



Year 4, Number 33  
Week IV August 2008

## **GROWTH IN THE SECOND QUARTER PICKS UP**

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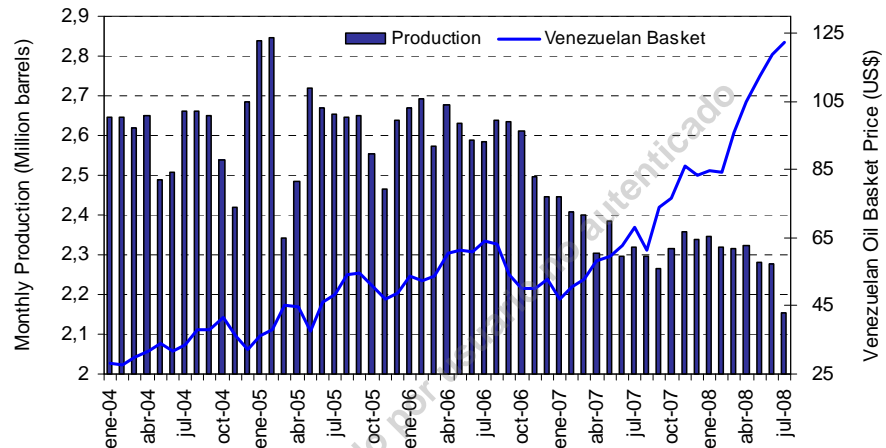
According to the figures recently published by the Central Bank of Venezuela (BCV), Venezuelan economy grew 7.1% during the second quarter of the year (2Q08) compared to the same quarter in 2007. This figure is substantially higher than the growth registered during the first quarter of 2008 (1Q08) (4.9%), when the economy started showing signs of slowing down as a result of the various fiscal and monetary restrictive measures applied by the government since the second half of 2007, which we have referred to in repeated occasions. Our economy has been performing well for 19 quarters in a row, with an average growth rate of 11.2%. However, GDP cumulative growth is 5.9% for the year-to-date.

### **The oil sector continues to recover**

Figures show that the oil sector has expanded 3.2% during the second quarter of 2008, following the trend prevailing in the proceeding quarter when growth was at 3.3%, and ending the negative growth streak the sector experienced for two whole years (2006-2007) when it shrunk 9.7%. Finally, PDVSA decided to curb the fall in oil production, increasing investments over recent months. According to BCV, oil volumes exported by mixed companies and PDVSA increased by 3.3% during the same

quarter, in addition to the “favorable development of the Venezuelan basket average price,” that increased 79.9% compared to the average price for the same quarter in 2007.

**PDVSA Oil Production and Venezuelan Oil Basket Price**

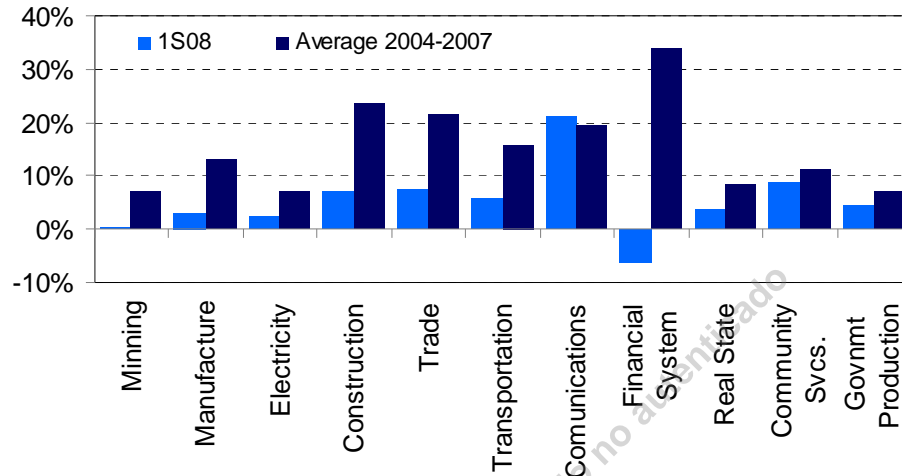


Sources: Bloomberg and Ecoanalítica

### The non-oil sector is another story

The non-oil sector, in turn, posted 7.8% growth. While this percentage surpassed the 5.0% of the first quarter 2008, it cannot be compared to the 12.4% average expansion observed between 2004 and 2007. During the first half of the year, the economic activities that grew the most were Communications (21.1%), Trade and repair services (7.3%), Construction (7.1%) and Transportation (5.8%). However, average growth of these sectors between 2004 and 2007 was 19.7%, 21.4%, 23.7% and 15.8%, respectively, which means that, except for telecommunications, these sectors have performed worse this year than in previous ones.

