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***How can domestic savings possibly be encouraged ... with this economic policy?***

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**THE CLIENT**

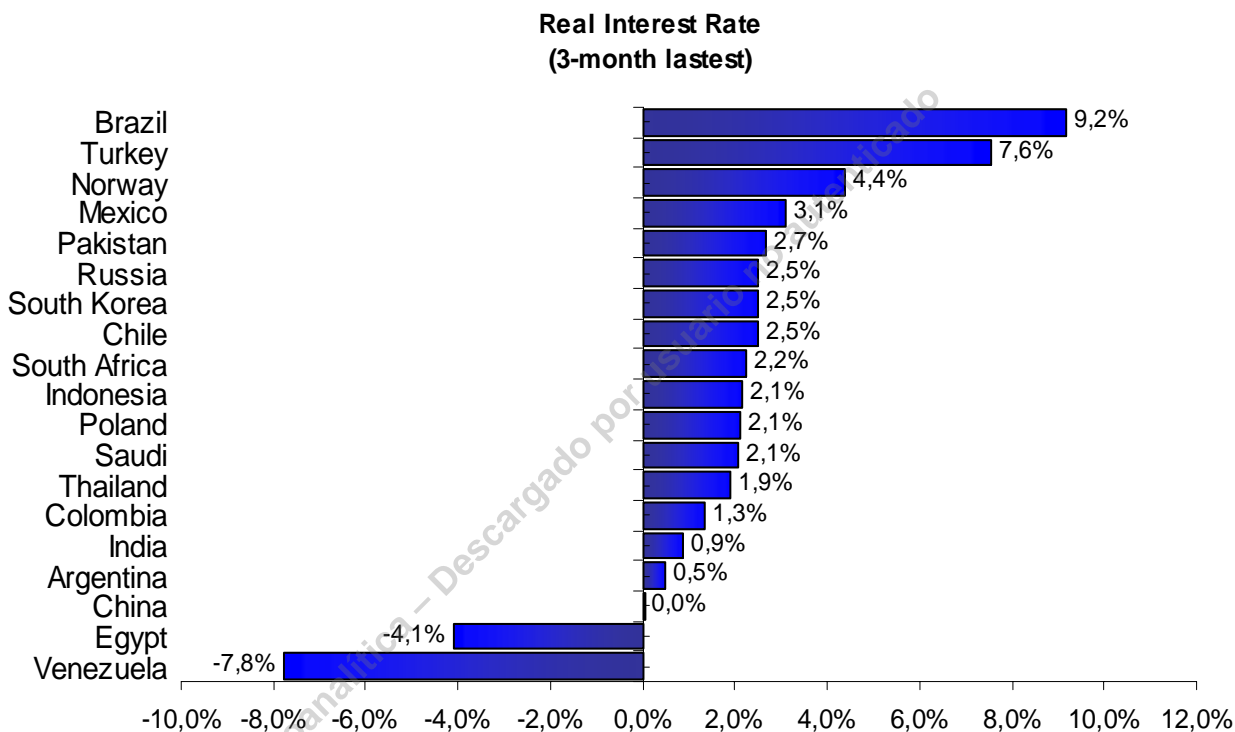
One of the goals of any government should be to strengthen its currency and encourage domestic saving. At **Ecoanalítica** we ask ourselves why the Executive doesn't seek to amend its economic policies and create confidence in the currency and encourage internal savings. Beyond talk – of monetary reconversion or “Strong Bolívar” – the government's economic policy does nothing to encourage saving, which is tantamount to saying that it promotes capital flight. The economic agents that have made and held a time-deposit since January 2003, have lost 21.3% of their domestic purchasing power and 44.4% of their external purchasing power. Far from tending to change, it looks as if this distortion will likely deepen.

**Venezuela has the lowest real (i.e., negative) interest rate among emerging economies**

As we have said before, Venezuela is the country with the highest inflation of developing countries, in fact almost double that of its closest follower. This does not necessarily mean, however, that countries with high inflation have to have the lowest real interest rates. Nominal high interest rates could compensate high inflation and obtain positive real interest rates. That is not our case however. As may be seen in the graph, Brazil is the country with the highest real interest

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rates with 9.2%, followed by Turkey with 7.6%. Norway and Saudi Arabia, oil-producers, both have real positive interest rates of 3.1% and 2.1% respectively. The only two countries, out of 43, that have real negative interest rates are Egypt with -4.1% and Venezuela with -7.8%. For **Ecoanalítica** it is clear that such countries cannot put in a good performance in domestic savings figures.



