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PDVSA IS JUST LIKE SAINT JOHN...HE'S GOT IT ALL, HE GIVES IT ALL

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"The festival of Saint John¹ is famous, full of magic and enchantment...the Saint owns the space, his faithful followers, and the soul of the festival, Saint John has it all...Saint John gives it all..."

Anonymous

Last week we analyzed PDVSA performance figures for the first semester of the year. One point that stood out was the increase of PDVSA's contribution to the State. However, one point which must be considered is that, little by little, PDVSA has been gaining more financial autonomy and autonomy in currency exchange matters, and its influence on the economy is equal to or greater than the Central Bank of Venezuela (BCV).

PDVSA before

Given Venezuela's economic nature, and its characteristic of being an oil producing country, PDVSA has always been a crucial factor immersed in the design of the country's economic policies. On number of occasion we have mentioned that most of the legal changes that were carried out in BCV

¹ Saint John the Baptist is the patron saint of a region in north central Venezuela. His followers celebrate his birth on June 24, coinciding with the summer solstice and the coming of the rains. Many African rituals have become a part of the celebration.

have not been for the better. Everyone knows how important PDVSA is to the Venezuelan economy.

Two figures help us understand this statement: 90% of exports are come from oil and around 50% of fiscal revenue comes from oil. This impact is measured in the real sector (purchasing power of goods and services), as well as in the monetary market (incoming and outgoing flow of bolivars from the system which could provoke abrupt increases in interest rates, and if it were the case, movement in the exchange rate.

In the past, the fact that the company was managed in a fairly autonomous way with respect to its investment decisions and financial management², it was legally obligated to turn over all its foreign currency earned from oil exports to the BCV. The BCV authorized PDVSA to manage an acceptable portion of the foreign currency so that it could meet its foreign payments and investments. This was known as the “PDVSA rotary fund.”

This way, the BCV absorbed the monetary shock that PDVSA produced in its different operations.

The new PDVSA

In 2005, this dynamic changed. The BCV Law was modified, especially article 113, which now allowed PDVSA to maintain funds in foreign currency. Then, in November 2005, the No. 9 Exchange Agreement was established. Article 1 states that PDVSA “will sell to the Central Bank of Venezuela only the amount necessary to cover operation spending...and the fiscal contributions that by Law it is obliged to comply with, for the amount estimated in the Budget Law of the Republic.”

In other words, since 2005, PDVSA is only obliged to sell only the foreign currency necessary to cover its operation expenses and to pay taxes to the Government, with this revenue now at its disposal, the company has been able to create funds in bolivars and in US-dollars, and what is worse, it can carry out exchange operations through any of the means that are currently available. The 2005 regulation made legal the so-called “parallel budgets” which feed on extraordinary resources from oil revenues and over which the State has no control.

BCV is just an administrator

With these legal reforms, the BCV lost a number of degrees of freedom over its monetary policies to control inflation, since it doesn't have any direct control over the country's main company. The last reform made to the BCV

² This autonomy also existed before the authorities of the Ministry of Energy and Petroleum (before know as the Ministry of Energy and Mines).

Law (July 2005) included an addition significant change: the estimation of the adequate level of the international reserves.

The most serious part of this reform is that the BCV must establish a single methodology to estimate the adequate level of the international reserves, and if the BCV and the Executive Office can't agree on the amount, the final decision rest with the Finance Commission of the National Assembly. In other words, the BCV losses authority of this matter and it infringes on its autonomy and independence with regard to the administration of the international reserves. These trespasses, with respect to the international reserves have much more effect on the BCV's equity than monetary policy.

