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**2006 CENTRAL
GOVERNMENT'S
ACCOUNTS BALANCED
IN SPITE OF
BURGEONING
EXPENDITURE**

By:
Alejandro Grisanti
Asdrúbal Oliveros

Edited by:
John Holden

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ECOANALÍTICA, invita a su primer foro interactivo:

*De la confianza a la cautela
Perspectivas 2007-2008*

Martes 01 de junio de 2007
8:00 a.m. a 1:00 p.m.
Hotel Tamanaco Intercontinental
Salón Naiquatá

Para mayor información comunicarse con Natasha Quintana.
natashaq@ecoanalitica.net / Teléfono: 266 90 80

The Finance Ministry has published the Central Government's 2006 financial data showing that it broke even last year with no fiscal deficit. It is also clear that oil income is playing a crucial role when it comes to analyzing Venezuela's public sector financing. **Ecoanalítica** has modified its fiscal panorama for the years 2007 and 2008 and we now expect 2007 fiscal deficit to close at 2.2% and 2008 at 3.5% of GDP.

Behind schedule, Finance Ministry presents Government's 2006 fiscal accounts

Just one week back, the Finance Ministry made public the Central Government's fiscal data. It must be borne in mind that the Central Government is only one element of what is known as the Restricted Public Sector or RPS. The RPS allows us a fuller view of the present Government's handling of its fiscal budget over the last few years. The reason is that this concept includes not only the Central Government but also PDVSA, non-financial public companies, the Social Security Institute and FOGADE. It should also include FONDEN, but the Government has so far not made public the final RPS numbers for the 2004-2006 period.

Five things stand out in the 1999-2006 period

When analyzing the Central Government's numbers, 5 things are immediately apparent and should not be overlooked:

1. There has been a significant rise of 12 points in total income. Nevertheless, this growth is essentially thanks to oil income, which rose by 8.7 points, or 73% of the total increase.
2. Total expenditure has risen 10 points, passing from 19.8 GDP points to 30. However, there is a hidden trap in these figures and public expenditure was in fact probably higher.
3. Current expenditure shows an increase of almost 6 points and capital expenditure of almost 4 GDP points, rising from 3% of GDP in 1999 to 6.8% in 2006. Salaries have grown by a mere 0.5 point of GDP.
4. The Central Government has advanced from a global deficit of 1.7 GDP points in 2001 to a state of equilibrium in 2006, since the fiscal result is zero.
5. What economists call "extra-budgetary expenditure" by the Central Government is irrelevant, standing at a scant 1.1% of GDP. This means that the real extra-budgetary expenditure is being recorded somewhere else on the books, particularly in the case of PDVSA and the non-financial public sector companies.

Fiscal Administration (% GDP)		1999	2000	2001	2002	2003	2004	2005	2006
Total Revenue		18,0%	20,2%	20,8%	22,2%	23,4%	24,0%	27,7%	30,0%
Oil Revenue		7,4%	10,6%	10,0%	10,9%	11,8%	11,3%	13,6%	16,1%
Non-Oil Revenue		10,7%	9,5%	10,8%	11,3%	11,6%	12,7%	14,1%	14,0%
Total Expenditure		19,8%	21,8%	25,1%	26,1%	27,8%	25,9%	26,0%	30,0%
Current Expenditure		16,4%	17,5%	19,3%	19,1%	20,8%	19,6%	19,1%	22,2%
Salaries		3,4%	3,7%	4,4%	4,2%	4,3%	3,9%	3,5%	3,8%
Interests and commissions of National debt		2,8%	2,5%	2,9%	4,6%	4,7%	3,7%	3,0%	2,1%
Capital Expenditure		3,0%	3,3%	4,4%	5,1%	5,5%	5,0%	5,8%	6,7%
Extra-budgetary Expenditure		0,4%	1,0%	1,5%	2,0%	1,5%	1,3%	1,1%	1,1%
Primary Balance		1,0%	0,9%	-1,5%	0,6%	0,3%	1,8%	4,6%	2,1%
Non Oil Balance		-9,1%	-12,3%	-14,3%	-14,8%	-16,2%	-13,2%	-12,0%	-16,1%
Fiscal Balance		-1,7%	-1,7%	-4,4%	-4,0%	-4,4%	-1,9%	1,6%	0,0%
Financing Requirements		1,7%	1,7%	4,4%	4,0%	4,4%	1,9%	-1,6%	0,0%
Domestic Debt		2,8%	4,0%	4,0%	3,1%	3,3%	-0,7%	-2,5%	-1,3%
Foreign Debt		-1,1%	-2,3%	0,3%	0,9%	1,1%	2,6%	0,9%	1,3%
Average Oil Price (US\$/BI)		16,2	25,8	15,1	25,6	26,7	32,2	48,6	56,4

