EXCHANGE MARKET REPORT

Year 17
February 2021

CONTENT

@ecoanalitica
www.ecoanalitica.com

Av. Blandín, C.C. Mata de Coco, piso 5, oficina 5-E, La Castellana, Caracas, 1060, Venezuela.
(+58 212) 266 9080 / Fax (+58 212) 266 5119 / RIF J-31130403-7

Ecoanalítica
acompañando las buenas decisiones

Foreign currency dry leather

Throughout January, the executive, in conjunction with the Central Bank, established several adjustments to the local financial sector regulations, focused on alleviating the lack of liquidity, in bolivars and dollars, in the local market. First, at the beginning of the year, Nicolás Maduro announced the authorization of foreign currency "convertible" accounts to facilitate the payment of goods and services[1]. Then, on January 19, the BCV published Official Gazette No. 42,050, establishing modifications to the current legal reserve and new credit regulations.

These changes have implications beyond the banking sector, including significant disruptions in the foreign exchange market. In this regard, it is important to highlight the possible effects that these adjustments may have on exchange rate fluctuations and their repercussions on the Venezuelan economy.

The fable of the Government that shouted ¡accounts in dollars!

Convertible accounts

As reviewed in our Weekly Report N°2 of this year[2], official statements regarding the "new"[3] foreign currency deposits of the Venezuelan banking sector seem to point to an offer of deposits payable in bolivars with debit of foreign currency funds. In an environment of scarce local currency liquidity[4], foreign currency funds would be acquired by the BCV, which could lead to a higher issuance of unexpected bolivars. Under the lack of knowledge of future shocks and policies in the Venezuelan economy, such additional local currency resources would be diverted to the purchase of other assets (including foreign currency in cash), putting further pressure on domestic prices while hyperinflation remains.

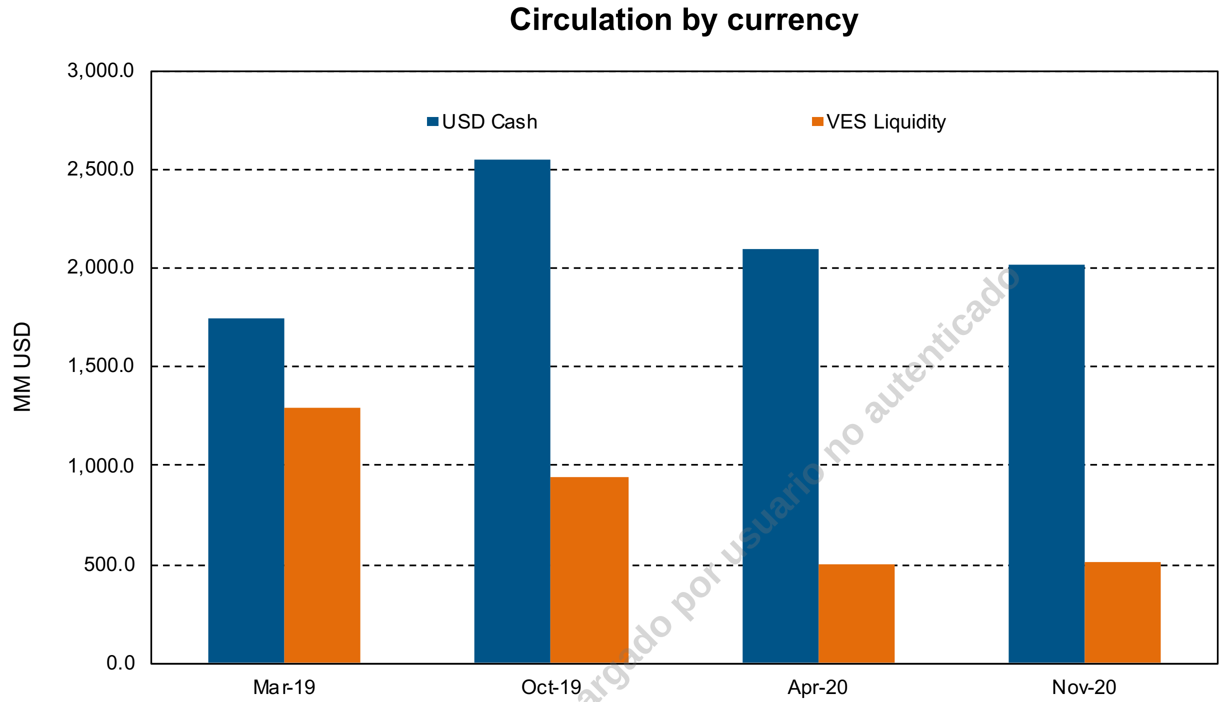
[1] Reuters. (January 1, 2021). *Maduro dice que autoriza cuentas en divisas en banca venezolana*.

