



Volume 3, Number 44  
Week III, November 2007

## **THE PARADOX OF THE VENEZUELAN ECONOMIC GROWTH**

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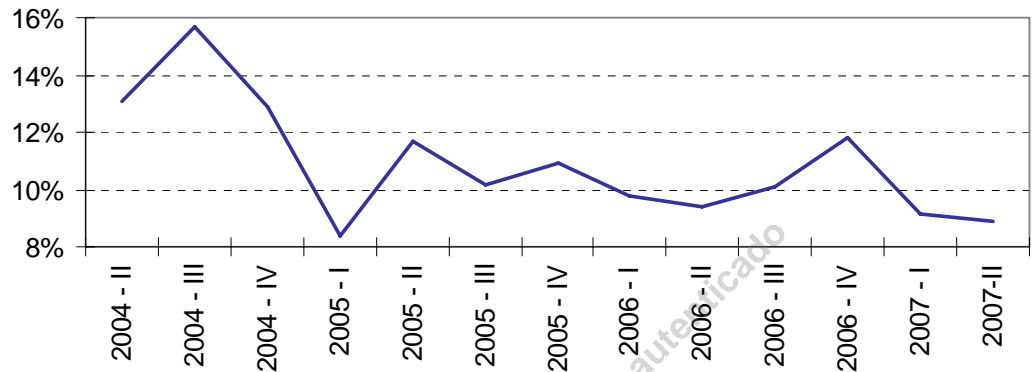
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According to the BCV, in the third quarter 2007 the Venezuelan economy grew 8.7% in comparison with the same period in 2006. Therefore, economic activity expansion reaches a year-to-year rate of 8.4% during the first nine months of the year.

### **Four years growing**

The BCV itself points out that with these results, the Venezuelan economy will post 16 quarters of “sustained, substantial, and overall” growth in a row, with an average growth rate of 12.1%; quite a record for an economy like the Venezuelan one.

## Gross Domestic Product (Annual %)



Sources: BCV y Ecoanalítica

### ¿What is growing?

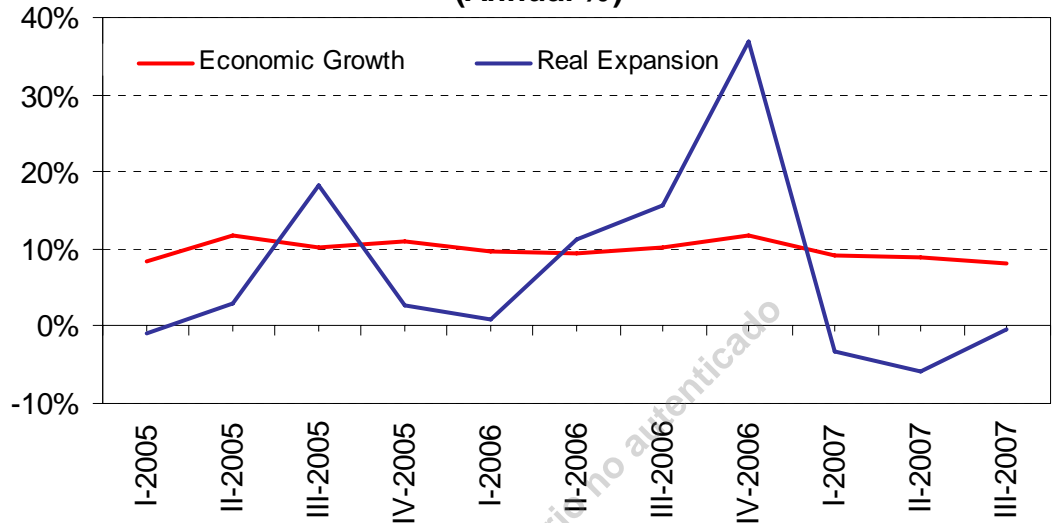
Considering figures for oil and non-oil sectors separately, it can be seen that the non-oil sector grew 9.7%, on a year-to-year base, in the third quarter. Oil activity, in turn, fell 4.4%.

### The great paradox

This is the origin of the paradox that the Venezuelan economy is now in. The country's economy has been registering an extraordinary growth rate for 16 quarters in a row, thanks mainly to high oil prices that have allowed public spending to expand significantly with the subsequent multiplying effect of the aggregated demand. The BCV itself recognizes this fact: *"Dynamism of the economic activity...continued to be stimulated by the higher domestic aggregated demand, both in investment spending as well as consumption, result of greater access possibilities to financing, of the permanence of the government's social programs, and of household real income."*

So far so good. The sad truth is that the sector responsible for the bonanza, i.e. the oil sector, has been showing signs of stagnation for some time now.

