



Volume 3, Number 33
Week I, September 2007

By:

Alejandro Grisanti
Asdrúbal Oliveros

Edited by:
John Holden

NOT BAD...

Reproduction and/or distribution prohibited

The foreign currency parallel market includes much more than the financing of imports, where one has to admit, CADIVI is doing a good job. This market also includes private capital outflows. This is where the pressure of the last few months has been coming from. The sale of structured notes may help ease this pressure but the deciding factor is in the hands of the Ministry of Finance.

The Government continues to downplay the parallel market

The Minister of Finance, Rodrigo Cabezas, recently assured that “the Government isn’t desperate to sell structured notes.” We don’t have any reason to doubt his words. However, what’s a bit contradictory is that the Ministry of Finance has pointed out on numerous occasions that it has an allocation program for those instruments that are mainly in the National Development Fund (FONDEN) portfolio.

What stands out even more is what he said with respect to the foreign currency parallel market: “The media makes a big deal of the parallel market. The parallel market doesn’t impose conditions on the Government. The country is being run by an Administration with a President that doesn’t bow down to exchange pressures; with regard to economic policy, the directives are not dictated by the parallel market... Of every US\$100 used for imports, US\$95 is being processed by the Foreign Currency Administrative Commission (CADIVI).”

But, the Government’s actions tell a different story

At *Ecoanalítica* we have mentioned on a number of occasions that given the conditions that currently exist in the Venezuelan economy, by introducing an exchange control you immediately create a black market, or a parallel or alternative market (the reader can choose the name that best suits them). In other words, you can’t separate the parallel market from exchange controls; it’s its alter ego.

The exchange control which was introduced in 2003 is no different. The parallel market immediately appeared and the Government has always known about it. It also knows that it has an important effect on the economy, because it serves as a relief valve. So, since August 2003, the Government has been trying out a number of strategies, some a bit more successful than others, in order to deal with the parallel market: bolivar-US\$ bond issues, Argentinean bonds, the bonos del Sur, PDVSA bonds, and the most recently structured notes.

So then Minister Cabezas, if the parallel exchange rate only finances 5% of total imports, why has the ministry that you head been so intent on reducing its price? It seems contradictory.

It’s a lot more than just imports

It’s hard to pinpoint exactly how much foreign currency the parallel market finances. There is something very important to point out, concerning this point, in order to really get an idea of how much the parallel market is financing. The parallel market doesn’t only refer to imports, it also a venue used by commercial agents to get capital out of the country. So, it would be appropriate to ask: How much foreign currency was allocated through the placement of instruments (bonds and notes, among others) since 2003 until now? How much foreign currency is being acquired through the parallel market to make payments abroad on accounts not covered by CADIVI, in other words,

purchases on the parallel market by companies and individuals for purposes other than imports? According to the information gathered by **Ecoanalítica**, this amount could well be significant, since a number of multinationals have periodically purchased great sums of foreign currency in order to satisfy the requirements of the (their parent companies??) main office.

To sum it up, the parallel market could be: Total imports (BCV) minus authorization from CADIVI plus capital outflows. In fact these capital outflows are not always "satisfied" by bond issues, so we are talking about a market that is much more substantial, far from the 5% that Minister Cabezas is talking about.

The parallel market finances a significant amount of imports

Even the BCV contradicts Minister Cabezas, since one of the distortions that the parallel market has been creating is the increase of the portion of imports that it is financing, which is growing substantially. In 2004, of a total of US\$17.02 billion in imports, only 7.5% was financed through the parallel market. This percentage increased in 2006 to 18.4% of imports that according to the BCV equaled US\$32.22 billion. In other words, in only two years, the demand for foreign currency in the parallel market increased five times going from US\$1.27 billion to US\$5.93 billion.

A necessary point to clear up

In the past we mentioned that the parallel market financed around 35% of imports last year. However, this figure didn't take into account the imports made through the ALADI agreement, which would make the actual figure be more like 18.4%. This figure is significantly less than what we originally reported but still far from the 5% reported by the Government.