[2] Weekly Report N°2, 2021: *New Year, New Life? Foreign currency accounts and their implications*.

[3] Deposits in dollars have been allowed in Venezuela since 2012, and after the Exchange Agreement 20, they have been increasing until reaching 35.0% of total private bank deposits in October 2020. However, transactions with these accounts have been strongly limited since their introduction, allowing their mobilization only with transfers and checks from foreign correspondents.

[4] This seems to be the current reality in Venezuela, where cash dollar liquidity is 3.9 times greater than bolivar liquidity (converted to dollars), as of November 2020.

@ecoanalitica
www.ecoanalitica.com
Av. Blandín, C.C. Mata de Coco, piso 5, oficina 5-E, La Castellana, Caracas, 1060, Venezuela.
(+58 212) 266 9080 / Fax (+58 212) 266 5119 / RIF J-31130403-7



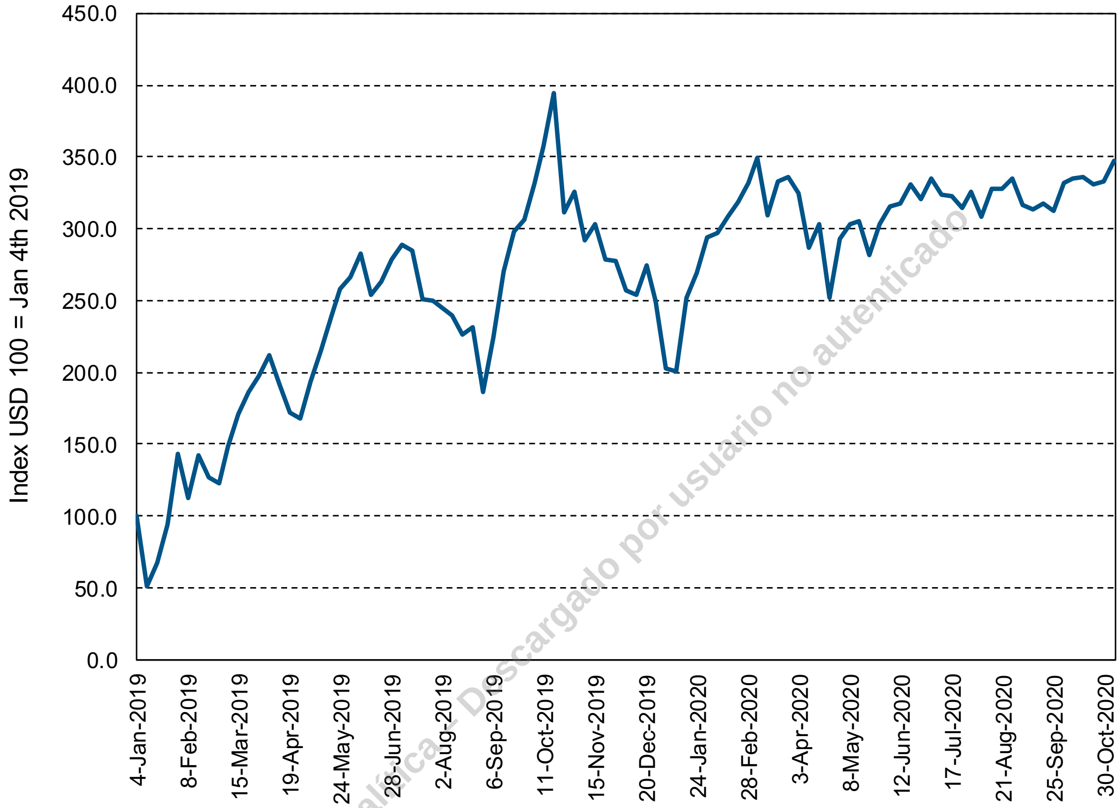
Note: Liquidity (M2) in VES converted to USD using the official exchange rate at month-end..
Sources: Gallup and Ecoanalítica.

The use of these new products will depend on maintaining a competitive official exchange rate on the money tables, attractive to both parties involved in the transaction (which, we assume, are still subject to local currency payments). If this condition is met, and the BCV establishes itself as the main source of compensation for the banking sector for the use of these deposits, higher inflationary pressures would lead to a re-intensification of the real appreciation of the exchange rate[5]. This is because it would establish an environment where the circulation of foreign currency is not affected, facilitating its use through convertible accounts, accompanied by higher monetary issuance, which would probably lead to higher inflation compared to currency depreciation. In this sense, a significant loss of the purchasing power of the dollar in the economy could occur again.