## Economic Growth by sector



Sources: BCV and Ecoanalítica

### Two sectors improved in comparison to 1Q08

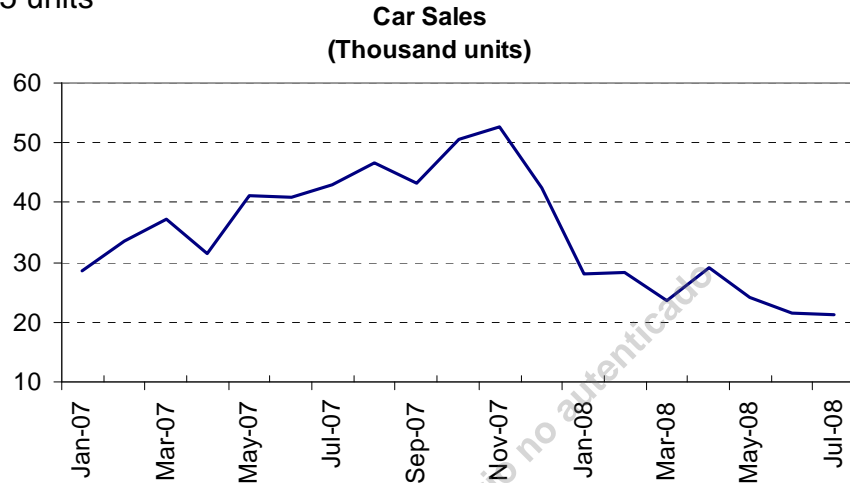
However, it is worth highlighting the positive recovery experienced in the second quarter of 2008 by the two most important sectors of the economy, classified as such due to their labor intensive nature and to the significant influence they have on employment levels. These sectors are manufacture and construction, which grew at a moderate rate of 2.6% and 1.4% in the first quarter of 2007 and 11.7% and 4.5% in the second quarter of 2008, respectively. BCV points out that the recovery of the construction sector is the result of the increase in demand for construction on the part of public sector (1.5% due to growth of oil companies) and private sector (23.2% given the increase in the construction of homes and works for industry and commerce). Concerning the manufacturing industry, BCV reports an increase in clothing (21.0%), paper (19.4%), non-metallic minerals (8.9%), and lumber products (81%), among others.

### Although some sectors have had a rough time

Although BCV reports a deceleration of the vehicle subsector, the bank doesn't reveal the real magnitude of this process when it refers to the manufacture sector. Since early 2008, the government has been making efforts to reduce the levels of foreign exchange allocated to the automobile sector, arguing that this sector was particularly benefited by CADIVI in 2007, and this allowed it to register historically high sales volumes (490,899 units). The creation of the so-called "import licenses" that limit the amount and models of vehicles that may be imported, along with the different obstacles at the time of applying to obtain permits, has

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had a devastating effect on the sector that over seven months sold only 175.885 units

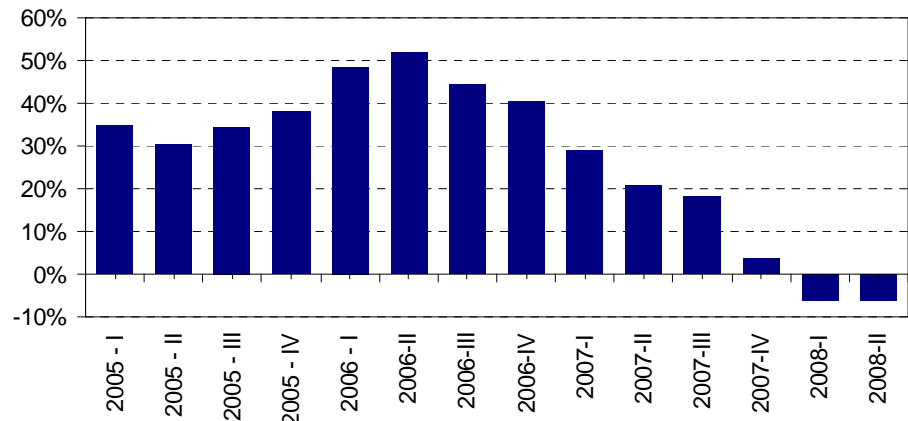


Sources: CAVENEZ and Ecoanalitica

**The worst impact comes from the performance of the leading sector**

A factor that started worrying us since late 2007 was the imminent slowing down of the Financial Institutions and Insurance sector. Between 2004 and the end of 2007, this sector was the one that most benefited with the Venezuelan economy's growth, posting average growth rates of 34.1% quarter after quarter. But this development began to lose momentum since 1Q07, until this year when growth rates became negative and fell 6.4% in the first quarter. This is the immediate result of the decisions concerning monetary policies made by BCV (increase of interest rates, control over bank fees and increase of legal bank reserve), as well as of the changes in payment flows implemented by the Ministry of Finance.

**GDP Financial Sectors and Insurance Companies  
(Annual Var)**



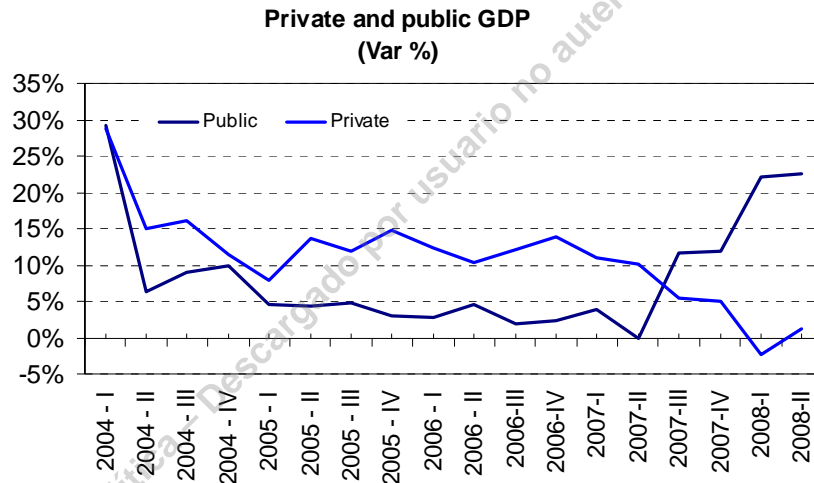
Sources: BCV and Ecoanalitica

**The public sector advances...**

Another point that deserves mention is the trend change in the development of the product generated by each industrial sector. During the second quarter of 2008, the public sector GDP expanded 22.6%, accumulating 22.2% growth for the first half of the year. Over the four previous years, the public sector activity increased at a pace of 5.4% on average.