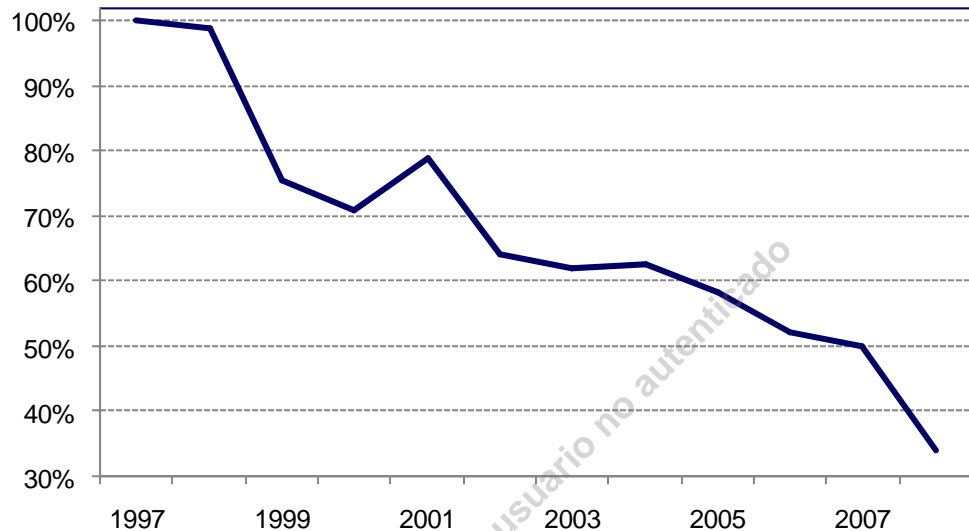
Plus, the new law requires that the BCV notify, in a timely manner, the Executive Office concerning the adequate levels of the reserves in order to calculate the National Budget and to include it in the yearly policy agreement that the BCV and the Executive Office must sign. At **Ecoanalítica**, we hope that the 2009 Budget Law discussion will debate this issue.

What has come of these changes?

It's evident that with these changes, PDVSA's power over the economy is significant, given the amount of foreign currency that it handles directly. According to BCV statistics, currently, PDVSA is only turning over 32% of total export revenue to the Central Bank. This means that the oil company is managing the other 68%. Of course, the statistics could be hiding the discrepancies regarding oil production and the amount of accounts receivable which the company has outstanding, especially from PETROCARIBE agreements. But even with these imbalances, it's still quite a large percentage, which gives the company much more power than it ever had in the past.

This is quite evident when one analyzes the "oil foreign currency / oil exports" indicator from 1997 to 2008. In 1997, PDVSA was turning over to the BCV almost all of its foreign currency which it earned from sales. Now this percentage has been dropping and settled at 50% in 2007. During the first semester of 2008, it reached 34%. Note the trend that the levels have been dropping as the Venezuelan basket oil price has been going up. Between 1997 and 2007, the Venezuelan oil basket increased by 361% in real terms.

Oil Currency (BCV)/Exports



Sources: BCV and Ecoanalítica

As time has passed, PDVSA has been withholding more and more foreign currency: the average turned over between 1997 and 1999 was 91%, then between 2000 and 2003, it dropped to 69% and between 2004-2007, it dropped again to 56%.

PDVSA is the key

At **Ecoanalítica**, we have been insisting that Venezuela seems to be immersed in a scenario of uncertainty with regard to the exchange issue, which is reinforced by what has been happening lately on the international scene, along with the fact that we are entering a seasonal period which traditionally put pressure on the exchange market, all this within a very exacerbated political context, and oil prices falling. In these last few weeks, looks seem to be going to PDVSA and its financial autonomy and autonomy with regard to exchange issues, to step into the market and stabilize the unofficial exchange rate. However, we at **Ecoanalítica** don't believe PDVSA will step up to the plate, at least not publically, and in any direct manner. However, if the exchange market gets totally out of hand, we don't rule out that PDVSA will have the final word in the matter.

Economic Tips

Possible instruments. According to preliminary information, technical personnel from the Ministry of Economy and Finance (MEF) delivered a proposal for repurchase of foreign debt, recommending that such bonds be repurchased maturing in 2010, 2013, and 2027.

More BODEN bonds could be on the way. Minister Rodriguez Araque said that although a new purchase of Argentine bonds is not contemplated, "it is not discarded in view of the relationship of mutual support that exists between the two countries which underlines a new relationship model between nations."

Plan to reduce public sector payroll. President Chavez has in his hands a plan to reduce the public sector payroll in order to alleviate the existing pressure of having too many government employees. Labor Vice-Minister Abraham Mussa noted that the best way to accomplish this is through the Communal Councils. In our opinion, such a plan is not feasible.

Price of Food Basket rises in August. For August 2008, the Food Basket cost Bs.F.802,50, 2.65% higher than registered in July, according to figures published by INE. The increase for the year is at 31.7%, fueled by a 24% rise in the cost of food products in the first eight months of the year.

Annual 2009 Operative Plan needs an additional budget. In spite of the rationalizing of costs set forth by President Chavez and his ministers, it is foreseen that an additional revenue budget will have to be drawn up for next year because of all the projects that were left out of the ordinary budget.

More bonds for the market. The Ministry of Economy and Finance said in a communiqué that it anticipates placing public debt bonds of US\$350 million on the local market on a weekly basis via auctions. In the next few days a ministerial announcement is expected to set forth the conditions and timetable for these placements.

