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LIQUIDITY, INTEREST RATES AND INFLATION: WHAT CAN WE EXPECT THIS SEMESTER?

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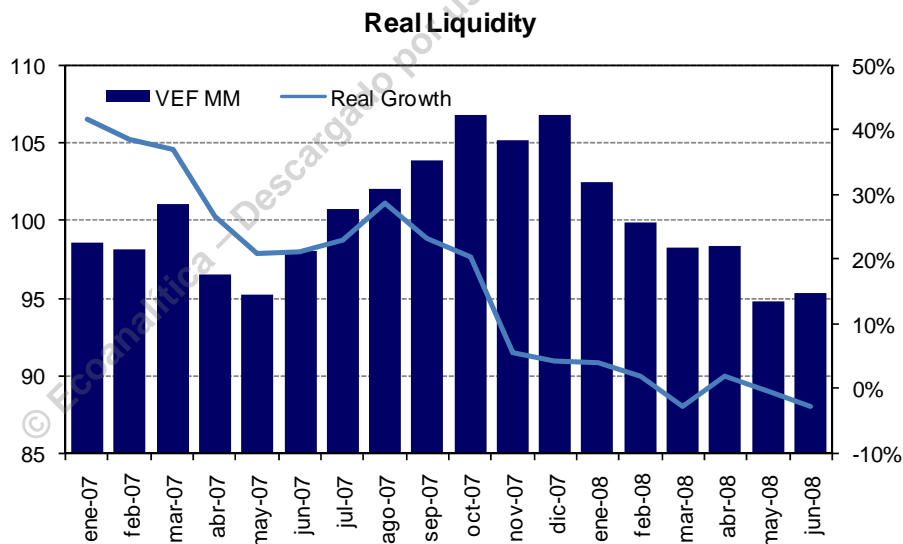
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So far during 2008, lending and savings interest rates have been steadily going up. According to the latest information released by the Central Bank of Venezuela (BCV), the average lending interest rate of the six main banks in the country was at 24.1% on July 18, up 7.9 percentage points compared to what it was during the same period in 2007. Meanwhile, time deposit interest rates were up by 6.4% during the same time period and are currently at 17.2%. Savings deposit interest rates closed the week at 15%, up by 7.6 points in one year. This steadily increasing tendency has clearly been reflecting since the second half of 2007 and is in direct response to actions taken by the BCV and the Administration with regard to fiscal and monetary policies. However, as we are about to explain, at **Ecoanalítica**, we believe that this tendency will be reverted in the near future.

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Liquidity dropping...

Since last year, the Administration has introduced certain measures to restrict public spending, thereby restricting monetary liquidity (M2), price increases, and the unofficial US-dollar exchange rate. Among other things, the National Treasury Office introduced a new scheme for releasing funds, converting the payment owed to certain Government contracting companies into US-dollars, and it began to transfer State resources deposited in private banks to public banks (currently, 65% of State resources are deposited in private banks compared to 80% from just one year ago). Furthermore, towards the end of April, US\$ 4.0 billion in 2023 and 2028 International Bonds were issued. These unorthodox monetary policies implemented by fiscal authorities led to a significant deceleration of the increase in the M2 in real terms since around the end of 2007. So, for the first semester 2008, liquidity increased by an average of 29%, while during the first semester 2007 it was increasing at an average rate of 60%.



Sources: BCV and Ecoanalítica

... has pushed interest rates up

In an attempt to stimulate domestic savings and slowdown ever increasing consumption and inflation, since July 2007, the BCV started to adjust minimum and maximum levels allowed of lending and savings interest rates, as well as its open market operation rates. In May 2008, the BCV made its last rate adjustment, increasing the maximum credit card rate allowed to 33%, and leaving the ceiling of the other lending rates where they had been at 28% (with the exception of those set for specific loans such as for the agriculture, tourism, and manufacturing

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sector). Meanwhile, minimum rates for savings and time deposits increased to 15% and 17%, respectively. BCV loan interest rates to banks (injection operations) increased to an average of 23%, depending on the term of the loan. Along with the interest rates, bank's legal reserve policies also increased leading to less expansion of M2.

