



# Weekly Report

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***AND OUR COMPETITIVENESS  
WON'T GET BETTER***

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In this Report, we will present an update to our Exchange Rate model which allows us to monitor and predict how price and cost of domestic items will evolve taking into consideration the impact of foreign prices measured through the exchange rate. In this way, the exchange rate can be used to measure the country's competitiveness.

In Venezuela's case, the Administration's decision to anchor the official exchange rate has produced a very significant over-valuation of the local currency which has severely affected out competitiveness with our main trade partners.

**What are we  
talking about?**

When we say that the exchange rate is appreciating, we are referring to the fact that domestic prices are increasing at a greater rate than the exchange rate which means that the local currency buys more goods and services abroad than locally. This makes Venezuela's exports less competitive and creates incentives to import. And, if the exchange rate were to depreciate,



then goods and services in the domestic economy become cheaper than abroad and our exports become more attractive and competitive.

The degree of overvaluation or undervaluation of our currency can be measured through an exchange rate index. Since we want to know how competitive we are concerning the production of tradable goods, the logical step consists of relating our currency with the ones in the countries that are our most important trade partners. Therefore, we at **Ecoanalítica** have updated our exchange rate index with respect to US-dollar, the Colombian peso and the Brazilian real, using the average between 1990 and 1993.

**How to read this indicator?**

An exchange rate index over 100 means that the currency is undervalued and therefore, the purchasing power is higher within the country than abroad. And, if RER is below 100, we can say that local currency is overvalued; meaning that purchasing power abroad is higher than at the local level.

**This is not a new problem**

If we only take the U.S. economy into consideration, our inflation compared to the U.S. the index is below 100 for most of the period in question, in other words, the purchasing power of the Venezuelan bolivar is greater in the U.S. than it is domestically. This creates great incentives to import.

**The figures say the exchange control is not sustainable**

The exchange rate control, which has been in force over the last six years, has increased bolivar's appreciation, which is reflected in the decrease in exchange index. In fact, our estimates show that, only considering the US economy, exchange rate that would compensate for overvaluation levels for the month of May is VEF 5.55 per dollar. This implies that there is a wide gap between the official exchange rate and its implicit value; this translates into a 158% difference, which is the same as a 61% devaluation of the currency.

However, as we have pointed out before, although the economy's behavior shows us that the exchange control should be lifted in the short term, the Government has little incentive to do that, because it can use the exchange control as a tool for political manipulation.

**The situation with Colombia isn't so serious**

Repeating the same exercise with the Colombian peso, we observed that the exchange rate index is also below 100, although in a lesser degree than with respect to the US dollar. This shows that the official exchange rate is overvalued by 44.8%. This results in an implicit exchange rate with



Colombia of VEF 3.9 per dollar. This value, although it's higher than the official exchange rate, shows us that Venezuelan exports have become less competitive vis-à-vis its second trade partner, although never at the same levels as those reached with the US economy.

Moreover, perhaps due to this fall in competitiveness, our exports toward Colombia have systematically dropped over the last years, whereas our imports from that country have multiplied. This has resulted in an increasingly negative trade balance between Colombia and Venezuela.

### **Things don't look much better with Brazil**

The exchange index with Brazil reflects an implicit exchange rate projected for the month of May equivalent to VEF 4.5 per dollar. This means a 52% over-valuation with respect to the current official exchange rate. In other words, in this case we have a "cheap" exchange rate, so that production costs in the Brazilian industry, measured in dollars, are lower than those in Venezuela, which favors the exports of that country.

However, we have to highlight that our non-oil exports are really low, and they account for 8% of total exports, on average. Furthermore, the situation with Brazil is analogous to that with Colombia: restrictions in the domestic productive sector, related to administrative obstacles or the lack of legal security, determine a clear deterioration of our trade balance with that country.

This becomes a vicious circle because the limited domestic supply of goods makes it necessary to cover consumers' needs with an increasingly larger volume of imports. When this demand can't be met, the economic activity of the non-oil sector will be severely affected.

