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By:
Alejandro Grisanti
Asdrúbal Oliveros

Edited by:
John Holden

THE BLAH-BLAH- BLAH COMES AT A HIGH COST.....

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THE CLIENT

The verbal diarrhea of the President of the Republic, his sensationilistic way of announcing his actions, and the frequent lack of prior analysis of the impact these actions will have on the future of the country's economy was all too clear when, during his latest announcement, he declared that Venezuela was going to withdraw from the International Monetary Fund (IMF) and the World Bank (WB). **Ecoanalítica** believes that the President is going to retract his words, but their cost will have to be paid for by all Venezuelans. The pronouncements have caused the risk curve of Venezuela to increase by 53 base points; even though the region's perceived risk has been steadily declining.

The President's blah- blah-blah

During the May Day ceremonies, President Hugo Chávez said he was going to pull Venezuela out of the IMF and the WB. His exact words were: "I want to make our withdrawal from the World Bank and the International Monetary Fund - and all that - *oficial!* We don't need them; we don't want to have a representative there; we're going to pull

out; we don't even want to be there and they have to give us back our money because now *they owe us*.... I want to sign off on that account (the withdrawal) right now, tonight."

Minister Cabezas, oblivious to the consequences, echoes Chávez' words

"As far as the International Monetary Fund is concerned, I'm told we've only got about US\$ 250 million left there." These were the words of Minister Rodrigo Cabezas when referring to Venezuela's balance of contributions as member of the FMI. **Ecoanalítica** is sure that this comment is simply a sign of the Minister's ignorance of the serious implications of President Chávez' threat to withdraw from the multilateral agencies.

5 years now, and no communication between Venezuela and the IMF or the WB

Venezuela paid off its debt to the IMF years back, and recently said it had settled its last remaining obligations with the World Bank, while at the same time pushing for the creation of *Banco del Sur*. Meanwhile, the only visit IMF officials have made recently to Venezuela has been under the excuse of shutting down the permanent offices the Fund had in the Central Bank (BCV) building. Even when coming on unofficial visits, contact with the Executive was meager. We think this was used as the excuse for the President's announcement, without his taking into account the serious repercussions this will have on the country's image.

Effects of our withdrawal from the multilateral agencies

Something over 70% of Venezuela's foreign debt is conditioned by a clause providing that the issuing country must remain a member of the IMF, and that any withdrawal from the international agency may be deemed a breach of such clause, whereupon the holders of securities can demand that the issuing country prepay capital and interest on the debt. For example, Venezuela's 2034 global bond issue stipulates that "... if Venezuela were to withdraw its membership of the IMF or were to become ineligible for using the general resources of the FMI, such situation shall be deemed a breach." Obviously a situation where the public sector is in breach of its obligations would have a deep impact on the Venezuelan economy.

Minister Cabezas eventually realizes this could happen and sets about trying to prevent fallout damage

Minister Rodrigo Cabezas dismissed the notion that an eventual withdrawal from the International Monetary Fund would trigger a technical breach clause affecting Venezuela's foreign debt payment conditions. The official even went as far as to declare that: "The Bolivarian Republic of Venezuela guarantees payment of all its debt, internal and external (...), all its liabilities, all its short, medium and