BCV. Interest Rates Changes

Date	Active Rates	Passive Rates		Others	
		Savings	Long		
10/07/2007	-	8,00%	11,00%	Absorption operations, 14 días Absorption operations, 56 días	Eliminated 11,00%
27/07/2007	Credit Cards: Min 17%; Max 28%	-	-	Injection operations, 28 days Injection operations, 14 days	19,00% 18,00%
03/12/2007	-	10,00%	-	Absorption operations, 28 días Absorption operations, 56 días	11,00% 12,00%
29/02/2008	Agriculture: 14% Manufacture: 19% Credit Cards: 32% Tourism Group "A" 17% Tourism Group "B" 19%	13,00%	14,00%	Discount, Rediscount and Advances	32,50%
01/05/2008	Credit Cards: 33%	15,00%	17,00%	Injection operations, 14 days Injection operations, 28 days Injection operations, 7 days (new term) Credit assistance	23,00% 24,00% 22,00% 33,50%

Sources: BCV and Ecoanalítica

Regulations imposed on banks increased the lending rate even more...in an environment where it's very difficult to place money in time deposits

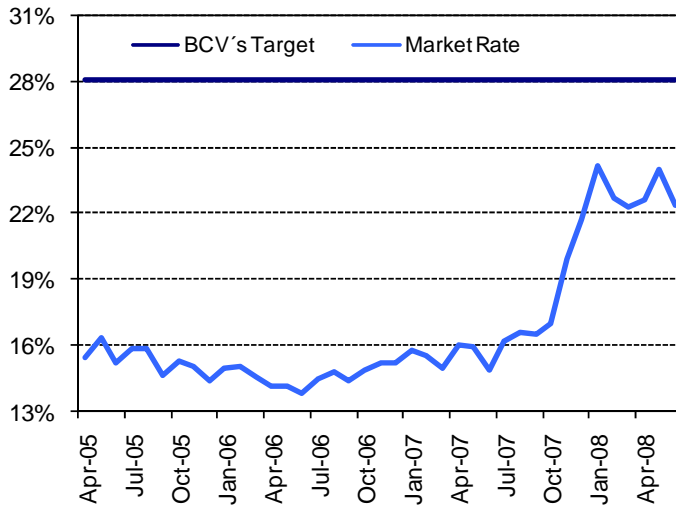
The greatest costs facing banks due to deposits, added on to the establishment of loan quotas and stricter control on bank fees, have led to it being increasingly more difficult for the financing system to maintain the margin of financial intermediation. Therefore, average lending rates tend to hug their maximum legal levels, while savings rates practically don't move off the minimum levels required by the BCV. This is so, despite the fact that 46.5% of bank loan portfolios is made up of compulsory loans (loan quotas), where maximum interest rates don't go over 19%. Even more so, given that the savings rates imposed on the financial system are way above the market; still, it's become practically impossible to open a time deposit or a savings account.

This is reflected by the number of savings and time deposits compared to the number of total deposits. According to the Bank Superintendent's Office (SUDEBAN) figures, during last June, these deposits represented 40% of the total, while up until a year ago, they represented 50%. This

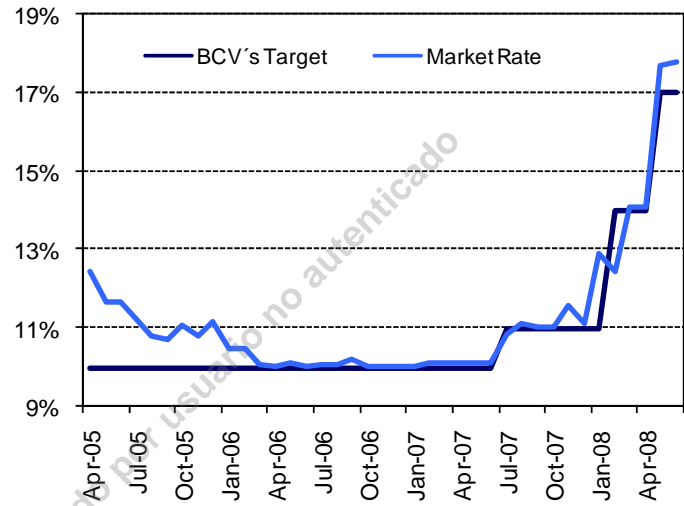
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drop has been totally absorbed by the increase in checking accounts, with or without interest, which went from representing 50% of the total to 60% during the same period.

