



Weekly Report

Year 8, Number 36
Week III, September 2012

The fairytale about inflation in 2012

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...The story of how inflation will close at below 20% or how to implement unsustainable economic policies

In recent months we have seen how the government has managed to put a brake on the spiraling inflation we have been experiencing since mid 2006, achieving the lowest year-on-year rate since October 2007, and how year-on-year inflation has fallen below the 20% barrier for the first time in four years (since the Central Bank started to measure inflation nationwide in 2008) and continues downward.

This is very good news for the Executive, which is seeking reelection, and for the economic cabinet, which sees it has a chance to meet the inflation goal for the first time in years. However, to what is this deceleration in prices due? Is this trend sustainable? Here in this report we will provide some answers.



**What has
the greater
weight?**

The index is made up of groups and subgroups that have more or less importance depending on their weight in the representative household consumption basket. So, the most important group is Food and Nonalcoholic Beverages, which alone accounts for 32.2% of the total index, followed, way behind, by Transport (10.8%) and Housing Rental (9.8%). The following table shows that, in the three groups with the biggest weightings (and in 9 out of 13), there is some policy or other of the Executive's exercising an influence, via either price controls or direct subsidies; hence the importance of considering each group in the Nationwide Consumer Price Index (NCPI) when analyzing this administration's anti-inflation policy.

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NCPI Weights Table		
Groups an Subgroups	Weight in the NCPI (%)	Weight in the group (%)
I. Food and non-alcoholic	32.2	
Food	30.0	93.2
Soft drinks	2.2	6.8
II. Alcoholic beverages and tobacco	3.0	
Alcoholic Beverages	1.9	65.8
Tobacco	1.0	34.2
III. Clothing and footwear	7.2	
Dress	5.3	74.2
Footwear	1.8	25.8
Rent for housing	9.8	
Rent for housing	9.8	100
V. Housing-related services (except telephone)	2.3	
Urban sanitation, water, electricity and gas	2.3	100
VI. Home Furnishing	5.6	
Furniture, accessories, decorations and carpets	0.8	14.8
Household Equipment	1.3	22.6
Goods and services for home maintenance	2.6	46.2
VII. Health	4.3	
Medicines and therapeutic equipment	2.4	56.8
Medical and paramedical hospital	1.0	23.6
Hospital services	0.8	19.6
VIII. Transport	10.8	
Vehicles	2.4	21.7
Operation and maintenance of transport equipment and personnel	2.7	25.0
Transportation services	5.8	53.3
IX. Communications	3.8	
Postal services	0.0	0.3
Telephone and fax equipment	0.4	10.0
Telephone and fax services	3.4	89.7
X. Leisure and culture	3.6	
Media and data-processing equipment and accesories	1.0	28.5
Recreational, cultural and sporting services	1.1	29.9
Newspapers, books and stationery	0.9	23.8
Vacational packages	0.2	6.1
XI. Education Services	2.7	
Preschool and basic education	1.1	39.9
Secondary Education	0.2	8.5
Higher education	0.9	35.1
Other education	0.4	16.6
XII. Restaurants and hotels	8.8	
Restaurants and hotels	8.7	98.6
Hotels and accommodation	0.1	1.4
XIII. Miscellaneous goods and services	5.8	
Personal Care	3.9	66.3
Social Services	0.1	1.2
Insurance	1.4	24.2

Sources: BCV and Ecoanalítica

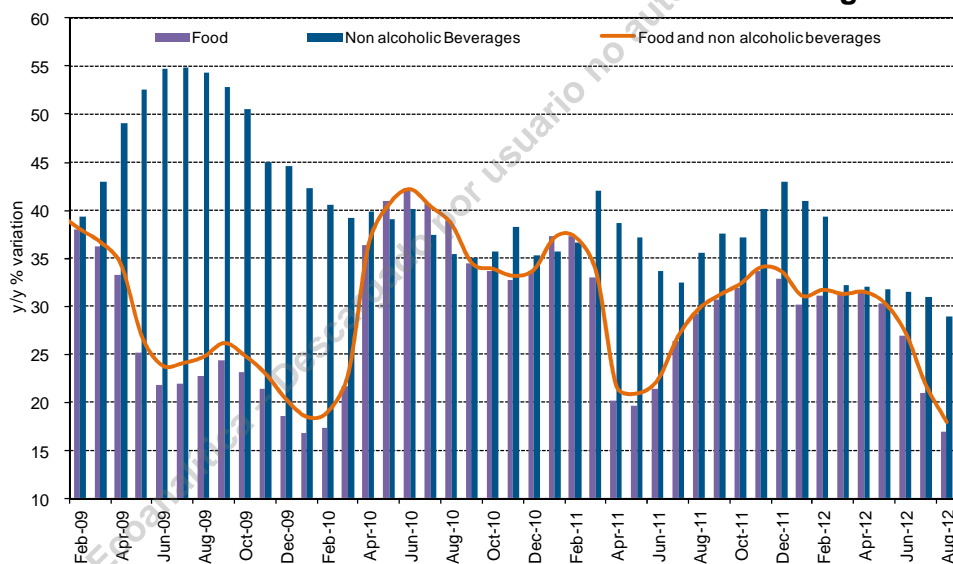
The heart of the NCPI: food

The Food and Nonalcoholic Beverages group has cut its year-on-year inflation rate nearly in half, going from 29.8% in August 2011 to 17.9% in August 2012, in other words 11.9 percentage points (pp) less. This group is made up, in turn, of two subgroups: Food, which is the most important as it accounts for 93.2% of the group and 30% of the general index, and Nonalcoholic Beverages, which represent 6.8% of the group and 2.2% of the general index.



A look at these two subgroups reveals that the first, the heart of the NCPI, has been steadily decelerating since the end of 2011, its year-on-year rate having dropped by 15.9 pp since December to 16.9% in August, whereas the second, even though it has experienced a marked deceleration, dropping by 14 percentage points since the close of 2011 after being on a par with Food in terms of year-on-year variations, has seen a halt in this deceleration in recent months, closing August with year-on-year inflation of 29.0%.

Inflation on food and non-alcoholic beverages



Sources: BCV and Ecoanalítica

Tall stories

Now then, what is causing this deceleration in food inflation? The Central Bank of Venezuela has alluded to increases in the supply and production of food as the essential factors that have determined lower inflation in this group. However, with a 9.4% drop in manufacturing production in the food subsector and growth of only 2.2% in Agricultural GDP during the first semester of 2012, the contribution being made by local production is clearly insufficient.

But the actual causes are quite different...

In *Ecoanalítica's* view, the government's strategy for bringing down inflation in this group consisted of three points:

1. **Increasing the release of foreign currency to the private sector:** According to Cadivi's figures, in the first semester of the year, foreign currency released for imports in the food sector accounted for 29.8% of the total and was 50.3% higher than for the same period in 2011,



whereas in 2011 releases for the sector contracted 16.7% year-on-year over the same period. That being the case, it is clear how important subsidizing the sector's private imports is for the government.

2. **And, therefore, increasing imports:** In the first five months of 2012 (last figures available from the National Statistics Institute), food imports increased by 73.9% in volume and 74.7% in value to US\$3.01 billion. For some items, the increase was even greater, as in the case of meat imports (which account for 27.6% of food inflation index and 8.9% of the NCPI), which posted an increase of 146.6% compared to the same period the previous year.

