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***DEBT DOWN, BUT NOT
BY AS MUCH AS IT
COULD HAVE BEEN***

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The Ministry of Finance (MF) recently published first quarter (Q107) sovereign debt (both internal and foreign) balances, especially mentioning a slight reduction of 2.2% in respect of the balance at the close of 2006. The fact is that the Government has resources enough to embark on a much more aggressive debt reduction program, but with all the announcements of more nationalizations in the air, this looks improbable.

Q107... and Venezuelan national debt stands at 21% of GDP

The above MF Q107 figures point to a Venezuelan public debt total of US\$ 41.776 billion, which, according to our calculations, equals 21.1 GDP points. At the close of 2006, this percentage stood at 23.8 GDP points, which means that the nation's debt fell by 2.7 GDP points, a not very significant net reduction of US\$ 928 million.

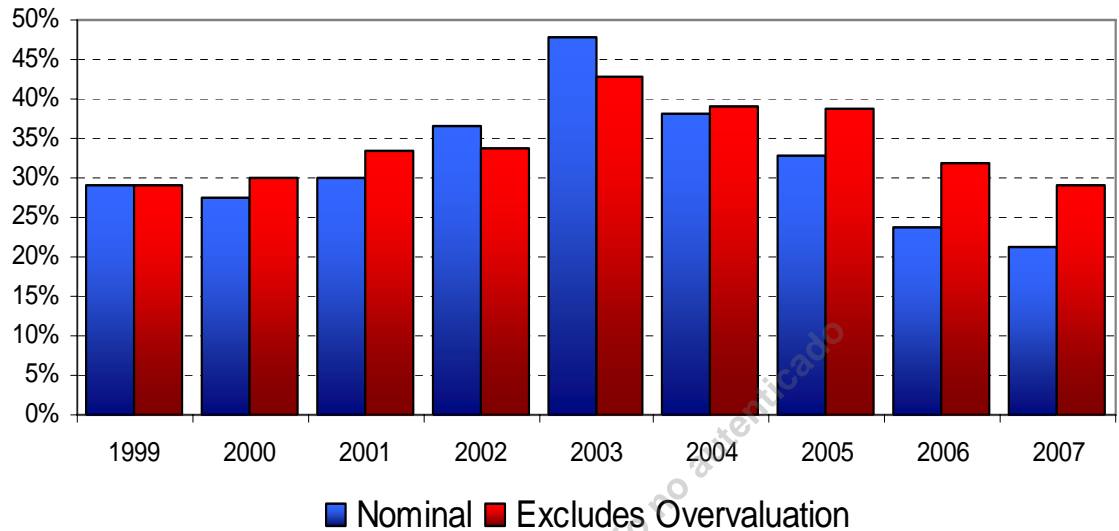
The effects of an over-valued currency

The main reason is that Venezuela's currency is over-valued, and this produces an "artificial" growth in our economy's nominal GDP. In fact, in 2003 sovereign debt stood at 47.7 GDP points, which, when compared to the Q107 numbers, means there has been a reduction of 26.6 GDP in less than 4 years. Clearly, this figure has been strongly affected by the effects of currency over-valuation. As this distortion is corrected, the debt reduction figures will also descend and adjust.

Ecoanalítica has estimated debt variation by eliminating the effects of currency over-valuation, as shown in the chart below. Thus seen, debt reduction in relation to GDP would be 13.8 GDP points – or 12.8 points less than the number mentioned above.

The MF foresees that sovereign debt will stand at 18% of GDP in 2008. In other words, the debt buy-back programs will continue over the upcoming months.

