Prospective Report

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THE TIME WE DIDN'T TAKE ADVANTAGE OF… THE CRISIS THAT'S UPON

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Updating 2008-2012 Economic Outlook and introduction to 2013

Ecoanalítica plans the release of four Outlook reports a year with the fourth one being released during the beginning of the month of October. We are continually gathering and analyzing economic conditions and variables with these reports in mind, so months of work and advanced planning goes into each and everyone one of them, and we are constantly updating and revising our information keeping in step with any changes which may occur in our economy and domestic and international markets. The current state of the world economy and financial markets has not only forced us to re-evaluate and update the release of our fourth Outlook Report but it has made us aware that the economic/financial events what we are witnessing and the behavior of world markets are of historic proportions.

In summary, one could say that the international economy situation goes beyond the financial crisis the world is experiencing, since it is a part of more general problems and imbalances that have been accumulating for years. The international economy is going through a financial crisis, high inflation, and an unusual dispersion of growth in the world. The other thing is that this scenario is very uncertain.

So, in essence, this Outlook Report is introducing a crisis scenario for the next few years. The global crisis has produced a drop in demand for energy which will be reflected around the world for the next few months, as OPEC has already recognized, and which will affect Venezuela severely. This drop in demand will cause oil prices to fall. At the moment this report is being written, Brent crude oil is being traded at US$ 60 per barrel, and without attempting to be an alarmist, no one really has any idea how far these prices will drop before they reach bottom.

Another point which is quite uncertain is: how long will this all last? As is the case with most issues concerning the economy, there is no consensus among economists. Optimistic economists think the United States will recover quickly from its current crisis and that the world crisis will not last more than a year; other believe that the crisis and its effects will be last for quite some time.

The projections included in this Outlook Report tend to lean towards the second opinion; they are more pessimistic compared to our previous Outlook scenarios. It's important to point out here that ***Ecoanalítica*** has always been accused of looking at the positive and bright side of the country's macroeconomic performance. On this occasion, market indicators and especially those having to do with oil have led us to establish a scenario that could be categorized as being explosive. Our expected average price for oil for the period between 2009- 2013 is 27.2% lower than what we stated in our previous Outlook Report. This adjustment will significantly impact key variables such as: exchange rate, inflation, economic growth, and fiscal deficit.

Of course, there is a chance that the world economy will correct itself quicker than what we expect here, and therefore, oil prices will bounce back quicker, and all the harmful effects that Venezuela will suffer on account of prices dropping so much will be minimized. There are still a number of analysts that still believe in this course of events, which is reflected by the fact that most of these people have yet to make any significant adjustments in response to oil prices dropping. At ***Ecoanalítica***, we have always been conservative when it comes to such issues, so if prices do bounce back, and adjustment have to be made, the scenario will only improve and adjustments will only make the situation easier to manage. But this type of optimism could be very costly if it's off the mark.

At ***Ecoanalítica***, we point out that between 2009 and 2010, Venezuelans will begin to wakeup from this “illusion of harmony.” The Venezuelan economy faces a drop in oil prices, fiscal policies become counteractive and they will negatively impact economic growth levels. Furthermore, due to the presence of the exchange control which has promoted an extraordinary increase in imports, a balance of payment crisis develops and this forces the Government to dismantle (even though they don’t want to) the exchange control and to significantly devalue the bolivar. Beyond 2010, the country will suffer the consequences of the irresponsible managing of the economy, especially the absence of a savings and stabilization mechanism. The most important thing during this stage is how the Executive Office will answer and what policies they will design to deal with an economic crisis while oil prices remain low, inflation remains high, significant social demands, and a bloated State.

We’d like to point out that it seems that Venezuela is condemned to always remain trapped in a circular never-ending story. We’ve received a very simple, though dangerous, impact from the global crisis in the form of oil prices dropping. The damaging affects that the country is feeling don’t come from having an economy that is overly inserted in international dynamics, with developed financial markets, a dynamic foreign sector, healthy public accounts, among other things. All these lessons have already been learned by most of our neighbors in the region and that’s why they have a bit more latitude and freedom when it comes time to deal with and overcome this crisis. The main economies in Latin America, unlike Venezuela, have leaned from the mistakes made in the past. They’ve learned that they need to have good economic policies; added to the fact that the world has also moved forward and progressed. The advances that have occurred in these countries during the last decade in terms of technology, flexibility, international integration, transparency, and other factors, have made it possible that today the world is better prepared to face adversity.

But in Venezuela, all we can do is to pray… Pray that oil prices don’t fall too much. Pray that we don’t have to pay the full price of a missed opportunity, of the progress that could have been, now vanished… Venezuela doesn’t have a framework of solid economic policies that is able to guide it through troubled times. This is nothing new.

Gross Domestic Product. The end of the party is closer than ever

During the last consecutive 19 quarters, the Venezuelan GDP has increased at an average rate of 11.2%, making it one of the most developing economies in Latin America during the last few years. Recent high oil prices on the international markets along with the restrictions created by the exchange control have made oil the only sources of revenue fueling the Venezuela's economic growth.

This led to significant increases in oil revenues, which in turn led to increases in public spending, which fueled an increase in consumption of domestic goods and services, most of which were supplied by a substantial increase in imports, which were favored with a fixed exchange rate and a domestic production apparatus with very limited capacity.

With the event of the global economic crisis, Government representatives have taken pride in the fact that Venezuela would not be affected by its impact. Analysts in general agree with the fact that not only Venezuela, but the Region, has achieved a certain degree of autonomy with respect to the international financial markets, which is better known as "monetary decoupling."