### **What does the index say...**

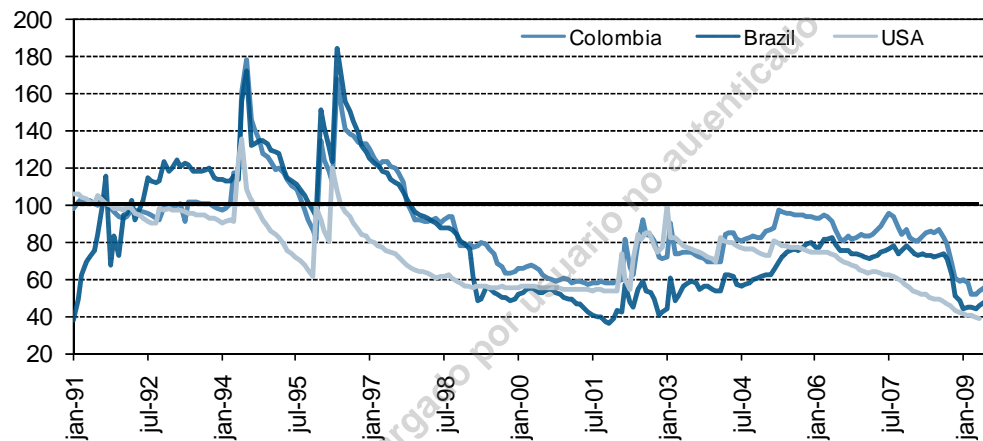
Up until now we have analyzed each case separately. However, the proper procedure is to determine, based on this simple exchange rate model, which is the exchange rate that we should have today, considering our three major trade partners. Therefore, the implicit exchange rate should be VEF 5.0 per dollar, i.e. 132% higher than the official exchange rate. It's important to stress that the current parallel rate has been trading at levels much higher than this.

As the table graph shows, Venezuela's exchange rate control has always had a tendency to over-value the currency, which is to say that we have a "cheap" exchange rate (appreciated), significantly below the balanced value



which increases its purchasing power abroad favoring imports. This tendency has been strengthened during the last few years and it is a direct effect of our dependency on oil.

**Real Exchange Rate Index  
1990-93 = 100**



Sources: BCV, IMF and Ecoanalítica

**Exchange controls subject to pressures**

Some analysts (especially financial analysts) use the relationship between monetary liquidity divided by international reserves to estimate what the implicit exchange rate should be and to determine the economy's vulnerability of the foreign market. Starting with this figure to determine the range of the exchange rate, we use the international reserves, which are at US\$29.30 billion, and the sum of the reserves and extraordinary funds (only those which are kept in foreign currency). In the first case, the implicit exchange rate for the close of May is at VEF 7.2 per dollar, but if we include the extraordinary funds, then the indicator drops to VEF 4.3 per dollar. We would like to point out that we are not saying that the exchange rate should necessarily be between this range, our point is to show that both figures are significantly higher than the official exchange rate, and that both are indicators of how vulnerable the foreign sector is and confirms how unsustainable the current exchange control is over time.

**Coverage operations are still the rule of the day**

Despite the fact that the parallel-market rate is still higher than our exchange rate index, considering CADIVI's increased restrictions and lower oil prices (compared to 2008 average prices), parallel-market rates should remain at current levels for the next few months, and close the year out at



higher levels. Therefore, we advise our clients to take into account these considerations when designing their coverage strategies.

## Economic Tips

**PDVSA's Bond Issue Part II.** The new issue of PDVSA's Bonds for a whole estimated of US\$3 billion, according to diverse sources, the papers will be constructed to zero coupon, that is to say, the yields will be cancelled to the maturity, and it estimates that the above mentioned rate is 7.5% per year, plus a unique commission of one percent point, additional to the 0.25 % of the managing by part of the entity. In addition, they will be able to be acquired in bolivars but it's denomination will be in US dollars, the maturity possibly will be ruled for the year 2011 and they will be distributed and negotiated "only" on the domestic market across the banking and investment entities, in consequence the PDVSA's Bond curve won't be affected because the international bond supply of this Bonds didn't increase.

**Unemployment remained steady in May 2009.** The National Statistics Institute (INE) released the May unemployment figures which were at 7.7% up by 70 basic points compared to May 2008, and remained the same compared to the previous month. The informal sector showed a slight increase with April figures showing it being at 42.8% while May figures are at 44.9%. The INE estimates that approximately 6.55 million people are working in the informal sector.

**Venezuela and Ecuador create a compensation mechanism.** The governments of Venezuela and Ecuador have created a bilateral mechanism for the compensation of payments in order to streamline trade operations. The mechanism cuts down on the flow of foreign currency between both countries.

**Oil price increase plays a part in lowering country risk.** Gabriel Osío, president of the Venezuelan Association for Brokerage Houses (AVCAB) said that the increase in price in the Venezuelan oil basket increased the price of Venezuelan public foreign debt and also played a part in lowering Venezuela's country risk. With respect to Venezuela's country risk, it has been improving during the last few months, citing as an example the increase in price in the trading of Venezuelan bonds.





