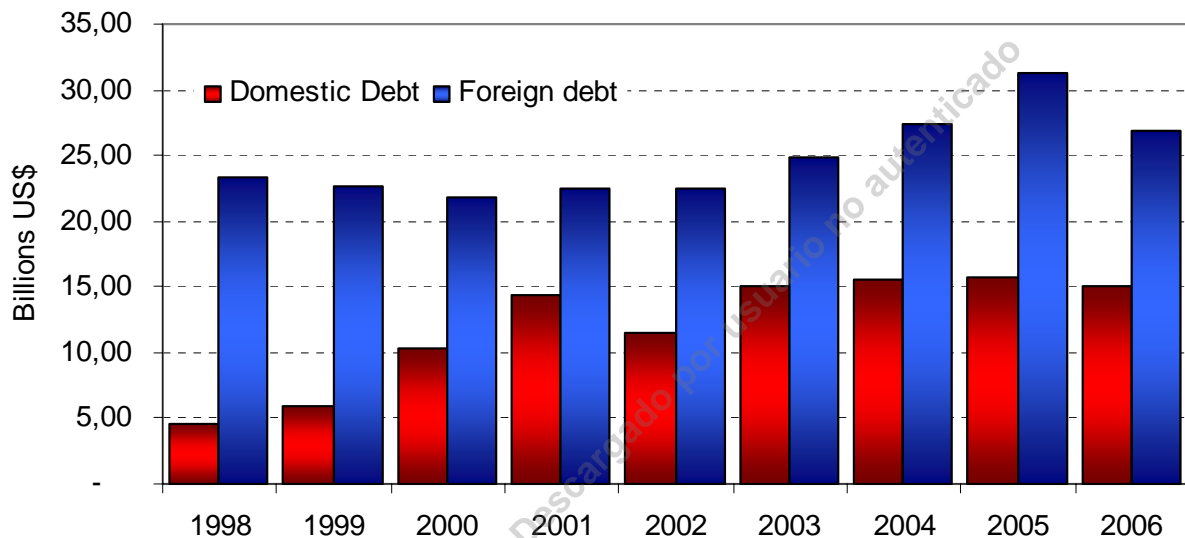
This growth model is not sustainable and will tend to stabilize, or even reverse, when oil prices fall. All countries that have achieved sustained long-term growth rate are economies that have turned to the external market. Clearly growth in the last 12 quarters is not the outcome of higher external demand but of an increase in domestic demand, simply because of high oil prices.

Economic Tips

Foreign debt edges up. According to the Ministry of Finance, public external debt increased US\$148 million in the third quarter of 2006 compared with the second quarter. Most of this growth was due to increased contracting with multilateral organizations, which now totals US\$216 million. This is despite statements from the government that it would reduce the debt with these organizations. However, indirect external debt was almost eliminated from US\$381 million in June to US\$1.0 million in September this year.

Internal debt also grows. Internal debt expanded VEB1.2 trillion (US\$567 million) between June and September due entirely to increased placement of public debt bonds. In total public debt (internal and foreign) totaled US\$42.00 billion at the end of September, down US\$5.19 billion from the end of 2005, when total debt was US\$47.19 billion. This fall is mainly associated with foreign debt buyback programs carried out by the Ministry of Finance in the first half of this year.

Total Debt



Sources: Ministry of Finance and Ecoanalítica

No more bonds this year. Rodrigo Cabezas, chairman of the National Assembly Finance Committee, said the government is not planning to make another combined offer of bonds with Argentina this year, despite high demand for the Bond of the South. Cabezas added that a new issue could be made in 2007. However, the conditions would have to be negotiated with Argentina.

No more countries. In another important announcement, Cabezas said that joint issues would be with Argentina. No plans have been made for operations with other countries.

October unemployment. According to INE, unemployment in October fell to 8.9%, down 2.5 percentage points from 11.4% in the same month last year. INE forecasts an unemployment rate of 7% for December. Seasonally unemployment always falls significantly in November and December in the approach to the Christmas season. The formal sector employs 55% of the working population while the remaining 45% are in

the informal sector. These results are a slight improvement: in October 2005 the formal sector covered 54.1% and the informal sector 45.9%.

Oil Tips

Down again. The Venezuelan crude basket ended last week at US\$50.47 per barrel, a loss of US\$0.57 from last week. The price of Venezuelan oil averaged US\$50.49 per barrel in November and US\$57.06 so far in 2006.

