



Weekly Report

Year 5, Number 41
Week V, October 2009

By:
Asdrúbal Oliveros
Maikel Bello

2010 BUDGET: WHEN DISTORTIONS REACH THEIR LIMIT

Reproduction or distribution prohibited

A month ago, the Minister of Economy and Finance, Alí Rodríguez Araque, introduced the draft of the 2010 Budget and Debt Law Proposal before the National Assembly. In this Report, we'd like to analyze the budget policies the Government has planned for the coming year.

Zero credibility

In theory, a country's National Budget is a technical document whereby the budgetary needs of a country are specified, with their respective financing sources, as are the socio-economic policies being considered for implementation during the corresponding fiscal year. Therefore, all public administration organisms should participate in the drafting of the Budget, an exercise which should require careful study and deliberation as well as a considerable amount of time. This doesn't seem to be the case in Venezuela. The National Budget, far from depicting the Administration's vision in terms of fiscal spending for the coming year, has glaring important omissions, giving the authorities responsible for drafting the Budget absolutely zero credibility.



Empty words

In Venezuela, it seems like the Budget is drafted and presented to the National Assembly and then to the people only as a formality, something which simply can't be avoided. The Budget is in the habit of being elaborated based on a series of premises that do not coincide or correspond to the current economic reality of the country. Therefore, historically, the Venezuelan National Budget has never been able to be used as a tool to help analyze fiscal policies for the coming year. This year, and this National Budget, is not different. The 2010 National Budget is just full of empty words.

We don't believe to it...

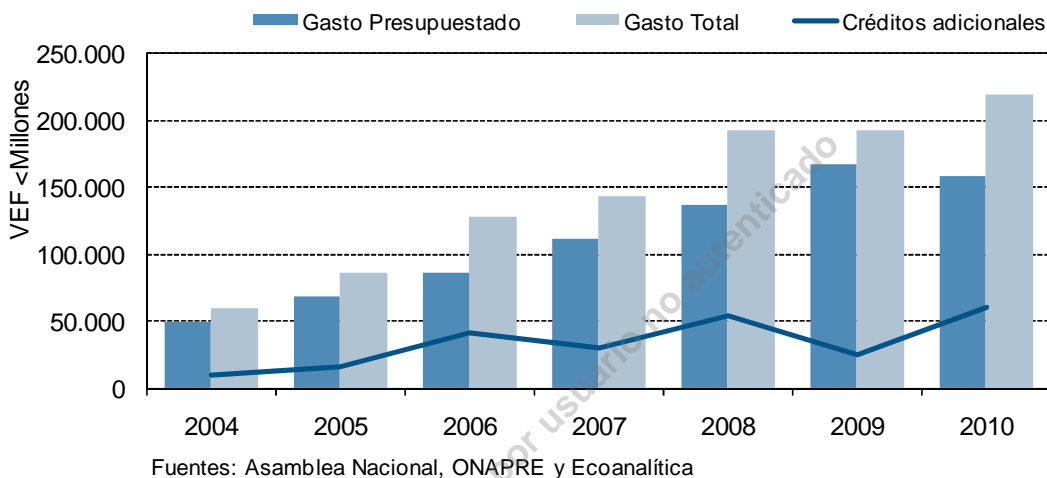
As has been known for some time now, the 2010 fiscal spending budget has been set at VEF 159.41 billion, a figure which is conservative, to say the least. In fact, this figure is 17% less, in nominal terms, than what this year's spending is being estimated to close at (VEF 192.94 billion). So, this would mean that the Administration is planning to cut back on fiscal spending; spending which increased at an average yearly rhythm of 72.9% between 2004 and 2008, and which dropped by 40% this year, and now the Administration plans to cut spending by 16.4% compared to the previous year for 2010. This does not seem likely, especially if one keeps in mind that 2010 is an election year.

With these spending figures, the drafters of the Budget seem to be strictly following the President's mandate to spend with "austerity," even while basing the Budget on a US\$ 40 per barrel price, which is much lower than international projections. But, it's a common practice now for the Administration to spend more than what's set in the Budget through supplemental appropriations. Keep in mind that for the 2009 Budget, spending was set at VEF 167.47 billion, which was later cut to VEF 156.38 billion, but increased through supplemental appropriations, in part financed with 2008 surplus resources that were deposited into the Miranda Fund, public indebtnees, and FONDEN.





**Gasto presupuesto y créditos adicionales
(2004 – 2010)**



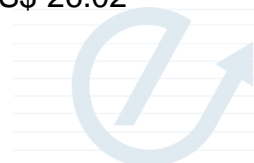
2010 is no exception

The same thing could happen in 2010, a year in which **Ecoanalítica** is estimating that public spending will be slightly higher than 29.1% of GDP or VEF 220.14 billion. Our estimate is higher than the official figure not only because we expect a higher level of spending to be financed through borrowing and surplus resources, but also that the appreciation of the exchange rate tends to “inflate” fiscal accounts in nominal terms. In fact, official figures project spending in 2010 at 17.7% of GDP, with the Ministry of Economy and Finance (MEF) calculating the GDP at the official exchange rate and putting it at VEF 896.40 billion (US\$ 416.93 billion!!!).

Furthermore, the official figures don't seem to be taking into account that during the last few years, spending policies have been marked by a noticeable increase of the Government load, in other words fixed obligations, which make it more difficult to cut back on spending during hard times.