Minister Rodríguez Araque calls for austerity. The Economy and Finance Minister, Ali Rodríguez called on "all Venezuelans to apply a policy of savings and austerity" during Social Economy and Finance Day. The call was made in light of the global financial crisis that is besetting important countries in the world. He added that said

crisis had not affected Venezuela to any large degree, thanks to the timely policies undertaken by the Executive.

Meanwhile, Maza Zavala says... That Venezuela finds itself in the eye of a financial hurricane and the Government should take bigger steps to reduce the impact of the world crisis on the country. As Venezuela depends almost absolutely on oil, changes in the price of the product make the economy vulnerable because export volumes are currently stuck or declining.

Venezuelan bonds fall. The global crisis has forced investors to back away from emerging market bonds and to take refuge in more secure investments. This resulted in a drop in the prices of Venezuelan bonds as seen in the Global 27, the most active on the stock market, whose value fell 80.7%, and the Global 28, which fell from 72.6% to 69.5%, according to Bloomberg News reports.

Venezuela's sovereign credit rating. Standard & Poor's rated Venezuela's sovereign debt 'BB-/B,' thanks to strong internal and external balance of payments that continue to strengthen as a result of high oil prices. S&P also rated the country's general panorama as "stable."

Food policies don't resolve problems. In spite of constantly hearing about the food security and sovereignty plan, domestic production lapses have forced the Government to import a large quantity of goods to satisfy internal demand, as the policies that were implemented have turned out to be costly and inefficient.

Less Unemployment. According to INE statistics, August unemployment was 7.1%. This figure is 1.5% less with respect to last year, when the unemployment rate was 8.6% among the active working population.

International Reserves. The international reserves remained relatively constant, compared to the to September 9, showing a weekly variation of 0,03% at the close of 26th of the last month, to settle at US\$ 39.479 millones.

Monetary liquidity. With a weekly variation of 0.22%, the monetary liquidity settled at VEF 165.485 millones. for the week closing on September 19.

Interest rates. Closing September 26, even the actives rates (22.3%) and the time deposits rates (17.04%) for the six main Banks in Venezuela remained relatively constant, recording weekly variations of 2 basic points and 4 basic points.

OIL TIPS

Venezuela's oil basket recovers. According to the Ministry of Energy and Petroleum, the weakness of the dollar and concerns about petroleum supplies caused the local oil basket to recover US\$9.5 in the fourth week of the month, rising to US\$98.28, when in the previous week it had fallen to US\$88.76.

Average for the month. In comparison to the average result of the last week in September, the average oil price for the month was US\$97.35. and for the year, US\$102.03 per barrel. This amounts to an excess of \$US67 over the price established in the budget for this year (US\$35), which means that additional revenues are on the order of US\$39 billion.

International oil prices fall. In the last week of September, the WTI for delivery in November closed down US\$1.13, at US\$106.89. Meanwhile, Brent crude for delivery in November fell \$1.06 to US\$103.54 per barrel.

Reserves fall. At the end of the third week of September, the U.S.'s crude reserves fell by 1.5 million barrels. At the same time, gasoline stocks fell for the ninth consecutive week, to settle at 5.9 million barrels.

Probable scenarios. The petroleum industry consigned to the Ministry of Planning, Economy and Finance, different crude prices in order to finance the budget, and the scenarios range between US\$40-US\$80 per barrel. The production variable was estimated 3.6 million barrels, although further studies are being conducted.

Discarded for now. Energy and Petroleum Minister Rafael Ramirez said that, for now, he would not be calling for an extraordinary meeting of the OPEC to talk about a new adjustment in the levels of production.

Resources earmarked. The Energy and Petroleum Ministry, through PEQUIVEN and the Ministry of Housing and Habitat, under the aegis of the National Housing Institute (INAVI), signed an agreement to build 347 oil consultancies and 110 housing annexes, using the Petrocasa system. For this, the National Executive will contribute an initial investment of Bs.F. 35.3 million.

More time to pay. Costa Rica asked Venezuela to extend payment terms to 90 days for oil that it purchases while its entry into Petrocaribe is being processed. Currently,

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Costa Rica imports 18,000 barrels of crude, almost all of it from Venezuela, and must pay within 8 days of delivery.

Crude for Citgo. The US Department of Energy announced this past Sept. 25 the delivery of 500,000 barrels of petroleum from its strategic reserves to PDVSA affiliate CITGO Petroleum Corp. in Lake Charles, Louisiana.

Oil exploration bidding. It is anticipated that at the end of this month, Barbados will make a bid for oil exploration blocks in Venezuelan waters.

