EXCHANGE MARKET REPORT

Year 16
October 2020

Ecoanalítica
acompañando las buenas decisiones

CONTENT

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The endless story

Again, in the last few weeks, the exchange rate in Venezuela (official and unofficial) has been involved in a new maelstrom of consecutive increases. All this has occurred amid new discounts to the legal reserve requirement maintained by local banks in the local central bank (BCV), in addition to new episodes of gasoline shortages. Both elements have tended to influence the demand for foreign currency by local agents, either because of the greater availability of resources to leverage their acquisition (in the midst of hyperinflation that still persists), or because of the uncertainty regarding the reappearance of unofficial gasoline markets.

However, as we saw in our 35th weekly report, such pressures do not seem to be as noticeable, compared to the results seen so far this year. The unofficial quote still does not exceed the 20.3% increase that this marker showed in one day, in early April, at the very beginning of the radical quarantine in the framework of the COVID-19 pandemic. At the corporate level, the price of currency at private tables has also not reached daily variations such as those seen at the beginning of such countermeasures, nor does it match what was seen in that space at the beginning of the year where increases of up to 23.6% would be reported in a single day.

The official scoreboard, completely unrelated to the decisions of the regulators, seems to be responding to this trend, with an intraday increase of up to 18.4% in early April, higher than the maximum seen in the last two weeks.

Certainly, in the local markets there is always concern about the exchange rate issue, especially the impact of constant fluctuations on local pricing and private business management. However, as we will see, current conditions and the close relationship between the exchange rate and inflation end up surrounding the true extent of exchange rate pressures.

Describing the adjustment

Despite initial numbers on its weekly trend, in year-on-year terms the rise in the unofficial exchange rate is still below what has been seen so far in 2020

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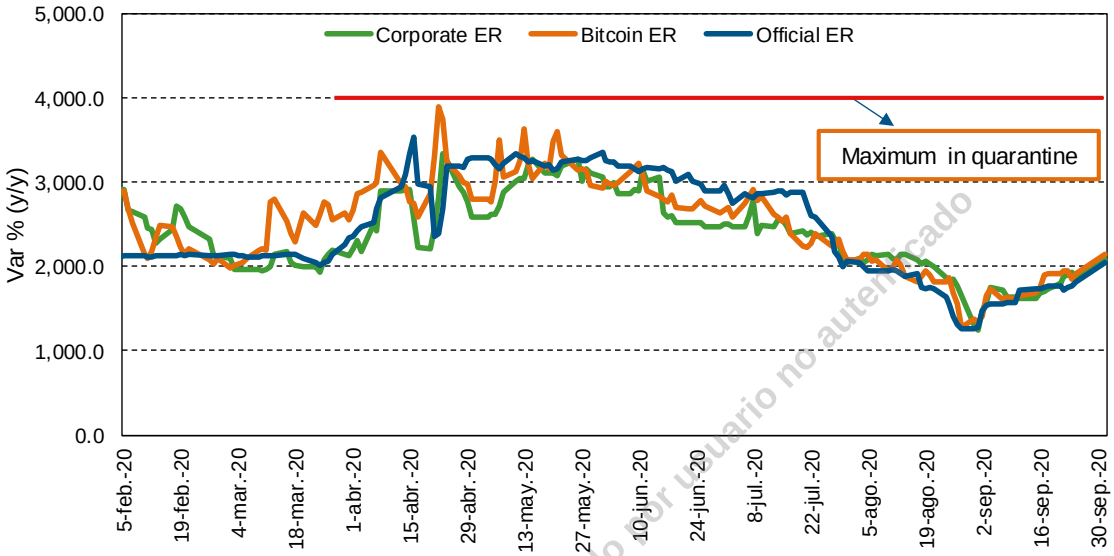
Year-on-year variation of the official and unofficial exchange rate of households and companies



Sources: BCV, Local Bitcoins and Ecoanalítica.

In fact, until last week, none of the exchange rate indicators (official, unofficial and corporate) have reached the maximum increase observed during the last 9 months (with respect to last year), registered precisely at the beginning of the quarantine in Venezuela.

However, this does not mean that the exchange rate will not accelerate its growth rate again in the coming weeks. Looking at the figures for the banking system in recent weeks, there are no clear signs of a (at least partial) revival of credit activity. Two weeks after the new discount of the legal reserve[1], credit [2]still does not exceed 15.0% of deposits, although it has risen by USD 34.7 MM since the new reduction. Likewise, the interbank market still shows signs of illiquidity, with rates still trading above 100% per year, still with real negative margins but close to what was seen before the new reductions.

Here, two conjectures arise: 1) the new discounts on legal reserves are still insufficient to solve the banks' cash deficit; and 2) as in the past discounts, the supply of credit will take time to respond to the new stimulus. If the former is true, it is likely that we will have already seen the largest exchange rate increases expected after the new reserve requirement measure. If the latter (or both) occur, further upturns in the growth rate can be anticipated in the coming weeks, with a more volatile currency price.