Stricter rules for royalties. The Ministry of Energy and Oil established a single price formula for liquid hydrocarbons based on types of segregation produced in the country. The Ministry established five formulas for calculating royalty settlement prices by type of benchmark crude: Santa Bárbara, Mesa 30, Merey 16, and Boscán. Hydrocarbon Vice Minister Bernard Mommer said a constant would be used as parameter which the ministry would adjust at its discretion in line with market conditions. The formulas apply to PDVSA crude sales and purchases from the joint ventures.

Oil exports to USA fall. According to the Energy Information Administration (EIA), in September for the sixth time this year, shipments of Venezuelan crude to the United States declined. According to EIA figures, Venezuelan crude exports in September averaged almost 1.13 million b/d, 22,000 b/d (1.9%) below August. Nevertheless, compared with September 2005 the fall is 56,000 daily barrels. In September, Venezuela continued as fourth crude supplier to the United States, after Canada, Saudi Arabia and Mexico. This year, Venezuela has placed an average of 1.15 million b/d crude on the US market versus 1.31 million b/d in the same period of 2005, down 153,000 b/d or 11.6%.

More back tax assessments from SENIAT. SENIAT issued two new back tax assessments after conducting income tax audits for fiscal year 2005. This time the companies affected are Total Oil and Gas Venezuela BV, and Jusepin Consortium. Total has to pay VEB37.14 trillion (US\$17.3 million) and Jusepin VEB567 billion (US\$263.7 million). Overall the assessments on oil companies for 2005 have resulted in additional receipts for the Treasury of VEB78.00 trillion (US\$36.3 million), according to SENIAT.

A new refinery. PDVSA offered US\$1.50 billion to the Curacao government for 49% of the Islas refinery. The Curacao Government Companies Commissioner Nelson Pierre said that PDVSA made the offer its during a recent visit, but the deal has not yet been sealed. PDVSA currently operates the complex, which processes 320,000 b/d, on lease until 2019.

Sectoral Tips

Withdrawal from Group of 3 ready. Venezuela is pulling out of the G3 (Mexico, Colombia and Venezuela) to focus its commercial strategy on Mercosur. The departure means that Venezuelan and Mexican products will rise in price and businesses could divert their trade to other markets. However, the governments could seek a new mechanism through the Latin American Integration Association (ALADI) to compensate loss of tariff preferences or negotiate partial scope or complementarity agreements. Currently, bilateral trade between Mexico and Venezuela is around US\$2.00 billion.

Rent controls extended. The ministries of Infrastructure, and Light Industry and Commerce extended until May next year the freeze on home rentals. This measure applies to homes built before 1987. The regulation takes the rent fixed in November 2002 as reference.

Boom for Audi. The first ten months of this year have produced positive figures for Audi, the European car company, which increased unit sales by 35% compared with the same period last year. In October alone sales soared 278% from the same month of 2005. Unofficially, 250 automobiles of this make were sold between January and October, while in sales in 2005 totaled 256 units for the entire year.

BANDES boosts lending. BANDES granted VEB1.2 trillion in loans to November. Industry was the most favored sector receiving almost VEB1 trillion directly and indirectly. Both the Industrial Credit Fund (FONCREI) and the Institute for Development of Small and Medium-Sized Industry (INAPYMI) have received lines of credit for VEB850 billion.

Controls on stockbroker borrowing levels. The National Securities Commission (CNV) amended various articles of the rules on intermediation activities to set limits on borrowing by stockbrokers and brokerage firms. Instead of a fixed amount, the Commission decided that the debt of these firms should not "exceed eight times the ratio of direct financial liabilities to equity." But the rule will not be applied strictly. If, after a market study, the CNV considers that a broker can borrow above that level, it will issue a resolution to that effect and notify the company.

Good numbers for Movistar. With billings of almost half a million euros, Telefónica's Venezuelan subsidiary could reach revenue of US\$2.60 billion by yearend. In the third quarter alone, Movistar signed up 205,300 new customers to bring the total number of lines in service to 8,025,900 lines. Movistar Venezuela added 2,707,000 subscribers to its networks in the year to September, 51% growth year on year. The forecast is for 9

Weekly Report

million by the end of 2006. Telefónica invested US\$147 million in the first nine months of 2006, up 41.6% from the same period last year

Electricity generation increases. Cumulative electricity generation in the country rose 6.26% in the first ten months of the year from the same period of 2005, the Venezuelan Electricity Industry Chamber (CAVEINEL) reported.

Supermarket sales increase. According to the National Supermarkets Association, supermarket sales so far in November have risen 13% from October. The main reason is nervous buying in view of the imminent presidential election on December 3.