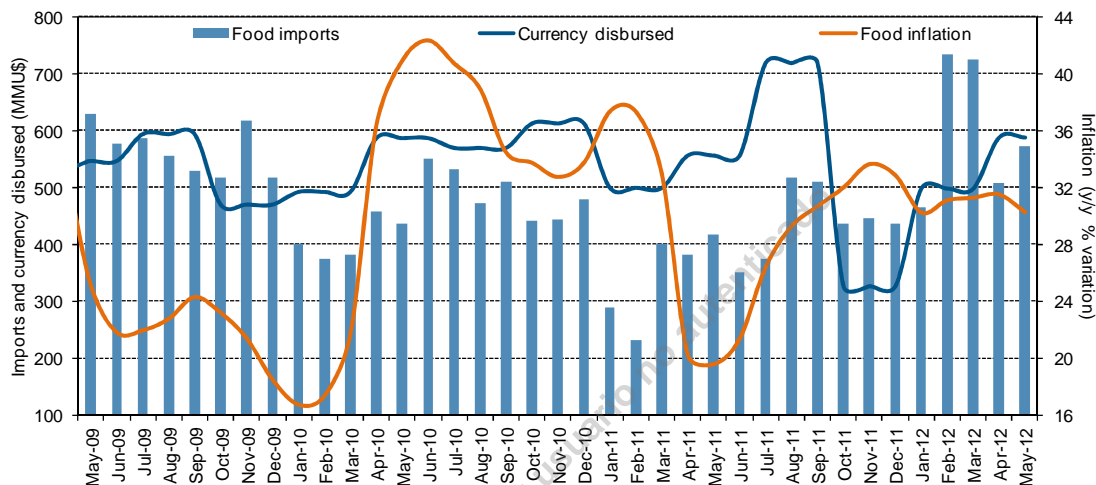
Even though official figures on food imports by the public sector are not available, *Ecoanalítica* gathered information that indicates that they accounted for nearly 45% of nonoil imports by the public sector during 1S2012. It is common knowledge what the government has been doing in this sector this year -increasing its distribution and marketing network of subsidized food products-, which leads us to deduce that public sector food imports must also be peaking.

3. **Lastly, putting off adjusting the prices of controlled products:** In view of the many complaints by domestic producers, the Executive has said categorically that the review and subsequent adjustment of prices for the more than 100 food products it is keeping regulated will happen after October. This is no coincidence given the current election scenario.





Disbursed currency* and Food Imports vs. Food Inflation



Sources: Cadivi, INE and Ecoanalítica

*Includes the amount disbursed for food imports through the Aladi Convention

And what about Sundecop?

We cannot ignore the effect that the passing of the Fair Costs and Prices Act and its enforcement via the Fair Costs and Prices Superintendent's Office (Sundecop) have had on the evolution of prices in 2012. There are two groups that have been affected by this law: Household Equipment and Maintenance and Miscellaneous Goods and Services, which together account for 11.4% of the NCPI and have experienced levels of deflation in 2012 that are unprecedented since the index started to be published.

Cheap detergents

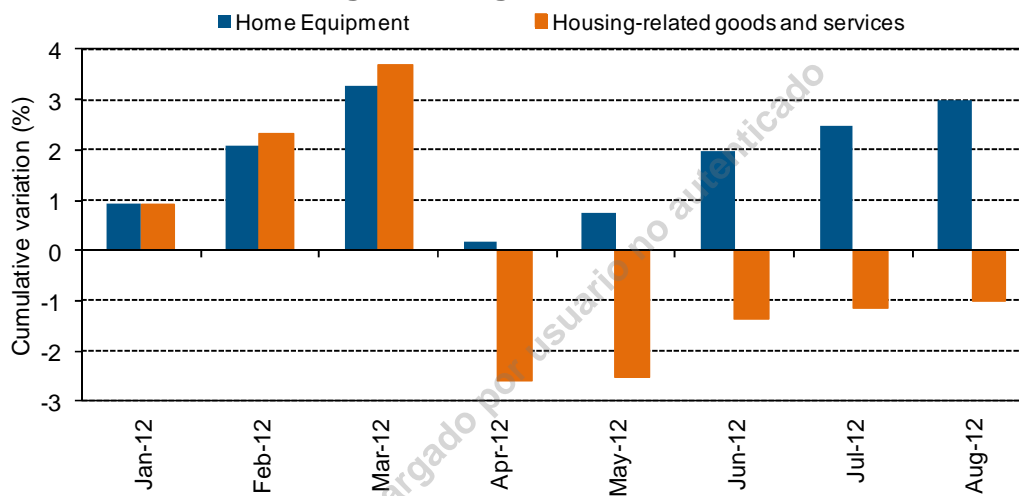
The Household Equipment and Maintenance group is made up of six subgroups, with the biggest weighting going to Household Goods and Services, which accounts for 46.2% of the group and 2.6% of the NCPI. This subgroup includes a wide range of products that fall under the new regulations, such as bleach, bars of household soap, and dishwashing and laundry detergents (the latter being the most important with a weighting of 11.2% in the Household Equipment and Maintenance group), so it comes as no surprise that cumulative inflation since April for this group is negative and that, as at August, it had posted cumulative deflation of 1.0%.

This behavior of the Household Goods and Services subgroup meant that, even though the remaining five subgroups posted cumulative inflation that was notably higher (furniture, accessories, decoration, and carpets 12.6%, household textiles 8.3%, household equipment 4.4%, domestic utensils 7.1%, and household and garden tools and equipment 9.4%), overall the



group only posted cumulative growth of 3.0% as at August and its year-on-year rate was 8.9%.

Home Equipment vs. Housing-related goods and services



Sources: BCV and Ecoanalítica

Personal care products deflate

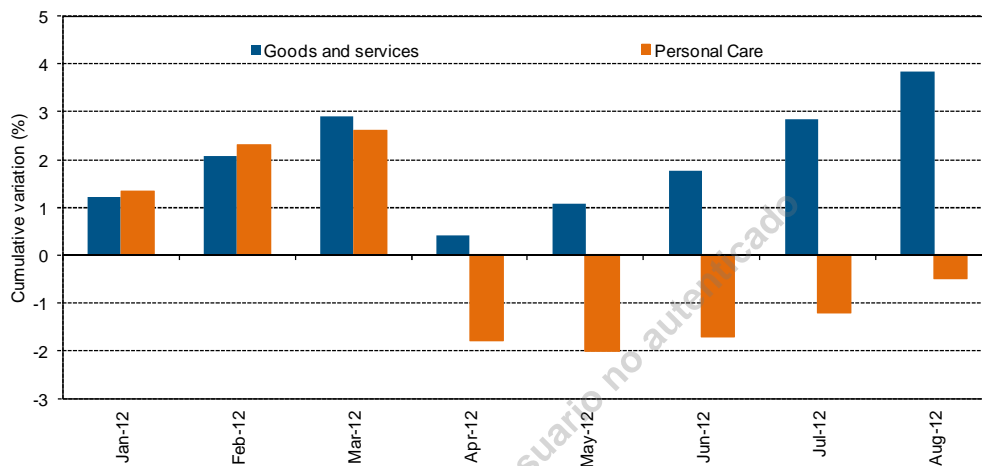
The other group subject to regulation is Miscellaneous Goods and Services, which, at first glance, does not seem to have anything to do with the Fair Costs and Prices Act. However, if we break it down, we find that 66.3% of this group's performance is influenced by the prices of personal care products, which include, among other things, shampoo, toilet soap, toilet paper, and disposable baby diapers, which have the biggest weighting (accounting for 12.2% of the group). Since April, this subgroup has also been posting negative variations and, as at August, had posted cumulative deflation of 0.5%.

The Miscellaneous Goods and Services group posted a year-on-year variation of 47.6% in February 2012 and, while this rate dropped slightly in 2011, closing at 30.0%, by August this year, it had decreased by nearly 20 pp to 11.8%.





Goods and services vs. Personal care



Sources: BCV and Ecoanalítica

Everything's going down in price, but why?

Even though these three groups explain the deceleration in prices, one might think that the remaining nine groups would show increases in prices, that is not so; quite the contrary. What we observe is an overall deceleration in prices in the remaining groups, which gives rise to the question, how, in an environment of high liquidity and shrinking production, is it possible that prices are continuing to fall?

