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WILL THE ADMINISTRATION DEVALUE THE CURRENCY NEXT YEAR?

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During the last quarter of the year, it's always been a tradition in Venezuela to begin to talk about the devaluation of the currency. The talk usually gets started around the middle of October which is when the Executive Office introduces its draft for the National Budget Law for the coming year. This year, the talk is more heated than ever given the current crisis in the international finance markets, the immanent recession facing the U.S. economy, and the sustained drop in oil prices. After four years now, with the official exchange rate fixed at Bs.F 2.15/US-dollar; is the Government finally considering devaluing the exchange rate?

**For the Government,
devaluing is always
that last option**

The exchange rate issue is a very complicated because it has ceased to be an instrument used for economic policies and become a strictly "political" instrument. There is much that can be said about this subject, but the fact of the matter is that the distortions produced by the controlled exchange rate have become much more severe due to the Government's inefficiency and clumsiness in managing the situation.

Our initial scenario with respect to 2009 was that it was going to be more of the "same old same old" with CADIVI being much more selective when it

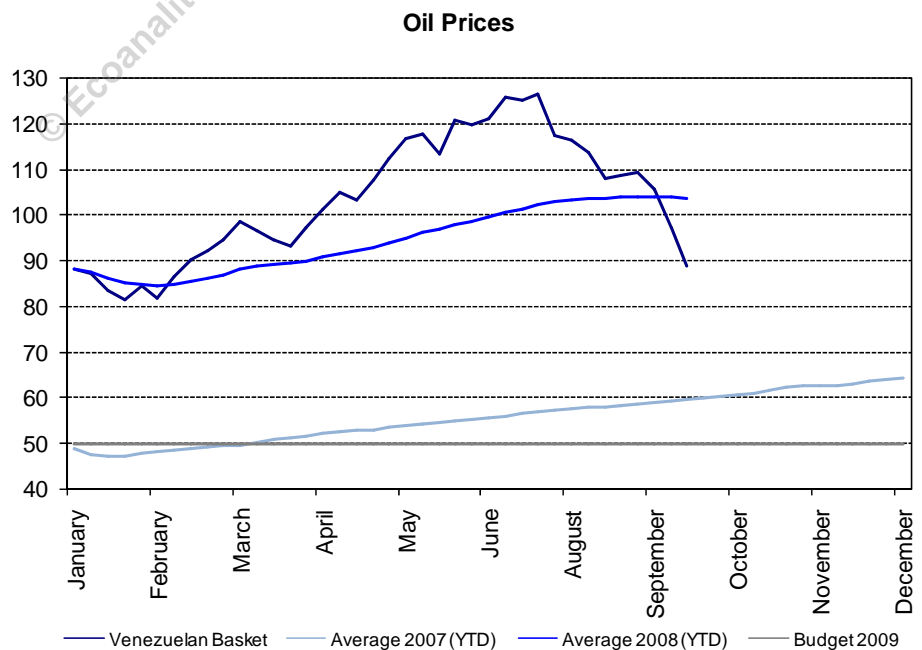
Weekly Report

came to authorizing foreign currency. At **Ecoanalítica**, we believed that the Government was going to instruct CADIVI to grant foreign currency for the so-called priority goods which all fall into three categories: food, medications, and capital goods for industry. At the same time, in order to avoid significant distortions, the Ministry of Finance would carry out sporadic issues of bonds in US-dollars payable in bolivars.

This scenario is what we have been calling the “politically correct devaluation” and it’s based on the fact that the Government is not really in any immanent fiscal danger, with plenty of extraordinary resources to back it up.

The international crisis changes the playing field

The financial crisis in the United States and the repercussions it’s having all around the world has introduced significant changes regarding our economic projections for the Venezuelan economy for the coming year. The first thing that we have adjusted is our estimations for the price of oil for next year, though it’s important to point out that it is still too early to know exactly what these prices are going to do, just how far will oil prices drop, and if the market will remain so for an extended period of time. Having said this, our preliminary estimates put average oil prices for the Venezuelan basket at around US\$ 70 per barrel, US\$ 20 lower than our original forecast for 2009 of US\$ 90 per barrel. This translates to US\$ 16.20 billion drop in oil exports and an approximate drop of US\$ 12.60 billion in oil revenues.



