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## **FISCAL EXPANSION THAT IS ON THE WAY...**

**Edition:**  
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2008 first quarter fiscal management figures show that the Central Government is continuing to cut-back on spending. However, recent announcements made by President Chávez, as well as new Minister of Finance, Ali Rodríguez, make us believe that during the upcoming months Government spending will increase significantly. The Government has plenty of resources to do it with in extraordinary funds and rising oil prices.

### **The first quarter reflects a cut-back in sending**

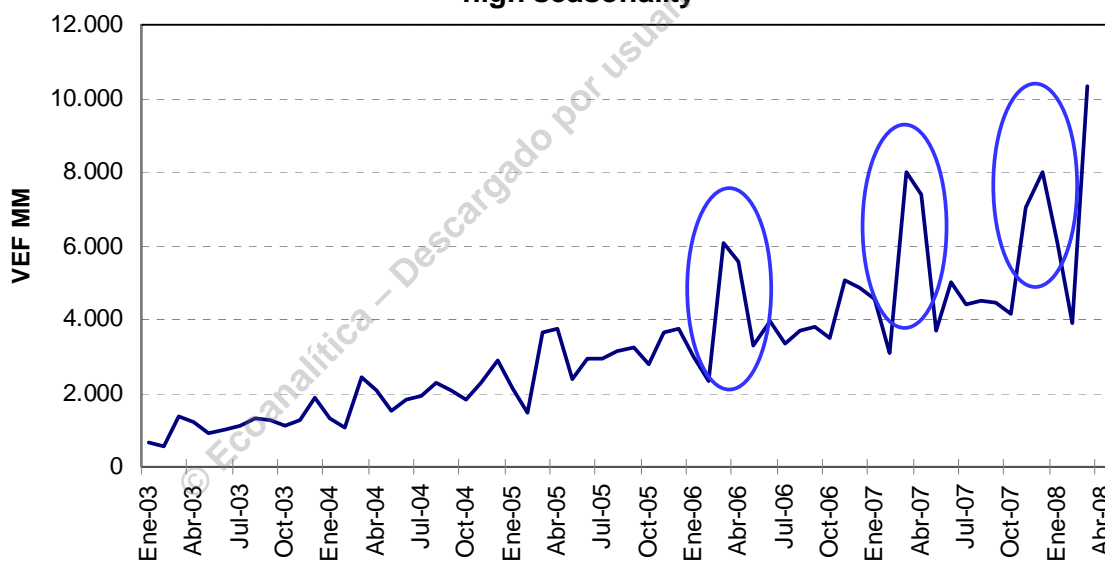
According to the figures released by the Central Bank of Venezuela (BCV), during the first quarter 2008, the Central Government's public spending was at VEF 33.31 billion, up by 21.5% compared to the first quarter of 2007, but reflecting a cut-back in real terms of 3.7%. So, up until now, the much heralded increase in public spending has not begun. It's important to point out that during the same period, fiscal revenues expanded in real terms by 9.9%, on a year-to-year basis.

# Weekly Report

## Significant impact of Financial Transaction Tax

The increase in revenues can be explained by the 26.1% real term increase in oil revenues. This suggests that the transfers PDVSA was making to the Treasury account in US-dollars (that don't go through the BCV) have become less frequent. On the other hand, SENIAT revenues only increased by 2.6% in real terms during the same period. This growth is very low and suggests that the SENIAT has not had a very easy time of it. At **Ecoanalítica**, we expect these hard times for the SENIAT to continue into the second semester, especially due to the elimination of the Financial Transaction Tax.

**The Non Oil income shows a high seasonality**



## A deficit that is not very worrying

At the close of the first quarter of the year, the Central Government's fiscal management reflects a deficit of VEF 2.23 billion (US\$ 1.04 billion), for which financing needs reached VEF 5.02 billion (US\$ 2.34 billion). Almost all of this was covered by other sources, which is the same as saying, that it reflected a drop in Government funds in the Treasury. Despite the fact that many analysts see the magnitude of this deficit as being significant, it doesn't reflect the total of the country's fiscal management.

## Weekly Report

This can be backed up by the fact that the Government has extraordinary accounts at its disposal and most of them are of extraordinary character, plus high oil prices guarantee that the Government will not get into any fiscal problems that it won't be able to manage.