Sources: MF and Ecoanalítica

Fiscal administration gets murkier

Generally speaking, when looking closely at Venezuela's fiscal discipline over recent years, we find that the main traits are a lack of transparency, disorder, inclusion of extraordinary sources of financing, such as currency exchange profits, transfers of international reserves and an increase in quasi-fiscal expenditure. A whole series of funds have been set up, which do nothing to help the overall transparency, and several different institutions spend money in the same areas. One example is sufficient: rather than education expenditure being centralized in its Ministry, we know that expenditure on education is spread around among the Central Government, PDVSA, FONDEN and BANDES. It is obvious that by handling the public purse-strings in this way it is far more difficult to keep control and present your figures, and this in turn invites corruption.

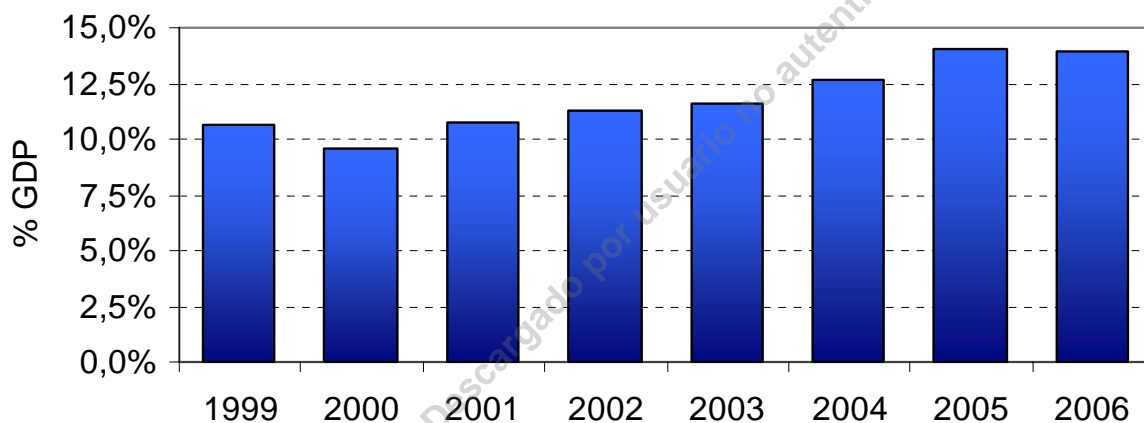
Oil income rises significantly between 2005 and 2006

One of the most notable aspects of the 2006 figures is the strong growth in oil income. Driven by oil prices, oil income grew by 2.5 GDP points, moving up from 13.6% in 2005 to 16.1% of GDP in the year 2006. We have repeatedly commented that this income is not recurrent, since it depends on a variable that is not under the control of the Venezuelan authorities. Therefore, expenditure should not rise on the back of this "extraordinary" increase of oil income.

Non-oil tax income stagnant

During the same period, non-oil income remained stable at the equivalent of 14 GDP points. Non-oil income is more stable and recurrent than oil income and it is feasible to put into place an expenditure growth policy. However, non-oil tax collections increased by a mere 3.3 GDP points during the 1999-2006 period, going from 10.7% to an equivalent of 14.0% of the GDP. In 2006 they represented 46.7% of total income.