[1] Details in our Outlook Note 03: *New "incentives" to banking credit in Venezuela*, September 2020.
[2] Using figures from universal and commercial banks.

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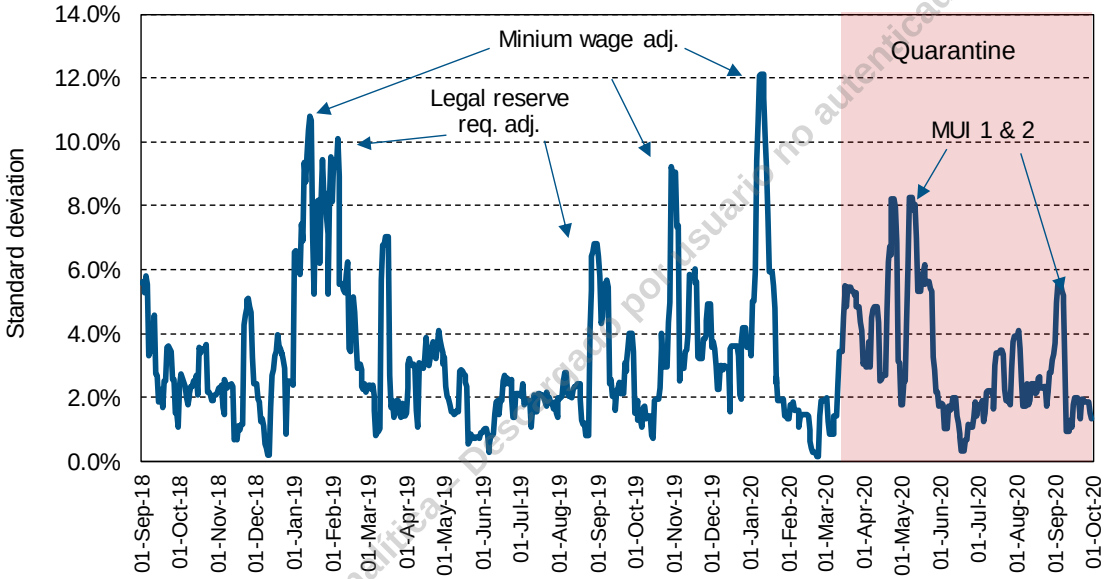
In that sense, the constant fluctuation of such markers seems to be the most predictable result for the days to come. While exchange rate variations have so far not been as noticeable as they were during the adjustments prior to the legal reserve or the minimum wage, the "noises" that would be introduced by the new discounts on the legal reserve or the growing scarcity of gasoline to exchange transactions could end up adding more variability to currency price fluctuations in the coming days.

Daily exchange rate growth volatility*



*Measured as 7-day-window standard deviation over daily log-differenced non-official nominal ER.
Sources: Localbitcoins and Ecoanalítica

In other words, even though the increase may slow down during these periods, the currency price may be plagued by multiple daily ups and downs, one after the other, even on an intraday basis. This, perhaps, is the element on which companies can take better advantage when generating cash in the very short term.

The sky is NOT the limit.

One explanation for the slower expansion of the exchange rate (compared to its recent history) is that, despite the upward pressures generated by both the expected new credits and the uncertainty about the real capacity of the Executive to continue supplying gasoline internally, the possibility of Venezuelans (households and businesses) to acquire foreign currency continues to be affected by the COVID-19 pandemic and the limitations on local activity resulting from the official quarantine.

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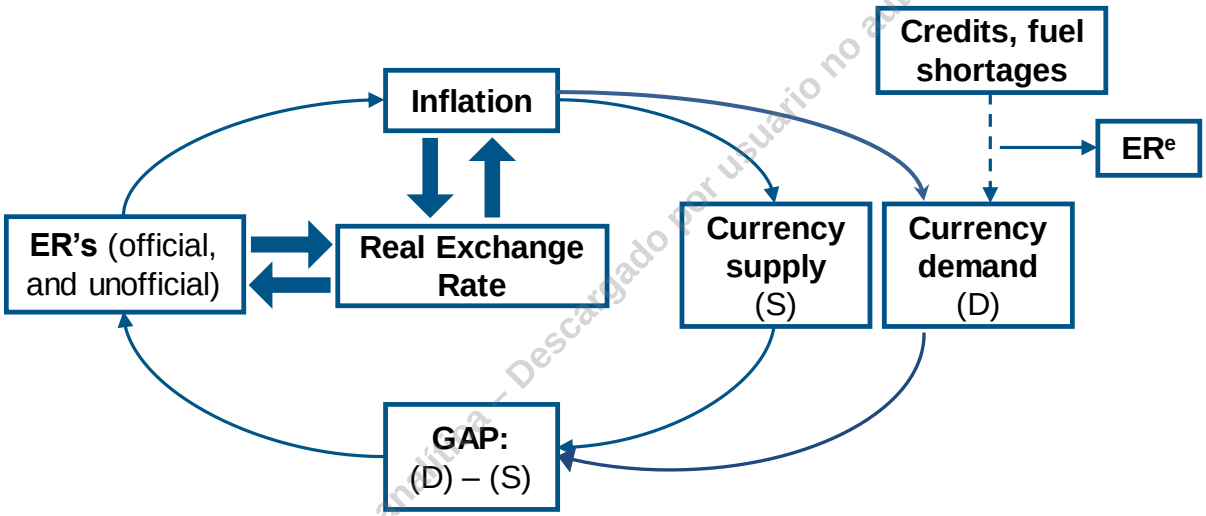
On the other hand, even with its deceleration, local inflation continues to contribute to such limitations, once its evolution continues to reflect the increases in the exchange rate marker and reducing the real income of those who still receive income in local currency. In fact, as we have highlighted in previous reports on the local exchange market, in most cases prices tend to continue to grow in the weeks following exchange rate adjustments[3]. This implies even less purchasing power for those with fully dollarized incomes, as the exchange rate rise begins to lag behind inflation and greater pressures are generated for its real appreciation.