The point is that they are nine, not three

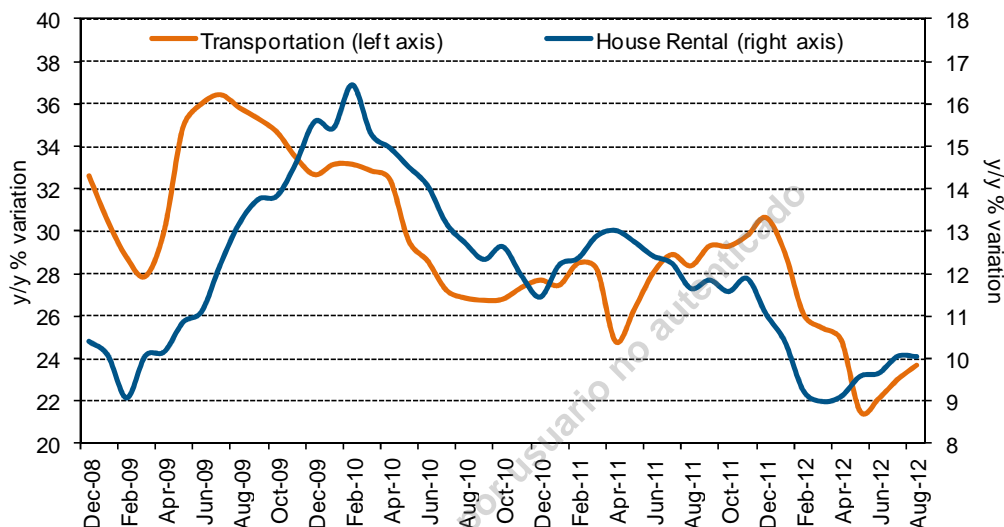
While the most notorious price regulations are those covering foodstuffs and personal care products, the fact of the matter is that we live in a highly regulated economy where the State influences, directly or indirectly, the prices of nine out of the 13 groups making up the NCPI.

So, in the Transport group, the second most important in the NCPI, more than half of the weighting goes to Transport Services (53.3%). This subgroup includes urban bus fares (accounting for 20.9% of the group), which have been regulated by the Executive. The third in importance is the Housing Rentals group, which represents 9.8% of the index and has been controlled since 2004; in addition, the regulations governing this sector were fine tuned in 2009 with the introduction of price controls for housing on the secondary market and for the acquisition of plots of land for buildings intended for rent.





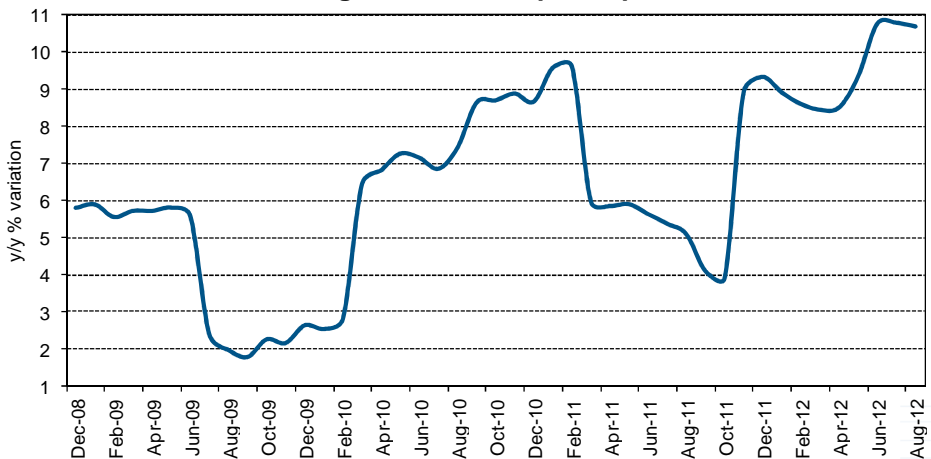
Transportation vs. Rent of Housing



Sources: BCV and Ecoanalítica

The remaining groups that are subject to regulation are Communications, where 54.9% of the index goes to mobile telephony and where the State has a large share of the market; Education Services, also regulated since 2007, where 39.9% is accounted for by enrollment and monthly fees for basic and pre-school education; Health, where medicines, the majority of which are subsidized, have a weighting of 51.3%; and Housing Services, except telephone, which covers garbage collection, gas, water, and electricity services, all of them subsidized by the State.

Housing Services except Telephone



Sources: BCV and Ecoanalítica



So, we can say that 77.4% of the NCPI is accounted for by items that are controlled, some more than others, by the Executive. This policy of controls has been exacerbated by the present administration, which has extended it to encompass more and more of the economy, generating distortions between supply and demand, with the consequent shortages of products, loss of diversity in the supply of goods, and volatility.

And the others

From this point of view, only four groups are not subject to state intervention of any kind, three of which posted cumulative inflation that is higher than the national average (9.8%): Alcoholic Beverages and Tobacco (21.3%), Leisure and Culture (12.1%), and Restaurants and Hotels (15.3%). Only Clothing and Footwear posted cumulative inflation below the national average (5.7%).

In *Ecoanalítica's* view, these groups will not escape the attention of the Executive if the present administration wins the elections, as, even though they account for a small share of the NCPI (only 22.2% of the total basket), they account for the main recreational habits of the Venezuelan population in general; for example, alcoholic beverages (whisky, beer, rum); cable television and the latest technology in major appliances and brown goods; "brand name" clothing; and eating out. Our recommendation to our clients in these sectors is that they avoid profiteering and that they comply with the regulations so as not to draw attention to themselves, because, as far as *Chavismo* is concerned, the "strategic" aspect is becoming increasingly important.

Nevertheless, even though the deceleration in prices has not been so acute for these groups, the trend has been for them to post a reduction in their prices, which is surprising in an environment of high liquidity and low local production, as mentioned earlier.

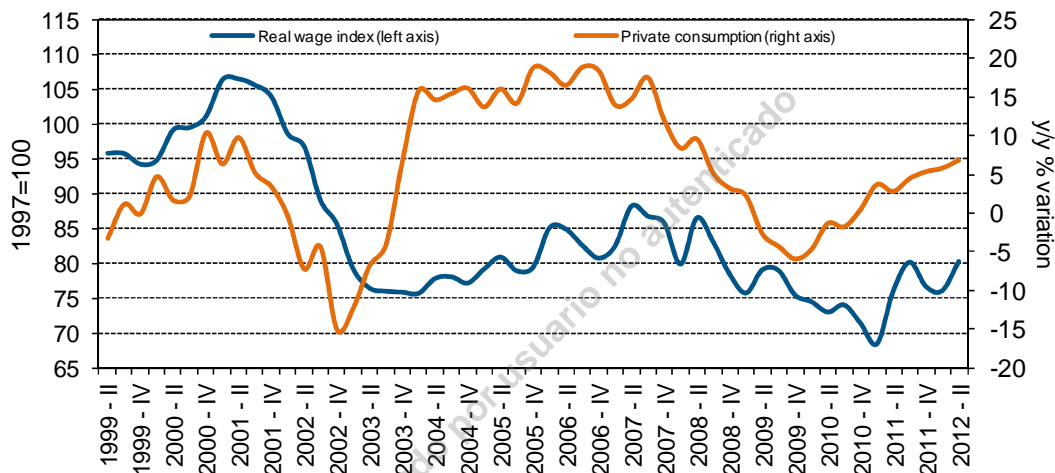
In *Ecoanalítica's* view, this situation has to do with two fundamental aspects, which will explain below:

- 1. Reviving purchasing power is uphill work:** Despite the wage increases granted each year, today workers' purchasing power is below 1997 levels. Added to that, as reported by a number of firms engaged in analyzing the behavior of consumption, the Venezuelan consumer, in a climate of extreme political uncertainty, has become more cautious, spending only what is necessary, a trend that is reflected in the fact that, in 1S2012, household consumption went up by 6.3% year-on-year,



whereas in 1S2006, for example (year of the last presidential elections), it rose by 17.2%.

Real Wages Index Vs. Private Consumption



Sources: BCV and Ecoanalítica

- 2. Controlling money supply at election time?** The second factor that could be influencing the deceleration in prices in these four groups, and inflation in general, is that, even though the Executive has increased its spending in the run-up to the presidential elections, the fact is that, this spending has been channeled more to investment spending than to current spending, which has meant that the pressures of demand have been much less. But apart from that, the government is exercising unprecedented control over its monetary policy, as, with a view to containing inflation, it is mopping up the bolívares it injects into the economy by placing domestic public debt instruments.