Debt / GDP

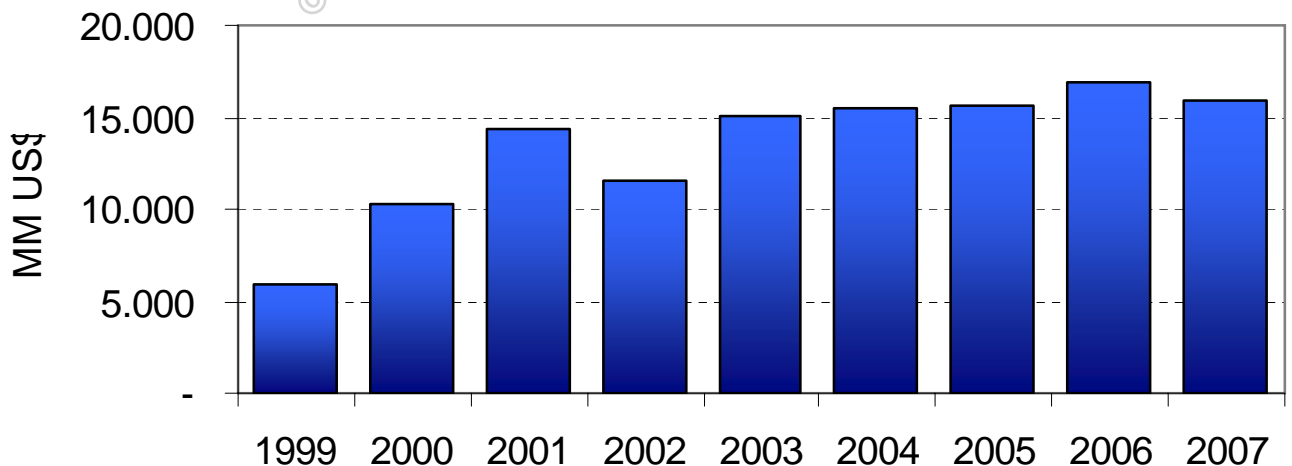


Sources: Ministerio de Finanzas and Ecoanalítica

Biggest reduction is in internal debt

On the internal scene, the central Government's debt stood at VEB 34.3 trillion (US\$ 15.933 billion) at the close of Q107, which, when compared with the close of 2006, shows a net reduction of VEB 2.0 trillion (US\$ 918 million). The biggest reduction was seen in treasury bills, which fell by VEB 1.4 trillion (US\$ 665 million), while total National Public Debt (DPN) bonds fell by VEB 0.5 trillion (US\$ 253 million).

Internal Debt



Sources: Ministerio de Finanzas and Ecoanalítica

Reduction of internal debt should be greater

The Government should reduce its placement of internal debt to a minimum, since fiscal administration could clearly be handled with ordinary fiscal income. Another point to be borne in mind is the Central Bank (BCV) debt which, although different, in the sense that it forms part of monetary policy, is ultimately a State obligation and stood at VEB 24.8 trillion (US\$ 11.531 billion) at the end of April. This signifies that VEB-based public debt stood at VEB 59.1 trillion (US\$ 27.470 billion).

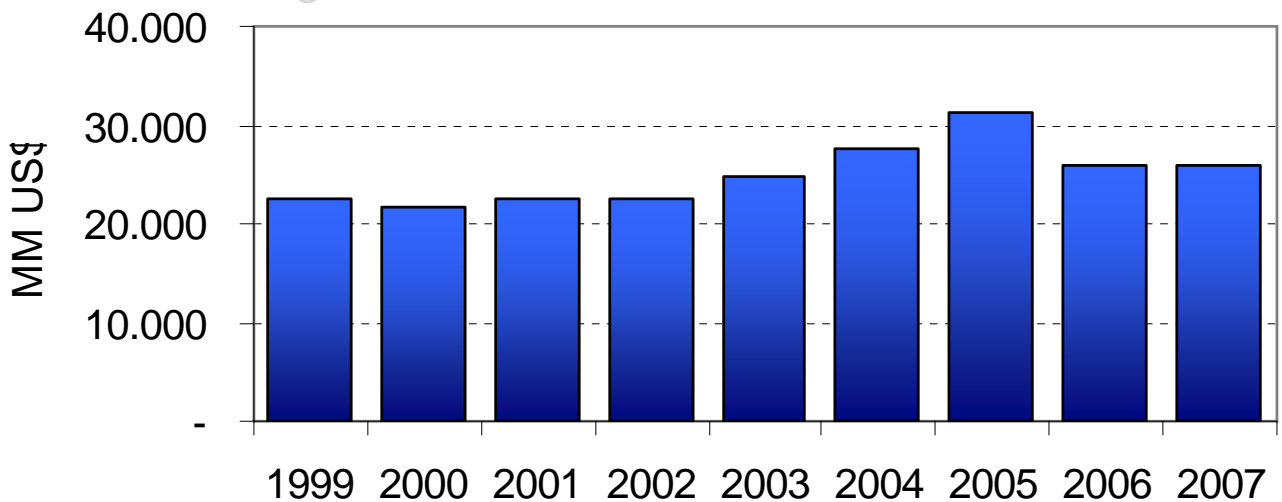
Exchange control offers significant advantages to the Government when it comes to handling internal debt

It should be noted that there are 3 significant advantages of the exchange control: 1) local long-term bonds are now being issued, helping to de-concentrate and lower servicing costs; 2) the cost of servicing internal debt has tended to descend significantly over the last two years as a result of the reduction in interest rates, brought about by the excess liquidity generated by the exchange control; and 3) thanks to the control, the Executive can make all kinds of internal debt swaps which enable the extension of debt maturity and, moreover, a reduction in interest rates.