Active Rate



Time Deposits Rate

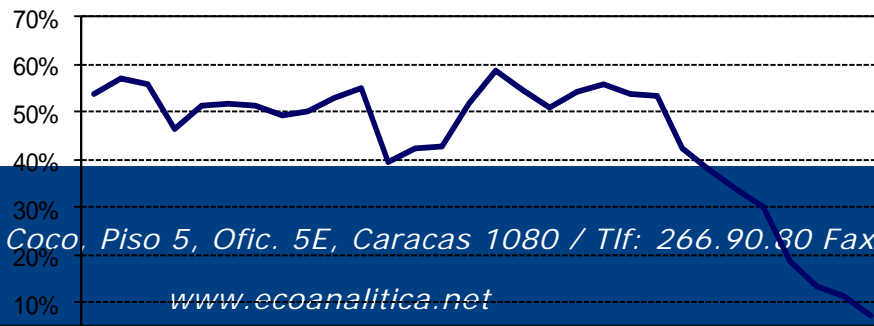


Sources: BCV and Ecoanalítica

The number of restrictions imposed on banks has provoked a slowdown in loan requests

As a result of less liquidity and the restrictions imposed on banking operations, loans granted by the national banking system began to slowdown. In fact, during the month of June, the loan portfolio was at VEF 115.66 billion, up by 42% compared to the same month in 2007. However, in real terms, the increase was only by 7.4%. Real increase in loan requests in June 2007 was at 51%. At **Ecoanalítica**, we believe that it was impossible to maintain these loan request growth rates without also having suffered severe inflationary pressures, therefore we see this slowdown as being positive.

Loan Portfolio
Real annual variation

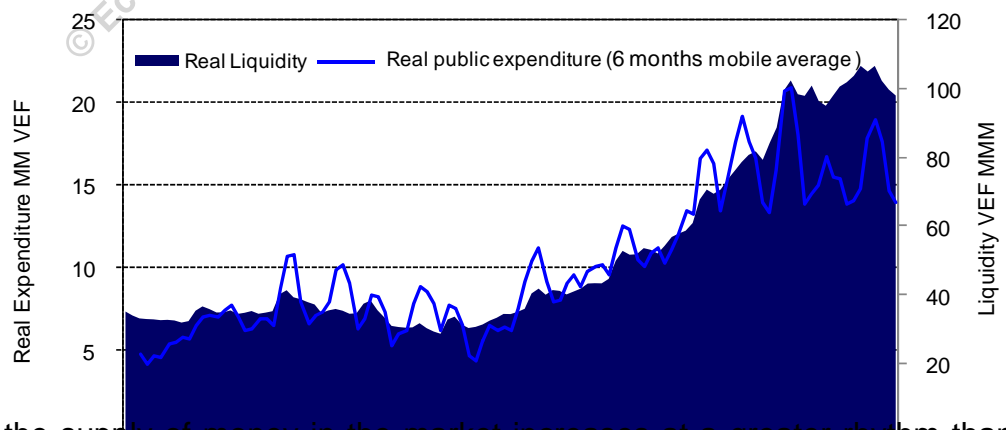


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The Government's fiscal management will cause this tendency to change

As we have mentioned in previous reports, at **Ecoanalítica**, we expect public spending to begin to increase more and more as the semester progresses. Despite seasonal factors that always signal an increase in public spending (usually 60% of the total budget for the year is spent in the second semester), the upcoming regional elections to be held in November will also spur the Administration to spend more. Public spending, as can be seen in the table below, significantly correlates with the amount of money circulating in the economy, so increasing public spending, added to fewer possibilities of reducing surplus with the purchase of foreign currency due to the exchange control, and fewer issues planned during the second semester, will all lead to liquidity increasing.

