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IS IT A GOOD IDEA TO GO INTO DEBT IN 2008?

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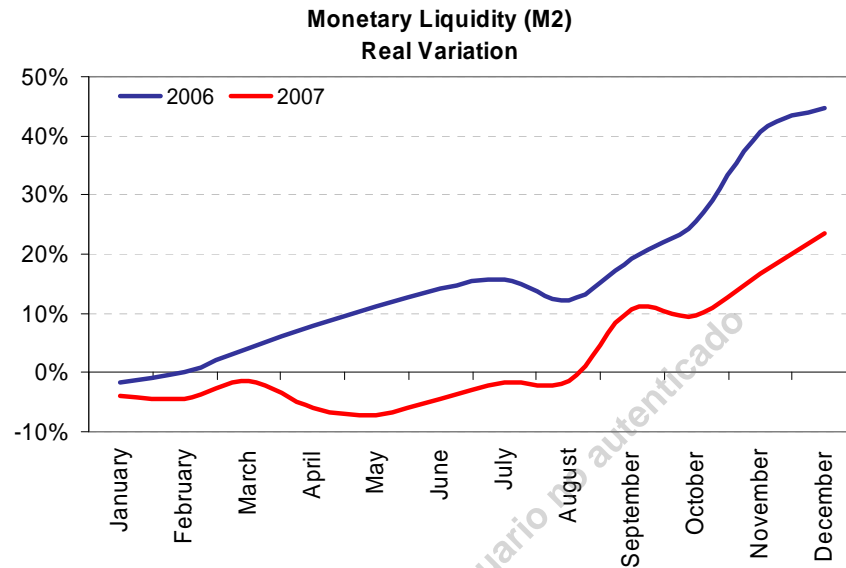
John Holden

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In the monetary scenario, 2008 begins with significant increases in interest rates and a drop in the liquidity surpluses in the domestic financial system. This makes us suspect that interest rates this year will be higher than in previous years. But the real question is, if the Government should continue to follow the borrowing policy in bolivars. However, before making this decision, one must also take into consideration the projections regarding the inflation rate for the year, as well as the role the Government will play through its fiscal policies.

In 2007, liquidity increased half of what it did in 2006

While exchange rate controls have provoked a significant increase in liquidity in the economy such as never been seen before, it has started to become more moderate. In 2007, M2 increased by 29.8% in nominal terms and 6.0% in real terms, while in 2006 it increased by 70.1% in nominal terms and 45.4% in real terms. In 2008, we expect M2 to increase by 31% in nominal terms and drop slightly by 0.8% in real terms.



The year begins with rising interest rates

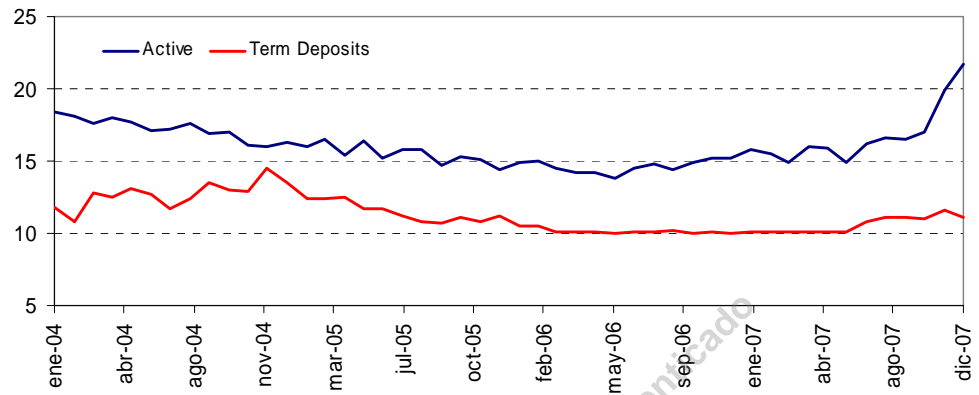
The decreasing M2 growth, in a high loan demand environment, resulted in an increase in interest rates, especially during the last quarter of the year. The average lending rate went from 15.4% in 2006 to 17.5% in 2007 and the average lending rate at the close of 2007 was at 22.5%. This increase in the lending interest rates was due to the latest issues of public bonds in US-dollars payable in bolivars, as well as, CADIVI's increased liquidation of foreign currency, and most importantly the migration of public deposits from the private bank to state-run banks, especially the Banco del Tesoro and BANFOANDES.

