



Weekly Report

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The Magical State

Popularity and Public Spending: Will it be enough?

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This week we want to take a harder look at the relationship between public spending and the President's popularity. Last week we saw how a significant increase in oil prices would ease pressures on the National Budget which would allow the Administration to increase its public spending without having to increase taxes. This very privileged situation enjoyed by governments with an abundance of certain key natural resources (in Venezuela's case, oil) allow them to buy the will of the people. As you will see, more than 80% of the President's popularity can be explained by the increases (or drop) in public spending and how it is used. In other words, the President's gift for communicating with the people, the radicalization process that the country is currently going through, the lack of a counter part or leadership within the opposition to stand up against the President, etc... everything else only explains 20% of Chávez' popularity.

An infallible President with an Opposition plagued by errors

Many of our clients have the impression that the President is infallible; that any mistake or thing that he neglects is all part of a superior strategy. A great speaker, that through his control of the media and the weakened state of institutions, he is able to hypnotize Venezuelans, drawing them to back his cause, without giving them anything in return. Many of those people see



the Opposition as a fragment of its former self, weakened, plagued with errors and incapable of uniting, despite the fact that since 2004 the Opposition has been presenting unified candidates in most of the elections held since then. They see an Opposition that is incapable of producing a figurehead that can convincingly stand up to Chávez, giving them hope that there is someone capable of assuming the Presidency instead of Chávez.

The source of the President's popularity is money

Without meaning to belittle Hugo Rafael's abilities as a social communicator and as a candidate, the main variable responsible for his high, though recently waning, popularity levels is public spending. Figure 1 shows the 12-months moving average public spending in real terms for the last years alongside the President's popularity levels¹. The first thing that stands out is the high correlation level (78%) between the two variables. In other words, 8 out of every 10 times that public spending goes up (or down) in real terms the President's popularity also goes up (or down). You can differentiate three periods in this graph:

- 1) From July 2001 to July 2003, during which the 12-months accumulated public spending in real terms dropped by 32.0%, and during which the President's popularity drops from 55.8% to 30.8%.
- 2) The second period shows increased public spending from July 2003 to December 2006 where the 12-months accumulated public spending in real terms triples, and the President is able to increase his popularity again to just under 70%. This period was highlight by two elections, the first one in August 2004, in which the President apparently won² through the Missions, a novel institutional structure introduced by the Administration which allowed it to increase public spending by 57% in real terms, and to have these resources directly reach the most needy sectors in a relatively efficient and quick manner. The second election, the 2006 presidential election, during which public spending reached the historic high figure of VEF215.00 billion.
- 3) The third period, from December 2006 until July of this year, during which public spending in real terms has dropped by 19.7% and the President's popularity has also dropped from 66.7% (in December 2006) to 57.3% (in July 2009).

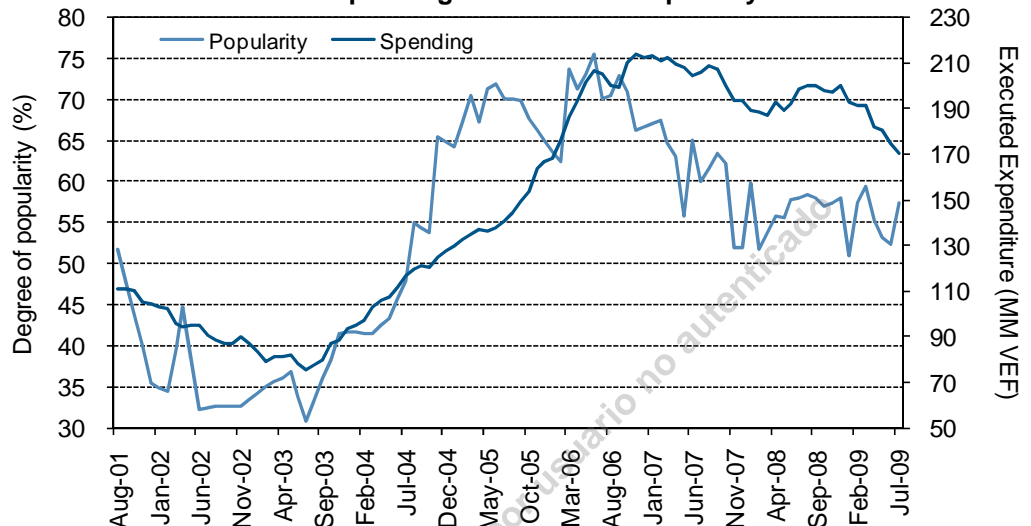
¹ We would like to thank Datanalisis for allowing us access to the data concerning the President's popularity over the years.

² We say "apparently won" because the supposed proof of fraud having occurred during the election was not overwhelming, and because an auditing process was not allowed during this election, allowing the minimum statistical requirements which would have eliminated the doubts and questions which were raised concerning this electoral process.





