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GOVERNMENT DISCLOSES FIGURES FROM ITS BLACK BOX

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THE CLIENT

The Finance Ministry (FM) published Restricted Public Sector (RPS) figures for the 2004-2006 period, following our last report indicating that the MF had not provided RPS figures since 2003. Interestingly, the RPS closed 2006 with a deficit equivalent to 1.5 GDP points after recording a surplus of 4.1 GDP points in 2005. In addition, RPS figures confirm our theory that Venezuelan public finances have become significantly murkier in the past years.

Why is the RPS important?

In our previous report we indicated that the Central Government (CG) was only a part of the RPS, and that the RPS provides us with an overall view of the Government's handling of its fiscal budget over the past few years. RPS includes the CG, PDVSA, non-financial public companies, the Social Security Institute and FOGADE. We believe, however, that 2006 figures hide resources that were spent via FONDEN.

| RESTRICTED PUBLIC SECTOR (% GDP) | | 1999 | 2000 | 2001 | 2002 | 2003 | 2004 | 2005 | 2006 |
|--|--|--------|--------|--------|--------|--------|--------|--------|--------|
| Public Consolidated Sector | | | | | | | | | |
| Total Revenue | | 26,85% | 32,74% | 27,31% | 29,51% | 32,35% | 34,39% | 37,80% | 37,87% |
| Tax Income | | 11,53% | 9,33% | 9,57% | 10,03% | 10,33% | 11,40% | 12,15% | 12,56% |
| Non Tax Income | | 15,31% | 23,41% | 17,74% | 19,48% | 22,02% | 22,99% | 25,66% | 25,31% |
| Surplus of PDVSA's Operations | | 11,18% | 18,70% | 12,47% | 14,31% | 17,62% | 16,70% | 17,57% | 16,58% |
| Surplus of EPNF Operations | | 1,45% | 1,42% | 0,52% | 1,11% | 0,81% | 0,95% | 0,71% | 0,32% |
| Interests | | 0,63% | 0,60% | 0,38% | 0,85% | 0,59% | 0,12% | 0,11% | 0,09% |
| Utility, Dividends and Commissions | | 0,32% | 1,49% | 3,01% | 2,00% | 2,08% | 2,03% | 3,62% | 4,15% |
| Other income | | 1,74% | 1,20% | 1,37% | 1,20% | 0,92% | 3,18% | 3,65% | 4,16% |
| Total Expense | | 26,10% | 28,29% | 31,90% | 30,99% | 32,18% | 31,91% | 33,69% | 39,37% |
| Current expenditure | | 18,11% | 19,65% | 20,90% | 20,70% | 22,14% | 21,88% | 21,43% | 24,23% |
| Remunerations | | 3,80% | 4,07% | 4,95% | 4,62% | 4,66% | 4,23% | 3,83% | 4,17% |
| Buy of Goods and services | | 0,99% | 1,31% | 1,62% | 1,87% | 1,91% | 1,56% | 1,52% | 2,62% |
| Other Operative Expenses | | 0,16% | 0,56% | 0,12% | 0,04% | 0,23% | 0,25% | 0,20% | 0,33% |
| Interests and Commissions of National debt | | 3,29% | 3,08% | 3,40% | 5,22% | 5,21% | 3,76% | 2,99% | 2,11% |
| Quasifiscal losses of the BCV | | 0,55% | 0,00% | 0,00% | 0,00% | 0,00% | 0,00% | 0,00% | 0,00% |
| Public Sector Transferences | | 7,00% | 7,84% | 8,56% | 7,05% | 8,07% | 8,83% | 9,83% | 12,13% |
| Private Sector Transferences | | 1,86% | 2,21% | 2,09% | 1,55% | 1,77% | 2,81% | 2,84% | 2,55% |
| Other Transferences | | 0,02% | 0,02% | 0,04% | 0,04% | 0,04% | 0,04% | 0,04% | 0,03% |
| Other expenses not attributable to the operation | | 0,43% | 0,56% | 0,11% | 0,31% | 0,26% | 0,41% | 0,18% | 0,31% |
| Capital Expense | | 7,60% | 7,55% | 9,58% | 8,96% | 8,84% | 9,37% | 11,52% | 14,33% |
| Acquisition of Assets of Fixed capital | | 4,97% | 4,60% | 5,92% | 5,56% | 5,19% | 3,80% | 3,95% | 4,52% |
| Capital transferences | | 2,63% | 2,95% | 3,66% | 3,40% | 3,64% | 5,56% | 7,57% | 9,80% |
| Other Financial Expenses | | 0,00% | 0,00% | 0,00% | 0,00% | 0,00% | 0,00% | 0,00% | 0,00% |
| Extra-budgetary Expenditure | | 0,39% | 1,09% | 1,42% | 1,33% | 1,20% | 0,66% | 0,74% | 0,81% |
| Total Result | | 0,74% | 4,45% | -4,59% | -1,48% | 0,17% | 2,47% | 4,11% | -1,50% |

