



Volume 4, Number 6
Week II, February 2008

PDVSA IN THE EYE OF THE HURRICANE

By:

Alejandro Grisanti
Asdrúbal Oliveros
Michael Penfold

Edited by:

John Holden

Reproduction and/or
distribution prohibited

According to the information released by Exxon Mobil Corp. on February 8th, the High Court of England and Wales ordered more than US\$12 billion of PDVSA assets worldwide to be frozen on January 24, 2008, while the dispute regarding the nationalization process of Cerro Negro, one of the strategic associations on the Orinoco Oil Belt. Besides this, on December 27, 2007, a New York court issued an order to freeze the Cerro Negro project account which maintains a balance of US\$315 million. In our opinion, this is mainly a negotiation tactic employed by Exxon aimed at increasing the value of its 41.7% participation in the project. Despite the seriousness of the measure, we don't expect it to affect oil industry operations, or that it will spark a situation where PDVSA, nor the Government, seriously contemplate not making payment.

In response, PDVSA suspends economic relations with Exxon. However, it's not clear how far reaching the measure is.

According to a press release published by PDVSA on Tuesday, February 12th, the company decided to end its commercial operations and relations with Exxon Mobil. PDVSA pointed out that it wished to cut all relations with Exxon, but at the same time assured that it would honor all currently valid contracts that it had with them. It's not clear what contracts and commercial relations PDVSA has with Exxon, other than the Chalmette refinery in Louisiana, where they both have equal capital participation. 80% of the crude oil produced at Cerro Negro is exported to this refinery. Based on all this information, at **Ecoanalítica**, we are of an opinion that this event shouldn't have an overwhelming effect on the market.

The agreements reached with Total and Statoil allow us to estimate the amount being disputed

Setting a value on Exxon Mobil's participation in Cerro Negro can be made based on the recent agreements reached by PDVSA with Total and Statoil, in which the European companies accepted a 22 percentage point cut in participation in the old Sincor project on the Orinoco Oil belt (from 47.0% to 30.3% in Total's case, and from 15.0% to 9.7% in Statoil's case), for which they agreed to receive from PDVSA US\$1.10 billion (US\$234.7 million in cash, US\$735.3 million in crude oil, and US\$130 million in bonds).

The value to be paid to Exxon would be closer to US\$1.50 billion

Based on these figures, Sincor's total value can be estimated at US\$5.0 billion, this taking into consideration the fact that the Sincor project produces 180,000 b/d of synthetic oil (almost double the 104,000 b/d produced by Cerro Negro), and that both projects have similar levels of reserves, we can estimate that Cerro Negro has an approximate value of US\$3.40 billion (Exxon has 41.7% participation which represents US\$1.42 billion). It's important to point out that the value set is not only based on production level and probable reserves, but it also has to take into account the issue of investment and the transfer of technology, a very sensitive issue in the negotiations both parties have had up until now. The technology transfer issue led Exxon to ask for US\$5.0 billion for its part of the project, a figure that for PDVSA was unacceptable.

Can we stop selling oil to the United States?

In the last 20 years, PDVSA has integrated its business with the purchase of 18 refineries outside of Venezuela, eight of them in the U.S. and two in England. The refineries in the U.S. have a capacity of producing 1.3 million b/d. As part of the integration process, PDVSA has adapted each one of these refineries to process the type of oil that Venezuela produces: heavy oil, with high levels of sulfur. Adapting a

Weekly Report

refinery to be able to process a different type of oil takes more than a year. China is the only country in the world that is currently adapting some of its refineries to process Venezuelan oil, but it's just at the beginning stage. In 2008 it could process around 100,000 b/d, which represents a tenth of Venezuela's exports to the United States.

Other than this, there are currently no other refineries able to process Venezuelan oil in the world. So, suspending oil shipments to the United States would mean a significant drop in Venezuelan oil production. Furthermore, an oil field is not like a faucet that you can turn it on and off based on demand. Cutting back on oil production doesn't change the fact that you have to maintain almost the same levels of investment in order to preserve production capacity.

This is why, the threat is not believable.

Based on these facts, President Chávez's threats seem almost impossible to make good. It's true, that given the current situation of the international oil market, the U.S. can't ignore the suspension of Venezuelan crude oil imports; it's also true that Venezuela can't afford the luxury of excluding the U.S. as a destination for its exports. Not only because of the technical reasons mentioned, but also for the fiscal sacrifice that such a measure would entail. Remember, that a good part of the power that the President has domestically, as well as in the international arena, is due to the significant cash flow that oil produces. It's what he used to buy domestic popularity and international support.