Real Spending Executed vs. Popularity

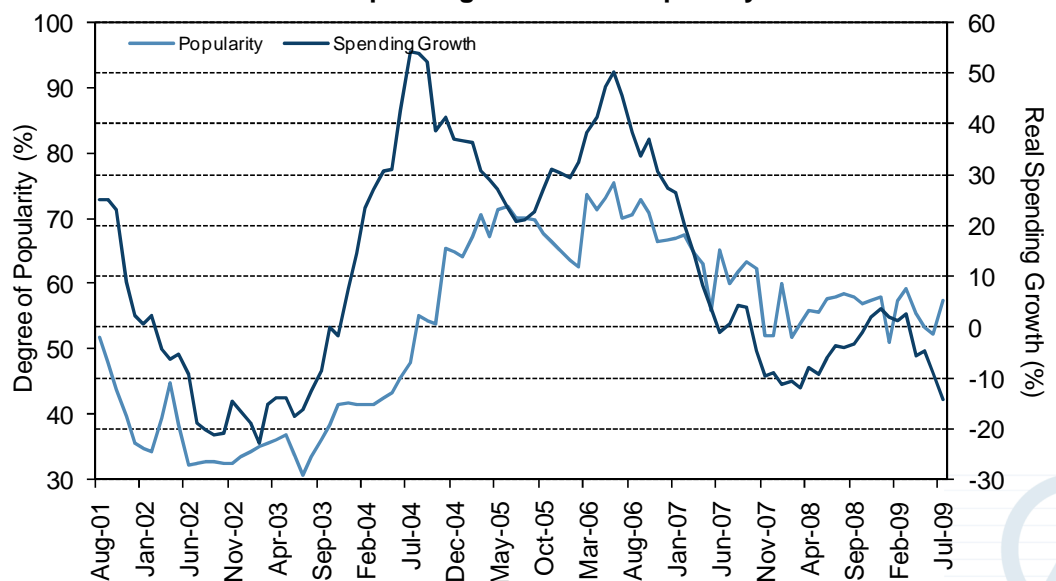


Sources: Oficina Nacional del Tesoro (MF), BCV, Datanálisis and Ecoanalítica

It's not just about more spending, but about how much more...

In terms of how it affects the Administration's popularity, it's not the same when the Government increases public spending by VEF 20.0 billion when the initial level of public spending is at VEF 80.0 billion than when it is at VEF 180.0 billion. The greater the increase in public spending "percentagewise" the greater the jump in popularity, and vice-versa, as can be seen in figure 2, where a greater percentage increase (or drop) of public spending in real terms reflects an increase (or drop) in popularity.

Real Spending Growth vs. Popularity



Sources: Oficina Nacional del Tesoro (MF), BCV, Datanálisis and Ecoanalítica



Public spending and its variations explain 80% of presidential popularity

If we look back, and make the President's popularity a dependent variable, and make the 12-months moving average public spending in real terms, and its percentile variation, into independent variables, we will find that 81.4% of the President's variations in popularity is explained by the level of public spending and how spending changes. This is the same as saying that only 18.6% of the President's popularity is explained by "other" factors such as weakness in the Opposition, or 21st Century Socialism policies, or his Sunday television program *Alo Presidente*, or the nationalization of "strategic" companies, or the approval of laws without public consent, etc.

These calculation also show that the first 24.4 percentage points of the President's popularity doesn't depend on public spending (represents hardcore chavists), and that for every VEF 1.0 billion of public spending, the President gets a 0.1% bump in popularity, and for every 1% increase in real terms of public spending, the President's popularity increases by 0.3%. In other words, the 57% increase in public spending (VEF 42.0 billion) leading up to the 2004 election, represented a 4.2 percentage point increase in the President's popularity, given the new level of public spending, and a 17.4 percentage point increase in popularity due to the increase this amount represented compared to the initial level of spending; together they represent a 21.6 percentage point bump in the President's popularity. In July 2003, the President's popularity was at 33.8%, and according to our model, the President was able to win the August 2004 election with 55.4% of the vote, a figure very similar to the 55.0% average of the President's popularity at that time measured by Datanalisis and the 59.0% of the results released by the National Electoral Council (CNE).

The President is aware of this and this is why he keeps such a close eye on oil prices...

What is probably the President's greatest virtue is that he is aware that his main strength comes from money. This is why he has always been very active on the international scene, lobbying OPEC members to keep oil prices high. We'd like to point out here that we do not believe that the high oil prices that Venezuela has enjoyed over the years and the recent slight increase in prices has anything to do with, nor are oil prices in any way affected by Venezuelan oil policies. It's just one more factor added into the equation along with increasing energy demands from Asian emergent countries, mainly China and India, and the drop in production from OECD countries which have led to prices increasing.