Real Liquidity vs Real Public Expenditure



If the supply of money in the market increases at a greater rhythm than its demand (measured by the behavior of loans) its price will drop. Said price, as we know, is the interest rate. This is why, despite the fact that

Sources: BCV and Ecoanalítica

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the BCV will probably not lower the ceiling nor the restrictions on interest rates during the second semester, at **Ecoanalítica**, we expect rates to come down, especially for the corporate sector, which is the most competitive sector for the financing system and where the simple laws of supply and demand are felt most. Of course, we don't expect rates to drop to pre-first semester 2007 levels. Our estimates point to this year's lending rate possibly closing at 21.9%, with rates for the corporate sectors slightly below 20.0%.

No amount of “haggling” will make any difference... The price will be absolutely no control over inflation

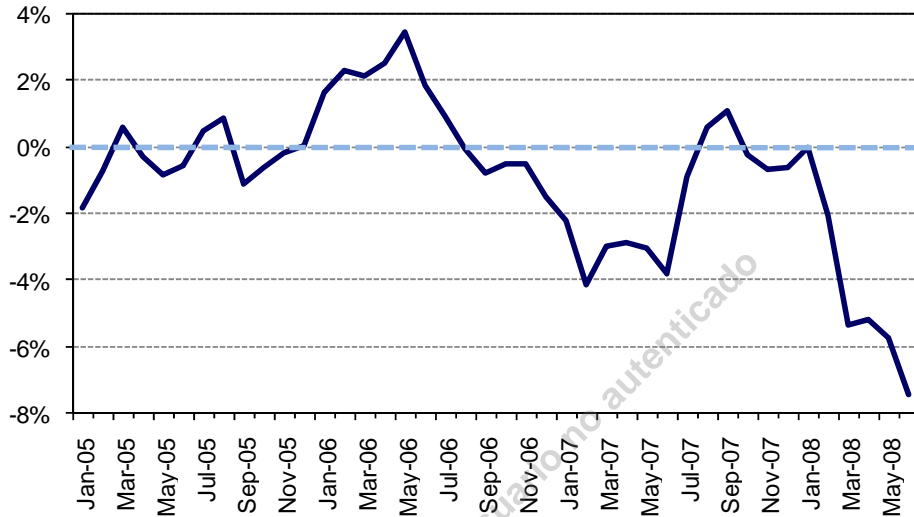
The greater levels of liquidity that we expect to be introduced to the economy will tend to lower interest rates, but at the same time, given that there will be an increased amount of money circulating, all looking to buy the same amount of goods and services, this will put pressure on prices to go up. Now, despite the fact that the country's economic policy makers point out that inflation is due to speculation and that this could be solved if people would just “haggle” over prices more and demand lower prices from vendors, the real problem is much more serious than that, and it lies in Venezuela's production apparatus and its inability to satisfy growing domestic demand. Our estimates indicate that inflation will close 2008 at 29.9%.

Under these conditions, there will continue to be no incentives to save

When you combine low interest rates with high inflation you get negative real interest rates which means that the loss of a person's purchasing power is greater than any revenue savings may earn by keeping your money in a savings account in a bank. It's clear that the real interest rates in our economy continue to be negative, so the BCV is going to be nowhere near meeting its objective focused on stimulating savings. Quite to the contrary, economic agents will prefer to spend their money before saving it. This will lead to the consumer boom being reactivated again for what's left of the year, though it won't reach the levels it was at in 2007.

