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By:

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## **2009: THE BUDGET ON ONE SIDE AND THE COUNTRY ON THE OTHER...**

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A few weeks ago, the Minister of Economy and Finance, Alí Rodríguez Araque, introduced the 2009 Budget Law and Debt Projects before the National Assembly. The National Assembly approved both in its first discussion. We would like to analyze the budget policies that the Government is planning to introduce next year.

### **Theory is one thing...**

In theory, the National Budget is a technical document which introduces expected budget needs, the corresponding financial sources which will cover these needs, as well as the socio-economic policies which the Government expects to implement during the year. Therefore, all public administration organisms must participate in drafting this budget, and they invest a significant amount of effort doing so every year.

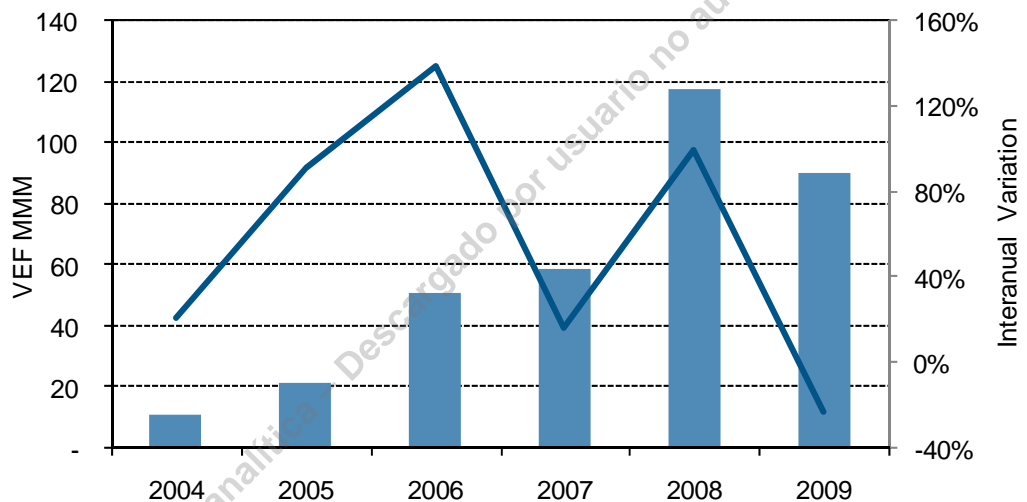
### **Doing things is another...**

But, it seems like in Venezuela, the National Budget is just formality which has to be fulfilled. And it's done so based on facts that have nothing to do with the economic reality of the country. So, historically, the National Budget is useless when it comes time to analyze fiscal policies for the coming year. The 2009 National Budget is not different from the rest.

## A tight budget

Spending in the 2009 Budget has been stipulated at VEF 167.47 billion (23.7% of GDP), a figure which is very conservative no matter how you look at it. In fact, this figure for spending is 18% less than what the Government is expecting to spend by the close of this year (VEF 203.30 billion). So, this seems to indicate that the Government is planning to cutback on the amount of money entering the economy from the fiscal sources, which between 2004 and 2008 has been increasing at a yearly rate of 72.9%, but in 2009 it is estimated that it will be cutback by 23.3% compared to the previous year.

Monetary Offer from fiscal sources



Sources: Budget Law and Ecoanalítica

With spending set along these lines, the Budget seems to be following the presidential mandate to “tighten spending,” maybe anticipating that oil prices won’t be quite so favorable in the coming year. However, let’s not forget that the spending budget for this year was set at VEF 137.50 billion but it has been inflated through supplementary appropriation, some of them financed with the 2007 surplus that were deposited in the Miranda Fund. The same thing could happen in 2009. At **Ecoanalítica**, we expect spending in 2009 to slightly higher than 25% of GDP or VEF 229.69 billion. This higher figure, compared to the official estimate, is due to the fact that we expect a higher level of spending to be financed by acquiring debt and that the appreciation of the exchange has a way of inflating fiscal accounts in nominal terms. Besides, the official numbers don’t seem to be taking into

account that the spending policies of the last few years has been marked by a significant increase in the Government's load which makes it more difficult to cutback spending when fiscal revenues are also dropping.

## And very optimistic...

In the next few days, our clients will be receiving the Monthly Report for the month of November. In it, we state that our expected price for a barrel of oil in 2009 is US\$ 48. This clearly signals the end of Chávez's economic model which totally depended on an oil boom and oil prices continuing to rise, and it also threatens the stability of his overall plan in general. The Government is expecting prices to be around US\$ 60 per barrel, which we think is much less probably, but which would generate more revenue guaranteeing that it will be able to meet its obligations.

With respect to oil production, the Government is expecting to be producing XX million b/d. At **Ecoanalítica**, we believe this is way above PDVSA's current production capabilities and it doesn't make sense with the fact that in a scenario of falling oil prices, Venezuela would be the first to propose to defend oil prices at the cost of lowering production even more.