For 2007, it's still impossible to tell

Currently, we only have figures for the first semester of the year. According to the BCV, the parallel market only finances 2.6%. If this number is correct, then **Ecoanalítica** would have to offer its apologies to Minister Cabezas since he overestimated: the parallel market finances only half of what he has announced. However, we need to wait until the year is over in order to be able to establish the definite proportion for two reasons: first, it will establish exactly how much CADIVI and ALADI allocated without seasonal distortions and second, the parallel market is much more than just imports as we have stated previously.

You can't deny that the Government is trying

It's probable that by the end of 2007 the parallel market finances a lesser amount of imports than 2006. Just in the first semester, CADIVI and ALADI authorizations for foreign currency increased 63.3% compared to the same period the year before. This is one of the main facts that explain the significant drop in the current account for the first half of the year. However trade agents are increasing their capital outflows; this is also substantiated by first semester figures and explains the strong pressure that this market has had been subjected to over the last few months.

The Government should systemize the sale of notes

Minister Cabezas also announced that another US\$1.0 billion in notes is in the works to be placed on the market; he said that "this amount covers the papers that have already been released." Which is to say that to date, the Ministry of Finance has placed notes for an amount close to US\$850 million, leaving only US\$150 million left to be placed. However, there are structured notes in the FONDEN and National Treasury portfolio for close to US\$6.0 billion. With this amount, the Government could continue to supply weekly amounts of US\$200 million in structured notes from now until the end of the year. This would add up to a total of US\$4.25 billion and have a significant effect on the parallel market.

Furthermore, the placement of these structured notes is a win-win scenario for all involved. On the one hand, the Government diversifies its risk (especial with regard to FONDEN), the financial system earns commissions, and the private sector gets foreign currency that will essentially be used for capital outflows. At **Ecoanalítica** we believe that the structured notes auctioning system should be institutionalized making it more transparent and opening it up so that not only financial systems may participate but also brokerage houses and firms.

The sky's the limit

If the Ministry of Finance decides not to sell any more structured notes, beyond the US\$1.0 billion that Minister Cabezas has already announced is in the works, and with the possibility of placing Bono del Sur III for US\$1.5 billion, the pressures pushing the foreign currency parallel market to increase will continue, as will the political uncertainty resulting from the President Chavez's constitutional reform proposal. So much so that VEB5.000:US\$ may be wishful thinking, just like what happened when it was on the verge of VEB3.000:US\$ and VEB4.000:US\$.

Economic Tips

1.1% inflation in August. According to the BCV, inflation for the month of August 2007 registered a variation of 1.1%, greater than that which was observed during the previous month (0.5%) and less than August of last year (2.2%). With this result, the cumulative variation of the Consumer Price Index (CPI) for the close of the eighth month of this year is at 9.4%, less than the 10.4% registered during the same period last year. The CPI yearly variation is at 15.9%, less than what was registered for the month of July (17.2%) and greater than what was registered for August 2006 (14.9%).

Items not controlled continue to increase. The increase in the CPI during this latest period analyzed was mainly due to the increase in price of items not controlled, going from 0.4% to 1.8%, slightly offset by the drop registered by controlled items which went from 0.6% to 0.2%. When itemizing CPI results by groups, 4 of the 13 categories presented higher month-to-month rates than in July: alcoholic beverages and tobacco (from 1.6% to 4.5%), foods and non-alcoholic beverages (from 0.8% to 2.3%), restaurants and hotels (from 0.2% to 1.3%) and miscellaneous goods and services (from 0.6% to 1.0%).

Government expects spike in prices. The Minister of Planning and Development, Jorge Giordani, assured that Venezuela was once again on the brink of inflation receding; however, he announced that the Government would do everything in its power to slow the increase of prices leading up to the Christmas season. Giordani stated that during the last three months of last year, consumer prices increased by 0.7% at the close of October, 1.3% at the close of November, and 1.8% at the close of December. He assured that this year, specific measures will be taken to avoid this seasonal trend of prices increasing so that it doesn't happen this time around.