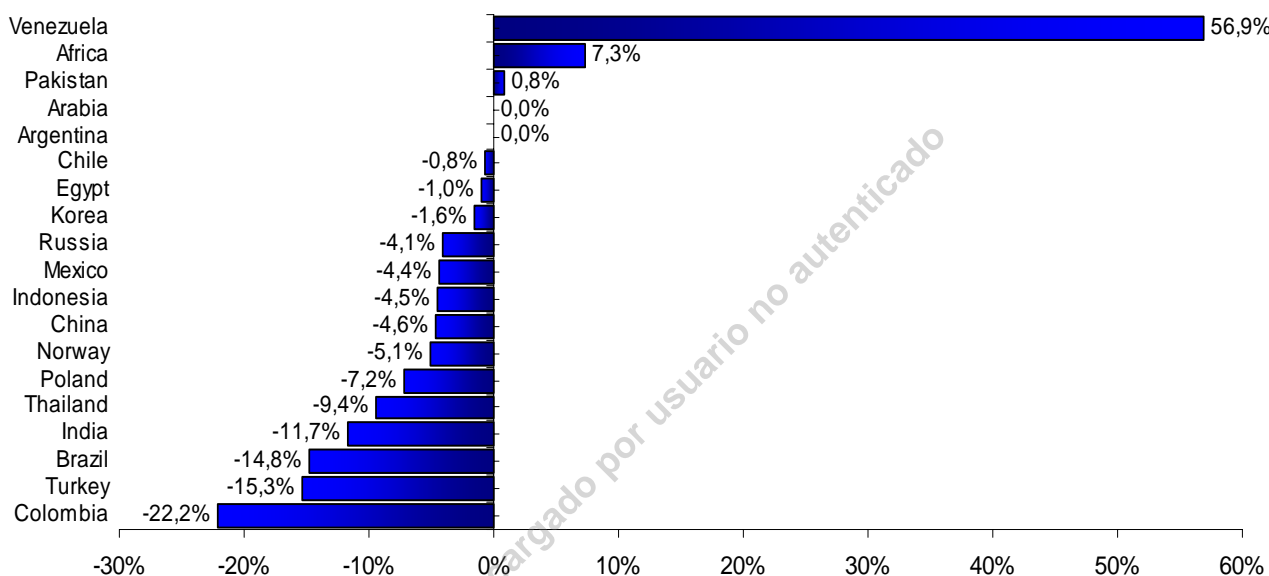
Sources: The Economist and Ecoanalítica

## Venezuela has the highest rate of depreciation among emerging countries

Last year the currencies of the majority of the economies that have real positive interest rates have undergone revaluation processes in respect of the Dollar. Highlights among these revaluation processes are Brazil and Turkey, with appreciations of 14.8% and 15.3% during the last year. This means that the higher the interest rates are, the more attractive a country is for an investor – whether from inside or outside the country. Of course, this is not the case in Venezuela, which has the highest devaluation rate among all countries sampled. For the last year, the market (unofficial) exchange rate in Venezuela has risen from CCC VEB/US\$ to XXX VEB/US\$, which represents a devaluation of 56.9%. It would be rash and extremely simplistic to say that just because we have real negative interest rates there has been a major

devaluation in the exchange rate over this last year. However, real positive (negative) rates avoid (stimulate) monetary devaluation.

**Devaluation  
(May 07 - May 06)**



Sources: The Economist and Ecoanalítica

**Negative real interest rates and the significant devaluation of the Bolívar are the result of the exchange control.**

We have commented time and time again that exchange controls in an oil-driven economy, where a high proportion of expenditure is financed by foreign earnings (from oil exports), produce a strong increase in the liquidity in the economy. As in all markets, if the offer of Bolívares grows in a more accelerated form than the demand for them, measured mainly by the demand for credit, the price of that market, which is the interest rate, will tend to fall. Moreover, this greater amount of Bolívares chasing after the same amount of goods, services and Dollars, will force a rise in their prices, together with inflation and devaluation. On the other hand, the exchange control translates into a subsidy for importers, which increases the demand for Dollars for imports, creating an additional pressure on the exchange rate. As we can see every time there has been an exchange control in the past, the interest rates are usually lower than inflation and both of these are below the exchange rate. CADIVI has not been, nor will it be, an exception to this rule.

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	RECADI 1983-1988	OTAC 1994-1996	CADIVI 2003-2007
Passive Interest Rate	7,9%	27,5%	13,1%
Inflation	20,1%	57,8%	19,7%
Average Depreciation Rate	44,5%	98,8%	28,5%

Source: Ecoanalítica

### Using the 1994-1996 exchange control as an example

For example, during the OTAC (*Oficina Técnica de Administración Cambiaria*) exchange control, the average rate of interest of the six main banks between June 1994 and April 1996 was 27.5%. For the same period the average annualized inflation was 57.8% and the average devaluation was 98.8%. If someone had placed and kept VEB 170,000, the equivalent of US\$ 1,000 of the time, in a deposit certificate, at the beginning of the exchange control, by April 1996 he would have VEB 260,071. However, those same Bolívares would only have bought him US\$ 520.10, or in real terms and discounting inflation, they would represent VEB 117,059. This means that during the 21 months of the OTAC exchange control, the Bolívar's external and internal purchasing power was reduced by 48% and 31.1% respectively.