Sources: Ministerio de Finanzas and Ecoanalítica

Total State expenditure has increased significantly in 7 years

At *Ecoanalítica*, we are interested in analyzing the evolution of the RPS since 1999, the Government's first year in power. Between 1999 and 2006, total State expenditure rose from 26.1 to 39.4 GDP points. In other words, it increased by 13 percentage points. The relevant issue here is the significant increase of capital expenditure, mainly in infrastructure spending, which increased nearly twofold from 7.6 to 14.3 GDP points. This upsurge was caused for the most part by the increase in transfers of capital

Transfers to the public sector is another area with a significant upsurge. These are transfers made largely to state and local

governments and to autonomous institutes, which were equivalent to 7% of GDP in 1999 and to 12% of GDP in 2006. This trend was particularly exacerbated in 2006, mainly because of the political changes experienced by the country, where pro-government parties took control of most state and local governments.

Income has risen less than expenditure

The situation turns more complicated when it comes to income. Although RPS figures show the State's general behavior, many items are recorded "net", allowing the FM to present only part of the information.

Between 1999 and 2006, total RPS income increased by 11 GDP points, rising from 26.9% of GDP in 1999 to 37.9% of GDP in 2006. In other words, income increased slightly less than total expenditure.

Wasted time

However, if we analyze income per area, we find that the same trend takes place both in the RPS and the CG, that is to say that we continue to depend on oil. PDVSA's so-called "operating-surplus" rose from 11.5% of GDP in 1999 to 16.6% of GDP in 2006. In 1999, oil contribution accounted for 42% of total GDP. In 2006 it rose slightly to 44%. In other words, the Government has missed the chance to embark on a deep reform of public finances that would have allowed it to reduce our dependence on such an unstable source of income as oil.

In fact, tax revenues (SENIAT) for the same period increased by merely one point, and, worse still, the tax revenue proportion of total revenues has been progressively deteriorating. In 1999 this proportion was 43%, whereas in 2006 it dropped to 33%, in other words, there was a decline of 10 equivalent GDP points. Moreover, "other income", which includes items that the FM fails to explain clearly, increased by 6.3 GDP points, rising from a mere 2.1% of GDP in 1999 to 8.3% of GDP in 2006.

What do PDVSA's numbers hide?

RPS figures may hide some traps. We say this because of the way the FM presents such figures, following the guidelines of the International Monetary Fund (IMF). According to IMF manuals, PDVSA, the country's main public company, and public sector financial companies should present net financial results, in other words, the net profits for the fiscal year.

Hence, if we take for example 2006, we will see that PDVSA's operating surplus amounted to 16.6 GDP points. In other words, this figure comprises a portion of public expenditure executed by PDVSA and which is not being recorded in total expenditure, and it also comprises transfers made by PDVSA to FONDEN. The same situation takes place, although to a lesser extent, in non-financial public sector companies. **Ecoanalítica** believes that this surplus does not include the amounts paid for royalties (11.3% of GDP), income tax (3.9% of GDP) and dividends (0.7% of GDP), which as a whole represent 96% of such surplus.

Naturally, although the IMF methodology underestimates expenditure, it also underestimates income, meaning that the deficit or surplus is the same in all cases. In view of the current boom in oil prices, the public sector as a whole has steadily turned in worse figures. It went from a deficit of 4.6 GDP points in 2001 to 1.5 GDP points in 2002, and in 2003 it broke even (0.2%). In 2004, it closed the year with a surplus of 2.5 GDP points, and it improved such surplus in 2005, reaching 4.1% of GDP. In 2006 the surplus disappeared completely and public spending closed the year with a deficit of 1.5% of GDP, despite the spectacular increase in oil prices.