## Real Expansion vs. Economic Growth (Annual %)



Sources: BCV and Ecoanalítica

### Oil sector's contraction is worrying

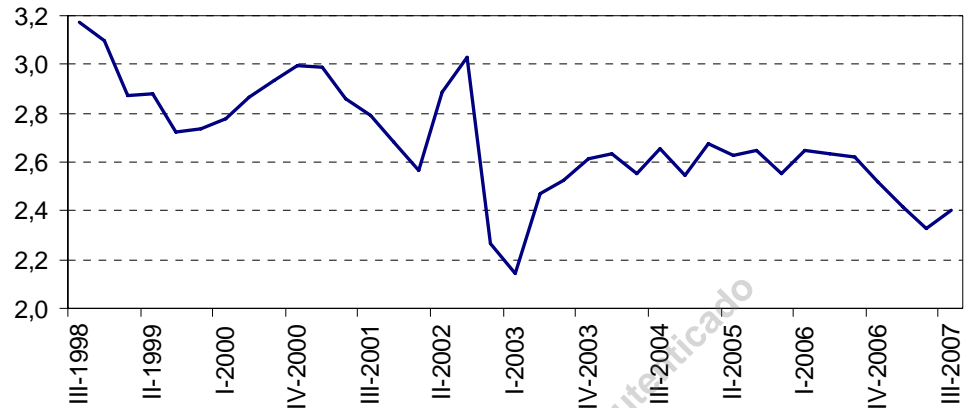
In the press statement, the BCV doesn't go into details concerning the oil sector's performance. The only thing it reports is that public oil-sector activity dropped 4.5% and private activity decreased 3.7%, both on a year-to-year basis. Oil sector has been falling from third quarter 2006, meaning that this would be the fifth semester in a row with a drop in oil-sector activity. Average growth rate is at -1.9%.

Before this poor performance phase, the oil sector had dramatically fallen in the period between the last quarter 2001 and the third quarter 2003. This performance has negatively impacted oil export behavior. However, the situation isn't critical thanks to high oil prices.

### What BCV says is consistent with what oil industry analysts say

Independent agencies that monitor oil market behavior have reported the drop in the Venezuelan oil production. Venezuela produced an average of 2.36 million b/d in the third quarter, down from the 2.37 million b/d produced in the second quarter of the 2.44 million b/d of the first quarter 2007. For instance, the IEA estimates that Venezuela's production capacity at 2.6 million b/d, so that it would be possible to increase production in around 220,000 b/d in the short run.

**Oil Production**  
(Million barrels per day)



Sources: Bloomberg and Ecoanalítica

## PDVSA's challenge

We have already mentioned that PDVSA's challenge is to prevent this fall from going on. According to unofficial sources, the situation is expected to start changing back in the fourth quarter 2007, thanks to PDVSA's plans to put new drilling rigs into operation and to accelerate investment plans. We estimate that oil sector (as GDP %) will regain in 2008 part of the lost ground and grow 2.2%.