### Same old, same old with CADIVI

Although the levels of inflation have been substantially lower during this present exchange control than during previous exchange controls, the basic relationship among the interest rates, devaluation and inflation are still the same. During the first 4 years of exchange control, the interest rates on a fixed-term deposit have averaged 13.1%, whilst average inflation for the same period has been 19.7% and the average devaluation has been 28.5%.

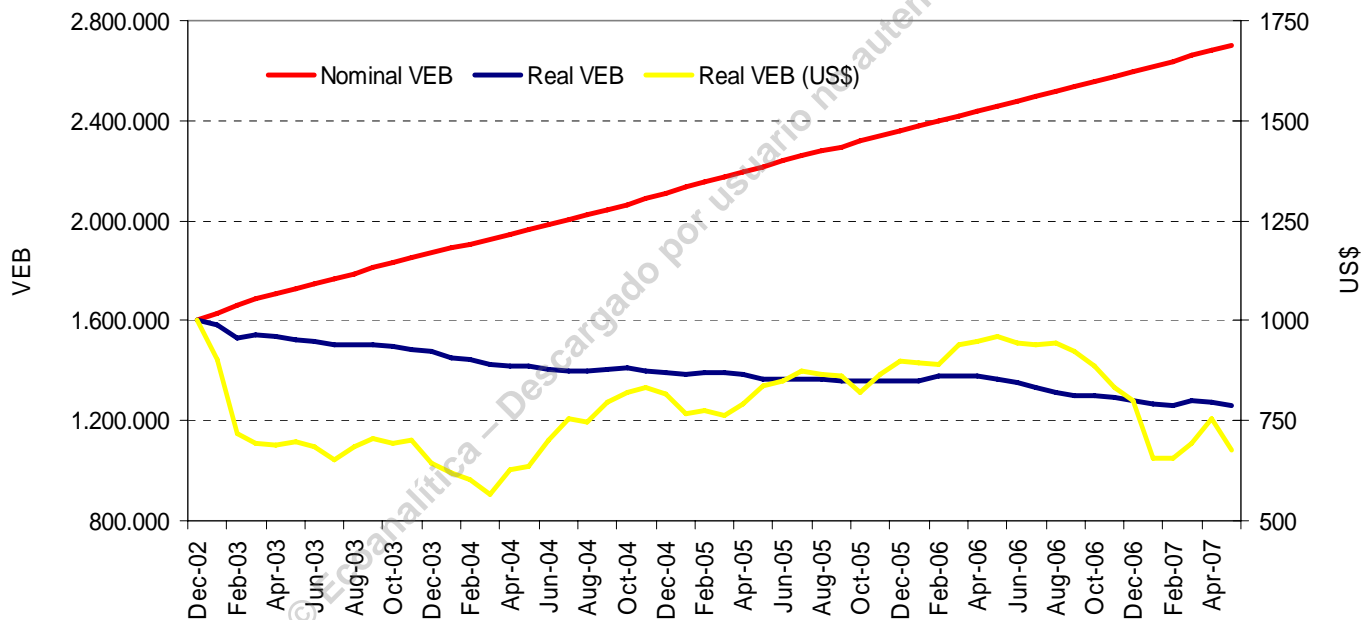
### What would happen to a US\$ 1,000 investment in the local financial system?

If, at the start of this exchange control regime, a person had placed and kept VEB 1.6 million, equivalent to US\$ 1,000 at the beginning of 2003, in a 90-day fixed-term deposit, by June 1, 2007, he would have a balance in his favor of VEB 2,702,772. These earnings of about VEB

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1.1 million are a monetary illusion, since VEB 2.7 million in June 2007 purchases less than the VEB 1.6 million invested. In fact, discounting inflation in order to calculate the balance of the investment in constant Bolívares, we find that the VEB 1.6 million deposited in 2003 would be equivalent now to VEB 1,259,855 in Bolívares of the same date. Put in another way, VEB 2.7 million today has the same purchasing power of Bs. 1.26 million at the beginning of 2003. In 4 years, this investor would have lost 21.3% of his money's purchasing power.

Behavior of the investment in the financial system



Sources: BCV and Ecoanalítica

If we compare this investment with one made in US Dollars for the same amount, the result is even more alarming, since the VEB 2.7 million obtained from the Bolívar deposit would only represent US\$ 675 today. But to calculate the opportunity cost of this investment, we could have deposited the asset in US Dollars for a fixed term, which would have given us an average annual return of 4% over the 4+ years of the current exchange control, which would mean that on June 1 this year we would have had US\$ 1,200 in our pocket, so we lost 43.8% with our Bolívar investment in respect of the investment in foreign currency.