What does 2007 hold?

2007 is a special year, not only due to the nationalization of CANTV and the electricity sector, which further bloats the public sector, but also to the enormous amounts of resources accumulated in FONDEN, now amounting to US\$ 15 billion - equivalent to 7.6 GDP points. Consequently, the total public outlay by the public sector will be significant. Obviously, when the FM presents the 2007 results, FONDEN will be presented net, just like PDVSA and non-financial public sector companies. Hence, it will still be very hard to carry out an in-depth evaluation of the RPS.

Another factor that should be taken into account is that, regardless of the Bank of the Treasury's growing importance, such bank will not be a part of the RPS tax balance sheet because it is a public financial company, therefore not included in the RPS concept.

What do the public finance figures tell us?

The BCV (Central Bank of Venezuela) also published figures on the Central Government's administration of its fiscal budget for March 2007, and also therefore for the first quarter of the year. Evidently, the CG does not represent the entire RPS, but it is nevertheless its main

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component, and as far as expenditure is concerned, the CG represents 76% of RPS.

In March tax revenues dropped 5.5%, while total expenditure decreased 2.3%, descending from VEB 11.2 trillion in March 2006 to VEB 10.9 trillion in March 2007. With regards to the Treasury's revenues, the 36% drop in oil income is to be noted, explained by the changes carried out by the Government whereby a part of the oil-generated foreign currency is not delivered to the BCV but rather accumulated in a special fund in the National Office of the Treasury (in Spanish ONT). March's fiscal deficit was VEB 768 billion.

Another notable result is that fiscal income recorded a 21% real drop in the first quarter of the year, explained by a 50% decrease in real terms of oil income compared to the first quarter of last year. It must be emphasized that there has been a 5.4% drop in real terms of total expenditure. The Government spent VEB 27.4 trillion during the first three months of the year, a monthly average of VEB 9.1 trillion.

| FISCAL BALANCE CENTRAL GOVERNMENT (VEB Billions) | March | March | Nominal | January-March | January-March | Nominal | Real |
|--|---------|---------|-----------|---------------|---------------|-----------|-----------|
| | 2007 | 2006 | Variation | 2007 | 2006 | Variation | Variation |
| Total Revenue | 10.170 | 10.758 | -5,5% | 22.420 | 23.863 | -6,0% | -21,1% |
| Non-Oil Revenue | 6.336 | 4.847 | 30,7% | 15.080 | 10.930 | 38,0% | 15,8% |
| Oil Revenue | 3.763 | 5.911 | -36,3% | 7.268 | 12.309 | -41,0% | -50,4% |
| Central Bank Earnings | 71 | - | | 71 | 624 | -88,6% | -90,4% |
| Total Expenditure | 10.938 | 11.193 | -2,3% | 27.413 | 24.342 | 12,6% | -5,4% |
| Primary Expenditure | 9.711 | 9.842 | -1,3% | 25.165 | 21.899 | 14,9% | -3,5% |
| Interest Payments | 1.227 | 1.350 | -9,1% | 2.249 | 2.443 | -8,0% | -22,7% |
| Domestic Debt | 348 | 351 | -0,8% | 872 | 913 | -4,5% | -19,8% |
| Foreign Debt | 879 | 999 | -12,0% | 1.377 | 1.530 | -10,0% | -24,5% |
| Quasifiscal Expenditure | - | - | | - | - | | |
| Fiscal Balance | (768) | (435) | | (4.993) | (479) | | |
| Primary Balance | 459 | 915 | | (2.745) | 1.964 | | |
| Non Oil Balance | (4.602) | (6.346) | | (12.333) | (13.412) | | |
| Debt Amortization | 1.125 | 871 | | 5.499 | 3.346 | | |
| Net Monetary Injection | 3.224 | 6.218 | -48,1% | 14.831 | 15.227 | -2,6% | -18,2% |
| Financing Requirements | 1.893 | 1.306 | | 10.492 | 3.825 | | |
| Foreign Debt | 11 | 54 | | 14 | 100 | | |
| Domestic Debt | 1.624 | - | | 1.624 | - | | |
| Treasury Bonds | 1.624 | - | | 1.624 | - | | |
| Treasury Debt | - | - | | - | - | | |
| Others | 258 | 1.253 | | 8.854 | 3.725 | | |