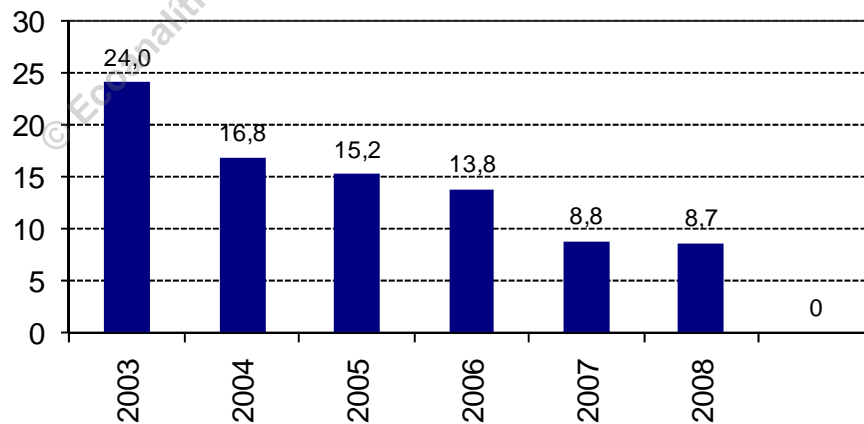
Stable oil prices signal the end of foreign exchange controls

At *Ecoanalítica*, we have always said that it is way past time to dismantle the exchange controls given that the longer it remains in place the more significant distortions it creates with the main economic variables in the country. As we have pointed out before, the exchange control in this country has produced an environment of negative real interest rates, which added to the “subsidy” offered by the State to the import sector by way of the official US-dollar exchange rate which creates incentives for purchasing imported items.

The only way this system can be sustained is if oil prices continue to increase, thereby covering the ever increasing demand for US-dollars to continue to cover the demand for imports. But this all seems to be coming to an end, because in the coming months, oil prices will most probably continue to show a tendency to drop or in the best case scenario, a tendency to stabilize.

So now, an adjustment in the official exchange rate is an answer to control the increase of imports and postpone a balance of payments crisis. In other words, an adjustment made to the official exchange rate this coming year would have less to do with fiscal urgency and more to do with controlling the use of foreign currency.

Months of Imports



Sources: BCV and Ecoanalítica

Though it will also generate additional resources for the fiscal coffers

Though the fiscal account situation is not critical, even if oil prices drop as we have mentioned, it's also true that the Government will not have the freedom to continue with its voracious public spending as it has gotten used to these past few years; characterized by unbridled public spending, high debt levels, and accumulating resources in out-of-budget funds.

If oil prices stabilize and the average price is around US\$ 70, the Government won't be able to continue to accumulate resources in its extraordinary funds, and what's worse, it will be forced to use a considerable part them. So, the Government will be seriously tempted to play the devaluation card in order to adjust fiscal accounts.

At *Ecoanalítica*, we have carried out an exercise on the net effect devaluation would have on fiscal accounts. As the following table shows, for each VEF 0.1 (VEB 100), the monthly effect on the Central Government's revenue is VEF 434 million while spending would only be affected by VEF 87 million. Therefore, the net monthly effect is VEF 347 million. So if a 27.9% devaluation of the official exchange rate were to happen, in other words, if the exchange rate were to increase by VEF 0.6 (VEB 600), in a year, this would create revenue "out of thin air" equaling VEF 24.98 billion (VEB 25 trillion), which adjusted to the new exchange rate would equal US\$ 9.09 billion. As one can see, the revenues produced by the devaluation cover the losses suffered by the drop in oil prices.

Adicionally monthly incomes for each VEF 0,1 of devaluation (VEF Millions)			
Effect over the incomes		Effect over the Cost	
Oil Royalty	230	Interest	25
Oil income tax	129	Recovery	36
Custom	9	Others	26
New External Debt	40		
Others	26		
Total	434	Total	87
Monthly Net Effect		347	

Source: Ecoanalítica

This new exchange rate would remain in place throughout all of 2009 and another adjustment would be made to the exchange rate during the first quarter of 2010. This adjustment won't only bring in additional revenues to the Administration but it will allow it to correct distortions in the Venezuelan foreign sector, since the real over-valuation of the exchange rate is closer to 61%.

**It's not all over
and done with for
Venezuela yet**

Regarding what we have just presented here we'd like to add two things. First, if a devaluation of the exchange rate were to happen, it would totally happen at the Government's discretion; which is to say that, the Government has plenty of resources to spend on the upcoming regional elections this year and the following months. So, with this projection we are acting and thinking more like a psychologist, getting in tune with the mind and the emotions of those who make economic policy decisions in Venezuela, and not really speaking as economists. And second, for the volatility that Venezuela usually suffers, mainly reflected by its exchange rate, it doesn't seem to us to be a very relevant debate to talk about whether the devaluation will be for 20% for all of 2009 or if the Administration will decide to continue to freeze the exchange rate until 2010. The only difference between these two scenarios is that in 2010, the distortions produced by the exchange controls will be much worse and the need for a devaluation much more urgent.

By not devaluation the official market, it does not necessarily mean that the unofficial market will be less volatile. During the last quarter of the year, before the heat of the regional elections, and everyone talking about devaluation, the unofficial market will probably be under a lot of pressure. Where the unofficial market will close at by the end of the year will mainly depend on the number of debt operations with other Latin American the Ministry of Finance is planning to carry out during these last few months of the year, or the role that PDVSA may play, but with the state the international markets are in, it's not going to be easy for the Government.