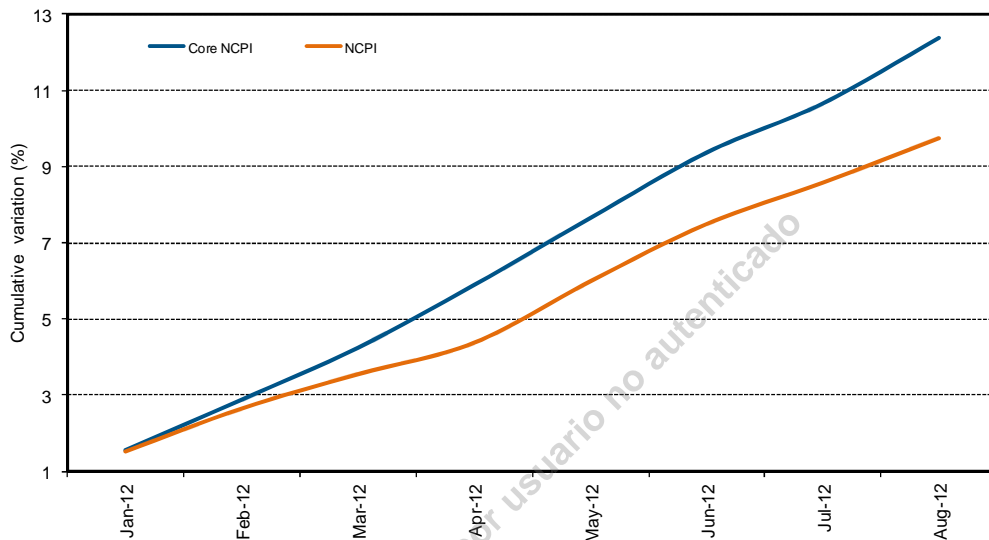
**Is this sustainable?
Here are some signs...**

First of all, inflationary pressures do not seem to have disappeared as the gap between core inflation (an indicator that removes all seasonal effects from the indicator) and the NCPI has widened, and core inflation accelerated in August, surpassing the NCPI's cumulative rate of inflation by 2.6 percentage points.





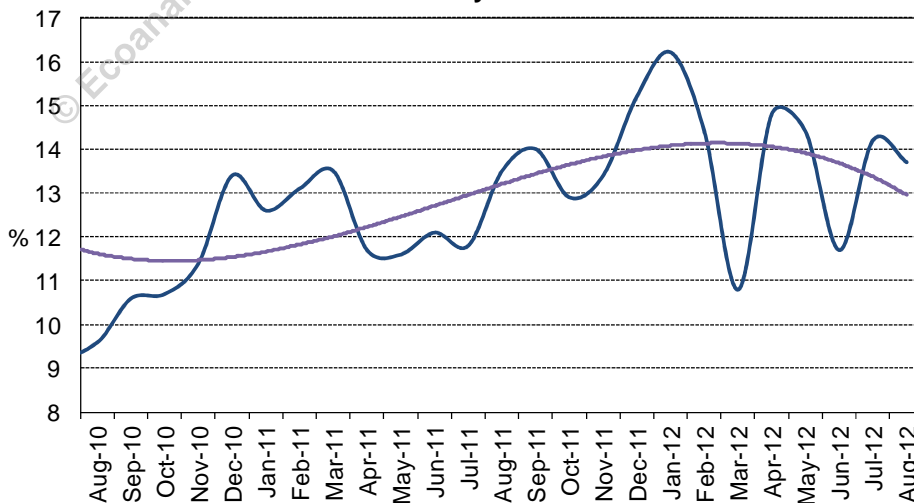
Core NCPI vs. NCPI



Sources :INE and Ecoanalítica

Secondly, a look at the shortages index reveals that not everything in the official figures is that positive. In August, the Central Bank's shortages index came to 13.7% and it has been above 10% throughout the year.

Scarcity Indicator



Sources: BCV and Ecoanalítica

While the Central Bank considers a level of shortages of more than 20% to be alarming, in line with a policy of restrictions and controls on the private sector, statistics issued by the Central Bank show that the shortages index



for some basic products was at critical levels in August (higher than 40%), among them powdered milk, which went as high as 100%, sunflower seed oil (86.6%), and corn oil (82.4%), and also indicates that there are shortfalls in the supply of vegetable oil (63.3%), full-fat powdered milk (46.2%), dried peas (43.5%), and whole pasteurized milk (42.8%). It is worth recalling that, from the political point of view, shortages are a worse enemy than high inflation.

Controlling the index, not the problem

The good results for prices during 2012 are a consequence of a whole series of economic measures that, in our opinion, are not sustainable over time; in other words, they do not aim to solve the problem as they have more to do with the State controlling the NCPI than with a real anti-inflation policy.

A conflict that is far from over

High inflation in Venezuela is a structural problem that extends beyond the present economic situation and even monetary variables. Venezuelan inflation can be explained as a conflict of interests between economic agents (workers and companies) that are fighting to protect their purchasing power on the one hand and their profit margins on the other.

When the Executive increases the minimum wage, workers feel relatively satisfied in terms of their wage objectives, but companies find their profit margins reduced below what they consider sufficient to compensate for the risk of investing in Venezuela and so they gradually put up their prices to recover the profit margin lost as a result of the wage increase. Then the workers find that their purchasing power has deteriorated, and the cycle starts all over again. In a model of excessive controls on production and disincentives for private investment and with an inefficient public sector, this conflict is far from over.

Expectations do not help either

When the cycle is resumed, the expectations of agents come into play, as both companies and workers want to reduce the impact of inflation to the minimum; in other words, if the workers expect retail prices to go up, they will demand higher wages in order to ensure that their real income does not shrink. The companies, in turn, also expect wages (as well as the prices of other inputs) to increase, as a result of which they too raise their prices to ensure their profits. So, expectations that prices could increase end up being a self-fulfilling prophecy.

Will the Central Bank recover its credibility?

This is where the Central Bank should come into play to convince agents that prices will not go up as much in the future; in other words, that expected inflation will be low, the idea being to turn expectations into an

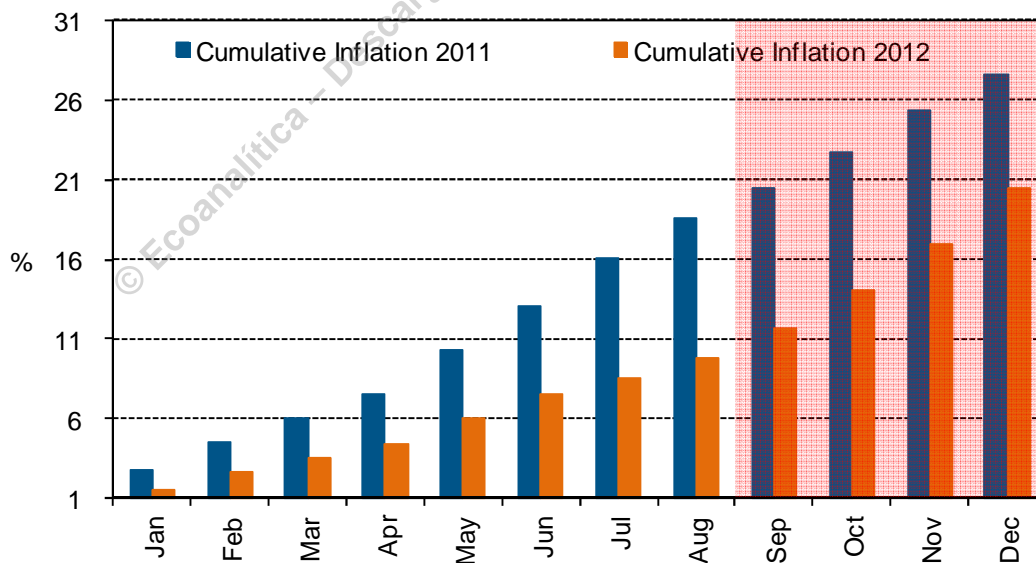


ally rather than an enemy. Even though the Central Bank is going to meet the goal this year, at **Ecoanalítica**, we feel it will be difficult to achieve single-digit inflation in 2014 if the present administration remains in office.