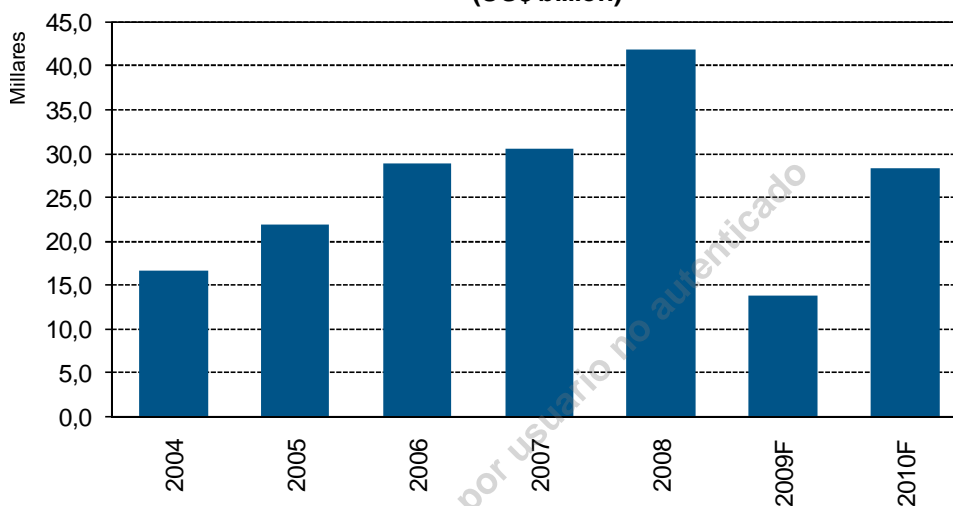
There will be extraordinary revenues next year

In the coming days, our clients will receive our Outlook Report for the fourth quarter. In it we estimate oil prices for 2010 at US\$ 71 per barrel, quite different from what was estimated by the Administration. That the MEF is setting a lower price guarantees that it will receive higher revenues in order to face the obligations it has been acquiring. We estimate that given the difference in price, in 2010 the Administration will take in around US\$ 26.02 billion in extraordinary revenues.





**Surplus Resources of the Restricted Public Sector
(US\$ billion)**

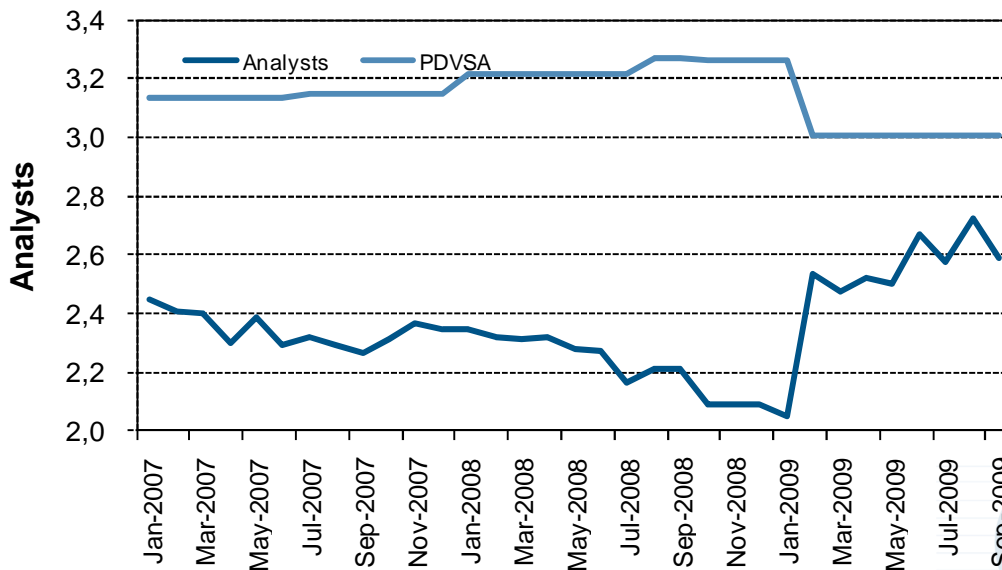


Sources: ONAPRE and Ecoanalítica

Despite distortions in oil production

With respect to oil production, the Government is hoping to produce 3.01 million b/d. At **Ecoanalítica**, we believe that this level is much higher than what PDVSA is currently capable of producing. Furthermore, in a scenario of falling oil prices, it's unlikely that Venezuela will be one of the first countries to propose oil production cut backs in order to protect prices, making it even more improbable that it could meet such lofty oil production goals.

**Oil Production
(b/d million)**



Sources: OPEP, EIA, PDVSA and Ecoanalítica



Believe it or not

The Budget anticipates a fiscal deficit equal to 3.9% of GDP. In this case, the estimate of the deficit is quite high, but in accordance to a projection of fewer oil revenues. At **Ecoanalítica**, we believe the fiscal deficit at the close of 2010 will be at around 2.6% of GDP. If to this we add an amortization level equal to 3.5 points of GDP, the result points to financing needs for around 6.1% of GDP. Quite a different figure than what is being estimated by the Government at 3.9 percentage points of GDP.