Economic Tips

Higher inflation. During the month of September, the Consumer Price Index for the Caracas Metropolitan Area rose 2.5%, a higher increase than that of the three previous months, bringing accumulated inflation to 23.2% for the year. The National Consumer Price Index, for its part, registered an increase of 2.01% in September, a rate higher than that of the previous two months, thus bringing accumulated inflation for the first nine months of the year to 21.8%.

Latin America and the Caribbean show greatest inequality. According to a World Bank study, Latin America and the Caribbean are the regions which show the greatest social inequality, where 10% of the population earns 40% of income, and the poorest 10% of Latin Americans and people in the Caribbean only earn 1% of total income.

Employment and growth run in opposite directions. According to official information from the National Institute of Statistics (INE), the percentage of formal employees in the industrial sector went from 16.7% of the working population in the first semester of 1999 to 14.3% in the first half of this year. This indicates that the economic growth that Venezuela is experiencing does not go hand in hand with job creation, which actually diminishes with the passage of time as the State increases its sphere of action.

Rodríguez Araque calls for austerity. The government cast the first stone to prevent a financial crisis in Venezuela with a more prudent National Budget, according to the administration. For his part, the minister of Economy and Finance called on the public to ape this conduct in order to reduce the impact of the financial crisis on the local environment. He added that as long as savings and austerity were adopted, there would be stronger resistance to a possible crisis within the domestic economic system.

Belt-tightening could affect Public Administration workers. The austerity plan that the Government is setting forth for next year - in light of the financial crisis affecting the big powers - is not only focused on reducing superfluous spending, but also on reviewing the Public Administration's pay scale, according to Planning and Development Minister Haiman El Troudi.

Bank portfolios lose value. Venezuelan commercial paper issued by the Government and PDVSA has suffered a significant drop as a result of the crisis in the international markets, forcing investors to migrate to higher quality instruments. That fall has significantly affected the portfolios of the country's banks, which have been

obligated to transfer a great portion of their bonds in order not to suffer price deterioration.

INE to measure Government's success. Planning and Development Minister Haiman El Troudi said that he has asked all public institutions to incorporate statistical management systems, later to be collected by the INE, as a way of determining whether Bolivarian goals are being met.

Scenarios under review. El Troudi also said that the turbulent financial situation in the U.S. has forced a review of the macroeconomic scenarios upon which the 2009 budget is based. The projections set the crude oil basket between US\$60 and \$US\$80, which means that tax revenues would be estimated at the lower end of the band, that is, at US\$60 per barrel.

Repurchase on standby. The Planning minister also mentioned the previously announced repurchase of foreign debt and said that the decision is under review. "There aren't any decisions taken in terms of mechanisms. In terms of policy we must examine everything in light of what is occurring because we don't know at what point this yoke will be lifted. We will wait until the rough seas become calm again before making a decision," he said. Reading between the lines, *Ecoanalítica* believes the debt repurchase plan was rejected by the President.

In spite of crisis, growth goal stays the same. Planning and Development Minister Haiman El Troudi noted that the Government has no intention of modifying the growth target for this year - in spite of the global markets crisis - and that it is projected that the Gross Domestic Product will rise 6% in 2008. This is logical, as the effects of the U.S. financial crisis will take hold only starting next year.

Without more risk. According to the Planning and Development minister, apart from the US\$300 million that FONDEN had invested with Lehman Brothers, there are no other Venezuelan State funds in the U.S. at risk.

International Reserves. With a loss of 1.53%, the International Reserves closed at US\$38.86 billion this past Friday, Oct.3.

Monetary liquidity. Monetary liquidity rose Bs.F 2.206 millions, to close at Bs.F. 168.543 millions on September 26, which amounts to a 1,33% increase with respect to the closing figure of last week.

Interest rates. Closing on September 26, the lending interest rate (21,08%) as well as that for term deposits (17,03%) for the main banks in the country remained mostly constant.

OIL TIPS

Venezuelan oil basket down. Venezuela's crude oil basket fell US\$6.74 per barrel, closing at US\$91.54 during the last week of September - due to a drop in demand for petroleum in the U.S. and an increase in their crude inventories.

Above US\$100. Despite the trend to a lower price of the Venezuelan oil basket, the average price of its export barrel is over US\$100. In the U.S. it is US\$101.8, which is way above the US\$64.74 average of last year.

Waiting. At the end of last week, international markets showed a downward trend for oil prices. According to agency reports, in the last week of September prices were maintained, as a result of approval of the bank rescue plan by the U.S. Senate.

Nevertheless, the trend is backwards. During the last week of September, the WTI oil barrel price fell US\$13 and the price for delivery in November closed at US\$93.88. Brent crude in London fell by 0.34% to US\$90.25, and the reference price for a barrel of crude in Europe for delivery in November fell US\$0.31 cents with respect to its previous close.

Beginning the week. This Monday a barrel of WTI for delivery in November ended the day at US\$87.81, amounting to a 40% decrease since the US\$147 per barrel record was set on July 11 of this year.