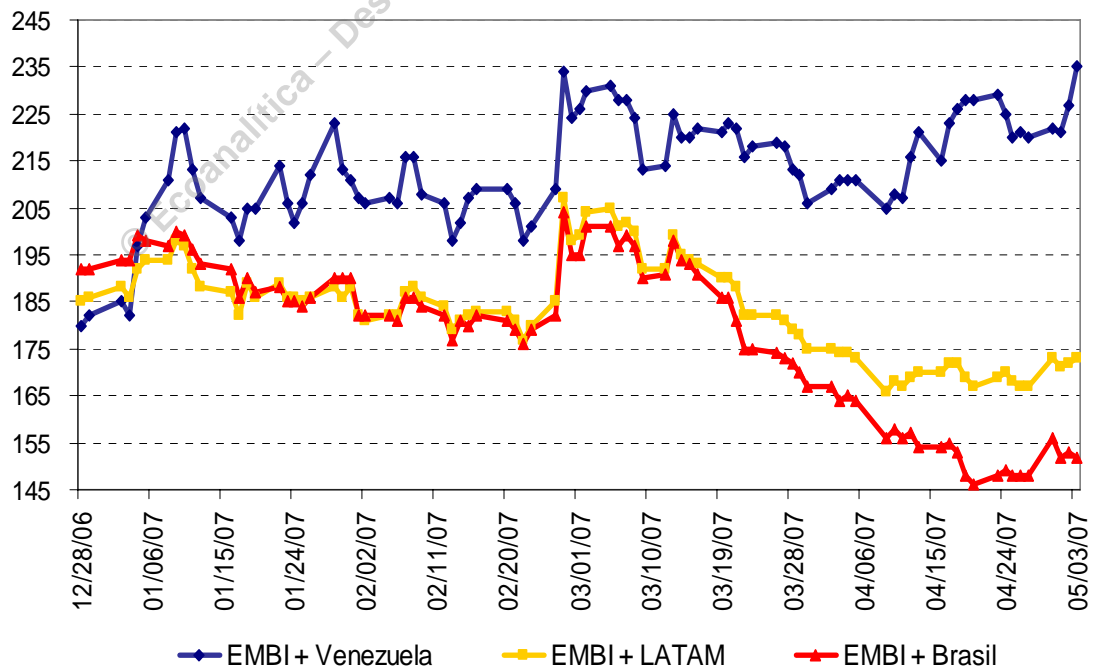
Weekly Report

long-term debt issues, respecting the capital and interest payment schedule.” The Minister added that Venezuela’s withdrawal from the multilateral agency was still not clearly defined. In fact, Rodrigo Rato, Managing Director of the IMF, has commented that Venezuela has yet to inform the institution of its intention to withdraw.

Which, of course, is unthinkable ... but some fallout has already been felt

In spite of all the attempts to smother the flames - and the price - of the President’s tirade, some costs have already surfaced. For example, the total return on Venezuelan debt rose 53 base points on JP Morgan’s EMBI+ (Emerging Markets Bonds Index Plus) following the speech. Sadly, this week’s reaction is a sign of things to come. At the beginning of this year, just prior to the start of the President’s radicalization plan and his announcement of the closing down of Radio Caracas Televisión (RCTV) and the nationalization of the CANTV, Electricidad de Caracas and of other services companies, the country risk factor for Venezuela was 182 base points. This perception of risk has been steadily growing, standing at 235 base points on May 3, a significant increase of 29,1% in the perceived risk of investing in Venezuela.

Emerging Markets Bonds Index (EMBI)



Sources: Cbonds and Ecoanalítica

This upturn in Venezuela's perceived risk curve contrasts sharply with the generally positive results for the region. Brazil, for example, which was perceived as representing a similar level of risk as Venezuela towards the end of last year, with an EMBI of 192 base points, has managed to reduce its perceived risk factor significantly to 152 base points as of May 3. For this same period, the average perception of risk for Latin American countries improved from 186 to 173 base points.

What exactly does the President seek to achieve with his announcements of nationalizations, expropriations, closings and dissolutions, etc.?

At *Ecoanalítica* we fail to understand why the President of the Republic is acting so harshly in announcing these actions. Obviously nobody is telling him how costly they are in economic terms. If this radicalization program had not been embarked upon, the country would today be in a far stronger position, in the sense that it would be under much less pressure from the non-official exchange market, and with no need to issue the US\$ 7.5 billion in PDVSA bonds that have seriously depleted our international reserves. The PDVSA bonds could have been issued with a return of 53 less base points, without affecting their price.

