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By:
Alejandro Grisanti
Asdrúbal Oliveros

**1ST QUARTER BALANCE
OF PAYMENTS RESULTS:
A WARNING FOR THOSE
WHO BELIEVE THAT
EXCHANGE CONTROL IS
SUSTAINABLE**

Edited by:
John Holden

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The BCV has presented the Balance of Payment figures for the first quarter of this year. Of note is the significant drop in the current account balance, the extraordinary increase in imports and the flight of private sector capital. These results start to show us that the exchange control is beginning to expose its vulnerable under-belly.

The Balance of Payments results are a natural consequence of the exchange control régime

According to the BCV, the Balance of Payments logged a significant surplus of US\$ 5.606 billion, which contrasts sharply with the US\$ 1.044 billion surplus recorded in Q106. This result arises from the 56% year-on-year capital account deficit, accompanied by a 48% fall in the current account for the same period.

The reduction in the current account is a logical consequence of the exchange control régime in force in Venezuela, since it is essentially due to the 47% increase in imports, which went from US\$ 6.205 billion in Q106 to US\$ 9.108 billion in Q107.

But exports also go down

On the other hand, the reduction of the current account balance cannot only be explained by the logical growth of exports, but also by the strange drop of 12% in exports. In spite of the oil boom and the sharp growth of the economy, both oil exports and non-oil exports fell by 13.2% and 1.0% respectively. In the specific case of the oil exports, the reduction is a result of a drop in Q107 oil prices compared with Q106 and a fall in production. According to the BCV, the oil sector recorded a 5.6% drop in the first quarter of the year when compared with the same period last year.

BALANCE OF PAYMENTS			
(General Summary)	Q1 2007	Q1 2006	Var (%)
(US\$ Millions)			
Current Account	3.662	7.004	-47,7%
Goods	4.571	9.329	-51,0%
Oil Exports	12.057	13.896	-13,2%
Non-Oil Exports	1.622	1.638	-1,0%
Import of goods f.o.b.	(9.108)	(6.205)	46,8%
Services	(1.115)	(841)	32,6%
Others	206	(1.484)	-113,9%
Capital Account	(9.268)	(5.960)	55,5%
Public Sector	(4.629)	(4.224)	9,6%
Private Sector	(4.639)	(1.736)	167,2%
Reserves Variation	(5.606)	1.044	-637,0%

Sources: BCV and Ecoanalítica

The increase in the capital account deficit is the responsibility of the private sector

The capital account deficit grew by 56% year-on-year in the first quarter of the year. During the previous quarters this increase in the capital account deficit was mainly due to the public sector, because of the debt operations and transfers of different funds that the Executive has been making recently. But in this case, the private sector is responsible for the deficit increase, since the public sector deficit rose by a mere 10%, while the private sector's increased by 167%, going from US\$ 1.736 billion in Q106 to US\$ 4.639 billion in Q107.

Seen from another perspective, it can be observed that the private sector capital account deficit represented 29% of the total. Now, in the first quarter of 2007, it represents 50%.

The exchange control is helpless when it comes to avoiding capital flight

The most dramatic results are to be seen when we divide the Balance of Payments into its private and public components. First of all, according to BCV figures, there has been a deterioration, both in the current and in the capital account, with deficits of 33% and 167%, respectively.

Weekly Report

However, there has been a significant increase in private sector capital flight, which stood at US\$ 3.437 billion, a high figure if we take into account that there is a foreign currency exchange control in force in our country, the purpose of which is precisely to control the indiscriminate exodus of hard currency. During the first quarter of last year there was no outflow of capital but rather a net inflow, albeit for the paltry sum of US\$ 297 million.

An important part of this capital outflow is associated with debt operations carried out by private agents endeavoring to send foreign currency out, but at an implicit exchange rate that is higher than the official one. It is a notorious fact in Venezuela that the economic agents have no confidence in their own currency and therefore prefer to get their assets out of country, in defiance of the exchange control currently in force. This is one of the reasons why the exchange controls are doomed to failure, their effectiveness fading over time.