Diagram 1: The endless cycle



A quick update to the multiecuational model used in other reports to explain the dynamics between prices[4], shows not only the positive and almost immediate effect of greater unanticipated depreciations of the exchange rate on weekly inflation, but also how the variations in the price of currencies tend to adjust (slow down, in strict) after the higher inflation caused by the initial changes in that exchange rate. However, the low certainty of responses (as measured by the width of the associated confidence intervals) indicates that such a process does not seem to occur in all the weeks examined. In other words,

[3] In fact, the lower future demand for foreign currency resulting from higher inflation and its impact on local income may be reinforced by the increased supply of foreign currency introduced by households or businesses to maintain their consumption path. In practical terms, this can be seen when people have to sell more foreign currency to continue to purchase a basket of typical goods (once they have exhausted their local currency resources), or when more dollars are introduced for transactional use when local currency income becomes insufficient amidst higher prices.

[4] Vector Autorregressive Approach (VAR) between inflation, monetary base variation, and exchange rate at weekly level, according to the settings used in previous reports.

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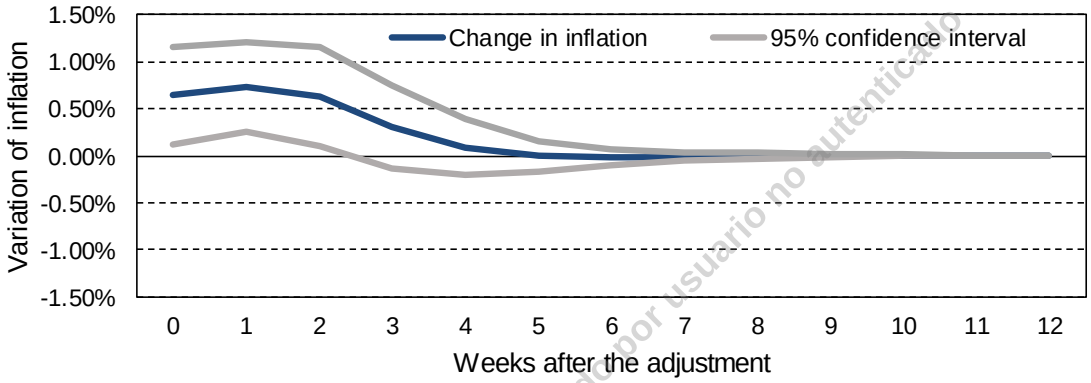
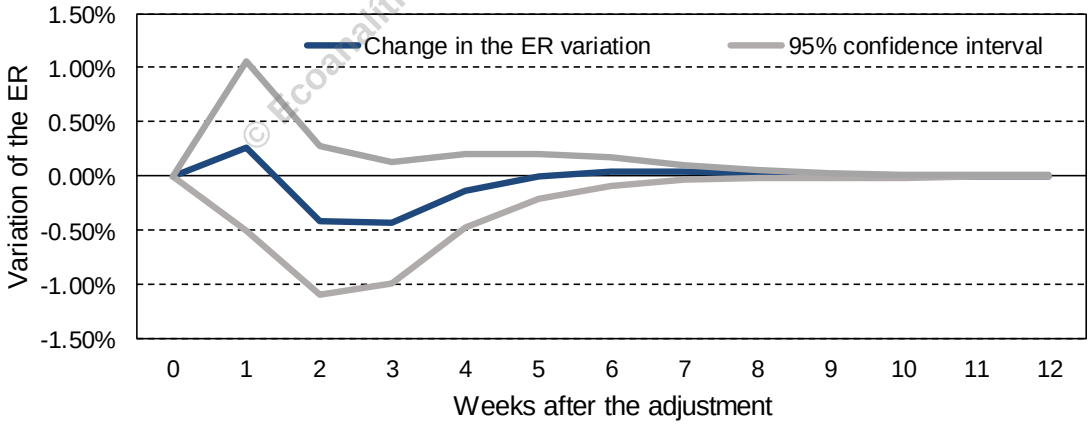
despite the validity of the argument, local agents do not always seem to see their demand for foreign exchange affected by higher inflation.