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Deposits Real Interest Rate



Sources: BCV and Ecoanalítica

At **Ecoanalítica**, we believe that behind all the problems we have described here lies another problem which is a serious lack of coordination between the entities that implement fiscal and monetary policies. Since the last reform of the BCV Law in July 2005, the BCV ceded part of its function as administrator of the international reserves. Since then, PDVSA has been managing its own revenues, sidestepping the traditional contribution mechanism to the State through taxes or dividends, and now it executes spending and contributions which for the most part, it doesn't have to account for. The same thing is happening with the National Treasury Office which manages part of the revenues, spends on its own account, and accumulates resources in accounts that are not audited. This complete disorder in fiscal spending deepens the structural problems of the economy and it will always tend to neutralize the effects of any anti-inflationary measure that the BCV may come up with.

Economic Tips

Unemployment close to official goal. According to National Institute of Statistic (INE) figures, unemployment for the month of June was at 7.6%. This figure shows unemployment dropping with respect to June 2007 (8.3%), but up

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compared to May 2008 (7%). The INE reported that 57.1% of the population is working in the formal sector of the economy, up by 1.3% compared to the previous month. The Administration has set a goal for itself to close the year out with unemployment at around 6%.

Banks and brokerage houses under the District Attorney's scrutiny. The District Attorney's Office is investigating banks and brokerage houses due to a number of irregularities like usurping a client's identity to make a purchase order, and the use of pre-paid credit cards to buy bonds. These institutions have been asked to turn over specific information concerning their clients. This requirement has caused some worry since it may violate bank privileged information rights and their duty to protect their clients personal information.

Econoinvest raided. The brokerage house *Econoinvest* was raided by the Disip last week. They were searching for information in order to prove whether the institution was engaged in fraudulent actions. So far, they have not released any information concerning their findings.

WTO looks to establish new agreements. World Trade Organization (WTO) ministers are looking to establish a global agreement to reduce tariffs during their upcoming meetings. Only a few developing countries will have to lower their tariffs, among them: Venezuela, Argentina, Brazil, Chile, Mexico, Peru, and China.

US\$ 300 million more for Bolivia = US\$ 300 million less for Venezuela. Bolivian President, Evo Morales, signed regional highway construction and cooperation agreements with Chávez and Lula for a total of US\$ 530 million. The agreement that was signed with Venezuela, for US\$ 300 million, is focused on Bolivian highway projects and creating bi-national social production companies which will build milk, corn, and plastic injection plants in Bolivia. The US\$ 230 million contributed by Brazil will focus on building highways between both countries.

More money given to others. The President of Nicaragua, Daniel Ortega, reported that with Venezuela's help, his country has been able to invest more than US\$ 200 million out-of-budget on economic and social development programs in the just one and a half years that Ortega has been President.

IMF modifies its projections. Despite the slowdown in word wide demand, the International Monetary Fund (IMF) increased its projections. Worldwide economic growth this year will be at 4.1% and next year it will be at 3.9%. On the other

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hand, due to the general high prices in raw materials, industrialized country's inflation will be at 3.4% in 2008 and 9.1% for emergent economies.

Oil Tips

The week closes out up. Despite market volatility registered during the week, the Venezuelan crude oil and oil by-products basket increased slightly by US\$1.30 to close the week out at an average price of US\$126.50 per barrel. Therefore, so far, for the month of July the Venezuelan basket has accumulated an average price of US\$ 126.00

Extra revenue. High oil prices during the year have led to an accumulated price per barrel of US\$ 102.00 which is 191% over the US\$ 35.00 per barrel price that the National Budget used as its base price when figuring out the yearly budget. Therefore, one can calculate that in a little over a semester, PDVSA has taken in around US\$ 29.37 billion, calculated at an average export rate of 2.2 million b/d, which doesn't include Orinoco Oil Belt associations.

OPEC production. The OPEC reported in its monthly bulletin that taking all member countries into account, average oil production increased by 123,700 b/d to close at an average 32.29 million b/d.