NON-OIL TAX COLLECTION



Sources: MF and Ecoanalítica

The never-ending story: more income, more spending

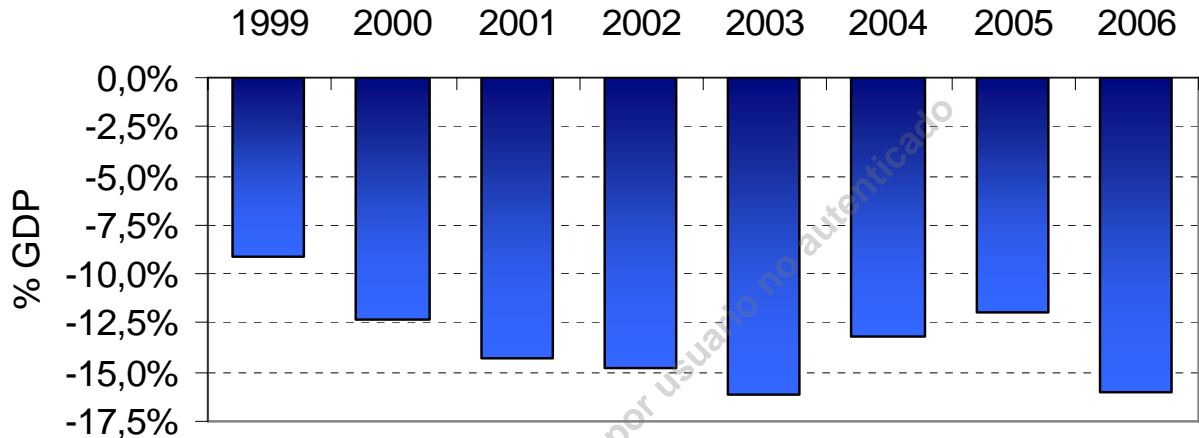
It looks as if we are condemned to an absence of fiscal discipline in Venezuela. Every time there is a boom in oil prices we rush to spend all the extra money and even take on debt. 2006 was no exception. The Government's primary expenditure grew by 4.9 GDP points, rising from 23 points of the GDP in 2005 to 27.9 points in 2006. If, on top of this, we add in interest payments we arrive at a total figure for Central Government spending of 30 base points of the country's Gross Domestic Product.

We mentioned above that the Central Government broke even in 2006. However, expenditure this year is far higher than the 25.3 GDP points average for the 1999-2006 period.

The non-oil deficit, the fraction of expenditure that has to be financed by oil or by taking on debt, is much more worrying still. In 2005 the

non-oil deficit stood at 12% of GDP, equivalent to US\$ 15.95 billion, whereas in 2006 it rose to 16.1 GDP points or US\$ 26.76 billion.

Non Oil Balance



Sources: MF and Ecoanalítica

Central Government's published expenditure figures do not necessary tell the whole story

The Central Government's balance sheet could come as a complete shock to those, like us, who have been saying that Government expenditure has been steadily growing over recent years. Its total expenditure last year, 2006, stood at a mere 30 points of the GDP. But this result is not a reflection of real total public expenditure.

Behind our above assertion is the fact that the numbers presented by the Finance Ministry do not include the significant expenditures made by PDVSA, FONDEN, BANDES and others.

Thanks to an oil boom, the Central Government, essentially the Executive, has been gradually improving its overall results. It moved from a 1.7 GDP point deficit in 1999 to a 4.4 point deficit in 2003, and then in 2005 it closed the year with a 1.6 point surplus which disappeared in 2006 to break even.

The crux of the matter is PDVSA

In light of these numbers we can but conclude that in order to really understand the evolution of Venezuela's public finances it is absolutely necessary to plunge into the financial results of PDVSA and analyze

the new expenditure structure, and above all, of the financing of the Missions (social outlays) and transfers to FONDEN and other public sector entities.