Comparison of the 2010 budget premises vs. Ecoanalítica

	MEF	Ecoanalítica
GDP Current Prices (VEF Million)	896,403	756,486
Oil price Venezuelan Basket (US\$/b)	40.0	71.2
GDP Growth(%)	0.5%	1.4%
Inflation (%)	22.0%	34.6%
Oficial Exchange Rate - end of the yea	2.2	2.9
Oficial Exchange Rate - average (VEF/l	2.2	2.8
Total Income	13.8%	26.5%
Non Oil Income	9.4%	10.5%
Income tax	2.9%	3.2%
Duty	1.2%	1.3%
VAT	4.3%	4.7%
Others	1.1%	1.3%
Oil Income	4.4%	14.5%
Income tax	1.9%	6.4%
Duty	2.2%	7.3%
VAT	0.2%	0.8%
Others	0.1%	0.3%
Central Bank profits	0.0%	1.5%
Total expences	17.7%	29.1%
Primary expences	15.9%	25.8%
Interests	1.9%	3.3%
Internal Debt	1.0%	1.8%
External Debt	0.9%	1.5%
Fiscal Balance	-3.9%	-2.6%
Primary Balance	-2.0%	0.7%
Fiscal Balance excluding oil income	-8.3%	-18.6%
Amortization	n/a	3.5%
Financial Needs	3.9%	6.1%
Total Debt	3.9%	5.8%
External Debt	n/a	3.0%
Internal Debt	n/a	2.8%
Others	0.0%	0.3%

Sources: MEF and Ecoanalítica



More borrowing

Why? Something that raises considerable concern with regard to the 2010 National Budget is that it does not allocate resources for the amortization of the debt. This means that the Administration plans to refinance the debt with new issuances. According to our calculations, debt amortization (domestic and foreign) for 2010 is at around VEF 9.62 billion (US\$ 4.47 billion). This amount represents 27% of the amount stipulated as financing sources.

The 2010 Borrowing Law set the ceiling for total gross borrowing at VEF 55.50 billion (US\$ 25.81 billion), a figure that is quite high. The subject of borrowing in 2010 is quite serious and very complex. We will be taking a closer look at this in next week's Report. What we can say now is that despite the fact that the Budget doesn't specify how much borrowing will be domestic and how much will be foreign, we expect that most of the debt that will be issued will be domestic, much like what has happened this year and what happened in 2001 and 2002.

Government priorities in 2010

Without getting into details, the 2010 Budget also shows us how the Administration is distributing the resources. Here is an example of just four important items: education, health, housing and security and defense. In 2010, global spending in defense will be at around US\$ 5.64 billion, more than double what it was in 2004 (US\$ 2.01 billion); spending in health will be at US\$ 6.46 billion, almost 4 times more than spending in 2004; spending in education is 2.5 times more; and spending in housing is 0.9 times more than 2004.

When seen in nominal terms, 2010 projected spending in education drops by 22.6% compared to 2009; defense spending drops by 8.6%. Health and housing spending show increases of 0.9% and 1.5% respectively. With respect to total spending, health represents 8.7% of the total, education 18.2%, defense 7.6%, and housing only 0.9%. It's interesting to point out that defense spending represents almost half of the health budget and five times more than the housing budget.

	Budgeted public expenditures (US\$ million)						
	2004	2005	2006	2007	2008	2009	2010
Education	5,378	5,903	9,256	11,090	16,510	17,450	13,513
Health	1,771	2,355	3,370	4,539	6,214	6,407	6,464
Housing	686	1,922	2,847	1,495	1,712	629	638
Security and Defence	2,013	3,201	3,659	4,175	6,011	6,170	5,641



	Budgeted public expenditures (as share of total expenditures)						
	2004	2005	2006	2007	2008	2009	2010
Educación	17%	14%	16%	17%	18%	19%	18%
Salud	6%	6%	6%	7%	7%	7%	9%
Vivienda	2%	5%	5%	2%	2%	1%	1%
Seguridad y Defensa	6%	8%	6%	6%	7%	7%	8%

Sources: ONAPRE and Ecoanalítica

Just like the shopkeeper

At *Ecoanalítica*, we have never been able to figure out why the Government wastes so much money and effort to draft a fictitious Budget. Minister Araque has promised that the figures introduced in the Budget will be strictly followed, but it's clear that this will be impossible. As can be seen, our estimates, which take into account the reality of the international scene, fully aware that it is still in recovery mode, is very different from that presented by the Administration. In our opinion, this National Budget is more a like a "guidebook of good intentions."

The 2010 Budget Law hides what will most likely be the policies implemented in 2010. If oil prices remain at favorable levels, then the Government will increase spending through supplemental appropriations and managing extraordinary resources at its discretion, along with an aggressive borrowing plan in order to avoid depleting of the out-of-budget resources. This Administration never learns that sustained and permanent growth can't be achieved just through spending.





Economic Tips

PDVSA placed 100% of its combined offer. PDVSA's combined offer of 2014, 2015, and 2016 Petrobonos for US\$3.26 billion, a bit more than initially announced (US\$3.0 billion) was complete placed in the market at a price of 138%. The demand for this issue was less than the Republic bonds because given the estimate price of these bonds on the international markets at 60%, almost the same rate as the swap-market exchange.