<b>FISCAL BALANCE CENTRAL GOVERNMENT (VEF Millions)</b>	<b>January 2007</b>	<b>January 2006</b>	<b>Nominal Variation</b>	<b>January- January 2008</b>	<b>January- January 2007</b>	<b>Nominal Variation</b>	<b>Real Variation</b>
<b>Total Revenue</b>	12.651	10.170	24,4%	31.078	22.420	38,6%	9,9%
<b>Non-Oil Revenue</b>	8.177	6.336	29,1%	19.515	15.080	29,4%	2,6%
<b>Oil Revenue</b>	4.474	3.763	18,9%	11.563	7.268	59,1%	26,1%
<b>Total Expenditure</b>	12.673	10.938	15,9%	33.308	27.413	21,5%	-3,7%
<b>Primary Expenditure</b>	11.439	9.711	17,8%	30.871	25.165	22,7%	-2,8%
<b>Interest Payments</b>	1.234	1.227	0,6%	2.437	2.249	8,4%	-14,1%
<b>Domestic Debt</b>	219	348	-36,9%	757	872	-13,2%	-31,2%
<b>Foreign Debt</b>	1.014	879	15,4%	1.680	1.377	22,0%	-3,3%
<b>Fiscal Balance</b>	-22	-768		-2.231	-4.993		
<b>Primary Balance</b>	1.212	459		206	-2.745		
<b>Non Oil Balance</b>	-4.496	-4.602		-13.793	-12.333		
<b>Debt Amortization</b>	882	1.125		2.789	3.576		
<b>Net Monetary Injection</b>	4.364	3.224		14.903	12.908	15,5%	-8,5%
<b>Financing Requirements</b>	904	1.893		5.020	8.570		
<b>Foreign Debt</b>	5	11		23	14		
<b>Domestic Debt</b>	0	1.624		0	1.624		
<b>Tresury Bonds</b>	0	1.624		0	1.624		
<b>Tresury Debt</b>	0	0		0	0		
<b>Others</b>	899	258		4.997	6.931		

Sources: BCV y Ecoanalítica

### Fiscal spending accelerating

Though we don't have any official figures yet, fiscal spending has accelerated in the second quarter. According to our estimates, public spending during the second quarter was at VEF 45.21 billion, which translates to an average monthly sending of VEF 15.07 billion, in other words, 35.7% greater than what was spent during the first quarter of the year. So, up until the close of the first quarter, public spending was at 48%. These public spending figures are based on the budget being at VEF 161.40 billion. This level of spending is due to the supplemental figures authorized during the period since the original budget was set at VEF 137.50 billion.

## Weekly Report

### **The fiscal party begins during the second semester**

At *Ecoanalítica*, we believe that given the performance of oil prices, supplementary appropriations will continue and 2008 budget spending could increase to VEF 185.00 billion. This would make public spending for the second semester of the year be around VEF 106.48 billion, representing an increase of 35.6%. This is one of the reasons why the Administration's inflation goal for the year, recently ratified by the new Minister, set at 19.5% seems to be almost impossible to achieve. Plus, the Government doesn't have any plans to restructure its fiscal policies, focusing them on creating a strategy for controlling inflation.

### **What sectors are benefiting?**

According to information coming from the National Treasury, the Ministries that have most benefited from recent appropriations have been the Ministry of Interior and Justice and the Ministry of Finance, this is mostly due to the fact that these offices are the ones which are authorized to make the transfers to decentralized entities like the mayor's and governor's offices through constitutional revenue sharing, the Special Economic Assignment Law (LAEE), and the Intergovernmental Fund for Decentralization.

### **Typical fiscal spending for an election year**

Official sources point out that besides the transfers made to Government entities, a lot of spending has gone to personnel. Spending for salaries and wages was at 80%. This increase is partially due to the adjustments in salaries made in May 2008, when a general salary increase for Central Government administration workers was authorized.

This fits the Government spending profile for an election year, significant amounts being transferred to Mayor's and Governor's Offices and increases in spending for personnel.

### **Liquid Government**

Another factor that should be taken into account when analyzing the Government's 2008 fiscal management figures is that the Administration has access to a number of extraordinary resources in a number of diverse funds that have been accumulating for quite some time now (2005) and which main characteristics are that they are not subject to control, they are to be used at the Administration's discretion, they grow over time, and a good portion of it is in foreign currency.