More deals with China. During this past week the governments of Venezuela and China signed various energy accords, in which the construction of three refineries was set forth (one in Venezuela, two in China) as well as four tankers by which the transport capacity between both countries is to reach 4 million barrels of oil. President Chavez said that petroleum exports to China could increase to 500,000 b/d by 2009, and to 1 million b/d by 2112.

BUSINESS SECTOR TIPS

One with risks. Studies carried out by the World Bank and the Fraser Institute place Venezuela in 174th place out of 181 countries evaluated with a classification of 136 out of 141 countries. Of the variables measured, the country got its worst marks in the areas of legal structure and protecting property rights, and public spending among other things. But despite the progressive deterioration that the economy shows, the finance sector still sees opportunity. In the midst of an uncertain environment for capital, a player or players will always appear who gamble big to make good business.

Preventive measures. Last September 24th, the Superintendent's Office for Banks and other Financial Institutions (SUDEBAN) issued a resolution which orders financial institutions in the country to create a guarantee fund to back the values that they have in their portfolios and which were issued by the international banking system affected by the international financial crisis. The SUDEBAN is requiring banks to cover 50% of the assets "being held or established in any type of title, issued, constituted, backed, or guaranteed" by any of the mentioned investment banks. Banks were given 24 hours to comply.

Semi-assembled with negative impact. The Chamber of Venezuelan Manufactures of Automobile Products (FAVENPA), warned about the negative impact that the import

of semi-assembled cars would have for domestic auto parts manufactures. The MILCO is currently controlling the import of already assembled cars, but is allowing car assembly plants and car imports to import semi-assembled cars to satisfy the domestic market.

No agreement at GM. Despite GM beginning operations at the Valencia plant, the collective agreement still has not been signed. According to a representative of the *Sindicato de Vencedores Socialistas* (labor union), organization which spearheaded the strike, GM has refused to pay wages for the days the plant was not operating due to the strike lasted.

Spare parts increased during the first quarter of the year. According to the National Chamber for Auto Parts, auto parts have increased by 15% during the first three months of the year. Auto parts shortages could become severe during the last quarter of the year if the Government continues to make obstacles for importation.

Export volume down. In a forum organized by CONSECOMERCIO, a reference was made to how severely merchandise was backed-up at the port of Puerto Cabello, and the total lack of coordination between all the entities involved with the export and import of goods. Figures show that the volume of exports from Venezuela is down by 50% in the last 4 years.

Strike at Bauxilum. After 12 days as president of CVG Bauxilum, Héctor Herrera Jiménez, tendered his resignation; as a result of this, workers have gone on strike at the bauxite processing plant alleging that all these management changes is affecting the optimum operation of the plant.

Prohibited the transportation of food items to Border States. The Ministry of Agriculture and Lands (MAT) published a resolution that which prohibits the transportation of food items such as milk, rice, coffee, and corn to the border regions in Apure, Táchira, and Zulia state, given that a number of irregularities have been observed which would only get worse if these areas were to continue to be supplied with these items.

Agreements with Cuba look to guarantee agro-food sovereignty. The Venezuelan Government, in an attempt to guarantee its agro-food sovereignty, has signed agreements with Cuba to create 6 ALBA mixed companies to produce rice, dairy products, wood, livestock (pork), fishing, and poultry. With regard to rice, sources say that the finished product would sell for VEF 1.6 while the normal price in the industry is VEF 4.

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Venezuelan underfed population increases. The number of underfed people in Venezuela, in other words those people that do not have sure access to enough quantities of healthy and nutrition filled food in order to grow and develop normally, with an active and healthy way of life increased from 6% in 2006 to 8% by the end of 2008. These figures imply that 470,000 people dropped considerably in their quality of life in one year.

Venezuelans drink the most malta in the world. Malta is sold in a number of countries around the world, but most in Venezuela. Per capita, Venezuelans drink 11 to 12 liters a year which equals 380 million liters a year. Polar company is responsible for 95% of all these sales. Notwithstanding, the company continues to research and develop innovative products, looking to grow and win more customers.

Health sector in fourth place. CADIVI figures reflect that the health sector is in the fourth place in terms of foreign currency being assigned to it, getting 10% of all foreign currency assigned. In a year, approval for medical equipment increased by 77% and 53% for pharmaceutical products.