BCV Law reformed. This week, the National Assembly will approve the partial reform of the Central Bank of Venezuela (BCV) law. The main aspects of this reform are the following: i) it is now allowed to grant loans to contribute with the development of the country, for example, the papers issued by the Republic and decentralized entities also become instruments for loan assistance; ii) the BCV will be able to fix loan periods and interest rates, but more relevant, the BCV is ordered to establish special periods and interest rates for projects determined by the Administration as being of vital importance to the country, and which are developed in the agriculture, manufacturing, construction, agro-food, projects with export capacity, and those focused on developing gold currency standard.

What else is in the reform? Other interesting aspects are: iii) the BCV is ordered to establish special conditions for financing operations for the aforementioned sectors; iv) establish special conditions for discount and re-discount operations when carried out with institutions or Funds from the State created for the development of said sectors; v) The BCV will be allowed to purchase PDVSA loan titles, said offer must be authorized by the Executive Office, and the MEF and the BCV will have binding opinions on the financing conditions of the issuances of PDVSA titles; vi) in the case that BCV were to acquire part of the titles issued by PDVSA in foreign currency, these become a part of foreign currency assets and become a part of the international reserves when they are liquidated or mature.

And lastly... The reform establishes that the BCV must transfer international reserves to the FONDEN, in accordance with the optimum level of reserves and amounts surpassing said optimum levels at the end of the year. Therefore, the BCV must determine optimum levels of international reserves at the end of each semester. Transfers to the FONDEN will take place 15 days after the close of each semester.

CADIVI liquidations dropped by 40.9%. According to figures released by CADIVI, up until the third semester 2009, liquidations registered a 40.9% drop compared to the



same period last year. Foreign currency liquidations for imports (ordinary imports plus ALADI agreement) dropped by 43.1%, which means that US\$11.9 billion was not liquidated for imports. At **Ecoanalítica**, we estimate that liquidation of foreign currency will increase for the coming year, supposing that the foreign currency budget is completed and that oil prices continue to recover.

Amount disbursed accumulated to IIIQ (US\$MM)			
	2008	2009	Var(%)
Imports	19,141.5	10,607.2	-44.6%
ALADI Convention	8,529.4	5,140.8	-39.7%
Credit Cards	3,399.6	2,636.9	-22.4%
Foreign Investment	1,322.7	516.3	-61.0%
Remittances to family	625.3	414.4	-33.7%
Lin. Air	671.3	552.9	-17.6%
Ext Private Debt	575.4	28.6	-95.0%
Effective for travel	201.2	220.8	9.7%
Students	167.2	179.6	7.4%
Insurance and Reinsurance	64.7	118.8	83.8%
Special cases	71.9	51.7	-28.1%
Consulates and Embassies	47.8	74.6	56.2%
Telecommunications	41.5	38.0	-8.5%
Retirees and Pensioners	30.3	37.8	25.0%
Services	7.6	8.4	11.3%
Total	34,897.4	20,626.8	-40.9%

Sources: CADIVI and Ecoanalítica

The fiscal budget continues to be deficit, though less dramatic. According to the BCV's monthly report for June, during the first semester of the year the government took in fiscal revenues for VEF 54.16 billion, down by 38.8% in real terms compared to the same period last year. Government spending was at VEF77.40 billion, which translate into a cut back in spending of 25.0% in real terms compared to the previous year, but less than the drop in revenues. Consequently, this equals a fiscal deficit where a bit more than 63% of financing needs were covered by domestic debt issuance.





FISCAL BALANCE CENTRAL GOVERNMENT (VEF Millions)	June 2009	June 2008	Nominal Variation	January-June 2009	January-June 2008	Nominal Variation	Real Variation
Total Revenue	8,596	13,738	-37.4%	54,160	68,734	-21.2%	-38.8%
Non-Oil Revenue	6,618	5,678	16.6%	37,630	39,635	-5.1%	-26.3%
Oil Revenue	1,978	8,060	-75.5%	16,379	28,839	-43.2%	-55.9%
Total Expenditure	12,865	14,502	-11.3%	74,766	77,402	-3.4%	-25.0%
Fiscal Balance	-4,269	-763		-20,606	-8,667		
Primary Balance	-3,421	-331		-15,670	-4,500		
Non Oil Balance	-6,247	-8,824		-37,136	-37,767		
Debt Amortization	1,419	625		2,522	4,954		
Financing Requirements	5,688	1,388		23,128	13,621		
Foreing Debt	1	16		138	6,354		
Domestic Debt	3,596	200		14,471	318		
Tresury Bonds	3,347	0		12,296	21		
Tresury Debt	249	200		2,175	297		
Others	2,091	1,173		8,519	6,949		

Sources: BCV and Ecoanalítica

2010 National Budget Law. According to the 2010 National Budget law draft, ordinary revenues coming in are set at VEF 124.07 billion; current and capital spending is estimated at VEF 159.41 billion; and diverse sources of financing estimated at VEF 35.34 billion. Furthermore, it's estimated that VEF 16.81 billion is being allocated for public debt service payments and public debt refinancing and restructuring operations will be carried for around VEF 14.67 billion.

Budget investment freefalling. According to the 2010 National Budget, only VEF640.50 million is being earmarked for direct investments, when after the adjustment made this year in March, VEF 997.50 million was slated for investment in 2009, which means that the coming year is showing a 36% drop in resources being set aside for investment. The Government will finance projects through FONDEN, and the China Fund, and the other mechanisms which have been recently created.