Foreign debt only down by US\$ 10 million

When analyzing the MF figures, we find that foreign public debt only fell by US\$ 10 million between December 2006 and March 2007. During 2006, the Government made an important reduction in foreign debt (by US\$ 5.347 billion in respect of 2005), mainly due to the MF's March through May buy-back program aimed at repurchasing high-coupon securities (Brady bonds and bilateral debt) in order to generate savings in the cost of servicing Venezuela's foreign debt.

Foreing Debt



Sources: Ministerio de Finanzas and Ecoanalítica

Buy-back to continue

At *Ecoanalítica* we believe that the Government will continue this year with its program of buying back foreign debt mainly contracted with commercial banks and bilateral entities, since its financing terms are particularly onerous. We are informed that the MF plans to pay off a high proportion of the debt with multilateral entities (about US\$ 2.5 billion). We calculate that the MF will use around US\$ 4.0 billion of the resources held in FONDEN for this, and that the program will be implemented during the second half of the year.

Debt with multilaterals down by US\$ 530 millions

Debt with multilateral organizations was reduced by a significant US\$ 530 million, senseless really, because this is the least expensive debt of all, the majority of which is aimed at financing development programs, public policy reforms and infrastructure projects.

Getting out of the IMF is costing us US\$ 180 million

Alejandro Dopazo, ex-director of public credit at the Ministry of Finance stated that the Government's decision to exit the International Monetary Fund (IMF) should be no cause for alarm, since Venezuela can initiate the so-called "consent request" procedure aimed at eliminating the obligation to belong to this organization from the debt-issuing prospectuses.

In fact, a team of analysts is already working on this at the IMF, and this is why the country's announced withdrawal from the IMF has been delayed. Enforceable securities would total around US\$ 17.573 billion, of which US\$ 4.5 billion would be subject to pre-payment.

Therefore President Chávez' whim of withdrawing from the IMF will end up costing the Republic something close to US\$ 180 million, at the most conservative estimate.

And this is not the first time

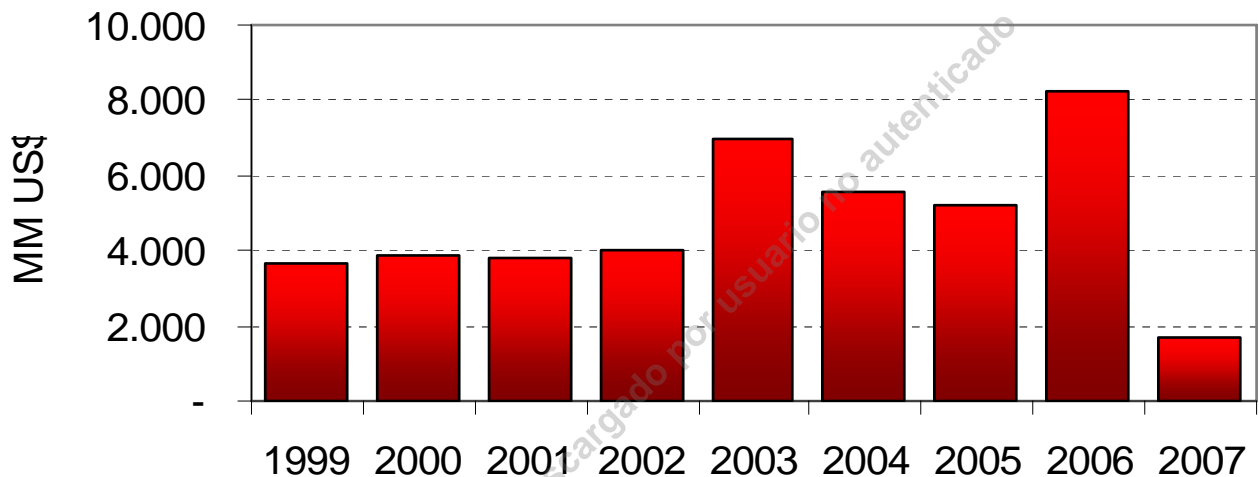
Dopazo added that the Republic already made use of this right in 2004, when, through PDVSA, it asked for the consent of PDVSA Finance bond-holders to modify certain clauses of the issue prospectuses. However, the withdrawal from the IMF brings far more serious consequences than this, since in practice it would signify Venezuela's exclusion from international finance markets..