Changes in weekly inflation in the presence of an unexpected rise in the depreciation of the unofficial ER



Sources: BCV and Ecoanalítica.

Changes in the ER variation in the presence of an unexpected rise in weekly inflation



Sources: BCV and Ecoanalítica.

Coverage and arbitration: the old reliable

The above shows that the great lesson that exchange events have left us in the last three years has not changed: as long as hyperinflation **lasts,** the exchange rate will be increasing, although, **as long as hyperinflation lasts,** the difficulties to acquire the same

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volume of currency in time will be maintained and even worse. This will continue to alter the pace at which the exchange rate rises, in an environment of increasingly higher prices, but will not prevent it from continuing to grow (again, as long as hyperinflation persists).

In the recent context, perhaps the most beneficial for businesses and households is, more than the increase in the exchange rate, its volatility and how it will continue to change under current conditions. Thus, taking advantage of the days when the price of currencies can be arbitrated, or seeking to acquire these currencies when a greater rise is expected in the coming days in the midst of a rising volatility, is probably a good strategy, considering the risks incurred in case such volatility ceases or mutates suddenly.

On the other hand, in an environment of greater dollarization, although the rise in the exchange rate is no longer bad news for those who receive income in hard currency, its lag with respect to inflation is still uncomfortable. In this sense, in the midst of unexpected upturns, companies or households should not fall into the game of completely dollarizing prices or wages if their business is still exposed to the local currency in some way. While the private business lives in a partially dollarized environment (something even desirable from the official view), the key is rather to take advantage of the moment, make the most of the currencies as a means of coverage or cash generator, but not as the only reference of the financial management of each company.

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Parallel Exchange Rate projections

Updates Fundamentals:

Given the technical difficulties in doing projections for the nominal exchange rate in a hyperinflationary environment, commented on in previous reports, at **Ecoanalítica** we find we are making adjustments to our prediction model. The results given in this report are due to that process of adjustment and, for that reason, they show relatively significant changes from our previous report.

Projections

Proyecciones del Tipo de Cambio Paralelo

Fecha	Valor efectivo *	Rango					
		Bajo		Moderado		Alto	
2019M01	2.175	849	1.187	1.415	1.881	**2.596**	3.418
2019M02	3.424	809	1.153	1.393	1.899	2.312	**3.604**
2019M03	3.362	553	881	1.120	1.674	2.170	**3.709**
2019M04	6.028	714	1.124	1.454	2.241	2.965	**5.257**
2019M05	6.450	916	1.204	1.589	2.577	3.538	**6.783**
2019M06	7.517	1.081	1.549	2.057	4.912	**7.539**	9.824
2019M07	11.974	2.468	3.448	4.111	5.465	9.078	**9.932**
2019M08	23.158	4.029	5.744	6.938	10.949	12.573	**17.949**
2019M09	19.662	7.198	10.743	15.947	**25.232**	32.784	38.528
2019M10	21.900	8.826	13.172	17.124	**26.827**	40.694	47.240
2019M11	37.191	11.428	17.055	19.574	30.258	**38.666**	61.168
2019M12	55.212	12.835	19.516	23.130	45.580	**54.411**	72.280
2020M01	72.027	12.790	19.447	23.049	45.421	**71.696**	72.027
2020M02	73.251	16.682	25.366	30.063	59.243	**75.158**	93.947
2020M03	89.197	16.212	24.651	29.216	85.451	**91.299**	170.097
2020M04	175.225	21.176	32.198	38.161	92.962	119.253	**237.964**
2020M05	195.647	65.528	107.279	**187.981**	207.635	268.682	342.777
2020M06	205.571	77.180	151.499	**196.612**	225.913	241.724	391.502
2020M07	261.415	84.624	172.993	**233.829**	294.665	351.803	429.260
2020M08	341.279	108.285	223.192	317.513	**365.428**	449.143	522.311
2020M09	432.117	110.036	340.751	374.678	408.605	**449.288**	489.971
2020M10		**115.887**	**215.215**	**351.970**	**488.724**	**525.269**	**643.814**
2020M11		**174.338**	**291.471**	**537.750**	**784.030**	**1.290.580**	**1.394.702**
2020M12		**251.940**	**316.458**	**791.975**	**1.003.500**	**1.701.993**	**2.219.395**

Fuentes: BCV, Ecoanalítica y Cálculos propios

*Al cierre de cada mes, a menos que se indique los contrario

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Foreign Exchange Market Indicators

Exchange rates indicators

Exchange Rate Indicators (VES/USD)			
	Sep-20	m/m (%)	y/y (%)
M2/IR*	33,238.4	21.4	1,612
RER**	741,987.8	30.6	2,000
Money desks ***	436,677.4	34.5	2,005
WER (Consumers)	400,510.9	29.0	2,387

Source: BCV, other Central Banks and Ecoanalítica

* End of month. ** Monthly average (Ecoanalítica). ***Last auction.