In countries where the central bank lacks credibility, as happens in Venezuela, expectations with regard to inflation are nearly always high. This is due to the fact that the measures that can be taken to alleviate them are generally unpopular and provide governments with incentives to intervene in the design of monetary policy, which results in the agents eroding the independence of the central bank.

In short, prices will go up as long as companies and individuals try to protect themselves against unexpected increases, and there is nothing a central bank can do to prevent this. We expect inflation to close at 20.4% this year, in line with the Executive's goal. The question is: Will it be sustainable in 2013? We will find out soon.

Cumulative Inflation 2011 vs. 2012



Sources: BCV and Ecoanalítica





Economic Tips

In the last place. According to the World's Economic Freedom Report, recently published by the Fraser Institute of Canada, Venezuela is last in a ranking that measures economic freedom, business opportunities and competitiveness. In the ranking of 144 countries, three Latin American countries are in the top 25: Chile (10) and Peru (24); and three countries: Bolivia (104), Ecuador (126), Argentina (127) and Venezuela (144), are among the last.

Malpractice. According to the Fraser Institute and Cato, Venezuela also has the worst political institutions of the region and it shares with Haiti the last place in the political system measurements of the region. The report also highlights the weakness of property rights and political freedoms, and the difficulties faced by entrepreneurs. In the country, the opening process for a new firm takes 141 days more than in any other nation in Latin America.

From bad to worst. In a review of the economic freedom index for Venezuela we noticed a fall in the economic freedom of the country. By 1980 the ratio was 6.72, so the positioned in 14th place in the ranking. By 1990 Venezuela fell to the 56th position in 2000 to 93th and for 2005 in the 136th.

Tax collection in July. According to figures released by the National Integrated Service for Tax Administration (Seniat), VEB 16.11 billion were collected in taxes for the month of August. Of this amount, VEB 3.75 billion (23.3%) are Income Tax, while VEB 7.62 billion (43.3%) were collected as VAT. The agency raised VEB 119.73 billion during the first eight months, of which VEB 32.24 billion came from Income Tax (26.9% of the total), and VEB 53.83 billion from Value Added Tax (VAT) (45% of the total).

In real terms, August tax collection was up by 9.6% compared to the same period last year. Both the Customs revenue and the VAT increased in real terms compared to the same period last year by 0.2% and 19.9% respectively. Revenue collected as Income grew by 9.8% in real terms compared to the same period last year. Total revenue in the first eight months grew by 6.3%. In turn, VAT and Other income tax revenues increased in real terms, 11.7% and 5.9%/y/y respectively. Meanwhile, Other income from customs decreased 54.6% in real terms over the same period of 2011.





Concepts (VEB Million)	Aug-11	Aug-12	Var (%)	Real Var	Jan-Aug 2011	Jan-Aug 2012	Nominal Var	Real Var
Total Income	12,443	16,108	29.5%	9.6%	91,911	119,733	30.3%	6.3%
Income Tax	2,895	3,754	29.7%	9.8%	91,911	32,241	-64.9%	-71.4%
VAT (Internal)	5,381	7,618	41.6%	19.9%	39,327	53,833	36.9%	11.7%
Customs revenue*	3,163	3,740	18.3%	0.2%	21,207	11,787	-44.4%	-54.6%
Other Internal Revenue	743	871	17.3%	-0.7%	5,377	9,303	73.0%	41.2%
Spirits	234	312	33.1%	12.7%	1,088	949	-12.8%	-28.8%
Cigarettes	478	516	7.9%	-8.6%	4,030	5,992	48.7%	21.4%
Inheritance	24	35	45.0%	22.8%	153	209	36.7%	11.6%
Random games or bets	6	9	34.8%	14.2%	102	67	-34.6%	-46.6%
Others	260	124	-52.3%	-59.6%	1,147	4,612	301.9%	228.1%

Sources: Seniat and Ecoanalítica

* Includes VAT on imports

Food basket increased by 0.7% in August. According to figures released by the National Statistics Institute (INE), the food basket value was VEB 1,835 in August, up by 0.7% from July and up 14.4% from August 2011, thus meaning that the reference food basket increased VEB 231 in one year.

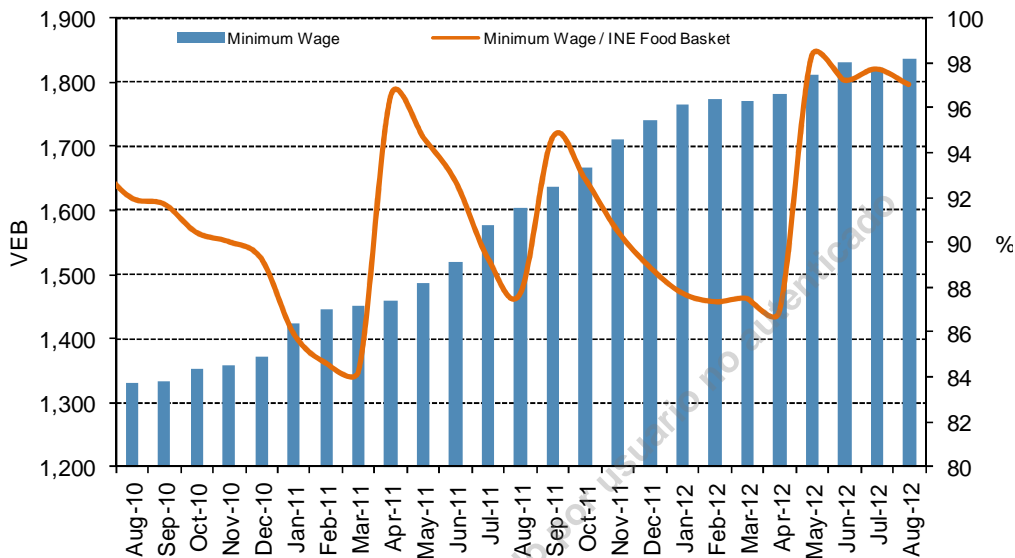
Minimum wage covers 97.1%. The last information confirms that the minimum wage does not cover the basic food requirements, because a worker that earns a minimum wage of VEB 1,781 can only buy 97.1% of the food basket calculated by the INE.

Barcelona-Pto La Cruz with the highest variation. The geographic figures show that the region with the highest increase on INE's food basket in August was Barcelona-Pto La Cruz (1.13%), followed by Rest of the Country (1.07%), Maturín (1.06%), Mérida (0.99%) and Maracay (0.96%).





INE's food basket Vs. Minimum wage's purchasing power



Sources: INE and Ecoanalítica

More delays are expected in Sitme. This week, exchange agreement N°20 entered into force, allowing the opening of accounts in dollars in national banks, a catalyst for the demand of Sitme bonds, so the waiting time to assign the titles, presently between 3 and 6 months, could be longer unless the Central Bank of Venezuela increases the supply of titles, which would force the Finance Ministry or Pdvsa to become indebted in foreign currency.

Private banks cautious. Although exchange agreement N° 20 entered into force, not many accounts in dollars have been opened, given the lack of information for the public, and banks are still waiting for more specific regulations on how to manage those accounts. While in state financial entities it is possible to open those accounts, private entities are waiting for the regulations regarding the accounts, as well as the accounting rules of the bank superintendence and the measures to prevent money laundering.

Gap between supply and demand. According to bank executives, individuals and companies that resort to Sitme every day demand around US\$100 million, while the Central Bank of Venezuela sells US\$44 million per day, a gap that could widen when the accounts opened in dollars allows any individual to access foreign currency through Sitme.