Furthermore, the Budget estimates a fiscal deficit equal to 1% of GDP which we find very conservative if we take into consideration the drop in oil revenues that is expected in 2009. At **Ecoanalítica**, we expect the fiscal deficit to be at around 4% of GDP by the close of the year. If we add on to this 2.3% of GDP which represents the debt service then we have that there is a need to finance around 6.3% of GDP. This is quite a bit different then the estimate financing need the Government is estimating at 1.7 percentage points of GDP.

## Domestic debt will predominate in 2009

The 2009 Debt Law estimates a total acquired debt of VEF 12.24 billion. Despite the fact that it doesn't specify which portion will be destined for domestic debt and which for foreign debt, we expect that a good portion of it will be placed in domestic debt given that the international financial crisis will significantly limit how attractive our debt will be on the international market. So, the domestic market will once again be marked an abundance of paper being placed as it was in 2001 and 2002.

## This is not good news for the parallel market

With international markets being practically closed to the placement of Venezuelan debt, this means that the Government won't be able to count on issuing bonds in US-dollars but payable in bolivars, one of its most important tools for controlling the parallel market. So, once again, we notify

our clients that this is the moment to begin to design your coverage strategies for the exchange.

<b>Fiscal Balance of the Central Government (%GDP)</b>		
	<b>MEF 2009</b>	<b>Ecoanalític a 2009</b>
<b>GDP Nominal (VEB Trillions)</b>	705.308,00	918.749,86
<b>Oil Price (US\$ per BI)</b>	60,00	48,00
<b>Economic Growth (%)</b>	6,00	0,60
<b>Inflation (%)</b>	15,00	39,20
<b>Exchange Rate (VEB per US\$)</b>	2,15	2,84
<b>Total Revenue</b>	22,00	21,00
<b>Non-Oil Revenue</b>	10,95	9,60
Income Tax	3,33	2,92
<b>Customs</b>	1,41	1,23
<b>Tax</b>	4,95	4,34
<b>Others</b>	1,31	1,15
<b>Oil Revenue</b>	11,05	10,40
<b>Oil Tax</b>	4,88	4,60
<b>Oil Royalty</b>	5,55	5,23
<b>PDVSA Earnings</b>	0,61	0,57
<b>Others</b>	0,2	0,2
<b>Central Bank Earnings</b>	-	1,00
<b>Total Expenditure</b>	23,74	25,00
<b>Primary Expenditure</b>	22,32	22,90
<b>Interest</b>	1,50	2,10
<b>Domestic Debt</b>	0,86	1,00
<b>Foreing Debt</b>	0,64	1,10
<b>Fiscal Balance</b>	-1,00	-4,00
<b>Primary Fiscal Balance</b>	-0,32	-1,90
<b>Non Oil Balance</b>	-12,79	-15,40
<b>Amortitation</b>	0,70	2,30
<b>Financing Requirements</b>	1,70	6,30
<b>Total Debt</b>	1,74	2,20
<b>Foreing Debt</b>	n/a	0,30
<b>Domestic Debt</b>	n/a	1,90
<b>Others</b>	n/a	4,10

Sources: MF and Ecoanalítica

**The story will continue to be the same**

At *Ecoanalítica*, we will never understand why the Government wastes time, effort, and money in drawing up a fictitious Budget. Minister Araque has promised to stick to the figures in the Budget, but it's obvious that this will be impossible. As you can see in the previous table, our estimates which take into consideration the reality of an unfavorable international environment, doesn't look very much like what the Administration is expecting. This Budget looks to us like a "manual for good intentions."

## Economic Tips

**Inflation control.** The 2009 Budget considers an inflation rate of 15%. The actions intended to control prices include: (i) tax exemptions to alleviate the impact on the basic food basket and (ii) bonds issues on the domestic market to influence liquidity behavior.

**11 million surplus.** According to the 2009 Budget, public spending will close at VEF 203.2 billion this year, but only 192.4 billion of it will be executed; therefore the remaining VEF 11.0 billion will be spent next year through supplementary appropriations. Including this figure, expected spending for 2009 would be at VEF 172.8 billion.

**10 months after the monetary conversion.** BCV's Director issued a directive for financial institutions that provides for the obligation to maintain a minimum stock of the different coin denominations to prevent coin shortages and guarantee service. The minimum amounts vary depending on the size of the bank office.

**The Executive is cautious about public spending.** According to President Chávez, the crisis will not impact Venezuela, but it's convenient to control public spending. Therefore, he notified government members that resources will be allocated only to those that really need them for the development of works; he also requested these works to be developed in an efficient manner.