**International Reserves.** International reserves increased by 1.8% going from US\$29.25 billion at the close of the second week in June to US\$29.78 billion at the close of the third week of the same month. This increase in international reserves comes at a time when PDVSA is planning to issue bonds.

**Monetary liquidity.** Monetary liquidity for the second month in June increased by 0.3% compared to the first week in June settling at VEF 203.57 billion. So far this year liquidity has increased by 4.8%, and compared to the same period last year it has increased by 33.1%.

**Interest rates.** Lending interest rates for the second week in June were at 23.08%, up by 98 basis points compared to the previous week. Time deposits and savings accounts rates were at 14.5% and 12.5% respectively, down by 148 and 125 respectively compared to the previous week. This increase occurs in a moment that we are waiting for the PDVSA emission.

## Oil Tips

**No decree, no indemnification.** Almost 2 months after PDVSA took control of 74 companies affected by the Law that Reserves for the State all Goods and Services Related to Hydrocarbons' Primary Activities, the Administration has not proclaimed the expropriations in the Law of Expropriation due to Public or Social Usefulness, reason why expropriation has stopped and indemnifications for the expropriated assets have been delayed. Sources state that PDVSA, along with representatives of the Oil Chamber, has already analyzed the procedure that will be used for the appraisal of said assets.

**PDVSA proposes to create a mixed company with PETROPAR.** The Paraguayan oil company has over due liabilities for approximately US\$280 million due to shipments made by the Venezuelan State company. Even though they have advanced in the refinancing process, PDVSA proposes the creation of a mixed company with which projects such as the modernization of a refinery plant, the installation of a storage plant, the installation of at least 25 gas stations throughout the country and even evaluating the possibility of having Venezuela perform explorations in Paraguay will be promoted.

**The lack of investment in oil fields will affect future production.** According to Fernando Travieso, an Advisor for the Venezuelan National Assembly's Energy and



Mine Committee, the low price of crude oil will affect worldwide investments in exploration and production, which, in the long term, could block supply. He predicts that a price of US\$70 per barrel is not enough to make such investments, estimating that (despite the impact being negative for the world's economy) a price of US\$100 per barrel is required to promote investment projects and avoid world shortage.

**Additionally...** Travieso said that, in spite of the prices recorded up to the first half of 2008, for every 5 barrels consumed in the world, only one is discovered, and, to complement that, the drop due to natural exhaustion of conventional (light and medium) oil fields in the world is of 4 million barrels a day (Mbd) per year, and out of the 84 Mbd produced worldwide, about 76 Mbd are conventional crude oil, while the rest is non-conventional crude oil (extra-heavy, from deep waters and polar areas) mostly found in the Orinoco Strip reserves, which grew 50%, according to a 2008 administration report

**Exports to “Strategic” markets increase.** In order to diversify exports, crude oil placement in Asian countries increased 73% between 2007 and 2008. Regardless of the fact that this process is not in response to a commercial logic towards maximizing the State's rent, this numbers reveal a progressive reorientation of exports to geopolitically strategic markets for the Government, such as China, Vietnam, India and Japan. Sales in South America, Central America and the Caribbean increased in 33%, 11% and 10% respectively, related to the same period. It is important to point out that all the crude oil placed in these regions has preferential financing conditions, which is why in *Ecoanalítica* we consider necessary to evaluate the effectiveness of this policy.

**In contrast, exports to “Traditional” countries decrease.** PDVSA's traditional market, basically U.S.A and Europe, is showing a tendency to decrease in the administrative report of 2008 presented by the state's oil company a few days ago. Sales to North America, which includes the U.S.A. and Canada, decreased in 10% versus 2007, making Venezuela drop from second to fourth place as an oil provider for the U.S. In the case of Europe, the drop is even higher, reporting a decrease of 15% versus last year.

**PDVSA's influence in the Caribbean increases** with the acquisition of 49% of Refinería Dominicana de Petróleo (REFIDOMISA) for US\$130 million. Last year (50% of the stock) was bought by the Dominican government to Shell Company for US\$110 million. The plant, with a current refining capacity of 34,000 barrels per day, represents another step for PDVSA in its urge to increase refinery capacity both in a national and international scale (especially in the Caribbean, where the state's oil company



operates Isla de Curazao refinery and has a 49% share of Camilo Cienfuegos refinery, in Cuba, and 49% of PETROJAM, in Jamaica) which decreased 4.4% in 2008 versus 2007.