Highest in Maracaibo. The Consumer Price Index of the metropolitan area of Maracaibo registered a variation of 1.3% during the month of August, slightly higher than that observed in July, but significantly less than the one reported during the same period last year (2.1%). With this result, the cumulative variation for the close of the month of August is at 8.4% and the yearly variation of the CPI is at 13.8%.

New regulations. The BCV announced the new rules that Public Administration organisms and entities, banks and other financial institutions (public and private), and public companies that provide services must follow in order to develop the information and formation campaigns concerning monetary reform. The BCV resolution is published in the Gaceta Oficial N° 38.756 dated Tuesday, March 28, 2007.

Public company earnings will be deposited into a fund. The Government is laying the legal ground work in order to centralize the decision making and manage public company earnings through the definition of a new Commerce Code. Sources inside the Government stated that the earnings that these establishments generate will no longer be managed by their respective board of directors, but that they would be deposited into a single fund which would be directly managed by the Administration. The sources, who asked not to be identified, pointed out that during the reform of the Commerce Code the question of which entity would have control over these funds came up, and since according to the constitutional reform proposal, public property is all that which belongs to the “entities of the State,” it was decided to make clear that the earnings generated by the public companies would remain at the discretion of the central power.

The President will review all the BCV procedures. President Hugo Chávez is as of this moment revising all the functions of the Central Bank of Venezuela (BCV). “The autonomy of the BCV is over, not only concerning the placement of international reserves, but in all its procedures,” announced the President during his television show on Sunday. Chávez criticized the overnight rate and said that the BCV should dedicate itself to financing productive activities instead of using the country’s money to “oxygenate private banks.”

Chávez as the region’s savior. President Chávez has promised more than US\$8.80 billion in donations, financing, and energy aid so far this year.

The Bono del Sur again. Venezuela could issue the Bono del Sur III in September, according to the Minister of Finance, Rodrigo Cabezas, after it was suspended due to the volatility of international markets.

Parallel exchange rate spikes. During the last two weeks, the parallel exchange rate has spiked, topping VEB4,500:US\$ and reaching VEB4,950:US\$. Some are predicting that the parallel exchange rate will close the year at VEB5,500:US\$.

Venezuela dropped in economic freedom ranking. Venezuela ranked 135 out of 141 in the World Index of Economic Freedom 2007, which represents a drop of nine places compared to where it was ranked last year at 126. This study measures the economic freedom for 2005 and uses 42 different parameters in order to create an index that classifies countries according to their public policies that promote economic freedom.

OIL TIPS

Up again. The Ministry of the People's Power for Energy and Petroleum announced that the Venezuelan oil basket price increased by US\$1.49 with respect to the previous week, settling at US\$65.77 per barrel.

Venezuela to join OPEC Investment Committee. The Minister of Finance, Rodrigo Cabezas, announced that Venezuela ratified that it was joining the OPEC Investment Fund Committee today, until now made-up by Saudi Arabia, Iran, and Kuwait. Cabezas pointed out that Venezuela has not been a member of the committee for the last five years. He also announced that the vice-minister of Financing for Endogenous Development from his ministry, Rafael Isea, will represent the Administration before this international entity.

Venezuela negotiates with Conocco and Exxon on their withdrawal. The Venezuelan government is negotiating the withdrawal of ExxonMobil and ConocoPhillips from the country. These two companies did not accept the transition to mixed companies with the Government as majority shareholder in the Orinoco Oil Belt, pointed out Minister for Energy, Rafael Ramírez. Sources in the industry say that among the possibilities being considered as ways to indemnify Conocco and Exxon is payment in crude oil or cash, which seems improbable. If they can't come to an agreement they must present their grievances before an international court.

PDVSA Gas consolidates. PDVSA signed an agreement for the acquisition of the companies Vengas and Tropigas, two of the largest filling and distributing companies for liquid petroleum gas (LPG) in the country. According to statements released by the president of PDVSA, Rafael Ramírez, the acquisition was planned and part of an operation to create a new subsidiary, Pdvsa Gas Popular. The new company's action plan was released last week by the Central Commission for Planning integrated by the Administration, which operational budget for the current year is being transferred from other instances of the main office just like the other six subsidiaries of the state-run company that are in the process of starting up.