Unemployment jumps. According to INE figures, unemployment closed the month of September at 8.4%, quite a bit higher than the rate reported in September 2008 (7.2%). This means that 170,551 jobs have disappeared during the last 12 months and that a total of 1,098,554 people are unemployed in the month of September.

Interests Rates. In the latest BVC report, the interest rate for lending for the third week of October is 18.9%, these represents a decrease of 13 basis points if we compare it with the week before. In other hand, the interest rate for long-term and



short-term deposits is at 15.9% and 12.6%, these represents an increase of 36 basis points for the first one, although the short-term rate didn't change in the period.

Internationals Reserves. The international reserves increase in a 0.2%, getting from US\$33.1 billion at the third week of October, to US\$33.2 millions at the end of the fourth week of the same month. If we compare it to the results from the same period in 2008 the reserves have decrease 17.3%.

Monetary Liquidity. According to the latest reports from the BCV the monetary liquidity decrease 3% on the third week of October, compared with the second week of October, getting to VEF 221.1 billions. Through this year it has increase 13.8 % and if we compare it with the results of same period in 2.008 the increase is 31.4%.

Oil Tips

PDVSA'S debt increased to US\$23 billion. After a drop in its revenues and an increase in its obligations, PDVSA has had to raise its debt, which has grown by US\$8.26 billion so far this year after the latest Petro-bonds were issued (certified loans: US\$2 billion, Petro-bond 2011: US\$3 billion and Petro-bonds 2014, 2015 and 2016: US\$3.26 billion), from US\$15 billion at the end of 2008, representing a debt increase to US\$23.26 billion, not taking into consideration Japan's US\$1.5 billion loan and Russia's financing.

BCV will be able to cover PDVSA'S needs, thanks to the modification of its legal regulations, which will allow this institution to acquire PDVSA'S bonds. The Administration stated that *"the operations will guarantee the Central Bank's possibility to expand its availability in securities to execute policies within its faculties,"* and that, should these securities be issued in foreign currencies, BCV's holding them *"would constitute an asset in foreign currency which will be part of the reserves upon its liquidation or maturity."* But the true implications will allow for PDVSA's deficit to be covered, which would surrender part of these resources to the treasury department, so the BCV would also be financing the State.

A 47.7% drop in PDVSA'S 2009 tax contribution is expected. The Administration estimates that by the end of the year, PDVSA'S tax contribution will reach VEF 43 billion, that is 47.7% less than its 2008 VEF 82.4 billion-contribution, but approximately VEF 5 billion more than the budgeted forecast. It is necessary to point out that the



average Venezuelan Oil basket price in 2008 was US\$86/bl, much higher than the average being considered by the Administration in 2009 (around US\$60/bl).

But the exchange rate doesn't help much either. Another factor to be considered is not only the oil price reduction, but also the effect of the real appreciation of the exchange rate on PDVSA's accounts, which is why we continue to say that PDVSA would be one of the main entities to beneficiary from an adjustment of the official exchange rate.

The Administration's Projection for 2010. 2010 Budget Law Draft states PDVSA's contribution (which has been affected by lower production levels and oil prices). Royalties are expected to reach VEF 29.1 billion bolivars, which represents a 51.6% drop compared to 2008. Contribution via Income Tax is calculated at VEF 9.6 billion, representing a drop of over 47% compared to 2008. Dividends are estimated to be at VEF 4.3 billion, similar to 2008, but in relation to this year's goal, fund surpluses will be reported.

National Production hindered. According to an analysis carried out by the international news agency Reuters, based on the estimation of the firm Energy Security Analysis, national crude oil production is projected to be between 2.2 and 2.3 million b/d both in 2009 and 2010, due to the fact that traditional oil fields will lose a quarter of their production each year unless they receive extraordinary investments. This is without considering the fact that the Orinoco Oil Belt projects could need a maturation period of five years or more before the first oil barrel is produced.

Problems in negotiating oil workers' collective bargaining agreement continues. The FUTPV has not received the CNE ballot yet, an indispensable requirement to start the negotiation of the collective agreement. Also, some of the parties challenged the process, which impedes the issuance of the document that legitimates this new Board of Directors before the Ministry of Labor and Social Security. The FUTPV'S executive committee said the labor office demanded the correction of some terms included in the collective bargaining agreement's draft.

And the National Guard arrests protesters. 50 former workers of steam plants recently nationalized by the State on the Eastern Shore of the Maracaibo's lake (Zulia state) were arrested by the National Guard last Wednesday while trying to announce a hunger strike. This arrest makes PDVSA the company with the highest number of violations to the workers' right to protest, with a total of 128 oil workers arrested during the last few months.

Anzoátegui spill cleanup started. PDVSA announced that *"in order to restore environmental conditions in approximately one kilometer of affected areas, a PDVSA*



multidisciplinary team in the region started carrying out actions to isolate this unknown product, to avoid its propagation and proceed with its collection.” A research committee was created to investigate the cause of the slick detected along the coast of the Peñalver municipality, in the Anzoátegui State. Also, fishermen complained of another spill in the Maracaibo Lake.

Paraguay Attorney General’s Office: Reviewing PETROPAR – PDVSA case. In a recent study, Paraguay’s General Comptrollership (CGR) reported that the payment terms and conditions in the agreements signed between PETROPAR and PDVSA are illegal, since they include clauses that are not expressly stipulated and are in contrast with the Energy Cooperation Agreement of Caracas. The CGR attributes these problems to the continuous negligence of PETROPAR authorities in said period, which resulted in an inefficient and short-falling administration of the company.