BALANCE OF PAYMENTS OF PRIVATE SECTOR			
(General Summary)			
(US\$ Millions)			
	Q1 2007	Q1 2006	Var (%)
Current Account	(7.690)	(5.778)	33,1%
Goods	(6.741)	(4.086)	65,0%
Non-Oil Exports	1.622	1.638	-1,0%
Import of goods f.o.b.	(8.363)	(5.724)	46,1%
Services	(1.072)	(802)	33,7%
Others	123	(890)	-113,8%
Capital Account	(4.639)	(1.736)	167,2%
Private Sector	(4.639)	(1.736)	167,2%
Portfolio Investment	(147)	(8)	1737,5%
Direct Foreign Investment	(1.055)	(2.025)	-47,9%
Private Capital Outflow	(3.437)	297	-1257,2%

Sources: BCV and Ecoanalítica

Foreign investment collapses and private foreign debt servicing on the decline

According to the BCV, foreign investment in the country was –US\$ 260 million, where the minus sign indicates that there was disinvestment during the first quarter of the year. This trend was already being seen in 2006, when disinvestment stood at US\$ 543 million. So far, thanks to the flood of petrodollars we have been receiving, foreign investment has not been necessary, but this constitutes one of the most dynamic components for achieving long-term stable growth, hence the concern of emerging markets to be deemed worthy of foreign investment.

On the other hand, foreign private debt servicing was only US\$ 240 million, a fall of 45% in respect of Q106. Public sector debt servicing cost US\$ 1.605 billion, just 5% less than in the same period last year.

Little change in the public sector situation

Public Sector Balance of Payments continues to show that the good numbers we see in the foreign sector come from the State, and more specifically from the oil sector, even though here too there has been a current account drop of 11% and a capital account deficit that remains almost stable, since it has only risen by 10%.

BALANCE OF PAYMENTS OF PUBLIC SECTOR			
(General Summary)			
(US\$ Millions)			
	Q1 2007	Q1 2006	Var (%)
Current Account	11.352	12.782	-11,2%
Goods	11.312	13.415	-15,7%
Oil Exports	12.057	13.896	-13,2%
Import of goods f.o.b.	(745)	(481)	54,9%
Services	(43)	(39)	10,3%
Others	83	(594)	-114,0%
Capital Account	(4.629)	(4.224)	9,6%
Public Sector	(4.629)	(4.224)	9,6%
Reserves Variation	6.723	8.558	-21,4%

Sources: BCV and Ecoanalítica

Q107 currency exchange activity also published

The BCV recently published the first quarter figures for the inflow and outflow of foreign currency. To be highlighted are the following points:

1. The BCV received foreign currency for oil exports equivalent to US\$ 5.562 billion, 46% of total Q107 oil exports.
2. The BCV sent US\$ 7.756 billion to the controlled market (CADIVI), i.e., 85% of the total imports of the first quarter of the year. Hence the parallel market is financing 15% of imports. Last year this proportion stood at 35%.
3. During the first quarter, an equivalent of US\$ 4.5 billion was transferred to FONDEN, although the BCV indicates that this is a *reclassification of assets assigned to FONDEN*, which is simply an accounting euphemism.
4. The Republic's income in foreign currency was US\$ 9.183 billion, while outflows amounted to US\$ 14.937 billion, denoting a reduction in international reserves of US\$ 5.754 billion.

Unless the necessary corrective measures are taken, the Q107 Balance of Payments results are a dangerous sign of things to come

At *Ecoanalítica* we maintain our thesis that the excellent performance of the Balance of Payments is founded exclusively on public sector activity. Moreover, by creating a differential between the parallel exchange rate and the official rate, the exchange control is encouraging imports, diminishing our strength abroad, as the results of this first quarter clearly demonstrate. We project that with a Venezuelan oil basket price of US\$ 45.8 per barrel for 2008, the current account surplus will practically disappear, becoming a scant 1.5 points of GDP. Exchange controls in Venezuela translate into a subsidy for importers and, paradoxically, these same controls have boosted capital flight. What is more, the advantage taken by the Executive of the exchange rate differential, when issuing securities such as the so-called Southern Bonds and those of PDVSA, has subsidized capital outflow. It is a well-recognized fact that such issues have enjoyed high demand, precisely because they are a mechanism that allows the purchase of US Dollars at an implicit price that is appreciably inferior to the parallel market rate.