## You can't compare oranges to apples

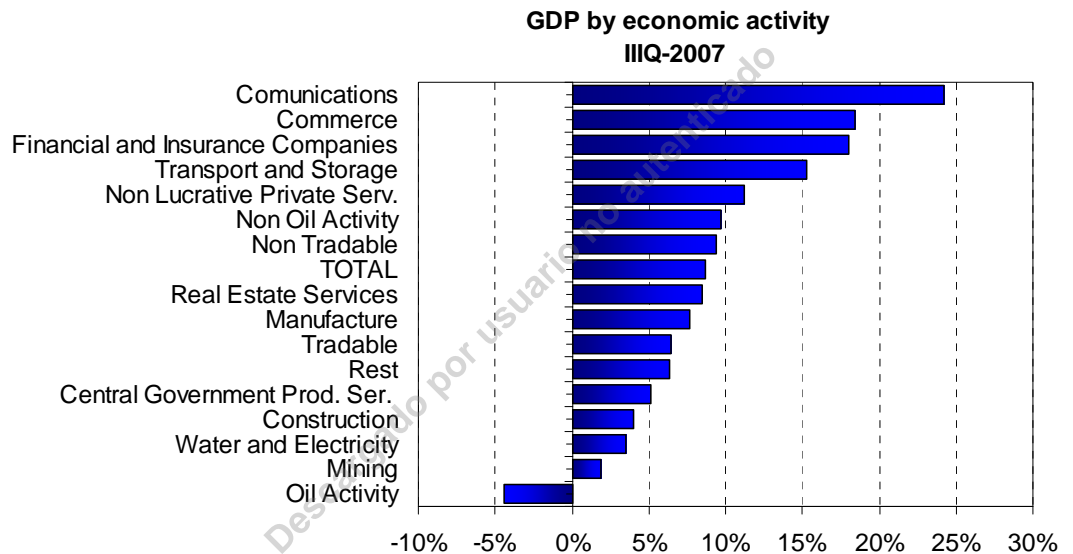
Another significant fact observed in the figures released by the Central Bank is the change in the growth trend of public and private sectors. According to the BCV, public-sector GDP grew 12.7% and the private sector posted 5.5% growth, on a year-to-year basis. This is the result of the nationalization of the telecommunication and electric power companies. In the past, private sector grew at a higher pace than public sector. However, in our opinion, these figures aren't comparable, because the calculation methodology has consisted of taking from this quarter on the GDP generated by these companies that were private and now belong to the State. It will be from 2009 on that we'll be able to see how the public and private sectors are really doing.

## Non-oil sector growth isn't Socialist

The BCV has been maintaining for some time that the non-oil sector growth is significant, harmonic and widespread. However, we at **Ecoanalítica** don't fully agree with this opinion. While this growth was significant, because it was close to 10%, it cannot be said that it was harmonic, because some sectors are expanding fairly well like

# Weekly Report

Communications (24.3%), Commerce (18.4%), Financial Institutions and Insurance (18.0%), and Transportation and Storage (15.3%), but other sectors are growing at a substantially lower rate such as Real State, Business and Renting Services (8.5%), Manufacture (7.7%), Construction (4.0%), Power and Water (3.5%), and Mining (1.9%).



Sources: BCV and Ecoanalítica

## Strong deceleration in the construction sector

Construction grew just 4.0% in the third quarter in comparison to the same period last year. This contrasts with the 18.1% growth posted in the first half of the year. The result was that the sector strongly decelerated, which is explained mainly by shortages in some basic products and a slower growth in private housing works. This deceleration will substantially impact employment, because this is a labor-intensive sector.

## Driven by consumption

When the sectors that registered the highest growth are analyzed, it isn't difficult to realize that they are related to the increase in the domestic aggregated demand and private consumption. In fact, according to the BCV, domestic aggregated demand expanded 17.0% in 3Q07 on a year-to-year basis. In the same period, private consumption grew 20.4%. This growth in consumption explains the

outstanding performance of sectors like commerce, communications, financial institutions, and transportation.

## **Investment is slowing down**

In the third quarter 2007, investment expanded 17.3% on a year-to-year basis. This is much less than the growth it showed in the second (27.1%) and first (27.0%) quarters.

On the other hand, it's regrettable that the BCV doesn't detail how much of this expansion corresponds to public and how much to private investment. If we base on what industrials and businessmen say that domestic private investment is slowing down, we could think that investment growth is driven by the public sector performance.

## **We are inexorably approaching our fate**

It's evident that the Venezuelan economy performance is tied to oil prices behavior. A fall in oil prices negatively impacts fiscal policy and, therefore, the economy's growth. We estimate that economy will grow 6.7% in 2008, with the non-oil sector expanding 7.4% and the oil sector, 2.2%. In year 2009, GDP will increase 4.3%. After 2009, the Venezuelan economy stops growing and will end up with a severe economic contraction of 11.7% in 2011 and 4.9% in 2012. The reason for this is that our strong dependence on oil will make us carry out a fiscal adjustment in 2011, which implies a dramatic devaluation and a balance-of-payment crisis which will result in the exchange rate control being dismantled. This is what we have described as "our inexorable fate."

## Economic Tips

**“El Venezolano II” has come.** The Government fixed a minimum price of 110% for the “El Venezolano II” bond issue worth US\$500 million. The ministry of finance will repeat the auction system used this month to allocate US\$1.65 billion in the “El Venezolano I” bond issue. The offer is made up of a Eurobond maturing in 2038 and a 7.0% coupon, along with two local Vebonos maturing in 2013 and 2014 with a first coupon of 10.37%, variable and indexed according to the yield of the Treasury bills for both papers. The transaction will be earmarked for individuals and legal persons.