**In the detriment of the private sector**

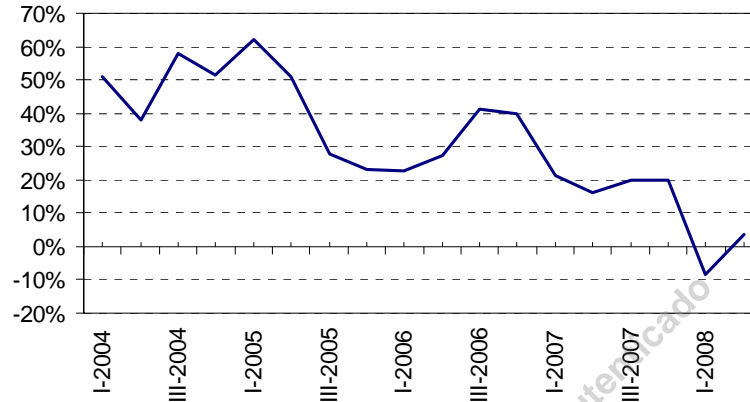
Meanwhile, the private sector grew only 1.1%. This along with the 2.2% contraction during the first quarter of 2008 resulted in a 0.5% drop during the first half of the year.



Sources: BCV and Ecoanalítica

This change was a consequence of the nationalization process of a considerable part of the country's production structure, including private oil companies that were involved in the operative agreements of the Orinoco Oil Belt (mixed companies) as well as electric power, telecommunications and food producing companies. Needless to say that this trend will become more marked as the government takes total control over the recently nationalized companies, including SIDOR, Banco de Venezuela and the cement companies. Given the climate of uncertainty provoked by the wave of nationalizations, it can be expected that the private sector will continue to grow at extremely moderate rates or even at negative rates, since this kind of climate generates no incentives for investment by private companies.

**Total Investment  
Quarterly Variation(%)**



Sources: BCV and Ecoanalítica

### In the detriment of the private sector

Given the significant increase of State involvement in the country's production apparatus, the Government faces a gigantic challenge. In its effort to advance the socialist production system, the current administration assumed a number of activities, some of which it had never performed before. This isn't an easy task; performing under criteria of strict efficiency isn't precisely the government's specialty, but this will be a key factor if it expects to obtain a positive balance in this new facet.

### We expect that growth will continue for the rest of the year

We, at **Ecoanalítica**, anticipate that public spending will continue to be the driving force of the country's economic activity for the rest of the year. The prevalence of high oil prices and the accelerated approval of supplementary appropriations over recent months lead us to project a 6.2% growth for the second half of the year, with a growth rate of 6.1% by the end of the year, down from the 8.4% registered at the close of 2007. Our estimate for the non-oil sector growth for this year is 6.5%, whereas oil activity will reflect growth levels close to 3.6%.

## Economic Tips

**The purchase of Argentinean Bonds hasn't finished yet.** Officials of the Argentinean government inform that the purchase of US\$3.0 billion of Argentinean bonds in 2008 was agreed with the Venezuelan government. Of this amount, only

US\$2.0 billion have been bought. The remaining amount is expected to be purchased before year's end.

**On some conditions.** It was also known that Argentina is considering the possibility that the next bonds to be bought by Venezuela aren't negotiable on the secondary market. In this case, the Venezuelan government should hold them until maturity so as to avoid adverse consequences on the credit quality of that country. However, this would not make any sense for the Venezuelan government since the main purpose of the Boden purchase is to use them to inject liquidity to the parallel foreign exchange market.

**Increasing spending.** The National Assembly has approved a total of VEF 33.2 billion in supplementary appropriations. This means that total spending for this year, including VEF 137.5 billion included in the budget, already amounts to VEF 170.7 billion. This represents an increase of 24% in annual spending. Supplementary appropriations have been financed with resources remaining from 2007 and with reimbursements from some public institutions.

**Funny statements.** In a TV interview, the Minister of Economy and Finance, Alí Rodríguez Araque, pointed out that the deadline for banks to eliminate their holding in structured notes is September 24<sup>th</sup>, because it has to be calculated based on working days. However, we have been informed that each case was examined separately, so that each bank was granted a different deadline, ranging between 3 and 18 months.

**Estimates are adjusted.** Minister Rodríguez Araque also informed that 2008 could close with an inflation rate of 27%, up 15 points from the target stated in the budget (12%) and up 7.6% from the target of 19.5% set later by the government.

**20 million for Uruguay.** The Venezuelan government contributed US\$20 million that will be used to remodel two hospitals in Uruguay, which will be re-inaugurated in 2009 by President Chávez. According to the El Universal newspaper, this contribution was made within the framework of the Cooperation Protocol signed by both countries in 2006.

**The same for Honduras.** Chávez announced that Venezuela will provide Honduras with economic assistance, including boosting the Agricultural Bank of that country by supporting the development of micro credits for small and medium sized rural producers. The Venezuelan president also announced the donation of 100 tractors for Honduran farmers.

**Mercal helps reduce extreme poverty.** According to a study conducted by the National Statistics Institute (INE), the government managed to reduce poverty by 2.8% through the food subsidy of this network. If the program would not exist, the percentage of homes with serious economic needs would have closed in 10.7% the second semester of last year. INE highlights that the existence of Mercal allowed extreme poverty to close in 7.9% the second half of 2007.