The last chapter of this story has to do with the hearing in the New York court

As fate would have it, we happened to attend the hearing that was held in the city of New York. The court handed down a decision to continue to freeze the Cerro Negro account. At ***Ecoanalítica***, we believe that this measure was taken because the amount being frozen (US\$315 million), which is considerably less than the value of the project (US\$1.50 billion). Furthermore, the account frozen is in the name of Cerro Negro. This last point is important, since the judge, Deborah Batts, made a distinction between PDVSA assets; those that were directly involved in this operation, and the rest. This is why, as far as this court is concerned, we don't believe that it will look to freeze any other assets PDVSA has in the United States.

It doesn't look like the solution will be a quick one

After having attended this hearing, we are less optimistic regarding a possible quick solution to this case. Exxon has definitely made a very aggressive move, that was carefully calculated, and that we don't think it will let go in the short term. On the part of the Government, though it's true that it should look to solve the conflict quickly, it's possible that the President will use this event, and present it as a foreign threat, in order to distract Venezuelans and take their minds off of his recent drop in popularity. This last scenario becomes even more relevant after hearing the statements issued by the spokesperson for the U.S. State Department, Sean McCormack, who said that the United States fully supports "Exxon Mobil's efforts to obtain a just and opportune compensation for its assets according to international law."

In England, a relative victory is expected for PDVSA

The next important chapter of this story will come from the London courts. In this case, we are slightly optimistic with regard to PDVSA obtaining a relative victory. The amount of assets that were ordered frozen more than doubles the amount set by Exxon as its estimate of the value of its part of Cerro Negro (set in early negotiations at US\$5.0 billion). Therefore, we expect a substantial reduction of the amount subject to being frozen, and that it be established that the amounts in question are only those assets directly involved in the Cerro Negro conflict. Meanwhile, alarmist rhetoric and headlines will take center stage.

PDVSA doesn't have any problems to pay

Lastly, we'd like to mention that we expect Venezuelan assets to be very volatile, especially those traded in foreign markets. PDVSA bonds will be very volatile and therefore have greater returns than Venezuelan bonds. PDVSA has sufficient liquid assets to pay Exxon, even its initial estimated value. Furthermore, the arbitrage process will take several years. The process is still separating the assets directly involved in Cerro Negro from the rest of PDVSA assets. This is why, despite the seriousness of the measure, we don't expect it to affect oil industry operations, or that it will spark a situation where PDVSA, nor the Government, seriously contemplate not making payment.

Economic Tips

Bonds take a dive. Venezuelan bonds take a dive dropping 3 points to settle at 95.875, while yields increase 36 base points to 9.72%, the highest they have been at since August 2007. The CDS increase 90-100 base points settling at around 590-595 base points. The same thing is happening to the Venezuelan part of the EMBI+, it's up 46 base points to 567 over the comparable rent of the U.S. Treasury, compared to an increase of 11 base points for the general index. All this is explained by Exxon's provisional freeze of PDVSA's assets.

Isea ratifies estimate. The Minister of Finance, Rafael Isea, announced that in 2008, Venezuela expects to register economic growth of at least 6% of GDP. He continued to say that inflation will be kept to around 11% this year and that this is an issue that will be dealt with and that will show improvement. More than a month after having been named to the new Economic Cabinet, we are still waiting for them to announce the so-called anti-inflation plan.

First transfer to FONDEN ready. Last week, the Minister of Planning, Haiman El Troudi, announced that the first transfer of reserves to FONDEN was expected to take place this week for an amount of US\$800 million. The Minister also said that the second transfer for US\$700 million was scheduled for the first part of March. Total transfers, according to El Troudi, will be for US\$1.50 billion. This year, the amount transferred will be less due to the fact that the optimum reserve level was set at US\$31.90 billion.

PDVSA Treasury fund balance drops. The account that was created in the National Treasury which accumulated US\$8.0 billion in six months, now, has a balance of US\$1.50 billion. In September, PDVSA notified the Minister of Finance that it would suspend placements to the Treasury account. Official sources say that no specific reasons were given, except to mention that foreign currency will only be sold to the Central Bank. The resources were used to service the foreign debt corresponding to 2007, carry out the purchase of Argentinean bonds (around US\$1.70 billion), and to attend to foreign service, which according to official sources, went to embassy expenses.