2006 was a special year, not just because of the Presidential elections, but also because of the arrival of FONDEN, which amassed around US\$ 18 billion in resources, the equivalent of 11 GDP points. We also now have the Bank of the Treasury, leading financier in the area of public sector trust funds. Therefore, since FONDEN fails to appear anywhere in the Finance Ministry's data, total public outlay by the Government was indeed significant, and it follows the trend of preceding years. Moreover, the Bank of the Treasury will not appear on the Finance Ministry's balance sheet because it is a financial public company.

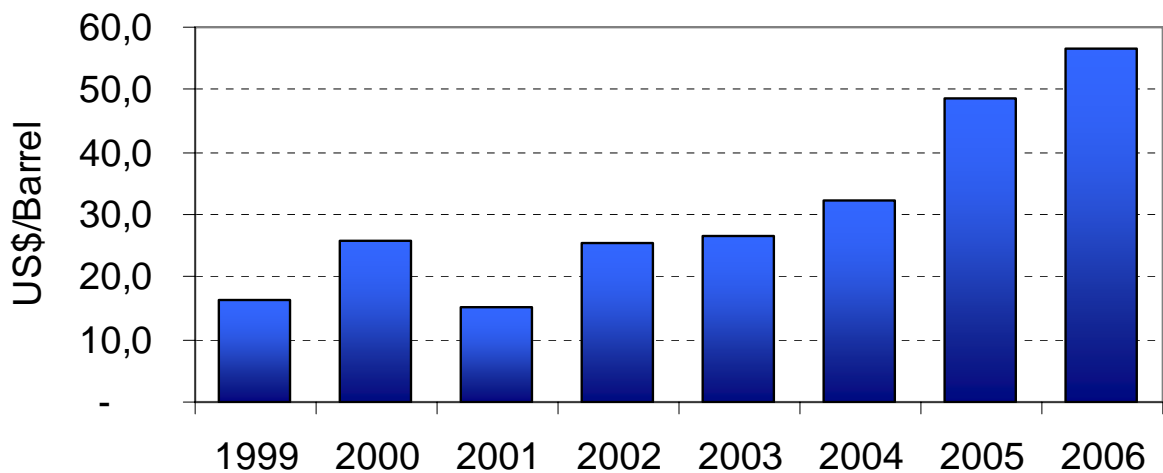
Central Government deficit to represent 2.2% of GDP

Total 2007 expenditure for the Central Government will be close at 31% of our GDP, using the same methodology as the Finance Ministry and the International Monetary Fund. This would mean that there will have been a minimal growth in GDP in 2007 of 1.1 points and of 11.3 points when compared to 1999. With these results, the Government would close out this year with a 2.2 GDP point deficit, since we calculate that fiscal income will reach 28.8% of the GDP, in other words, a drop of 1.2 points in respect of 2006.

Government's health dependent on oil price performance

It cannot be denied that the public sector can display some positive numbers, but they are essentially thanks to the great performance of oil prices during recent years, exploding by a nominal 248% between 1999 and 2006.

Average Oil Price



Sources: MF and Ecoanalítica

If this continues, the adjustment will soon be here

If non-oil tax collections meet their target and the present boom in oil prices holds up, the Government can maintain its projected expenditure levels for at least one more year. This is not, however, a recommendable policy and, in light of its monetary implications, it will turn sour in the medium and long term. It would be very different if the Government stuck to a coherent fiscal plan and, ahead of the inevitable decline in oil prices, sought a soft landing that would ensure that the adjustment is less severe. Nevertheless, judging by recent statements of Finance Minister Rodrigo Cabezas, we can expect no modifications to fiscal policies, since the Government has no intention to reduce expenditure.