**Honduras becomes member of ALBA.** The president of Honduras informed that the Central American country will sign its accession to the Bolivarian Alternative for the People of our America initiative in a ceremony with his counterparts from Venezuela, Nicaragua and Cuba. He also pointed out that he expects that the US will not take reprisal against Honduras because they are allies and the US must *"respect the freedom of association and integration with Central America and Latin America in order to advance."*

**International Reserves.** International reserves closed Wednesday, August 27th at US\$37.80 billion, up by 3.12% compared to the previous week when they were at US\$36.51 billion.

**Interest rates.** Interest rates for the six main banks around the country were at 24% on Friday, August 22th, up 0.25% compared to the previous week when they were at 23.94%. Time deposits were down by 0.53% and settled at 17.10% during the same week.

**Monetary liquidity.** For the week ending on Friday, August 15th, monetary liquidity was at VEF 162.63 billion, down by 0.33 percentage points compared to the previous week when it was at VEF 163.17 billion.

## OIL TIPS

**Prices pick up again.** Thanks to the tropical storm Fay that attacked the Gulf of Mexico, the decreasing trend of oil prices reverted. As a consequence, on the third week of August the Venezuelan oil basket showed a slight increase of US\$ 0.7 with respect to the second week of the same month, to close the week at an average of US\$ 108.6 per barrel and reach a cumulative average of US\$ 110.5 for the month.

**International markers also increased.** The prices of WTI and Brent international markers increased at the close of the third week of August. The WTI gained US\$1.1 to average US\$ 115.8/bbl., and Brent increased US\$ 1.6 to close at US\$ 114.5 per barrel.

**OPEC dropped.** Although WTI and Brent managed to increase their weekly averages, the OPEC basket lost US\$ 1.1 to drop for the fifth week in a row and closed at US\$ 109.6 per barrel.

**More resources to FONDEN.** Calculating an export volume of 2.2 million b/d (excluding mixed companies at the Oil Belt) and a cumulative mean of US\$ 103.7 per barrel for the year-to-date, PDVSA has received about US\$35.4 billion of extraordinary revenues, most of which are being directed to FONDEN pursuant to the windfall profits tax.

**PDVSA to perform the expropriation.** To speed up the expropriation process announced last week by the Executive office, PDVSA would be entrusted with the performance of the expropriation. However, the procedure could not be completed due to the differences between the decree and the law.

**In the hands of the new regional authorities.** Last week President Chávez announced that the a regional authority as the one and only authority for the Belt would be entrusted with the development of the Orinoco Oil Belt in order to plan regional public policies in accordance with centralized planning.

**“Petrochemical revolution makes its way.”** The government will earmark US\$ 950 million of FONDEN for petrochemical plants. According to PEQUIVEN president, Saúl Ameliach, production of the different resins will reach 2 million tons by 2012.

**Negotiations go on.** According to Eulogio del Pino, vice president of exploration and production of PDVSA, negotiations between the Venezuelan oil company and ConocoPhillips to reach an agreement as to the compensation for the assets expropriated in the Oil Belt and the Gulf of Paria progress parallel to the arbitration process initiated by the US oil company before the International Centre for Settlement of Investment Disputes (ICSID).

**New oil agreement just around the corner.** President Chávez has plans to sign an agreement with South Africa’s state-owned oil company PETROSA, according to which this latter would acquire hydrocarbon assets in Venezuela. Reuters reports

that PETROSA has had talks with PDVSA on oil exploration and production projects in the Orinoco Oil Belt.

**Energy crisis in Barinas.** According to CADAFE Barinas distribution coordinator, Nilio Germán Silva Navas, power generation crisis in Barinas became more acute last week, due to the shutdown of the Termobarrancas plant for maintenance.

**PDVSA will address athletes' needs.** Besides its activities of crude oil exploration, exploitation and transformation, President Chávez has entrusted PDVSA with a number of additional tasks over recent years, including housing construction; food production, import and distribution; and the organization of educational plans. In the last *Aló Presidente*, for instance, president Chávez asked the Minister of Energy and Mines and president of PDVSA to take care of the athletes with potential to participate in the Olympic Games.

## BUSINESS SECTOR TIPS

**Decreased Collection.** According to the last figures published by SENIAT, tax collection in July was at VEF 5.76 billion, down 12% in real terms from tax collection in July last year. Collection for the first seven months of the year reached VEF 42.44 billion, a figure that reflects a real contraction of 24% in comparison to the same period in 2007. The item exhibiting the greatest drop is Income Tax (-52.5% in real terms), as a consequence of the reform according to which oil companies no longer pay this tax to SENIAT. In addition, the actual drop of 21% in VAT collection is mainly determined by the cutback in the aliquot introduced around the middle of last year.

NATIONAL TAX COLLECTION (VEF Millions)				
JULY				
	2008	2007	Var %	Real Var %
<b>TOTAL</b>	5.758	6.452	-10,8%	-12,2%
<b>Income TAX</b>	1.843	3.435	-46,3%	-47,2%
<b>Tax</b>	2.520	1.445	74,4%	71,6%
<b>Customs</b>	785	719	9,2%	7,5%
<b>Others Incomes</b>	610	144	324,8%	317,9%
JANUARY- JULY				
	2008	2007	Var %	Real Var %
<b>TOTAL</b>	42.442	43.414	-2,2%	-24,4%
<b>Income TAX</b>	13.261	21.583	-38,6%	-52,5%
<b>Tax</b>	16.057	15.784	1,7%	-21,4%
<b>Customs</b>	4.667	4.887	-4,5%	-26,2%
<b>Others Incomes</b>	2.842	837	239,4%	162,4%
<b>ITF</b>	5.614	-	-	-

Sources: SENIAT and Ecoanalítica

**The State reserves for itself fuel “intermediation”.** The chairman of the Energy and Mining Commission of the AN, Ángel Rodríguez, expects that negotiations with fuel supply intermediary companies that are to be nationalized or expropriated will last a maximum of 60 days, once the Organic Law for Rearrangement of the Liquid Fuel Domestic Market is passed. The law provides for that by reasons of national interest this activity will be handed over to the State.