International reserves. For the week ending on February 8th, total reserves dropped by 4% compared to the previous week settling at US\$32.36 billion. So far this year, reserves, in absolute terms, have dropped a total of US\$2.12 billion.

Interest rates. For the month of January, the average lending rate for the six main banks in the country was at 24.14%. The value registered in December 2007 was at 21.73%. Meanwhile, the average savings interest rate was up 1.77 percentage points to settle at 12.92% compared to the month of December.

OIL TIPS

Oil prices drop. According to the Ministry of Energy, the price of the Venezuelan crude oil basket was at US\$81.76 per barrel this week, down US\$2.62 compared to the previous week.

Exxon says it wants to negotiate. Exxon Mobil is interested in commencing "substantial" discussions with Venezuela about the value of Cerro Negro, said a company official. *"We continue to be interested in having substantial negotiations with the Venezuelan Government and with Petróleos de Venezuela (Pdvsa) about the fair market value of the assets that were expropriated,"* said Mark Albers, senior vice-president of Exxon Mobil at the CERA energy conference.

Petrocedeño will have a major shutdown of seven weeks. The mixed company, Petrocedeño, will begin a major shutdown starting on February 25th that will last for seven weeks ending on April 14th due to maintenance, cleaning, inspection, repairs, and equipment modifications, which due to natural wear and tear, have lost their efficiency. Activities will be carried out under the strictest security and environmental protection guidelines, aimed at maintaining and preserving the integrity of the people.

PDVSA extends credit line. The US\$1.0 billion credit line that a group of banks extended to Petróleos de Venezuela through French BNP Paribas was extended for one more year, after the initial term of the credit expired on January 30th.

This year's service. Despite the fact that PDVSA now doesn't have the obligation to immediately pay the US\$1.12 billion total that it owes BNP Paribas, in a few months the US\$200 million loan owed by the home office at a LIBOR rate of more than 0.5%; the US\$1.0 billion that Citgo borrowed in December at LIBOR plus 1.75% of annual interest; a promissory note in bolivars that the company Tropigas requested (acquired by PDVSA last year for US\$5.0 million at 17.67% interest; and a

guaranteed loan of US\$3.0 million taken out by the subsidiary, Bariven, at a variable interest rate.

And a little bit more. On top of all that, this year a part of the US\$562 million in bonds that Citgo has in circulation become due, as well as, part of the US\$76 million in PDVSA Virgin Island bonds that were guaranteed by the company. And lastly, this year PDVSA must face the US\$4 million debt it owes Electricidad de Caracas that is due.

PDVSA transferring accounts after Exxon measure. PDVSA began to move its oil revenues to Swiss banks in order to avoid a possible embargo of funds by Exxon Mobil, therefore it has ordered all its clients to make there payments to the UBS bank in Switzerland.

An agreement may be reached with CONOCO. The Government announced that it is close to reaching an agreement with the U.S. based oil company ConocoPhillips. Rafael Ramírez, president of PDVSA, announced that important meeting have been held with the company in order to negotiate and reach an agreement and he believes that we are on the way to achieve this.

Despite all this, PDVSA sells assets. PDVSA announced the sale of its storage terminal Bahamas Oil Refining Company International Limited (BORCO), located in the Bahamas, for US\$900 million. *"This operation, of a purely business nature, began last April 2007 and concluded in a satisfactory manner for the Corporation,"* announced PDVSA in a press release.

Ecuador authorizes mixed refinery. The Board of state-run oil company Petroecuador, authorized the creation of a company of mixed economy to carry out the construction project of the Manabí refinery, in which Venezuela will participate. Petroecuador announced in a press release that the refinery will have the capacity to process 300,000 barrels of crude oil a day. The construction of the refinery will cost around US\$5.0 billion.

BUSINESS SECTOR TIPS

VEF1.8 million in INDECU fines. The INDECU has temporarily closed 2,800 commercial establishments which represent fines for a total of VEF1.8 million, which

are destined to be deposited in the special Fund for Communal Councils. In said establishments, an indiscriminate increase in price of the following items was found: meat, chicken, cheese, and bread among other things. Also, there were a number of items belonging to the basic food basket that were not marked with a price.

Problems due to regulations. Miguel Pérez Abad, president of Fedeindustria, said that *"as process are being periodically adjusted (of controlled items), regular and formal distribution channels will have improved levels of supply, and price speculation and contraband provoked by the difference in prices compared to neighboring countries will be avoided."*

It's a structural problem. Former Central Bank of Venezuela (BCV) board member, Domingo Maza Zavala, alerted that the current shortages being felt throughout the country are not seasonal nor is it produced by the actions of speculators, but that it is a structural problem. He accused the shortage of basic products to be due to domestic production's obvious inability to satisfy the increasing demand of a population that is earning more income, and therefore the situation will not be resolved automatically.