**Wages and salaries will account for 23% of the Budget.** Of the VEF 167.4 billion estimated in the 2009 Budget, VEF 37.6 billion is earmarked for personnel expenses, specifically to pay the public sector payroll that will be substantially increased next year and will account for 23% of public spending. As per official data, the share at the end of this year is 17%, that is, VEF 35.9 billion of the spending estimate of VEF 203.3 billion, with a year-to-year growth of 4.8%, but with a much higher GDP percentage.

**Financing sources expanded.** The National Assembly has authorized supplementary appropriations for VEF 45.6 billion this year. This off-budget spending has been financed through different funds, including Fondo Miranda and the trust fund of the Ministry of Finance and the National Treasury Office, among others. Now a new financing mechanism has been added: the Simón Bolívar Fund.

**Before 11/23.** Ricardo Sanguino pointed out that the 2009 Budget, estimated at VEF 167.4 billion, will be approved before November 23rd. Consultation rounds with the Minister of Finance, Alí Rodríguez Araque, the Minister of Energy and President of PDVSA, Rafael Ramírez, and the National Tax Superintendent, José David Cabello, will begin the first week of November.

**Inflation or growth?** The Administration is facing a profound dilemma: food prices have increased more than 50% this year and the strong bolívar has lost 21.8% of its value; however the best solution to counteract this situation implies a high cost: reducing liquidity at the expense of economic growth; the Government has to make a decision.

**International Reserves.** The increase registered by International Reserves is due to the fact that Venezuela's crude oil sales are paid 90 days after invoicing. Consequently, the BCV is currently receiving payments corresponding to the period when crude oil prices hit their record highs. The international reserves showed an increase of 2.58%, going from US\$ 39,188 million at the close of the third week of October to US\$ 40,199 million at the close of the fourth week of the month.

**Interest Rates.** Active Interest rates closed the fourth week of October with a slight decrease of 0,53% over the previous week, closing at 22,64%. On the other side, the increase in the rate of term deposits was negligible, 0.06%, from 17.1% to 17.2%. The passive rate remained at 15%.

**Monetary liquidity.** At the end of the fourth week of October, the monetary liquidity recorded an increase of 1% over the previous week to close at VEF 173,341 million.

## Oil Tips

**Imminent collapse.** According to the Ministry of Energy and Petroleum, the Venezuelan oil basket closed at US\$ 54.6 per barrel the last week of October, down US\$ 6.5 from a week earlier.

**Year-to-date average.** As per recent data released by the Ministry of Energy and Petroleum, the Venezuelan oil basket average for the year-to-date was US\$ 97.81 per barrel, that is, US\$ 62.8 per barrel over the US\$35 per barrel considered in the 2008 Budget.

**PETROANDINA starts works.** President Evo Morales inaugurated the seismic exploration activities of the Bolivian-Venezuelan company PETROANDINA in Bolivia last week. According to a written statement of the Ministry of Hydrocarbons, the initiative includes an initial investment of US\$ 92 million with an estimate of 600 new jobs.

**Cutback in December.** Rafael Ramírez, Minister of Energy and Petroleum and President of PDVSA, declared that the OPEC might decide a new production cutback as part of the price stabilization strategy, at its next December meeting.

**Tanker purchase.** BANDES will finance US\$ 122 million for the purchase of two oil tankers from Transportes del ALBA. The operation will be closed the first quarter of 2009.

**Increase in crude oil reserves.** With the addition of 10.25 billion barrels from the state of Guárico, PDVSA proven reserves amount to 152.56 billion barrels. A total of 826.55 billion of cubic feet of gas was also added.

**PDVSA starts gas development projects.** President Chávez announced that PDVSA and Lukoil from Russia will start joint operations in the Gulf of Venezuela with the drilling of the first offshore gas well in that area. The drilling is part of the Rafael Urdaneta initiative, which has a potential of 26 tcf of non-associated natural gas.

**Special contribution drops.** Revenues from the windfall profit tax are being impacted by decreasing oil prices. The tax law establishes that if the Brent crude oil surpasses US\$ 70 per barrel, a rate of 50% will be paid for the additional amount and 60% if the price exceeds US\$ 100. In June, July, August and September, PDVSA transferred to FONDEN more than US\$ 5.0 billion; however, Brent is starting to fall, averaging US\$ 74.1 in October, so that the excess paid was only US\$ 5.11.

**Bid in the Orinoco Oil Belt.** The Ministry of Energy and Petroleum invited 47 companies, which would have the status of minority stockholders, to bid on the Orinoco Oil Belt. Minister Ramírez informed that the block will be divided into four areas and that mixed companies with PDVSA as majority stockholder (+60%) will be organized for the exploitation of the four areas. Ramírez estimated that total production on the Orinoco Belt, including production of this new block, will exceed 1.5 million b/d by 2013.

**Venezuela insists on another cutback.** Minister of Energy and Petroleum, Rafael Ramírez, pointed out that OPEC must agree another cutback of at least 1 million b/d in December or perhaps before. He added that in addition to the cutback, a price band should be established between US\$ 70 and US\$ 90 or US\$ 80 and US\$ 100.