...and why he keeps resources "squirreled" away in different funds

This dependency the Administration has on maintaining the President's popularity through public sending is what has led them to squirrel away significant amounts of resources in a number of different funds which are managed with almost no transparency and are at the absolute complete



discretion of the Executive Office. Chávez doesn't dare take the chance that oil prices drop before an election, just like what happened during the last constitutional amendment election. Oil prices dropped by almost 70%, but the Government was able to maintain high levels of public spending which allowed it to win the constitutional amendment referendum for indefinite reelection.

What can we expect in the future?

As we have mentioned before, it's not enough just to keep public spending levels high, you also have to be able to continually increase them. Oil analysts expect that oil prices have to remain at current levels, if not slightly higher, and almost none of them expect oil prices to be increasing very significantly in the next few years. In other words, a sustainable increase of public spending in real terms in the middle term is not realistic, to put it mildly. Plus, a Government that for a number of different reasons (nationalizations, exchange controls, etc.) is not very efficient in making sure that spending gets to the sectors that most need it, is a Government that is headed for some serious problems in terms of popularity. This is why, just like our growth analysis of last week, to keeping public spending at these high levels will not be enough to maintain the President's popularity.

The Magical State

In 1997, Fernando Coronil published a book called "the Magical State: Nature, Money, and Modernity in Venezuela. The book includes the following quote from José Ignacio Cabrujas "The oil industry appearing in Venezuela created a kind of cosmogony. The State immediately acquired a "providential" matrix. It went from painfully slow development, like development is when it's based on agriculture, to a miraculous and spectacular development...A candidate that doesn't promise the people paradise is committing political suicide. Why? Because the State has nothing to do with our reality. The State is a magnanimous magician...Oil riches had the power of myths...Betancourt, Leoní and Caldera didn't go too far in that "Venezuelan Dream" because budgetary realities didn't allow them to. We were still rich, just not so rich. But then the other Pérez, Carlos Andrés Pérez, and then we found the phrase that defined us. We were building The Great Venezuela. Pérez wasn't a President, he was a magician." Cabrujas would probably say that, Pérez was the opening act, and Hugo Rafael Chávez a reprise.

This book tries to make sense out of the transformations suffered by Venezuelan society during the last century, led on by promises of collective progress and how oil played its part. When a country sees its revenues increase by six times during the last six years, the Government can



significantly expand these revenues and if it so wishes, lower taxes. The capacity of the State...

Economic Tips

The IMF grants Venezuela US\$3.43 billion in Special Drawing Rights (SDR) to increase RRII. The multilateral entity granted each one of its 186 members, resources through special drawing rights (SDR) in order to strengthen reserves and provide the financial system with increased liquidity. Venezuela received US\$3.43 billion; this amount is proportional to the quota that Venezuela contributes the IMF. Countries may keep the SDRs or sell them to third countries in a market controlled by the IMF. The IMF injected US\$250.0 billion to global economy and the organization will grant another US\$33.0 billion on September 9th.

Unemployment increased to 8.5% in July. Unemployment rate went from 7.2% up to 8.5% from July 2008 to July 2009, due to the deceleration of the economy. Unemployment increase from 7.8% to 8.5% between June and July 2009 means that 94,373 jobs were lost in only one month. We at **Ecoanalítica** do not expect any substantial improvement in job creation in the second half of the year.

10% minimum wage increase in force. The 10% minimum wage increase entered into force on September 1st. With the increase, the current minimum wage is now VEF 967.06. Cendes' director, Oscar Meza, expressed that almost two minimum wages are required to pay for the basic food basket, which includes 56 different food products for a household with five members. According to figures estimated by Cendes, this amount was closed at VEF 1,712.56 the month of July.

Approved conditions for new bond issues. The Finance Committee of the National Assembly approved in August the conditions governing the issue of VEF 12.15 billion (US\$5.651 billion) in public debt bonds. Ricardo Sanguino stated that the Government can sell a portion of the bonds in dollars, which are included in the 2009 Borrowing Law.

Inflation. According to BCV figures, the National Consumer Prices Index rose by 2.2% in August, slightly higher than the variation shown in July (2.1%). According to this index, inflation in the last 12 months was 26.7% and the cumulative price increase since December 2008 is 15.6%. Furthermore, the Consumer Price Index for the metropolitan area of Caracas presented a variation between July and August of 2.0%.



In **Ecoanalítica** we expect an acceleration of price growth in the short term because of the increased minimum wage and rising prices of some basic items for the month of September.

Fiscal management continues to be characterized by the deficit. According to the BCV's monthly report for the month of May until the fifth month of the year the central government tax revenue received by the order of VEF 45.564 million, which means a contraction of 35.8% in real terms compared to same period of 2008. Meanwhile, central government spending stood at around 62,900 million VEF, which means that total expenditure fell by 23.8%, compared with the same period last year, but less rapidly than revenue. As a result, the government has a fiscal deficit, from which a little over 60% of the funding needs were supplied with domestic borrowing.