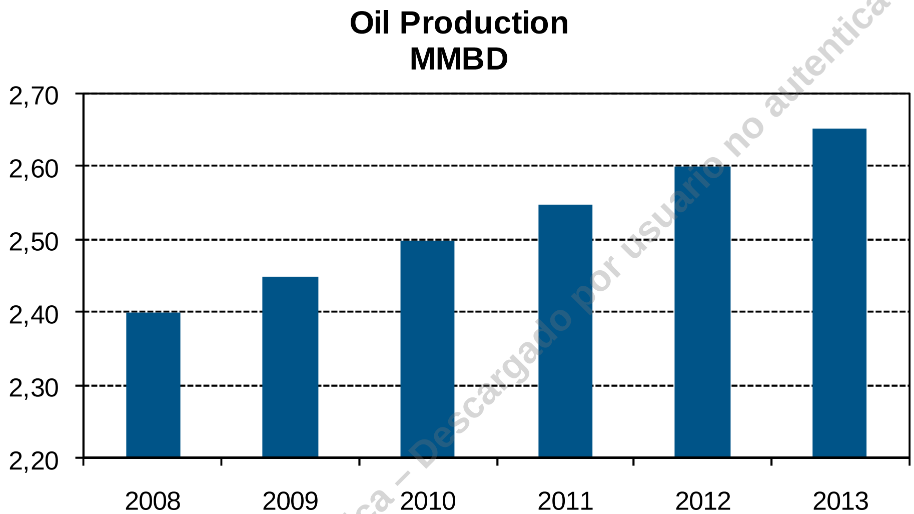
However, this is not completely accurate if you analyze the other side of the real sector, and as we will see, Venezuela is a classic example of this. Many of these so-called financially "decoupled" countries didn't take advantage of the global boom to transition out of being mono-exporters, relaying solely on raw material exports; they preferred to continue being in the comfortable position of being simply rentier nations. Now the effects of the crisis are beginning to be felt as the world economy slows down and commodity prices begin to fall.

The last world outlook report released by the International Monetary Fund (IMF) forecasted a significant slowdown in the U.S. economy which GDP is only expected to grow by just 0.8% during the coming year, while the rest of the industrialized economies are expected to grow by a mere 0.2% during the same period. It's obvious, and by now, everyone in the market agrees, that one of the most important consequences of this crisis has been the worldwide drop in demand for energy and the subsequent drop in oil prices.

This environment will not cause any new problems for what's left of the year, so we expect the economy to close out the year with a positive growth level, though less than previous years, at 6.1%.

At ***Ecoanalítica***, we believe that if PDVSA, with all the resources it has been taking in during these last few years when prices have soared to historic high levels, was unwilling to implement an investment plan to expand oil production capacity, then there is no reason to expect that it will make the attempt to do so when prices are low.

So, in 2009, PDVSA will most likely invest the minimum amount of resources required to at least stop production from continuing to drop and try to maintain current production levels, which we estimate to be around 2.4 million b/d; for the following years after that (at least up until 2013), we don't expect any significant increases in oil production. In fact, the Government, which up until recently had been saying that it had set a goal to increase production to 5.2 million b/d by 2012, has now changed the date to 2021.



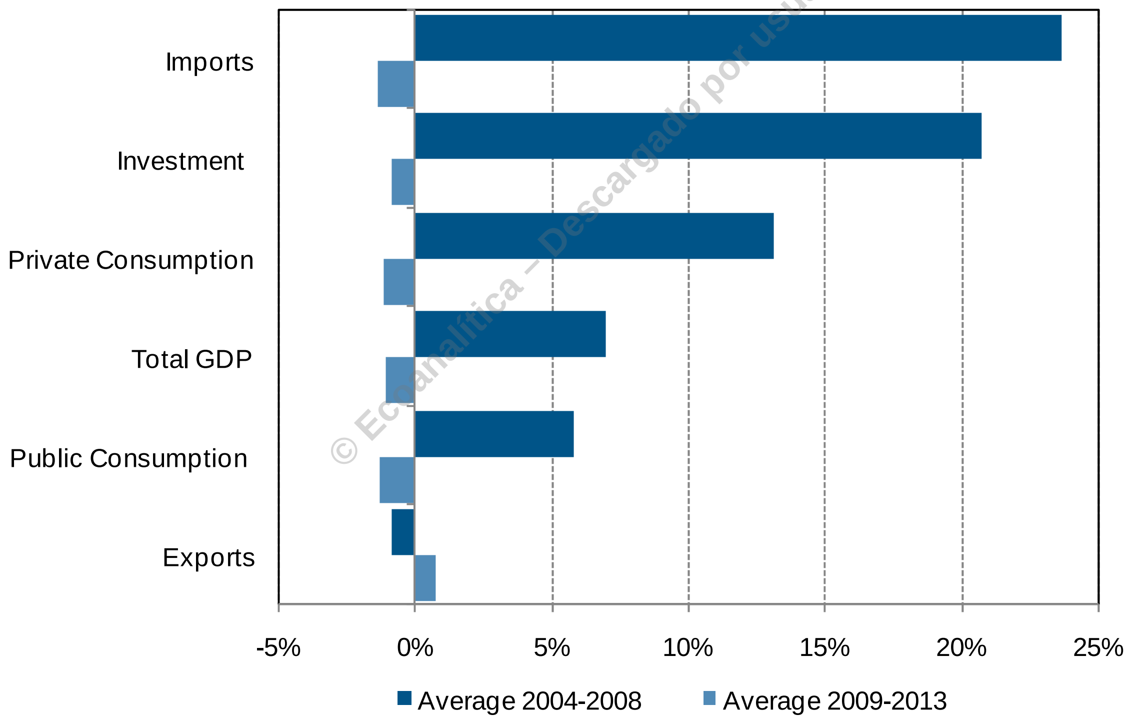
Source: Ecoanalítica

Despite the high oil prices, during the last two years, the oil sector has been shrinking by a yearly average of 5.1%, in sharp contrast to the 11.1% growth level of the non-oil sector during the same period. As of the first quarter of 2008, the oil sector has bounced back and we estimate that it will grow at a rate of 3.6% by the close of this year, while the non-oil sector will expand by 6.5%. This will reflect a global growth rate of 6.1% by the close of 2008.