[5] For more details on the real appreciation of the exchange rate and its implications in Venezuela, please refer to the Exchange Rate Report N°9 of 2019: *Appreciate the exchange (rate).*

@ecoanalitica
www.ecoanalitica.com
Av. Blandín, C.C. Mata de Coco, piso 5, oficina 5-E, La Castellana, Caracas, 1060, Venezuela.
(+58 212) 266 9080 / Fax (+58 212) 266 5119 / RIF J-31130403-7

USD required to keep purchasing power



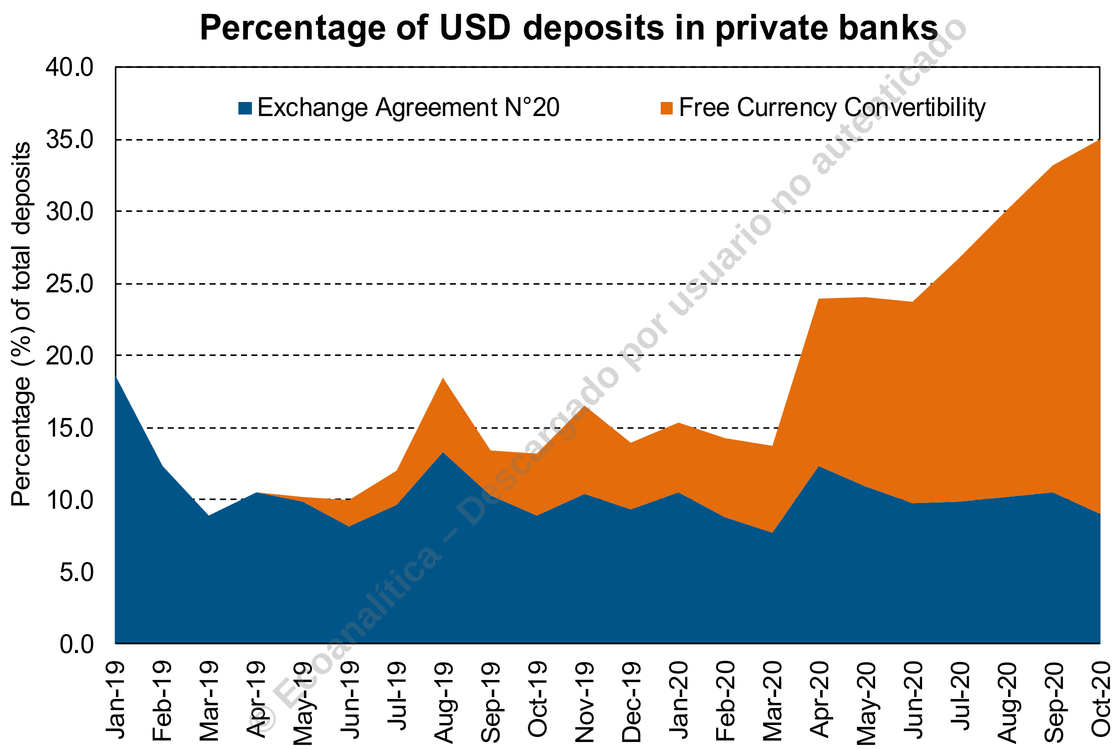
Sources: LocalBitcoin, BCV and Ecoanalítica.

Despite showing a slowdown, during 2020 goods became 34.3% more expensive with respect to the dollar, showing an upward trend practically throughout the year. The dollar has even lost 4.9% of its purchasing power in 2021, up to the week of February 12. In this case, an acceleration of the real appreciation of the exchange rate would have two main repercussions on the Venezuelan economy. First, there would be greater pressures to import goods, as they become cheaper relative to local goods, which would leave local industry with even less capacity to compete. Second, as long as bolivars continue to be used for a non-negligible percentage of transactions, dollar indexation schemes, whether for the payment of inputs, credits or salaries, could become insufficient to prevent the loss of purchasing power, since a larger amount in dollars would be needed to purchase the same amount of goods.

@ecoanalitica
www.ecoanalitica.com
Av. Blandín, C.C. Mata de Coco, piso 5, oficina 5-E, La Castellana, Caracas, 1060, Venezuela.
(+58 212) 266 9080 / Fax (+58 212) 266 5119 / RIF J-31130403-7

From dollars to dollars

Another possibility, although less feasible, is for the Government to allow the opening of deposits where both parties receive foreign currency. The elimination of barriers to this kind of instruments would represent a step forward for financial dollarization in Venezuela, complemented by real dollarization[6].



Sources: Sudeban and Ecoanalítica.

In that sense, specialized literature has not found consensus on the effects that a higher level of financial dollarization may have on foreign exchange markets. On the one hand,

[6] Following the definitions established by Levy-Yeyati (2020), where a distinction is made between financial dollarization, referring to the use of foreign currency as a store of value; and real dollarization, the use of foreign currency as a means of payments and unit of account (i.e., including what is known as transactional dollarization). For more information, review: Levy-Yeyati (2020). *Dolarización y desdolarización financiera en los 2000*. FLAR.