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As we have pointed out on previous occasion, monitoring these resources has allowed us to draw two conclusions. First, that the Government will use a part of these resources in order to avoid losing any political space during the upcoming regional elections in November, and second, that the fiscal adjustment that we expect in the future will happen gradually and it is not about to begin in the near future.

### Doesn't let its guard down

Since the Government is caught in a spiral where it wants to take advantage of the best of both worlds, on the one hand it wants to increase public spending, and other hand, accumulate important amounts of resources, it is not letting its guard down with regard to tax collection or in acquiring debt.

The estimated amount of resources that the Venezuelan State has accumulated at the close of May, not counting international reserves, is at US\$61.90 billion, no all of it in foreign currency or with the same degree of liquidity.

Government Resources	May-08 (MMM US\$)
<b>Central Government</b>	<b>27,9</b>
Treasury (BCV)	4,9
Treasury (Foreign Currency)	4,1
FONDEN	11,6
Fondo Miranda	1,3
Other funds	6,0
With China	4,5
With Irán	1,5
<b>PDVSA</b>	<b>1,4</b>
<b>BANDES</b>	<b>11,3</b>
<b>BDT</b>	<b>8,0</b>
<b>Deposits in Financial System</b>	<b>13,3</b>
<b>TOTAL</b>	<b>61,9</b>
<b>Future Expenses</b>	
Oil Compensation	5,5
Cement Producers (100% Value)	1,92
Sidor (60% valor)	2,34
<b>TOTAL</b>	<b>9,76</b>

Source: Ecoanalítica

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The increase in public spending expected during the second semester of the year will have an important impact in the growth of the economy, but it will also put added pressure on inflation. This will force the BCV to be more active in terms of monetary policies, with added interest rate or legal reserves regulations.

### *Economic Tips*

**The solution is to reduce demand.** The Minister of Finance, Ali Rodríguez, recognized that the problem with inflation lies in the “imbalance between supply and demand,” therefore lowering inflation would be achieved by “moderately” attacking demand. The Minister also proposed to create an “Agriculture Chief of Staff” to introduce incentives to increase the production of food items.

**In no danger.** The president of the Banking Association of Venezuela, Víctor Vargas, announced that the banking system is not worried about the structured notes and he assured that there is a lot of misinformation concerning the subject. In his opinion, there is no reason for this to affect the financial system.

**Proposes a monetary system for Latin America.** The Minister of the Coordination of Economic Policies for Ecuador, Pedro Páez, proposed the creation of a common monetary system for Latin America, as a financial defense mechanism for the region this Friday in Caracas. Venezuela supported the idea.

**Ministry of Finance restricts bank mergers.** A resolution issued by the Ministry of Finance was published in the *Gaceta Oficial* dated June 18, 2008, limiting the purchase, sale, and merger of financial institutions which include banks, insurance companies, brokerage houses, and foreign exchange houses.

**New regulations for the stock market sector.** The National Securities Commission issued a resolution which forces brokerage house to increase their minimum operative capital. For example, with regard to brokerage houses that are able to carry out universal intermediation activities, the category which allows the greatest freedom to structure financial products, they must have paid in capital equaling VEF 1 million and liquid equity equaling VEF 3 million. Furthermore, the Commission determines the risk that each type of investment runs in a report that is already available.

## Weekly Report

**Monetary conversion costs.** According to an Institutional Report issued by the BCV, the monetary conversion project cost VEF 667.20 million. The first stage which included the production schedule and design of new bills and coins cost VEF440.60 million. The second stage which included the distribution of the bills and coins cost VEF 226.60 million.

**Supplementary Appropriation for debt buy-back.** The Finance Commission of the National Assembly expects to finance the Venezuelan debt buy-back by authorizing a supplementary appropriation. The authorities expect to use the approximately US\$ 600 million in prime collected from the issue of US\$ 4.0 billion of 2023 and 2028 International Bonds.

**Poverty drops according to INE.** The president of the National Statistics Institute (INE), Elías Eljuri, announced that Venezuela has lowered its extreme poverty index by half compared to where it was a decade ago, which meet the Millennium objective set by the U.N. According to these figures, the number of Venezuelan households in extreme poverty dropped from 17.1% in the second semester of 1998 to 7.9% in the same period in 2007.