Sources: BCV and Ecoanalítica

The Central Government has accumulated a deficit of VEC 5 trillion in the first quarter of the year, as opposed to a slight deficit of VEB 479 billion recorded for the same period last year. Financing needs, meaning the resources required to cover the fiscal deficit and debt amortization, amounted to VEB 10.5 trillion and were mainly covered (VEB 8.9 trillion) by Central Government resources in the Treasury and the national finance system.

The Government still hasn't learned: expenditure decline makes a u-turn in April

According to FM sources, the Executive spent VEB 43 trillion in the first four months of the current year. This would mean that April spending amounted to VEB 15.6 trillion, a real figure for the record books! Based on this result, public expenditure increased by 5.4% for the first four months of the year in real terms, compared to the same period last year.

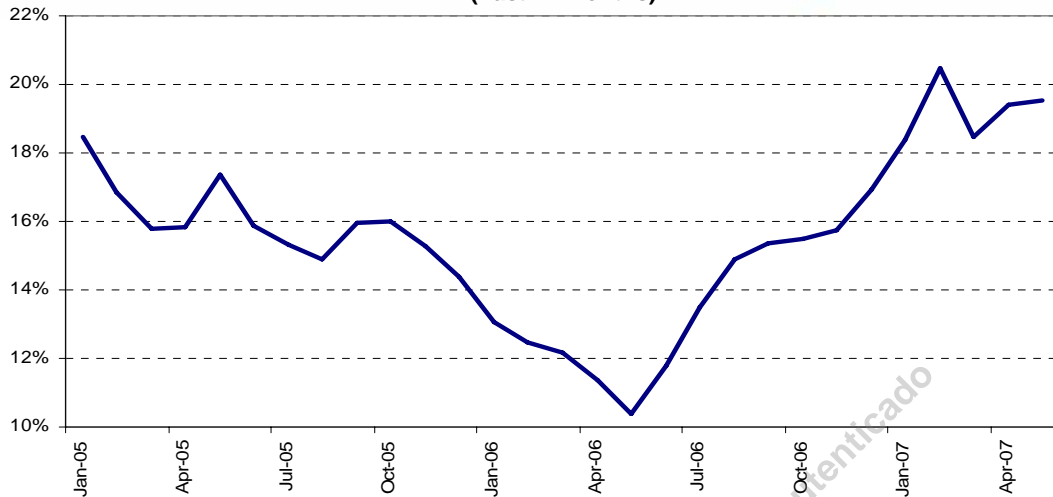
Spending will continue to rise

Following the FM and IMF methodology, RPS expenditure in 2007 will be close to 42 GDP points, when showing net results for PDVSA, other non-financial public sector companies and FONDEN. This would represent an increase of 2.6 GDP points in just one year and of 15.9 GDP points when compared to 1999. Based on these results, the RPS should close this year with a deficit of 2.7 GDP points.

Economic Tips

Inflation continues on the rise. The BCV has reported that the Consumer Price Index (CPI) for the metropolitan area of Caracas recorded a 1.7% variation in May 2007, higher than the rates observed in the previous month (1.4%) and in May of last year (1.6%). It is therefore evident that the measures applied by the Executive to control inflation have not achieved the desired effects. Thus far this year, CPI has accumulated a 5.9% variation, higher than the 3.6% variation recorded for the same period in 2006, while the annual variation is calculated at 19.5%, significantly higher than the annual variation recorded in May 2006 (10.4%) and than the estimated 2007 annual inflation of 12%.