Not long until the Chinese rigs arrive. 13 oil rigs coming from China will arrive in Venezuela starting in October at a rate of approximately one per month, announced the president of PDVSA, Rafael Ramírez. The subsidiary PDVSA Servicios will be created to run these rigs, said Minister Ramírez. This new subsidiary will be in charge of providing construction and maintenance services to oil wells.

To Ecuador. Despite the fact that PDVSA declared the current shortage of rigs in the country “an emergency,” in Zulia state, they are beginning to dismantle two rigs that will be sent to Ecuador to be used by ECOPEPETROL. The document states that the rigs are currently located at the former Corpoven, now PDV 16 and PDV 34, and that they had been used to drill wells in the Ticoporo Field, which according to measurements, produce between 1,000 and 2,000 barrels.

New client for Venezuelan oil. The transnational oil company Esso Oil Standard will buy Venezuelan crude oil through the state-run Petróleos de Nicaragua (Petronic).

Opportunities vanishing for private companies in the oil sector. With the 21st Century Socialism being more firmly established in the country, private companies see their opportunities to participate in the oil sector dwindling with each passing day. The reform to article 302 of the Constitution clearly states that among all activities that have to do with the oil sector, the “exploitation” of domestic hydrocarbons (liquid and gas) will be exclusively reserved for the State; this clause is not provided for as part of the organic law that corresponds to the matter, rather it is expressly established as part of the Constitution.

Petrobrás to start without Venezuela. Despite having reached an agreement with PDVSA, concerning the construction of a refinery in the northeastern part of Brazil, Petrobrás prepares to begin the project without its Venezuelan partner since the terms of the project are still being discussed.

BUSINESS SECTOR TIPS

Changes to how invoices will be issued to go into effect in February 2008. Tax authorities published a modification to the provision that established the parameters to be followed in the issuing of invoices. The provision establishes that the new adjustments will be required starting in six months. So, it will be in February 2008 when the new SENIAT regulations will go into effect.

Venezuela lives by text messaging. Cell phone use is much higher than fixed phones. 77% of the population communicates by cell phone and not necessarily making calls, but also by text messages. During the second quarter of the year, 371 text messages were sent by cell phones for every 290 minutes of phone calls made, according to the most recent figures released by CONATEL.

Movilnet grew. CONATEL reported that Movilnet registered a growth of 504.000 clients during the second quarter. During the first quarter of the year, the total number of cell phone users registered in Venezuela reached 19,604,430 people, and of those, 41.5% (8,135,838) were Movilnet customers. Movilnet's total market share dropped by 0.7 percentage points (41.5% to 40.8%), but this "doesn't reflect a loss of customers," assured CONATEL.

Digital Television continues to move forward. The tests announced by Minister Jesse Chacón to decide which digital television standard Venezuela will choose this year began at the Mecedores station, where two transmitters were installed: one of the Japanese standard, and the other of the European standard.

Problems among CVG companies. According to the president in charge of Alcasa, Ramón Betancourt, the company is in no shape to pay the full price for the aluminum anodes owed to Carbonorca, because the plant is having a series of problems with its production plants, therefore it will have to reach some kind of an agreement with the company to lower the cost.

Industrial jobs increased 29% during the first semester. The latest survey of the current industrial climate taken by FEDEINDUSTRIA reflects an increase in its production capacity, especially an increase in the work force. According to information provided by Miguel Pérez Abad, president of FEDEINDUSTRIA, during the first semester of 2007 small and medium companies registered an increase of 29% in direct jobs, which represents an approximate increase of 55,000 new jobs; while the number of contracted workers increased by 21%.

Shops getting up to date with the Bolívar Fuerte (strong bolivar). Shops have already begun to comply with the Monetary Conversion Law Decree which states that starting from January 1, 2008 the new currency will begin to circulate, and from October this year prices must be included on all products in both current and new currencies so that the public can begin to familiarize themselves with the coming change.

Credit and debit card fraud increases. This year, Indecu has received 10,000 cases of fraud concerning credit and debit cards. The benefits of having a credit card seem to be becoming overshadowed by the risk of using them.