In fact, the Government has transferred to the Banco del Tesoro and BANFOANDES at least 35% of the resources it had in private banks. It's estimated that private banks manage VEF30 billion (VEB30 trillion) in Government accounts. According to the Superintendent of Banks, Trino Alcides, by 2009, the amount of Government resources in private banks will be minimal.

It's probable that the BCV will raise the ceiling on lending interest rates

To the interest rate increase that was introduced last year, a liquidity restriction is added, which, due to seasonal reasons, takes place during the first quarter of the year. We at **Ecoanalítica** expect that the BCV should increase the ceiling of the lending rate from 28% to 30% in the first instance and later set it at 32% around the middle of the year. In this scenario, the average lending rate in 2008 will be at 25.8% and close the year at 29.1%.

Interest Rates



Sources: BCV and Ecoanalítica

2008 is expected to be a complicated year from the monetary standpoint

The reasons that explain why we see interest rates going up and only moderate growth in M2 are:

1. The Government is going to focus this year on expanding and technologically improving public banking, and therefore will continue with its migration process of moving public deposits from the private to the public financing system. It's important to point out, regarding this point, how different the impact this measure will have on medium sized and small banks compared to big banks. Most definitely, the smaller the bank the more significant the impact.
2. Within the framework of the Special Powers Law, the Government will most probably approve the General Bank Law reform which up until now includes an increase in the loan quotas and greater regulation with regard to the control of commissions.
3. With respect to controlling inflation, the BCV will intensify its restrictive monetary policies in order to stop the significant expansion of private consumption.
4. The Government and PDVSA estimate that they will issue around US\$8.0 billion in papers in US-dollars payable in bolivars, which is a vary large amount given the surplus levels

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of liquidity in the system. At *Ecoanalítica*, we believe it is impossible that they would make just one big issue, for such a large amount like they did last year, in the next four months.

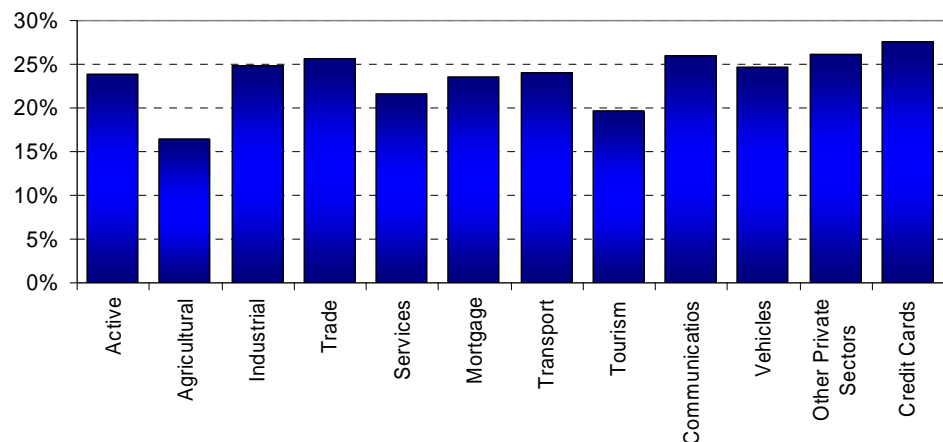
- Loans will continue to expand, and even though interest rates have gone up, the increase won't stop the easy access to financing, especially the so-called personal loan.

It won't be the same for everyone

It's important to point out that the interest rate increase won't affect all the sectors the same. The commercial sector and the small and medium sized companies are the ones that will face the highest increases in interest rates this year. However, if interest rate ceilings were to be raised, then lending rates, credit cards rates, and personal loan rates would migrate towards it. But, since the raise is not a significant one, it won't affect consumption very much.

During the last few months, interest rate increases have mostly affected those sectors that have been enjoying substantially lower rates, like the corporate sector, small and medium sized companies, and commerce. BCV statistics indicate that the average interest rate for loans granted to businesses closed the year at 24.2%, a figure that translates into a jump of 10.5 percentage points compared to the close of 2006 and represents the highest levels reached since April 2003. With respect to commerce, the jump went from 16.9% to 26.6%.