Crude futures register largest loss. In the last week of September, crude futures tumbled 28% in the third quarter, the biggest drop since 1991. During this quarter, crude was operating on the fringes of US\$56 before setting a record of US\$147.27 in July. Crude deliveries for November fell US\$39.36 during the three months, closing at US\$100.64 per barrel at the end of last week.

Price stability. After the fall of crude oil prices due to the financial crisis in the U.S., President Chavez said the price of Venezuelan oil should stabilize at an average of US\$80-95 per barrel.

New petrochemical complex. PEQUIVEN is building the Paraguaná Petrochemical Complex in Falcon state, with capacity to produce 8 million metric tons per year. The complex is the biggest of its kind in Venezuela, according to Pequiven president and Petrochemical vice minister Saul Ameliach.

BUSINESS SECTOR TIPS

Done in two months. Finance Minister Al Rodríguez affirmed that within a maximum of “two months” the previously announced nationalization of Banco de Venezuela, owned by Spain’s Santander Group, will be completed. This past Sunday, Rodriguez denied once again that the Government intends to nationalize the entire Venezuelan financial system.

More banking controls. Sudeban has imposed controls on the issuing of shares by banks looking to guarantee the solidity of capital increases. Sudeban established that banks which want to issue shares should have their loan portfolios frozen “at below average rates,” “not present inadequacies in terms of provisions,” reflect “adequate” capital levels that are more than two percentage points above the minimum required level, and hold no more than 30% of patrimony in foreign currency. Also, the share placements should not be more than “20% of the social capital,” and the funds generating these operations should be invested in “profitable shares that can be cashed out in the short term.”

Labor conflict continues at Coca-Cola. During the last week, the ex truck-loaders of Coca-Cola retook possession of the installations to protest their severance payments. In this instance, the company failed to take in US\$5 million for products that were not placed in the market during the first two days of the takeover. In total, in the last two years, Coca-Cola has suffered losses of US\$55 million as a result of similar actions.

Bauxilum still on strike. The company is operating at minimum capacity, with only 80 of the 300 regular workers taking part. The conflict, now a week old, has diminished production at the plant by approximately 1 metric ton per day.

New role for INDEPABIS and SADA. The Institute for the Defense of Individuals in the Access of Goods and Services (INDEPABIS) and the Superintendency of Silos, Warehouse and Agricultural Deposits (SADA) have new assignments. In this case, they are traveling across Venezuela with the intention of locating every last grain of

coffee available. They have already made various confiscations and seizures for hoarding and contraband.

Company payrolls more expensive. Companies in 2003 registered an increase of 2.3% in the cost of their staffs due to the effect of official regulations. This percentage has increased to at least 5% due to the entry into force of laws with social impact, and also due to the country's climate of labor strife. Experts explain that companies' more costly payroll is the result of the judicial framework set forth by the Government and the proliferation of unions that incite what is called "the heating up of labor."

Electricity crisis in Bolivar. CADAFE workers asked the National Electric Power Corporation (CORPOLEC) to declare a state of emergency owing to the continuous blackouts that have occurred in Ciudad Guayana. The objective of the emergency call is to have the necessary funds approved immediately to make the required investments to resolve the problem of breakdowns in the system,

Auto sector enters its list. Before the deadline of Sept. 30 could pass, manufacturers and marketers of vehicles delivered their requests for the import licenses of the car models that will be sold next year. The document is a fundamental requirement for the National Foreign Currency Commission (Cadivi) to authorize the disbursement of hard currency.

Stark numbers for auto market. The Venezuelan Automobile Chamber (CAVENEZ) published in its bulletin the number of cars sold during the first 9 months of the year (212,699). That figure, compared to the number of autos sold in the same period last year (346,189) represents a drop of 38.6%.

Petrochemical Industry lagging. In its most recent Joint Survey, the Venezuelan Association of the Chemical and Petrochemical Industry (Asoquim) found that 68% of the sector was operating at full capacity, although 40% said production had diminished. The association groups together more than 100 companies which represent 85% of the value of production of the chemical industry in the country. Among the results, it should be noted that 34% of the interviewees use 81-100% of their installed capacity and 34% uses between 61-80%. Despite this favorable response, 40% said production had fallen by 10% during the survey period, while 37% said that production at their plants had increased an average of 8.5-23%, and that these levels remained unchanged in 2007.

Meat processing down in Venezuela. Reports from the Association of Cold Storage Plants and Slaughterhouses show a reduction of 12% in the volume of beef processed

in the slaughterhouses, a figure that adversely affected the supply of meat between January and July of 2008.

Venezuelan franchises go foreign. The president of the Venezuelan Chamber of Franchises, Alfonso Riera, announced that his group had initiated contacts with BANCOEX in order to drive the presence of the ideas of national businesses in international markets (Profranquicias).

Third place. Venezuela is third in development of franchises in Latin America, after Brazil and Mexico, but it runs the risk of being displaced by Colombia, after that country received the backing of the Inter American Development Bank.