**Standard & Poor's reaffirms its Venezuelan debt rating.** Standard & Poor's Ratings Services announced that it had reaffirmed its credit rating for Venezuelan debt in “BB-” (long term) and “B” (short term), maintaining the prospect as stable.

**Supplementary appropriations to pay labor liabilities for the armed forces.** The National Assembly approved supplementary appropriations for VEB397.5 billion that will be used to pay labor liabilities owed to active and retired military personnel of the National Armed Forces. These liabilities result from the 30% wage increase decreed by President Chávez.

**Efficient ITF.** With VEB491.2 billion collected during the first 14 days the Financial Transaction Tax has been applied, the SENIAT's expectations have been exceeded, because estimates for these two weeks were at VEB353.2 billion.

**An “non-existent” foreign exchange market finances 21% of imports.** According to the figures reported by the BCV and CADIVI, non-oil imports during the first nine months of the year amounted to US\$28.45 billion, whereas the amount of foreign exchange authorized by CADIVI was US\$22.38 billion. This means that 21% of the imports during this period were financed with dollars from the parallel market, described by some government's officials as “non-existent” or “curious”.

**Cabeza recognizes.** Rodrigo Cabeza, minister of finance, pointed out that the basic factor that will prevent the Government from attaining its inflation target of 12% at the end of this year is “the gap between supply and demand that occurred in September and October.” However, the minister should know that this gap has existed for some time now.

**ECLAC reports a decrease in poverty in Venezuela.** Venezuela is among the 14 countries in the region that have registered a decrease in poverty levels between 2002 and 2006, out of 16 nations that were evaluated. The country exceeded the extreme poverty reduction target expected. Concerning total poverty, the country didn't achieve the reduction target. In 2006, 36.5% of the population within the region lived in poverty, whereas 13.4% of the population lived in extreme poverty or INDIGENCIA (¿were homeless?).

**ECLAC: Latin America economic grow will continue in 2008.** According to ECLAC, the Latin-American region is expected to post an increase in the per capita GDP in 2008, which will represent the fifth year of economic growth in a row and the highest income index since the '70s. ECLAC reports in its Latin America Social Outlook 2007 that GDP grew 5.6% in 2006, which is equivalent to a 4.2% increase per inhabitant; this figure determines a sustained expansion period that started in 2002 and is characterized by an average yearly increase of 3.3% in the per capita product.

**Unemployment among young people is up.** According to the last report by the National Statistics Institute (INE), the active population segment between 15 and 24 years of age registered an unemployment rate that is twice the general mean, with 17.7% by the end of September. Nationwide unemployment was at 8.3%, according to official figures.

**Consumption grows more than investment.** The figures disclosed by the Bank Superintendent' Office show how financing through credit cards has been substantially increasing up to around VEB12.2 trillion by the end of October, whereas credits granted to manufacturing industry only amounted to VEB6.7 trillion, thus showing the trend followed by the economy, according to which consumption grows at a fast pace while investment reflects a much more slower rate.

**Christmas food basket shows 27% inflation in comparison to 2006.** This year, the price of the Christmas food basket, consisting mainly in *hallaca*, chicken salad, roasted pork and *pan de jamón*, increased 27% on average in comparison to 2006. The price of the main Christmas dish varies depending on where it is consumed. In the eastern part of the city, it ranges between VEB25,000 and 65,000, whereas in the western side of Caracas it costs between VEB15,000 and 60,000. Last year, the Christmas dish was selling at VEB15,000 and 50,000.

## OIL TIPS

**Venezuela's oil basket drops.** The Venezuelan oil price per barrel dropped slightly and averaged US\$85.04 on the week, down US\$1.26 from the last week, said the Ministry of Energy and Petroleum.

**Maza Zavala warns of possible financial crisis in PDVSA.** According to the former BCV Director, the state-owned oil company "can be heading for financial crisis", since the corporation is "posting financial deficits and thus has to turn to domestic and foreign borrowing to find resources."