FISCAL BALANCE CENTRAL GOVERNMENT (VEF Millions)	May 2009	May 2008	Nominal Variation	January-May 2009	January-May 2008	Nominal Variation	Real Variation
Total Revenue	8,629	10,130	-14.8%	45,564	54,996	-17.2%	-35.8%
Non-Oil Revenue	5,645	5,434	3.9%	31,013	33,957	-8.7%	-29.3%
Oil Revenue	2,833	4,697	-39.7%	14,400	20,779	-30.7%	-46.3%
Total Expenditure	15,769	13,588	16.0%	61,901	62,900	-1.6%	-23.8%
Fiscal Balance	-7,140	-3,458		-16,337	-7,904		
Primary Balance	-6,019	-3,042		-11,682	-4,168		
Non Oil Balance	-10,123	-8,154		-30,888	-28,944		
Debt Amortization	316	960		1,103	4,329		
Financing Requirements	7,456	4,418		17,440	12,233		
Foreing Debt	21	6,277		137	6,338		
Domestic Debt	4,719	97		10,875	118		
Treasury Bonds	4,426	0		8,950	21		
Treasury Debt	293	97		1,926	97		
Others	2,716	-1,956		6,428	5,777		

Sources: BCV and Ecoanalítica

Additional credit boom. Between January and August 2009 the National Assembly approved additional credits in the order of 20,200 million VEF, as is currently managing a budget of VEF 180.000 million, which means it is 12.6% higher than budget that was stated in March 2009. These additional credits are being financed through Miranda Fund, the Fund Alan and extraordinary income from the National Treasury. As we have stated on several occasions, the government is betting on the recovery in the price of crude.

Measures don't include dollar auctions. According to sources of the Ministry of Finance, the Caracas Stock Exchange (BVC) will not organize dollar auctions through the purchase of public debt bonds. However, new debt issues are to come soon, aimed at lowering spread between the official and the swap exchange rate.



Reluctant to devalue... According to a source at the Central Bank of Venezuela (BCV), president Chávez is reluctant to devalue the Venezuelan currency; therefore, CADIVI will be reorganized so that it will manage only basic goods, whereas foreign exchange will be approved over a shorter period of time. However, the list of goods considered luxurious is going bigger, meaning that the swap market will be increasingly larger.

Stimulus for social economy? A study by the Centro Internacional Miranda reveals that the little impact of the global economic crisis on the Venezuelan economy is due to the much criticized capitalist economy, and that growth has been based on telecommunications, businesses, services and financial institutions and insurance. In this regard, this report underscores that growth and sustained development must be stimulated instead of the capitalist dynamics.

Private sector is now heavier... Víctor Álvarez, one of the researchers at the Centro Internacional Miranda, points out that private sector GDP went from 64.7% in 1998 up to 70.9% in 2008, whereas social economy weight increased from 0.5% to 1.6% over the same period; total social economy employees only grew 16% IN a decade. This information confirms that the current economic model in Venezuela is basically capitalist.

Socialism in Venezuela isn't on the workers' side. Víctor Álvarez also stated that the monetary illusion according to which workers improved their standard of living in 2004-2008 truly hides the fact that employers have improved their standard of living much more than workers.

Distribution mechanisms encourage waste. According to the Centro Internacional Miranda study, dollar overvaluation, public sector payroll, wage increases through decree, gasoline subsidy, supplementary appropriations, and public sector financing for employers, among others, are elements that should be analyzed. *Ecoanalítica* has referred to some of these aspects several times.

Interest rates: According to the latest information available, the lending rate for the last week of August was 20.3%, up 88 basis points from the third week of August. Term deposit and savings account rates were 14.5% and 12.6%, a reduction of 6 and 0 basis points.

International reserves: The international reserves posted a decrease of 0.8%, going from US\$31.46 billion at the close of the third week of August to US\$31.20 billion in the fourth week. Compared to the same period last year, the reserves have dropped by 18.1%.





Money supply: According to the latest information from the Central Bank, money supply at the end of the third week of August posted fell by 0.7% compared to the second week of the same month, to VEF 218.84 billion. Money supply has increased by 12.7% so far this year and by 34.8% compared to the same period last year.

Oil Tips

Venezuela: now importing gasoline. After the simultaneous detention of the generation units of gasoline in PDVSA'S main national refineries, operators think, that the oil company, will have to import at least 6 shipments of gasoline and components to be able to attend the domestic market. Between 2008 and 2009 Amuay, Cardón and El Palito's refineries have had constants stops, so much programmed like by incidents, bringing as consequence a wear in the processing of crude oil at national level.