Nestlé has no information regarding possible expropriation in Venezuela. A source inside Nestlé, who asked not to be identified, informed that the Swiss food giant, Nestlé, found out about the possible expropriation of its factories in Venezuela through the press without having received any official notification from the Government. President Hugo Chávez, during his Sunday broadcast of *"Alo Presidente"* threatened to expropriate the milk processing plants that the Italian company Parmalat and Swiss Nestlé have in Venezuela.

Bureaucracy is maintained. Alejandro Uzcátegui, president of Businessmen for Venezuela (Empreven), explained that to date, the cutback on procedures to imports goods and basic items that the Administration ordered haven't taken effect. He states that 36 steps are required, from the moment the process begins with the Ministries of Light Industry and Commerce or the Ministry of Food, until the merchandise arrives.

Domestic natural gas prices increase. Clients receive direct natural gas in the Greater Caracas area received in their January bill the increase in rate for 2008, according to the yearly adjustment tabulator created by the Ministry of Energy and Petroleum and the National Gas Entity (Enagas) in 2006. The increase is of 3.5% or VEF0.28 which puts the monthly rate for household and commercial use at VEF8.18 per 40 cubic meters of methane gas, compared to the VEF7.9 it cost during 2007.

Excellent commercial exchange between Venezuela and U.S. Commercial exchanges between the United States and Venezuela are going full speed ahead, posting figures that have continually been increasing for the last nine years, despite all the Government's aggressive rhetoric against the "empire." According to figures from the U.S. Department of Commerce and the opinion of Latin American experts, the bilateral economic dependency that exists is in direct contrast with the continual derogative references by President Hugo Chávez towards the United States. Just in energy, the bilateral exchange surpasses US\$30.0 billion.

Controlled medicine shortage. CADIVI authorized 90% of the foreign currency requested by the medicine sector to import raw material for production in order to cover the 35% shortage of products in the market throughout the country.

Insurance sector increasing. In 2007, the growth reflected by certain sectors affected the insurance sector which posted sales for the year around US\$7.10 billion registering an increase of 46.5%, compared to 2006 when sales reached US\$4.80 billion. The industries performance was due mainly to three factors: the increase in collective health policies in the public sector as well as in the private, an increase in car insurance policies related to the boom in car sales, and the *banca-seguros* system (policies obtained through the bank system) which allowed more people to join the sector.

Public bank without merger. "The public bank will not merge," so said the head of the Superintendent of Banks and Other Financial Institutions (SUDEBAN), Trino Alcides Díaz. He pointed out that the Ministry of the People's Power for Finance has a project defined to allow for the unification of the technology platform and promote the integration of the state-run first tier banking entities. Díaz agrees with the head of the Ministry of Finance, Rafael Isea, regarding the fact that this strategy will allow for a greater level of banking by the people; in other words, include more people in the banking system.

Car sales drop. The Venezuelan Automotive Chamber informed that during the month of January, 27,943 new cars were sold, 34% less than in December 2007, and 2.4% less than sales were during the same month in 2006. Of the cars sold, 6,236 (22.3%) were domestically produced and 21,707 (77.7%) were imported. This represents a 17.3% drop in domestically produced units in January 2007 and an increase of 3% in the case of imported units.

Problems with plastic production. The Venezuelan Association of Plastic Industries (Avipla) announced in a press release that the shortage of resin in the country will force the close of a number of plants next week.

Electric plants sent to Nicaragua. The President of Nicaragua, Daniel Ortega, announced that the 24 electric plants sent by the Government of Venezuela to generate 60 megawatts of electric energy began to be unloaded from the docks at the port of Corinto.

Banca Comunitaria Banesco gave out more than 11,600 micro-credits. At the close of December 2007, *Banca Comunitaria Banesco* had awarded 11,613 micro-credits. The vice-president of the department informed that of the *Banca Comunitaria* micro-credit portfolio, 75% of the loans were for amounts ranging from VEF1,000 to 5,000. The delinquency rate registered a low 1.01% of the portfolio, which reflects how well beneficiaries are fulfilling their loan obligations.

It's estimated that in 30 to 60 days rice supplies will be normal again. The President of Fedegro announced that the supply of rice in the country will begin to return to normal in between 30 to 60 days, thanks to the new price adjustment made by President Hugo Chávez last Sunday.