Political Tips

Magnicide, sticks and goes on. Mario Isea, the president of the committee investigating the matter, announced that next week the second report on the purported plan to assassinate the President will be ready.

Doubts about new voters. Figures from the National Electoral Council (CNE) are raising concerns. Even though the majority of the newly registered (738,000 new electors) are between the ages of 18-22, it is curious that 8,605 new voters are over 52 years of age. The phenomenon could be attributed to the process of obtaining identity cards that the Executive set forth and/or literacy programs instituted in the last few years.

Chavez denounces violent plan against him. This Saturday, President Chavez denounced "a plan of violence" that would be carried out by sectors of the opposition in order to destabilize his government and even assassinate him, with less than one month to go before the elections for governors and mayors.

Inter American Press Society (SIP) evaluates Venezuela. The SIP is currently analyzing the progress of, and threats to, liberty of expression in different countries of the world. The principal focus of attention of the group is on Venezuela, Bolivia, and Ecuador, among others.

FARC ready to help Chavez. The Colombian guerrillas said that if necessary they would be "first in the line of battle" to defend the revolutionary project of the

Venezuelan president against the U.S. In a communiqué published on the website of the Bolivarian Press Agency (ABP), the Western Block of the FARC, the group's most powerful, urged the Venezuelan people to "get ready for the anti-imperialist fight."

Caracas the most violent. The main story of the magazine Foreign Policy, run by economist Moises Naim, reveals that Venezuela's capital heads the list of the most violent cities in the world with a rate of 130 homicides per 100,000 inhabitants, and that these figures are manipulated by the Government to diminish the real crime rate.

Governorships to be controlled by Executive. According to the Organic Law for the Ordinance and Management of the Territory, approved by the National Assembly, the regional authority is designated by the President of the Republic in each region, for "the development of policies of ordinance and development of the territory," granting to same the authority to establish regions and productive districts, in areas that may coincide or not with the territorial limits of states, municipalities and federal dependencies.

Complaint filed against President with Attorney General's Office. Retired Captain Carlos Guyon filed a complaint with the Attorney General of the Republic against the Chief of State for conspiring against the Constitution. He pointed out that the President should uphold and make sure that the laws of the Constitution are obeyed without altering them.

He alleged that Chavez committed this offense, not only in imposing his packet of 26 decree-laws, but also in instigating the propagation of socialism.

Red alert for Moscow relationship. The pacts and accords signed between Russia and Venezuela are making neighboring countries nervous. The minister of Defense of Colombia, Juan Manuel Santos, believes that the military maneuvers that Venezuela and Russia will conduct in the Caribbean will reactivate the Cold War between Moscow and Washington and place the region's stability in jeopardy. Nevertheless, Russia's foreign minister, Serguei Lavrov, stated that cooperation between his country and Venezuela is not directed at any third party country.

USA Crisis Tips

Employment falls in the U.S. During the month of September, the North American economy laid off 159,000 employees, making it the ninth consecutive month of job slashes. This represents the greatest employment decrease in five and a half years that the U.S. power has experienced.

Bush's financial rescue plan approved. The U.S. House of Representatives finally approved the rescue plan proposed by Bush for US\$700 million, after a previous rejection. Nevertheless, due to nervousness and skepticism, the stock market kept falling.

Possible loans. The Federal Reserve (FED) and the U.S. Department of Treasury are studying the possibility of guaranteeing loans to maturity between banks in an effort to maintain the flow of credit in the financial system. Likewise, the FED announced that it will pay interest on bank deposits that it has in reserve and will increase loans to banks to US\$900 billion by the end of the year.

Well Fargo Bank buys rival Wachovia for US\$15 billion. In a joint communiqué reported by AFP, the entities announced that Wells Fargo will buy rival Wachovia for an amount close to US\$15.1 billion in shares. In this report, it is underscored that shareholders will receive 0.1991 Wells Fargo shares for each Wachovia share.

Meanwhile, in Europe.... Leaders of the major European economies, France, Germany, Italy and Great Britain, met in Paris and decided to send out clear signals that they are taking steps to contain the economic debacle many had forecast. France acknowledged that it finds itself in a "technical recession" after three quarters of "negative growth," while the latest quarterly results from Great Britain show a stagnating economy.

U.K. increases deposits guarantee. In a communiqué, the FSA announced that in order to boost the confidence of consumers in the British banking sector, the U.K. has decided to increase the bank deposits guarantee to 50,000 pounds sterling, that is, EUR.63,836 at the current exchange rate. With this new measure, shared savings accounts will be guaranteed for up to 100,000 pounds (EUR 127,701).

German bank rescue. Hypo Real Estate, the fourth largest bank in Germany, had to be rescued by the Government and banking sector of that country with an infusion of EUR 50 million to avoid its bankruptcy. Germany's Finance Minister announced that

the financial sector will grant “a supplementary line of credit of EUR15 billion” that will be added to the other EUR35 billion already contributed in large part by the German state.