According to Rodríguez Araque, gasoline prices should be reviewed. In a TV interviewed at VTV, the Minister of Finance repeated that while *"it is a political decision, I believe that this is a measure that will have to be taken any time and I'm convinced that if we explain it to the people, they will understand that a liter of gasoline cannot be cheaper than a liter of water."* He added that measures are being prepared concerning some sectors, including exchange rates, in order to revert the unfavorable numbers of the economy.

PDVSA delivers additional royalties to the Executive. Since July, the state-owned oil company started delivering additional royalties to the national Treasury. The goal for 2009 was set at VEF 17,200 billion; however, contributions amount to VEF 18,100 billion, meaning VEF 900 million in excess. It is evident that the recovery of the Venezuelan oil basket price (up more than US\$10 from the budgeted price) has given rise to increased disbursements by PDVSA. However, revenues are not enough to cover the central Government's spending, which continues to depend on VAT and borrowing.

Financial situation affects PDVSA Citgo. According to unofficial information, Citgo's net income fell 51% in 2008 to \$ 813 million, although sales increased 8.5%. The deterioration is because since 2007 PDVSA stopped selling crude at preferential terms to Citgo, higher dividends charged from PDVSA to Citgo and began to demand payment in advance of some shipments.





EIA: Exports to US decrease. According to EIA figures, PDVSA oil exports to the US dropped 8.7% in July, to 1.11 million b/d, as compare to May when exports reached 1.22 million b/d. However, the monthly report states that Venezuela is the second crude oil and product supplier on the US market over Mexico and only behind Canada. In comparison to June 2008, the increase was at 2.8%, for 1.8 million b/d exported during that period.

Paradox... A few months ago this data seemed to be consistent with PDVSA's policies to reduce exports to the US; but the fact that Venezuela is the second supplier plus President Chávez' statements that Venezuela will continue to sell oil the US are signs of a new stance by PDVSA. *"Venezuela has seven major refineries in US territory and part of the Venezuelan crude oil meets the needs of poor citizens in North America,"* President Chávez stressed.

Oil workers report PDVSA before ILO. Workers that were not absorbed by the Venezuelan oil industry after the nationalization process will report PDVSA before the International Labor Organization (ILO) for violation of labor rights. Despite the order to hire all outsourced workers, union sources claim that at least 600 workers were not included in the payroll, including 72 union leaders, *"which is a proof of the persecution to which union independence is being subjected in Venezuela."* They added that *"this will not be the only case to be brought before the international organization; we will also file the case of union representatives and workers who are on probation for having exercised their right to protest."*

FUTPV election: September 30th, now... Although workers have assured that operational activities will not be affected in spite of the discontent with the expired collective contract and the suspension of FUTPV election. The new "possible" date for the election is September 30th, after FUTPV and the CNE agreed to use fingerprint readers and voting machines in the electoral process. Some union leaders point out that this delay is due to the creation of the new labor organization Vanguardia Obrera Socialista (VOS), because this group has challenged the election repeated times and this has paralyzed the process. VOS, in turn, defends itself alleging that their intention is to render the electoral process more transparent.

Increased military control of gas stations on the border. To prevent fuel smuggling to Colombia, military troops are permanently controlling the arrival of gasoline and diesel tank trucks in Táchira and Zulia States. In the meantime, presidents of associations of gas station owners in the region say that supply is normal. ECOPETROI, in turn, informed that fuel supply for vehicles is normal in Colombia-Venezuela border areas.





FENEGAS, in turn... The National Federation of Gasoline Business Owners (FENEGAS) proposed last Friday a 30% increase in gasoline price and assured that this will not have any impact on inflation. The association proposes increase to affect only 95-octane gasoline, the most expensive one, which accounts for 80% of fuel sales and is used generally in privately owned cars.

Abreu de Lima refinery has tripled its costs. According to a document released by Petrobras, the refining project between Brazil and Venezuela, which was originally worth US\$4.05 billion, will have a final cost of US\$12.0 billion, due to an increase in their refining capacity (from 200,000 b/d to 230,000 b/d), to higher service costs, the inclusion of a sulfur treatment system, and the reduction of toxic emissions. The Brazilian oil company admitted that the construction will cost three times higher than the original amount, but denied the possibility of overbilling. Furthermore, PDVSA participation has not been defined due to disagreement concerning the stake the Venezuelan holding will have in the sales of the refined product; therefore, Petrobras started the project without its partner.

Petropar renegotiates US\$250 million debt. After the UNASUR summit, Uruguay's President, Fernando Lugo, agreed to renegotiate with Hugo Chávez Petropar's 2003-2008 US\$162 million debt for diesel supply, which had been frozen. Uruguay's proposal includes financing US\$60 million at 2% interest over a period between 10 and 20 years with a two-year period of grace. Further negotiations between representatives of both countries are expected for next Thursday, after a US\$37 million payment of the debt that is still to be negotiated.