Venezuela with the highest inflation in food items. A report of the United Nations Food and Agriculture Organization (FAO) for the end of July states that among Latin



American and Caribbean countries, Venezuela had the highest price increase in food items. Between July 2011 and July of this year, the cost of food increased 21.7% in Venezuela, double the 8.9% average for the region, despite strict price controls, and a fixed exchange rate that is a sort of import subsidy.

US\$7.7 billion just to pay for the debt. Figures published by the Ministry of Planning and Finances state that in one year and a half, the amortization of the domestic and foreign debt amounts to US\$10.3 billion, most of it to pay for the domestic debt estimated at US\$7.7 billion between the second semester of 2012 and all of 2013. The debt service in local currency has increased significantly, since most of the operations of the central government have been in the domestic market.

A heavy payroll. Resources included in the 2012 budget to pay for salaries, pensions, and benefits, amounting to VEB 90.0 billion, have fallen short, one of the main reasons for the increase of the debt in bolivars. For the year, the National Assembly (NA) approved around VEB 64.4 billion to cover labor liabilities, allowing the government to meet the increase of around 70% in spending for those purposes.

Salary adjustments fire back. Among the main reasons for the increase in the government's payroll is the 32% adjustment in the minimum wage and the new wage scale. Another important factor has been the pension adjustment of the Venezuelan Social Security Institute (Instituto Venezolano de los Seguros Sociales - IVSS), channeled through the "Gran Misión in Amor Mayor", which has led the government to issue a complementary indebtedness Law for VEB 30.0 billion, of which VEB 25.0 are to pay for pensions.

Bread and circus for a while. President Hugo Chávez, who aspires to be reelected on October 7, said that if he wins the elections, his next six years of government will focus on supporting the social aid system through the misiones, expand the pensions, and create regimes for those sectors that don't have social security. In Chávez's government plan for 2013-2019, social security is considered one of the ways to go towards socialism.

No changes in view. Hugo Chávez, president of the republic and candidate for reelection, said during a press conference that Venezuela's macroeconomic variables are stable because the economic policy of the Bolivarian Government has been successful, and thus, he doesn't foresee any adjustments for his next presidential period. The exchange, monetary, and fiscal policies are working, therefore "*we don't foresee any adjustment*" said Chávez.

Payment of Petrorinocos begins. Last week, 1,008 workers of the Ministry of Education started to receive payment of their social benefits. According to the list



published in the newspapers, those summoned must enter their data on the web page of Banco de Venezuela, "Pago de Petrorinoco", and then take the requested documents to any office of Banco de Venezuela so that payment is delivered.

Caracas the most expensive city in Latin America. According to a recent report of the Swiss bank UBS, the Venezuelan capital is number 9 in a ranking that includes 72 cities worldwide; in the region, Caracas is the most expensive city in Latin America, followed by Sao Paulo and Rio de Janeiro, at number 44 and 45 of the general ranking. The report evaluates the price of a basket that includes 122 products and services, measured in terms of the work hours necessary to purchase it.

More imports expected. According to ECLAC forecasts, Venezuela will continue increasing its imports of goods and services for the remainder of the year. The last report of the entity estimates that Venezuela's foreign purchases will increase 18.8% (year/year) at the end of 2012, after recording 25.3% (y/y) in the first semester. Also, Venezuelan exports are expected to increase 6.5%, which would also imply a lower trade superavit.

Agreements with Portugal for US\$1.68 billion. Venezuela and Portugal signed 14 new cooperation agreements for US\$1.68 billion, with projects in energy, electricity, housing, construction, food distribution, computers, and medicines. Venezuela is the second largest client of Portugal in Latin America; only in the first semester, Portugal's exports to the country were for EUR 159 million.

Interest rates. The lending rate for the first week of September was at 16.6%, up by 0.2 percentage points compared to the previous week. The time deposit rate remained unchanged since July 2011 in 14.5%, while the passive rate has not experienced any significant variation since November 2011, placing well at 12.5%.

International reserves. International reserves decreased 2.4%, going from US\$25.7 billion during the first week of September to US\$25.1 billion during the second week of September. Compared to the same period last year, international reserves have decreased by 19.5%.

Monetary liquidity. Monetary liquidity (M2) drop by 0.8% in the first week of September compared to the previous week, settling at VEB 555.941 million. The M2 has increased 56.7% in relation with the same period last year.

Sitme figures. So far this year, US\$7.5 billion have been negotiated through the System for Foreign Currency Transactions (Sitme), averaging US\$43 million a day, with an implicit exchange rate of 5.3 VEB/US\$; this represents an increase of



US\$1.60 billion (28.1%) over the same period of 2011, when US\$5.9 billion were negotiated. Lastly, during the first week of September the amount traded reached US\$206.3 million US\$11.2 million less than the previous week when US\$217.5 million were traded, with a daily average of US\$42.3 million.

Oil Tips

Fears return and the prices shows volatility. On Monday September 17, the Brent and WTI indicators fell around 3%, the greatest drop in one day since June 21. This drop was attributed to the fact that some operators materialized earnings after the increase in the last few weeks, the fear of a crisis in the Euro Zone, and that the White House reiterated the possibility of using its oil reserves to prevent further increases in gasoline prices.

At half speed. Rafael Ramírez, Minister of Oil and Mining, informed that the Amuay refinery is presently processing 330,000 barrels per day (kbd) of crude oil, that is, 51.5% of the processing capacity of the refinery located in Falcón (640 kb/d). Ramírez said that the safe startup process of the facility continues and that the investigations of the accident are 75% completed.

Production falls. According to OPEC's monthly report, in August Venezuelan oil production fell 1.8% compared to the same month last year. Crude oil extraction in August was 2.36 mb/d, 43 kb/d less than in August, 2011. In terms of the direct report that the countries present to the organization, Venezuela's production was 2.84 mb/d, over the average of 2.81 mb/d of August, 2011.

Amuay generated nervousness. OPEC's last reports indicated that despite the statements of some Pdvsa directors, the explosion at the Amuay refinery did affect fuel supplies in the western hemisphere and led to nervous purchases in some countries in Latin America and the Caribbean, leading to a price increase in refined products.

6,000,000 barrels of oil in 2019. Rafael Ramírez, President of Pdvsa, said at the opening of the first meeting for oil and industrial integration between Argentina and Venezuela, that thanks to the Orinoco oil belt, Venezuela can have a production horizon of around 4,000,000 barrels per day (mb/d) for 2014, and of 6 mb/d for 2019.



Ramírez explained that the Orinoco oil belt is the largest oil province in the world, and “we doubt that a similar one exists”, he added.

Venezuela loses space. After five years of high oil prices, Venezuela apparently didn’t take advantage of the opportunity to increase its crude oil production and earn a larger space in the oil market. In 1999, Venezuelan oil production represented 10.5% of OPEC’s production, and presently it is only 8.0%. Also, during that same period, Venezuelan production dropped 16.0%, going from 2.80 mb/d to 2.35 mb/d, according to secondary sources, while the production of the cartel increased 10.6%.

The target moves away. As is becoming usual, Pdvsa didn’t reach its production target for the year. In August, the state owned Oil Company extracted an average of 2.99 mb/d, 150 kb/d below the target of 3.15 mb/d estimated for this month, according to data from a Pdvsa report that Reuters reported. The target for the end of the year is to pump 3.50 mb/d in December for an annual average of 3.13 mb/d.

The Faja doesn’t start up. Part of the problems to reach the target is the lower production of the new projects in the Orinoco Oil Belt, were the expected startup times and volumes have not been met, given the large debt Pdvsa has with its suppliers, and the infrastructure issues to meet the plans. Indeed, last week Pdvsa announced that it was reducing the early production volume of those projects by around 41%, from around 170 kb/d (announced in the beginning of 2012), to around 100 kb/d.