**OPEC doesn't give in.** The Venezuelan delegation failed in having its ideas of creating an OPEC bank and a university, setting up an aid mechanism for poor countries, and changing OPEC's basket of 12 crude oils from US-dollar to Euros included in the Riyadh summit declaration, which summarizes the balance of the 3<sup>rd</sup> Summit of Heads of State and Government that ended last Sunday. OPEC member countries committed themselves to guaranteeing a proper supply of oil to world market and contributing to mitigate climate change, as well as provide energy for sustainable development.

**PDVSA aims at diversification.** Minister Rafael Ramírez announced the signature of a number of protocols between Venezuela and China intended to promote a series of joint energy projects, including the shipment of 500,000 b/d of oil by the year 2010, one million by 2012 and the setting-up of a joint investment fund for US\$6.0 billion earmarked for social development. The projects being discussed by both countries also include the creation of a joint venture to build oil drilling rigs.

**Chinese oil rigs have come.** Venezuela received the first two (out of 13) oil rigs made in China, which will be used for E&P activities. The Chinese rigs have 1000 horsepower and will operate in the exploration and production at the San Tomé oilfield on the Orinoco Oil Belt.

**Agreement with TOTAL signed.** The Minister of Energy and Petroleum, Rafael Ramírez, announced the signing of an agreement with France's TOTAL for the development of the Orinoco deposits, which would allow increasing production from 200,000 b/d now to 600,000 b/d.

**Portugal will buy Venezuelan gas.** Gal Energía, Portugal's oil and gas company, announced that it will buy natural gas from Venezuela and perhaps it would take part in the construction of a gas liquefying plan in Venezuela. Galp explained in a written statement send to regulating entities that it has plans to acquire up to 2,0 billion cubic meters of liquefied natural gas a year from PDVSA. The price has yet to be negotiated.

**El Tablazo Complex with ethane gas shortages.** The Ministry of Energy and Petroleum issued a resolution which orders replacing the ethane gas being sent to the Petrochemical Complex Ana María Campos (former El Tablazo) with propane gas, a measure that aims to overcoming the gas shortages faced by this Complex.

**Mixed company model will be applied to the gas sector.** According to Rafael Ramírez, Minister of Energy and Petroleum, the mixed company model with the State as majority stockholder will be imposed through the Hydrocarbon and Gas Hydrocarbon Organic Laws, which are being reformed. According to the reforms, hydrocarbon commercialization is to be unified, so that gas won't be able to be sold separately by each individual mixed company.

**Petrobras out of the Mariscal Sucre project.** Petrobras' CEO, José Sergio Gabrielli, announced that the Brazilian oil company will not invest in the national gas project. The company decided to drop out of the project because it considers it to be unattractive.

**Ecuador returns to the OPEC.** "Ecuador returns to the OPEC because: we believe that our return strengthens the Organization and because we expect this will be a favorable venue for information exchange, cooperation and the exchange of good practices and experiences in the oil industry," pointed out Ecuador's Minister of Energy and Mining, Galo Chiriboga. Brazil informed that it is also interested in becoming a member of the OPEC.

**PDVSA is reviewing its foreign assets.** PDVSA, with a view to streamlining its operations, is conducting an assessment and optimization process of the assets it holds abroad, announced the minister of Energy and Petroleum, Rafael Ramírez, in a statement.

## BUSINESS SECTOR TIPS

**Shopping malls expanding.** According to Arnold Moreno, chairman of the Venezuelan Chamber of Shopping Malls (Cavececo), sales have increased by almost 30%. Based on their estimates, between 2006 and 2008, 20,000 new outlets and businesses will open in shopping malls throughout the country.

**The Government approved an exceptional plan for food supply.** The Government approved the "V Exceptional Plan for Social and Economic Development to supply basic foods and raw materials for the production of basic foods and other agricultural and food products." The information was published in the *Gaceta Oficial* No. 38,811. The Plan calls for spending more than VEB4.4 trillion to buy 1,137,800 mt of agricultural products over a maximum period of 180 days, as well as packing material, which would be distributed by Mercal.

**Ministry of Food thinks food production should be increased.** Minister of Food, General Rafael Oropeza, stated that he has verified that a number of food products are scarce in private businesses and that he doesn't know if this is due to political or administrative problems, either intentional or not. Therefore, he urged the industrial and agro-industrial sector to increase production to meet domestic demand. The industry denied this information.

**Production of precooked flour is up.** Nicolás Constantino, chairman of the Venezuelan Association of Corn Producers (Venmaíz) pointed out that the production of corn flour is completely normal and that it even increased by 8% in comparison to year 2006.