However, by next year, the makeup of our economic growth will look quite differently and it will demonstrate how valid the term "Dutch Sickness" still is. We expect that the economies growth rate for 2009 will with difficulty reach 0.6%, spearheaded mainly by oil activity (with a 2.5% growth rate) and which will to a certain degree compensate for the significant slowdown of the rest of the economy which will only grow by an average 0.3% during the same year. The drop in revenue will force the Government to be much more careful with how it uses foreign currency and this will make CADIVI much more strict and selective when it comes to liquidating its foreign currency. This will generate a drastic drop in imports which will lead to more severe shortages of essential goods in the market given that up until now the gap between domestic supply and demand has been covered by imports.

A lack of dynamism in the oil sector is the key to forecast a shrinking of the non-oil sector in the coming quarters. Plus, given the institutional reclassification that the Government has been carrying out through the nationalization process, the progress of the non-oil sector will also be negatively impacted due to the increased presence of the public sector in non-oil sector economic activity. So, in 2010, the non-oil sector will contract by around 5.5%, while the oil GDP will remain relatively stable growing by 2.0%. Imports will of course continue to drop, as will investment and public and private consumption.

GDP growth by components



Sources: BCV and Ecoanalítica

As we have already pointed out, there are those who believe that the current crisis will bring with it a temporal “suppression” of the demand for energy and not a “destruction” of the demand. In other words, means that the structural situation of the oil market, in terms of its effective supply and demand levels, will only be altered as long as the crisis lasts, so a rebound in oil prices can be expected as the market begins to recuperate. However, at ***Ecoanalítica***, we believe that even if this scenario were to occur, by the time that it does happen, it will already be too late for Venezuela; the oil industry will have significantly weakened and the distortions that have been plaguing the local economy (inflation, fiscal and foreign sector imbalances) will have become too severe.

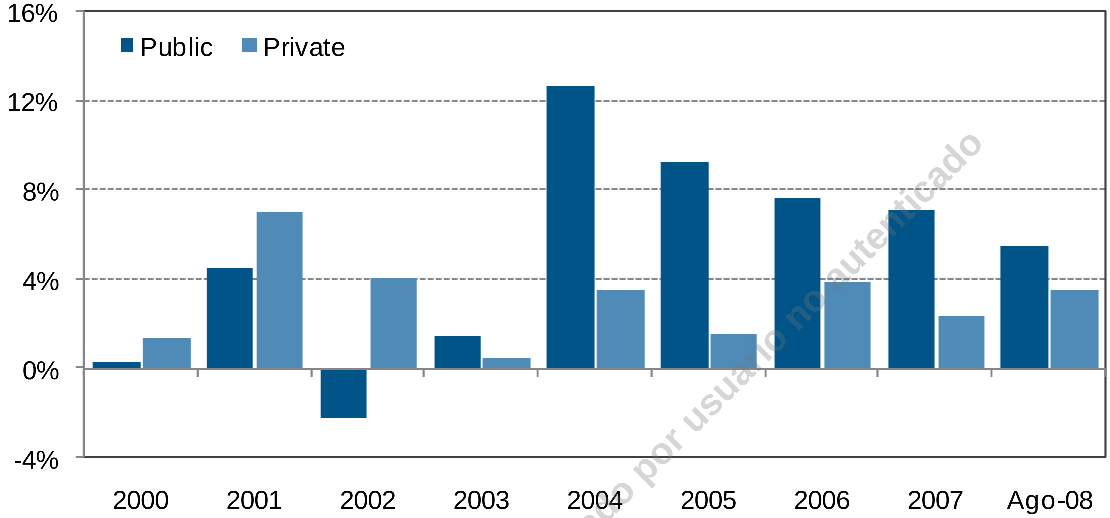
On a number of occasions we have said that sustainable economic growth was only possible through the strengthening of our foreign sector, in other words, becoming more competitive and increasing investment in fiscal capital such as human capital, paying special attention to the oil sector. But when we had the chance to do so, we didn't improve production levels; we didn't diversify our product base and export markets; nor did we lower production costs. PDVSA turned a blind eye to all these important aspects, the exchange control contributed to weakening our competitiveness, and there is no doubt that the current international crisis accelerated the end of the party.

Jobs and salaries. The public sector load increase and inflation continues to be out of control

During the last few years the labor market has been marked by a few peculiar traits. On the one hand, the expanding number of Ministries and other public institutions, plus the Government's determination to nationalize a good part of the productive sector, has all translated to a significant increase in the public sector payroll.

According to the figures released in the National Statistics Institute's (INE) monthly report for the month of August 2008, the number of people working in the public sector increased to 2.07 million. This is equivalent to 17.6% of the working population, and these numbers have been growing at a 53% average yearly rate compared to August 1999, when the number of people working in the public sector equaled 15.5% of the total working population. Meanwhile, the number of people working in the private sector shrank at a slower rate (31%) during the last nine years and in August 2008 settled at 9.7 million, or 82.4% of the total working population. Starting from next year, this tendency will become more pronounced given that there are a number of companies that are in the middle of the nationalization process, not yet completely absorbed by the State, such as: the Banco de Venezuela and the companies belonging to the cement sector.