Political Tips

Opposition unity advances. Arnaldo Arocha turned down a possible bid for governor of Miranda state, while calling on voters to elect Henrique Capriles Radonksi this Nov. 23. Meanwhile, Cesar Perez Vivas won the unitary candidacy of the opposition for governor of Tachira state with 44.6% of the vote, followed by Gabino Paz with 25%, Gustavo Azocar with 18%, and Sergio Omar Calderon with 10% of the vote, establishing an irreversible trend.

PSUV against Manuitt and Carlez. In the opening event of his electoral campaign, President Chavez called on the members of the PSUV party to take the coming elections in a landslide. He noted that Manuitt was a big traitor, and for that reason his daughter had to be defeated in November. As for Acosta Carlez, he exhorted Mario Silva to "pulverize that tremendous charlatan and traitor," in Carabobo state.

Regional elections. Consulted about which party's candidates they were most in favor of, 41.5% of the interviewed said chavismo candidates, 20.3% those of the opposition, 25.2% were not inclined to favor either party's candidates, 3.3% said their decision would depend on the particular candidate, 3.2% said they would not vote, and 6.5% did not respond.

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Chavez wants indefinite reelection. The 2D Movement for Democracy and Liberty denounced a new attempt by President Chavez to call a referendum in March of next year to achieve indefinite reelection. The information was divulged by sources from that organization who preferred that their identities were not revealed.

Doubts about the quality of electoral indelible ink. The confidentiality of the indelible ink that will be used in the Nov.23 elections will depend on correct usage of the product. Although the Central University of Venezuela (UCV) Sciences Faculty – provider of the chemical substance – sends out usage manuals before every election, it seems that the steps are not followed correctly.

Peking discards ideological ties to Chavez. According to statements by Jian Yu, spokesman for the China's Foreign Ministry, relations between Venezuela and China are normal and not based on ideology, directed at third parties, and will not affect other countries. For President Chavez, one of the reasons for his trip to China is to strengthen food production, and also to establish a telecommunications accord.

USA Crisis Tips

Another American bank fails. The North-American financial crisis seriously affect the biggest savings and loan institution in the country, Washington Mutual (WaMu), which was acquired by JP Morgan Chase for US\$1,9 billion, after falling under the control of the Federal Deposits Insurance Corporation. Founded in 1889, Washington Mutual is the biggest bank to fail in the history of the U.S.

Financial bailout rejected. The House of Representatives rejected the financial system bailout plan of the North American financial system, proposed by President Bush. However, Bush assured that the defeat of the \$700 billion plan did not put an end to efforts to rescue the economy.

What gives? In light of an extremely hostile public reaction towards Wall Street, and a perception by voters that the bailout plan is a mere rescue - using taxpayers' money - of Wall Street business deals gone awry, many representatives seeking reelection in five weeks are feeling panicky at the thought of presenting themselves before constituents waving the wrong flag. According to some accounts, an overly partisan speech by Pelosi may have angered some Republicans, although this does not appear

to have been a decisive factor. Opposition to the bailout plan was extensive and unquestionable on both sides of the aisle. But it was the Republicans who were most responsible for capsizing the ship.

And now what? Plan C? Now that plan A (TARP Original) and plan B (Modified Tarp) have been defeated, it's time for Plan C. In the absence of a global rescue plan, we go back to square one, that of ad hoc bailouts of individual institutions (Wachovia), case by case, with wave after wave of liquidity injections by the FED and other central banks.

A big risk. With the passage of time, it is certain that the bill will go higher, and that Congress will probably have to approve a final package of more than the US\$700 billion originally rejected. But the real risk is that in order to make the plan more politically palatable, that they take on a massive public debt, with the government assuming not only the cost of bailing out the banks but of everyone who owns a mortgage.

The recession is closer. With the worsening of the "credit crunch" and the fall of share prices forcing many families into bankruptcy, the recession now seems more probable, not only in the U.S. but in the whole industrialized world (and with it, with the drop in price of primary materials, you can forget about the emerging markets being immune in this case.)

The European solution: The serious financial problems have infected Europe. Aside from all the bailouts of banks in national government hands that we have witnessed this week (Fortis, Hypo, Bradford & Bingley, Glitnir) we have another case of the rescue of a financial institution. Dexia will receive help in the amount of 6.4 billion euros from Belgium's federal and regional governments (3 billion euros), from the French government and the state bank Caisse des Depots y Consignations (another 3 billion euros), the government of Luxembourg (376 million euros of a convertible credit in Dexi shares), in an operation similar to that of Fortis.

Ireland goes one step further: In a step considered even more audacious, the government of Ireland announced without blinking an eye that it would guarantee the deposits, mortgages, senior debt and the subordinated debt of all Irish banks for a period of two years. The European governments are reacting with notable speed and effectiveness, each one taking care of its own territory.