**Inflation
(Last 12 Months)**

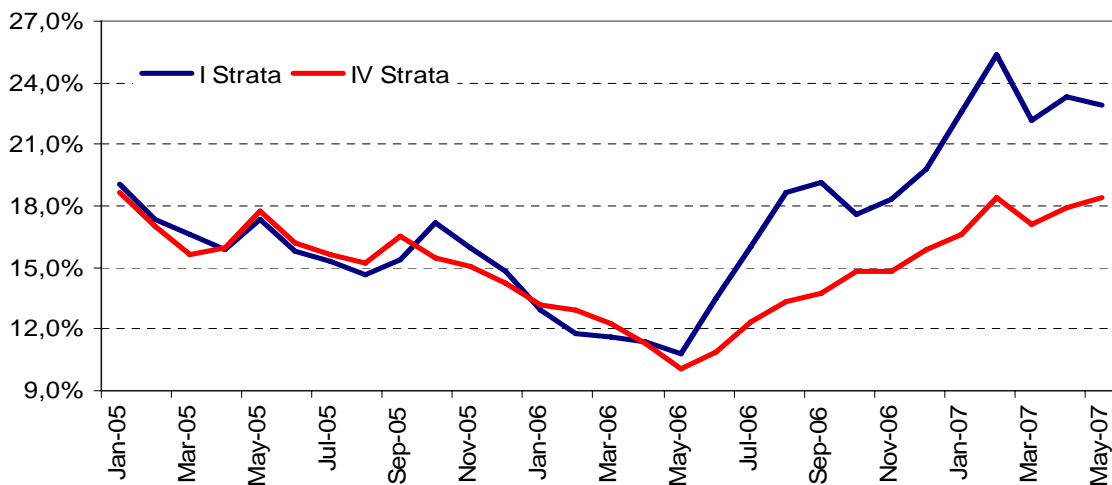


Sources: BCV and Ecoanalítica

Three factors explain it. The upswing in inflation is mainly due to three factors: firstly, the increase in minimum wages; secondly, the spike in the parallel market exchange rate, and finally, supply problems of some items, particularly foodstuffs. According to the BCV, both controlled and non-controlled items recorded variations exceeding those of the previous month, jumping from 0.9% to 1.1% and from 1.9% to 2.2%, respectively.

The poor are hit hardest. A significant fact highlighted by the BCV is that when inflation is analyzed by social strata there is a higher month-on-month variation in Level I (the lowest income group) of 2.1%, whilst the variation for the other three higher strata averaged 1.7%.

**CPI BY STRATA
(Annual %)**



Sources: BCV and Ecoanalítica

Wholesale prices go up as well. According to the BCV, May's WPI (wholesale price index) increased by 1.2% against April, with the national component rising by 1.4% and the imported component rising 0.4%.

Food basket cost increases. According to figures from the Center of Analysis and Communication for the Workers, the price of the Workers' Food Basket (in Spanish CAT) increased by 3.7% in May, compared to its price in April. Between January and May 2007, the food basket cost has increased by 11.4%.

Salaries go up. According to BCV data, employee compensation in the private sector rose by 3% in the first quarter of the year and those of the public sector by 1.3%. The report points to salary adjustments based on policies of evaluation, leveling-off and merit being applied by some private companies. This increase also reflects the rise in the value of Venezuelan food stamps called "cesta tickets".

Upcoming reform to the Exchange Crimes Law. According to the press, the National Assembly is preparing the text of a reform to the Exchange Crimes Law which was approved in September 2005. The National Assembly's subcommittee in charge of drafting the change will present a proposal that includes adjustment of the sanctions of those selling foreign currency in violation of current regulations (i.e., on the parallel market). The rest of Article 6 remains unchanged, therefore keeping securities exempt from the legal framework

More power for CADIVI. On the other hand, this reform also contemplates giving more attributions to the Currency Control Board (*Comisión de Administración de Divisas* - CADIVI), whereby it will now be the authority that enforces sanctions on those who violate the exchange control régime, a power previously held by a special authority within the Finance Ministry. In addition, the reform proposes giving more autonomy to the administrating entity in order that the legal consultancy take on a larger scale and that pertinent action be taken swiftly.

OIL TIPS

Venezuelan oil basket down slightly. According to figures released by the Ministry of Energy and Petroleum, oil prices experienced a slight drop of US\$ 0.63 and closed at US\$ 60.63 per barrel. In light of this result, the average oil price in May stood at US\$ 59.41 per barrel, thereby raising the 2007 average to US\$ 53.68 per barrel.

Crude production down 10%. According to figures from the Bloomberg Agency, Venezuela produced an average of 2.34 million barrels of oil per day in May, which

represents an average decline of 40,000 barrels per day (1.7%) compared to April, and of 260,000 b/d (10%) compared to May 2006.