The world is going under... Fear took over the Madrid stock market, which fell 6.06%, London's, 7.29%, Paris's, 9.04%, and Frankfurt's, 7%, while in Moscow, after a plunge of 15% the authorities suspended operations.

Latin America beginning to feel the winds of the crisis. In the first days of the first week of October, the Sao Paulo stock market, Latin America's principal exchange, was hit hard by the crisis and fell 5.43%; at one point it accumulated losses of 15% that obligated a suspension of activities to try to calm the volatility for periods of 30 to 60 minutes. For its part, Mexico's stock market plunged 5.04%.

Brazil prepares for the crisis. The president of the neighboring country, Lula Da Silva, has begun to evaluate plans to mitigate the effect of the North American financial crisis on his country. He said that although greater damage was not expected in that country, they would have to be on the alert for any eventuality. He assured that since it is a credit crisis that Brazil is back up by its reserves.

If the U.S. suffers, then Venezuela will too. The difficult period the North American economy is going through could affect the local economy in a significant way. According to Ricardo Hausmann, the U.S. recession will provoke a drop in spending that will translate into fewer petroleum imports as well as non-traditional imported goods. The U.S. is Venezuela's principal trading partner; in the first half of the year exports to the U.S. already totaled US\$25.71 billion.

IMF forecasts U.S. downturn and Europe with better prospects. Based on a comparison between this crisis and previous ones, the International Monetary Fund believes that there is a strong probability of a pronounced economic downturn in the U.S., while the European zone is better protected against a brutal economic convulsion.

Remittances affected. Remittances to Latin America will fall for the first time in 10 years as a result of the economic downturn and inflation, according to a BID forecast report. According to the analysis, this year Latin American and Caribbean émigrés will send some US\$67.5 billion to their countries of origin, as compared to US\$66.5 billion sent in 2007. Nevertheless, because of high inflation, the 2008 value will be 1.7% less than the amount of the previous year.

Weekly Report

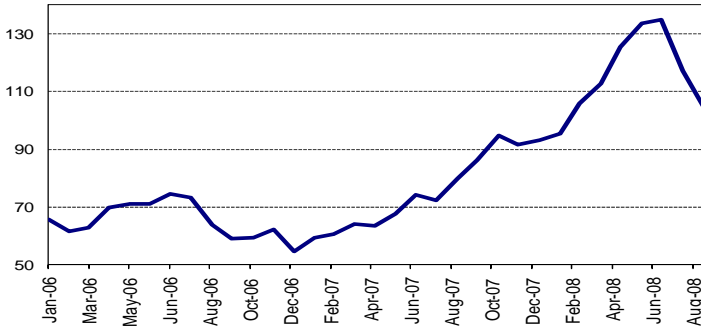
CEPAL revises. The Economic Committee for Latin America and the Caribbean (CEPAL) will revise downwards its Latin American and Caribbean growth projections for 2009, as a result of the effects of the international financial crisis on the region. Several weeks ago, CEPAL had forecast regional expansion at 4.7% in 2008, and 4.0% for 2009. The revision for 2009 will depend upon the extent of the economic downturn in the U.S., which has strong commercial ties especially to Mexico, the second largest economy in Latin America.

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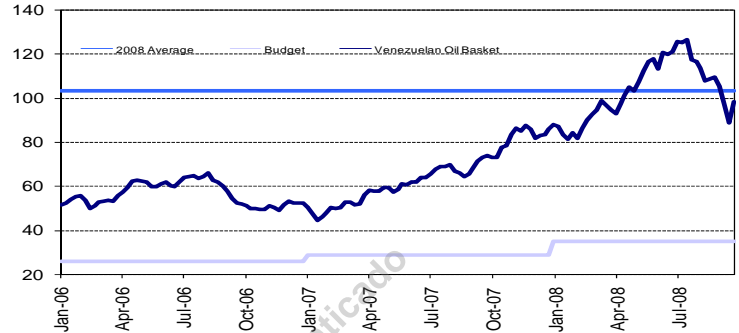
Weekly Report

ECONOMIC OVERVIEW

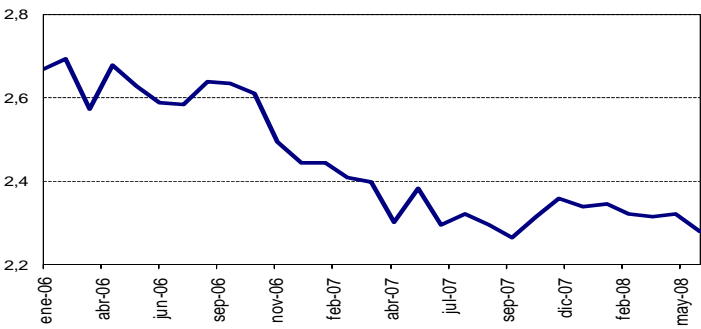
Oil Prices (WTI US\$pb)