But even if we leave aside the surprising Irish case (taking into account that the size of the country and its public debt of 46 billion euros as very small) there are a couple of problems in the European approach. If the problems get worse and take on a more cross-border aspect, there is no significant mechanism of transnational cooperation in

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effect; so how do we manage a case like Switzerland, with various big banks but a small State?

The Russian solution. What, the market dropped? Well, then we'll prohibit trading. The Russian market regulator once again closed the Russian Stock Exchange and reintroduced an order prohibiting short sales.

Chávez alerts the region. President Hugo Chávez pointed out that the financial crisis is evidence of the capitalist system's failure, producing the effects of "a hundred uncontrollable hurricanes." He also warned that raw material prices could come down, so he called on the region to activate regional mechanisms to withstand the crisis. Along these lines, he mentioned that the creation of the *Banco del Sur* is now closer than ever.

Another hard hit. On Monday, the U.S. Stock Exchange suffered another hard hit losing US\$ 1.2 trillion. London and Paris exchanges opened down but recovered later in the day.

Other Tips

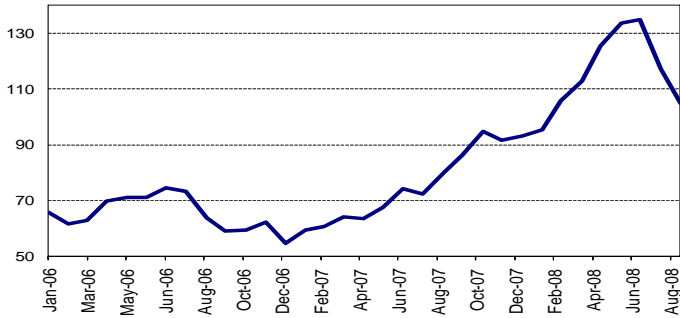
Not very transparent. According to the Corruption Perception Index, carried out by the International Transparency organization which evaluates anti corruption programs in 180 countries, Venezuela placed 158th. 22 countries around the world received very unsatisfactory points which imply very serious and out of control levels of corruption. The countries with the least levels of perception in Latin America are Chile and Paraguay.

The best. Brazil, Mexico, Argentina, and Chile are the countries in the region that are attracting the most investors, but in the medium term, Chile is surpassed by Peru and Colombia, according to a survey by KPGM, an international company which surveyed 140 businessmen from seven countries in the region. Brazil and Mexico are the places where most corporate investor want to invest with international projects, Argentina comes in third with Chile fourth.

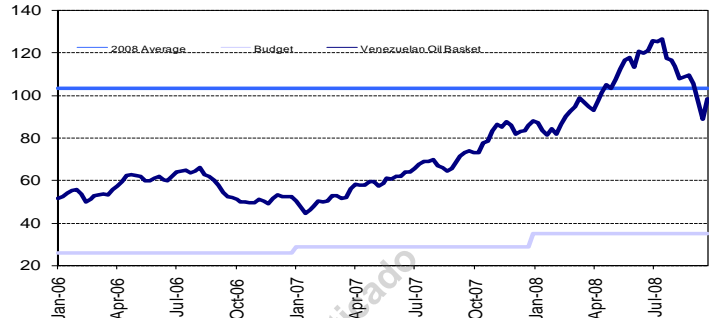
Weekly Report

ECONOMIC OVERVIEW

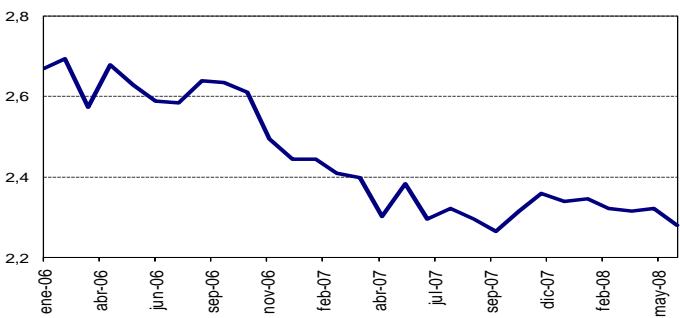
Oil Prices (WTI US\$pb)



Oil Price (Venezuelan Basket US\$/pb)