Impact seen in servicing costs

Although still incomplete, the debt reduction program has important advantages: less need for financing, improved debt-servicing profile, better negotiation basis for bilateral and multilateral debt, and more homogeneity in foreign debt securities. According to the MF, debt-

servicing savings will amount to US\$ 500 million in 2007 and US\$ 450 million per year from 2008 over the following 6 years. This is a significant figure if one considers that the average cost of Venezuela's foreign debt servicing over the last 7 years has been US\$ 4.4 billion, meaning that the above savings represent 10% of total servicing costs.

FOREIGN DEBT-SERVICING COST



Sources: Ministerio de Finanzas and Ecoanalítica

And abroad... more aggressiveness required

Under current economic conditions, the Government should have been more aggressive in its sovereign debt buy-back programs. According to our estimates, the Government could have used surplus resources (mainly in the hands of FONDEN) to buy back up to US\$ 10 billion of foreign debt, or twice the amount it has bought back so far, without impacting present expenditure levels. It could also have embarked on a program to swap costly debt for debt with better financing conditions, negotiated over the next 5 years, rendering new debt much less costly than that of the past.

Very important that Government continue its debt-reduction strategy

The Government must continue with the stabilization of its debt buy-back strategy while oil prices are high. In this manner, "extraordinary" resources are used to reduce the Republic's liabilities and free up resources for future years, when they can be used for investment in physical and human capital.

Economic Tips

PDVSA Bonds on the US market. Thursday, May 24 marked the expiry of the 40-day period required by the corresponding regulations for US investors to acquire such paper. This measure is necessary since PDVSA no longer submits its financial statements to the US Securities and Exchange Commission (SEC). At **Ecoanalítica** we expect that the asking price for these securities will rise as a result of the increased demand caused by access to the US market.

CADIVI foreign currency authorizations up by 30% this year. Manuel Barroso, President of the Foreign Exchange Commission (CADIVI), has stated that through May 15 requests for US\$ 13.9 billion have been approved, of which US\$ 13.2 billion have been settled, signifying an increase of 30% compared with 2006. This figure signifies a daily settlement of US\$ 161 million, and 54% of the resources authorized (US\$ 7.6 billion) have been for imports, US\$ 2.02 billion for capital goods and US\$ 1.9 billion for consumer products.

The economy according to Giordani. Jorge Giordani, Planning and Development Minister, has indicated that national industry is working at almost 90% of its capacity, and emphasized that, according to BCV investigations, 60% of the companies operating in the country are doing so at 100% of their installed capacity. In fact, we are of the opinion that this is one of the factors pressuring prices, since, although the majority of the companies are working at full capacity, they are not yet ready to raise the level of their investments.

Government recognizes stagnation of private investment. Following along this line of thought, Giordani pointed out that if manufacturers want to respond to demand “you have to invest more, before competitors arrive to push you out of the market. You shouldn’t go believing in the market and perfect competition, because that only exists in the mind of some people.” What the Minister did not say was that investment has stagnated partly as a result of the Government’s attack on the private sector, partly as a result of the deepening of economic controls, of the lack of transparent rules of the game and finally of the feeling that the economic bonanza is a passing phenomenon.

Excessive growth? The Planning Minister insisted that too much growth is unhealthy. After highlighting that the country’s economy has grown at an average rate of 12.6% for the last 14 quarters, the highest rate registered in the last 50 years, he warned that rates of over 12% “would maybe have to be reined in a little.” He added that the

Weekly Report

country's GDP, measured as the added value of economic activities, was close to US\$ 200 billion.