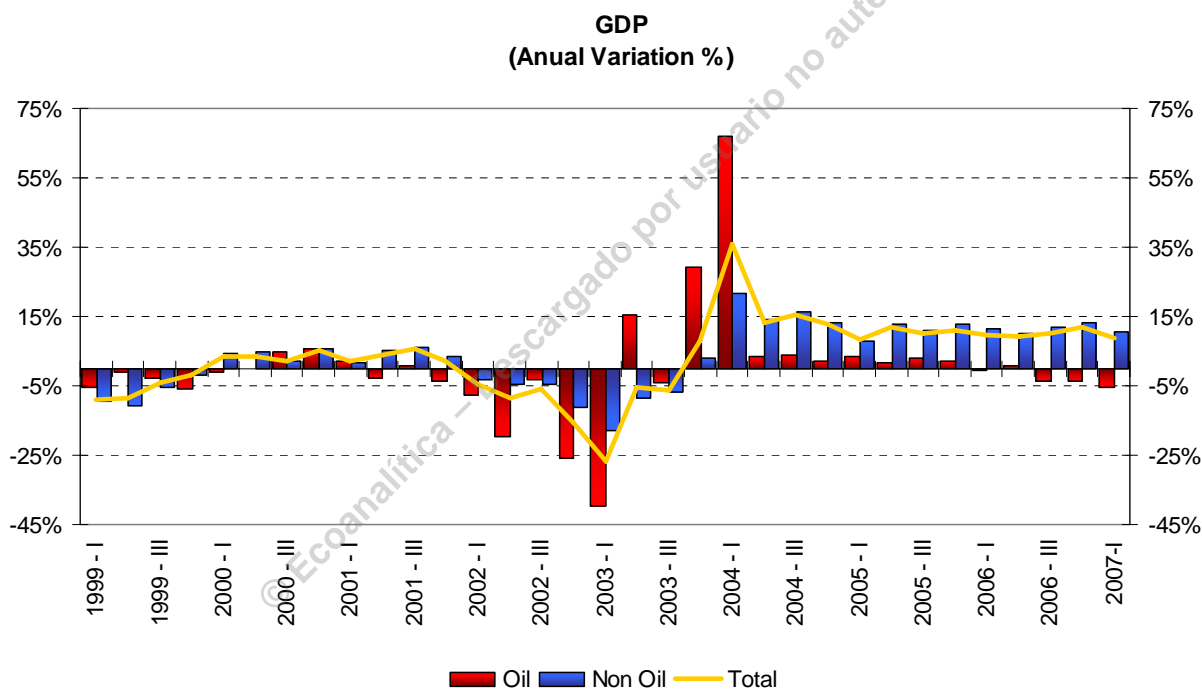
It is high time the Government start to dismantle exchange control

There is at this moment no valid economic theory that could support the convenience of prolonging exchange control. Eliminating this control is important because while in force it produces serious distortions in the country's principal economic variables. As we have commented in the past, exchange control in this country creates an environment of negative real interest rates which, together with the "subsidy" offered by the State to importers in the form of official Dollars, simply encourages the purchase of imported products. The only way to be able to stick to this system is if oil prices continually rise so as to face an increasing demand for Dollars to pay for the imports. This is why, sooner rather than later, exchange controls in Venezuela will collapse amidst a profound balance of payment crisis, macro-devaluations, abrupt losses of purchasing power and therefore a generalized impoverishment of all Venezuelans, particularly affecting those in the lower-income strata.

In spite of everything mentioned above, we do not think the Government is even close to dismantling the exchange control. It is too powerful a political weapon in Venezuela and so it is unthinkable that the Executive will simply discard it.