**“Refining” is now the premise.** The structural transformation of PDVSA’s businesses seems to be aligned with its export policies. As the number of refineries in the U.S. decreased, the construction of three refineries in China with a processing capacity of 800,000 b/d was settled. Likewise, PDVSA is planning to open refineries in Syria, Vietnam, Haiti, Nicaragua, Cuba, Ecuador, Paraguay, Brazil and Uruguay, adding up to a processing capacity of approximately 1,300,000 b/d, including expansions in Cuba and Jamaica. Refineries will be built in the national territory in Guarico (400,000 b/d), Barinas (60,000 b/d), Monagas (50,000 b/d) and Zulia (200,000 b/d). These projects will increase PDVSA’s production in 2.9 million b/d.

**A Law for the Development of Petrochemical Activities is in effect.** In the Official Gazette N° 39,203 of June 18 was made effective the Organic Law for the Development of Petrochemical Activities. As for the reservation of petrochemical activity to the State, it will be directly exercised by the National Executive through state companies or mixed companies in which the state has decision control and a participation of no less than 50% of the stock capital. Said law also allows the creation of special areas to attract private partners in economic, tax, scientific and technological matters, to which the Executive will be able to grant any benefits it might deem necessary.

**Crude oil price pickups retained.** Oil prices closed at a low on the third week of June in the international markets. WTI closed at US\$72.04 per barrel (pb), dropping US\$2.02. Brent lost US\$2.48 to close the week at US\$69.32 pb. At the beginning of the week, prices were US\$67.50 pb for the WTI and US\$66.98 pb for the Brent.

**Venezuelan oil market had a slight increase.** According to a report by the Ministry of Energy and Oil, the oil price went up US\$0.57, closing the third week of the month at US\$64.58 dpb versus the previous week’s US\$64.01 pb, raising the annual average to US\$45.16 pb.





## Business Sector Tips

**April was the month with the least number of liquidations since 2006.** Such a low level of liquidations (US\$1.791 million) had not been seen since two years ago (April of 2006), 56.4% less than April of 2008, and the total accumulated from January to April (CADIVI's last updated data) is 40.9% lower than the same period of 2008.

**The effects of this drop are not felt yet.** According to the National Institute of Statistics' import data, total imports increased 5.3% between January and April of the current year, compared to the same period of 2008. The only sectors affected so far have been food, drink and tobacco industries, with -6.3% and transportation materials with 33.9%, in inter-annual terms. The transportation materials sector includes auto-parts, and we already know the first consequences (GMV).

**¿What is going to happen with CADIVI?** The BCV's current president, Nelson Merentes proposes for the foreign currency administration to become a dependency of the BCV, a measure we find coherent since it could eliminate a great deal of bureaucratic and discretionary ways that characterize this organization, but we don't think it is very probable, since it would limit the Executive to distribute Petro-dollars.

**General Motors freeze assembly in Venezuela.** Since June 22, GMV froze activities without a reactivation date, but the company will remain closed at least until mid-September as long as CADIVI liquidates the necessary foreign currency on time. According to statements by the company's representatives, CADIVI is late in currency liquidation since 290 days ago, so GMV has a debt of US\$1,200 million with its international providers, to whom they haven't paid since approximately 4 months ago, for which their credit lines have been cancelled, so they are forced to freeze operations due to a shortage of auto-parts.

**The impact of closing.** GMV has 4,000 direct employees in its two plants in Carabobo state; it generates 60,000 indirect jobs through 254 national providers, and another 10,000 employees in its 77 dealers. We hope the government can solve this problem promptly, before national providers begin to go out of Business for losing income from sales to GMV for several months. GMV assembles more than 50% of Vehicles assembled in Venezuela, so its absence will have a strong negative impact on the national motor-vehicle market





**The Government says it is not CADIVI's fault, but that of GM's bankruptcy.** The Government says GMV's closing is not due to a lack of currency, but due to its headquarters' bankruptcy statement.

**Bolivarian unions are against the elimination of the CPI.** Representatives of the Construction Workers Sole Union (SUTIC) asked to debate with Minister Cabello and with the President about the elimination of the indexation of real estate payments to the CPI, since, as we had mentioned, generates even more uncertainty about construction companies' future income. According to SUTIC, every new home unit under construction generates an average of 4 direct Jobs, so by cancelling a substantial proportion of 120,000 projects programmed by the private sector, an important number of jobs would be lost.