Retirees demand the accounts. Retirees and pensioners of the oil industry, grouped in the Association of Retirees of the Oil Industry (Asociación de Jubilados de la Industria Petrolera - AJIP), don’t accept the accounting management of the Oil Pension Fund of 2011. Luis Villasmil, coordinator of AJIP explained that during fiscal year 2011, “the earnings were VEB 2.23 billion, so VEB 493 million should have been distributed and wasn’t”. Villasmil said that almost 24,000 retirees and pensioners receive a single bonus of VEB 6,500, which represents only around VEB 157 million.

Explosion in a refinery in Mexico. Last Tuesday, September 18 there was an explosion and fire in the facilities of a gas plant of the public company Petróleos Mexicanos (Pemex) in Reynosa, in the northeastern state of Tamaulipas. Pemex sources said that the accident occurred “in the valve area” of a Pemex gas station, and at least 3 people died, and 19 were injured.

International baskets. Last Friday September 14th, in New York, WTI closed at US\$97.1/bl, which shows a increase of 1.3% compared to US\$95.8/bl recorded the previous week. Meanwhile, Brent grew by 1.1% to reach US\$ 115.4/bl compared to the previous week when it reached US\$114.2/bl.



Local basket price. On Friday September 7th the Venezuelan oil basket price closed at US\$105.1/bl resulting in an increase of 1.1% compared to US\$104.1/bl recorded the previous week. Meanwhile, the average of the Venezuelan oil basket stands at US\$ 105.2/bl.

Business Sector Tips

The fall in food marketing increases. According to the survey “Tendencia” that the Venezuelan Food Industry Chamber (Cámara Venezolana de la Industria de Alimentos - Cavidea) carries out every month, food sales dropped 4.1% in August (y/y), worse than the previous month, when sales had dropped 3.5% (y/y). According to Cavidea’s study, the negative food marketing trend continues, and the industry is accumulating 18 consecutive months of drops in the sale of basic items.

The item with the least movement. According to the report of Cavidea, milk is the item with the sharpest marketing drop. Powdered milk sales dropped 33.4% comparing the behavior of the market between August 2012, and the same month in 2011, while the marketing of pasteurized milk fell 1.4% in the same period.

Banks with greater earnings. According to the latest report of the Bank Superintendence (Superintendencia de Bancos - Sudeban), in the first eight months of this year, banks perceived earnings for VEB 5.16 billion, an increase of 112.0% compared to the same period in 2011. This increase goes hand in hand with the higher investment in public bonds (which provide tax free benefits for the banking system), commissions in dollars from Sitme, and the significant increase in the credit portfolio.

But less intermediation. The report of Sudeban also reveals that credit intermediation was 53.7%, a drop of 2.7 percent points compared to the same month last year, when it was 56.4%. The drop in the intermediation index is due to the significant increase in savings of the public, of 60.1% (y/y), while the credit portfolio increased at a slower pace, with an increase of 53.0% in the same period.

Catching up. During an interview with a regional channel, President Hugo Chávez, candidate for reelection, said that private banks will have to “catch up” if he wins the elections of October 7. According to Chávez “private banks must update themselves



in terms of national development programs and housing programs". The head of state said that if he wins the elections, public banks and community banks will continue to be strengthened.

Review of the automotive policy requested. Industrials in the automotive sector fear that there will be a contraction for the fifth consecutive year in the area, and the drop has coincided with the implementation of the automotive policy that entered into force in 2007. Thus, José Hernández, President of the Chamber of Automotive Products Manufacturers (Cámara de Fabricantes Venezolanos de Productos Automotores - Favenpa) called upon the Administration to review the automotive policy. Between 2007 and 2011 the assembly of cars dropped 40% going from 172 thousand units to only 102 thousand.

"A little help" for the textile industry. Ricardo Menéndez Minister of Industry, said that 1,082 textile enterprises are being helped, of which 522 have already received financing for US\$5.5 billion from the Fondo Bicentenario. The financing will go together with training in financial and technological aspects, and its goal is to *"replace imports and promote exports"*. It is estimated that with this measure, the sector will grow 37%, an increase in domestic production of 30,000 to 42,000 tons of fabrics and knits.

Small pharmacies won't present accounts. Small pharmacies don't have to register with the Automated Price Administration System (Sistema Automatizado de Administración de Precios - Sisap) of the National Superintendence of Costs and Prices (Superintendencia Nacional de Costos and Precios -Sundecop). The instructions issued by Sundecop explain that "pharmacies considered small establishments will have to load information through Sisap once Sundecop establishes the special procedures for these subjects".

A new black market and it's not in dollars. Lags in regulated prices, less foreign currency for imports, and the implementation of product guides have affected supplies in the pharmaceutical sector, leading to the emergence of a black market. Several products that have disappeared from pharmacies and supermarkets are found at a higher price, but without sanitary permits. The entrepreneurs of the area question: if there are no dollars for them, how can those that supply the black market import?

Even through internet. Such is the shortage of some pharmaceutical products that there are e-trade offers in web pages. Recently, the digital web portal mercadolibre.com.ve removed the sale of medications from their page. That page was offering Glucophage and Euthyrox, two of the medications that are scarcer in



pharmacies. According to the company's policy, the sale of pharmaceutical products is forbidden.

Binational trade recovers. Trade relations between Colombia and Venezuela are recovering. According to figures of the National Statistics Administration Department of Colombia (Departamento Administrativo Nacional de Estadística DANE) during the first seven months of the year, binational trade reached US\$1.88 billion, a 50.1% increase with respect to the US\$1.25 billion recorded during the first seven months of 2011. The trade balance of the first seven months of the year favored Colombia for US\$1.11 billion.

World Economy Tips

OECD perceives a slowdown for its economies. According to results of the Composite Leading Indicators (CLI), published in the last bulletin of the Organization for Economic Cooperation and Development (OECD), the global economy is slowing down this year. The CLI, was designed to anticipate inflection points in economic activity, and indicates a slowdown in the economic activity of the main economies of the OECD and an even more marked slowdown in larger non OECD economies for the year.

Germany puts its hand in its pocket. The German Constitutional Tribunal approved Germany's participation in the European Stability Mechanism (ESM) removing the last obstacle for the implementation of that rescue fund that had been approved by the rest of the Euro countries. The Tribunal's approval will allow Germany to contribute with EUR 190.0 billion, 7% of its GDP, for the mechanism to rescue European countries that may have problems in the future.

A definite weapon against the crisis. ESM is a new fund that will be able to make loans to countries with problems, with the condition of complying with certain fiscal adjustments. The fund may purchase sovereign bonds in the primary market to relieve the pressure of countries with problems, while the ECB will do so in the secondary market. The ESM will have EUR 700.0 billion, of which EUR 200.0 billion have already been committed to rescue those that went into a crisis first: Greece, Portugal and Ireland.



Tension in the Far East. The dispute between China and Japan about a group of uninhabited islands has led to attacks against well-known Japanese companies in Chinese territory. Companies like Panasonic, Canon, Mazda and Honda have announced that they will stop operations in China after a series of anti-Japanese protests in that country. Chinese estate media warn that Japan could have another “lost decade” if trade relations between both countries are affected, with amounting to US\$340.0 billion last year.

Unfair competition. According to White House officials, the President of Barack Obama’s government presented a claim against the People’s Republic of China before the World Trade Organization (WTO) for unfair competition in the export of cars and auto parts. According to a high official, China is accused of granting US\$1.0 billion in illegal subsidies to car and auto part exporters between 2009 and 2011, which would violate the WTO’s regulations regarding subsidies for exports.

Latin America: an oasis for Spaniards. Shaken by the crisis in Europe, Spanish companies are increasingly looking towards Latin America, a region that according to the Economic Commission for Latin America and the Caribbean (ECLAC) will grow between 3.5% and 3.7%, and also has large reserves of natural resources. Countries like Brazil, Guatemala, Chile, Colombia, Bolivia, Uruguay and the Dominican Republic, have perceived the greatest increase in the number of Spanish companies registered in their chambers of commerce.