**Credit slows down.** The credit expansion trend over the last three years has changed back. Bank loans grew at a 10.2% rate until last July, which is substantially under the 35% registered for the same period in 2007. Loans for the trade sector were the worst performers, growing only 1.9% between December 2007 and July 2008. Even consumption with credit cards, the most dynamic of all, increased 23.5% until July, substantially lower than the 47% growth registered in the same period in 2007.

**Cemex was thinking to sue.** Mexico’s Cemex announced last week that it was to apply for arbitration before the International Centre for Settlement of Investment Disputes (ICSID), because the company considers that the expropriation measure taken by the Venezuelan government violates the “*principles of International Law and treaties for the reciprocal protection of investments, which prohibit the confiscation of assets and the deprivation of rights without a fair and effective compensation and without a previous expropriation proceeding.*”

**Negotiation deadline extended.** However, Vice President Ramón Carrizales announced that a new deadline of 60 days was set to decide on the final valuation of the company. According to Carrizales, negotiations with Cemex are progressing amidst a climate of “harmony and flexibility,” but that it is still “too early” to fix the compensation amount.

**But CEMEX will be CEVEN anyway.** President Hugo Chávez announced that the recently nationalized CEMEX will be now Cementos Venezuela (CEVEN) and that it will work along with SIDOR and PDVSA to guarantee that cement is used first of all for housing projects.

**Enthusiastic Government.** The president also announced that the Corporación Nacional del Cemento will be created as an entity attached to the Vice Presidency of the Republic. This entity will coordinate the operations of all cement producing companies. According to the president, the idea is that each cement plant be related to the production activities carried out in its surroundings: plants located close to oil areas will produce to meet the cement needs of this sector, and the same will happen with the areas where housing projects are being developed, among others.

**CSV will be created.** The incorporation of the Corporación Siderúrgica de Venezuela was also announced. This entity will help the State “recover the national power that was in transnational hands,” because it will integrate the whole steel production chain, from iron ore until the different end products. There is also a plan to establish “Ferresidor,” which is a network of hardware stores that will open up a “socialist market” and will be jointly designed by PDVSA, SIDOR and CEMEX.

**A construction dream.** The President of the Republic announced his wish to establish a national construction company, taking advantage of the recent acquisitions of companies related to this sector. The company would follow the socialist model, according to which the communities will manage production in the pursuit of greater social well-being.

**SIDOR cuts production back.** Despite the recovery of raw material production at the iron and steel company Siderúrgica del Orinoco, now a state-run company, figures for the first half of 2008 show that production has fallen by 470 thousand tons. This drop jeopardizes the production target of 4.3 million tons for the close of the year. The international rise of steel prices (75%) somehow conceals production drop.

**40% of state-run companies have labor conflicts.** Since 2007, a total of 27 national and foreign companies have faced serious labor conflicts with their workers, including blockades of the facilities or requests for nationalization. Of these 27 companies, 11 are already controlled by the State, either as a result of expropriation, intervention or buyout.

**SIDOR still with labor conflicts.** SIDOR's hired workers are protesting asking for their labor demands to be satisfied. After the company was nationalized, there are still about eight thousand workers, hired through approximately 300 private companies, who demand promises of "eradicating hired labor and the exploitation of hired workers," to be fulfilled.

**Fear in the auto parts sector.** According to Omar Bautista, representative of the Chamber of Venezuelan Manufactures or Automobile Products (Favenpa), sales in the auto parts sector fell 5% in the first half of 2008 in comparison to the same period in 2007. This is due mostly to the decrease in the activity of car manufacturing plants, which are the main component of the auto parts sector, which sales dropped 15% in one year.

**Law for the Defense of Citizens to the Access to Goods limits imports.** According to this Law, labels on imported products must state, in Spanish, data concerning their origin, ingredients, expiration date and instructions, among others. Failure to comply with this Law has resulted in a number of products not being able to go through customs, as some representatives of foreign companies have reported.

**More paperwork for the domestic agro-alimentary production.** According to advisers of the Venezuelan Chamber of Food Industry (Cavidea), as a result of the new Decree-Law of Alimentary Sovereignty and Security, about 28 new steps are being created, which will have to be followed by companies to produce and market foodstuffs.

**Seized goods are not to be paid to suppliers.** The president of the Institute for the Defense of Citizens in the Access to Goods and Services (INDEPABIS), Eduardo Samán, informed that goods that are seized from supermarkets due to failure to comply with the regulated price must not be paid by these businesses, because the lack of compliance came from the plant.

**Beef from Paraguay.** In the framework of the agreements signed by both countries, the ambassador of Paraguay to Venezuela informed that his country will export beef to Venezuela. Furthermore, a shipment of 550 Nicaraguan cows was agreed the

third week of August as part of the agreements between Nicaragua and Venezuela in the framework of the Bolivarian Alternative for the Peoples of our America (ALBA).