**Parmalat's sale is closed.** After two years of negotiations, Parmalat de Venezuela finally sold its plant located in Machiques, state of Zulia, to the Ministry of Light Industries and Commerce (MILCO). The Corporation of Intermediate Industries of Venezuela S.A. (Corpivensa) will administer the plant. Parmalat will continue to operate with the five plants it has lefts in the states of Barinas, Mérida, Carabobo, Falcón, and Bolívar.

**Spanish investment goes up.** The Spanish investment in Venezuela exceeds EUR1.7 billion (around US\$2,500 billion) and is mainly focused on bank, energy, hotel, and editorial sectors. Spanish businesses with mayor holdings in Venezuela are BBVA, Banco Santander, Repsol YPF, Movistar, Sol Meliá, Iberia, Air Europa, Mapfre,

Prisa, Inditex, and Elecnor. These businesses are the ones that have invested the most in recent years, according to data issued by the Spain Trade Office in Caracas.

**Colombia's exports to Venezuela jump 76.8%.** The 15.5% growth of Colombian exports, registered between January and August this year, was driven mainly by Venezuelan consumer dynamics. Colombian sales to Venezuela jumped by 76.8% during that period, mainly due to the increase in vehicle and parts exports.

**CONATEL anticipates a strong increase in cell phone market penetration.** CONATEL estimates show that cell phone market penetration in Venezuela will exceed 100% over the next two years. This indicator is now at 80.4%.

**The Government promotes free software.** The 24-month period provided for in Decree No. 3,390 expired on October 17<sup>th</sup>. This period was granted by the Presidency of the Republic to establish as a priority the use of free software in all governmental agencies. According to the National Center for Information Technology, around 65% of the servers in public entities have been migrated to free software, although only 6.21% of the public workers have been trained to use this technology. The minister for Telecommunications and Information Technology, Jesse Chacón, assured that the Government of Venezuela has no intention of investing a single bolivar more in proprietary software.

**Offer of real state properties for rent has dropped 40%.** The offer of real state for rent in the country has dropped almost 40% over the last four years, informed Luis Emilio Vegas, chairman of the Real State Chamber of Venezuela (CIV).

**Rents are still frozen.** The People's Power Ministries for Light Industries and Commerce, Infrastructure, and Housing and Habitat extended for another six months the freeze on rents fixed for properties used for housing and mixed-use properties used for housing purposes, at the levels they had on November 30, 2002. Since this is considered a staple service, housing rents have been frozen since April 8, 2003.

**CANTV workers will organize themselves in cooperatives.** CANTV announced that hundreds of its workers will organize in association schemes based on solidarity principles, such as cooperatives, social production companies, social property companies, among others, from where they will be suppliers of the state-owned telephone company.

**Tourism loans are up.** Bank loans for tourism sector posted an 18% increase by the end of October this year, according to the last SUDEBAN report. Total placements in tourism sector were at VEB1.4 trillion on the tenth month analyzed. According to the

report, these placements account for 2.2% of the total gross loan portfolio as of December 31, 2006.

**MINFRA to invest in mass transportation.** The National Government will invest more than VEB877 billion in the construction of mass transportation systems during 2008 fiscal year. The largest part of the resources will be earmarked for different subway systems.

## Political Tips

**ILO condemns the Venezuelan Government.** The International Labor Organization (ILO) condemned the actions of the Venezuelan Government, because they violet businessmen's rights. The ILO also asked the Government to suspend the arrest warrant issued against the former FEDECÁMARAS chairman, Carlos Fernández, and to lift the prohibition against Albis Muñoz, former vice-chairwoman of the organization, to travel abroad.

**Labor ministry will submit a formal complaint before the ILO.** Labor and Social Security Ministry will submit a formal complaint before the International Labor Organization (ILO) next Monday, due to the statement by the Organization questioning the union process being advanced in Venezuela.

**Legal security indispensable for Spanish businessmen in Venezuela.** The clash between the King of Spain and the Venezuelan head of State, along with Chávez's public remarks concerning Spanish investments in Venezuela, has given rise to concern in this Venezuelan business sector. Red Eléctrica Española (REE) CEO, Luis Atienza, pointed out that legal security is "fundamental" for companies investing in infrastructure in third-party countries, in reference to the Venezuelan president, Hugo Chávez's warning directed to Spanish companies.