Radicalization translates into less investment and growth, higher inflation, more unemployment and lower real salaries

It is obvious that in countries where there is no respect for private property or where contracts are violated, investment is going to be substantially lower than in those countries, socialist or otherwise, where a stable legal framework is upheld and respected. Private investment is the source of sustained long-term growth, job creation and greater productivity of the jobs thus created. Real salaries (i.e. salaries' purchasing power), depend on the country's productivity levels, simple as that.

Ideology takes over

This radicalization policy being enforced by the Government makes no political or economical sense at all. The only possible explanation is that ideology is being imposed regardless of the economic or political costs of such measures. If this is the correct conclusion, and ideology is indeed the main reason behind the Government's announcements, then the economy is in a lot shakier position now than it was at the end of 2006.

Weekly Report

In light of the deterioration of several indicators, we have to change our recommendation from “confidence” to “caution”

Up to now, ***Ecoanalítica*** was keeping the traffic light in green for the private sector, saying “in the short run, there is no reason for concern.” Even though we are sure the President will not keep his promise to withdraw from the multilateral agencies and that oil prices will remain high, we feel obliged to raise our perception of risk for Venezuela. In other words, erring on the side of caution and faced with the worsening of different early warning signs (reduced international reserves, low liquidity of funds held by the State in foreign currency, fiscal expenditure levels, etc.), we are forced to take a more cautious position, changing our traffic light from GREEN to AMBER. This does not necessarily have to be a one-way street. If certain economic indicators improve, we can return the traffic light of national confidence back to green, but “for now” we recommend that the private sector be careful. In our upcoming reports we will revisit that theme.

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Economic Tips

Inflation higher than expected. The April consumer price index (CPI) rose by 1.4%, quite a high level and definitely not aligned with the Government's 2007 target of 12%. This number puts accumulated inflation for the first three months of the year at 4.1%, double the 2% of the same period last year. In interannual terms, inflation was 19.4% - almost double the 11.4% inflation for the same period last year.

Main movers. When breaking down the CPI results into areas, it can be seen that prices in 5 of the 13 categories grew, relatively speaking, by more than the global average: Health Care (up 3.4%), general Goods & Services (2.5%), Food and Non-Alcoholic Beverages (2.5%), Alcoholic Beverages and Tobacco (1.9%) and Home Furnishings (1.8%).

February measures announced by the Government ineffective. In its February 21 Report, *Ecoanalítica* warned that "Chávez announces measures to dampen inflation but fails to attack the root cause: his fiscal policy." At the time, this was in stark contrast to Jorge Giordani's outlook, when he said that "the benefits of the measures we have adopted will begin to be felt in the months of April and May." Sad to say, time proved us right.

20% increase in the minimum salary. This week, the President of the Republic, Hugo Chávez, announced a 20% rise in the minimum salary as of May 1, from VEB 512,325 to VEB 614,790. He noted that the monthly income of public sector workers can now be put at VEB 1,064,690 if the Nutrition Bonus (commonly known as "Cesta Ticket"), a maximum of VEB 450,000 for public administration employees, is taken into account.

"One of the highest in the whole Continent." This was how Chávez defined the new minimum salary, now fixed at US\$ 286. The only problem with this figure is that it is insufficient, and that it is simply an illusion for the working class, since in real terms it is 25% below what it was when Chávez took power in 1999.

Unemployment down by 0.6%. According to numbers released by the National Institute of Statistics (NIS), 1,160,145 people were out of work in March, or 9.5% of the able-bodied population of Venezuela. This figure represents a reduction in comparison with the one for March last year when it stood at 10.1%.

Formal employment also shows positive results. In its monthly report, the NIS also registered an increase of 218,550 in the number of “formal” workers. Percentage-wise, the formal workers now represent 57.4% of all the employed.

PDVSA bond issue well received by small investors. According to numbers published by Econoinvest, 8% of the PDVSA bonds were acquired by just over 129,000 small investors who, if we put their purchases at between US\$ 3,000 and US\$ 5,000, acquired securities for around US\$ 600 million. This is a very positive result in a country with scant culture in capital markets.