**Less space for Aeropostal.** Aeropostal signed a new contract with the Instituto Aeropuerto Internacional de Maiquetía, according to which the airline will operate with 40% of the space it had before. Despite of the space reduction, the president of the company claimed that labor stability of the 1,600 employees is assured, as well as the fulfillment of the scheduled flights.

**Bankruptcy.** According to figures of the Bank Superintendent's Office, Banco Industrial, the country's major public bank has accumulated loses in the order of VEF 71 million in 2007 and 2008. At the en of June, the bank reflects the highest delinquency rate of the entire financial system.

## Political Tips

**Imbalanced balance.** The 18 months the Special Powers Law was in force are equivalent to three periods of ordinary sessions of the National Assembly. During this period, President Chávez approved 66 laws while the National Assembly only passed 29.

**IACHR decides in favor of former magistrates.** The Inter American Commission on Human Rights decided that the Venezuelan State violated the articles related to Judicial Guarantees and Protection in the case of the 3 former magistrates of the First Contentious Administrative Court, Ana María Ruggeri Cova, Perkins Rocha Contreras and Juan Carlos Apitz Barbera. The award orders their reinstatement in the Judicial Power, if the magistrates want to come back, and under labor conditions similar to the ones they had before. If this decision is not complied with within six months, the magistrates shall be compensated with US\$ 100,000 each one.

**Former magistrates don't want any money.** The three former magistrates declared that they aren't interested in the payment decided by the IACHR as compensation for damage caused to them or for their not being reinstated in their

former positions. The former magistrates demand their reinstatement in the judicial power.

**The opposition demands CNE to put and end to privileges.** Opposition parties requested the CNE to enforce the law on opportunistic practices due to the abuses committed by parties that support the president, which use resources from the State for their propaganda campaigns.

**The Executive will present draft Law on Social Security.** In a few days, according to the vice minister of social security, Jesús Faría, the Executive will submit to the National Assembly the draft Organic Law of Social Security, pursuant to which all Venezuelans will be included in the social security system, regardless of their status of independent workers.

**More troubles for mass media.** The draft Organic Law of Telecommunications, which is to be approved by the National Assembly, poses a new threat for TV channels and radio stations. The draft law provides for 57 reasons for fines and penalties, 34 more than the law currently in force. The new law also affects license periods, which change from 25 to 15 years. Tax burden to be faced by the sector companies is also increased.

**The “Paquetazo” goes to the OAS.** Primero Justicia party announces that it will support the initiative of several sectors of the civil society and professional associations which will collect signatures to request the Organization of American States, to discuss the current situation of the country, specifically the violation of the Constitutional Order as a consequence of the 26 decree-laws announced by President Chávez in the framework of the Special Powers Law.

**Chávez calls the people to vote to defend his government.** In the last *Aló Presidente*, Chávez called the people to vote for his governors and mayors in the next November 23<sup>rd</sup> elections to safeguard his government. President Chávez claimed: “They want to win to sabotage my government and overthrow me.”

## Other Tips

**Worse economic climate.** According to the study “Latin America Economic Survey,” business climate in Latin America, which has been deteriorating since July 2007, confirmed its negative trend in July with a score of 4.6 points. The report

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states that “*deterioration of the economic climate in Latin America is more related to pessimism over future expectations than over current situation.*” Venezuela occupied position 9 out of 16 countries.

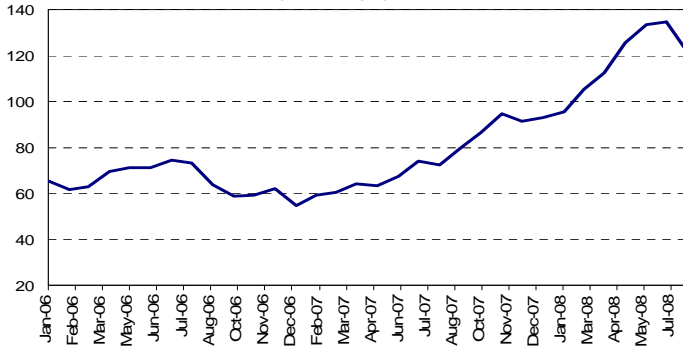
**Venezuela: strong support for democracy.** A survey conducted in 22 countries in the region by the Universidad Católica de Chile reports that Venezuela is among the three first countries that support democracy as a form of government. Venezuela, with 78.4% of votes in favor of democracy, followed Argentina with 86.9% and Uruguay with 85.3%. The least scores were obtained by Peru with 65.5%, Paraguay with 62.9%, Guatemala, 60.5%, and Honduras with 59.9%.

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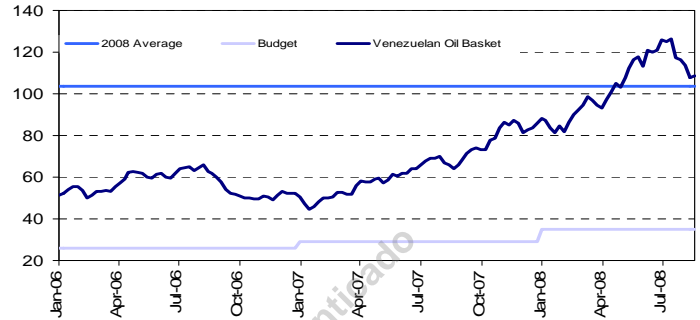
# Weekly Report