**The Government also plans to regulate the price of used homes.** There are plans to establish a minimum and maximum price per square meter of construction for each zone of the Caracas Metropolitan Area.

**Delinquent payments increased in May.** SUDEBAN informed that the national financial system's delinquent payment rates went up from 2.50% to 2.58%, from April to May, credit intermediation (quotient between funds loaned and funds captured by the financial system) decreased to 56.54% from 57.07%, while the same month of last year it was on 62.27%; this added to an increase in the investment in securities being bigger than the credit portfolio (8.59% vs 1.22%) and an increase in the capitalization index from 9.90% to 10.14% (higher than the mandatory requirement, 8%), indicates an increase in the aversion to risk by the financial system, a result of the economy's deceleration that has as consequence, among other factors, an increase in arrears.

**Oil-contractor expropriations affect the income of municipalities in the Lake's East Coast.** Now that the Maracaibo Lake's East Coast contractors belong to the public sector, they are exempt from paying duties, so the area's municipalities' income is seriously decreased. These municipalities include Lagunillas and Simon Bolívar, with a total income decrease of 70% and 40% respectively. The mayor's office of the Simon Bolivar municipality estimates the commercial activity also decreased between 70% and 80%.

**The sale of tour packages to foreign countries has dropped 50%** versus the same vacation period of last year, and the country's hotel occupation is estimated to drop in 10 to 15%. This drastic drop of international tourism is due to several reasons: The fear of AH1N1 influenza, the reduction of CADIVI's currency allocation and the increase of bureaucratic paperwork necessary to receive the allocation.



## World Crisis Tips

**World Bank cuts down its world growth forecast.** The World Bank cut down its world growth forecast from -1.7% to -2.9% for the current year. This change in the prediction coming from this important international organization had a strong negative impact on world markets (including oil) this week. It's important to remember that markets tend to overreact and that they will most probably stabilize in a few days.

**World stock markets are affected.** The world's most important stock markets went down between 2% and 3% last Monday after the World Bank's announcement. Wall Street's three main indicators, Dow Jones, S&P500 and NASDAQ dropped 235, 306 and 335 basic points, respectively. Meanwhile, the price of United States Treasury Bills went up 1.23%.

**U.S. Sales of used homes increase.** Sales of used homes increased for the second consecutive month, 2.4% in May versus April, it is still 3.6% lower than sales 12 months ago; supply of non-sold houses decreased in 3.5%; the recovery is less than the market's expectations, but it is still a positive sign of the future recovery of the real estate market.

**U.S. Debt is still triple A according to Moody's rating.** The risk of the American debt is still almost none for the qualifier Moody. Its recent confirmation of a higher rating indicates that it will probably not be changed in the short-term; but the qualifier states that this rating is not guaranteed forever, unless the U.S. Government proves in the mid-term that it is capable of reducing the debt level to its previous long-term trend.

**In the UK May's new mortgages were 7% higher than April's.** 31,162 home loans were approved in the United Kingdom in May, 7% more than in April, the highest number of approvals in the last 13 months; the low interest rates encourage the demand of homes, but a higher risk aversion of the banking system kept the data from being more positive. It is estimated that in the same month, 16,000 mortgage applications were rejected in the United Kingdom, whereas the average in December was of 12,000 rejections.

**Spain needs a labor reform:** As we have mentioned in previous reports, Spain has the European's highest unemployment rate (18.1%), this extremely high number is a result of the institutions governing this country's labor market, that make the real salary too rigid and not adjusted to the economic conditions, they also make layoffs too



expensive and pays an unemployment insurance that is too high and without enough regulations. This is why the president of the BCE and the president of Banco Español asked President Zapatero to make a labor reform now, but Zapatero answered: "It is not in this government's agenda to make layoffs less expensive or to make reforms to restrict labor rights".

## Political Tips

**The creation of a Law to regulate cable and satellite TV was ruled out.** The president of the National Assembly's Media Committee, Manuel Villalba, informed that a new Law regulating cable and satellite TV will not be created. Villalba also stated that any planned modification shall be done through a reform of the current Telecommunications Law.

**The Supreme Justice Tribunal (TSJ) is subject to an international courts' decisions.** Pedro Nikken, former president of the Inter-American Court of Human Rights stated that foreign tribunals should not be mistaken for international tribunals, since a foreign tribunal belongs to another country and an international tribunal is not within the jurisdiction of a particular country. That is why the decisions of foreign tribunals have no impact on Venezuela, but international tribunals with legitimately accepted jurisdiction do have an impact.