**Contribution from oil surplus prices.** FONDEN has received US\$ 13.0 billion from the oil industry for the year-to-date. US\$ 8.0 billion correspond to weekly deposits that PDVSA must make after discounting tax payment. The Minister of Energy and Petroleum and President of PDVSA, Rafael Ramírez, pointed out that US\$ 5.0 billion has been paid for special contribution.

**No agreement yet.** The deadline announced by the Executive to define the value of the cement company's shares expired at the end of the third week of October; however, since no agreement has been reached, negotiations were extended another 30 days.

**"Payment will be made soon".** Minister Rafael Ramírez stated that the payment for the shares of the subsidiary companies of Lafarge and Holcim will be made soon. These two companies accepted to work under the mixed company modality and retain 11% and 15% stakes, respectively. Payment is expected to reach about US\$ 810 million.

## Business Sector Tips

**Profit ceiling for new car sales.** Deputy Elvis Amoroso, chairman of the National Assembly Committee that is investigating alleged irregularities in car sales, informed that they will try to fix a "fair profit margin" although he didn't specify if this is a definite proposal; he suggested a 20% ceiling.

**Government is requested to declare power service emergency.** Leading members of the National Federation of Power Sector Workers (FETRAELEC), vis-à-vis the constant power outages, requested the Government to declare emergency in the power sector. The President of the Federation, Ángel Navas, explained to the members of the Energy and Mining Committee of the NA that an "immediate and deep" diagnosis of the crisis and "prompt actions" are required. In Navas' opinion, the crisis is of structural and integral nature due to the convergence of factors that go beyond operational issues.

**TSJ is about to decide on the Cemento Andino case.** Jaime Riveiro, legal representative of the Corporación Cemento Andino, stated that they expect the issue can be settled through diplomatic channels; however, they don't rule out resorting to international courts to settle the dispute over Cemento Andino shares, since their representatives are anticipating an unfavorable ruling by the TSJ.

**Credit deceleration.** According to data released by the Bank Superintendent's Office for the third quarter of 2008, total credit increased 5.28% at the end of September, to VEF 121.0 billion. However, comparing this figure to the same period in 2007 and 2006, a deceleration is observed because growth corresponding to those years was 12.3% and 13.9%, respectively.

**Tube factory was declared public utility.** The National Assembly declared Helvesa (Anzoátegui state) as public utility and of social interest. According to the chairman of the Energy and Mining Committee, Ángel Rodríguez, the decision will contribute to the expansion of the national gas, oil and petrochemical industry. Rodríguez added that the declaration includes operability, use and utilization of movable and immovable property and improvements of the industrial complex. With this acquisition, PDVSA will have a stake of about 20% in the sector's production process.

**Mixed company with Bolivia.** The organization of the Empresa Grannacional Socio-Productiva Venezuela y Bolivia of ALBA, which is ascribed to the Ministry of Communal Economy, was organized for the purpose of implementing projects in the areas of polymers, milk, corn, and any other productive sector. It shouldn't be any surprise that the social capital is 100% subscribed and paid by Venezuela and that 40% of it may be transferred to Bolivia.

**Expansion of the bank system forces banks to increase security.** Access to new technologies, such as invoice payment and purchases on the Internet has allowed criminals to devise new methods of fraud; therefore it's being recommended that financial institutions increase security concerning access to clients' information in order to avoid this kind of thefts.

**Delinquent bank loans increase.** As per figures published by the Bank Superintendent's Office, delinquent loans have increased by 109.64% over the last 12 months. Although this isn't an alarming percentage of the total bank loan portfolio (2.23%), the speed at which it has increased is impressive.

**Excess agricultural sector supply.** The Director of Small and Medium-sized Poultry Industries (PYMI Avícolas), Simón Leal, informed that the supply of chicken is guaranteed throughout the entire country. However, local producers are having troubles

in terms of sales because the product is not being placed in the state-owned network (PDVAL and Mercal), since the Government committed itself with imports for the rest of the year.

**Coffee sales under control.** After a couple of weeks of coffee shortage, ministries of Agriculture and Land and Food, along with representatives from the Venezuelan Coffee Producers' Association and the Superintendence of Silos and Warehouses, agreed to limit coffee sales to one kilo per person, and only in the morning.

**The Administration is interested in acquiring an interest in Cerámicas Carabobo.** Due to irregularities in the operation of the refractory area of Cerámicas Carabobo, the Government announced a possible nationalization of said area, pointing out that the company is of social interest because of its many government clients.

**Automotive sector affected by union conflicts.** Labor conflicts in Johnson Control, a company that supplies raw materials to car seats manufacturers, are impacting the automotive industry, forcing car assembly plants to stop production two days ago.