Interest Rates by Sectors



Sources: BCV and Ecoanalítica

Monetary policies may affect inflation goals

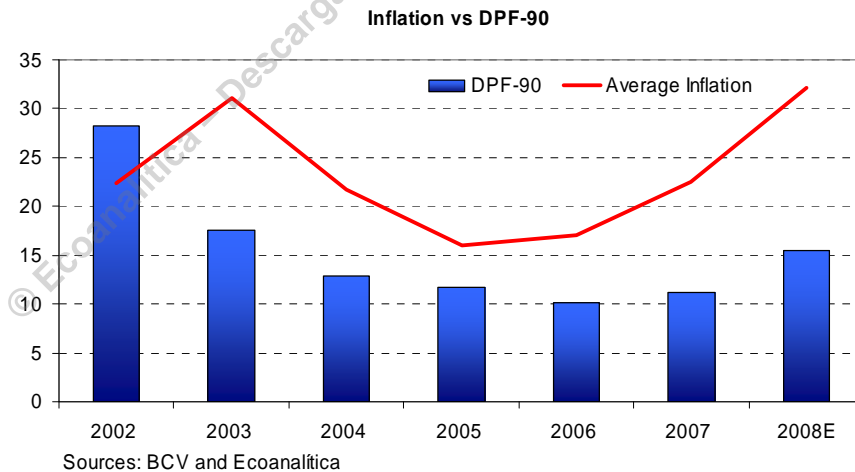
An aspect that the BCV should consider is that an interest rate increase means that businesses will pay more for financing and therefore logically, in cases regarding non-price-controlled items, part of this cost will end up being paid by the consumer.

The corporate sector may come out ahead

In fact, compared to December 2006, financing cost for industry sector businesses has increased by 77%. In this scenario, where all the sectors are paying very similar rates, we expect a reaction from the financing system, cutting back on high risk consumer loans and increasing corporate sector financing, which presents substantially less risk besides being very competitive for the financial system.

Definitely, the answer is yes

At *Ecoanalítica*, we continue to believe that considering the inflation rate that is expected for 2008 and that economic growth is expected to be at 6.5%, going into debt in bolivars is still an option to be considered. Of course, going into debt this year will be a little more expensive than in 2007 or 2006, but rates are still slightly below inflation.



The key will be the payment terms

Given the scenario regarding interest rate increases, our non-financial sector clients should try to negotiate the lowest possible interest rates they can get, but looking to get the longest payment terms possible. Furthermore, since inflation is so high, the incentives to save are virtually nonexistent, especially since inflation rate is expected to double the savings rate.

Economic Tips

Ministry of Finance preparing to place titles. The new conditions which will govern the new bond issues have already been turned in to the National Assembly. The premises will be discussed so that the Government can carry out the appropriate operations to service the debt for VEF7.5 billion as well as the conditions for the refinancing and restructuring operations of the public debt for VEF8.6 billion.

The Government won't make any contributions to the FEM in 2008. On January 9, 2008, the Administration, for the ninth time, modified the Macroeconomic Stabilization Fund Law (FEM), so that they wouldn't have to make contribution to the Fund this year.

Contribution to FONDEN to be defined. The Central Bank of Venezuela (BCV) set the optimum level for the international reserves which in turn allows for the surplus that will be transferred to the National Development Fund (FONDEN) to be calculated. The BCV set the optimum level at US\$31.90 billion which would put the surplus at around US\$2.0 billion. President Chávez pointed out that such an amount was too low.

Spending continues to drop. According to the BCV, in October 2007, total spending was at VEF11.7 billion, which represents an 11% drop compared to October spending in October 2006. The drop in revenues was more pronounced at 24.1% based on a year-to-year basis which led to the Government closing with a deficit of VEF3.30 billion. During the 2007 January-October period, public spending reflected a real drop of 7.6% less than what revenues reflected dropping 9.8%. During this period, the Government's fiscal deficit was at VEF4.40 billion and financing needs were at VEF10.30 billion.

FISCAL BALANCE CENTRAL GOVERNMENT (VEB Billions)	January- October 2007	January- October 2006	Nominal Variation	Real Variation
Total Revenue	76,1	67,8	12,3%	-5,3%
Non-Oil Revenue	39,6	30,4	30,1%	9,8%
Oil Revenue	36,4	36,7	-0,8%	-16,3%
Total Expenditure	76,3	67,6	12,8%	-4,9%
Fiscal Balance	-0,2	0,1		

Sources: BCV and Ecoanalítica

More supplementary appropriations to come. The Government didn't use all the additional resources that were registered in 2007 since they were to be used for extraordinary operations authorized in 2008. In October last year, the Government began to receive extraordinary royalties since by that time the oil industry had already contributed the VEF26.1 billion (VEB 26.1 trillion) it was supposed to contribute to the budget. Of the funds that were delivered, the Administration only used a portion to address the authorized salary adjustment for the health sector. The rest of the funds were deposited in the Miranda Fund and in the Ministry of Finance trust and the National Treasury Office (ONT), for the purpose of using them in 2008.