Yet OPEC production is increasing. According to figures published by Reuters, OPEC raised its crude production in May as a result of more oil being pumped by member states such as Algeria and the United Arab Emirates which balanced out the fall in Nigeria's supply. The 10 member countries subject to quotas, i.e., all of them except Iraq and Angola, pumped 26.76 million b/d, 110.000 b/d more than in April.

BUSINESS SECTOR TIPS

New president appointed at EDC. The Director for Exploration and Production of the Venezuelan Petroleum Institute (INTEVEP), Javier Alvarado, has been named the new chief executive officer of Electricidad de Caracas.

No bank nationalizations. The Superintendent of Banks and Other Financial Institutions (SUDEBAN), Trino Díaz, has explained that despite President Chavez's assertions that more social commitment from the banking sector is necessary, rumors that banks will be nationalized are mere speculations. Mr. Díaz added that 8 authorizations to create new banks in 2007 have already been approved.

Price of milk likely to rise. The Ministry of Food is currently studying an adjustment to the price of milk in view of the volatility of international milk prices.

Tourist tax collections up. According to the Tourism Minister, Titina Azuaje, collections of the 1% tourism tax paid by tourism operators and companies have increased by 30% since the beginning of the year, to VEB 15 billion. The Minister indicated that this is proof that tourism activity is growing significantly, particularly in regard to the movement of Venezuelans themselves around the country.

Car sales up According to CAVENEZ, 172,081 new cars were sold in the country between January and May 2007, which means a 54.2% increase in car sales over the same period last year, when 111,549 cars were sold. 41,125 cars were sold in May, a 60.6% increase vis-à-vis the 25,592 cars sold in May of last year.

Increase in sales of construction material. According to the BCV, between May 2006 and May 2007 dispatches of materials by wholesalers rose by 18.7% and materials from producers increased by 18%. Groups experiencing the highest growth over the past 12 months include: clay products with a 58.4% increase, concrete

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products 37.4%, carpentry and locksmith inputs 34%, electric materials 26.3%, aggregates 24.9% and plumbing materials 22.9%

The names CADAPE, EDC and EDELCA will disappear. PDVSA and the Ministry of Energy and Petroleum are studying the upcoming transformation of the national electricity sector. The organizational structure of this electricity holding, which will emerge as a super-entity, will absorb all the thermal- and hydro-powered generating companies of the country, which will be under State control in the following weeks, once nationalization procedures are finalized.

Mercal sales improve. According to its president, the Mercal network sold 50,000 tons of food in January and boosted that figure to 110,000 tons in May.

Changes at ALCASA. Carlos Lanz, current head of CVG ALCASA, will hand over his position to Ramón Betancourt, after deciding to dedicate himself fully to providing strategic support for projects proposed by the Executive.

Political Tips

Finger-pointing between Venezuela and United States at the 37th General Assembly of the OAS. As was to be expected, the Annual General Assembly of the member countries of the Organization of American States witnessed more finger-pointing between United States and Venezuela. This diplomatic fracas took place in the midst of protests by different groups in Panama against the closing of RCTV.

Record number of arrests. Protests involving the RCTV issue resulted in at least 251 people being arrested between Saturday May 26 and Wednesday May 30. According to the Attorney General's Office, of the 251 people arrested at least 30 were teenagers who were criminally charged with street demonstrations. This group of minors is not being held in jail but must appear regularly in court while awaiting the outcome of the investigations being conducted by the District Attorney's Office, which will determine if the youngsters are to be sent to trial, if their files are closed, or if they are acquitted.

Controversy in Brazil. The two major Brazilian opposition parties, Social Democracia and Democrata, announced that they refused to ratify in Congress the protocol for Venezuela's joining MERCOSUR, in the midst of the bilateral controversy concerning RCTV's being pulled off the air.