@ecoanalitica
www.ecoanalitica.com
Av. Blandín, C.C. Mata de Coco, piso 5, oficina 5-E, La Castellana, Caracas, 1060, Venezuela.
(+58 212) 266 9080 / Fax (+58 212) 266 5119 / RIF J-31130403-7

McKinnon (1993[7] and 1996[8]), Honohan (2007)[9] and Lay et al. (2012)[10] argue that, as the use of foreign exchange in the financial sector increases, the exchange rate depreciation in the economy accelerates and its volatility increases. This is due to the fact that this period is characterized by an increasing demand for foreign currency, thus increasing the price of foreign currency in the market. For the Venezuelan case, the greater variability of the exchange marker would also come from the impact of higher inflation (associated with the initial rise in the exchange rate) on the demand for foreign currency, suddenly slowing down its price. However, Giovanni and Turtelboom (1992)[11] argue that a higher level of dollarization can reduce exchange rate volatility. As described in the first case, the exchange market could reach such stability once foreign exchange liquidity is able to meet the new demand.

Considering the above, measures that encourage currency substitution in Venezuela could lead to greater volatility in the medium term. Furthermore, as long as the executive does not establish a clear plan to either dollarize or de-dollarize the economy, upward shocks and a high degree of volatility will be present in the Venezuelan foreign exchange market.

Cash flow, credit and (again) higher volatility

In our Weekly Report N°3 of this year[12], we reviewed the new changes in credit. First, the new minimum reserve requirement was reduced to 85.0% (from 93.0%), a measure that seems to indicate a greater willingness on the part of the regulators to offer domestic banks a larger deposit base to boost credit in local currency. Additionally, in the same Gazette, it was established that all loans granted by domestic banks must be expressed under the Commercial Value Unit (UVC), representing in practical terms an indexation of this portfolio to the official exchange rate. In addition to presenting a (half-hearted) step towards real dollarization, the indexation of credits seems to discourage the use of these

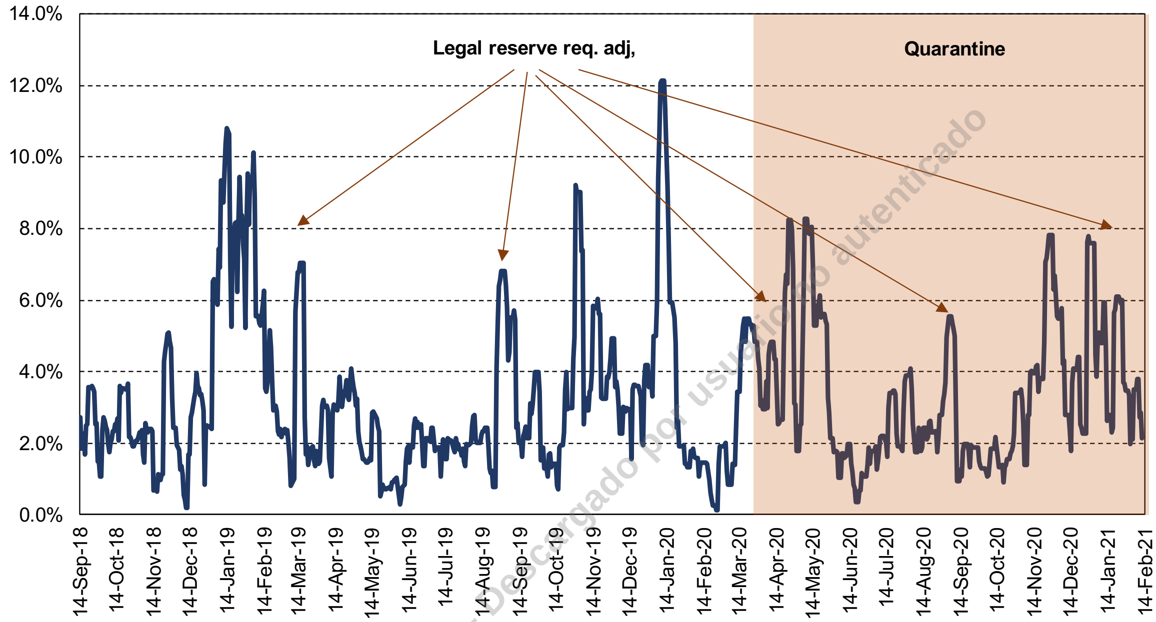
[7] McKinnon, R (1993). *The Rules of the game: International money in historical perspective*. Journal of Economic Literature 31.
[8] McKinnon, R (1996). *Direct and indirect concepts of international currency substitution*. Edward Elgar Publishing
[9] Honohan, P (2007). *Dollarization and exchange rate fluctuations*. World Bank Policy Research Working Paper.
[10] Lay, S., Kakinaka, M. & Kotani, K. (2012). *Exchange rate Movements in a Dollarized Economy. The Case of Cambodia*. ASEAN Economic Bulletin.
[11] Giovanni, A. & Turtelboom, B. (1992). *Currency substitution*. NBER Working paper.
[12] Weekly Report N°3 of 2021: *Bank credit in the spotlight... again*.