BCV explains round-offs. The BCV has prepared a draft resolution to regulate the rounding-off of prices. According to the BCV, prices will all be reduced by being divided by one thousand, and must contain two decimals. The rule for expressing values is that each fraction of less than 0.5 cents "will be the same as the lower cent," and those that are equal to or greater than 0.5 cents, will be equal to the higher cent.

Important exception. "In the case of auto fuels; of liquid petroleum gas sold in cylinders; of water, electricity and telephony; of exchange rates; and of the tax unit," prices must be divided by one thousand and reflect at least five decimals, unless the operation gives a lesser number. Such prices with five decimals shall be rounded off to two decimals, but only "at the moment of payment or of their respective recording in accounts."

Government calculates 7% unemployment for 2007. José Rivero, Labor Minister, has indicated that by the close of this year the unemployment rate will stand at 7%. This sounds plausible, since the unemployment rate tends to experience a seasonal reduction approaching Christmas.

OIL TIPS

Oil basket US\$ 24 above budgeted price for 2007. According to Ministry of Energy and Petroleum data, the price of the Venezuelan oil basket rose by US\$ 1.45 at the end of last week to close at US\$ 58.71, meaning that the May average was US\$ 52.96, thus registering a surplus of US\$ 23.96 against the budgeted price of US\$ 29 per barrel for crude.

Supply of oil to China up by 40%. During the first quarter of this year, oil dispatches to China averaged 55,000 barrels per day (standing at 60,411 barrels per day at the close of March), translating into an increase of 40.3% when compared with the same period of 2006, according to figures of the General Customs Administration of that country.

We are its 7th biggest supplier. The increase in crude exports to China have meant that Venezuela has become its 7th biggest supplier, behind countries such as Angola, Saudi Arabia, Iran, Russia, Oman and Sudan, all of which are nations much closer to Asia than Venezuela. In spite of this, Venezuela appears as the only western country among the top ten suppliers.

BUSINESS SECTOR TIPS

First announcements of the new CANTV. President Hugo Chávez has announced a 20% reduction in the rates applied by cell phone company Movilnet. The reduction will be executed in two stages: a 10% reduction on June 15, and 10% on August 15. CANTV rates for fixed land-line calls to cell phones will also be brought down by 20% in June. President Chávez did not specify the exact date.

Announcements do not end there. The President indicated that as of January 2008, low-income areas will have special low rates, including a 10% reduction for local calls, 15% for national calls and the elimination of VAT. The Head of State also announced that Movilnet will sell 2 million new lines and CANTV will install 1.2 million new lines during the next 18 months.

New Board ready. The above announcements were made on occasion of the swearing in of the new Board of Directors at CANTV. Socorro Hernández will officially be President of CANTV and its Board, and Jackeline Faría will be President of Movilnet. Also sworn in were Yelitza García, chosen to represent Class C shareholders, Rafael Isea Romero, President of BANDES, to represent Class B shareholders, Euclides Campos (for the Ministry of Defense), Franco Silva and Elba Rodríguez (Ministry of Telecommunications), Nury Orijuela (Ministry of Science and Technology), Jesús Villanueva (Petroleum Ministry) and Angel Belisario (Light Industry and Trade Ministry), among others. The central questions of the new philosophy at CANTV are whether the company's profitability can be sustained and if the Government will stick to the policy of heavy investment held by the CANTV, which amounted to around US\$ 700 million per year.

Venezuelan imports from China have grown by 112%. According to Ya-Lan Liu, BBVA Group's chief economist for China, the huge boom in demand has been the main reason behind the strong increase in goods coming in from China, which closed 2006 at US\$ 2.207 billion, while during 2005 they had barely broken the US\$ 1 billion level. With these numbers, China climbs to position No 4 on the list of importers to Venezuela.

Ours do not grow at the same rhythm, however. While the Chinese send more and more products, our participation in this market has declined by 41.8%. The placement of Venezuelan products in the Chinese market has gone down from US\$ 216 million in 2005 to US\$ 126 million at the end of 2006, caused by the loss of competitiveness of Venezuelan exports as a result of the over-valuation of the Bolívar.