**The economic agents are doing their normal job. What is unintelligible is what the State is doing**

In this economic environment like ours where people quite sensibly seek assets that will hold their value against the US Dollar, what is the Government doing? It is promoting, encouraging and publicizing the purchase of foreign currency by the private sector – and the flight of capital that comes with it! We have even seen the President in his Sunday chat extolling the virtues of purchasing bonds, in other words, encouraging people to keep their savings in US Dollars. Worse still, the chests of the State apparatchiks swell with pride each time they sell off their packages of bonds, exclaiming that “*demand outstripped availability by n percent*”. The awful truth behind the euphoria is that the invisible hand of Adam Smith is there, outstretched for hard currency, and thanks to this financial mechanism, it gets to grab some, avoiding along the way the loss it would be hit by if it kept its savings or business profits in a weak currency like the Bolívar.

## Economic Tips

**Non-official Dollar at Bs. 4,300.** Pressure continues to be exerted of the non-official exchange rate in a shallow market where demand is low-to-average. **Ecoanalítica** thinks therefore that the “parallel” price will be volatile and hesitates to make predictions.

**Foreign currency reserves down slightly.** Gross International Reserves held by the Central Bank (BCV) stood at US\$ 24.645 billion on June 20, down by US\$ 152 million when compared with the week before. Reserves have risen by US\$ 289 million so far in June.

**Money supply (M2).** Liquidity figures have not been published this week. On June 1, money supply stood at VEB 117.5 trillion, 1.3% up on the previous week and 1.1% down so far this year.

**National Assembly (NA) to begin review of the amendments to the Exchange Crimes Law.** During the first semester, a special sub-committee of the NA made some draft adjustments to the Exchange Crimes Law. The report prepared by the sub-committee will now be studied by a full session of the NA and once approved it will be remitted to the Finance Commission, which will then be in charge of carrying out consultations and preparing the final report. Simón Escalona, Vice President of the Commission, has indicated that at the beginning of the second period of sessions

there will be a second discussion, since “some adjustments have to be made after consultation with the Executive.”

**National Assembly recognizes inefficiency of price controls.** Ricardo Gutiérrez, President of the Commission for Economic Development of the National Assembly, recognized that price controls are a mistake, stating that the measures are an obstacle to investment in the controlled areas.

**Fondo Miranda III, the Finance Ministry’s trust fund and the premiums paid for Bono Sur II will finance 7 additional credits for VEB 1.7 trillion**, of which VEB 1.35 trillion will go to the Health Ministry, VEB 226 billion to the Central Bank of Venezuela, VEB 90.8 billion for the Infrastructure Ministry, VEB 29.8 billion for the Ministry of the Interior, VEB 2.5 billion for the Ministry of Foreign Affairs, VEB 4.9 billion for the Tourism Ministry and VEB 16 billion for the Housing Ministry.

**BANDES up and running in Nicaragua** with the idea of granting credits under special conditions to the small business owners of Nicaragua.

**Bartering begins with La Lionza in Yaracuy.** Bartering among country people, cooperatives and small tradesmen has begun in Yaracuy. Under this system, participants offer goods and services and in return receive symbolic money - called La Lionza by popular request - that is interchangeable with other products.

**Food imports up by 16%.** According to numbers published by CADIVI, US\$ 898.6 million were authorized for the importation of foodstuff between January and May this year, an increase of 16% over the same period last year.

**The Treasury has estimated that this week’s expenses, excluding public debt payments, were VEB 4 trillion** reflecting a significant increase of 100% in respect of last week and 160% in respect of the same period last year.

**Net Debt Portfolio of the banking system was VEB 75.2 trillion in May**, an increase in nominal terms of 84% over the same month of last year (53.7% in real terms). Total Deposits stood at VEB 123.3 trillion, a nominal increase of 52.8% in relation to May 2006 (27.8% in real terms).

**Mega production project envisages a series of support and financing strategies to improve the quality of life of the farm workers.** Part of these strategies includes the start-up of the Banco Agrícola; the creation of assessment programs on cultivation techniques; the installation of different laboratories for dual-purpose rearing of cattle; a progressive reduction of imports and a war on the big estate owners (*latifundistas*).

**According to President Chávez, by March this year the Government had recovered 1.9 million hectares from the big estate owners.** Of this total, 49% has been redistributed among the farm workers, 40% for strategic State-owned projects and 11% dedicated to Zamora plan cooperatives.

**Banco Nacional de Fomento de Ecuador to present a US\$ 200 million financing project to Bandes.** Bandes will be opening an office in this country with a capital of about US\$ 30 million and part of the resources will be for non-reimbursable project financing.

**Caracas Stock Exchange proposes to the Ministry of Finance and the BCV that National Debt Bonds (DPNs) be quoted on the Venezuelan securities exchange.**

**Under the reformed Exchange Crimes Law, the national Assembly is considering making the Exchange Administration Commission (CADIVI) the authority in charge of applying sanctions to individuals and companies.**

**Banco del Sur put on hold.** The signing of the deed of incorporation of Banco del Sur, planned for June 26, has apparently been postponed due to “scheduling problems” of the South American heads of state, but the target of starting operations this year is still official.