@ecoanalitica
www.ecoanalitica.com
Av. Blandín, C.C. Mata de Coco, piso 5, oficina 5-E, La Castellana, Caracas, 1060, Venezuela.
(+58 212) 266 9080 / Fax (+58 212) 266 5119 / RIF J-31130403-7

Ecoanalítica
acompañando las buenas decisiones

instruments for the purchase of foreign currency, thus limiting increases in the exchange rate[13].

Daily ER growth volatility (*)



(*) Measured as 7-day-window standard deviation over daily log-differeced non-official ER
Source: Localbitcoins and Ecoanalítica.

After the announcement, there was a 15.4% increase in the unofficial exchange rate at the end of that week, only three days after the reserve requirement modification was announced. During this period, the price of the currency also showed the usual volatility associated with changes in the Executive's monetary stance, so that agents' expectations regarding the expansion of credit (or the flow of bolívares in general) seem to continue to be linked to a depreciation of the local currency. Thus, it would seem that the Government's measures aimed at reactivating the economy, even when accompanied by containment policies such as indexed credits, entail (as well as dollarization policies) greater volatility, upward exchange rate pressures and, finally, greater hyperinflationary pressures[14].

[13] This seems to be part of the Government's strategy to mitigate inflationary pressures generated by exchange rate fluctuations. A more detailed review of the pass-through effect of the exchange rate to prices and the policies taken in this regard was made in our Exchange Rate Report N°2 of 2020: *From exchange rate to prices: the pass-through effect today*.

[14] In addition, as mentioned in the text, greater hyperinflationary pressures will cause agents to lose purchasing power, limiting their ability to buy foreign currency. This means that an increase in the exchange

@ecoanalitica
www.ecoanalitica.com
Av. Blandín, C.C. Mata de Coco, piso 5, oficina 5-E, La Castellana, Caracas, 1060, Venezuela.
(+58 212) 266 9080 / Fax (+58 212) 266 5119 / RIF J-31130403-7

Dry leather economics: an environment that will remain unstable

The famous "dried leather" analogy serves as a reference to understand the government's regulatory limitations: "you step on it on one side and it rises up on the other". To the extent that central entities establish such policies to alleviate market needs, they also have repercussions in other parts of the economy that may counteract their benefits.

This is mainly due to the fact that they are "half-baked" policies, in which the executive does not clearly state its future intentions, thus fostering uncertainty in the economy. Such level of uncertainty generates that the agents of the economy seek to hedge against the different risks present, generating changes in their demand for foreign currency and other assets, which leads to a high degree of instability in the Venezuelan exchange market. Thus, if the Government fails to establish clear transition schemes, the private sector will continue to expect the worst, with repercussions on the exchange rate and hindering the effectiveness of future policies that respond to the current situation.

Diego Santana Fombona

rate that generates an increase in prices could be followed by a slight appreciation or stagnation in the depreciation of the local currency against the dollar, which would represent greater volatility in the exchange rate environment.

Ecoanalítica
acompañando las buenas decisiones

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

Non-official exchange rate forecasts

Date	Actual value *	Forecast range					
		Low		Medium		High	
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	11,974	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	505,483	115,887	215,215	351,970	**488,724**	525,269	643,814
2020M11	1,034,437	174,338	362,381	528,195	697,768	849,775	**1,001,782**
2020M12	1,072,790	295,285	580,294	**1,128,906**	1,430,167	1,811,823	2,952,848
2021M01	1,724,778	355,685	796,865	1,156,080	**1,515,295**	2,002,887	2,593,191
2021M02		**936,107**	**1,356,411**	**1,776,714**	**2,429,531**	**3,009,805**	**3,744,428**
2021M03		**1,310,571**	**1,626,824**	**1,943,077**	**2,575,584**	**3,527,877**	**4,480,169**
2021M04		**1,343,706**	**1,931,146**	**2,518,586**	**3,693,466**	**6,339,747**	**8,986,027**
2021M05		**1,364,120**	**2,263,942**	**3,163,764**	**4,963,407**	**10,474,171**	**15,984,934**
2021M06		**1,220,772**	**2,431,164**	**3,641,555**	**6,062,339**	**12,698,227**	**19,985,307**
2021M07		**1,006,881**	**2,516,962**	**4,027,044**	**7,047,207**	**15,407,241**	**24,557,389**
2021M08		**969,668**	**3,049,195**	**5,128,721**	**9,287,775**	**21,253,432**	**33,219,089**
2021M09		**866,411**	**3,447,544**	**6,028,676**	**11,190,941**	**28,835,653**	**46,480,365**
2021M10		**785,140**	**4,054,755**	**7,324,370**	**13,863,600**	**40,593,980**	**67,324,359**
2021M11		**848,849**	**5,743,858**	**10,638,867**	**20,428,885**	**68,124,437**	**115,819,989**
2021M12		**666,405**	**5,944,551**	**11,222,697**	**21,778,989**	**82,832,631**	**143,886,273**

Sources: BCV, Ecoanalítica and own calculations.