Oil Price (Venezuelan Basket US\$/pb)



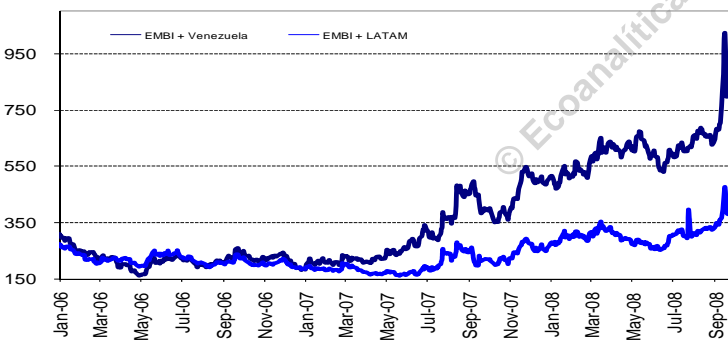
Oil Production MMBD



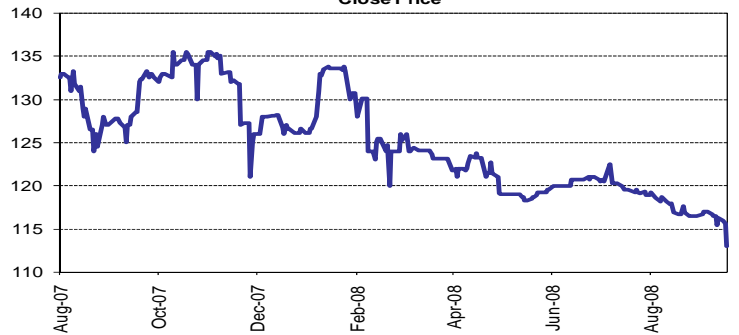
Fx Reserves - BCV (US\$ Million)



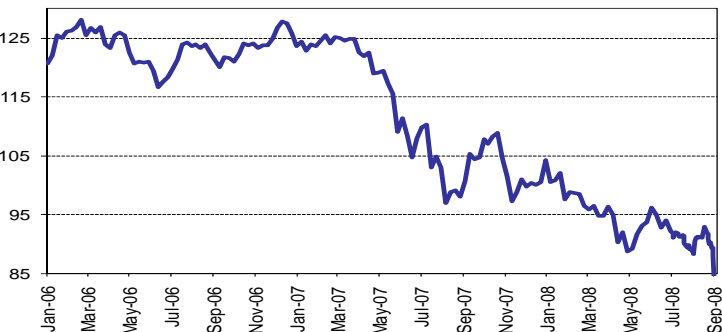
EMBI +



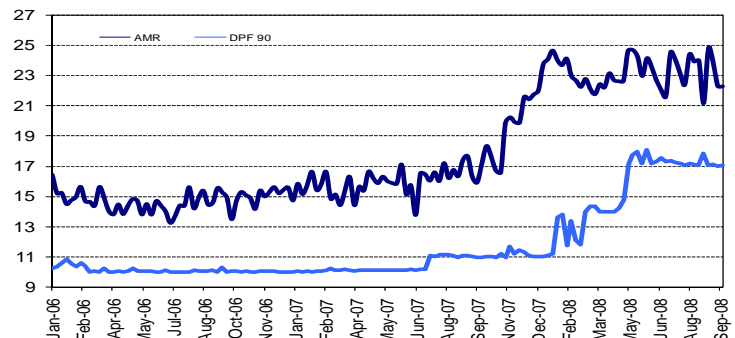
Venezuelan Global 18 Close Price



Venezuelan Global 27 Close Price



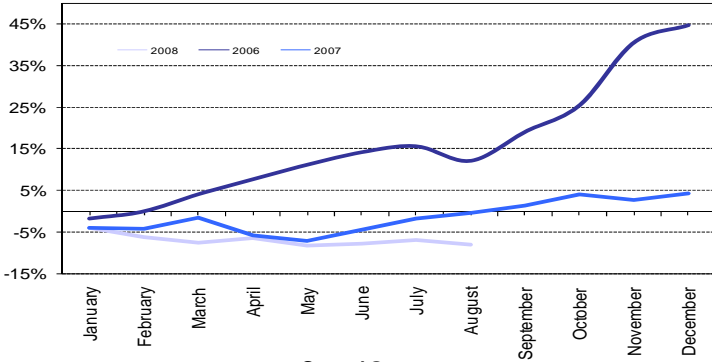
Interest Rate (Six Principal Banks)