**MERCOSUR summit was postponed until late July.** The Mercosur presidential summit originally planned for July 3 and 4 could be postponed until later in July due to a series of commitments still pending by member country representatives, said the Paraguayan foreign secretary last Friday. The meeting programmed to take place on the outskirts of Asuncion will gather the heads of state of Argentina, Brazil, Paraguay and Uruguay, as well as Venezuela, which is in the process of becoming a member. The Presidents of associated countries members Bolivia and Chile are also expected to attend.

**ILO adopts a world pact to channel employment policies facing today's crisis.** The International Labor Organization (ILO) adopted a world pact to orient policies to encourage economic recovery and to generate employment. The pact was presented and discussed during the World Labor Summit, celebrated as part of ILO's Annual Conference. According to this organization, the labor crisis could last between six and eight years, even if economic recovery were to start this coming year, especially if preventive measures are not taken now.



**Iraq requests Venezuela to reopen their embassy.** Iraqi authorities urged the Venezuelan Government to reopen their embassy in Bagdad, which remains closed since the American invasion of Iraq in March of 2003. The Iraqi vice-minister of foreign affairs, Abid Abawi, also requested Venezuela to increase investment in their country, as well as encouraging cooperation in several sectors, especially the industrial sector, and the reconstruction of Iraq.

**Elimination of the National Journalists' Association (CNP) proposed.** A group of pro-government journalists, among them the director of Radio Nacional, Helena Salcedo, submitted to the National Assembly's Media Committee a proposal to reform the Practicing Journalism Law. Among her proposals is the elimination of the National Journalists' Association (CNP), since this organization expired and has become commercialized. Salcedo expressed the need to create a new organization in which journalists are able to enroll only if they want to. Likewise, she proposes to reform articles 1, 4, 8, 40 of the Journalism Code of Ethics.

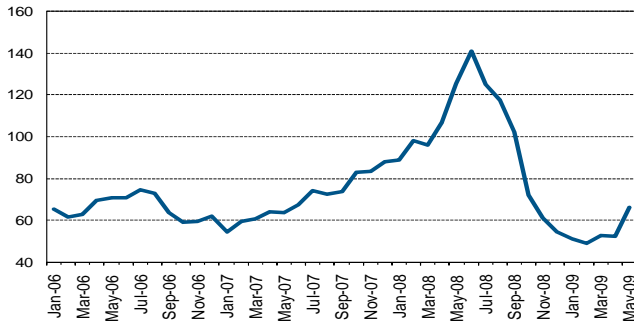
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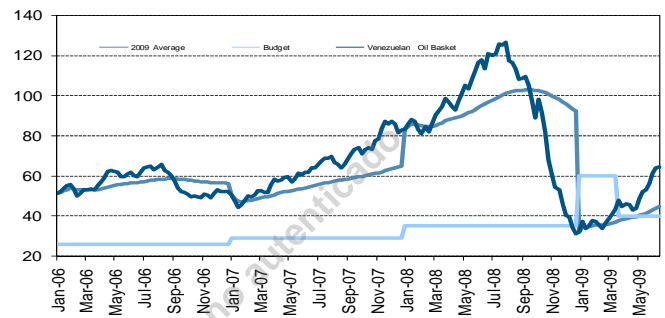


## ECONOMIC OVERVIEW

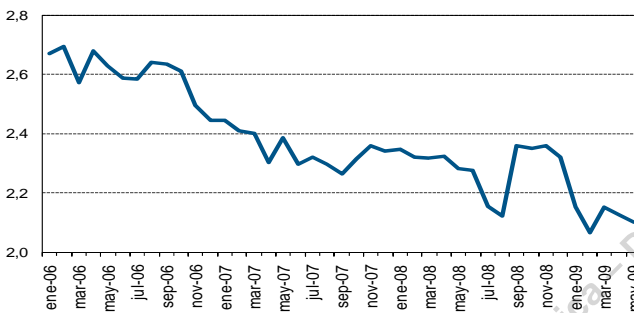
**Oil Prices (WTIUS\$pb)**



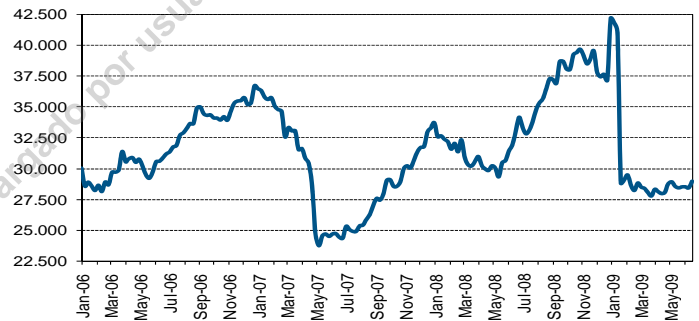
**Oil Price (Venezuelan Basket US\$/pb)**