**General Motors solved one problem to get another.** Although GM successfully settled its labor problems earlier this year, 50% of its production is affected again by the situation which is undergoing its car seat supplier.

**Russian-Venezuelan bank.** President Chávez's ratified in Ecuador last week that the possibility of establishing a Russian-Venezuelan bank will be discussed during the visit of the Russian Vice Prime Minister, Igor Sechin, to Venezuela. He also pointed out that the creation of financial entities with Iran has been considered.

**The Executive finances socialist production model.** 2009 Budget contemplates an initial budget of VEF 2.9 billion for communal councils, which will be placed in the National Fund for Communal Councils (SAFONACC). Of this amount, VEF 1.4 billion correspond to the Law of Special Economic Allocations and VEF 1.5 billion to FIDES. The draft law establishes that most resources will be earmarked for production, social and infrastructure projects.

**Back tax claim against Banco Mercantil.** SENIAT notified Banco Mercantil of a back tax claim for more than VEF 14.4 billion, for revenues derived from taxed transactions that were considered exempt by the bank during its 2006 fiscal year. SENIAT highlighted that the claim amounts to VEF 4.92 million, which will have to be paid to the National Treasury Office.

**Sale to be closed in November.** Alfredo Sáenz, Banco de Venezuela's adviser, declared that the process "is going as scheduled and it's well advanced," and that the successful closing of the sale of the bank to the Venezuelan government could be announced in November.

## Political Tips

**Abstention could be low.** According to Datanálisis, polls have shown that a very large number of voters would be willing to vote in the next November election; therefore, it's expected that abstention levels will be much lower than those in prior regional elections, when abstention reached 45-50%. According to the pollster, this year's participation could be close to 77%.

**TSJ doesn't obey IACHR ruling.** Former judge of the First Contentious Administrative Court, Juan Carlos Apitz, who was removed along with other two judges from the court in 2003, assured that he will insist that the Inter American Court on Human Rights ruling ordering his reinstatement be complied with, after the Plenary Chamber of TSJ appointed another judges to this Court without including the ones that have been removed.

**Evidence against Manuel Rosales will be reviewed.** Deputy Mario Isea, chairman of the NA Economic Development Committee, submitted to the General Comptroller, Clodosbaldo Russián, alleged evidence of Manuel Rosales's corruption. The evidence consists of recordings of telephone conversations that were broadcasted on national TV.

**Stanford Asesores de Inversión offices raided for alleged espionage charges.** The Military Intelligence Direction (DIM) raided the company linked to Stanford Bank to investigate alleged espionage activities by people belonging to the US Government.

**Venezuelans are waiting for a change.** Despite the Venezuelans' political trends, a qualitative study on the Venezuelan Democracy Perspectives vis-à-vis 2008 election, conducted by social researchers John Magdaleno, Olga Ávila and Roberto Briceño León, reports that Venezuelans are waiting for a change after next 11/23 election.

## World Crisis Tips

**FED cuts rates again.** The Federal Reserve (FED) decided to cut federal funds rate again in order to stimulate interbank credit reactivation, which has been substantially paralyzed due to financial market uncertainties. This time the rate was cut by a half percentage point to 1%.

**Another cut?** A report released by FED states that “*intensification of turbulences on financial markets will likely impose an additional restriction on spending, in part due to the less ability of households and companies to obtain credit,*” therefore another cut of 50 pb over the upcoming months is not ruled out.”

**Eurozone and Japan on the same road.** In line with FED actions, the European Central Bank decided to cut interest rates by 0.5% starting this week. The Bank of Japan also reduced interest rates by 25pb, to 0.25%. The Japanese currency lost 5% of its value with respect to the US Dollar (its sharpest fall since 1974) and 6% against Euro.

**Everybody's cutting back.** Noruega's Central Bank also cut back interest rates for the second time in October (-0.5%), to 4.75%. China's Central Bank reduced rates by 27pb, leaving lending rate at 6.66% and savings rate at 3.60%. The Bank of Canada, in turn, decided a 0.25% cut, to 2.25%. Slovakia brought its rates down by 50pb to 3.75%, in order to bring them in line with the interest rate levels within the Eurozone, of which this country will become a member starting January 1, 2009.

**FED reaches emerging countries.** FED and other central banks liquidity lines have already limited their reach to developed countries. FED announced a swap line worth US\$ 30.0 billion with central banks of Mexico, Singapore and South Korea.

**IMF speeds loan procedures up.** Due to the global financial crisis, the International Monetary Fund (IMF) is speeding loan granting procedures up. Its Director, Dominique Strauss-Kahn pointed out that countries with a record of sound economic policies won't have to comply with any special requirements. The IMF has earmarked about US\$ 200.0 billion for loans.