Shopping center sales rise. Arnold Moreno, president of the Venezuelan Shopping Centers Chamber forecasts that sales in these establishments will be 30% higher than in October by de same month of the last year.

Regulations on construction inputs. As President Chavez promised, the government declared 14 construction inputs as goods of primary necessity. These products will now be regulated with a fixed maximum sale price. The controlled items are: wire, wire rod, sand, blocks, rebars, cable, cement, wood, mesh, asphalt lining, iron frames, stone, metal doors, and tiles. Sources in the construction sector said that the new regulation could worsen the supply situation of inputs because few companies will be willing to expand their production capacity for products with fixed prices.

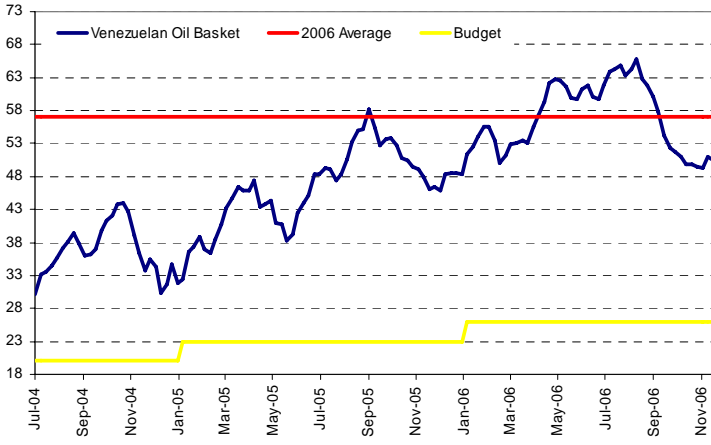
Political Tips

Carter Center will come but with limited observation. The Electoral Council signed a memorandum of understanding with the Carter Center for observation of the presidential election. However, the scope of its activities will be "limited" and "exclusively technical." The Carter Center team will not evaluate all the election process, but focus specifically on the automated voting system but even that will not be an exhaustive and integrated observation given the mission's short stay.

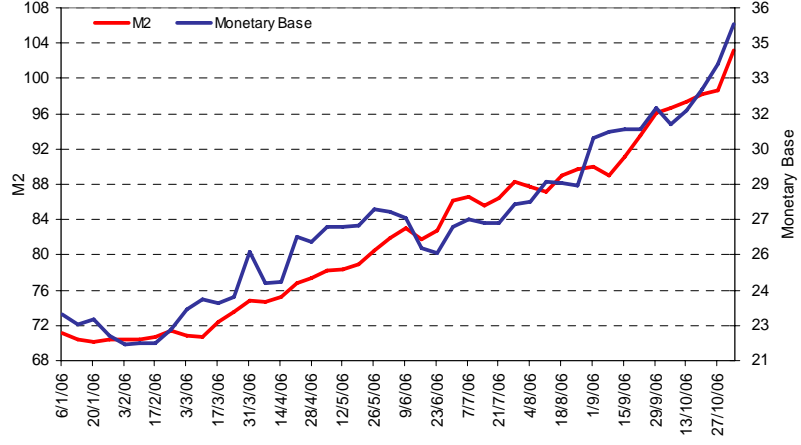
Another ministry. President Chavez announced the setting up a new ministry, this time the Ministry of National Sport, with the appointment of Eduardo Álvarez Camacho as director.

ECONOMIC OVERVIEW

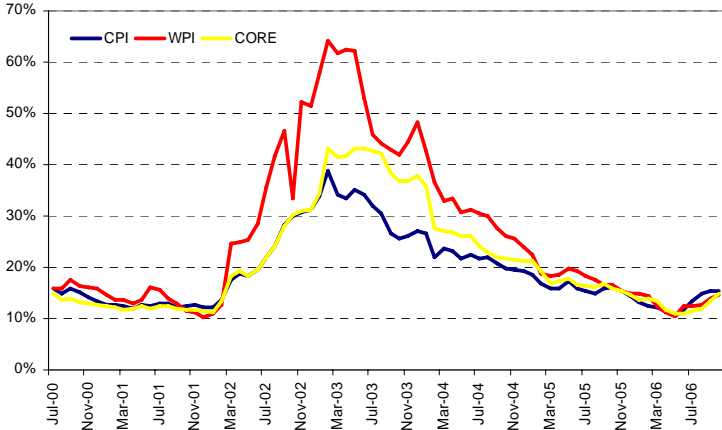
Oil Price
(Venezuelan Basket US\$/pb)