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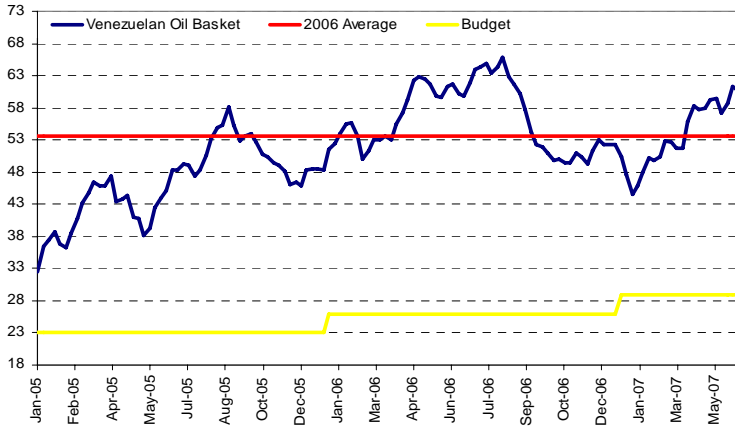
Union members clash too. Representatives of the UNT and CTV (major workers' unions in Venezuela) attending the International Labor Organization's annual assembly continue to disagree over the possible addition of Venezuela to the list of countries violating workers' rights. A communiqué sent by the Labor Ministry emphasized that the Venezuelan delegation, headed by the UNT, is currently being pressured by CTV members who are requesting the support of the Rules Committee for Venezuela to be added to the list of countries that fail to respect workers' rights.

New responsibility for mayors' offices. The Official Gazette of June 1 published the CNE (electoral authority) resolution whereby governors and mayors are instructed, to complete the transfer of competences related to the Registry of Marital Status from the offices of the prefects to the respective mayors' offices.

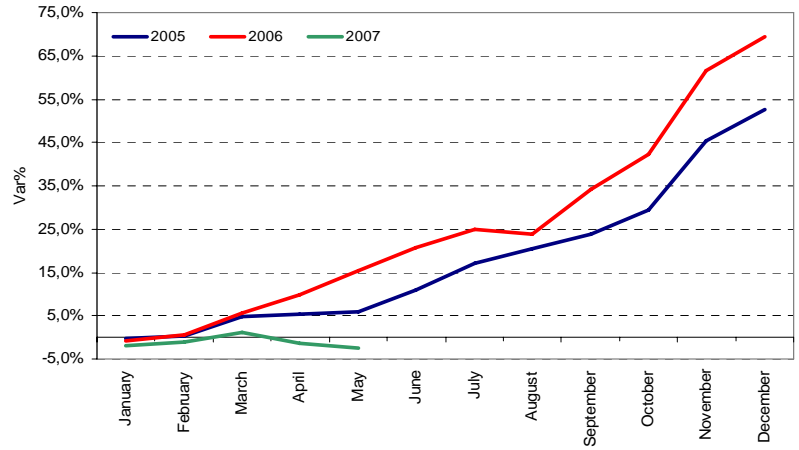
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ECONOMIC OVERVIEW

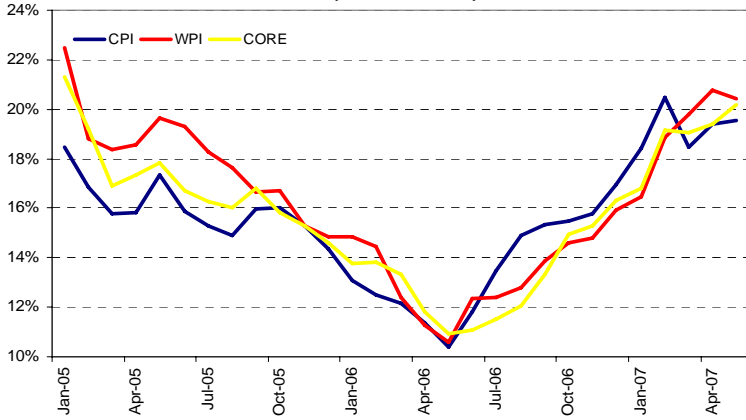
Oil Price
(Venezuelan Basket US\$/pb)