**International reserves.** At the close of the third week in June, international reserves increased by three percentage points to settle at US\$ 33.78 billion thereby continuing its upward trend of the last six weeks.

**Interest rates.** For the second week in June, the lending rate for the six main banks in the country dropped by 2.48% to settle at 23.56%. Fixed rate term deposits dropped by 4.93% at the close of the same week settling at 17.18%.

**Monetary liquidity.** For the second week in June, monetary liquidity was at VEF153.12 billion, down 0.72 percentage points compared to previous week.

### *Oil Tips*

**Oil prices dropped.** According to the Minister of Energy and Petroleum, the price of a barrel of Venezuelan oil went down by US\$ 0.99 to settle at US\$ 119.84 at the close of the third week in June.

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**Production full speed ahead.** According to the vice-president of Exploration and Production of PVSA, Luís Vierma, national crude oil production is currently averaging 3.2 million b/d, despite the fact that international organizations like the OPEC and the International Energy Agency agree that Venezuelan production figures have been reflecting a tendency to drop since the beginning of the year. According to the company's vice-president, the eastern region of the country broke a production record, extracting 1 million b/d, while the western region remained steady extracting around 875,000 barrels.

**Production goals.** According to the Administration, the goal to produce an average of 3.45 million b/d this year is attainable since there are 180 drilling rigs active. However, Baker Hughes figures indicate that for the month of May there were only 78 rigs active in Venezuela. Of PDVSA's investment budget for 2008, US\$ 15.60 billion are earmarked for the areas of exploration and production.

**Natural Gas drilling operations begin.** Vierma announced that the natural gas drilling operation carried out by the drilling ship Neptune Discoverer, at the *Campo Dragón* belonging to the Mariscal Sucre Project began. This ship is expected to produce approximately 600 million cubic feet of gas a day during the first stage which is initially earmarked for the domestic market and in 2012 it will begin the export process.

**European crude oil market threatened.** President Chávez questioned the legal framework approved by the European Union for the expulsion of illegal immigrants and threatened European countries with cutting off their supply of Venezuelan crude oil if they planned to abide by this ruling. This puts the country's third largest market at risk which represents 8% of the export supply.

**In 2009 the agreement with Cuba enters into effect.** According to the Minister of Basic Industry and Mining, Yadira García, the first petrochemical factories to be built by Cuba and Venezuela for US\$ 5.0 billion will be under construction by the end of the year, beginning of 2009.

**Saudi Arabia could increase production.** During the consumers and producers of crude oil meeting to stabilize prices, it was agreed that more investments should be made in oil production and refinery, as well as to improve the transparency and regulation of the financial markets. The representative of Saudi Arabia indicated that if it was necessary Saudi Arabia would be willing to once again increase production. It was reported that the Saudis will be making investments to take their production from the current 9.7 million b/d to 15 million b/d.

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**Half a million.** The Natural Gas for Vehicles (NGV) expansion project is in its preliminary stage and of the 500 service stations capable of providing NGV that the Ministry of Energy and Petroleum have set as a goal (during the first stage which ends in 2009), 145 service stations are completely operational. It's estimated that between the cars that are being built with the dual system engine and the cars that are being fitted with the conversion kits that were imported by PDVSA that by 2009 there will be around 500,000 vehicles circulating using natural gas.

**Regulation could be made more flexible.** According to the current regulation, vehicle assembly plants must begin producing dual system engines and installing them starting on this coming July 1<sup>st</sup>. However, the Minister of Energy and Petroleum, Rafael Ramírez, stated that the regulation would be made more flexible in order to establish a production schedule, and only a part of it would be for dual systems. Some assembly plants would only produce units to run on NGV.

### Political Tips

**80% against people being declared ineligible.** According to the last survey by Keller & Asociados, 80% of Venezuelans are against the decision made by the Comptroller's Office to declare 368 public servants ineligible to run for candidates for mayor and governor elections on November 23<sup>rd</sup>.

**The list was shortened.** Of the 368 names that were originally in the General Comptroller's, Clodosbaldo Russián, list, Germán Yépez, director of the CNE, informed that more than 100 of them have already complied with their penalties; therefore they will be eligible to occupy public positions.

**Overruled.** Cilia Flores, chairperson of the National Assembly, announced that the dismissal of the Supreme Court (TSJ) justices, Blanca Rosa Mármol de León and Carlos Oberto Vélez, was inadmissible. Flores explained that the National Assembly (AN) will not admit the alleged faults on which the dismissal of the judges was based because legal requirements were not met.