**Positive sign for handling of Venezuela’s debt.** In his International Development Bank (IDB) report entitled: “*Living with debt: How to limit the risks of public indebtedness*,” Ugo Panizza highlighted the fact that Argentina and Colombia are the most indebted countries of the region, while Chile, Peru and Mexico are among those with least debt. He mentions that Venezuela is experiencing a “positive period” in respect of its debt, which has been significantly reduced thanks to high oil prices. In many of its reports **Ecoanalítica** has agreed with this view.

**Finance Ministry fine-tunes purchase of Bolivia bonds, programmed for this month.** Finance Minister Rodrigo Cabezas is waiting for the Andean nation to issue the securities in order for Venezuela to conclude an operation calculated to be worth US\$ 100 million. If this purchase is resold on the parallel (non-official) market it would have a minimum impact on the exchange rate, both for its modest size and the low liquidity of Bolivian debt on the international finance markets.

**Fondafa ups coffee financing.** Fondafa plans to finance more than VEB 1 billion to assist coffee farmers in the highlands of the Araure Municipality. The amount will be distributed according to the requirements of the 506 producers in the jurisdiction.

**Banking overseer (*Superintendencia de Bancos*)** recently reported that mortgage portfolios have grown by 158% and stood at VEB 6.7 trillion at the close of May.

**Robert Zoellick, candidate to head the World Bank**, said that the organization would not lose any influence as a result of Venezuela's withdrawal, and mentioned that the Bank's major challenge is to find new financing instruments for nations with medium income levels.

**Brazil, Colombia and Ecuador are the Latin American countries with highest unemployment levels.** Venezuela shows improvement, pushing its unemployment levels below Argentina and Uruguay. Unemployment rate in Venezuela is now 8.0%, whilst Colombia's stands at 11.6%, Brazil 10.1% and Ecuador 10%. Countries with the best records in Latin America are Mexico with 3.6%, Costa Rica with 6% and Chile 6.1% of people out of work. Next week we will be looking again at the Venezuelan labor market.

**The Enabling Law enforces socialism in taxing.** One of the taxes to be introduced will be on capital gains, levied on people with a capital of over 25,000 tax units (VEB 940.8 million). The tax will cover accounts held in local or foreign currency. The expected aliquot will be less than 1%, paid annually and compensated in the income tax filing.

**Basic food basket up by 0.9%.** According to the Statistics Office (*Instituto Nacional de Estadísticas - INE*), the cost of the regulation food basket was VEB 495,879 in May, against VEB 491,676 in April. According to the report, the food basket has risen by 3.4% since the beginning of the year, compared with the same period last year.

## OIL TIPS

**Minor drop in crude basket value.** Venezuela's basket of crudes averaged US\$ 61.73 per barrel, according to the Energy and Petroleum Ministry. The barrel of Venezuelan crude has an accrued average price for this year of US\$ 54.04, slightly below the 2006 average of US\$ 56.44.

**Production unchanged.** According to the International Energy Association, there was no change in Venezuela's production last month, again standing at 2.37 million barrels per day. This figure follows a descending curve against the 2.44 million bpd of the first quarter and 2.5 million bpd of the last quarter of last year. One point to be highlighted is that the Oil Belt (*Faja*) production has held steady at 455,000 bpd.

**PDVSA and private companies at loggerheads.** The private firms are looking for profitable business while PDVSA wants to maximize taxes and royalty payments to the Government. This a major concern for the oil companies that will now be minority partners of the mixed companies. The crucial point is the veto power they will have over relevant decisions.

**China sucking up oil.** China's oil imports increased by 9.6% during the first 5 months of the year, in comparison with the same period of 2006.

**New mixed companies Petrodelta and Lagopetrol published in the Official Gazette.** Mixed companies Petrodelta and Lagopetrol have been created as part of the operating agreements to ensure "full oil sovereignty". In Official Gazette N° 38.706 of Friday June 15, the National Assembly was quick to delimit the areas of action of the new companies.

## BUSINESS SECTOR TIPS

**Currency purchases increase.** In the first 5 years of this year, authorization of foreign currency purchases increased by 66.4% in the automobile sector and 46.4% overall for commerce, when compared with last year.

**If strategies to stimulate agriculture and offer cheap products to the people have failed, it is definitely not because of a shortage of resources.** Between 2003 and 2006, the Executive and the banks have disbursed more than VEB 12.6 trillion – about US\$ 5.8 billion at the official exchange rate – to boost agricultural production and create a distribution network at subsidized prices. According to the numbers presented by the Ministry of Finance in November 2006, since 2003 MERCAL has received VEB 3.1 trillion; the Zamora Missions VEB 1.1 trillion; *Vuelvan Caras* Missions, whose purpose is to "bring about a change in the economic model by modifying relationships based on an endogenous development focus," has received VEB 1.5 trillion, and the banks have granted VEB 7 trillion with preferential exchange rates.