Adjusting the tax unit. The SENIAT turned in to the appropriate commission of the National Assembly the report which increased the tax unit by 22.5%, however, this report will be revised before being approved. The representatives asked the Economic and Financing Advisory Office of the Parliament to determine some other parameters to calculate the tax unit so that the increase would be less.

The nerve! The president of the INDECU, Samuel Ruh, affirmed that the final conclusion, after meeting with the Minister of Light Industry, William Contreras, is that the country is not suffering from any shortages. *"We concluded, after analyzing and making a survey with all our personnel around the country, that there really aren't shortages of any kind."* But, contrary to what Ruh announced, on December 19, 2007, Rodrigo Cabeza, then Minister of Finance, admitted that *"there were shortages around the country of up to at least 60% in around 10 items,"* among which he mentioned cooking oil and sugar, while in the case of milk, the shortage reached 90%.

Lack of liquidity has eased in the financial system. Last week, the lack of liquidity forced a group of banks to ask for a VEF3.20 billion loan, at an average interest rate of 26%; when last year most of these operations were carried out at an inter-bank overnight rate of 10.7%. Regardless, the pressure is starting to be felt ease, thanks to the fact that the Government has cancelled pending agreements and injected resources into the financial system this way.

Circulation intensifies. Trino Alcides Díaz, head of the Superintendency of Banks and other Financial Institutions, announced that the BCV will intensify its distribution of bolívar fuerte (strong bolivar) coins to banks, business, and people who go to exchange their old bolivars for strong bolivars.

Inflation in January will be high. During the first half of January, it has been possible to verify in a number of different businesses that between October and January prices were adjusted. The merchants all agreed and pointed out that before the monetary conversion

process, suppliers increased their prices, and therefore they passed the increase along to the consumer. Other merchants said that they generally make the necessary adjustments to products and services that aren't regulated by the Government at the beginning of the year.

Anti-inflation plan still being studied. The Minister of Finance, Rafael Isea, stated that the Government still doesn't have a defined plan to fight inflation and achieve the inflation target set for this year. He insists that he has no details concerning this issue, that what needs to be reviewed he will review and he will adjust what needs to be adjusted. With respect to a new adjustment in price control policies, he stated that the issue was not his responsibility but to be decided by the Economic Cabinet.

17.6% of the population earn minimum wage. The Minister of Labor and Social Security announced through a press release that at the close of 2007, minimum wage benefited a total of 2,058,373 urban, rural, and domestic workers. This figure represents 17.6% of the people working in the country. The freeze on firing employees saved the jobs of 6,496,997 workers, guaranteeing that they couldn't be fired, transferred, or subject to negative changes in their work conditions.

International reserves. According to the BCV latest figures, total reserves were at US\$33.35 billion, a 1% drop compared to the previous week.

Interest rates. During the first week of January, the average lending interest rate of the six main banks was at 23.74%, a 1.71 percentage point increase compared to the previous week, while the average interest rate for 90-day term deposits was at 11.06%.

Monetary liquidity increases. The amount of currency circulating, in savings accounts, or in term deposits for the week ending on January 4, 2008, was VEF153.6 billion, up 0.47% from the previous week.

OIL TIPS

Venezuelan oil down. Venezuelan oil lost almost a US-dollar during the week due to U.S. economic concerns that a deceleration of the global economy may affect crude oil demand. The average price per barrel of the Venezuelan oil basket during the week of January the 7th to the 11th was at US\$87.06, down US\$0.99 compared to the close of the

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previous week. The barrel of Venezuelan oil closed 2007 at an average price of US\$65.20, compared to the close of the previous year which was at US\$56.35.

PDVSA expects to invest US\$15.60 billion in 2008. The Minister of Energy and Petroleum, Rafael Ramírez, announced that this amount, within the framework of the Oil Seeding Plan, is earmarked for increasing production to 5.8 million b/d over the next five years. However, Ramírez pointed out that for 2007, PDVSA investments would reach US\$10.0 billion, and according to unofficial sources within the industry, investments reached around US\$5.5 billion.