Mercal food supply doubles. Minister of Food, Rafael Oropeza, assured that Mercal chain food product distribution has doubled since February. "We estimate that we will close this month over 120,000 tons, while in January we were at 60,000 tons", pointed out Oropeza.

Demand compensation for the sugarcane left un-harvested. Because of a lack of industrial capacity during the month of June, 900,000 tons of sugarcane was left un-harvested. Sugarcane growers expect that the Ministry of Agriculture and Land will indemnify them for their losses totaling VEB31.50 billion.

Chávez orders Cemex investigated. During a broadcast of Aló Presidente, the President ordered that a Cemex plant be investigated in order to determine its impact on the environment and the extent of the space it occupies and threatened to take “corrective actions” if something wasn’t in order.

Government remodels Mercal stores. With an investment of more than VEB200 billion, the Government is setting out to remodel around 170 Mercal stores throughout the country.

Government occupies slaughterhouses. No sooner had the President given the order to “take back” the municipal slaughterhouses, than the military were occupying the Pariaguán Breeding Center in the municipality of Miranda in Anzoátegui state.

Tourism loan portfolio reaches VEB1 trillion. According to the vice-minister of Tourism, Carlos Molina, tourism has increased thanks to efforts of different cooperatives and the Vuelvan Caras Mission. Of the total amount granted in tourism loans, 80% were allocated to the private sector and 20% to public entities.

New provision. Manuel Barroso, President of CADIVI, established the regulation that the civil aeronautic sector must follow in order to request foreign currency allocations. CADIVI and the INAC, each representing their area, signed a provision that groups the aeronautic sectors. This sector has foreign currency needs that depend on each office.

Good market for Colombia. Colombian exports to Venezuela increased by 69.1% during the first semester of 2007 compared to the same period last year, reported the state-run National Statistics Department (DANE). In a balance report on Colombian trade, the DANE highlighted that sales to Venezuela had gone from US\$1.13 billion to US\$1.91 billion during the aforementioned period. The products that were most sold were cars and spare parts, clothes, and clothing accessories.

Political Tips

This week again. According to Cilia Flores, the second round of debates on the constitutional reform project will take place this week. The third round, according to Flores, will take place on October 20.

Recognizes corruption. The Minister of Energy and Petroleum, Rafael Ramírez, explained that PDVSA also has problems with corruption just like all the other sectors of the economy. "In a company as complex as ours, where all types of transactions take place, everyday, we have cases (deviations) that we are investigating and processing," he said.

Division among chavismo ranks. National Assembly Representative, Francisco Ameliach was removed from the chair of the Parliament Defense Commission. President of the National Assembly, Cilia Flores, appointed representative Rafael Gil Barrios, a lieutenant colonel (r) of the army, to take Ameliach's place. Sources inside the National Assembly say that this all has to do with events regarding representative Ameliach, who is under investigation by the interim disciplinary tribunal of the President's still yet to be legally constituted one-and-only socialist party (PSUV). Ameliach's fall from presidential favor and current scolding is due to statements he made concerning delaying the establishment of the PSUV and resurrecting the MVR (Venezuelan Revolutionary Movement) for the mayor and governor elections which are due to be held next year, as well as comments concerning internal problems existing among the President's closest advisors.

New US Ambassador to Venezuela. The new US Ambassador to Venezuela, Patrick D. Duddy, has arrived to begin his diplomatic duties. Duddy, Deputy Assistant Secretary to Tom Shannon, head of United States diplomacy for Latin America, replaces former Ambassador William Brownfield, who has been posted in Bogotá.

Insulza disagrees with increases in power. The Secretary General of the Organization of American States, José Miguel Insulza, made public yesterday his disagreement with the constitutional reforms put forward by Venezuelan President Hugo Chávez and which will allow for indefinite presidential reelection.

CNE submitted its Civil Registry Law project. The Civil Registry Law project was submitted by one the board members of the National Electoral Council (CNE), Sandra Oblitas, to the majors of the Greater Metropolitan Caracas area and Vargas state municipalities. She explained that once the CNE has the three projects back that are

“in the streets being discussed” they will be presented to the National Assembly. She said that they still don’t know how much the implementation of the new civil registry will cost.