*End-of-month; otherwise, if indicated.

@ecoanalitica
www.ecoanalitica.com

Av. Blandín, C.C. Mata de Coco, piso 5, oficina 5-E, La Castellana, Caracas, 1060, Venezuela.
(+58 212) 266 9080 / Fax (+58 212) 266 5119 / RIF J-31130403-7

Ecoanalítica
acompañando las buenas decisiones

Foreign Exchange Market Indicators

Exchange rates indicators

Exchange Rate Indicators (VES/USD)			
	Jan-21	m/m (%)	y/y (%)
M2/IR*	103,494.2	13.0	1,334
RER**	2,876,711.1	55.1	2,613
Money desks ***	1,823,627.3	67.4	2,332
WER (Consumers)	1,633,208.7	41.9	2,159

Source: BCV, other Central Banks and Ecoanalítica
* End of month. ** Monthly average (Ecoanalítica). ***Last auction.

Annual exchange rates indicators

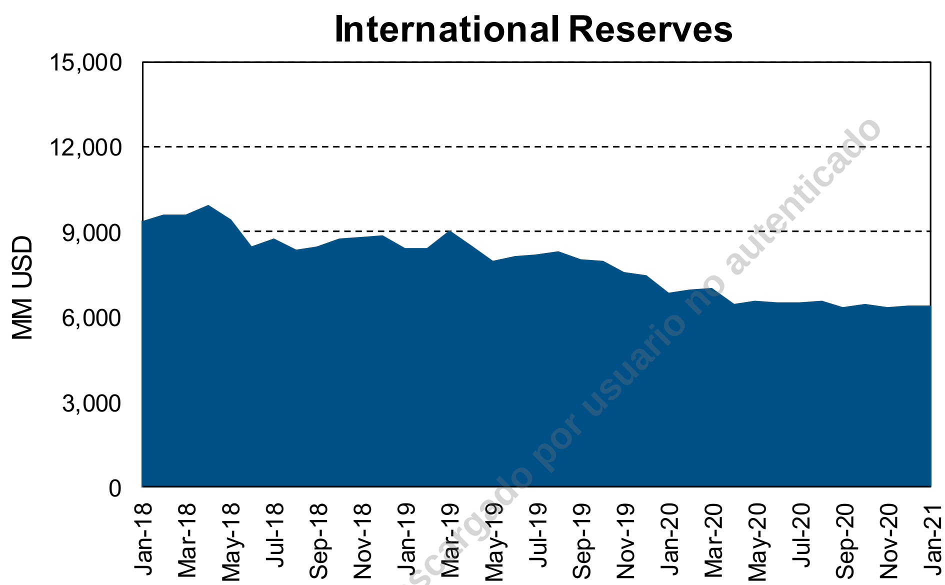
Exchange Rates (VES/USD)					
	2018	2019	2020	Depreciation/ Appreciation	Real Depreciation/ Appreciation
Public Sector ER [1]	70.8	10,584.0	371,303.3	-97.15	-79.99
Imports ER [1]	111.5	10,841.1	377,475.2	-97.13	-79.65
Real ER [2]	3,754.0	151,121.0	1,855,226.8	-91.85	0.00
M2/IR [2]	91.1	4,328.0	91,554.3	-95.27	-95.07

Sources: BCV and Ecoanalítica
[1]Annual average. [2]Year ending.
*Information until November. Additionally, the calculations were made with the National Assembly's inflation.

@ecoanalitica
www.ecoanalitica.com
Av. Blandín, C.C. Mata de Coco, piso 5, oficina 5-E, La Castellana, Caracas, 1060, Venezuela.
(+58 212) 266 9080 / Fax (+58 212) 266 5119 / RIF J-31130403-7