The State has still to consolidate its position in the Petrochemical industry. After publishing in June's Official Gazette the Organic Law for the Development of Petrochemical Activities (which reserves for the State a minimum 50% share and control as to decision making), the National Executive has not still taken possession of at least 50% of the petrochemical sector. According to official information, this process will be different to the one carried out in the oil sector which follows the mechanism of joint venture companies. Currently PEQUIVEN has 37.50% in METOR, whereas the remaining shareholding is in private hands, and 49% in Superocéanos.

Crude oil price is around US\$70/bbl. According to our Bloomberg database, oil prices closed August with a decreasing trend. WTI closed the month at US\$72.7/bbl., for a drop of US\$1.2, which accounts for a decrease of 1.6% in comparison to US\$73.9/bbl. a week earlier. On the other side of the Atlantic, Brent lost US\$3.5 to close the week at US\$72.8/bbl., for a fall of 1.9% vs. US\$74.2/bbl. Earlier in the week baskets dropped below US\$70/bbl., with US\$69.6/bbl. for WTI and US\$69.3/bbl. for Brent.



The Venezuelan oil basket rallied at the end of the month. The price of the Venezuelan oil basket gained US\$1.5 in the last week of August, closing at US\$68.71/bbl. compared to US\$67.2/bbl. a week earlier. With the increase, the annual average was US\$50.9/bbl., 27.1% over the budgeted price.

Business Sector Tips

GMV will resume its work in late September. Osmar Gómez, National Assembly deputy said that in the next few days General Motors Venezuela will restart their activities after having stopped their production on June 19, thanks to having reached an agreement with the Ministry of Science, Technology and Intermediate Industry, to clear the debt of CADIVI with GMV. The plant will resume its operations using less than one third of its installed capacity (about 150 units daily of the 500 that are capable of producing), since only implement a work shift and will only be producing two of its models (Optra and Silverado) but hope to add a second shift later this year if the Government complies with the agreement.

The government plans to give U.S. \$ 2,000 billion to automakers during H2 09. According to statements by the Minister of Science, Technology and Industry Intermediate, Jesse Chacon, CADIVI will deliver during the second semester a total of US\$2.000 billion to the auto industry to import auto parts and other necessary inputs, of which 25% has already been delivered.

Loans for the private sector are affected by economic contraction and public debt crowding out). The economic contraction experienced in the second quarter of the year (-2.4%), which was already evidenced since the fourth quarter of 2008, has had a negative impact on loan demand from the private sector, plus the increase of public debt issue, which are a good opportunity for private banks to be benefited (low risk, moderate interest rates), has reduced free (not subject to compulsory quotas) loans to 40.7% for July 2009, whereas this indicator was 60.8% last year.

Banesco will issue shares for VEF 75 million. The National Securities Commission has authorized the public offer of common, nominal, non-convertible-to-the-bearer shares. With this issue, Banesco equity will be now VEF 1.125 billion.

Non-production certificates to import goods from Colombia are being rejected. The Ministry of Science, Technology and Intermediate Industry has rejected non-production certificates submitted by companies that import raw materials from



Colombia; without these certificates it is not possible to process foreign exchange applications at CADIVI.

CADIVI owes US\$700 million to the telecommunication sector. The president of the Telecommunication Service Company Association informed that the sector is waiting for the BCV to pay US\$700 million in foreign exchange quotas that have already been approved. As a consequence, telecommunication companies have been forced to go to the swap market.

Seniat is active. Chrysler's local affiliate must pay Seniat US\$6.2 million over the next 15 days for overdue tax payments corresponding to year 2003. Pfizer paid the tax authority VEF 36.6 million on May 15th, due to "omissions in operational and extraordinary revenues and adjustments in the manufactured product export sales." Seniat detained 96 foreign ships in Vargas State for not having the legal documentation authorizing their entering in Venezuelan waters, and visited 484 businesses in Merida, of which 443 were fined (the total amount of the fines amounts to VEF 2.117 million), and 293 were closed.

GMV will restart activities at the end of September. Osmar Gómez, representative of the National Assembly informed that General Motors Venezuela will restart its activities in a few days, after having stopped operating in June 19th. Details of the agreement between the Ministry of Science, Technology and Intermediate Industry and GMV were not given.

Mitsubishi and labor conflict. MMC Automotriz started a conciliation process with the national government to settle its labor conflict. Barcelona Labor Inspector's Office ordered operations to be restarted and back wages to be paid, because in the Office's opinion this unannounced indefinite suspension is illegal. However, MMC Automotriz claims that secure conditions required to restart operations do not exist and denied to continue negotiating with the Nueva Generación de Trabajadores union.