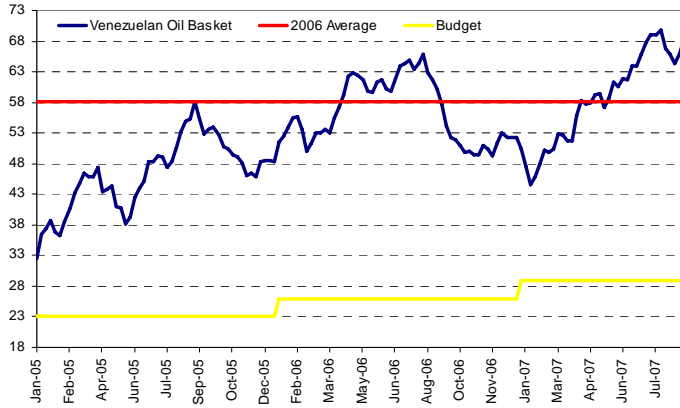
CNE opens the electoral registry for the referendum. The CNE opened the registration process for new voters to be included in the electoral registry. 2000 centers have been opened by the CNE to accommodate these new voters or to update voter information throughout the country. This information appeared published in ads in national newspapers. This registration will make it easier to participate in referendum process for the constitutional reform proposal expected to take place this coming December.

Chavez’s intermediation in Colombian conflict predicts a political success for the Venezuelan president. President Chávez would almost be assured success for his role as a mediator between the Colombian government and the FARC if he could just negotiate the release of Ingrid Betancourt and a few other prisoners. It would be a “great victory,” so much so that the Colombia as well as Venezuela would be grateful and it would revitalize his image, internationally as well as domestically.

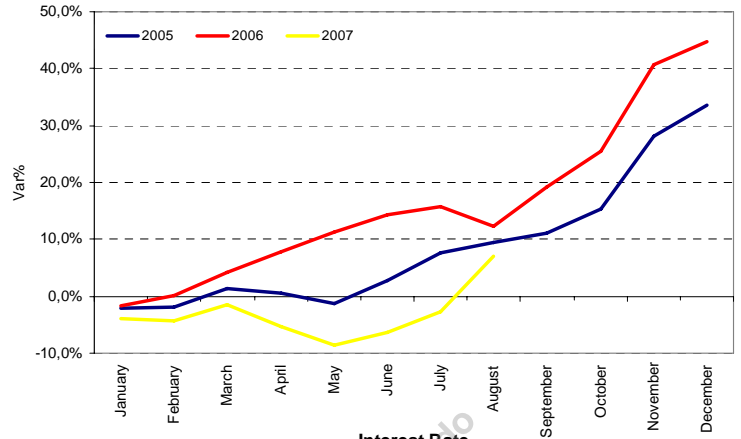
© Ecoanalítica – Descargado por alejandrog@ecoanalitica.net

ECONOMIC OVERVIEW

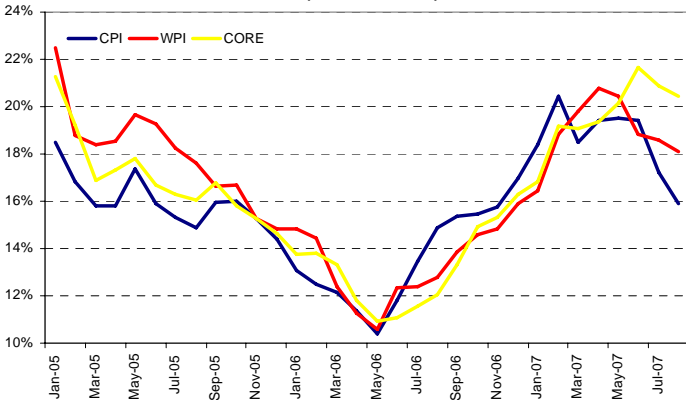
Oil Price
(Venezuelan Basket US\$/pb)