Clearing House rates adjusted. The Board of Directors of the Central Bank of Venezuela approved a reduction in the rates paid by the banks to the central Clearing House (*Cámara de Compensación*) for cheque-clearing transactions, and the application of a differentiated rate for direct credits and domiciled payments. The decision took effect on May 1. These represent a 15% reduction in transformation costs, which should have a positive effect on banks’ financial spread.

OIL TIPS

Venezuela basket improves considerably. The Venezuelan crude oil basket was up US\$ 1.3 (2.3%) this week, rising from US\$ 57.9 to US\$ 59.2 per barrel. The average price so far this year is US\$ 52.0, still US\$ 4.5 less than the 2006 average.

Although starting the year with a sharp decline, prices are recovering. So far this year the Venezuelan basket has bounced back strongly, moving up from US\$ 46.83 a barrel in January to US\$ 58.27 in April, marking an average monthly rise of 7.6%.

Venezuelan crude production down 7.3% for the first quarter. According to OPEC’s March report, Venezuela’s average production was 2.4 million barrels per day, against an average 2.6 million barrels per day for the same period of 2006, signifying a reduction of 187,000 bpd. The production cut corresponds to the agreement signed by the OPEC member countries in November 2006.

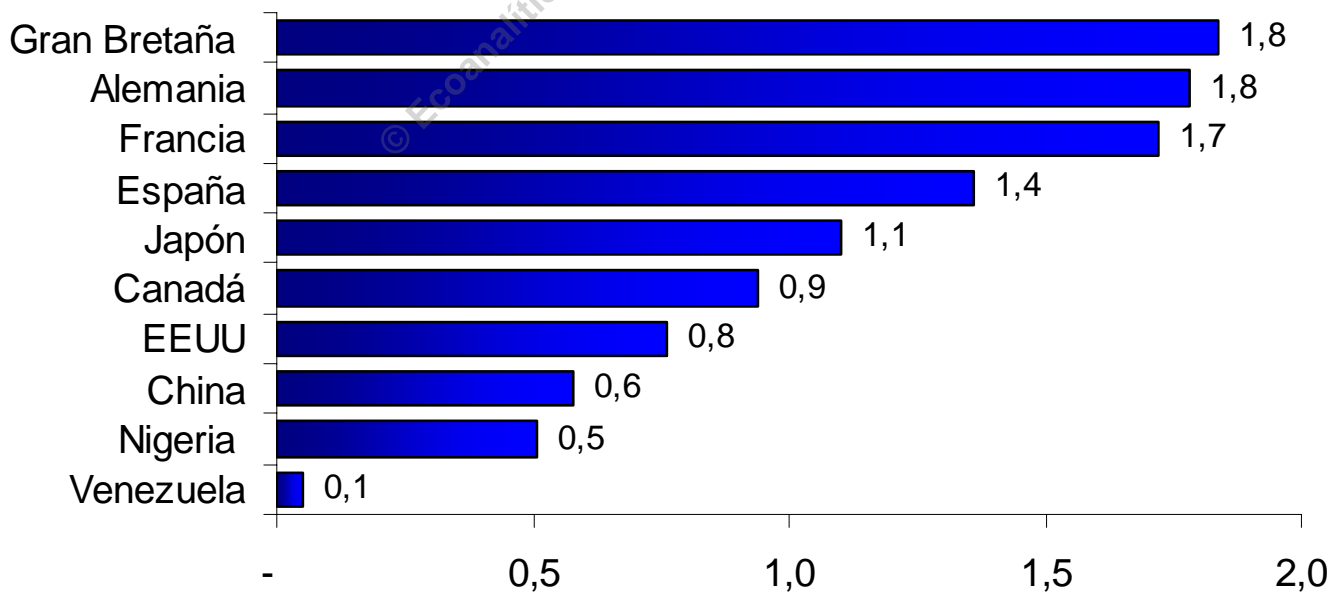
Crude exports to the USA down, while exports to China are on the rise. According to data made public by the Energy Information Administration (EIA), the amount of Venezuelan crude earmarked for the US market during the first two months of this year was an average of 1.03 million barrels per day, 14.3% less than the 1.2 million barrels exported on average during January and February 2006. Dispatches of derivatives have declined even more, with January and February figures