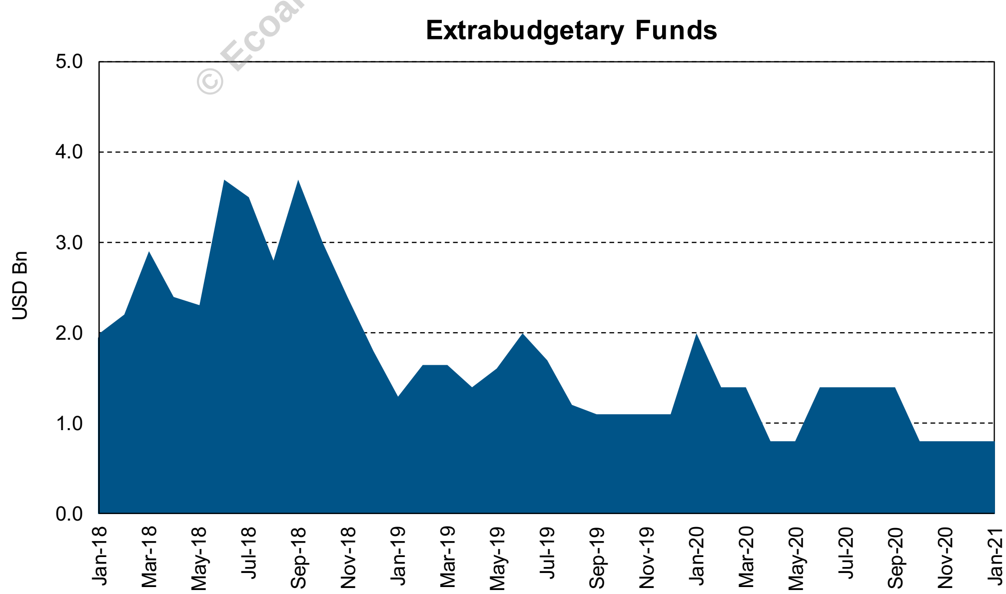
Foreign Currency Availability Indicators

International Reserves



Sources: BCV and Ecoanalítica

Extrabudgetary Funds



Source: Ecoanalítica

@ecoanalitica
www.ecoanalitica.com
Av. Blandín, C.C. Mata de Coco, piso 5, oficina 5-E, La Castellana, Caracas, 1060, Venezuela.
(+58 212) 266 9080 / Fax (+58 212) 266 5119 / RIF J-31130403-7

Non-Financial Debt with the Private Sector

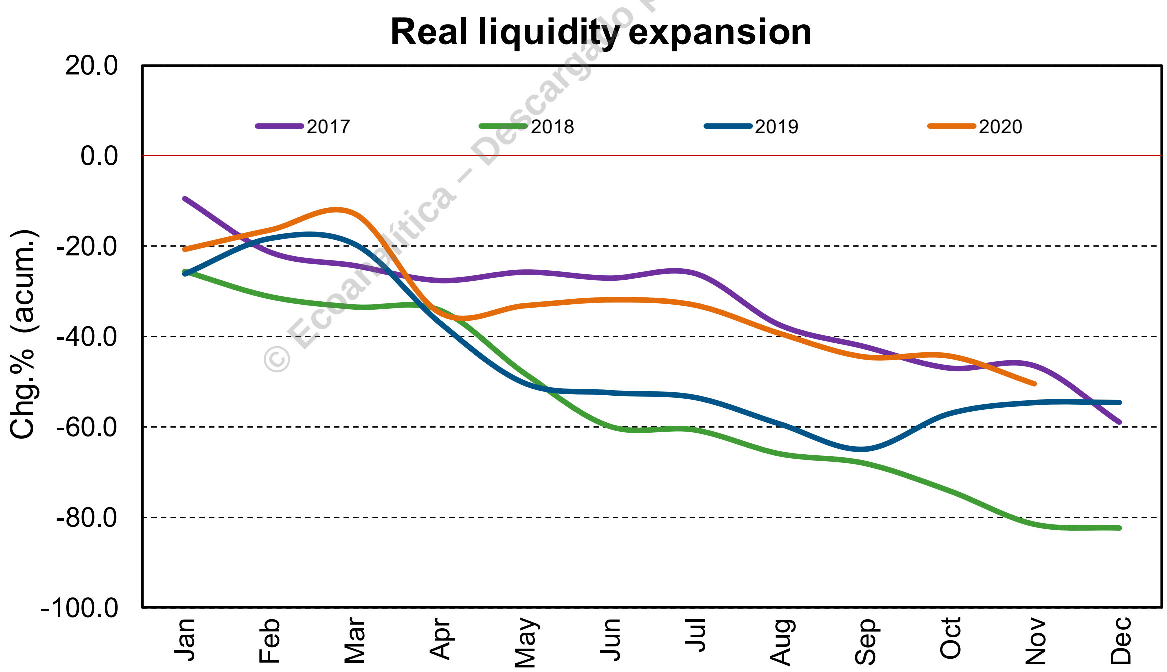
Non-Financial Debt with the Private Sector (USD MM)

	4Q2019	1Q2020	2Q2020	3Q2020	2020	y/y (%)	q/q (%)
CADIVI -Non-settled imports	5.3	5.3	5.3	5.1	5.1	-20.8%	-5.7%
CADIVI -Dividends approved and unpaid	0.2	0.2	0.2	0.2	0.2	-63.0%	-0.5%
CADIVI -Rent and Services*	1.1	1.1	1.1	1.1	1.0	-42.9%	-0.1%
Mixed Companies - PDVSA partners	9.3	9.0	9.0	9.0	9.0	2.5%	2.7%
Total	**15.9**	**15.6**	**15.6**	**15.4**	**15.3**	**-10.6%**	**0.0%**

Source: Ecoanalítica
* Includes debt with airlines.