Annual exchange rates indicators

Exchange Rates (VES/USD)					
	2017	2018	2019*	Devaluation	Real Depreciation/ Apreciation
Public Sector ER[1]	**0.001**	**70.8**	**10,584.0**	**99.331**	**-93.0**
Imports ER1	0.03	111.5	10,841.1	**98.972**	-92.8
Real exchange rate[2]	**0.2**	**3,754**	**178,037**	**97.52**	**0.0**
M2/RRII[2]	0.1	91.1	4,328.0	97.9	-97.1

Sources: BCV and Ecoanalítica

[1] Annual average. [2] At the end of the year.

*Data compiled until November. Additionally, the calculations were made using the National Assembly's inflation

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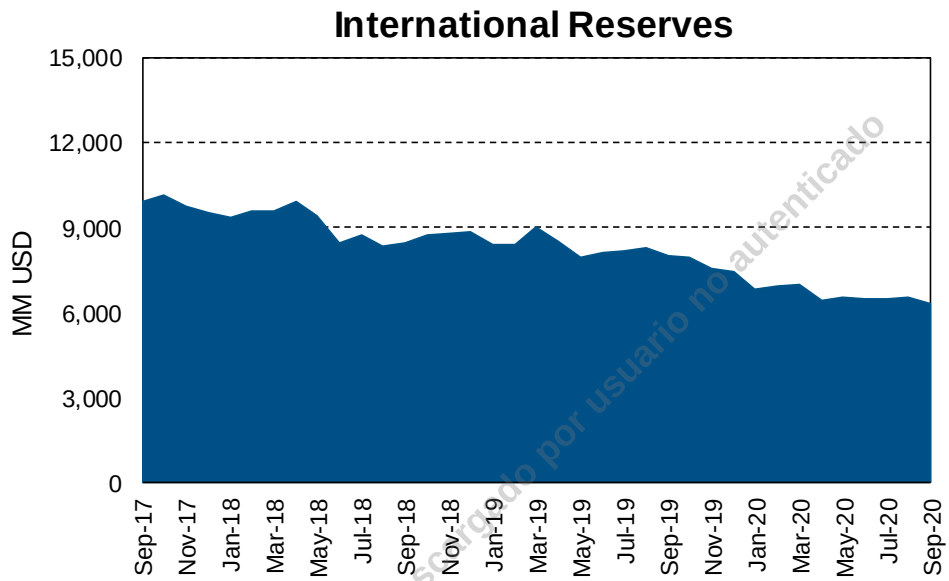
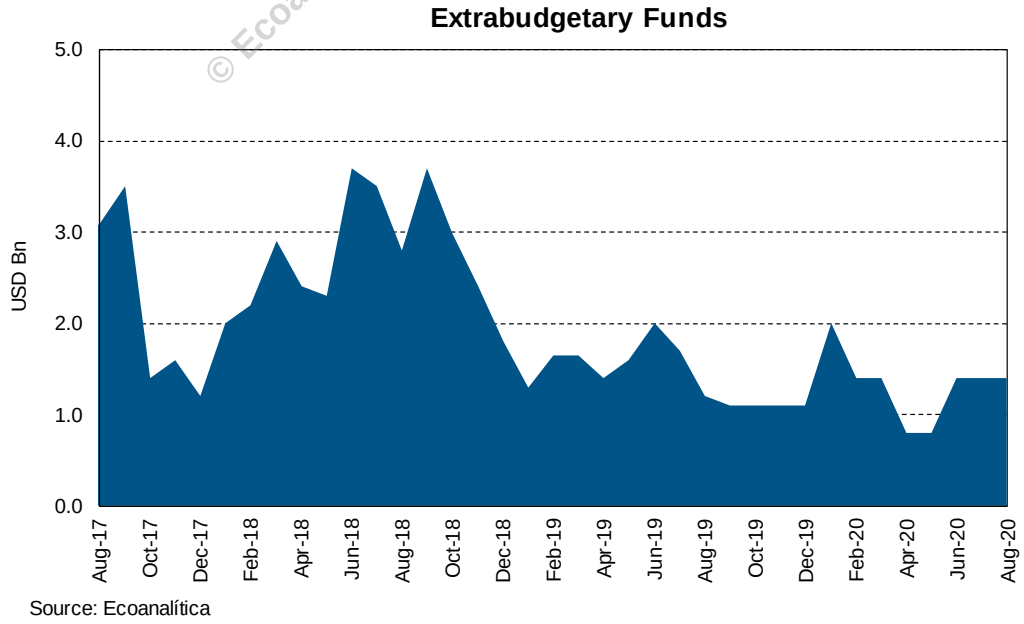
Foreign Currency Availability Indicators