for 2006 exports to the USA at an average of 304,000 bpd, against only 239,000 bpd for the same period this year – a drop of 21.4%. This reduction in crude exports to the USA is explained by the production cut-backs and an increase in exports to China.

Oil “nationalization” process concluded. This week, the State of Venezuela will take control, through Corporación Venezolana del Petróleo (CVP), of the Orinoco Oil Belt (*Faja*) operations and at-risk exploration agreements. The completion of this “re-nationalization” procedure will mark the beginning of a two-month period for agreeing upon the core matters of the migration: shareholdings, valuation of investments, settlement of pending private and public debt, compensation packages and start-up of the new mixed companies.

The cheapest gasoline in the world. A price comparison study conducted by Reuters revealed that the price paid by drivers in the USA is 50% less than that paid by drivers in European countries such as France, Germany and Great Britain, where gasoline costs between US\$ 1.72 and US\$ 1.84 per liter. The lowest-ranking country, price-wise, is Venezuela, where you pay between VEB 70 and VEB 97 per liter, somewhere between 3 and 4 cents of a US Dollar.

Gasoline Price US\$/Liter



Sources: Reuters and Ecoanalítica

BUSINESS SECTOR TIPS

Shortage of housing solutions hits the real-estate sector. 92% of all transactions in the real-estate market are sales and just 8% are rentals. Over the last year there has been a 25% reduction in the number of rentals. Felipe Martínez, President of the Real-Estate Chamber, points out that the dearth of housing solutions is putting an upward pressure on rental rates.

Wild swings on the Caracas Stock Exchange (BVC). The BVC has witnessed large-scale fluctuations due to the opportunity opened for arbitration of CANTV and Electricidad de Caracas shares for buying foreign currency. Intermediaries resorted to buying CANTV shares in order to sidestep CADIVI and acquire foreign currency by converting the shares into ADRs. This option is now closed, thus producing an important adjustment to the share prices.

Cemex and Banco Venezolano de Crédito (BVE) dividends approved. Both annual general meetings, held on April 30, approved dividend payouts: 1) Cemex, VEB 130 per share for holders of Class 1 and 2 registered as of May 16, payable on May 28 this year; and 2) BVE payments for the first and second quarters of 2007 of VEB 10 per share, and an extraordinary dividend of VEB 100 per share for shareholdings as of May 8, payable next May 14.

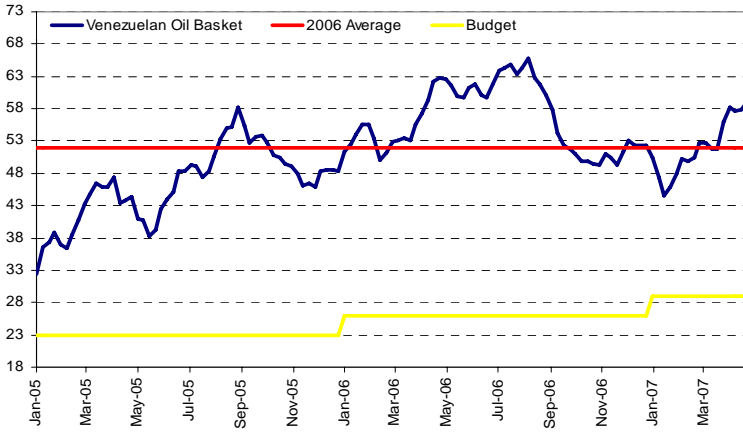
CANTV puts forward its special shareholders' meeting originally planned for June 4. The special shareholders' meeting to appoint the new president and board of directors of the CANTV has been put forward to May 21. Apparently, three new top company executives will be confirmed at the meeting.