**Miban and SIDOR reach an agreement.** José Khan, Minister of Basic Industry and Mining, has reported that there is a tentative agreement with the directors of SIDOR in regard to the prices of cast steel products on the domestic market. The Minister emphasized that the Executive will not accept that "prices on the domestic market were above those on the international market."

**One million cell phones to be produced.** The Chinese company ZTE is aiming at producing one million phones in Venezuela in 2008. The President of the company, Shen Kai, reported that more than 1 million GSM sets had been sold during the first semester and that inter-annual growth had been 10% over recent years.

**Sectors less likely to be nationalized will enjoy most growth.** According to Datanálisis, the food and drug producing sectors will continue to be productive while oil prices remain high, whilst sectors like telephony, construction and finance will also be profitable and be less likely to be intervened by the State.

**Almost 50% of the country's sugar consumption will be imported this year.** According to Rafael Chirinos, President of FESOCA (*Federación de Asociaciones de Productores de la Caña de Azúcar*), 700,000 tons of sugar will be produced this year, against 780,000 tons last year, a drop of 10.2%. According to Gustavo Moreno, President of Fedeaagro, consumption this year will be around 1.3 million tons, meaning that 50% of domestic demand will have to be imported.

**Electricity supply shut down in the western region.** According to reports from the Ministry of Energy and Petroleum (MENPET), the breakdown caused interruptions in the service, equivalent to 3,351 megawatts in the National Electricity Grid (SEN), corresponding to 22.5% of domestic demand.

**Venezuelan expenditure higher than the region's average in certain items.** According to a study made by the CEPAL, using data from the year 2005, the real expenditure per capita in Venezuela on hotels and restaurants is 45.3% higher than the regional average; in telecommunications it is 26.6% above the average; in housing, water and energy, it is 3.6% higher, and in non-alcoholic beverages, 6.5%. On the other hand, expenditure on health and education stands at 6.5% below the regional average.

**CANTV looking at a "social" rate.** Socorro Hernández recognized that applying a new fixed-rate program by sectors, taking into account the level of income and socio-economic status is going to be no easy task, and therefore will not be applied immediately. She said that the company will wait for the results of the census being made to determine who should benefit from the social rate, which will apply to the lower-income sectors, with 15% discounts for domestic long-distance calls and 10% on local calls, and will enter into force at the beginning of 2008.

**Evo wants Venezuela to return to the Andean Community of Nations (CAN).** Evo Morales, President of Bolivia, reiterated his wish that Venezuela return to the Andean Community, because with its vote and that of Ecuador they would have the majority

necessary to approve reforms that require the bloc's vote, thus breaking the deadlock between two countries in favor of free market policies and those who oppose them.

**AES appoints Jonathan Coles President for Latin America.**

## Political Tips

**National bodies to be centralized.** President Hugo Chávez Frías has announced that a Central Planning Commission is to be created by Decree, using his Enabling Law powers. The Commission will be in charge of centralizing companies by sector, eliminating the autonomy of the State institutions. The Commission to be in charge of executing the centralization plan will be headed by Vice President Jorge Rodríguez, with the participation of the Planning and Development Ministry, together with the Central Bank of Venezuela. We understand, extra-officially, that regional vice presidents will be the main administrators of public funds, relegating the governors and mayors to a secondary role. Needless to say, the selection of such regional VPs will be made by the President of the Republic. The reform is a serious set-back for the decentralization process.

**Ex-Minister Tobías Lóbrega accused.** The Attorney-General's office has accused the ex-Minister of Finance, Tomás Nóbrega, of the crime of culpable embezzlement in the purchase of two assets during his time at the head of the Ministry.

**Caracas-La Guaira viaduct inaugurated.** After flying over the area, President Chávez proceeded to cut the ceremonial ribbon and open the new Caracas-La Guaira viaduct. The infrastructure's cost was VEB 175 billion.

**Venezuela "puts a distance" between itself and Spain.** President Chávez considers that the declarations of the Spanish Minister of Foreign Affairs, Miguel Ángel Moratinos, regarding RCTV show a "lack of respect" and, therefore, he said, "I'm going to keep my distance" from Spain and "it's sad."

**Spain beefs up its Embassy in Caracas.** Spain's Chancellor said that Spain's embassy in Caracas has been, is and will continue to be in contact with the Spanish citizens affected by the invasion of their land in Venezuela.

**"No plans in sight" for new nationalizations.** Venezuela's Head of State issued a call to "collaborate with the private sectors." He also made a point of saying that, independently of whether they are nationals or foreign they can "coexist with this revolution, as long as they obey the laws."

**Regulations being prepared for the battalions and assemblies.** The Promotion Committee of the PSUV is drafting the regulations for the organization and functioning of the socialist battalions and the regional assemblies, according to General Alberto Müller Rojas. He informed that each regional assembly will be coordinated by a promoter who will assume the work involved in organization, logistics and methodology. After the first meeting, the promoter will form part of the assembly in equal conditions.