**Crisis impact.** According to the Latin American Economic System (SELA), the US financial crisis will have a “profound impact” on Latin America, although its magnitude will depend on each country's structural and macroeconomic features. In SELA's

opinion, economic integration process among Latin American countries has to be strengthened to face the crisis in the region.

**The US economy goes backward.** The US GDP lost 0.3% in the third quarter of 2008 with respect to the previous quarter. The components that dropped the most were private consumption (-3.1%) and fixed investment (-5.6%). This data strengthens the fears of a recession hitting this economy.

**And the UK shrinks.** England's GDP shrunk at a yearly rate of 2.1% during the third quarter of 2008. Although this drop cannot be described as a technical recession (at least a three-month contraction is required), it's clear that England's economy is headed to a recession.

**Confidence collapse.** Figures published in last week of October show that the US consumer confidence index fell by 23.4% to its record low of 38%.

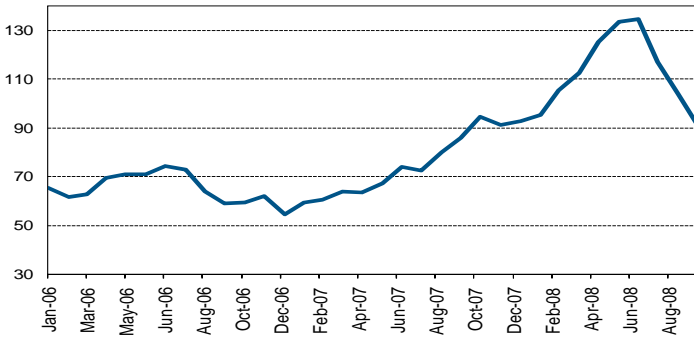
## Other Tips

**Large bank merger.** Two of the largest Brazilian private banks, Itaú and Unibanco, announced the creation of the fourth largest Latin American company based on its market value. The new company Itaú Unibanco will manage assets for up to US\$ 263.8 billion; it will concentrate 19% of the loan portfolio and will have 4800 offices throughout the country. Although the negotiation had been brewing for several months now, representatives from the new bank pointed out that they had to move fast due to the current global crisis, because it demands greater concentration of the global financial system.

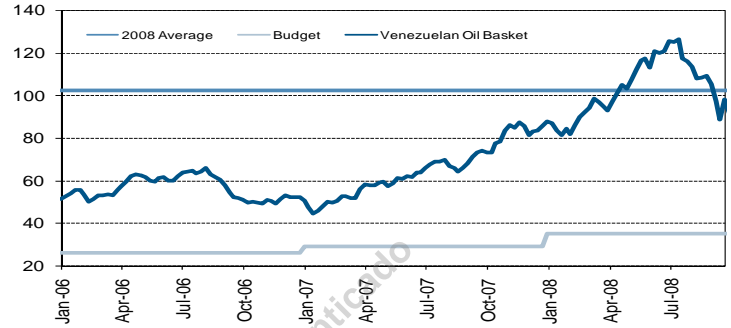
# Weekly Report

## ECONOMIC OVERVIEW

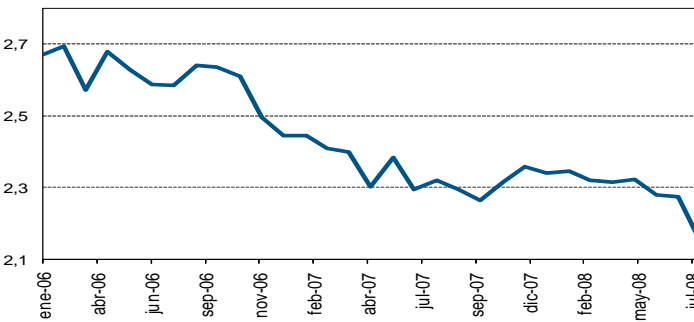
**Oil Prices (WTI US\$pb)**



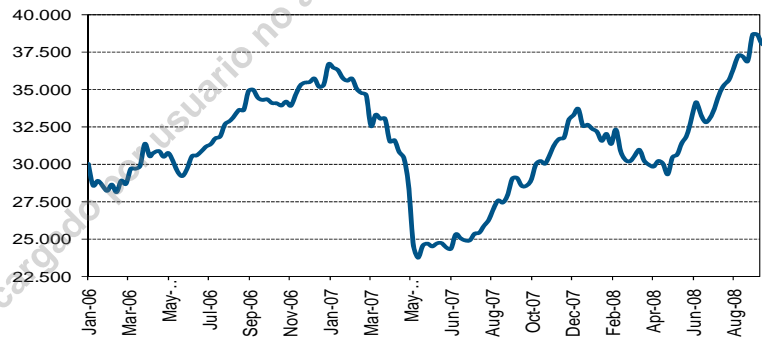
**Oil Price (Venezuelan Basket US\$/pb)**