Venezuela topped all Latin American sales of AUDI. Venezuela was the leader in imports AUDI's luxury car last January, according to the German carmaker's region office figures. The Venezuelan market came in first place with 22% sales while Chile registered 20%, Colombia 14%, and Peru 9%. One of the favorite models was the SUV AudiQ7 which is priced at US\$90,000

Foreign companies offer food. A number of Russian and Argentinean companies have announced their willingness to supply the country with more than 50 tons of food weekly. So informed the president of Fedeindustria, who disclosed that he has been in contact with a number of companies interested in exporting products like chicken, milk, eggs, among other high domestic demand goods to Venezuela.

Coca-cola case. The Perijá, La Fría, and Mérida distribution centers were illegally taken over by former Coca Cola employees on February 5th. This action has already had an impact on 43% of the volume of company sales at the national level given that the center that are occupied and the plant at Maracaibo control the supply of water, juices, tea, and soft drinks, said a spokesperson. This situation gives rise to possible shortages of the beverages around the country.

Political Tips

CNE began to discuss draft of the Electoral Process Law. The CNE board began to review the draft of the Electoral Process Law that was made and presented by the National Electoral Junta, and if approved will take the place of the Organic Law of Suffrage and Political Participation. The authorities also approved the reassembly of the AD party.

Government supporter look to take Globovisión off the air. A group of government supporters held a meeting last week to search for ways to block the renewal of Globovisión's broadcast license. They also studied the possibility of requesting the CNE to hold a referendum to withdraw the channels operating license.

El Salvador investigates the financing guerrilla movements. The President of El Salvador called its ambassador to Venezuela to provide any information available concerning the supposed financing of the Salvadorian leftwing movement *Frente Farabundo Martí para la Liberación Nacional* (FMLN) by the Venezuelan Government.

FARC with Venezuelan guns. A deserter of the FARC informed the Colombian authorities that there is a comradeship between some of its members and some Venezuelan military personnel. He also led the authorities to a secret place where the Colombian guerrillas kept guns and all of them had Venezuelan seals.

Ortega names her vice-Attorney General. The Attorney General of the Republic, Luisa Ortega Díaz, named Iraida Alfonzo Durand, a lawyer, and her current Office Coordinator, as her second in command in a provisional manner. The naming is included in the resolution number 96, dated February 1, 2008, from the Public Ministry, which was published in the *Gaceta Oficial* number 38.865 dated February 7. Alfonzo worked with Ortega Díaz when the latter was named director of Procedural Measures of the Attorney General's Office in the beginning of 2007 and prior to that she worked in the SENIAT and she was the president of the Liquidating Junta of the Eastern Development Corporation (Corporiente) in 2000.

Other Tips

The figure: US\$400 billion. Peer Steunbruck, Minister of Finance of Germany, revealed at a G-7 meeting that his Government calculates that the losses that banks will suffer as a consequence of the real estate crisis in the United States will reach US\$400 billion. That huge financial hole is equivalent to a little over twice the Venezuelan economy. The figure clearly surpasses Wall Street's projections of US\$120 billion.

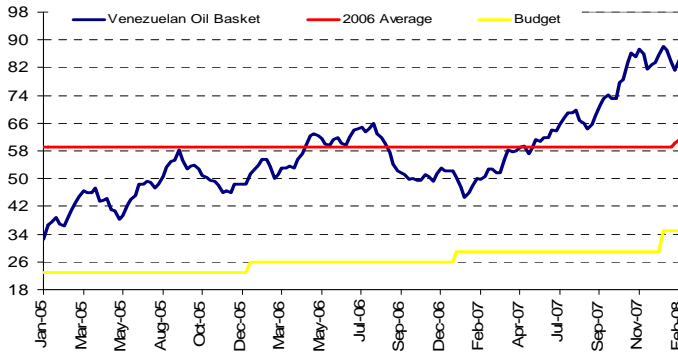
Yahoo! rejects Microsoft's purchase offer. The Internet portal Yahoo! rejected the purchase offer of US\$44.60 billion made by U.S. software giant Microsoft, because it considered it not to be in the company's best interest and that it was not the appropriate offer taking into account recent investments on the advertisement platforms and future growth perspectives.