Subsidies will continue. The plans to exploit the Ecuadorian gas sector initially require an investment of US\$150 million that according to Ecuadorian Minister of Mines and Petroleum, Galo Chiriboga, will be financed by PDVSA. This financing is a part of the bi-national cooperation agreements concerning energy matters signed by both countries.

Technicians too. Venezuela rented two drilling rigs to Ecuador that will arrive between February and March. They will be used to explore the Sacha crude oil field. 26 Venezuelan technicians will also go along to offer technical assistance in the use of the drilling rigs.

PDVSA shortens payment period. The period of time that PDVSA's international clients have to make payments was shortened from 30 days to 8 days as part of a strategy to safeguard the company's interests and accelerate reinvestment plans. This represents cost for the country given that discounts are offered for prompt payment. The main reason this change was made is due to a presidential order which requires a greater flow of resources from PDVSA to be guaranteed.

Oil reserves. President Hugo Chávez, during his yearly message to the National Assembly, highlighted that at the close of 2007, proven oil reserves were at 100.0 billion barrels and that this figure is expected to reach 313.0 billion barrels by 2010, which would make this country have the greatest volume of oil reserves in the world. Venezuela expects to make these reserve volumes official once the Orinoco Oil Belt certification process, which is being carried out by Brazilian, Russian, Chinese, Iranian, Indian, and oil companies from other countries, has concluded.

223 cooperatives and PYMES unite to do contract work for PDVSA. A total of 76 cooperatives, 122 small and medium sized companies (PYMES), and 25 companies, were pre-qualified to be able to enter into alliances and be able to opt for contracts with PDVSA Exploración and Producción Occidente, to carry out jobs within the framework of the Extraordinary Maintenance Recovery Plan of the Western Facilities (PREMIO).

Lagopetrol authorized to operate. The Administration granted the mixed company Lagopetrol the right to develop primary exploration, extraction, collection, transportation, and initial crude oil storage activities.

BUSINESS SECTOR TIPS

ArcelorMittal acquires Unicon. ArcelorMittal, the largest steel company worldwide, announced that as part of its strategy to strengthen its position in the market for steel pipes soldiers, to acquire Unicon, Venezuelan company engaged in such activity.

SENCAMER prohibits Cemex to sell cement. The National Autonomous Service for Quality, Metrology, and Technical Regulations (Sencamer) prohibited Cemex to market Portland cement. The company has also been issued a fine it must pay for VEF3,763. Cemex pointed out in a statement that *"the company will obey the measure, but does not agree with the decision made by the organism, and therefore, the company plans to take all the necessary actions aimed at normalizing the supply of our product in the shortest time possible."*

CAF loan. The Andean Development Corporation (CAF) announced that they have approved a loan for US\$50 million for the Drinking Water and Treatment Plant program in urban and rural areas which will have a cost of US\$72.3 million. The rest of the money will come through local contributions. The states that will benefit from this program are Amazonas, Anzoátegui, Aragua, Bolívar, Cojedes, Delta Amacuro, Sucre, and Trujillo.

License plates changed. This past December, the first phase of the license plate change program started introducing the new license plates that will identify Venezuelan cars. The director of vehicle registry of the INTT announced the delivery of 300 thousand new plates to car assembly plants around the country. The director also announced that the license plate exchange program will be done progressively for all vehicles around the country between 2008 and 2009.

PEQUIVEN denies increasing fertilizer prices. Since 2003, no official price increases have been made to fertilizers for agriculture, therefore these should have nothing to do with the cost structure of items like rice, corn, sorghum, and sugarcane, among others, assured Saúl Ameliach, president of PEQUIVEN. These statements were made in answer to what the head of the Federation of Agriculture Producers Association (Fedeagro), Gustavo Moreno, said about a supposed increase of up to 40.5% on the

price of agrochemical items which would affect the price of agriculture food items and producer's profits.

Problems in the bakery market. Tomás Ramos, president of the Venezuelan Federation of Bakery Industrialists (Fevipan), made reference to the problems with the supply of flour that occurred last year. According to industry figures, wheat flour supply is down by almost 50%; this has negatively affected the production of salted bread.