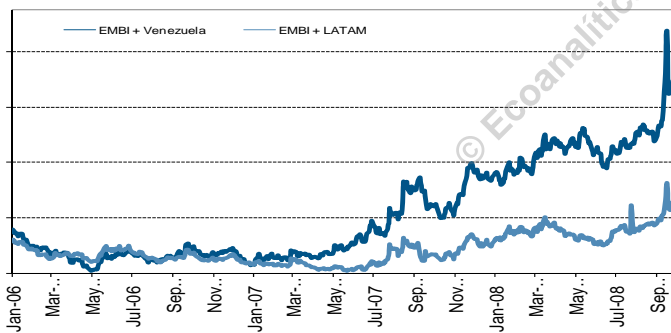
**Oil Production MMBD**



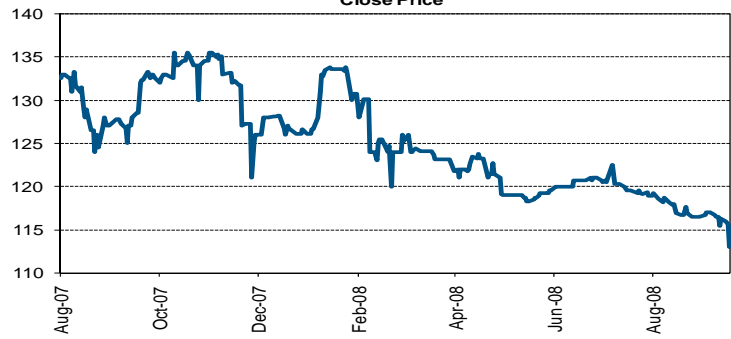
**Fx Reserves - BCV (US\$ Million)**



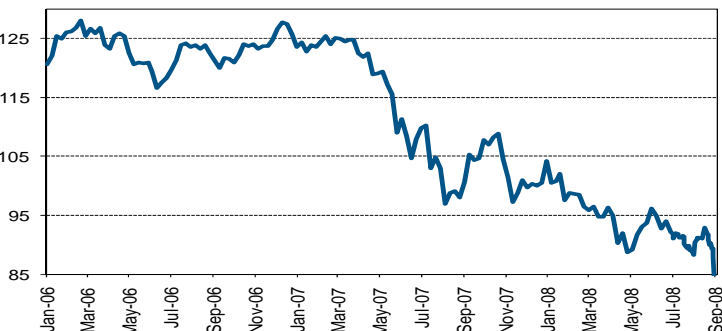
**EMBI +**



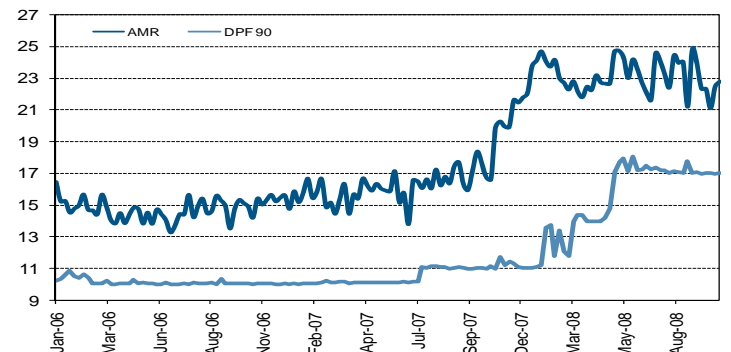
**Venezuelan Global 18 Close Price**



**Venezuelan Global 27 Close Price**



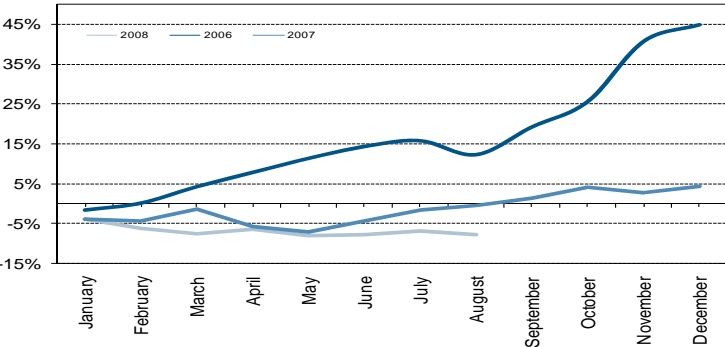
**Interest Rate (Six Principal Banks)**



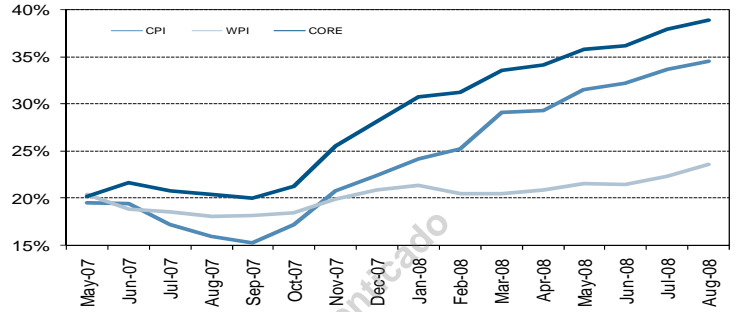
# Weekly Report

## ECONOMIC OVERVIEW

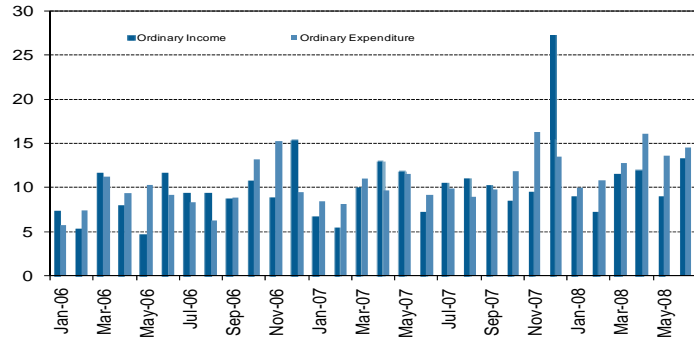