Private and Public Employment
Annual Variation

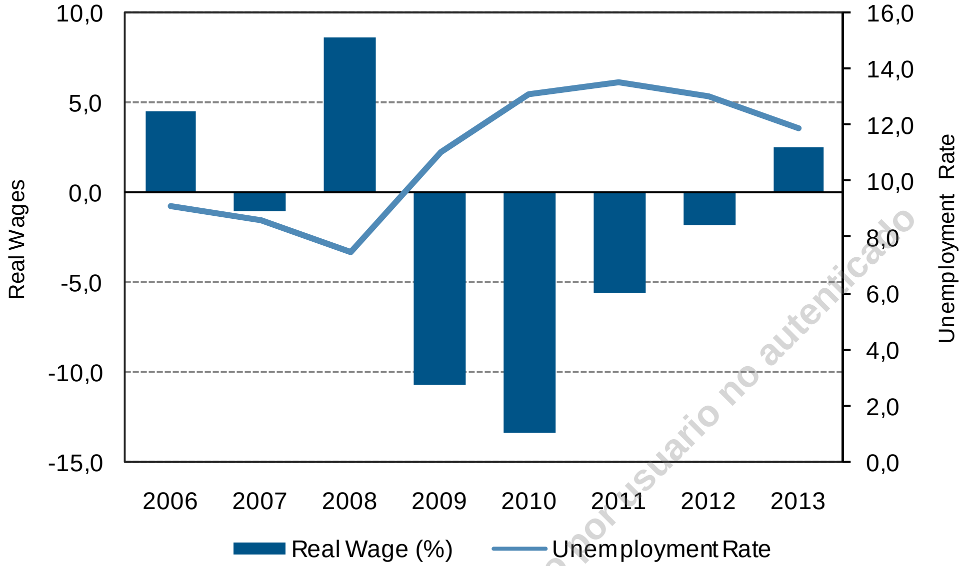


Sources: INE and Ecoanalítica

On the other hand, the unemployment rate has been steadily dropping during the last few years. Some of this is due to economic growth, of course; but some of it is simply due to underestimating the figures which has been made possible thanks to changes made to the methodology used to calculate unemployment introduced by the INE. These changes mainly have to do with inclusion of people in the education Missions, and categorizing them as “inactive” and not “unemployed” thereby artificially lowering unemployment figures. But despite the manipulation of the unemployment figures, we are sure that during the economic boom that Venezuela has just been in, the creation of new jobs must have been high.

Furthermore, the increase in public employees is not a result of real public sector needs or production levels and this has contributed to the perception that government employee salaries are much higher than private sector salaries. But the expected increase in the level of prices in the economy will play an important role in lowering the real value of those salaries, public as well as private. This in turn may translate to greater discontent among the population and an increase in labor conflicts.

Real Wages and Unemployment



Sources: INE and Ecoanalítica

At ***Ecoanalítica***, we predict that unemployment, which could close out the year at 8.7%, could increase significantly in 2009 as a consequence of the economic crisis scenario that we have described. Therefore, we estimate that unemployment will be around 11.0% in 2009, and will average around 12.9% in the following years. But independently of what the unemployment rate may be at the end of the year or in the coming years, the main problems that affect the domestic labor market (weak institutions, political uncertainty, legal insecurity, and now the slowdown of the economy) will continue to exist and become much worse.

Exchange policy. The time has come to adjust the exchange rate and the exchange control can't last much longer

During the last quarter of the year, it's always been a tradition in Venezuela to begin to talk about the devaluation of the currency. The talk usually gets started around the middle of October which is when the Executive Office introduces its draft for the National Budget Law for the coming year. This year, the talk is more heated than ever given the current crisis in the international finance markets, the immanent recession facing the U.S. economy, and the sustained drop in oil prices.

After four years now, with the official exchange rate fixed at Bs.F 2.15/US-dollar; one wonders if the Government is finally considering devaluing the official exchange rate. In principle, one would have to answer no by looking at the 2009 Budget Law which continued to establish the official exchange rate as Bs.F 2.15/US-dollar.

The exchange rate issue is a very complicated because it has ceased to be an instrument used for economic polices and become a strictly "political" instrument. There is much that can be said about this subject, but the fact of the matter is that the distortions produced by the controlled exchange rate have become much more severe due to the Government's inefficiency and clumsiness in managing the situation.

Our initial scenario with respect to 2009 was that it was going to be more of the "same old same old" with CADIVI being much more selective when it came to authorizing foreign currency. At ***Ecoanalítica***, we believed that the Government was going to instruct CADIVI to grant foreign currency for the so-called priority goods which all fall into three categories: food, medications, and capital goods for industry. At the same time, in order to avoid significant distortions, the Ministry of Finance would carry out sporadic issues of bonds in US-dollars payable in bolivars, and/or debt operations with other countries.