© Ecoanalítica – Descargado por www.ecoanalitica.net / autentica.com

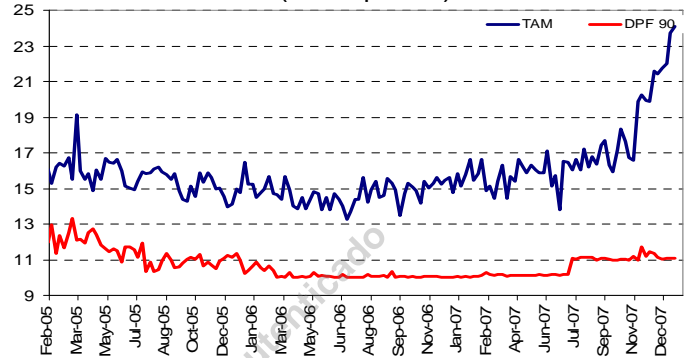
Weekly Report

ECONOMIC OVERVIEW

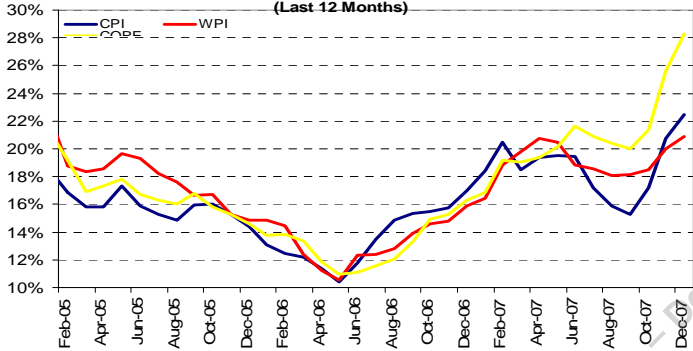
Oil Price
(Venezuelan Basket US\$/pb)



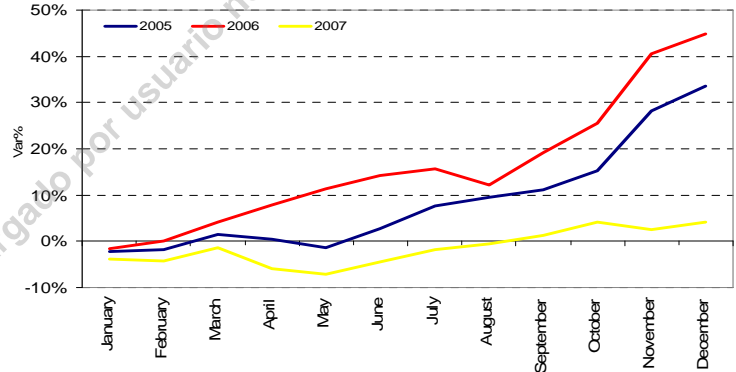
Interest Rate
(Six Principal Banks)



Inflation
(Last 12 Months)



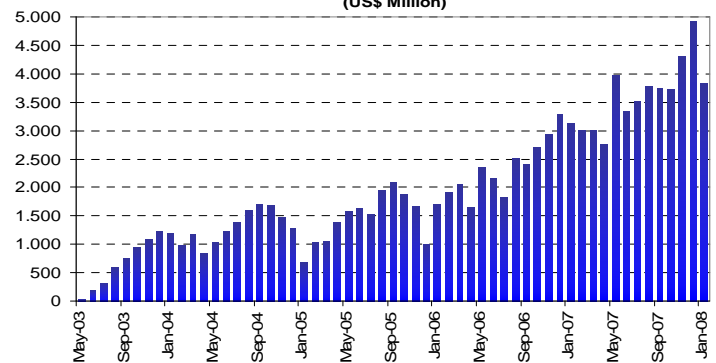
Real Expansion (M2)



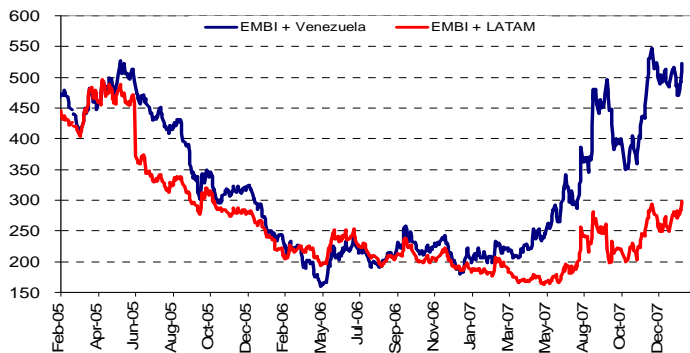
Fx Reserves - BCV
(US\$ Million)



Disbursement
(US\$ Million)



EMBI



Central Government
(VEB Billion)