Economic Tips

One more quarter. The BCV reported that the Venezuelan economy, measured in terms of GDP, grew by 8.8% in the first quarter against the same quarter last year. Thus Venezuela has accumulated 14 straight quarters of economic growth. By sectors, private activity expanded by 10.3 %, while the public sector grew by a scant 1.7%.



More of the same. First quarter growth continued to show the same dynamism of preceding quarters, where the items that advanced most were imports (+ 42.3%), followed by fixed gross investment at +27% and private consumption which was up 19%. Public consumption expanded by 4.5%. This growth is derived from the boost given by oil-financed public expenditure. During this period, the non-oil GDP grew by 10.6%, while oil activity actually declined by 5.6%.

Oil sector results are worrying. The oil sector is practically at a standstill. Over the last quarters, growth had come mainly from the private sector, with the public sector on the decline. This tendency was reversed during the recent quarter, when private sector activity fell by 24.3% and the public sector showed a minimum contraction of 0.7%. The descent seen in oil activity during the first quarter is mainly attributable, according to the BCV, to the entry into force of the OPEC-ordered oil production cuts, of which 138,000 barrels per day corresponded to Venezuela. In our opinion, the drop in private sector economic activity is not only a product of the OPEC cuts, but also of the game-rule changes introduced for the process of migration to the mixed companies.

Growth in the sectors not subject to buying and selling activities on the international market. The areas of greatest growth were: construction, with 26.5%; commerce, with 20.8%; financial institutions and insurance, with 18.3%; and transport and warehousing with 16.4. Growth in sectors exposed to international marketing was low. Within the latter sector, manufacturing grew by 7.8%, and mining is the only sector of the economy that showed a fall of 4.9%.

Demand growing strongly. According to the BCV numbers, it is interesting to note that aggregate supply has risen by 17.2%, but aggregate internal demand has grown by a brisk 22%.

FONDEN has received US\$ 27 billion. During a recent presentation to the National Assembly, Minister of Finance Rodrigo Cabezas stated that the mechanism had received US\$ 17 billion during the last 19 months from the BCV by means of transfers of international reserves, while the remaining US\$ 10 billion have come from PDVSA.

74% committed. Cabezas stated that of the resources deposited, US\$ 20.158 billion are already committed to 130 projects, and that of this total, US\$ 12.445 billion has already been disbursed; therefore FONDEN now has a balance of US\$ 14.885 billion available in these resources.

High proportion in “structured notes.” Cabezas also made reference to structured notes which, in our opinion, are high-risk assets. 41.6% of FONDEN’s total investment portfolio – US\$ 6.18 billion – is held in these instruments.

Liquidity levels increase. In spite of the authorities’ commitment to not use the funds within the country, Ministry of Finance numbers indicate that FONDEN spent US\$ 1.737 billion (in VEB) internally, which has boosted liquidity and put extra pressure on prices.

Weekly Report

April tax collections rise to VEB 8 trillion. According to the latest figures published by the tax authority (SENIAT), non-oil collections were up by 34.3% year-on-year, or 12.5%, discounting inflation. This increase was largely thanks to a strong growth of Income Tax collections, which grew by 49.1% with respect to April 2006. On the other hand, Value Added Tax (VAT) collections were down by 16.3% in April, a reflection of new exemptions and the 3-point percentage reduction in the aliquot.

NATIONAL TAX COLLECTION		APRIL		
(VEB Billions)	2007	2006	Var %	Var % Real
TOTAL	8.022	5.972	34,3%	12,5%
Income TAX	5.245	3.517	49,1%	24,9%
Tax	1.398	1.202	16,3%	-2,6%
Customs	1.244	1.135	9,6%	-8,2%
Others Incomes	134	118	13,5%	-5,0%
Debit Tax	0	0	0,0%	0,0%

NATIONAL TAX COLLECTION		JANUARY-APRIL		
(VEB Billions)	2007	2006	Var %	Var % Real
TOTAL	24.542	17.405	41,0%	18,3%
Income TAX	12.603	7.827	61,0%	35,1%
Tax	6.307	5.171	22,0%	2,3%
Customs	5.159	3.658	41,0%	18,3%
Others Incomes	474	425	11,4%	-6,6%
Debit Tax	0	324	0,0%	0,0%

Sources: SENIAT and Ecoanalitica

Government steps up control of expenditure. The *Law to Regulate the Return to the Treasury of Sums Accredited to the Accounts of the Republic and its Decentralized Entities Through Additional Credits* was published on May 10 in Official Gazette No. 38.680. Through this new Law, the Executive establishes that any entity that has not executed 100% of the resources received in additional credits and has such sums deposited in bank accounts, will now have to return the money to the Treasury.