## ECONOMIC OVERVIEW

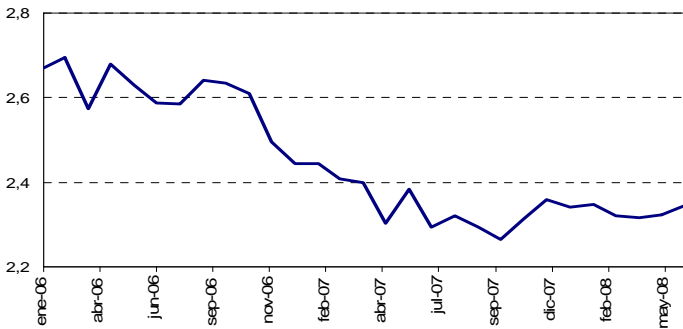
**Oil Prices (WTI US\$pb)**



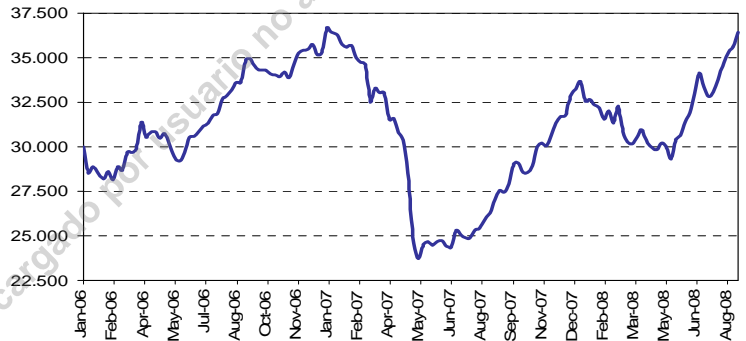
**Oil Price (Venezuelan Basket US\$/pb)**