New social production milk processing plant will be opened in October. The Minister of Science, Technology and Intermediate Industries, Jesse Chacón, informed that this social production company, which will be administered by the Corporación Venezolana Agraria, will be opened in October with an initial processing capacity of 6,000 lt/d. However, the plant has a capacity of up to 18,000 lt/d if it operates round the clock.

New proposal to calculate pension benefits. In order to restore part of "retroactivity" of pension benefits, it has been proposed to maintain the payment of 5 days per month up to the legal ceiling and add 15 days per year in the retroactive calculation of pension benefits. Some AN representative consider that the best way to guarantee



retroactivity is to comply with the Constitution: link payment proportionally to the time of service and calculate it based on the last wage. However, the Executive thinks that this model is not viable.

Unifying collective contracts of all workers in the electric sector costs VEF 5,700 million. In 2007 the government proposed unifying collective contracts of all workers of the electric sector; two years later, this project continues to be difficult to apply, because this implies a cost of VEF 5,700 million that neither the State nor Corpoelec want to assume. To top it all, public entities (mayor's and governor's offices, ministries and basic companies) owe VEF 2,700 to the Corporación Eléctrica Nacional.

World Crisis Tips

Confirmed 1% contraction in the second quarter. Although forecasts said that growth for the second quarter in the US would be downwards adjusted, the Department of Commerce reported that US economy recorded a contraction of only 1% in the second quarter of 2009, after having lost 6.4% in the first quarter of this year (seasonally adjusted annual rate).

Manufacturing ISM Report on Business shows clear signs of recovery. Manufacturing ISM ROB for August shows the PMI index at 52.9 points, after having registered 48.9 point in July (it's worth noting that the PMI index had not exceeded the 50 point mark since 19 month ago). Let's remember that a value over 50 points indicates that industries are growing and below 50 means that industrial production is contracted. Other variables that reflected signs of improvement in August were new orders and exports; on the contrary, imports and inventories continued to fall although these latter at a slower pace.

Consumers' confidence in the US drops in August. The University of Michigan published the definite result of its consumers' confidence index on Friday August 28th, showing a drop of 65.7 points from 66 in July, for the lowest level since April. Consumer expenses (which represents two thirds of GDP), measured by the Department of Commerce, increased 0.2% in July, but fell 1% on a yearly basis during the second quarter. The average personal income remained constant in July after a 1.1% increase in June.





Real estate market is recovering. The Department of Commerce reported that sales of new one-family homes increased at a 9.6% yearly rate in July, compared to the prior month. This is the highest increase rate since February 2005.

Financial institutions in the US lost US\$3.700 billion in the second quarter 2009. The US financial system reported losses for US\$3.7 billion. Two thirds of the 8,195 banks in the country reported profits lower than those obtained in the second quarter of 2008 and more than a fourth posted losses. 81 banks have closed in 2009, whereas only 25 were closed last year.

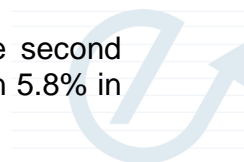
Unemployment in the Eurozone increases (9.5%). Unemployment rate of the 16 countries using euro as a common currency averaged 9.5% in July, for the highest rate in 10 years, after having averaged 9.4% in June. Unemployment rate in the European Union (27 countries) averaged 9% in July, from 8.9% the prior month. The worst case, as noted in previous reports, is Spain, where unemployment rate was 18.5% in July, with the worst case being unemployment among people under 25 years of age, with a 38.4% rate.

Record deflation in Japan. Underlying CPI (excluding fresh food prices, due to their high volatility in that country) showed a year-to-year rate of -2.2% in July, whereas unemployment rate reached a record level of 5.7% in Japan in the same month and family expenses were 2% below that of July 2008. All this puts a lot of pressure on the Bank of Japan for this institution to apply a more aggressive monetary policy (lower interest rates) to manage to rescue the world's second largest economy.

Opposition party wins election in Japan. Japan's Democratic Party won election to the House of Representatives (the most important election in Japan) on August 31st, after more than 50 years of nearly unbroken rule of the Liberal Democratic Party.

Bond holders concerned about possible Japan Democratic Party's policies. Japan Democratic Party (JDP) has planned a US\$180.0 billion social spending package and a program to assist new parents that will be applied until 2013. With a gross public debt that, according to some estimates, will amount up to 215% of Japanese GDP (the highest in the world) and with tax revenues that have dropped 27% over the last 12 months, it is difficult that this plan may be implemented without launching new bond issues, despite the fact that JDP informed that there will not be more bond issues. Current Japanese bonds yield 1.3%; but if this would go up to 3% or 4% (the average OCDE level), the Japanese government would face severe problems to pay debt service.