Economic Tips

Joint bond issue with Bolivia on the way. The head of public finance, Rodrigo Cabezas, has stated that a joint US\$ 500 million bond issue together with Bolivia is in the making, and should take place this semester. The placement method will likely be similar to the one used for the joint bond issues with Argentina.

Southern Bond III and maybe ALBA bonds too. Cabezas also announced the launching of a third issue of Southern Bonds (III), estimated at between US\$ 500 million and US\$ 1 billion, for the second half of the year. Finally, he mentioned a possible ALBA Bond issue with the participation of the countries making up the Bolivarian Alternative for the Americas (Spanish initials "ALBA"), among them Cuba, Nicaragua and Bolivia.

FONDEN earnings. FONDEN obtained US\$ 620 million in profits according to Rodrigo Cabezas. He went on to say that US\$ 200 million had been assigned to the Simón Bolívar Fund, a dependency of FONDEN, and would be used to finance certain of the projects presented by the ministries. The first quarter report indicates that of the earnings achieved by the investment portfolio, 30% had been assigned to the Simón Bolívar Fund, 2% for operating expenses and 0.3% for sundry commissions and bank charges attributable to each disbursement. Nothing has been said about the remaining 67.7% of the resources.

15.5% unemployment among young people in April. According to figures released by the National Institute of Statistics (INE), total unemployment fell last month to 8.8% of the total workforce, but in spite of this, the level of unemployment among young people between the ages of 15 and 24 is far higher, standing at 15.4% of the working

population, with 359,353 young people out there looking for a job without being able to find one.

OIL TIPS

Venezuela's oil basket up by US\$ 2.55 per barrel. The price of Venezuela's oil basket rose by 4.3% in respect of the week before, to stand at US\$ 61.26 per barrel, the highest so far this year, raising the May average to US\$ 59.11 per barrel. Seen year-on-year, the basket has risen by 2.7%, since for the same week last year the Venezuelan basket was priced at US\$ 59.67 per barrel.

84% above budgeted 2006 price. So far this year the Venezuelan oil basket has averaged US\$ 53.35 a barrel which, although 5.13% below the price for the same period last year, is still US\$ 24.35 above the priced used for preparing the nation's budget.

Migration process gets complicated. The countdown began on May 26 for partners of the four Orinoco Oil Belt projects plus Sinovensa and the three at-risk and profit-sharing exploration agreements to agree on the terms of their migration to mixed companies (*empresas mixtas*), where PDVSA will have a majority shareholding. The term expires on midnight June 26 and so far progress over the last few weeks has been minimal.

SINCOR moves ahead. The information we have is that negotiations at SINCOR are those that have advanced most, albeit with serious discrepancies over labor matters, and this is going to affect the other companies, because discussions have recently begun on the collective bargaining agreement for the oil sector that will cover the personnel working on private company projects.

Matters still pending. Any way you look at it, the migration process is still very green, with many matters still to be resolved, to wit: Negotiation of the debt taken on by the strategic associations, which is by far the most sensitive matter. The Government has insisted that the debt will not fall in arrears, since each partner will assume its portion. Another crucial matter is the valuation of the companies, the basis for practically all remaining negotiation. The Government has insisted that book values will be used as a reference, not market values. Finally, there is the matter of the compensation to be paid by PDVSA to the private companies to raise its shareholdings in the eight projects. This theme is one of great concern among the trans-nationals, since the Executive has made public its intention to minimize cash outlays, opening the way for the handover of IOUs similar to those received by the operating agreements. So far,

one year after the migration, the ex-operators have only been able to cash one of all those IOUs.

Petrochemical sector nationalization. In the midst of the migration of the oil-opening-born businesses to majority State-held “mixed companies”, the National Assembly and the Executive are preparing to repeat the business format for the petrochemical industry, which currently allows joint State and private sector participation. The reform of the Petrochemical Activity Development Law will toe the line of the Hydrocarbons Law and in this sense will define different participation models according to the levels of development existing in the industry, i.e., basic petrochemicals, transformation and preparation of end products (mainly plastics and fertilizers).