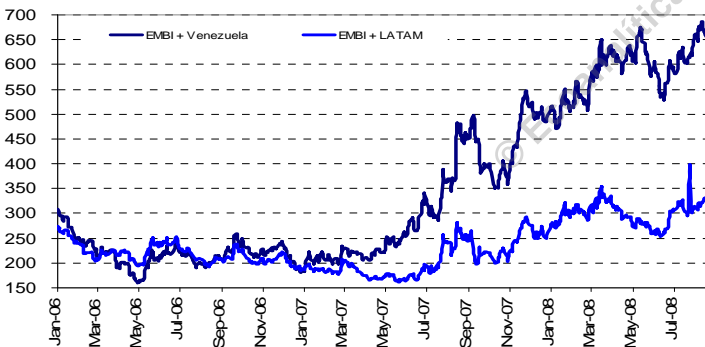
**Oil Production MMB/D**



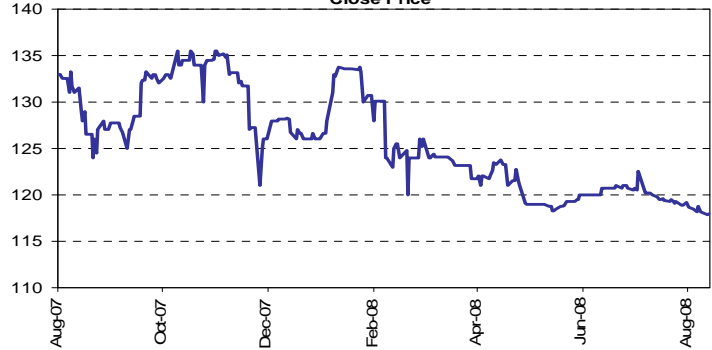
**Fx Reserves - BCV (US\$ Million)**



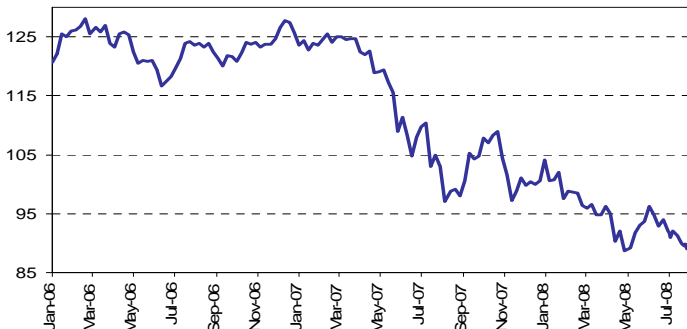
**EMBI +**



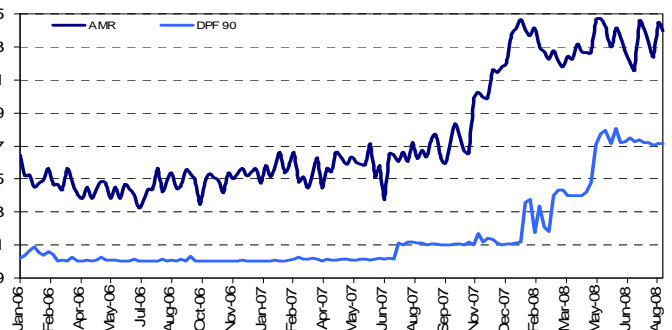
**Venezuelan Global 18 Close Price**



**Venezuelan Global 27 Close Price**



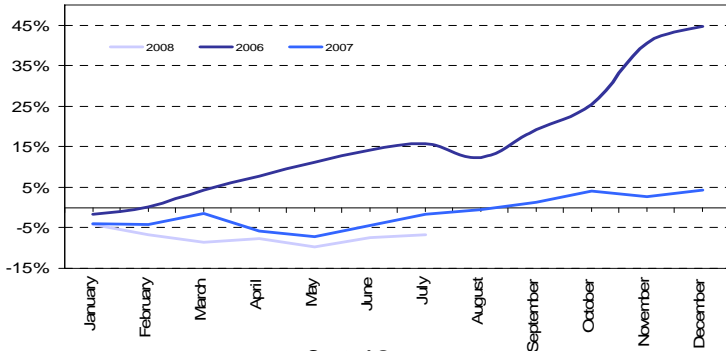
**Interest Rate (Six Principal Banks)**



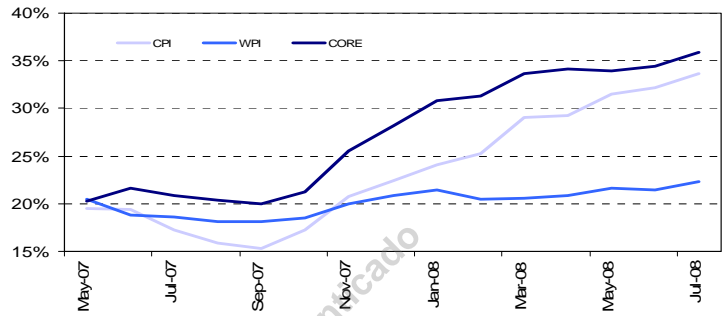
# Weekly Report

## ECONOMIC OVERVIEW

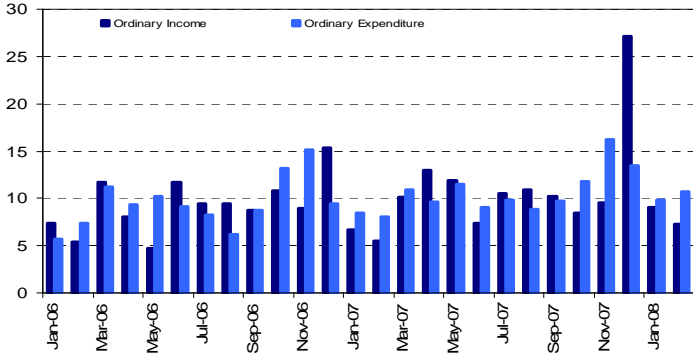
**Real Expansion (M2)**



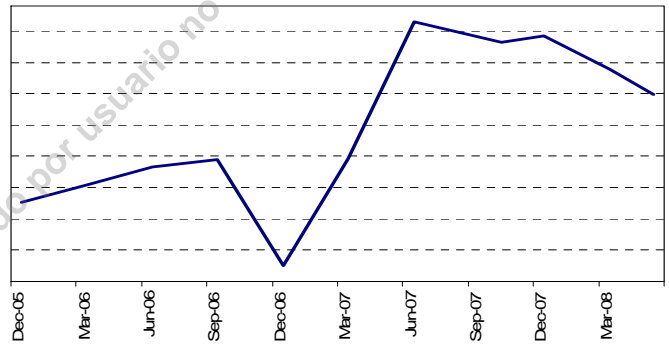
**Inflation (Last 12 Months)**



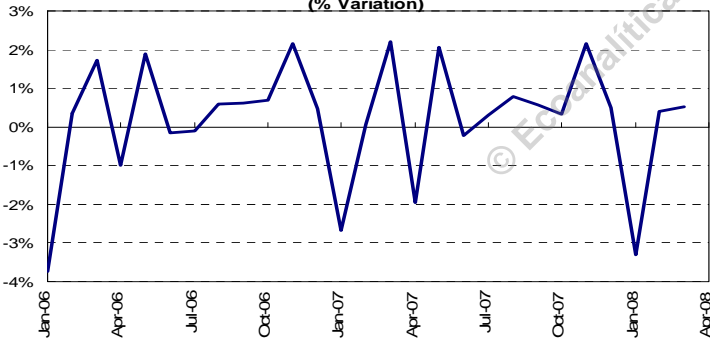
**Central Government (VEB Billion)**



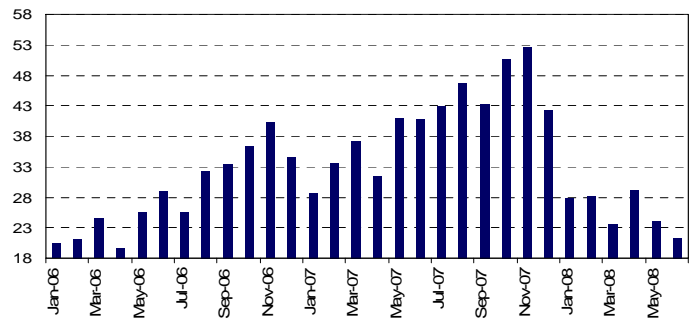
**Resources of the State (US \$ MM)**



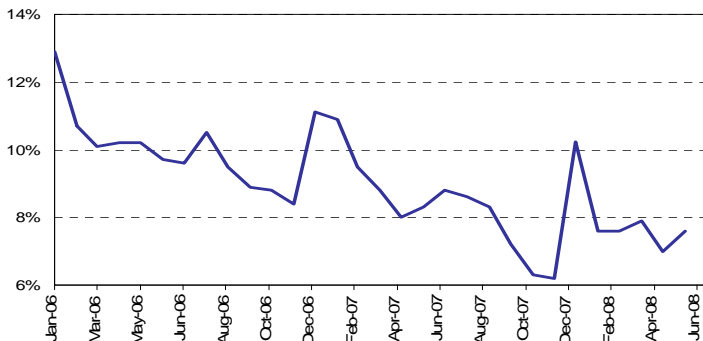
**Volume of Sales (% Variation)**



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



**Rate of unemployment (% Variation)**



**Disbursement (US\$ Million)**