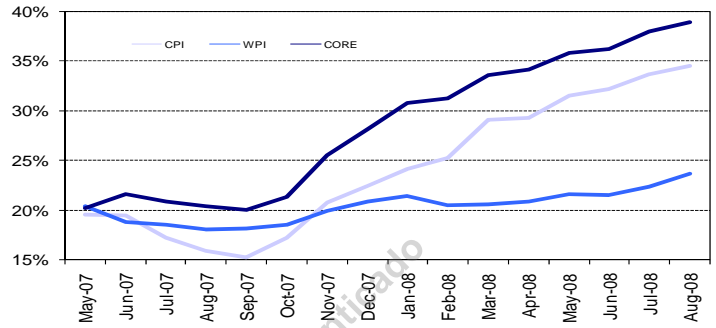
Weekly Report

ECONOMIC OVERVIEW

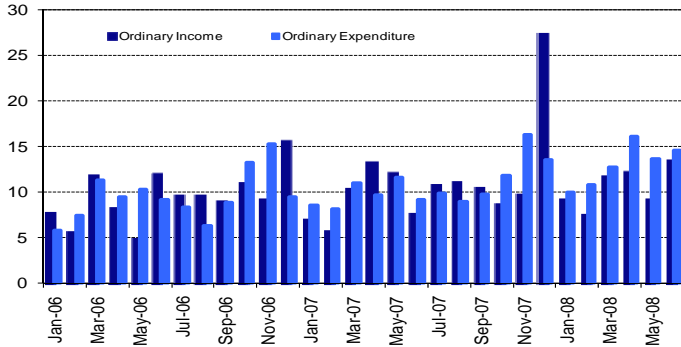
Real Expansion (M2)



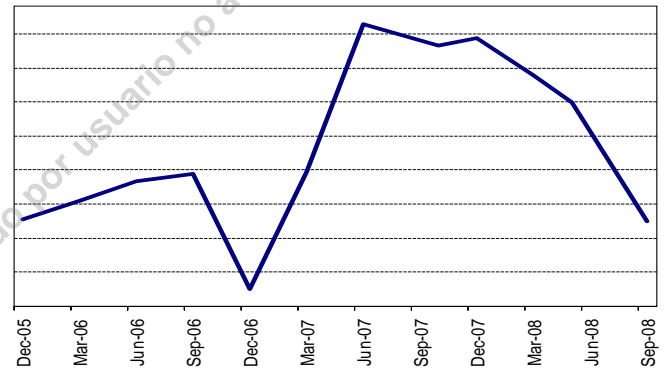
Inflation (Last 12 Months)



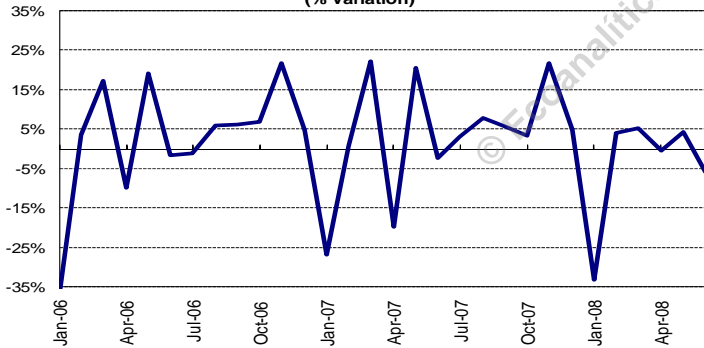
Central Government (VEB Billion)



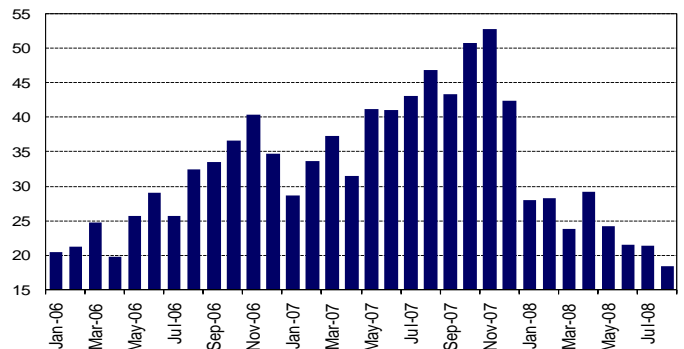
Resources of the State (US \$ MM)



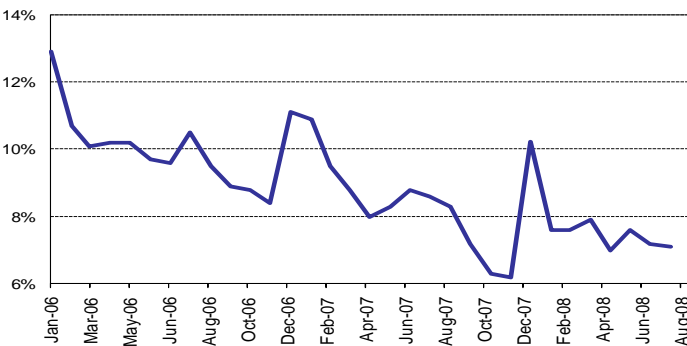
Volume of Sales (% Variation)



Sale of Vehicles (Thousands of Sold Units)



Rate of unemployment (% Variation)



Disbursement (US\$ Million)