Three Iranian dairy plants installed. The Government is currently constructing three milk processing plants in the municipalities of Torres (Carora), Urdaneta (Siquisique), and Simón Planas (Sarare), in the state of Lara. The vice-minister for Communal Economic Projects, Marlene Arenas, pointed out that the plant in Carora will have the capacity to process 36 thousand liters (9,513 gallons) of cow's milk a day and VEF12 million will be invested. The other two plants are expected to process 18 thousand liters (4,756 gallons) of milk a day with an investment of VEF8 million.

Poultry (chicken) imports increase by 83.5% during 2007. The increase in the consumption of food items during 2007, calculated at 40% by the former Minister of Food, Rafael Oropeza, was clearly reflect by the poultry sector which registered an 83.5% increase in imports. The figures from the National Federation of Poultry Breeders of Venezuela (Fenavi) indicate that during 2007, 101,000 tons of chicken were imported, while in 2006, only 55,000 tons were bought from aboard.

More loan controls for agriculture. The reforms made to the Agriculture Sector Credit Law puts an end to the banks discretion in deciding how much of the financing earmarked for agriculture goes to the producer and how much goes to finance the crop. The reform *"not only defines how much of the total bank loan goes to agriculture, but it also fixes the primary sector percentage and the agro-industry sector."* Furthermore, the Ministry of Agriculture *"will establish the items of each one of the sectors that will make up the agriculture loan portfolio,"* a decision that up until now had been left to the bank.

Pre-paid credit card have expired. The extension granted for the use of pre-paid credit cards expired on January 11th. The extension was granted due to requests made to the Bank Superintendency from banks around the country.

Car sales dropped by 19.6 % in December. Car sales in Venezuela dropped 19.6% during the last month of 2007, registering the sale of 42,350 units, which represents 10,308 less cars than what were sold in November of the same year, according to the Venezuelan Automotive Chamber. However, this drop didn't prevent the industry from registering a record year in sales at the close of 2007 with 491,899 cars sold. This figure represents a 43.3% increase compared to the 343,351 cars sold between January and December 2006.

Only 14%. The Government pushed back the date that car assembly plants have to have made the adjustments necessary to their assembly process to include natural gas processing equipment for the vehicles that come off their production lines to July 1st. This is how it is stated in the joint resolution 354, 1970, and 280 of the Ministries of Light Industry and Commerce, Finance, and Energy and Petroleum, published in the *Gaceta Oficial* dated January 9. PDVSA Gas would have standardized 40% of the models produced in the country (there are over 100 models), but according to industry spokespeople, only 14% of the total catalogue are really apt to run on natural gas. In the same *Gaceta Oficial*, the creation of the Socialist Mixed Company for Venezuelan Vehicles was decreed, which will make cars for the National Armed Forces.

Aeropostal has a new president. Abelardo Valiño, with 11 years experience in Aeropostal, was recently named president of the company. Valiño expects significantly re-structure the company.

Political Tips

A “small amendment” to the Constitution proposal. During the President’s yearly message to the National Assembly, he referred to a possible “small amendment” to the Constitution, insisting on the issue of an indefinite reelection option. He pointed out that *“since I have the power to call for a referendum, if the opposition doesn’t do it, I would, a recall referendum against myself, but with two questions: Do you agree with Hugo Chávez continuing to be President? And Do you agree with making a small amendment to the Constitution to allow for indefinite reelection?”*

The year of Socialist training-orientation. This is the year the Government expects to carry out socialist training-orientation workshops in ten companies (public and private) in each one of the country’s 24 states. This process will be mainly carried out by the Daniel De León School of Socialist Training-Orientation. The main subjects presented will have to do with socialism, contemporary history, and critical thinking.

Antarctic Presidential Commission created. This Commission was created Aimed at advising the Administration on matters related to climate changes. It will be attached to the vice-presidency, and coordinated by the Ministry of the People’s Power for Science and Technology. The office of the secretary general of the Commission will be held by the Ministry of the People’s Power for Environment.

Rodrigo Cabeza to run for governor of Zulia state. The former Minister of Finance announced that he was one of the possible candidates interested in running for the governor's office of the state of Zulia; however, the decision depends on the United Socialist Party of Venezuela (PSUV).

Government will re-launch the missions this year. The President mentioned in his speech before the National Assembly that the missions will be reviewed and re-launched during the first quarter of 2008, with the objective of strengthening them and making them more effective in reducing the poverty index.