**Monetary conversion and constitutional reform proposal contradict each other.** The constitutional reform proposal and monetary conversion are Government's initiatives that contradict each other. The enforcement of one of them weakens the other, explained the economist Francisco Vivancos concerning, specifically, the National Constitution enforcement if the reform proposal is approved.

**AN will investigate Catholic schools for alleged attacks against the reform project.** The plenary session of the National Assembly instructed the Interior Policy and Education committees to investigate catholic schools throughout the country, based on reports that they would be urging their students to reject the constitutional reform project.

**Chávez starts tour before the referendum.** President Hugo Chávez started a tour through several countries, France among them, where he will hold talks about the humanitarian exchange in Colombia, amid its recent encounter with Spain and the constitutional reform campaign.

**Mercanálisis reports an increase in the No vote trend.** Regardless of the voting intention, the option against the reform proposal will impose itself in the constitutional referendum. This is the conclusion drawn by Mercanálisis, which thinks that the NO block is supported by 58% of the voters, whereas the YES block capitalizes 37% support by the Venezuelan people.

**Request for stay based on reform unconstitutionality.** Lawyer Carlos Ayala Corao, on behalf of Foro por la Vida, submitted before the TSJ Constitutional Chamber a popular action requesting a stay based on unconstitutionality of the constitutional reform proposed by President Chávez and the National Assembly.

## Other Tips

**US\$80 million in donations for Bolivia.** In an interview published by the Bolivian newspaper *La Prensa*, the Minister of Finance of Bolivia, Luis Arce, stated that donations from the Venezuelan Government amount to around US\$80 million. The Bolivian opposition protests against the lack of transparency surrounding these donations.

**Venezuela builds hospital in Nicaragua.** The Venezuelan Government is building a medical diagnosis center worth US\$2.4 billion in Nicaragua.

**Venezuela invests US\$250 million in energy plant in Nicaragua.** Francisco López, CEO of Nicaragua's state-owned company Petróleos de Nicaragua (Petronic) announced that Venezuela will invest US\$250 million in Nicaragua starting from next

## ***Weekly Report***

year to build the first stage of a refinery, a petrochemical plant and social interest housing units.

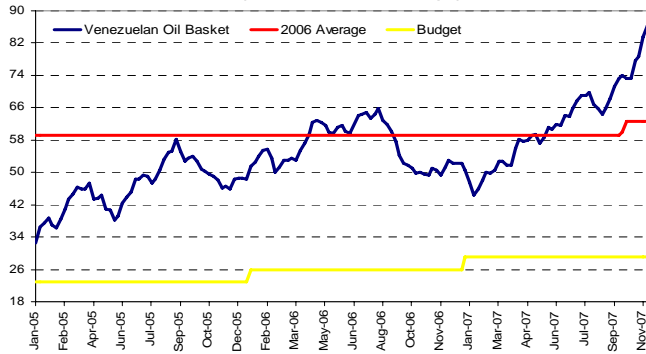
**Milk shortages in Belarus.** The authoritarian Belarusian President considers that guaranteeing the supply of cheap powder milk and infant formula to the people is a priority; but this product has been lacking from the supermarkets' shelves in that country. Consumers blame President Chávez for the situation.

**CAF is operating with Mexican pesos.** As part of a strategy aimed at having resources available to assist Mexican customers, especially the micro finances sector, the Andean Development Corporation (CAF) signed a credit agreement with BBVA de México for 100 million Mexican pesos.

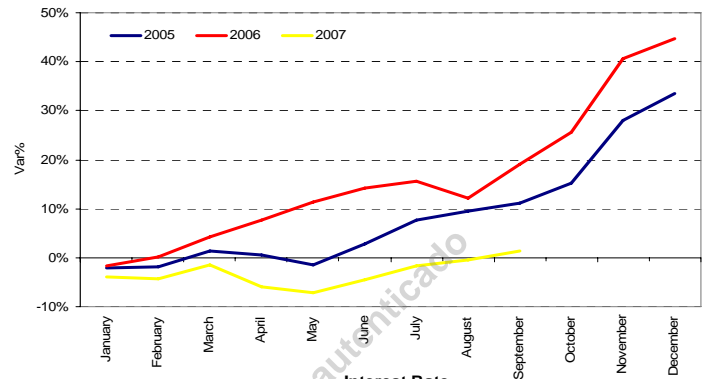
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## ECONOMIC OVERVIEW