Positive results announced by CANTV. The telephone company presented its financial and operating results for the first quarter of 2007, which reflect earnings of US\$ 117 million, almost 40% up on the same period last year. EBITDA stood at US\$ 249 million, an impressive jump of 24.2% in relation to the same period last year.

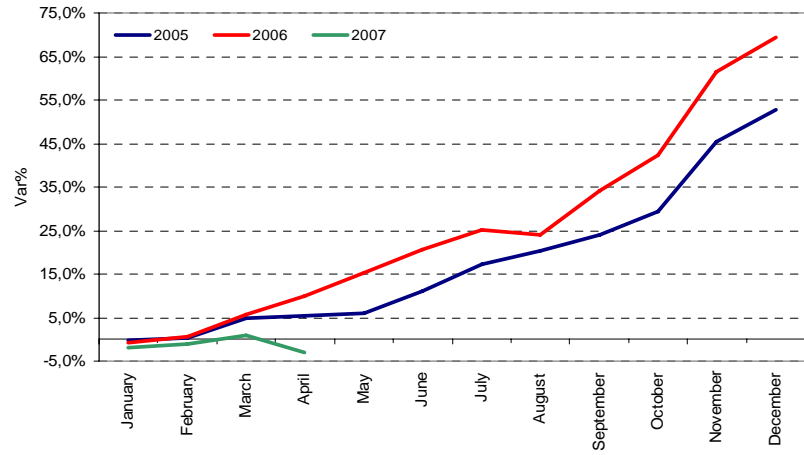
RCTV closing. Time and time again the President of the Republic has said that he will stick to his decision to shut down RCTV. There is no question that this is the most unpopular measure so far taken by this Government, and its effects will surely be felt.

ECONOMIC OVERVIEW

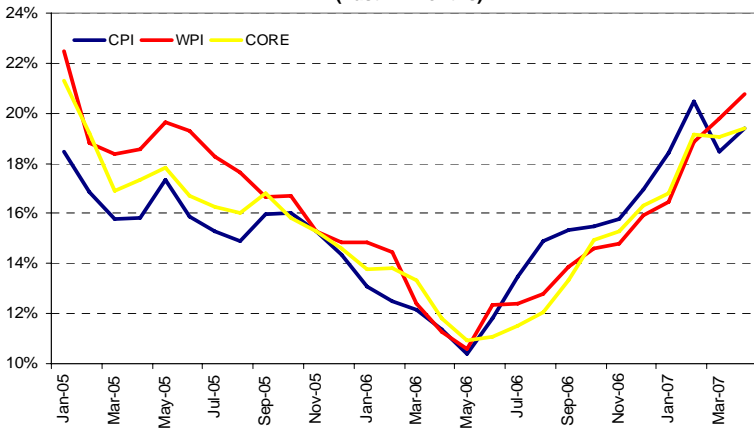
Oil Price
(Venezuelan Basket US\$/pb)



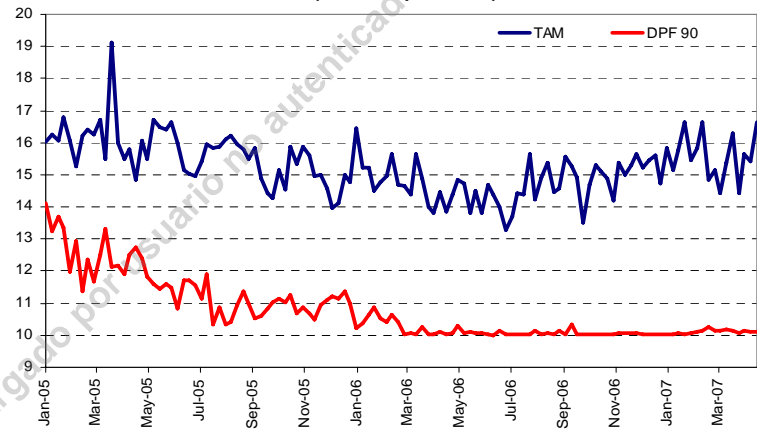
Real Expansion (M2)