Monetary Indicators

Liquidity (M2)



Sources: BCV and Ecoanalítica

@ecoanalitica
www.ecoanalitica.com
Av. Blandín, C.C. Mata de Coco, piso 5, oficina 5-E, La Castellana, Caracas, 1060, Venezuela.
(+58 212) 266 9080 / Fax (+58 212) 266 5119 / RIF J-31130403-7

Ecoanalítica
acompañando las buenas decisiones

You should take into account

- ✓ Throughout the national territory, the month of January occurred under a framework of partial and flexible intermittent confinement measures under the "7+7 plus" scheme implemented by the authorities since they began to relax the confinement measures, where the activity of most of the economic sectors was allowed in staggered time bands in most of the weeks of the month in the capital city and the border states.
- ✓ According to four government officials close to Reuters, at least four medium-sized private banks and the Banco del Tesoro have begun issuing debit cards to clients with foreign currency accounts, despite the fact that the Venezuelan Central Bank has officially banned these means of payment for the time being.
- ✓ According to the Venezuelan Finance Observatory of the National Assembly, in January, prices increased 55.2% compared to December and 3,478% compared to January of last year.
- ✓ In detail, the OVF indicated that the items that showed the highest price increases in January were leisure, with 312.7%, restaurants and hotels, with 70.3%, and clothing and footwear, with an increase of 69.8%.
- ✓ In addition, the OVF indicated that the Venezuelan economy contracted 42% in the fourth quarter of 2020 compared to the fourth quarter of 2019.
- ✓ According to the report published on Twitter, the most adversely affected sector was the financial sector, with a year-on-year contraction of 60%, followed by the public sector, which showed a year-on-year decline of 42%, and the oil sector, which had the third largest contraction with 41%, compared to the fourth quarter of 2019.
- ✓ The Venezuelan Central Bank made another intervention in the foreign exchange market last Monday, February 8. The monetary authority placed euros at a rate of VES 2,205,055 on the exchange tables, which generated a decrease of 1.36% in the price of the official dollar.
- ✓ The US Department of Justice is offering up to USD 15 million for information related to the financial mechanism used by Iran to trade crude oil with Venezuela. The U.S. Ambassador to Venezuela, James Story, stated that this transaction would be in violation of the sanctions on Venezuela and are supporting "Iran's terrorist" activities.
- ✓ According to a press release issued on January 28 by Sudeban, banks were prohibited from offering credit instruments in foreign currency. Among the prohibited credit instruments are leasing, invoice discounting, letters of credit, discounts, advances, repurchase agreements, guarantees and any other type of financing or operations.
- ✓ However, the press release establishes that the implementation of these instruments is prohibited as long as the financial entity does not have prior authorization from the Venezuelan Central Bank and Sudeban.

@ecoanalitica
www.ecoanalitica.com
Av. Blandín, C.C. Mata de Coco, piso 5, oficina 5-E, La Castellana, Caracas, 1060, Venezuela.
(+58 212) 266 9080 / Fax (+58 212) 266 5119 / RIF J-31130403-7

Ecoanalítica
acompañando las buenas decisiones

ECOANALÍTICA'S TEAM

Alejandro Grisanti / Director
alejandrog@ecoanalitica.net / @agrisanti
Asdrúbal Oliveros / Director
asdrubalo@ecoanalitica.net / @aroliveros
Pedro Palma / Director
pedrop@ecoanalitica.net / @palmapedroa
Cristina Rodríguez / Director
cristinar@ecoanalitica.net
Luis Arturo Bárcenas / Senior Economist
luisb@ecoanalitica.net / @barcenasluis
Giorgio Cunto Morales / Economist
giorgioc@ecoanalitica.net / @giorgiocunto
Corina Fung / Economist
corinaf@ecoanalitica.net / @corinafung7
Jhoan F. Castellano/ Economist
jhoanc@ecoanalitica.net / @castellanojhoan
Diego Santana Fombona / Economist
diegos@ecoanalitica.net / @diegosantanaf

RESEARCH ASSISTANT
Diego Almau

CONTÁCTENOS
Venezuela:(+58-212) 266 9080/ Fax: (+58-212) 266 5119
Estados Unidos: (+1 212)-994 1850
ventas@ecoanalitica.net
www.ecoanalitica.com
@ecoanalitica