Unemployment closes April at 8.8%. According to figures published by the National Institute of Statistics (the INE), the number of persons unemployed now stands at 1,101,078 or 142,691 less unemployed than in April 2006. This result represents a fall of 1.4 percentage points in respect of the close of April last year, when unemployment stood at 10.2%. The number of people employed in the formal sector is now 55.4% of

the active population, an increase in absolute terms of 239,428 over the same month last year.

OIL TIPS

Oil Basket retreats by US\$ 2.24 after a three-week climb. The price of a barrel of Venezuelan oil closed at a weekly average of US\$ 57.26, lifting the yearly average to US\$ 52.66 per barrel, still below the 2006 average, when the Venezuelan oil basket stood at US\$ 56.45 per barrel.

Number of active rigs falls by 10.5% to a total of 76. According to Baker Hughes statistics, which are used as a reference by the OPEC, the number of active rigs fell by 9 to a total of 76 during the first quarter of this year. This represents a drop of 10.5% in respect of the same period last year. This reduction may have to do with the implementation during this period of a sizeable part of the OPEC-ordered production cuts, which signified a reduction of 195,000 bpd of crude production for Venezuela, although the BCV indicates that this cutback was actually 138,000 bpd.

Oil production down. According to figures of the International Energy Agency (IEA), average crude production in Venezuela was 2.35 million bpd last month, 40,000 bpd less than in March. According to the Agency's records, Venezuela produced 2.56 million bpd in 2006 (150,000 bpd less than the year before), and went down to 2.44 million bpd in the first quarter of this year.

BUSINESS SECTOR TIPS

Telecommunications grow. According to CONATEL, mobile phone lines increased by 43.6% during the first quarter, compared to the same quarter of 2006. CONATEL calculates that by the end of March this year there were 71.6 mobile phone lines for every 100 Venezuelans, which results in a figure of 19.6 million lines. Text messaging grew by 32.7% in the first quarter. On the other hand, fixed landlines grew by 15.8% to total 15.7 lines for every 100 inhabitants during the same period.

Public Share Offering (PSO) concluded. PDVSA expects to pay out US\$ 739 million this Friday, equivalent to 82.14% of the shares of Electricidad de Caracas (EDC) still held by AES Corporation. This will signal the end of the Public Share Offering, thus sealing the State's control over the electricity company.

Weekly Report

The last results. EDC recorded a first quarter net profit of VEB 64.8 billion, a 17.9% increase over the same period last year, and also reported an EBITDA margin of 42.9% for the same quarter.

Manufacturing sector growth not enough to cover market needs. Eduardo Gómez Sigala, President of CONINDUSTRIA, states that companies are functioning at high levels of operability of between 60% and 65%, but they are not investing in installed capacity.

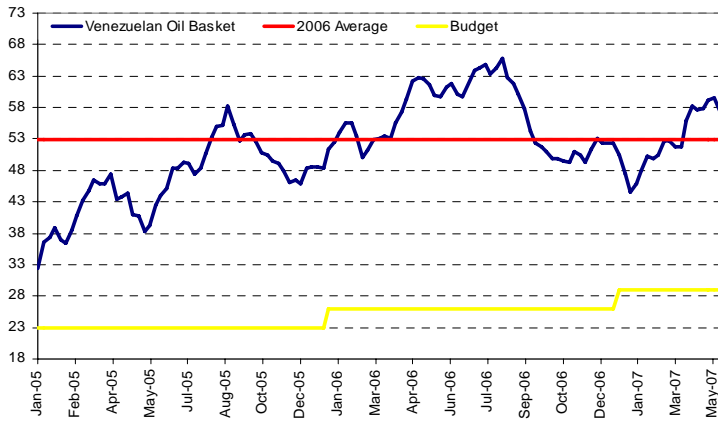
Major growth in the insurance industry. The sector grew 50% in 2006 in respect of 2005, to a total of US\$ 4.88 billion. Most growth, +66%, was seen in the health sector, followed by the "general" sector (which includes vehicles) of 38.7%. Earnings fell by 2.5% in 2006, from US\$ 290 million to US\$ 282 million, because of higher claims. The sector grew by 66.7% in the first two months of the year. The number of companies in the insurance market is now 49, of which 10 control 69% of the market.