Lower profile sought for private sector. To date, private companies may participate on their own both in the transformation and in the manufacturing of end products, and can enter into associations with PEQUIVEN for upstream projects. According to the Government’s draft project, individual private participation will be limited to the manufacturing of end products, together with cooperatives and Social Production Enterprises (EPSs). Therefore the petrochemical industry will be reserved to the State and PEQUIVEN will come to dominate most of the activities, since it will control the whole basic petrochemicals industry and will hold a majority shareholding in the “mixed companies” of the transformation sector.

Changes at PDVSA. Asdrúbal Chávez was appointed Vice President for Refining, Trading and Supply at PDVSA. Chávez was Director of Trade and Supply of Petróleos de Venezuela and replaces Alejandro Granado, who has assumed the Presidency of CITGO, PDVSA’s US affiliate. In turn, Félix Rodríguez, who used to hold this position, was appointed to head PDVSA’s businesses in Ruhr Oel, a refining complex in Germany, 50% owned by PDVSA. Finally, Fernando Valera will replace Asdrúbal Chávez at the head of Trade and Supply in the corporation and will continue to be in charge of Planning at this department.

BUSINESS SECTOR TIPS

Changes in the electricity sector. Within the scope of the Enabling Law (*Ley Habilitante*), the Government is to reform the Electricity Generation Law, reserving for the State not only the hydrological sources, as currently stipulated, but also the thermal sources, and hence the assets of the electricity infrastructure. The law will also regulate State’s control over the companies in the sector and the governance to be exercised by the Electricity Corporation of Venezuela.

Weekly Report

More bank regulations. The Ministry of Housing has fixed the commission to be charged by banks for processing operations before the Obligatory Housing Savings Fund, indicating that financial operators who provide services related to the generation of savings and also provide financing, will be able to charge a maximum 8.5% commission to cover their operating costs. The provision indicates that the percentage will be distributed, 6.5% for the processing of credits and 2% for the collection service of obligatory savings.

An ambitious goal. According to Ramón Carrizález, Housing Minister, the Government plans to build 143,000 homes this year, but not all that are presently being built will be delivered during this financial year. He calculates that 25,000 homes will have been terminated by the close of the first semester, and that by the end of 2007 a total of 80,000 homes should have been delivered. This means that the goal for this year is 105,000 units. What is not clear is when the Government plans to deliver the remaining units and meet the figure of 143,000 units.

2006: Not a good year. 33,000 units were completed in 2006, and the homes promised for last year will be carried forward to this year. Investment in housing programs will total VEB 8 trillion.

Preferential rates. Movilnet will be offering special plans to the presidents of the country's community councils, including preferential rates. This will also apply to civil servants who will be able to take advantage of a special subscription plan. According to Movilnet's President, Jacqueline Farías, US\$ 400 million will be added to the corporation's investment budget in order to guarantee meeting the goal of 2,000,000 mobile phone lines and the interconnection of 5,200 schools throughout the country.

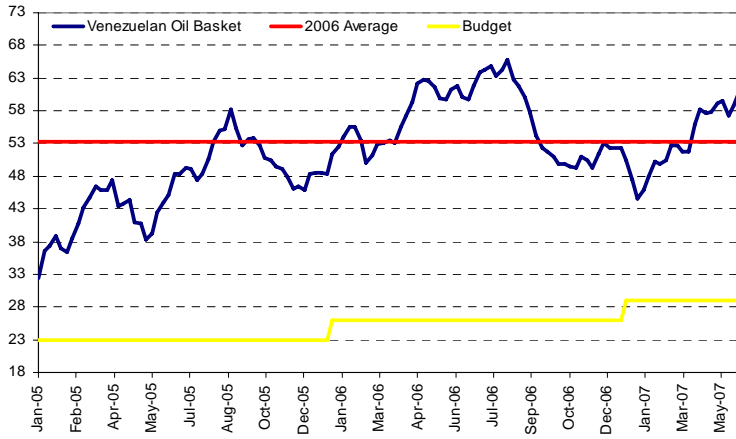
TV sales sky high. 200,000 Liquid Crystal Display (LCD) TVs will be sold this year in Venezuela. This is the calculation made by the Olevia television company, which opened operations in the country some months back, and which hopes to capture 10% of the total market this year.