**Giovanny Vásquez apprehended.** The Attorney General's Office witness for the Danilo Anderson's assassination was detained by the National Guard on the Lara-Zulia highway, based on a warrant order issued by the Fourth Criminal Court of the First Instance of Mérida state.

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**Obama supports Leopoldo López.** At the Mayor's Hemispheric Meeting, Leopoldo López, along with mayor from other LA countries and the US, met the US presidential Democrat candidate, Barack Obama, who expressed his support for Leopoldo López, reminding that he will always be on the side of democracy and respect for human rights.

**AN is considering to revise the law for the payment of severance debts.** One of the solutions being considered by the AN representatives to pay the severance payment debt is to reform the Organic Law on Public Sector Financial Administration. According to the studies developed by the Finance Commission sub-commission, the cumulative debt amounts to VEF17.00 billion.

### Other Tips

**The G-3 of politics.** The Presidents of Colombia, Álvaro Uribe, Mexico, Felipe Calderón, and Venezuela, Hugo Chávez, have the highest acceptance rating in the Americas according to a study carried out by the Mexican consulting firm Mitofsky which analyzes the backing of 19 different leaders. Uribe would receive 84% of Colombian backing him, ahead of the conservative Calderón, who has 61% of the people backing him, with Chávez coming in at 59% of Venezuelans backing him. U.S. leader, George W. Bush, continues to come in with one of the lowest rating, receiving only 30% backing from his people. The worst results were posted by Argentina's Cristina Fernández, at 26%, Nicaragua's Daniel Ortega, at 21%, and Paraguayan Nicanor Duarte, at only 5%.

**Safety figures getting worse.** A study carried out by the *Observatorio Venezolano de Violencia* (Venezuelan Violence Monitor) indicates that during the last ten years the number of murders has more than doubled going from 19 per 100,000 inhabitants in 1997, to 48 in 100,000 inhabitants in 2007. This study makes a comparison with Colombia, where the murder rate has been reduced by almost half. The report points out that "the police force has been weakened, it's become less efficient, and its image has deteriorated even more. The capacity of the Mayor's office has not been strengthened."

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**U.S. perspective change.** The International Monetary Fund significantly increased its provisions regarding economic growth in the U.S. after three months ago it suggested that it was headed for a recession. It warned that for most of what is left of this year economic growth will remain fair stagnant. Growth throughout this year is expected to reach a little over 1%. In April the Fund had said it would only grow by 0.5%.

**Brazil attacks inflation.** Brazil looks to solve the immanent problem of inflation which is attacking the whole world by creating incentives for agricultural production, instead of doing what Argentina did, increasing its exports, or what Mexico did, controlling the price of a number of basic goods.

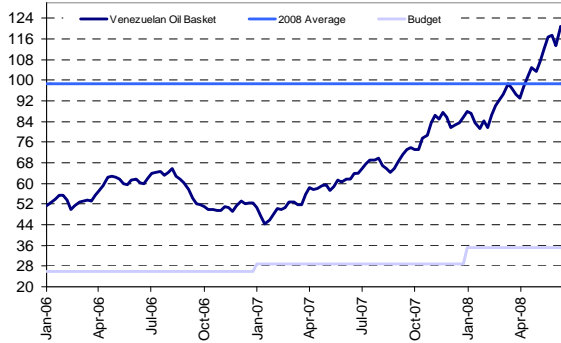
**More planes.** The Government is planning to purchase a still undetermined number of Russian Su-35 planes (attack/intercept planes) according to reports appearing in the international press. From Caracas, there were also statements which express a desire to purchase at least 10 Mi-28NE Russian helicopters (night hunters helicopters), which could be delivered as early as the second semester of 2009.