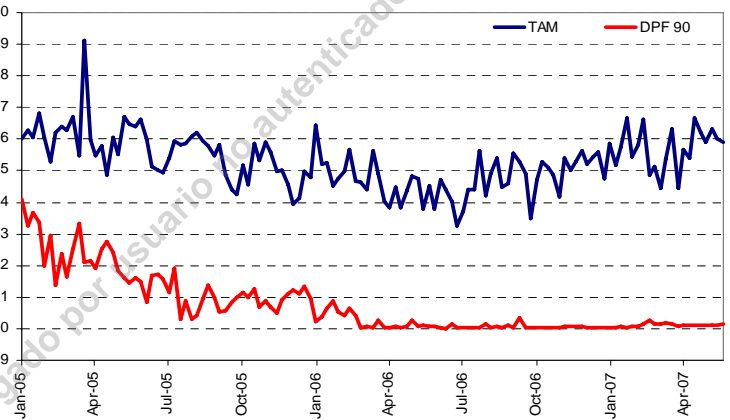
Real Expansion (M2)



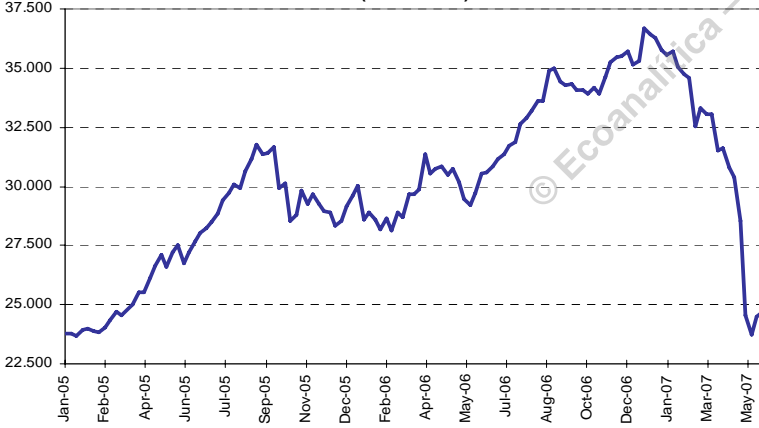
Inflation
(Last 12 Months)



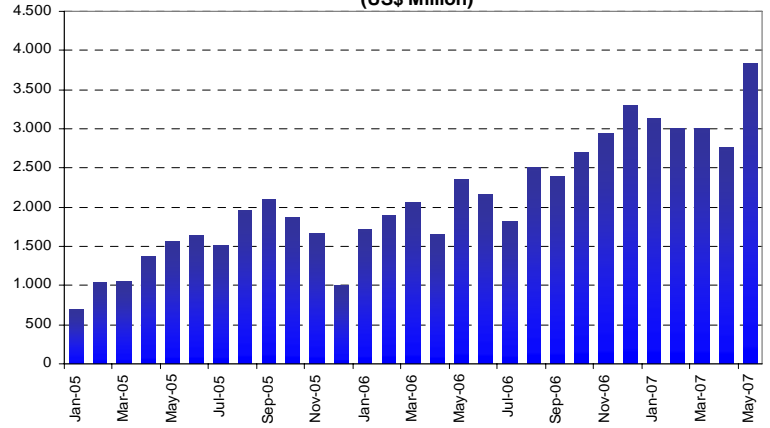
Interest Rate
(Six Principal Banks)



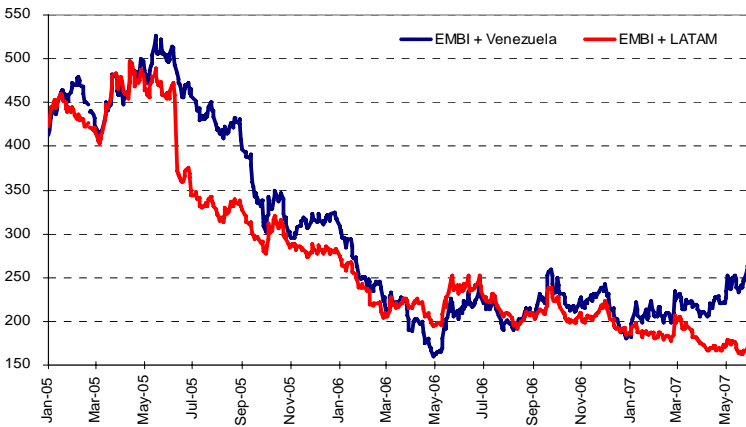
Fx Reserves - BCV
(US\$ Million)



Disbursement
(US\$ Million)



EMBI



Central Government
(VEB Billion)