**Another attack on freedom of expression?** The Editor-in-Chief of the daily newspaper Reporte de la Economía, José Rafael Ramírez, was arrested and sent to the La Planta Jail. Jesús Izaguirre, 52<sup>nd</sup> Control Judge, issued an arrest warrant for having presumably committed extortion and resisting authority. This newspaper has been denouncing supposed acts of corruption within the State oil company.

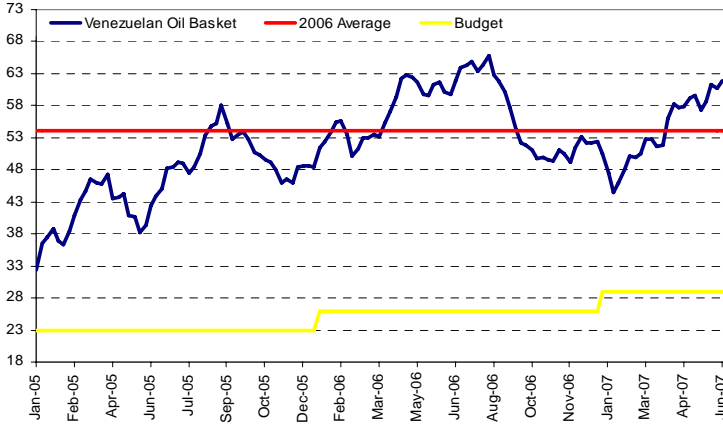
**Recall Referendums for October.** The CNE has confirmed that 8 recall referendums against mayors and one against a legislator in the State of Amazonas. Recall Referendums will be held in the Manapire and Atures Municipalities (Amazonas), Anzoátegui and Rómulo Gallegos Municipalities (Cojedes), Sucre Municipality (Falcón), Pedro Gual Municipality (Miranda), San Rafael de Onoto (Portuguesa) and Padre Municipality (Bolívar).

**Sectors ask for prompt passing of the Referendum Law.** Faced with low attendance and the high cost of collecting signatures to hold recall referendums against mayors and governors, different sectors have pointed out the need to accelerate the discussion and sanctioning of the Recall Referendum Law by the National Assembly.

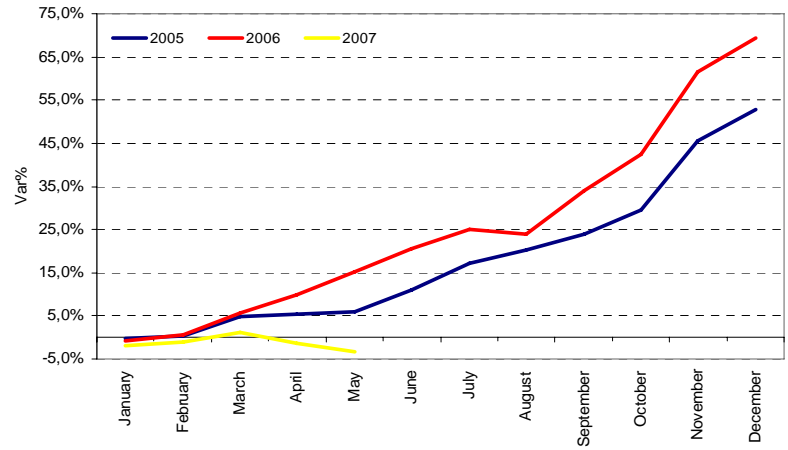
**RCTV asks the Carter Center to enforce compliance with commitments of the Roundtable.** RCTV exhorted the Carter Center to make the Government respect the commitments it assumed under the pact that closed the Negotiation and Dialog Roundtable. By means of a public communiqué, signed by RCTV President Marcel Granier, the Carter Center was called upon to act "firmly" in this case.

# ECONOMIC OVERVIEW

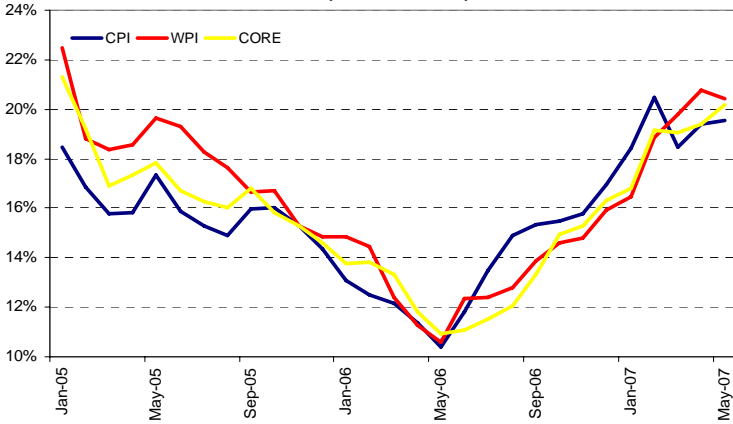
**Oil Price**  
(Venezuelan Basket US\$/pb)