Rents still frozen. The Ministries of Housing, Infrastructure and Light Industries have published a resolution in the Official Gazette that extends the rent freeze by a further six months. With this latest extension, rents will have been frozen for four years at their November 2002 levels. According to comments of representatives of the real estate sector, the rent control has seriously impacted rental operations, which have fallen by 70% over the last three years.

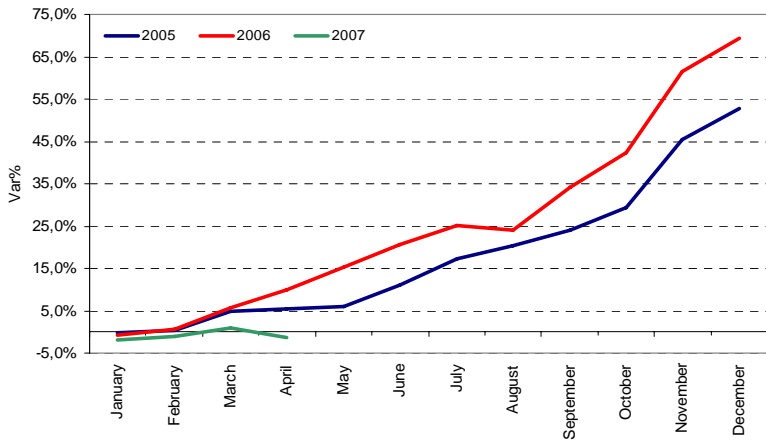
A country of pirates. A recent study made by the Business Software Alliance of Venezuela revealed that 86% of all software installed in personal computers in Venezuela in 2006 was obtained illegally. This means a rise of 4 percentage points in respect of 2005, a year that generated a loss of approximately US\$ 307 million for the industry. The software piracy rate is considerably superior to the average of 66% recorded for the Latin American region.

ECONOMIC OVERVIEW

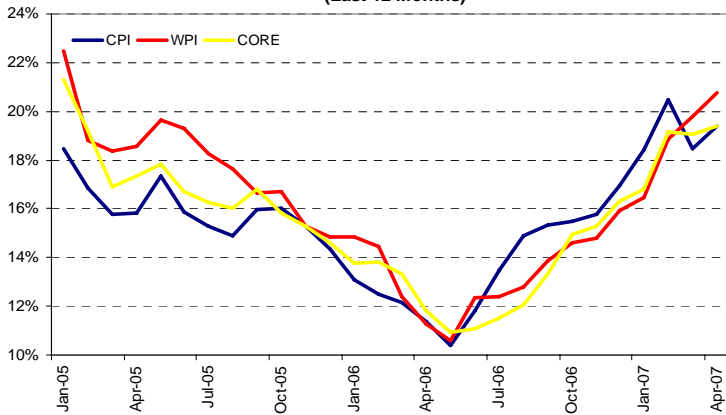
Oil Price
(Venezuelan Basket US\$/pb)