Disagreement in the National Assembly. Last week, representatives of the National Assembly argued amongst themselves while trying to come to an agreement concerning the make-up of the 15 permanent commissions to the Parliament. The disagreement was mainly among one group of representatives that see themselves as being a "renewing" faction, who don't support the president of the Legislature, Cilia Flores, and other groups who are loyal to her. The "renewing" faction already has a list of the candidates for the key positions, while the other group is of an opinion that the decision should be decided by all.

Chávez requests that the FARC and the ELN not be considered terrorist groups. During the President's yearly message to the National Assembly, where the President should be talking about the state of the nation regarding economic, political, social, and administrative issues, he mentioned the subject of guerillas. In his own words, the President said: *"I request of the countries of this continent and Europe, to take the FARC and the ELN off the terrorist group lists because the only reason they are on it is because of: the pressure from the United States."*

Upcoming election. The upcoming election to elect governors, mayors, and regional representatives are scheduled to be held on Sunday, November 9th or Sunday, November 16th. The CNE drive to update the National Electoral Registry begins during the second week in February. New voters, and voters who need or wish to change their assigned voting center to vote can make these changes up until the second week in August, when the updating drive will close.

Other Tips

Gold tops US\$900 for the first time in NY. The most traded future gold contracts in New York reached record price levels at US\$900, which reflects strong investment tendencies in this precious metal which serves as an investment shelter in times of economic

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uncertainty. This latest figure puts gold prices at near record for the first time in years. The weakening US-dollar before the Euro and other currencies, which has been persistent since last year, has increased the attractiveness of this and other precious metals that are traded in US-dollars and are looking more profitable to investors. It's expected that demand for these metals on the world market will continue.

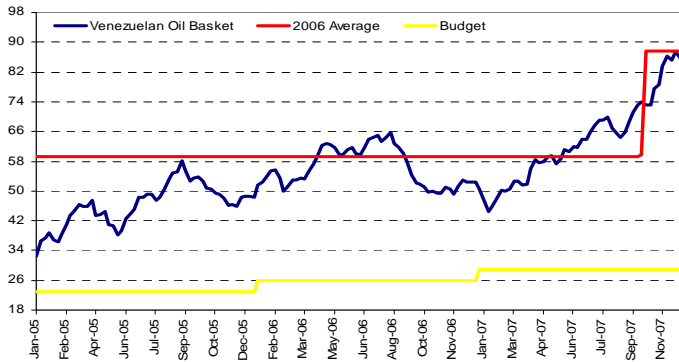
Leaders are from Brazil. The oil company Petrobras and the mining company Vale do rio Doce closed 2007 as the highest-rated open capital companies in Latin America. At the top of the market value, the Brazilian companies beat out the Mexican company América Móvil which came in third, according to a study made by an economic consultant company.

Our fiscal policy is the most expansionist. According to a report published by the CEPAL, titled "*La macroeconomía de la bonanza económica latinoamericana*" (The macroeconomics of the Latin American economic bonanza), Venezuela "stands out for having the most expansionist fiscal policy, accompanied with monetary and loan policies that are also pro-cyclic." On the other hand, only Argentina and Venezuela have seen their risk-country factor affected by elevated levels of political uncertainty.

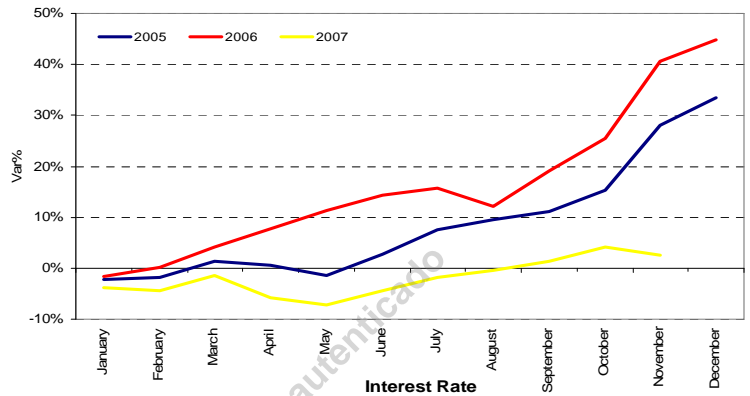
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ECONOMIC OVERVIEW