Political Tips

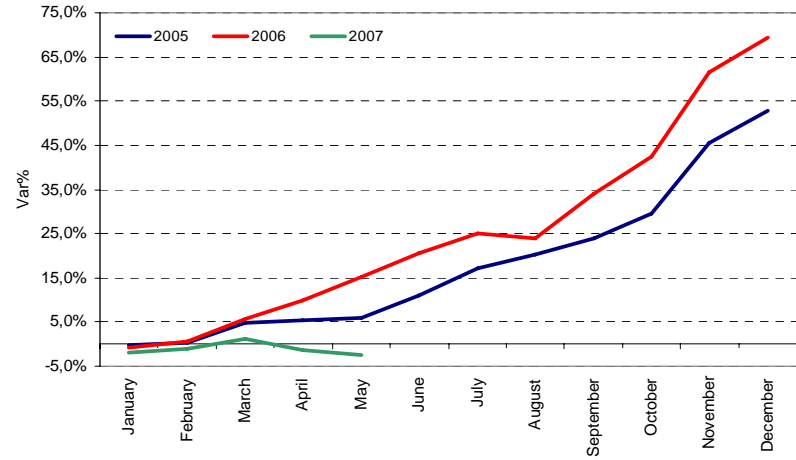
Spontaneous protests. Last week the university students spontaneously took to the streets to protest in favor of freedom of expression, as a result of the shutting down of Radio Caracas Television (RCTV). The protests have taken the Executive by surprise and it has reacted by using excessively repressive measures. In light of the spontaneous and anti-political nature assumed by the protests, it is difficult to foresee

ECONOMIC OVERVIEW

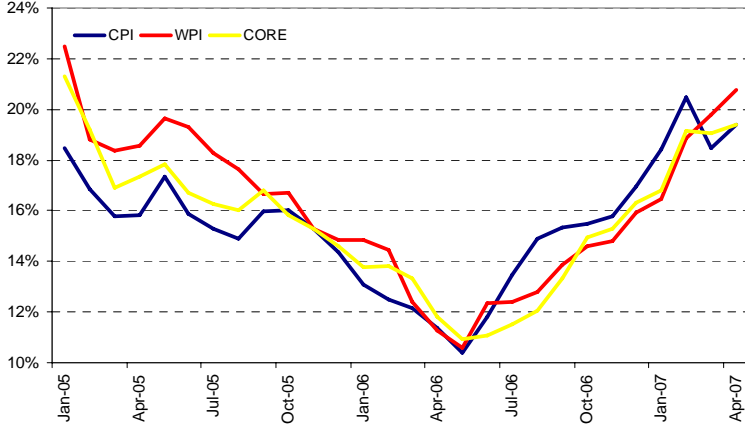
Oil Price
(Venezuelan Basket US\$/pb)



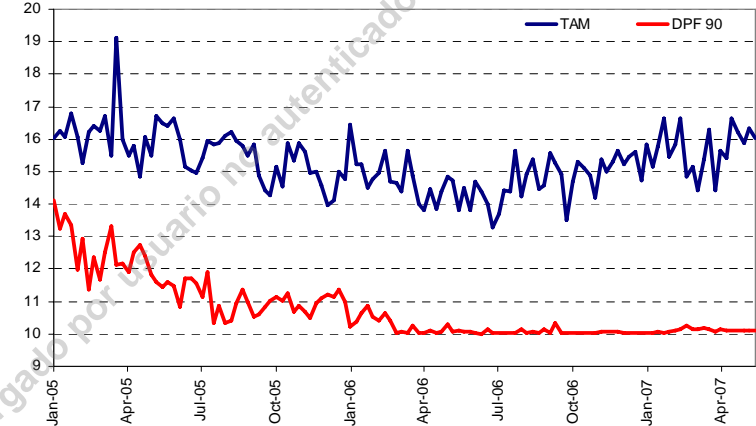
Real Expansion (M2)