Iran: we have not surpassed the quota. According to the local news agency Mehr, Iran’s representative before OPEC, Mohamad Ali Jatibi, said that the adverse reports recently released by the International Energy Agency and other sources “*lack foundation and are not reliable.*” According to these sources, in a quest for higher prices, Iran exceeded its quota in January by nearly 0.5 MB.

International baskets. The WTI ended on Thursday, the 29th of October in US\$79.9/bl reflecting a decrease of 1.6% with regard to the US\$81.2.1/bl registered at the closing of last Thursday. For its part, the Brent also diminished, but in a slightly major proportion, falling 1.9% to place in US\$78.0/bl, in relation to the US\$79.5/bl of Thursday, the 22th of October.

Local oil basket price. The Venezuelan oil basket price went up by US\$5.4 last week, to close on Friday, October 23 at US\$73.5/bl against US\$68.1/bl of the previous week. Meanwhile, the basket’s annual average reached US\$53.7/bl, 34.3% over the budgeted value. Projections for the close of this year are estimating additional income of around US\$11.5 billion.

A new trend? Oil prices increased (from levels around US\$90 per barrel) during the first few months of 2008 until peaking over US\$145/b in July. Since then, the price dropped to a low US\$ 34/b in December, to start a new increasing trend that has pushed it to the current US\$ 70/b. This has had great base effects on energy prices, which have been crucial to determine the course of inflation before much slighter moves in the subjacent inflation caused by cycle conditions.

Impact on inflation. The year to year crude oil price rate has been around -60% during the first half of this year, significantly helping negative inflation rates in most of the world. But this has changed. Since the first half of October, the year to year price



variation rate went back to a positive number, and judging for futures market indications, that rate will continue to increase substantially during the upcoming months.

Business Sector Tips

2010 Foreign currency budget. The Minister of Planning and Development, Jorge Girdani, said this year's foreign currency shortage will not repeat itself in 2010, although the priority will go to industries that are part of the National Socialist Plan. He also said the Ministry is looking to negotiate 75% of approved but not liquidated foreign currency allocation applications.

Meetings between the BCV, CADIVI and Ministries to start, facing 2010. Meetings between the Venezuelan Central Bank, the Foreign Currency Administration Commission and several Ministries are to begin this week to give way to the 2010 foreign currency budget planning. According to Nelson Merentes, president of the BCV, the goal is to overcome the difficulties faced in 2009 to achieve a positive growth in 2010, and fight inflation.

New exemptions to imported goods. According to Decree No. 6,985, published in the Official Gazette on October 23 of 2009, import of all tradable capital goods, parts and accessories indicated for the execution of projects in the Economic and Social Development Plan are exempt from the VAT and import taxes, as long as said goods are either not produced in Venezuela or its production does not cover the local demand. This will be in effect for 3 years and the application shall be submitted to the Ministry of the People's Power for Science and Technology.

Discussion of the Bank Law is in progress. According to the Bank Law draft, National or Regional banks would have to devote between 5% and 10% of their previous year's gross portfolio to micro-loans. They would also have to devote 5% to sponsor social responsibility projects. Banks shall constitute a trust with 10% of their stock capital, which would be in the employees' hands. Finally, the President of Venezuela would be authorized to set interest rates he considers to be of social concern to activities classified as being "for national development".

A few months after its nationalization, Banco de Venezuela loses profitability. Banco de Venezuela's wealth profitability gauge was at 30.8% in December of 2008, in June of 2009 it reached 25.8%, and at the end of September it closed at 22.5%.



Delinquent payments have increased as well, going from 2.45% in July, below the financial system's average, to 2.6% in September (same as the system's average). Although it is still too soon to establish a trend regarding delinquent payments, the profitability trend is clearly decreasing.

Banco de Venezuela's portfolio intensifies its investment in public securities. Although the original intention to nationalize Banco de Venezuela was to increase credit intermediation and to direct loans to the country's productive sectors, the bank's investment in public securities increased by 21% from July to September 2009.

76% of the banking system has not met the manufacturing portfolio goal. The Government's goal, announced by Minister Chacon, to meet the mandatory loan portfolio for the manufacture sector, currently at 10% of the total loans portfolio, will hardly be achieved during the next months. Out of 38 banks in the Venezuelan banking system, 29 are below the required 10%. Even public banks are not complying with the manufacturing loan portfolio, only one out of five public banks met the 10% goal, Banco de Venezuela and Banfoandes are both below 7%.

10% of crops were lost due to electric power failures. A report released by the Portuguesa Farmers' Association (ASOPORTUGUESA) indicates the electric power failures in the area have been causing a decline in productivity of up to 10%, since in several opportunities farmers have spent days without being able to start the irrigation engines at their farms. For instance, in rice farms, productivity went from an average 5,000 kg per hectare to 4,500 kg per hectare. Power shutdowns also cause severe damages to machinery, which can increase production costs by up to 20%, according to ASOPORTUGUESA.

Stimulus for the automobile sector. In order to achieve the official vehicle production goal proposed for 2010 (200,000 units), the Administration will extend the raw material imports' special regime to vehicle manufacturers and auto-part dealers. This measure will reduce the tax on the imported goods to only 3%.