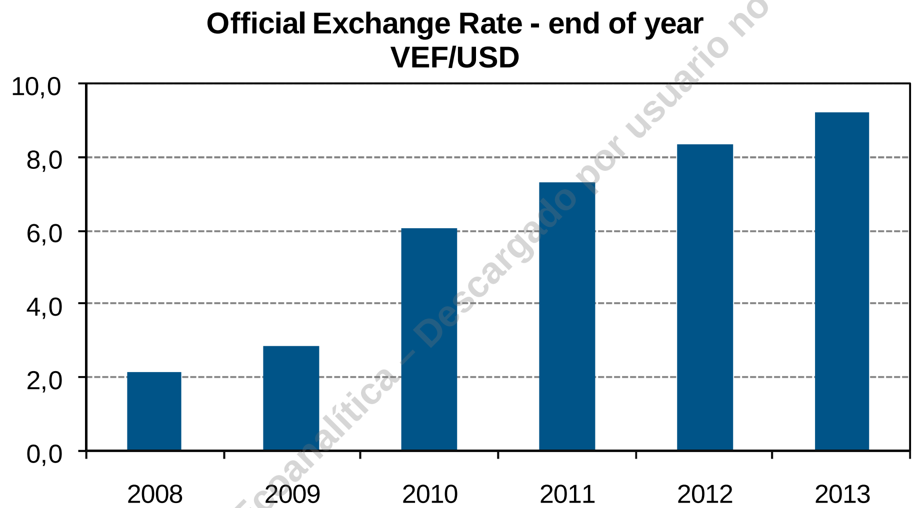
This scenario is what we have been calling the "politically correct devaluation" and it's based on the fact that the Government is not really in any immanent fiscal danger, with plenty of extraordinary resources to back it up.

The financial crisis in the United States and the repercussions it's having all around the world has introduced significant changes regarding our economic projections for the Venezuelan economy for the coming year. Given the severe distortions created by the exchange control, it is becoming very expensive for the country and the only way it can remain in place is for oil prices to continually be increasing in order to be able to cover the ever increasing demand for US-dollars for imports. But, in the medium term, there is no indication that oil prices will bounce back, in fact, it's more likely that they will continue to fall or stabilize where they are now.

So, the Government will be tempted to devalue the currency in order to adjust fiscal accounts. An exchange rate adjustment is the quickest answer to controlling increasing imports and to postpone a balance of payment crisis, in the near future. In other words, the exchange rate adjustment expected in the coming year doesn't have so much to do with fiscal accounts as it does a with rationing the use of foreign currency.

But, as we will see in the fiscal policy section, a devaluation will generate additional fiscal resources for the State.

The new exchange rate will remain in place during all of 2009, with another adjustment expected during the first quarter of 2010. These adjustments to the official exchange rate are replicas of what was done in 1989 and again in 1996, and these produced the highest inflation rates ever seen in the history of Venezuela, impoverishing the people across the board. It's sad that a country has to make the same mistakes over and over again, a mistake that so devastated the population in general and the poor even more.



Sources: INE and Ecoanalítica

Regarding what we have just presented here we'd like to add two things. First, if a devaluation of the exchange rate were to happen, it would totally happen at the Government's discretion. Second, for the volatility that Venezuela usually suffers, mainly reflected by its exchange rate, it doesn't seem to us to be a very relevant debate to talk about whether the devaluation will be for 35% for all of 2009 or if the Administration will decide to continue to freeze the exchange rate until 2010. The only difference between these two scenarios is that in 2010, the distortions produced by the exchange controls will be much worse and the need for a devaluation much more urgent.

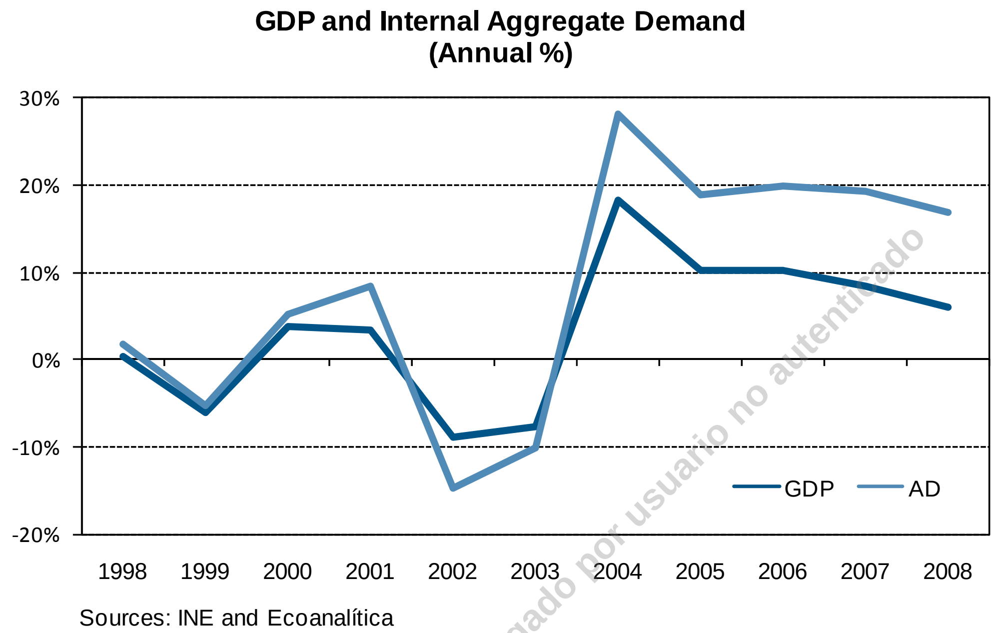
By not devaluation the official market, it does not necessarily mean that the unofficial market will be less volatile. During the last semester of the year, the unofficial market will probably be under a lot of pressure. Where the unofficial market will close at by the end of the year will mainly depend on the role that PDVSA may play, given that the international scenario won't allow the Administration to continue with debt operations with other Latin American countries (Argentina) or issue new Venezuelan debt. So, it should be clear to our clients that coverage strategies are more important than ever now.