Weekly Report

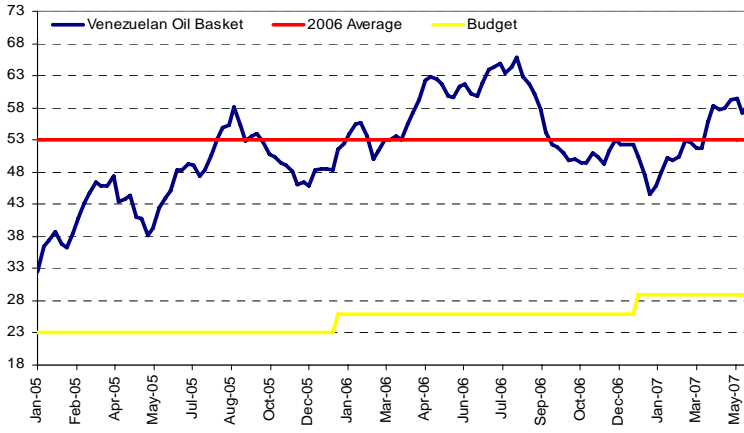
Electricity generation continues to rise. Electricity generation for the first quarter of this year rose by 4.23% in respect of the same period of 2006. On the other hand, maximum demand of the National Electricity System (SIN) grew by 0.28% between January and April in respect of the same period of 2006.

Controls looming for the construction sector. From the Executive's viewpoint, the legal framework governing the housing area needs changes that will guarantee more regulation of the financing institutions and the constructors who, together with the Government, are developing the housing policies. Housing Minister, Ramón Carrizález, has indicated that the Housing Contribution Régime Law should be reformed and a Real Estate Speculation Law be created, and estimates that some of the texts will be ready by the end of the first semester. The purpose of this new regulation will be to review the cost structures of the construction companies, particularly those dedicated to home building.

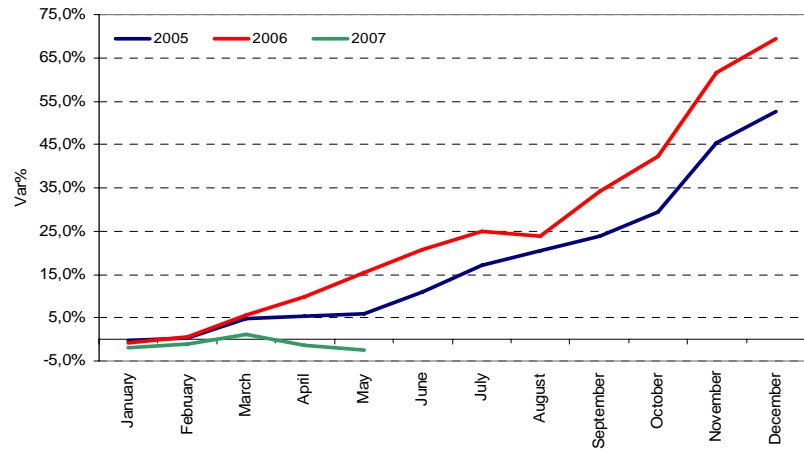
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ECONOMIC OVERVIEW

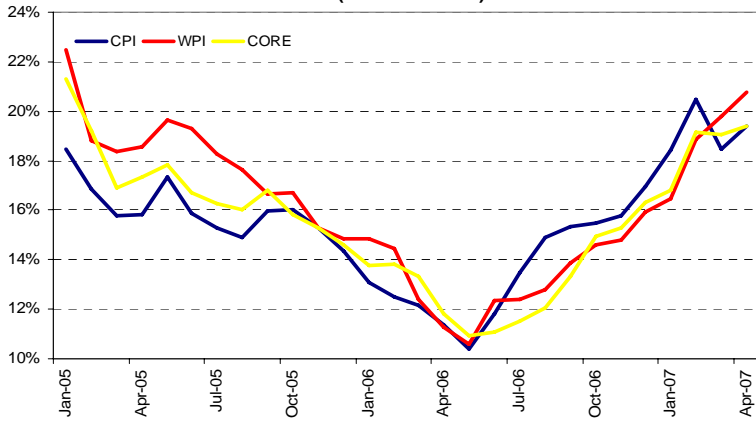
Oil Price
(Venezuelan Basket US\$/pb)