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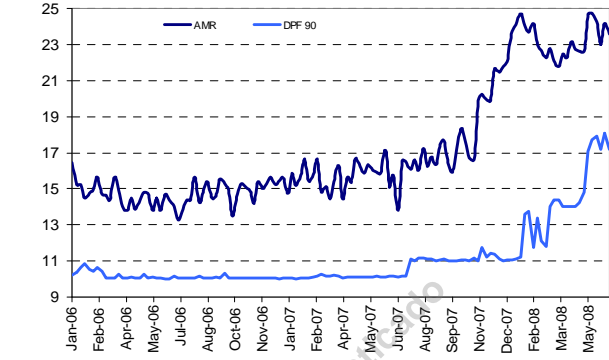
# Weekly Report

## ECONOMIC OVERVIEW

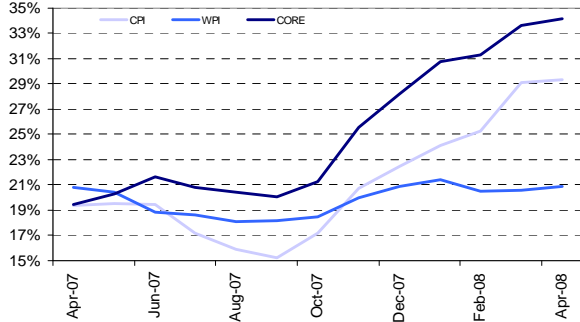
**Oil Price**  
(Venezuelan Basket US\$/pb)



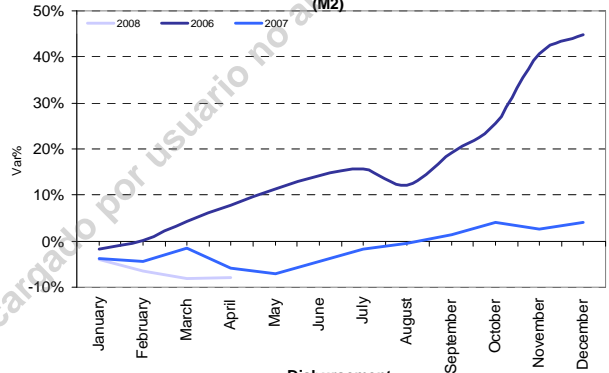
**Interest Rate**  
(Six Principal Banks)



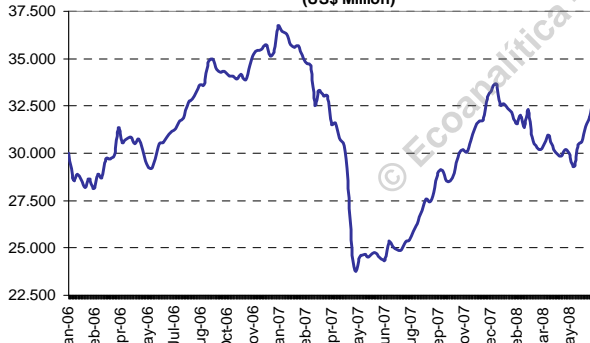
**Inflation**  
(Last 12 Months)



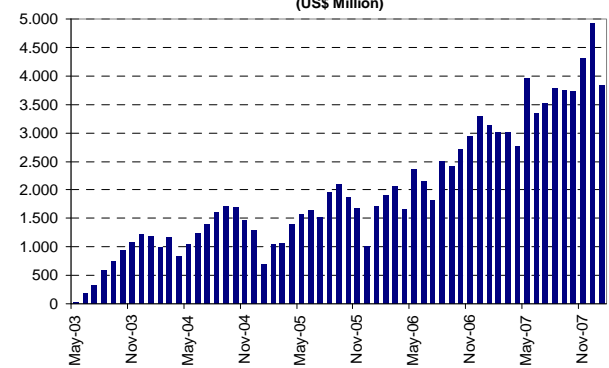
**Real Expansion**  
(M2)



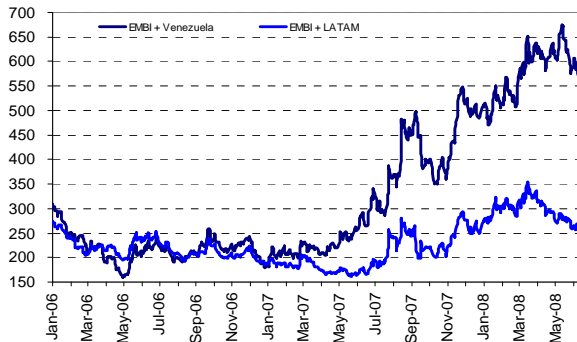
**Fx Reserves - BCV**  
(US\$ Million)



**Disbursement**  
(US\$ Million)



**EMBI**



**Central Government**  
(VEB Billion)