Inflation. The only thing left that is "Strong" is the name

On January 1, 2009, it will be one year since the monetary conversion plan was implemented. The Economic Cabinet spent most of 2007 telling us how a simple change of currency would help us control the inflation that has plagued Venezuelans for so long. The Government assured us that by whittling away three zeros, prices would stop increasing and they insisted that they would achieve their 12% inflation goal for the close of 2008. It didn't take too long for this goal to be adjusted to 19% and then finally adjusted to 27%. And the Government is still going to be unable to achieve this goal. Accumulated inflation up until the month of September is at XX%, which leads us to estimate that inflation will close out the year at 30.2%.

The Government tried to combine the monetary conversion plan with a series of measures aimed at controlling the growth of monetary aggregates. Among these measures were the issuing of International Bonds in may, the modification of National Treasury Office payment scheme, making the payment of certain government contractors in US-dollars, and the transfer of public funds from private banking institutes to public banking institutes. As we have mentioned before, liquidity did drop significantly, but the ever increasing trend prices had been reflecting continued.

The problem with inflation has become so persistent that it has led certain members of the Government to propose creative methods of fighting it. These methods include everything from haggling more to boycotting (refusing to buy) from shops that are inflating the price of goods. These measures clearly show the lack of understanding by policymakers concerning inflation in Venezuela, and the structural nature of the problem, and that its roots, as our clients already know, are found in the gap that exist between the domestic demand for goods and services and the limited supply available.

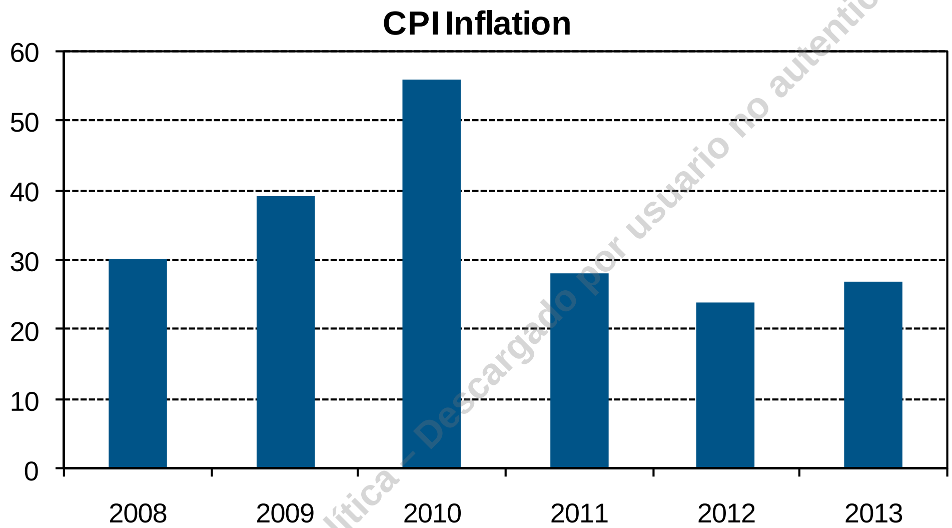


During the next few years, one could expect the Government to cling to its price control policies. At ***Ecoanalítica***, we have already pointed out how harmful these controls are given that most of the time regulated prices don't even cover production costs, which leads to a drop in supply of the product in the market. So, it's a vicious circle with price controls only making the problem worse and in no way doing anything to help control inflation. A coherent anti-inflationary policy would require a complete redesigning of control mechanisms, since this Administration has no intention of dismantling them, they should establish a system whereby they are permanently being revised.

It's also quite clear that the devaluation that is expected during the beginning of 2009 will have a direct and immediate effect on prices by increasing the cost of importing and producing goods. So, due to the absence of policies that try to make domestic production more compatible with demand, we can only expect that in 2009 inflation will be worse than it is this year and that it will close that year out at 39.2% (no where near the Government's goal of 15% established in the 2009 Budget).

The situation won't get any better in the years after that. The history of price controls in Venezuela shows that once the control is dismantled, the official exchange rate falls in line with the market or parallel exchange rate. This effect is known as "overshooting" or over reaction of the exchange rate and its effect on inflation is all-encompassing and practically immediate. To get an idea of what we are talking about, remember that when the previous exchange control (OTAC) was dismantled, the yearly inflation rate went above 103%. Along these lines, the maximum devaluation in 2010 will be such that it could generate inflation around 55.8%.

This over-shooting effect will correct itself during the year and inflation will drop in the years after, though not any less worrying that it is now.