International Reserves



Sources: BCV and Ecoanalítica

Extrabudgetary Funds



Source: Ecoanalítica

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Non-Financial Debt with the Private Sector

Non-Financial Debt with the Private Sector (USD Bn)

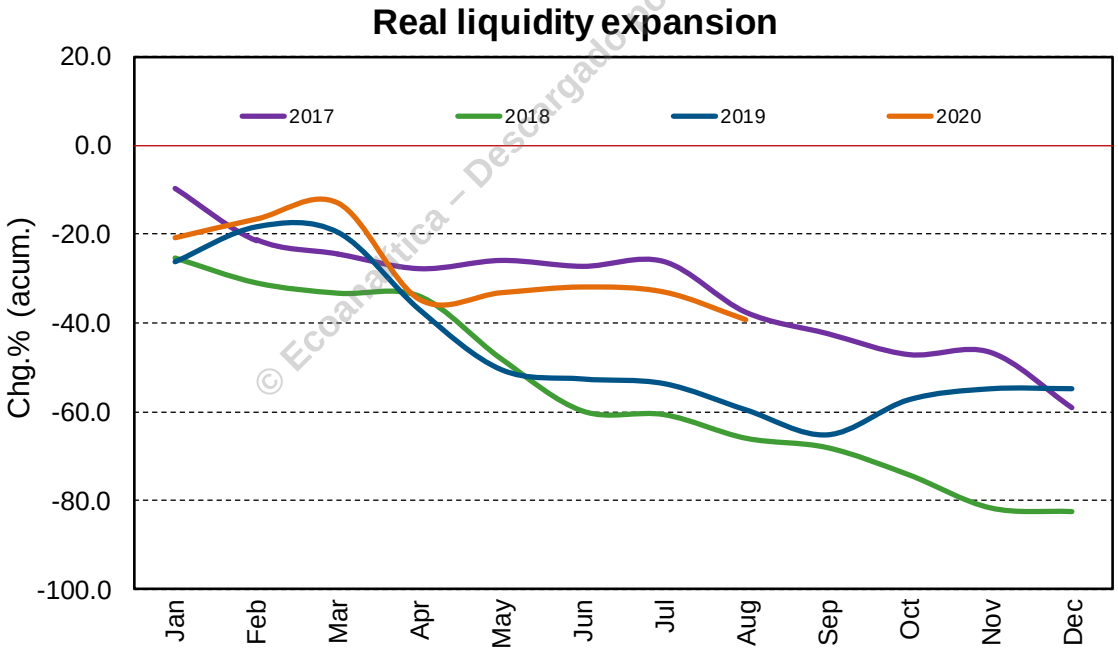
	4Q2017	4Q2018	2Q2019	4Q2019	1Q2020	2Q2020	y/y (%)	q/q (%)
CADIVI -Non-settled imports	8.7	6.3	5.7	5.3	5.3	5.3	-7.7%	-0.2%
CADIVI -Dividends approved and unpaid	1.6	0.4	0.2	0.2	0.2	0.2	-0.5%	0.0%
CADIVI -Rent and Services*	3.4	1.4	1.1	1.1	1.1	1.1	-0.7%	-0.2%
Mixed Companies - PDVSA partners	12.1	12.1	12.1	9.3	9.0	9.0	-25.4%	-0.3%
Total	**25.9**	**20.2**	**19.1**	**15.9**	**15.6**	**15.6**	**-18.4%**	**-0.3%**

Source: Ecoanalítica

* Includes debt with airlines.

Monetary Indicators

Liquidity (M2)



Sources: BCV and Ecoanalítica

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You should take into account