Asian energy markets continue to increase. India grew 6.1% during the second quarter of 2009 in comparison to the same period in 2008, after having grown 5.8% in





the first quarter. This is largely due to the government spending that increased to 9.9% of GDP from 9.6% during the same period in the previous year. China's PMI index for the month of August rose 0.7 points, to 54; the production index gained 0.6 points, to 57.9; and the new orders index increased 0.8 points, to 56.3. All these figures as compared to the previous month back up growth expectations of more than 8% for this year.

Trade between Aladi partners drops by 28.8% due to the crisis. Intra-regional trade among the 12 countries members of the Latin American Integration Association has dropped by 28.8% and trade exchange with the rest of the world fell 26.8%, as compared to the same period in 2008.

Further contractions in the second quarter. Spain's GDP for the second quarter in 2009 contracted shrank 4.2% with regard to the same period in 2008, after having contracted 3.2% in the first quarter of this year. Canada contracted 3.2% in the second quarter of 2009, on a year-to-year-basis, but it will recover soon, because its economy grew 0.1% in June, in comparison to April.

Political Tips

Community councils have received VEF 18,000 million. The Ministry for Communes informed that it community councils have received a total of VEF 18,000 million over the last four years. The ministry's goal for this year is to allocate another VEF 5,000 billion to community councils. There are more than 30,000 of these councils registered in the country.

Top officials' remuneration adjustment was postponed... The discussion of the Remuneration Law was differed once again at the National Assembly, after representatives decided to go on vacation until mid September. The bill was submitted by Luis Tascón in 2007 and provides for fixing ceilings for monthly wages and holiday and yearend bonuses paid to government's top officials, including the President, ministers, vice ministers, governors, comptrollers, public university rectors, mayor, among others.

Limits proposed for the Remuneration Law. A proposal to reduce the scope of the Remuneration Law was made so as not to affect the minimum directive levels. In this regard, high-level employees are considered the CNE board members and the Ombudsperson, among others. The AN will review the functions of these posts in



order to avoid affecting career officials and officials that do not belong to high ranks. Vice Chairman of the Finance Committee of the AN, Simón Escalona, stated that an article will be included that provides for that a career official temporarily occupying a high-level post will obey the law and after leaving the post, the official will return to the normal regime corresponding to a career official.

Uribe reports Chavez at the UNASUR Summit. President Álvaro Uribe reported the presence in Venezuela of FARC chieftains Iván Márquez and Timochenko at the Summit of the Union of South American Nations (UNASUR). However, president Chávez declined to respond. A few days later, Chávez described Uribe's accusations as a "provocation" and denied the presence of FARC leaders in Venezuela.

And military bases were not rejected. A resolution was approved at the UNASUR Summit which did not include a rejection to the military agreement being negotiated by Colombia and the US, for the use of seven Colombian military bases. Presidents reaffirmed in the resolution that the presence of extra-regional military forces cannot threaten sovereignty and integrity of any South American nation and, therefore, peace and security in the region.

Democratic Unity Board requests IACHR to visit Venezuela. Members of the Democratic Unity Board sent a letter to President Hugo Chávez and to the Organization of American States (OAS), to request the Inter American Commission on Human Rights to visit Venezuela. Delsa Solórzano, leader of Un Nuevo Tiempo, said that Venezuela and Cuba are the only countries that have denied receiving a commission of the IACHR to confirm the situation of human rights in Venezuela.

Is protest criminalized? Attorney General Luisa Ortega Díaz, talking about citizens that protested against the Education Law, said that any citizens that disturb public order and peace in order to destabilize institutions or the Government, and attempt against the democratic system will be tried.

The Inter American Press Association (IAPA) is hosting a forum on freedom of speech. The Inter American Press Association and the Venezuelan Press Block informed that a forum will be held in Caracas on September 18th, which will deal with the situation of the freedom of speech in the continent. Journalists, writers, academicians and special guests, including Bolivia's former president Carlos Mesa and Mexico's former Minister of Foreign Affairs, Jorge Castañeda, will participate in the event "Emergency Forum on Freedom of Speech."

Disarmament intentions? According to the new rules of the Direction for Weapons and Explosives of the National Armed Force (DARFA), published in the Official Gazette No. 39,251, August 22nd, all police corps, private surveillance companies and



federations that use weapons for sports purposes, among others, must update their administrative files at DARFA, in a period of 30 working days, upon the entering into force of this provision. If this provision is to be applied, it would be possible to have an idea of the number of illegal weapons in Venezuela and this would be an initial step to disarm the population.

Corruption cases continue to appear. Uruguayan Partido Nacional de Uruguay reported that the cost of the books exported to Venezuela for US\$32 million didn't exceed US\$500,000. The controversy of this millionaire sale is that it can hide the possible financing by the Venezuelan Administration of the election campaign of the Uruguay's government party Frente Amplio for the election scheduled for October. The main suspect of this fraud is the firm Apliser S.A.

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