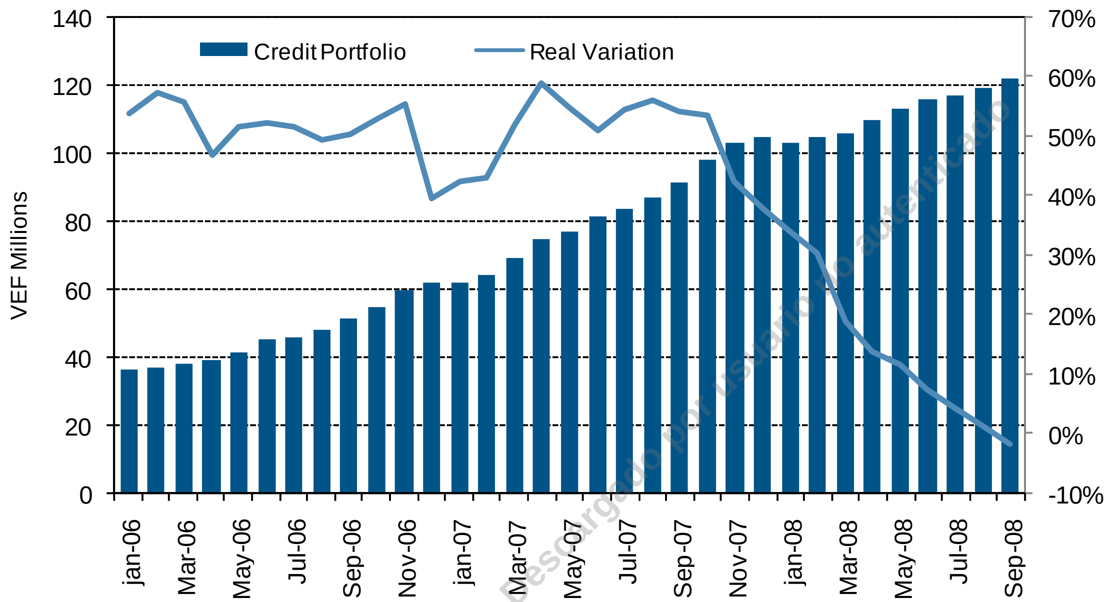
Sources: INE y Ecoanalítica

Interest rates and monetary policy. Pressure on rates and less growth in monetary aggregates

So far this year, the Central Bank of Venezuela (BCV) has been applying a restrictive monetary policy in an attempt to control inflationary pressures. The BCV has been practically alone in this battle. This is reflected in the increase of monetary liquidity (M2) which has accumulated a nominal increase of 9.6% so far this year but a real contraction of 5.7%. Implementing these policies has brought with it an increase in interest rates. The average lending rate so far this year is at XX%, XX basic points over what it was a year ago.

Financial system figures have also been impacted by these policies, mainly affecting loan portfolio growth, which continue to show signs of slowing down. While it still show a real growth rate of 1.6% this year, in 2007 the growth rate was at 38%, and in 2006 it was at 40%.

Credit Portfolio of the Financial System



Sources: INE and Ecoanalítica

In 2009, in a scenario which points to fiscal cutbacks, which is reinforced by the premises included in the 2009 Budget Law, we expect that monetary policies will continue to be implemented as they have been. We expect nominal M2 growth for next year to be at 23.7%. With regard to interest rates, we see much the same scenario as what has occurred in 2008. In an environment where economic growth will be slowing down we don't anticipate that the interest rate ceiling established by the BCV will be modified and we don't rule out that they may be lowered.

Starting in 2010, given the scenario which sees the exchange control dismantled, interest rates will be pressured to increase due to the macroeconomic adjustment. This year will see the average lending interest rate settle at around 30.9%. In this context of prelude to a crisis, it's important that our clients, starting next year, pay very close attention to their debt in bolivars and how exposed they are because of it.

With respect to savings interest rates, and despite their expected increase, if inflation maintains its current levels, deposits should feel any difference. In fact, for every Bs.F

100 placed in a time deposit you loose around 10.4% in purchasing power assuming that inflation remains at 30.0%. At ***Ecoanalítica***, we believe that the BCV should continue with its efforts obtain positive real interest rate levels in order to take pressure off the demand for foreign currency and stimulate domestic savings.

Balance of payment. Foreign sector imbalances begin to appear

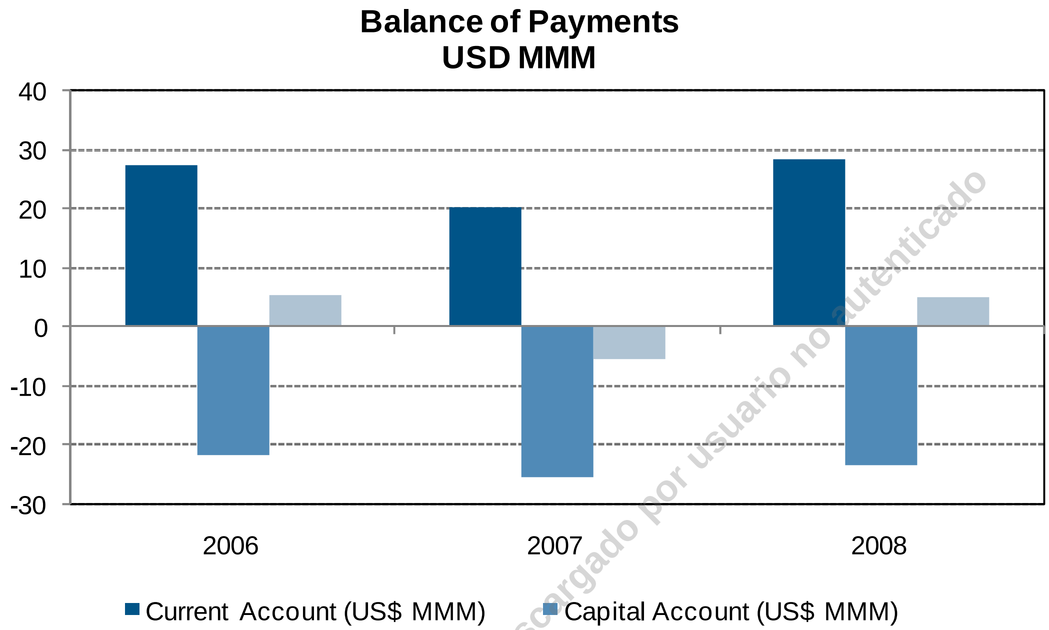
The first semester balance of payment figures released by the BCV point out some important elements. Foreign accounts for the first semester of 2008 reflect a surplus in the current account equivalent to US$ 26.55 billion which is 193% more than it was during the same period in 2007. This important trade surplus is due to the 78% increase registered in oil exports which were at US$ 48.47 billion, countered by the 7% drop in non-oil sector exports.