However, the region has also been affected. According to the report “Perspectives of International Insertion” ECLAC forecasts that exports for the whole region could increase only 4%. The organization states that the recession in the Euro zone, the lower economic dynamism in the United States, and the moderate growth of China and other emerging economies will affect trade in the region, which in 2012 will be around 20 percent points below the growth rates of last year.

The MIST are coming. The term MIST, coined by Goldman Sachs, refers to Mexico, Indonesia, South Korea and Turkey, as the emerging economies that follow the path established by the “Brics” (Brazil, Russia, Ireland, China and South Africa). The MIST economies doubled their size in only a decade, and in the last year they grew 12%, and it is expected that they will be an important driver of the world economy.

A US\$6.0 billion speech. A 30 minute appearance of Mark Zuckerberg, creator of Facebook, at a technological industry conference, translated into US\$6.78 billion of additional market value for that company. The value of Facebook shares skyrocketed after the public appearance of its Executive President, where he mentioned that the company could enter the Search Market.



USA Back to gold? In several US states, legislators concerned by the fiscal crisis, the Fed's policies, and the weakness of the dollar, have presented bills to allow citizens to use precious metals like gold to declare their taxes and do business. Although the measure is interesting and could be implemented in a small scale, analysts consider that it is impossible to implement in an economy that moves billions of dollars per day.

Political Tips

Positive results: winds of change? During an interview with the newspaper El Universal, Armando Briquet, coordinator of Comando Venezuela stated that the candidacy of Henrique Capriles is growing, and surveys carried out for his command, already place him two points above Chávez, which at less than a month for the elections and facing a "powerful government" is a "positive result". According to Briquet, the behavior of president Chávez is that of someone who "knows" will lose the elections.

Go over the roof. During an interview with the national TV channel Telesiglo Veintiuno, Hugo Chávez candidate for reelection and President of the Republic, announced that he hopes to win the elections with more than 65% of the votes. The government candidate also expressed his desire that "from the remaining debris" (of the opposition), after their electoral defeat, a new leadership will emerge with which it will be possible to dialog. "As President, I am forced to talk", but a serious leadership is required, he said.

The advantage "is not insurmountable". José Antonio Gil Yépez, Director of Datanálisis, said that the study by that company presented by President Chávez, showing his advantage of 17 percent points over Henrique Capriles, could come from a private survey carried out by the above mentioned pollster. Gil said that the last study of Datanálisis, carried out between September 03 and 08 showed that there were 13 points in favor of the reelection candidate, and although the president is correct in saying that his has an advantage, "*it is not insurmountable, because it has been falling in the last four months*".

Threat or warning? After reminding that a revolution cannot be unarmed, President Hugo Chávez said that his victory in the next presidential elections of October will enable the country to keep moving away from "*the horrors of a civil war*". Chávez



said that *"he is not threatening with a civil war"*, but that if the opposition wins, the economic measures or *"el paquetazo"* that will be implemented will make the country *"tremble"*, and if he wins, we would continue moving away from a possible civil war.

"20 years are nothing". After being consulted if 20 years in power would be enough for him, if he won the elections, the President and candidate for reelection, Hugo Chávez, said that *"20 years are nothing"*. The head of state said that *"it is not about Chávez. Chávez is just a circumstance"*; he said that the success of his government is because the program has been successful in the political, social, economic, and international arena: *"we are creating the foundations of a historic project which will take our whole life"*, he added

Clear cut. With a decisive statement presidential candidate Henrique Capriles rejected the actions of Representative Juan Carlos Caldera, who appeared on video receiving money allegedly for the presidential campaign. *"I don't accept anyone using my name and the project to drag me into his filth"* were the words of Capriles, saying that representative Caldera is out of the *"project for progress"*.

We set the example. Representative Julio Borges, spokesman of the national direction of Primero Justicia, set the position regarding the claim involving Representative Juan Carlos Caldera, a member of the organization, with an alleged bribe. The political organization, strictly adhering to its values, decided to remove Caldera from the party. The decision was made considering that *"Our goal of having a Venezuela with justice for all forces us to set the example, starting with our own organization"*, said Borges.

"If corruption was fought, there would not be any ministers left." During a public event in Lara, Henrique Capriles, presidential candidate for Unidad, urged his followers to dismiss *"the fight"* that the government promotes, and focus on constructing *"the future and progress"* that his victory promises. Referring to the attitude of the government and of PSUV regarding his claims, he said that if the government took them seriously *"no ministers would be left, because the more loyal they are to the regime, the better the posts are given to them as a reward"*.

Preparing the ground. The president of Colombia, Juan Manuel Santos, received the presidential candidate, Henrique Capriles Radonski. After the meeting of about 25 minutes, settled to *"prepare the ground"* to strengthen relations between the two countries (both in economic as far as border security concerns), Santos reiterated the neutrality of Colombia with respect to the electoral process of next October, and hoped that it will have a massive participation of Venezuelans.



Warming up the engine. The “Partido Socialista Unido de Venezuela” (PSUV) carried out a drill to check the operations of its electoral machinery, in preparation for the presidential elections of October 7. In this event, its political structure was activated in all electoral centers of Caracas. According to Robert Serra, PSUV activist, testing the party machinery so close to the presidential elections allows them to have information about arrival times, logistics, mobilization, and everything that “cannot fail that day”.

The hurricane was only a storm. “Here comes the Bolivarian hurricane” said Nicolás Maduro, foreign affairs minister, referring to the arrival of President Hugo Chávez to a proselytist act in the populated sector of Catia (Caracas). The fact is that “the hurricane” was only a storm, the event only mobilized three blocks of “militants” that came from public entities. Such was the apathy that Chavez decided not to talk at the end of the caravan. Asked about the poor attendance, representative Freddy Bernal said that “The most important mobilization will be on October 7”.

Antidrug failure: negligence or complicity? In a memo distributed by the White House, the United States accused Venezuela of “failing” in its fight against drugs, and placed the country on its “black list” for the fourth consecutive time. The report says that among other reasons, “the permeable western border with Colombia, its weak judicial system, and an inconsistent international cooperation against drugs” make Venezuela one of the preferred routes for drug trafficking from South America.

Spain wants to be an observer on October 7. According to José Soria, Spanish minister of Industry, Energy, and Tourism, the Spanish Government would be willing to send observers for the upcoming presidential elections, but the CNE apparently isn’t interested in the participation of Spain. Soria said that the Spanish government, through the Minister of Foreign Affairs, requested his Venezuelan counterpart to send observers for the presidential elections of October 7 and the response of the Venezuelan National Electoral Council was that it reserves its right to make such invitations.

Legislative Tips

Period of sessions begins. The National Assembly (NA) started its second period of sessions on September 18, which will end on December 15. Representatives are expected to activate the political trial of Representative Juan Carlos Caldera, from



Unidad, for appearing on a video where he received money from entrepreneur Wilmer Ruperti.

Investigations about the video of Caldera began. Juan Carlos Alemán, Psuv representative before the NA, said that a commission started investigating the video of Representative Juan Carlos Caldera, which allegedly implicate him in illegal actions by receiving money for the campaign of Capriles Radonski. Alemán said that the Assembly has not yet contemplated to eliminate the parliamentary immunity of Juan Carlos Caldera, however, that measure may be taken depending on the results of the recently appointed commission.

Environmental penal law will increase the costs for companies. Attorney Gregory Odreman said at a forum with the Venezuelan Confederation of Industrialists (Confederación Venezolana de Industriales - Conindustria), that *"one of the consequences of the law is that it makes the operations of companies more expensive, because they have to be more careful"*. The attorney noted that the legal text, reformed on May of this year, establishes up to 78 rules that contain criminal sanctions or fines both for companies and for the individuals running the companies.

Partisanship prevents legislative effectiveness. The group "Monitor Legislativo" said that a high politicization and partisanship of the Legislative Power during the first day of sessions of the second legislative period prevented the harmonious and effective work of parliament. The NA identified as priorities for this second period the need to reform the Organic Code of Military Justice, and elaborate and discuss at the Plenary the Law of Information Classification and declassification, together with a public consultation.





ECONOMIC OVERVIEW