**Real Expansion (M2)**



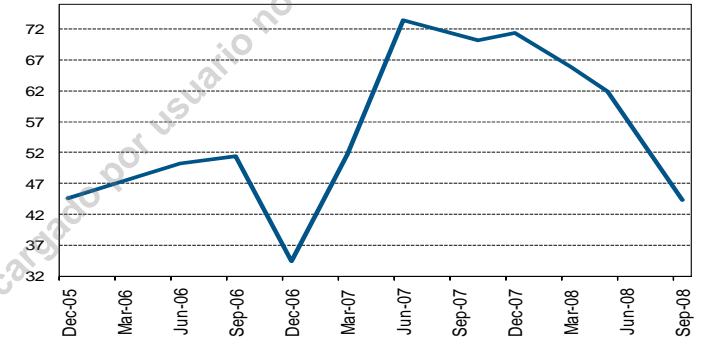
**Inflation (Last 12 Months)**



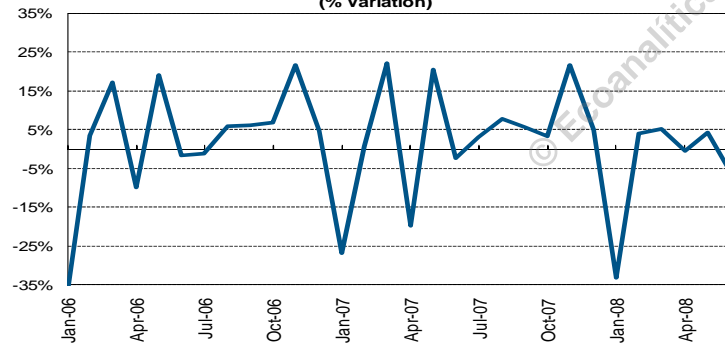
**Central Government (VEB Billion)**



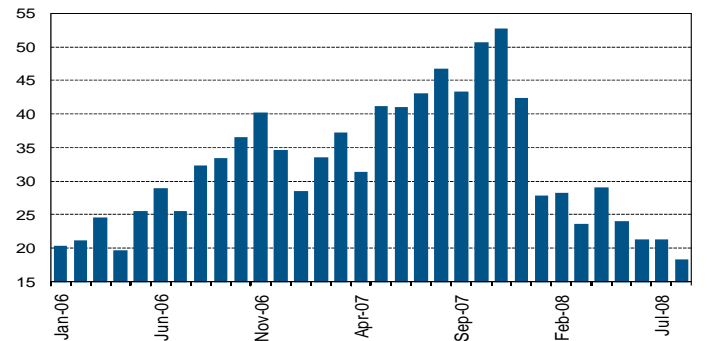
**Resources of the State (US \$ MM)**



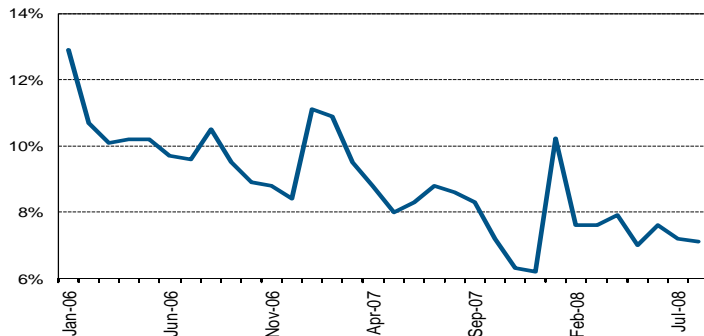
**Volume of Sales (% Variation)**



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



**Rate of unemployment (% Variation)**



**Disbursement (US\$ Million)**