The last one in Latin America. Legatum Group, a firm devoted to investing in promoting world development released its Prosperity Index ranking, which measures and relates a country's growth in terms of personal freedoms, democracy and quality of life. The ranking leader is Finland; United States occupies the ninth place and the best-positioned in Latin America is Costa Rica, followed by Uruguay, Argentina, Brazil, and Venezuela is in last place of countries on the continent, right below Bolivia, due to the deficient economic principles and low levels of innovation.





World Crisis Tips

Profitability down. Profitability of United States Treasury bills continues to decrease. Other general factors are contributing to that, such as the fact that the insurance program for foreign exchange market funds expired in September, which has made many dealers rediscover the value in the Treasury bill. Also, the reduction in the offer of Treasury bills announced in September has pushed its prices up. The fact that there is a limit for State indebtedness that must be approved by the Congress and in the last few years has caused the re-edition political confrontations between the Administration and Congress groups, and in occasions has created the possibility, due to technicalities, for the United States to be in “default” for several weeks, is a peculiarity of the American system. The indebtedness limit was raised in May 2003, November 2004, March 2006, October 2007, and July & October 2008 and February 2009 (up to US\$ 12.1 trillion). The US Treasury Department announces in August they expected the limit to be reached by the first half of this month, and requested a new extension by US\$ 925 billion.

The crisis will cost about US\$150 billion to Latin America. According to IMF estimations, the world crisis will have a cost of US\$150 billion for countries in the region. The International Monetary Fund estimates Latin America will contract this year by 2.4% in average, and will have a growth below its trend during 2010 (3%). It is worth mentioning that, although the external shock was stronger than that of previous crises, Latin American economies were much less prepared and had DGP contractions below the average of developed countries.

USA is expected to grow by 3.5% during the third quarter of 2009. According to a survey carried out by Marketwatch, in average, economic consultants expect the US GDP to grow by 3.5% (Seasonally adjusted annual rate, SAAR) during the third quarter of 2009, which would confirm (although not officially) the recession is over in the United States.

China grew by 8.9% in the third quarter. The originally Chinese Government’s 8% growth goal set at the beginning of this year was originally perceived as hard-to-achieve, but now, with a y/y growth of 8.9% in the third quarter, and accumulating a y/y growth rate of 7.7% during the first three quarters of the year, the official goal seems conservative. China has achieved these high growth rates in spite of the world crisis (which has affected them significantly in the foreign commerce sector, imports in September are still 3.5% lower than those of September of 2008, and exports are 15.2% less), thanks to a substantial fiscal and monetary stimulus plan.



National activity index above recession levels. The Chicago Federal Reserve Bank prepares a nationwide economic activity index comprising 85 different indicators, in which a zero value means the economy is growing at the same pace as its long-term trend. During the July-September quarter, this index was at -0.63 points, up from -0.96 in the June-August quarter. Historically, the end of a recession usually coincides with the quarter in which this index passes -0.7 points, one more sign that the recession is being overcome.

More regulations for the financial system. Ben Bernanke, president of the FED, said it is time for the policy makers to take actions to reduce the probability of future financial crisis. So far (over a year after the crisis) there have not been any clear proposals for a regulation, but the FED'S intentions are to increase stock capital requirements for financial institutions (both in quantity and quality) and to reform the structure of bank employee remuneration incentives, to avoid the excess of high-risk decision-making.

Real estate market recovers slowly but steadily. The average home prices in 20 major cities of the United States, measured by the Case-Shiller Home Price Index, increased for the fourth consecutive month. In August, prices recovered by 1.2% compared to July. Out of the 20 cities, only three showed a contraction in terms of prices (Charlotte, Cleveland and Las Vegas). Compared to August of 2008, prices are still 11.3% lower.

Consumer confidence is still low. Consumer confidence, measured by the Conference Board's Consumer Confidence Index in which 5,000 families are surveyed, went down for the second consecutive month. In October, the index was at 47.7 (1985=100) points, down from 53.4 points in September. The current situation component went down to 20.7 from 23 points last month, the lowest mark since February of 1983 when it reached 17.5 points. The expectations component decreased to 65.7 points, down from 73.7 in September.

The British economy shrinks more than expected. United Kingdom's official growth figures showed the GDP shrinking by 0.4% (Seasonally adjusted annual rate) during the third quarter, which in y/y terms represents a 5.3% drop, much worse than the slightly positive number that was expected by the market, so the Pound Sterling value (GBP) decreased from €1.11 to €1.08 and from US\$1.67 to US\$1.63.

The Pound is likely to continue debilitating. The unexpected shrinking of the GDP in the UK in the third quarter will pressure the Bank of England to increase its quantitative easing program, currently estimated at GBP 175 billion, to a level of GBP



200 billion, which will debilitate the Pound Sterling even more, which, according to currency experts, could be equivalent with the Euro in the next months.

Credit shrinks in the Eurozone. For the first time since this data has been available (1991), credit in the Eurozone shrunk in y/y terms, showing a level that is 0.3% lower than that of September 2008, in spite of the European Central Bank's strong monetary stimuli.

Political Tips

People's lack of confidence in the President increased. According to surveys carried out by Datanalisis, 83.3% of the AB social class doesn't trust the President, as well as 65.8% of class C. Surprisingly, 58.3% of sector D and 50.5% of sector E have lost confidence in President Chavez' actions.