Tendency to drop. National oil production averaged 2.34 million barrels per day for the second quarter of the year, down slightly compared to the 2.38 million b/d registered during the first quarter. Last year, production was at 2.39 million b/d which in turn was quite a bit less than the 2.54 million b/d register in 2006.

Demand to increase. According to OPEC estimates, world wide oil demands will increase by only 900,000 b/d in 2009 to average 87.7 million b/d.

Possible association. Within the framework of Petrocaribe's V Extraordinary Summit, the Presidents of the Dominican Republic and Venezuela contemplated the possibility that Venezuela could become a shareholder in the Dominican Refinery (Refidomsa). PDVSA and Refidomsa began discussions to participate as partners in the exploration and exploitation of the Orinoco Oil Belt.

Increasing investment in Bolivia. The Hydrocarbons Minister of Bolivia, Carlos Villegas, announced that the company Petroandina, a partnership made up by

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the two oil companies YPF (Bolivia) and PDVSA, will invest US\$ 883 million in exploration and exploitation of hydrocarbons in Bolivia.

Rejected new agreements. Eddie Ramírez, national coordinator for *Gente del Petróleo* (Oil People) rejected the new energy cooperation agreements signed with other countries at the PETROCARIBE summit because they translate into losses for the country. An example of this is the US\$ 14.70 billion that was injected into the social Missions in 2007, while investments in the oil production area were only at US\$ 5.90 billion. This doesn't include the financing given to the 18 countries through PETROCARIBE.

New agreements. The Russian oil company Lukoil still hopes to sign an agreement to develop the Junín 3 block of the Orinoco Oil Belt during the President's visit in Russia. The company has just finished quantifying and certifying reserves. The President is expected to sign around 20 agreements during his visit.

Buying-back bonds. PDVSA announced that it had reached an agreement to buy-back most of the bonds in circulation that pertain to the old PETROZUATA upgrader project. The company offered to buy the papers that PETROZUATA issued which are due to mature in 2009, 2017, and 2022 at par value with accrued and unpaid interest, plus a third of the bonds expected redemption prime.

OPEC consumption. According to figures released by the OPEC in its Yearly Statistics Bulletin last year, the 13 members of the organization consumed approximately 7 million b/d of oil by-products. This represents 22% of their combined crude oil production and 77% of the by-products they produce. Among the countries which consumed the most by-products last year were: Iran, Saudi Arabia, Indonesia, Iraq, and Venezuela.

Domestic oil by-product consumption. Venezuela's domestic oil by-product consumption increase was greater than the average increase for the OPEC which reached 6.1% last year. The figures show that the increase was spearheaded by a 6.6% increase in gasoline consumption which went from 257,000 b/d in 2006 to 274,000 b/d in 2007.

In third place. Given the increase in domestic use of nationally produced oil by-products (36.4% in 1998 compared to 55% in 2007), which generates a drop in exports, Venezuela went from being the second OPEC country with most oil by-products exported in 1994 to third place in 2007.

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OPEC countries each year more dependent. The value of crude oil sales and the sale of refined products for OPEC countries has begun to represent more and more of their total exports. In 1998, the value of hydrocarbon exports represented 53% of total exports, while in 2007 it represents 72%. There is no doubt that current high oil prices are the main reason for this increase which lessened the pressures to diversify exports making oil producers ever more dependent on their main resource.

Venezuela is not the exception. Venezuela has increased the value of its exports going from US\$ 8.93 billion in 1987 to US\$ 51.45 billion in 2007, spearheaded mainly by current high oil prices. Hydrocarbons exports for Venezuela represented 74% of the total value of exports.

Refinery and Petrochemical Complex of the Pacific draws international interests. China and Iran are interested in investing in said complex, much to the satisfaction of its founding presidents, Chávez and Correa. PDVSA will be in charge of construction, but they are very pleased to welcome Iran for its vast experience in oil matters, and China, because it is the world's main oil consumer.

Business Sector Tips

Deposits increase in banking system. According to the figures released by Superintendent of Bank's Office, deposits in the banking systems current account increased from May to June by 7.23%. Total liabilities for the banking system reached VEF 224 million, reflecting an increase of 5.76% compared to the previous month.