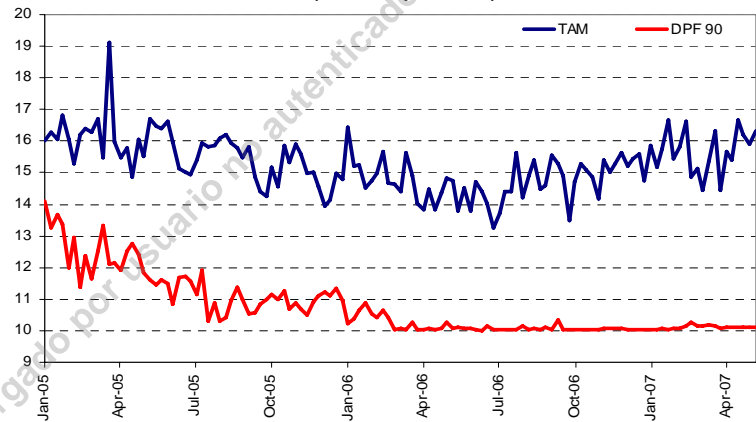
Real Expansion (M2)



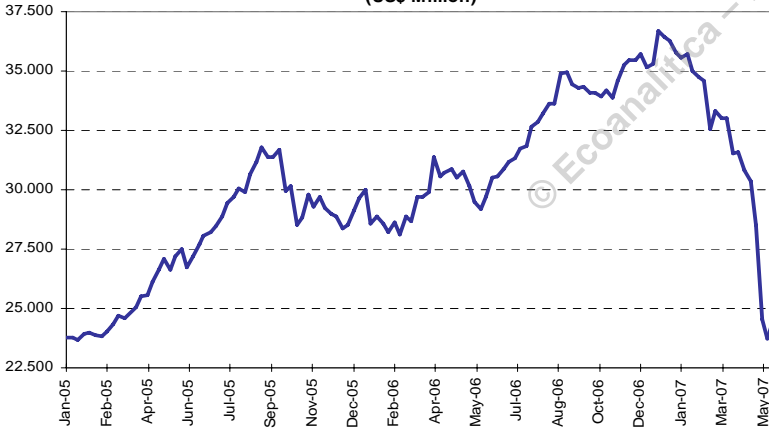
Inflation
(Last 12 Months)



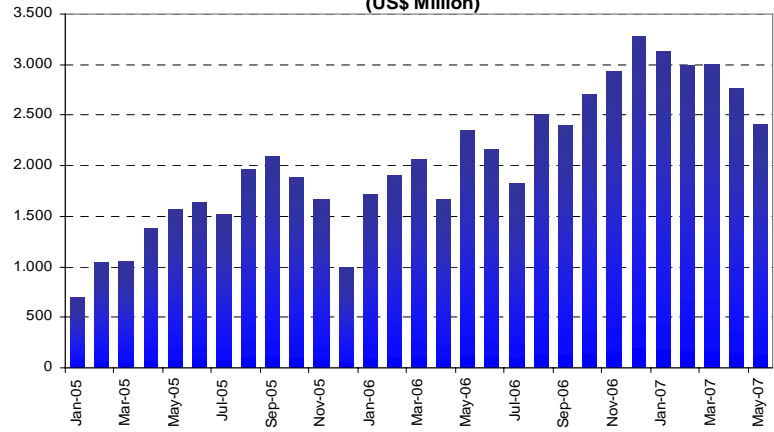
Interest Rate
(Six Principal Banks)



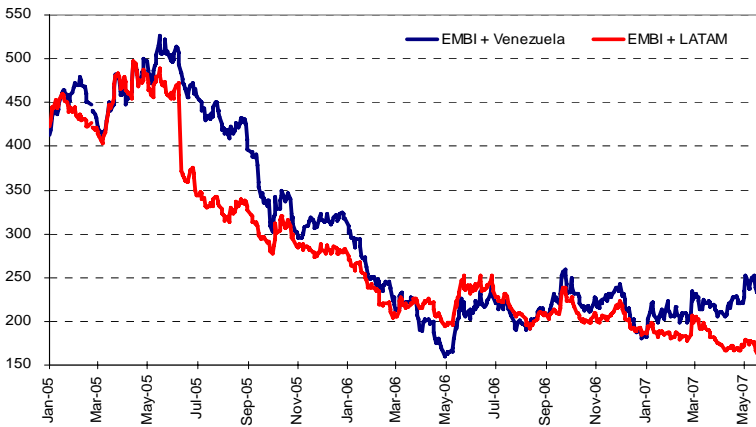
Fx Reserves - BCV
(US\$ Million)



Disbursement
(US\$ Million)



EMBI



Central Government
(VEB Billion)