However, he is still the main man. According to Datanalisis, although 21.5% of the people define themselves as pro-government and 17.4% as opposition, 54% of the citizens express they don't belong to any of the two groups. This is aligned with party identification, for, even though the PSUV has lost constituents (barely 19.5% of respondents identify with that party, a loss of 12 percent points of acceptance between September and October), parties such as Accion Democratica (Democratic Action), Un Nuevo Tiempo (A New Time), Primero Justicia (Justice First) and Proyecto Venezuela (Project: Venezuela), barely enclose 9.3% of the people (in September the number was 9.8%).

The missing ingredient. President Hugo Chavez announced exceptional measures, including the creation of a ministry to fight water shortage and the difficulties to cover the national electric power demand. Chavez said that among the measures to be implemented is the release of a *"strong campaign" to save water and electric power, as well as the creation of a ministry to "directly and exclusively" take care of the energy problem.* Also, a Strategic Commission for the electricity sector will be created and will be directed by the Government Vice-President Ramon Carrizales, *"with a direct worker intervention"*.

Measures. Among the exceptional measures announced by the President is renting a special plane to bomb the clouds over the Guri Dam (Eastern Venezuela) and produce rain, since its water reserves are reaching *"alert"* levels, which is the same as *"the average of its lowest historical level."* He also mentioned the increased demand as a



cause of these problems, calculated in 7% y/y, and the waste of energy Venezuelan people are used to. Chavez said the decree that will create a new ministry will include the obligation of public offices to reduce consumption by 20% and the prohibition to import non-energy-saving electric equipment.

New minister. The President of Venezuela, Hugo Chavez, announced he appointed Representative Angel Rodriguez to be in charge of the new Ministry of Electric Power. Chavez said Rodriguez is a social fighter and is the current president of the National Assembly's Energy and Mine Commission. Angel Rodriguez will also be president of Corporacion Electrica Nacional (Coprpoelec), substituting Hipolito Izquierdo. President Chavez did not comment on Izquierdo's new position in the National Government.

China-Venezuela mixed commission meeting suspended. The eighth China-Venezuela mixed commission meeting to be celebrated between October 29 and 31 was suspended. The commission would have analyzed the status of the bilateral relations and would have prepared possible new agreements. Spokespersons for the National Reform and Development Commission (CNRD) and China's Ministry of Commerce reported *"the meeting date has not been set."*

CNE requested funds to organize 2010 elections. The execution in 2010 of all 11 drafts developed by the People's Power is estimated to require an amount of VEF 1.63 billion. However, in the Budget Law draft presented before the National Assembly, only VEF 35 million (2.1% of the total requested) will be allocated for the execution of the two elections planned for 2010: city council and community representatives' elections and the National Assembly elections.

Impasses between Colombia and Venezuela continue. The Colombian Minister of Defense, Gabriel Silva, said there is a "free traffic" of aircrafts bearing drugs throughout the Venezuelan airspace. In response, the Executive Vice-President, Ramón Carrizález said Silva's statements were cynical and assured Venezuela makes efforts to maintain cordial relations with neighbor countries.

Coming soon: PSUV Congress. Off the record, that party's organization director and Mayor of the Libertador municipality, Jorge Rodriguez, said 64,046 candidates have postulated themselves to be delegates in the 1st PSUV Extraordinary Congress. Rodriguez said that, once the automated candidacy process and the submission of all physical requirements to the Electoral Commission is over, PSUV regional Vice-presidents will present the corresponding lists of al 355 municipalities to the National Director's Office.

Ministry of Internal Affairs and Justice demands VEF 461 million to activate the National Police. The activation of the National Police represents the most expensive



budget entry of all 13 projects intended to be executed by the Ministry of Internal Affairs and Justice (MIJ) in 2010, that is, VEF 461 million, out of VEF 911 million budgeted. 96.8% of these funds will be devoted to staff expenses; 1.7% to “non-personal services” and 1.5% to “materials, supplies and merchandizes.” According to the Budget Law draft, in 2010, the MIJ will give priority to strengthening the National Anti-drug Plan; minimizing risks and natural disasters; improving the penitentiary system; strengthening relations between the Administration, the Powers and the civil society, and generating changes in the Venezuelan police system.

Agreements between Syria and Venezuela proliferate. The President of the Arab Republic of Syria received Minister Nicolas Maduro in the People’s Palace, in Damasco, in order to accelerate the construction of a joint refinery, as well as to catalyze the commercial trade of Syrian olive oil and Venezuelan rice. The Syrian President said the Syrian Minister of Commerce and Economy, Amer Husny Lutfi, would be visiting Caracas soon to lead a commercial and entrepreneurial delegation that will evaluate the creation of new cooperation proposals between both nations.

More conflicts. According to Victor Martinez, president of the Universidad Central de Venezuela Teachers’ Association, the university strike called for October 26 was a total success. 16 universities stop their activities to protest against the incompliance with the homologation norms, that is, failure to comply with the teachers’ agreements regarding debts of 2008.

Will Venezuela be on the black list? Republican Representative Connie Mack announced a resolution that demands that the American Government include Venezuela on the list of countries that sponsor terrorism. Countries considered as terrorist-sponsors cannot receive financial aid from the United States nor can they enjoy commercial benefits or financial treaties, among other exclusions. This list is updated every year, and is currently integrated by Cuba, Sudan, Iran and Syria.





ECONOMIC OVERVIEW