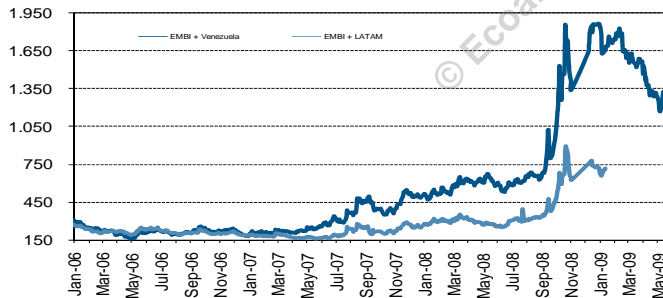
**Oil Production MMBD**



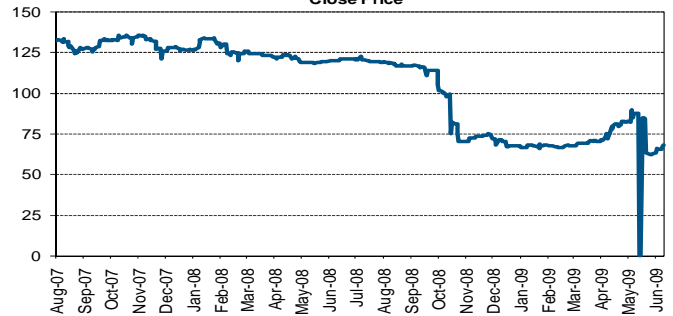
**Fx Reserves - BCV (US\$ Million)**



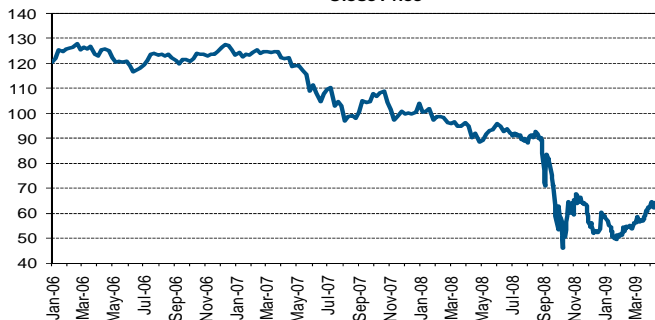
**EMBI +**



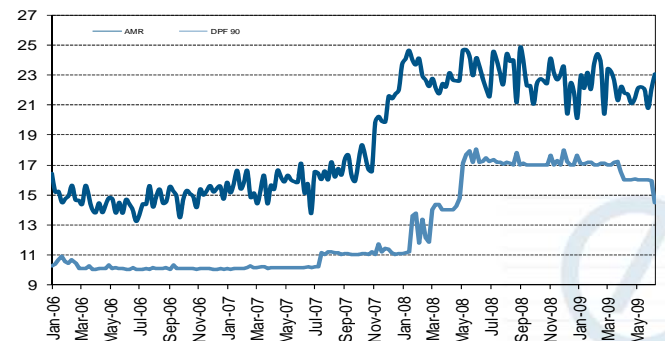
**Venezuelan Global 18 Close Price**



**Venezuelan Global 27 Close Price**

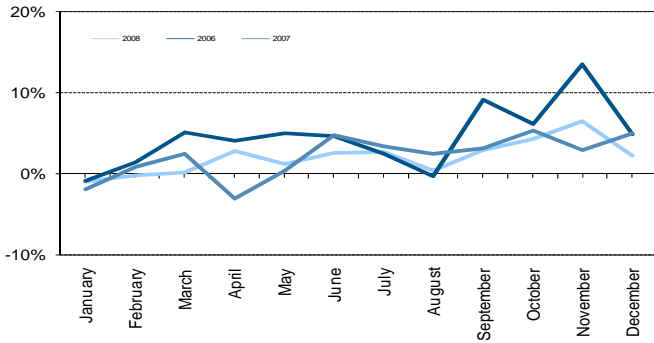


**Interest Rate (Six Principal Banks)**

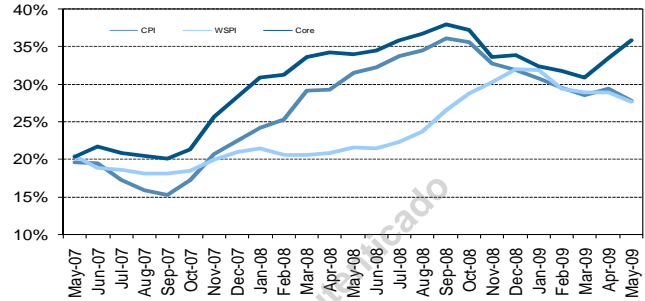




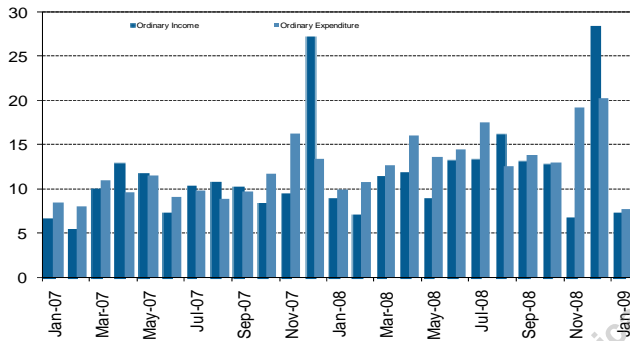