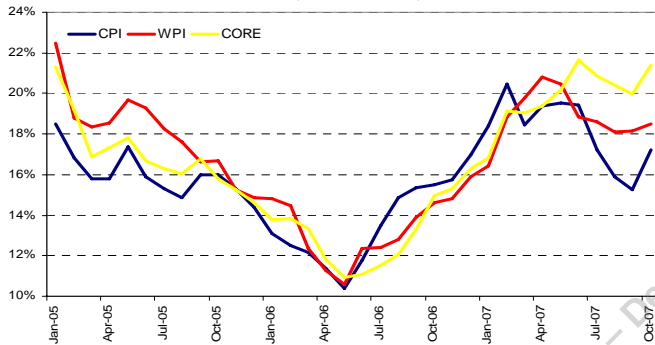
**Oil Price**  
(Venezuelan Basket US\$/pb)



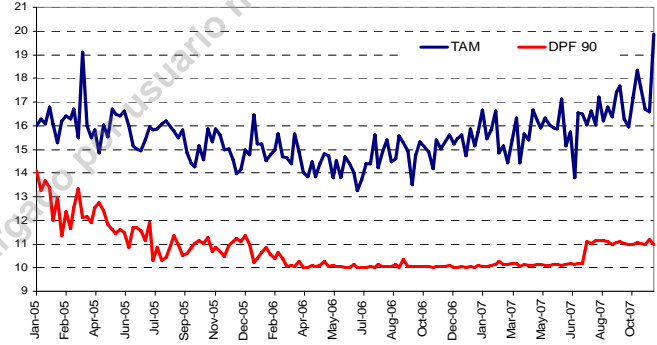
**Real Expansion (M2)**



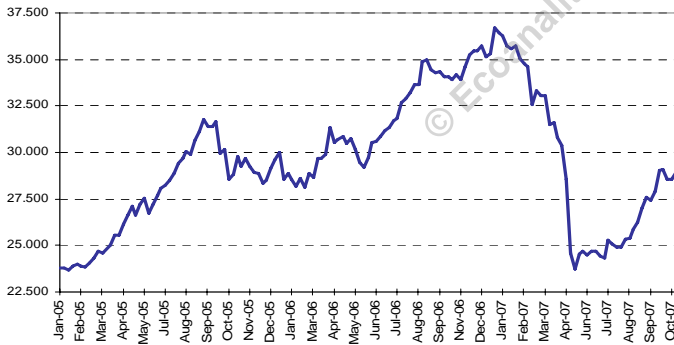
**Inflation**  
(Last 12 Months)



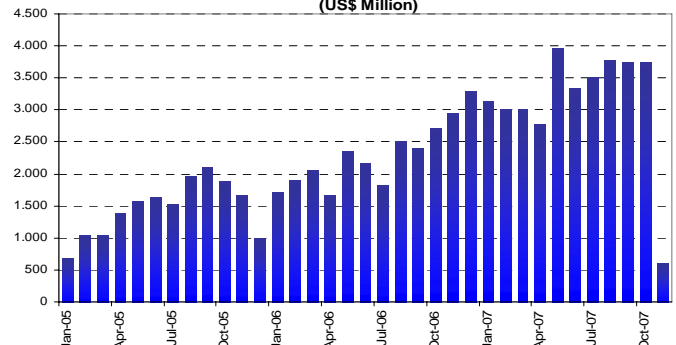
**Interest Rate**  
(Six Principal Banks)



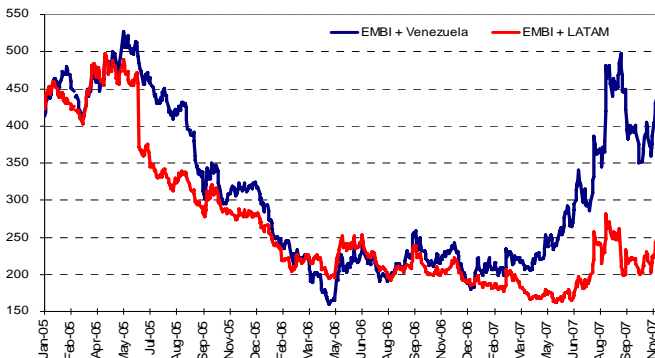
**Fx Reserves - BCV**  
(US\$ Million)



**Disbursement**  
(US\$ Million)



**EMBI**



**Central Government**  
(VEB Billion)