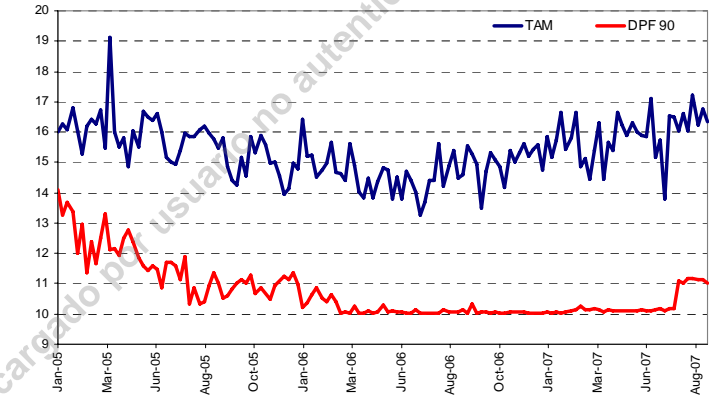
Real Expansion (M2)



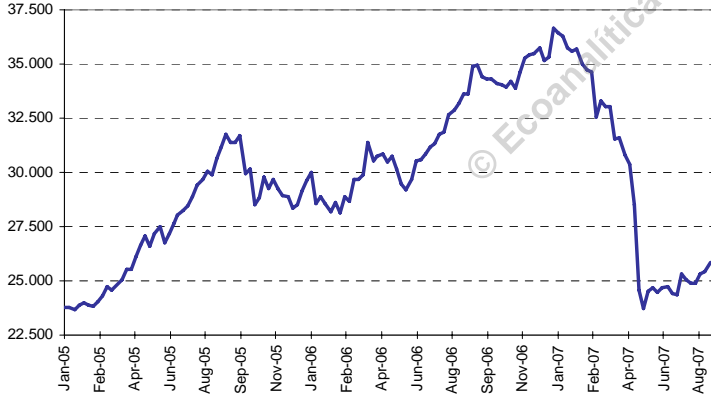
Inflation
(Last 12 Months)



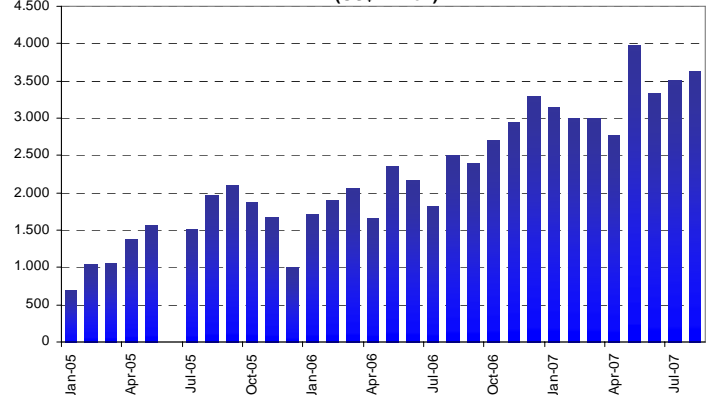
Interest Rate
(Six Principal Banks)



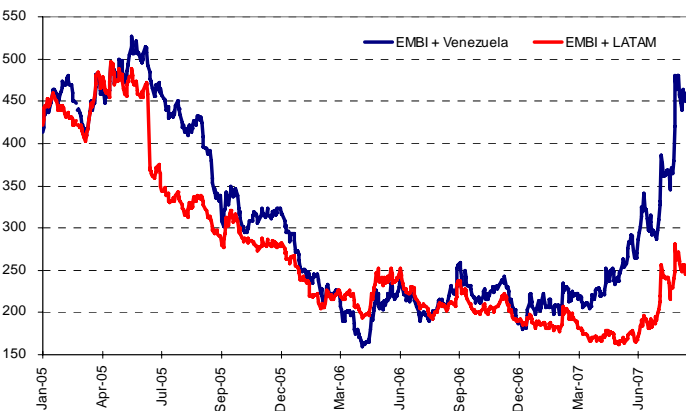
Fx Reserves - BCV
(US\$ Million)



Disbursement
(US\$ Million)



EMBI



Central Government
(VEB Billion)