- ✓ The month of September passed under a framework of partial confinement measures within the 7+7 scheme implemented by the authorities, where most of the economic sectors were allowed to operate in staggered time bands in some weeks while other weeks more severe confinement measures were applied in the capital city and the border states.
- ✓ According to information that **Ecoanalítica** has been able to access, Venezuelan authorities are evaluating collecting taxes in dollars to avoid the economic crisis and the constant loss of value of the Bolivar.
- ✓ Delcy Rodríguez announced that an "interruption" of the service of the Republic's debt, PDVSA and Electricidad de Caracas, was offered in order to continue advancing in the restructuring process. For his part, the President in charge, Juan Guaidó, established that this mechanism does not apply because the legal terms for making such offer have not yet been complied with.
- ✓ The Venezuelan Central Bank (BCV) issued a circular indicating that "an amount equivalent to VES 30 billion will be discounted from the total reserve requirements". According to the average exchange rate for that week of VES 375,000, US$ 80 Million will be released, however, this amount in dollars will decrease as the exchange rate continues to increase.
- ✓ The discount of the applicable legal reserve will be determined through a methodology foreseen in the circular letter that will be in force until September 17, 2021 on a weekly basis and proportionally according to the participation of each bank in the total amount of legal reserve.
- ✓ Considering the provisions of the resolution, approximately VES 19 billion of the VES 30 billion released, will not increase the credit portfolio, since they will be destined to cover the reserve requirement deficit of the private banks with the BCV.
- ✓ It is then estimated that the bank will have approximately USD 29 million, which is presumably directed to a large extent to commercial financing, due to its indexation to the exchange rate through the unit of commercial credit value.
- ✓ Consequently, it is expected that further upward pressure will be added to the exchange rate as new excess circulation in bolivars resulting from the financing puts pressure on the demand for foreign currency.
- ✓ Reuters informs that PDVSA is presenting quality problems in the delivery of Merey, the most popular variety of its exports among its clients in Asia and Europe. These problems have caused delays in exports, forcing PDVSA to replace scheduled shipments of Merey with other varieties such as Hammock and Leona 24.
- ✓ According to Reuters, India registered 140.9 kb/d of oil imports from Venezuela in August, after not importing in the previous two months. The average of imports from January to August was 210.3 kb/d, 41% less than in the same period last year. India

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has been importing more from Ecuador, Qatar, United Arab Emirates, Kazakhstan, Egypt and the United States.

- ✓ The Thai bitumen company, Tipco, will stop its purchases of Venezuelan oil at the end of November in order to avoid US sanctions, reports Argus Media. 90% of the crude oil supplies for the Kemaman refinery come from Venezuela. It is planned to close Tipco until further notice.

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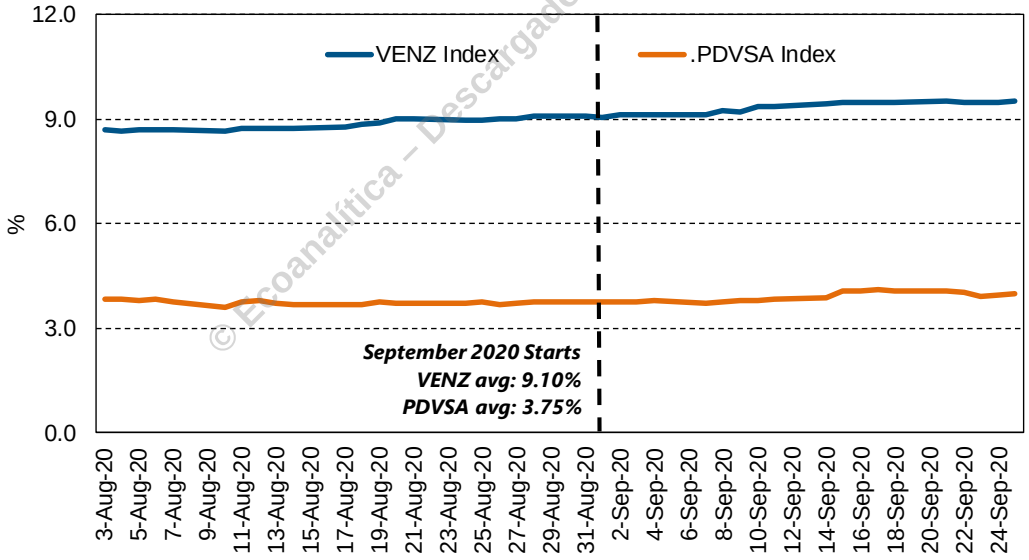
Debt report of Venezuela and PDVSA

By: Knossos Asset Management

After being appointed as Finance Minister on September 10th, Delcy Rodríguez renewed interest in Venezuelan bonds when she debuted in her role revealing a consent solicitation to extend a "prescription period" included in the clauses of Venezuelan, PDVSA and ELECAR bonds. This occurred almost three months before reaching the third anniversary of Venezuelan bonds default next November and seems to be related to some noise from local holders who were worried about losing the chance of taking legal actions to claim payments. The real incentives behind this proposal are unclear and price reaction was weak, monthly return averaged 6.4 percent for sovereign bonds and 8 percent for PDVSA bonds, while they moved from their year lows reached between July and late August.

VENZ/PDVSA bond indexes (Aug – Sep 2020).



Sources: Bloomberg BGN and Knossos Asset Management

The proposal announced by Rodríguez offered bondholders a deal that would suspend statutes of limitation contained in the indentures, but in exchange bondholders would have to agree not to sue Venezuela or PDVSA or ELECAR, and suspend any ongoing litigation. According to Rodriguez, the offer aims to protect bondholders' rights amid the US Government sanctions regime. Investors interested in participating in this offer would

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have to get in contact with the Maduro administration, PDVSA and ELECAR before October 13th.