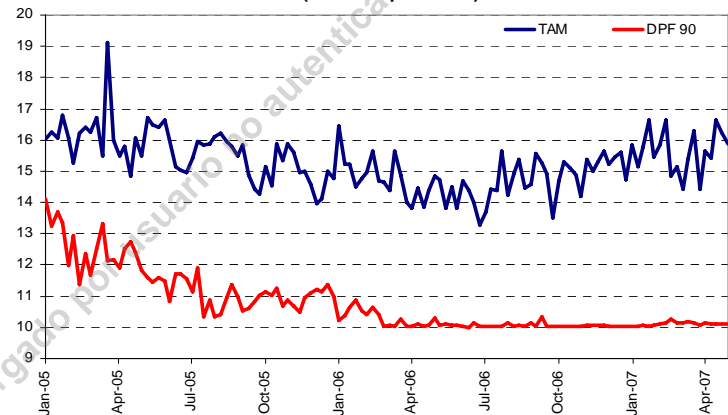
Real Expansion (M2)



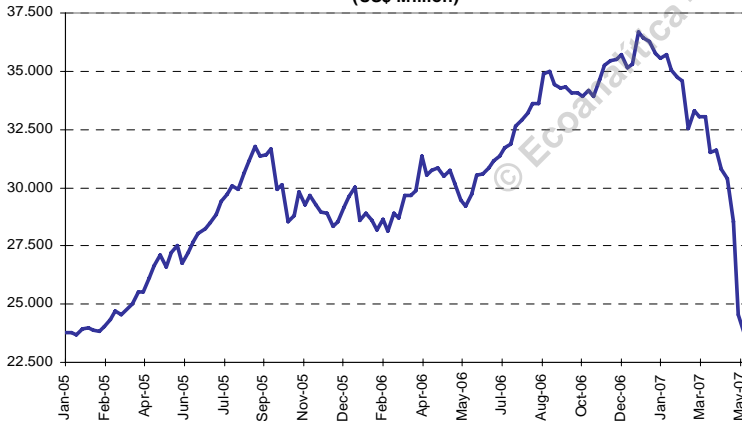
Inflation
(Last 12 Months)



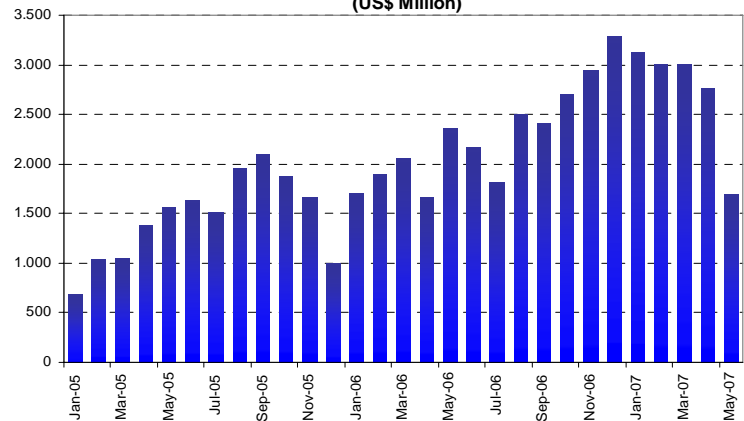
Interest Rate
(Six Principal Banks)



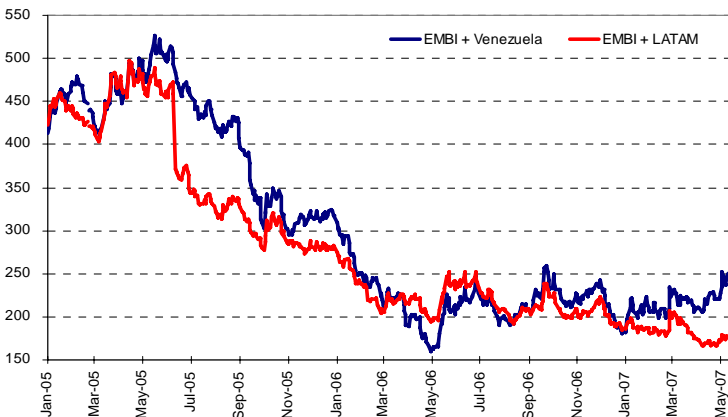
Fx Reserves - BCV
(US\$ Million)



Disbursement
(US\$ Million)



EMBI



Central Government
(VEB Billion)