National Assembly blames the Government for high car prices. After reviewing the automobile industry's cost structure, the Administration and Service Commission announced that based on the information that it had gathered, the delays generated by the MILCO and Cadivi are the cause of automobiles being so expensive.

Is agriculture really receiving incentives? According to the information published by Banking Association, the amount of loans approved to the agriculture sector reached VEF 14.41 billion, which is 7 times more than what was granted in 1998 in real terms.

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Airline tickets going up. The National Civil Aeronautics Institute (INAC) authorized a 15% increase in airline tickets for the following airlines: Aserca, La Venezolana, and Avior. This was due to increasing price of fuel and the price control fixed by the Government which was only resulting in losses for the companies. Another 5 airlines are waiting for the authorization that will allow them to increase their fares also.

Pymes sector leading employer. Américo Mata, president of the Institute for the National Development of Small and Medium Sized Industry (INAPYMI), pointed out how important this sector was to national economy and argued that almost 80% of people working are employed by the sector across the country and that it represents almost 95% of the aggregate value of finished products.

But some can't take the current market. The Venezuelan Association for the Coffee industry announced that so far this year, 20 of the 36 of the sectors small and medium sized companies (Pymes) have closed down. This is due to the high prices reflected in the coffee market which don't correspond to the regulated prices that local coffee has to be sold at.

More restriction from the MILCO. The Ministry of Light Industry and Commerce (MILCO) issued a resolution which announces that once a company has requested a Production No. Certificate, the web-page portal won't allow for any additional transactions to be carried out for the next 20 days. These certificates must be presented before CADIVI by the importing company in order to justify that the goods being imported are not produced in the country, or that domestic production has been declared insufficient.

Let's talk about imports. Haiman El Troudi, Minister of Planning and Development, informed that the Executive is going to meet with the business sector with a view to coordinating conditions on which the foreign exchange budget is going to be developed, i.e. the maximum amount of foreign exchange that will be allocated for imports. The Minister explained that the idea is to get to know what the private sector's needs are and avoid setting rigid quotas. Although a definite date hasn't been set for when the new system will be implemented, William Contreras, Minister of Light Industries and Commerce, said that the proposal should be ready before July 30, 2008.

Foreign exchange allocations increased by 23% during 1Q08. Manuel Barroso, president of Cadivi, informed that the institute he leads increased foreign exchange allocations by 23% in comparison to the first quarter of 2007, despite of the Administration's policy of "turning of the faucet". Concerning the

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food sector, the increase was 83%, thereby meeting the President's request of prioritizing this sector.

New items were included. Cadivi included 5 new tariff codes into its automated system: pasture seeds, premixes, lanolin, shell eggs for vaccine manufacture, and live cattle for reproduction. However, these items require presenting the non-production or insufficient-production certificates issued by MILCO, which does not guarantee that foreign exchange will be allocated more quickly.

Government's attention is focused on the telecommunications sector. The estimated figure of foreign exchange needed for this sector was US\$ 2.00 billion. However, the cumulative amount of foreign exchange allocations for the first quarter of 2008, which was at US\$ 1.3 billion, drew the Government's attention. The solution proposed by the Administration was a project to relaunch productivity of the telecommunications sector, which includes aspects such as the incorporation of joint venture companies with private business, which would be focused on installing plants and factories, as well as a progressive decrease of foreign exchange needs to import raw materials and products for the sector.

Unifying the electric sector. The board of Corporación Eléctrica Nacional (Corpoelec) and its affiliates will prepare a medium-term strategic plan next August, which will define the steps to be taken to unify the electric sector. This plan will be aimed at complying with the electric sector reordering law, which, among other things, seeks to improve service quality and maximize energy use efficiency.