This "market friendly" approach may be an attempt to persuade investors to reconsider their strategies regarding Venezuelan debt, something that may eventually translate in some political profit for the Maduro administration. However, this poses a risk as this kind of interaction with the Venezuelan government could expose investors to OFAC penalties.

VENZ/PDVSA bond penformance, september 2020

Security	8/31/2020	9/30/2020	Total Return	Total Return (2020 YTD)
VENZ 6 12/09/20	7.60	7.95	+4.61%	-32.34%
VENZ 12 3/4 08/23/22	7.65	8.15	+6.54%	-33.23%
VENZ 9 05/07/23	7.70	8.00	+3.90%	-32.76%
VENZ 8 1/4 10/13/24	7.60	8.10	+6.58%	-32.56%
VENZ 7.65 04/21/25	7.60	8.00	+5.26%	-30.00%
VENZ 11 3/4 10/21/26	7.60	8.20	+7.89%	-31.71%
VENZ 9 1/4 09/15/27	7.65	8.20	+7.19%	-32.67%
VENZ 9 1/4 05/07/28	7.60	8.20	+7.89%	-32.35%
VENZ 11.95 08/05/31	7.65	8.25	+7.84%	-32.29%
VENZ 9 3/8 01/13/34	7.60	8.15	+7.24%	-31.33%
VENZ 7 03/31/38	7.60	8.00	+5.26%	-33.02%
PDVSA 8 1/2 10/27/20	11.60	11.35	-2.16%	-34.66%
PDVSA 9 11/17/21	2.85	3.10	+8.77%	-61.69%
PDVSA 12 3/4 02/17/22	2.85	3.15	+10.53%	-61.04%
PDVSA 6 05/16/24	2.85	3.20	+12.28%	-60.82%
PDVSA 6 11/15/26	2.85	3.10	+8.77%	-61.28%
PDVSA 5 3/8 04/12/27	2.80	3.05	+8.93%	-60.14%
PDVSA 9 3/4 05/17/35	2.85	3.15	+10.53%	-61.68%
PDVSA 5 1/2 04/12/37	2.95	3.10	+5.08%	-60.97%

Sources: Bloomberg CBBT, Knossos Asset Management.

*NOTE: Returns were adjusted to take into account the loss of interest earned after EMTA's resolutions.

Considering that the proposal refers to bonds issued under New York law, it is worth highlighting that there is a six-year period which bondholders have to initiate actions against the Republic for principal or interest pending payment and is independent of the prescription clause cited by Rodríguez.

The prescription clause in the Venezuelan sovereign bonds states that claims in respect of principal and interest will become void unless presentation for payment is made within a period of ten years in the case of principal and three years in the case of interest from

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the Relevant Date, to the extent permitted by applicable law. The focus need to be set in the Relevant Date, that means whichever is the later of (i) the date on which any such payment first becomes due and (ii) if the full amount payable has not been received by the Fiscal Agent on or prior to such due date, the date on which, the full amount having been so received, notice to that effect shall have been given to the Bondholders. This makes it clear that we have not reached the relevant date for the sovereign bonds as no payments have been received by the Fiscal Agent.

Bonds denominated in US dollars issued by PDVSA and ELECAR expressly establish that claims against these issuers for principal or interest pending payment expire six years from the maturity date. The provisions of these bonds are also in accordance with the statutory limitation period under the laws of New York.

It is worth noting that there is consensus among bondholders about the fact that the prescription period has not been extinguished. Furthermore, Cleary Gottlieb, the legal advisor of the Venezuela Creditors Committee, has a similar opinion that was made public on February 5th, when they pointed that given the definition of Relevant Date and in particular because of the use of “the later of" formulation, the purpose of the prescription clause is to establish a limitations period only if the Fiscal Agent is holding funds from the issuer that it has not disbursed (which implicate the responsibility of the Fiscal Agent). The limitations period is not triggered if the issuer fails to cause interest or principal to be paid to the Fiscal Agent (i.e., a traditional payment default). Thus, the New York statutory limitations period of six years still applies.

More interestingly, on September 28th, the interim government also declared trough it official web site, sharing the same opinion as bondholder and Cleary Gottlieb explained above, and stating its willingness to negotiate extensions once the prescription period expires, something they expect to happen not before 2023.

All things considered, we assess the recent developments as positive as Venezuelan debt is back in the market’s radar and the position of the Interim Government on the matter has been made clear. Bondholders may expect a forthcoming Venezuelan government not to raise this issue again, as the likelihood to retract their willingness to cooperate with bondholders on this matter seems low.

Further signs of hope come from the initial call on participation by some opposition leaders in next National Assembly elections that led to the release of a significant number of political prisoners. We view this as a signal of the continuation of negotiations which together with the news coming out of the UN and the now more unified position locally and internationally regarding the elections, implies that we are not in a stalemate and that we could have a positive breakthrough in the medium term.

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acompañando las buenas decisiones

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