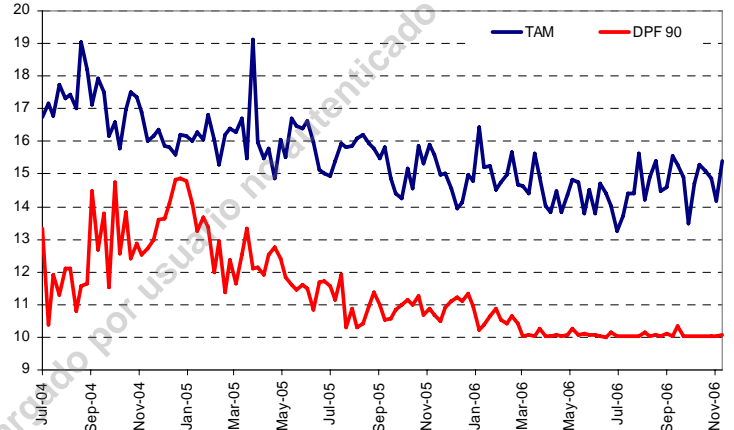
Monetary Base & M2
(VEB Billions)



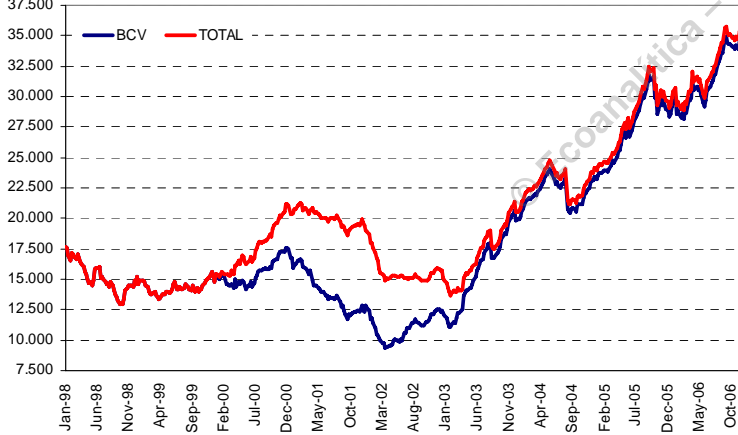
Inflation
(Last 12 Months)



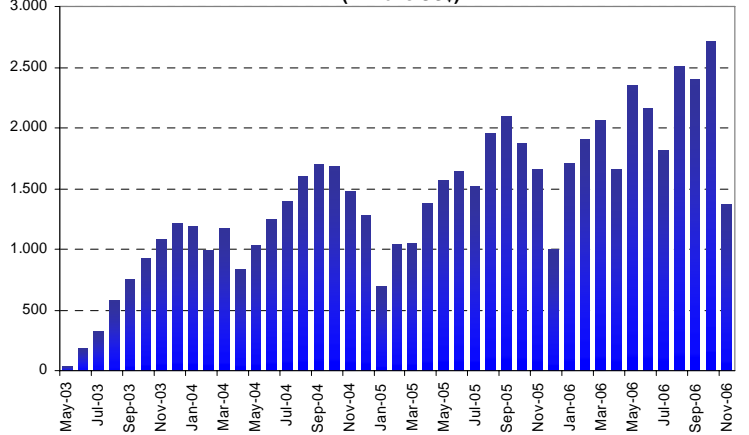
Interest Rate
(Six Principal Banks)



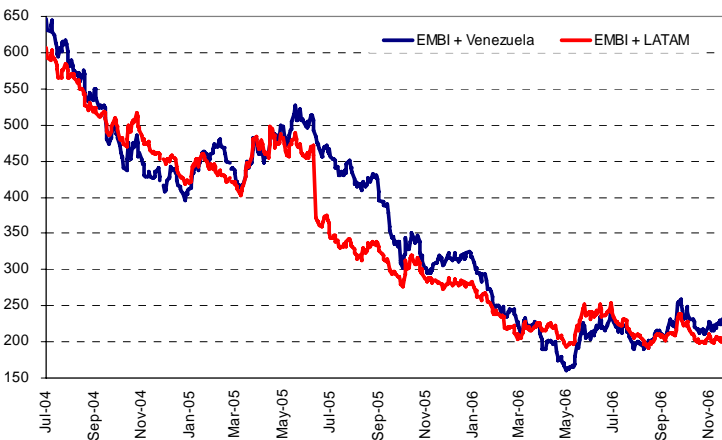
Fx Reserves
(Millions US\$)



Disbursement
(Millions US\$)



EMBI



Central Government
(VEB Billions)