**Real Expansion (M2)**



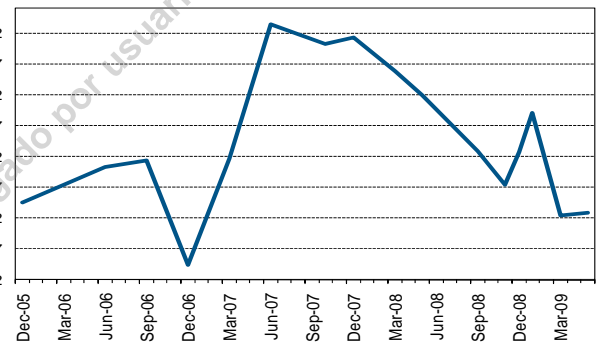
**Inflation (Last 12 Months)**



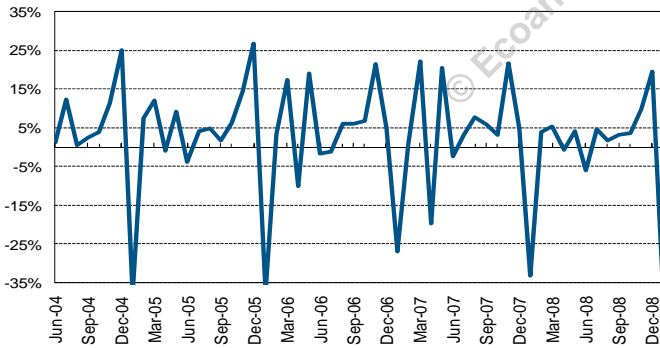
**Central Government (VEB Billion)**



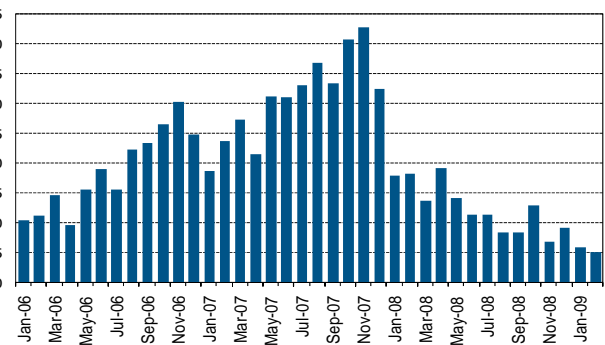
**Resources of the State (US \$ MM)**



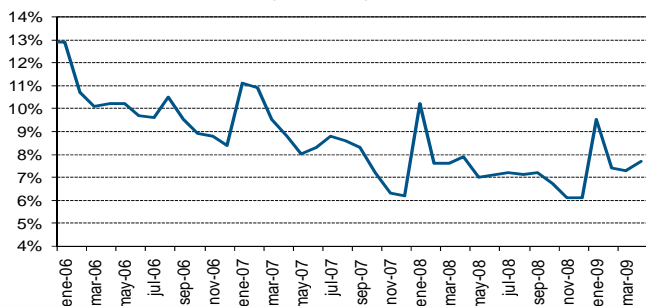
**Volume of Sales (% Variation)**



**Sale of Vehicles (Thousands of Sold Units)**



**Rate of unemployment (% Variation)**



**Disbursement (US\$ Million)**