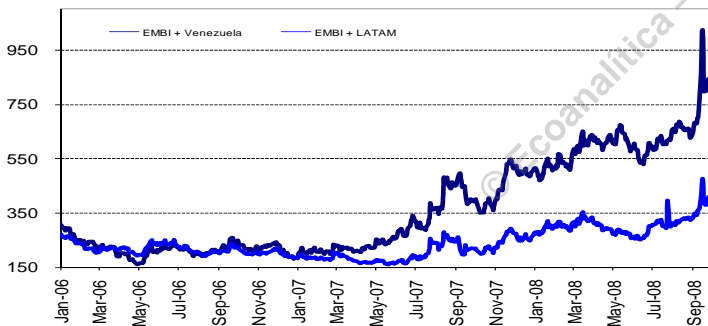
Oil Production MMBD



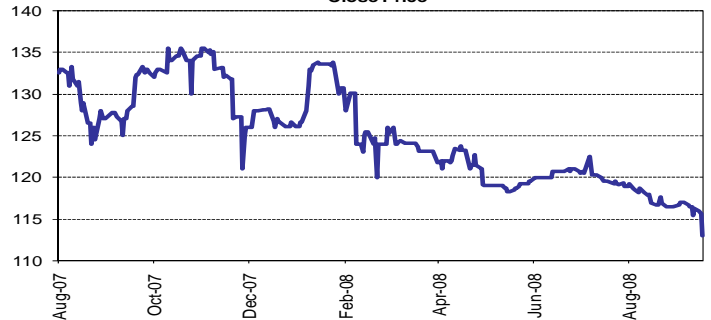
Fx Reserves - BCV (US\$ Million)



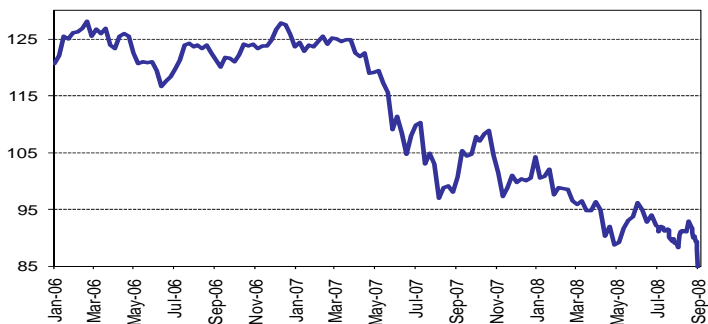
EMBI +



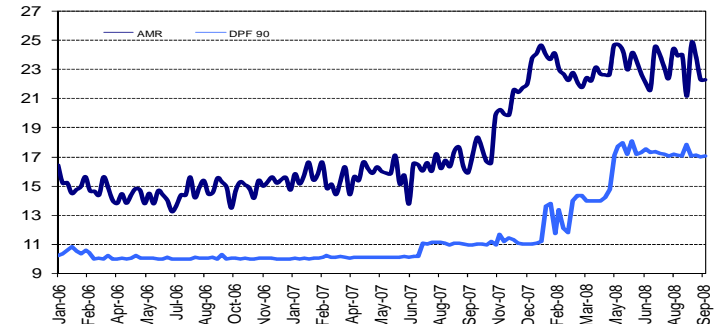
Venezuelan Global 18 Close Price



Venezuelan Global 27 Close Price

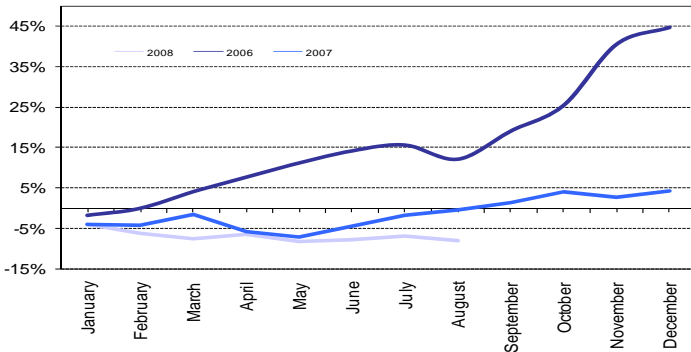


Interest Rate (Six Principal Banks)