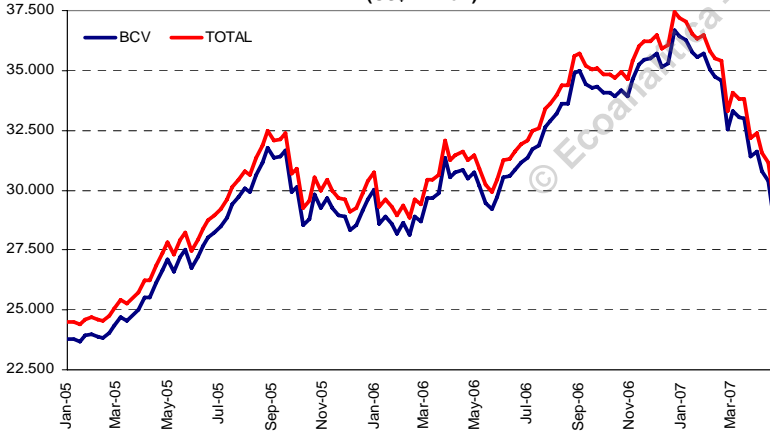
Inflation
(Last 12 Months)



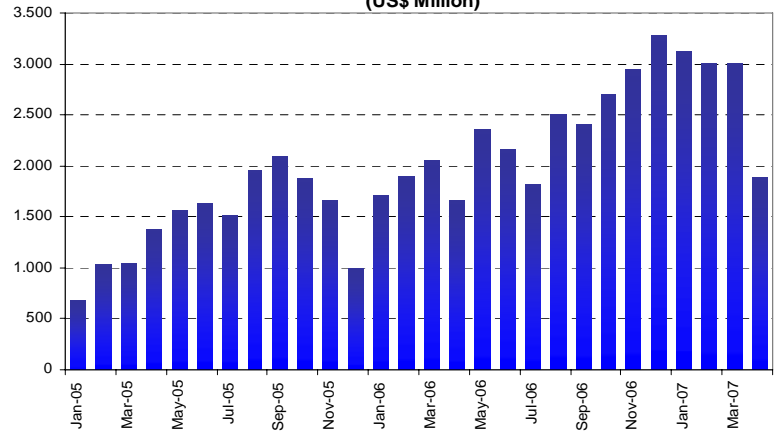
Interest Rate
(Six Principal Banks)



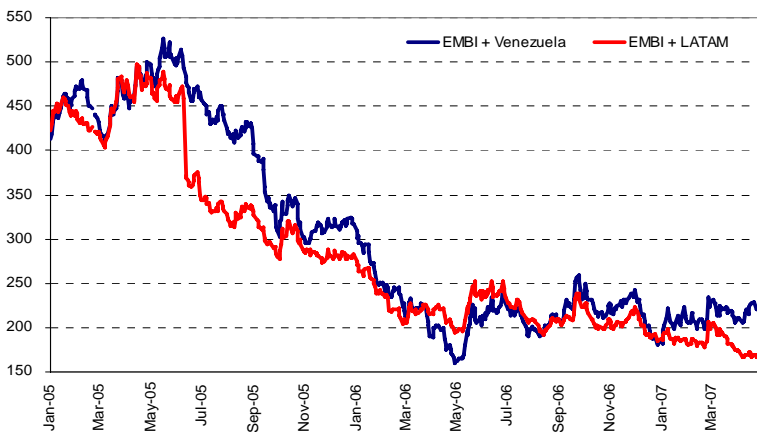
Fx Reserves
(US\$ Million)



Disbursement
(US\$ Million)



EMBI



Central Government
(VEB Billion)