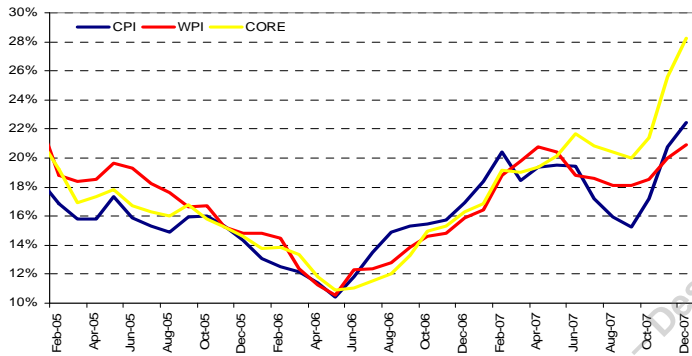
Oil Price
(Venezuelan Basket US\$/pb)



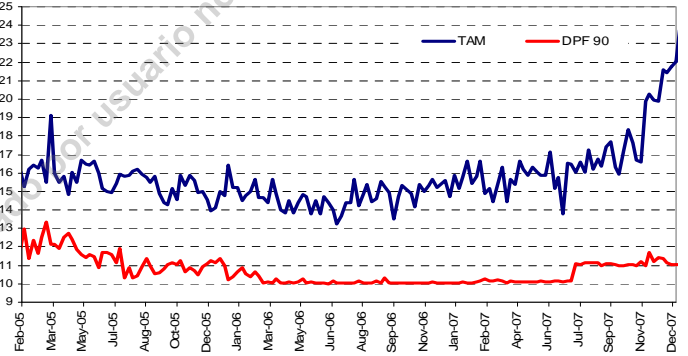
Real Expansion (M2)



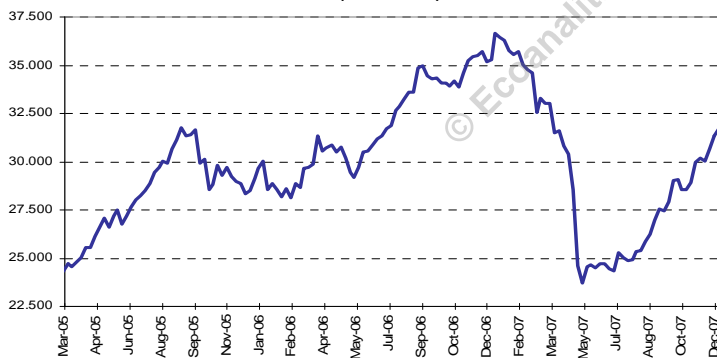
Inflation
(Last 12 Months)



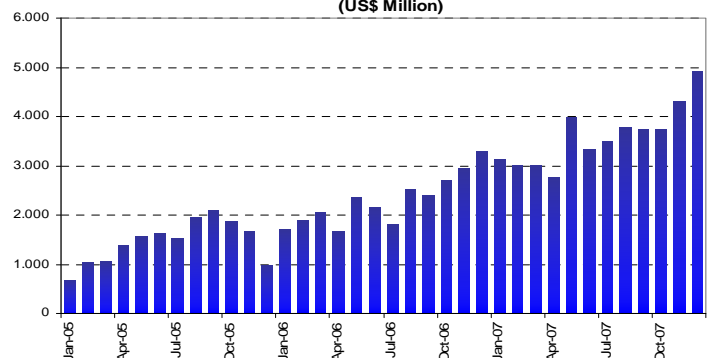
Interest Rate
(Six Principal Banks)



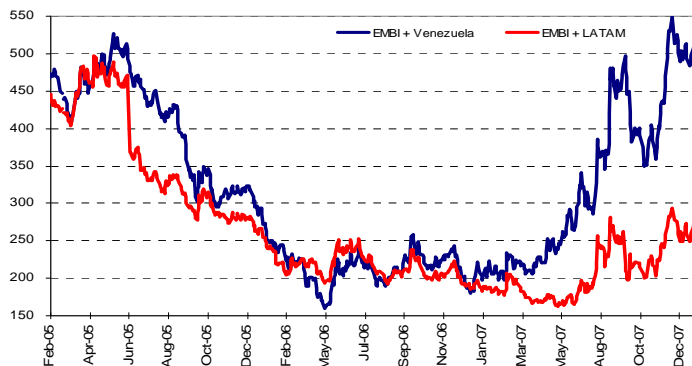
Fx Reserves - BCV
(US\$ Million)



Disbursement
(US\$ Million)



EMBI



Central Government
(VEB Billion)