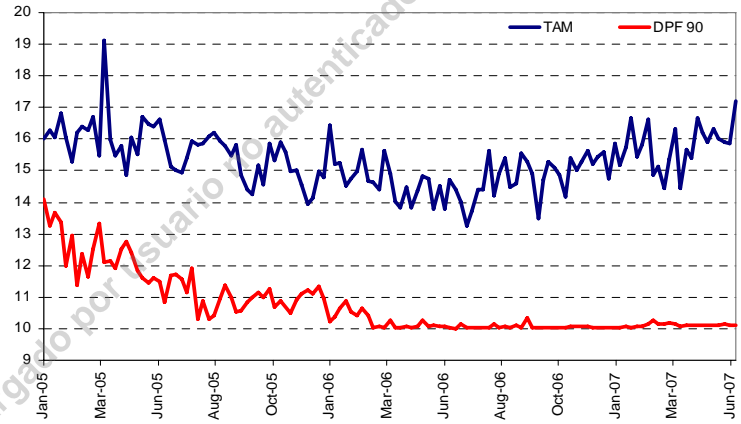
**Real Expansion (M2)**



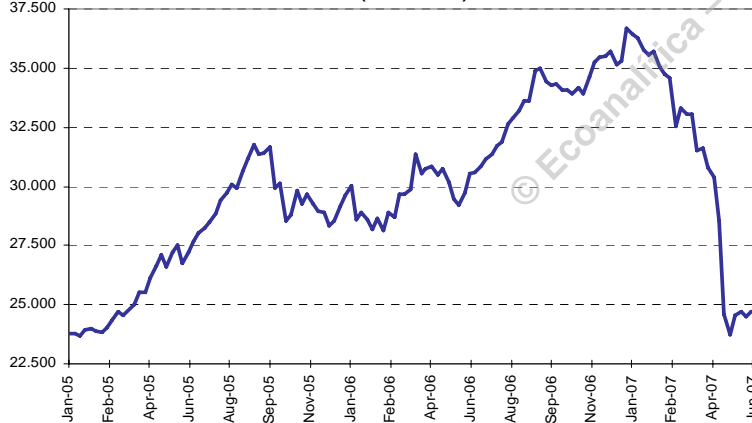
**Inflation**  
(Last 12 Months)



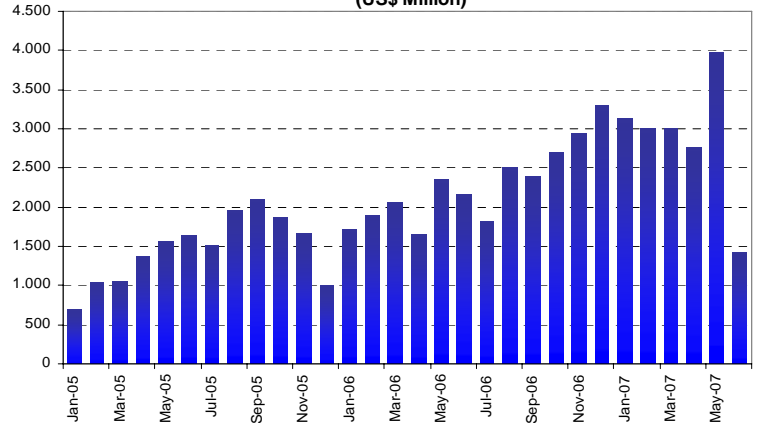
**Interest Rate**  
(Six Principal Banks)



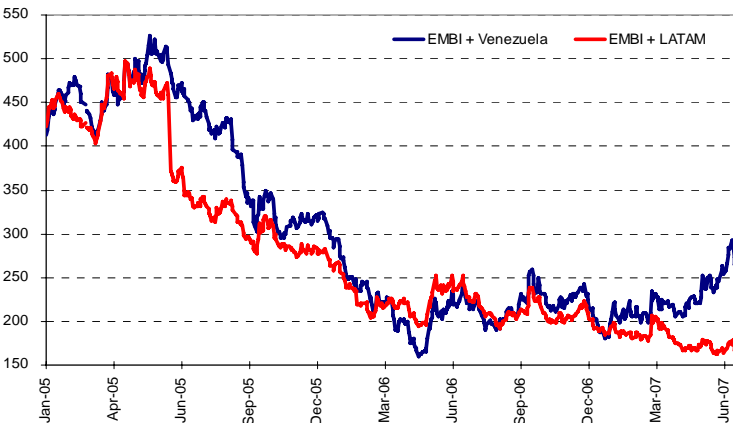
**Fx Reserves - BCV**  
(US\$ Million)



**Disbursement**  
(US\$ Million)



**EMBI**



**Central Government**  
(VEB Billion)