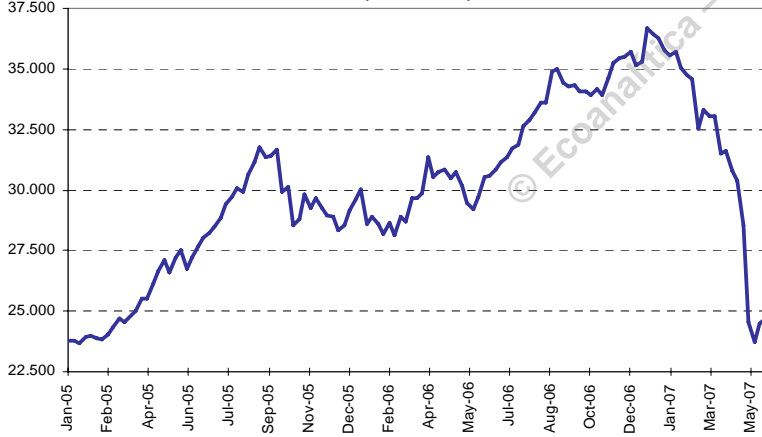
Inflation
(Last 12 Months)



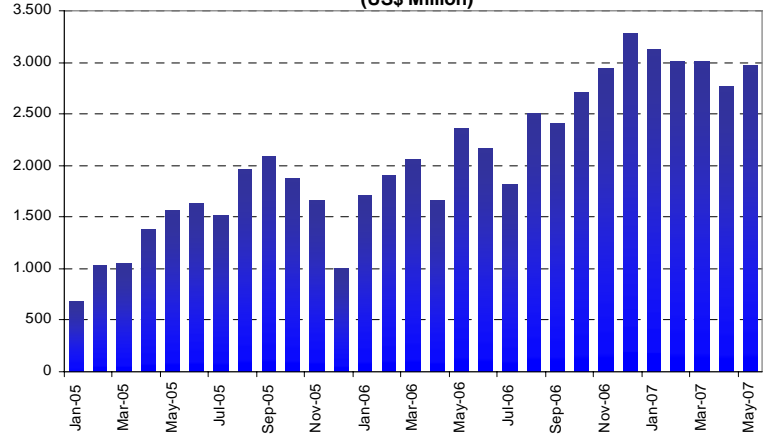
Interest Rate
(Six Principal Banks)



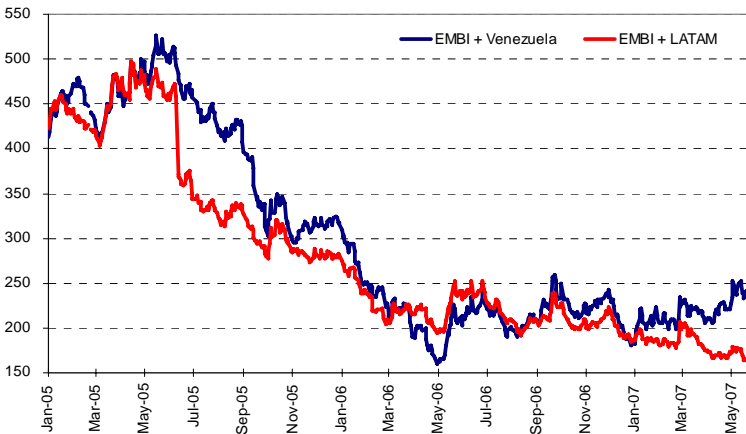
Fx Reserves - BCV
(US\$ Million)



Disbursement
(US\$ Million)



EMBI



Central Government
(VEB Billion)