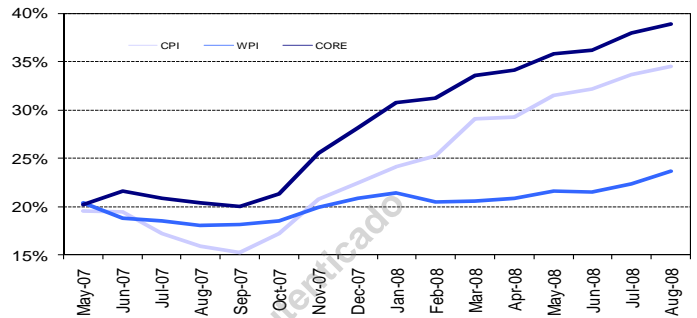


ECONOMIC OVERVIEW

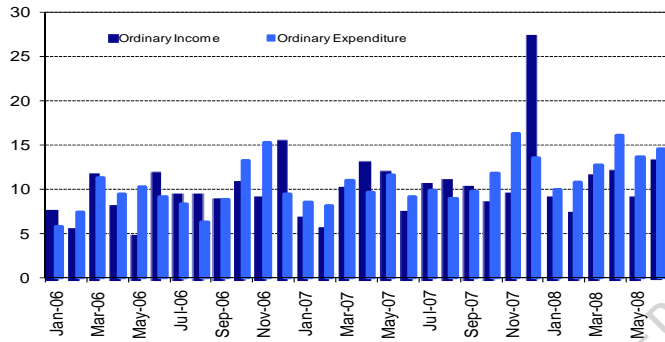
Real Expansion (M2)



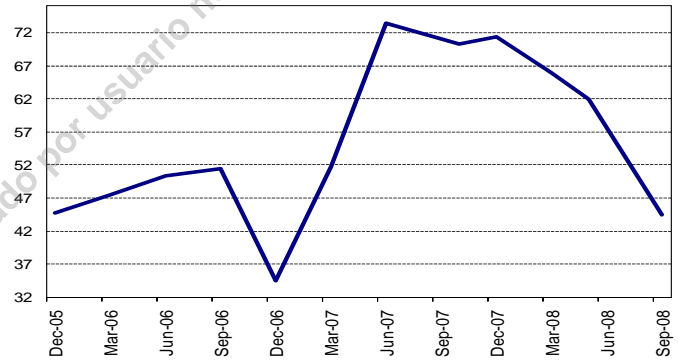
Inflation (Last 12 Months)



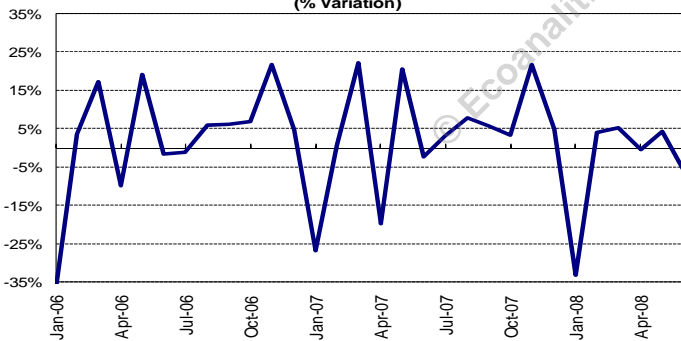
Central Government (VEB Billion)



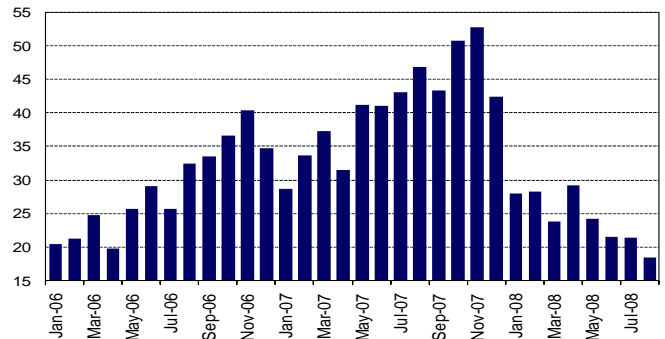
Resources of the State (US \$ MM)



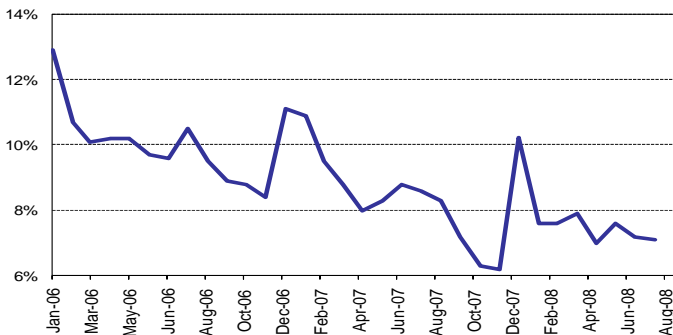
Volume of Sales (% Variation)



Sale of Vehicles (Thousands of Sold Units)



Rate of unemployment (% Variation)



Disbursement (US\$ Million)