More protection for tenants. The National Assembly is currently discussing the reform of the Real Estate Renting Law. The procedures to be followed in dealing with tenants and the steps that the owners of the property have to take are being adjusted in the new legal instrument. According to the proposal, the owner may sue the tenant that is late in the payment of three months of rent; the current law provides for two consecutive months of default.

Increased cocaine traffic through Venezuela. The head of the US Joint Interagency Task Force South reported that at the close of year 2007, cocaine traffic through Venezuela had increased by 400% since 2002, from 51 tons to 255 tons. These figures don't include traffic that took place in illegal planes or ships that aren't detected by Venezuelan radars.

Maybe this time. After innumerable promises, President Chávez finally announced that the Ezequiel Zamora Agroindustrial and Sugar Mill Complex will

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start operations in March 2009. According to the last promise, the Complex would be opened in April 2008. It is expected that the sugar mill can produce about 7,000 t/d of sugar, thereby resulting in a processing capacity of 45% of the Venezuelan market sugar need.

INVEPAL paralyzed. Industria Venezolana Endógena de Papel (INVEPAL) has been paralyzed for a year and a half, reported INVEPAL workers. The company was nationalized in 2005, when its name was changed from Venepal to INVEPAL. Of the almost three years the company has been run by the State, half of the time it has been out of operations.

Wage increase for doctors. President Hugo Chávez announced a 30% wage increase for doctors working for the public administration, as well as a bonus of VEF 6,000 for the workers of Ipasme, an agency of the Venezuelan Institute of Social Security, and of community clinics. The increase will be retroactive as of July 1st.

Political Tips

How much do Chavez's tours cost? Carlos Eduardo Berrizbeitia, former representative of the National Assembly, keeps track of the number of days and the cost of presidential trips. Up until now, according to Berrizbeitia's estimates, the President has spent a total of 450 days abroad, highlighting Chávez's last trip, which cost US\$ 2.8 million, given the huge delegation that is accompanying him. According to his estimates, presidential trips have amounted to more than US\$ 55 million.

Not everybody agrees. Justice Pedro Rondón Haaz prepared a draft ruling according to which article 105 of the Organic Law of the Republic General Comptroller's Office is partially void. The General Comptroller, Clodosbaldo Russián, based upon this Law to declare the political illegibility of 272 people. According to Rondón, this decision is in breach of fundamental rights like the rights to defense and to a due process, and it establishes "limitations to the exercise of political rights."

Will Chávez buy Russian weapons? According to Russian sources, President Chávez may sign a number of agreements to purchase Russian weapons such as missiles and submarines, in his next trip to Russia.

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Chávez declares war. During the celebration of the Children's Day in Miraflores Presidential Palace, Chávez declared that if the opposition would win important governorships and municipalities in the next elections in November, 2009 will be a year of war and Venezuelan children will have no future.

"Niños y Niñas del Barrio" Mission (Children of the Barrio). President Chávez announced that CANTV will contribute VEF 263 million for the "new Socialist mission intended only and exclusively for children, especially those living in poverty, who are still suffering a number of hardships."

Equal participation for men and women in the nominations of candidates for Regional Legislative Councils. CNE's president, Tibisay Lucena, informed that the electoral entity approved equal participation for men and women in the nominations for Regional Legislative Councils.

Russia doesn't support Chávez politically. A Russian newspaper published an article that clarifies the stance of Russian President, Dmitry Medvedev, who assured that he will not allow Chávez to take advantage of the scheduled meetings as a platform to attack the USA; however, he will maintain his liberal stance supporting weapon sales to and private investment in Venezuela

Other Tips

Worrisome inflation in Latin America. Despite the good growth rates registered by Latin American countries, attention is focused on the worrisome inflation. According to data from the different Central Banks, inflation in Uruguay, Paraguay, Bolivia, Peru, Colombia, among others, has already surpassed 2008 estimates, whereas in Brazil, Argentina, Chile, Ecuador, Venezuela, among others, it is close to the target, thus forcing government to make additional efforts to control it. Venezuela registers the highest inflation rate among the countries listed before.

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ECONOMIC OVERVIEW