It's no secret that the significant increase in oil exports is mainly due to the historically high oil prices recorded during this period, in fact, the Venezuelan oil basket increased by 80% during said period compared to the first semester of 2007. The BCV also recognizes a slight increase in export production (3.2%) during the first semester 2008.

Even though imports increased by 13% during the first semester of 2008, the rate at which imports increased dropped compared to previous periods (31% during the first semester 2006 and 37% during the first semester of 2007). This is a result of the many restrictions imposed by the Government through CADIVI since the beginning of the year having to do with the authorization of official exchange rate foreign currency.

The capital account deficit reflected an increase of 26% during the first half of the year, spearheaded mainly by capital transactions made by the public sector. However, thanks to the significant amount of surplus in the current account, the global tally for the balance of payment was a slight deficit of US$ 924 million, 93% less than what it was during the first semester 2007.

Given the behavior of oil prices during this last quarter, ***Ecoanalítica*** expects that the final average price for a barrel of Venezuelan crude oil at the close of the year will be at US$ 92 per barrel. This means that revenue taken in due to oil exports will be at US$ 79.50 billion and non-oil exports at US$ 7.50 billion which alongside the total we estimate was spent on imports US$ 52.80 billion would leave a trade surplus of US$ 34.20 billion. Despite the US$ 23.60 billion deficit that we estimate will be reflected by the capital account, high oil prices have allowed us to obtain a global surplus of US$ 4.60 billion in the balance of payment account.



Sources: INE and Ecoanalítica

As we have already stated our estimate of the price of the Venezuelan oil basket for 2009 is US$ 48 per barrel, considerably less than what we had previously estimated. However, at Ecoanalítica, we have always pointed out that we prefer to be conservative in our estimate of prices, and in this way guarantee that any increase in price will translate into better results in foreign sector accounts.

Keeping this in mind, we expect that oil exports in 2009 will close at US$ 44.30 billion while imports are expected to be at US$ 42.50 billion. If we fix non-oil exports at US$ 6.0 billion, that would give a surplus of US$ 7.80 billion in the current account of the balance of payment. Assuming that foreign capital transactions will lead to a deficit of US$ 14.90 billion in the capital account, 2009 will close with a balance of payment deficit of US$ 12.90 billion. This deficit isn't higher because the public sector will have begun to draw on the US-dollars it has in different funds abroad.

It's important to point out that for the coming year we estimate that CADIVI will implement important controls on the increase of imports, which added to the negative effect the devaluation will have, will lead to a significant drop in this sector. Up until now, the Administration has made it known that it is considering establishing import quotas for the different productive sectors, duplicating the model implemented on the automotive sector this year (it's important to point out any action taken like this will put more pressure on the parallel foreign currency market). This policy will cause a slowdown in the economy and create severe bottlenecks in demand pushing prices higher.

With the price of oil at US$ 48 per barrel, which would imply a deficit in the balance of payments (which would represent a drop in international reserves), the situation becomes much more difficult, especially during the last quarter of the year.

Balance of Payments
US$ MMM

	2008	2009	2010	2011	2012	2013
Current Account	28,3	2,0	21,1	14,4	15,4	16,5
Balance of Trade	34,2	7,8	25,8	20,4	20,5	20,7
Exports	87,0	50,3	60,0	59,0	64,0	66,2
Imports	(52,8)	(42,5)	(34,2)	(38,6)	(43,5)	(45,5)
Capital Account (US$ MMM)	(23,6)	(14,9)	(19,2)	(12,4)	(12,9)	(13,0)
International Reserves (Var)	4,7	(12,9)	1,9	2,0	2,5	3,5

Sources: BCV and Ecoanalítica

In 2010, the exchange control begins to take in water; the resources that the Government had been able to squirrel away in foreign accounts have been used; so, during the first quarter of the year, the Government will proceed to dismantle the exchange control leading to a significant devaluation of the official exchange rate. The devaluation will be around 110.3%. This year, the current account will have a surplus of 9.0 points of GDP due to the significant drop in imports. The capital account deficit will be at US$ 19.20 billion.

Fiscal Policy. The Administration breaks the piggybank and gets ready for an adjustment

In general, during Chávez' Administration, the Government's fiscal policies have been characterized by levels of public spending that are higher than the fiscal revenue coming in. In other words, being more dependent on oil revenue which increases the vulnerability of fiscal management, leaving it at the mercy of the volatility of the international oil market, as well as increasing the opacity in the management of fiscal accounts, which only makes it even more difficult to analyze and study.

However, at ***Ecoanalítica***, we have always believed that the Government is very pragmatic when it comes time to set down its fiscal policies given that it adjusts to the circumstances facing it, increasing or cutting back in public spending depending on how oil revenues are doing. But, the problem with this strategy which we have at times called the “shopkeeper strategy” is that public spending becomes less and less flexible and unable to adjust to cutbacks in revenue, making its adjustment for future period of low revenue more complicated.

So, the economic panorama that we have describes based on lower fiscal revenue and distortions becoming exacerbated, unavoidable will require a change in paradigm with regard to fiscal spending with an adjustment which severity may vary depending on how the Government decides to handle each one of the elements involved.

One of the least transparent factors one has to evaluate when it comes time to analyze the sustainability of fiscal management in 2009 and the years that follow are the extraordinary resources that the State, thanks to high oil prices, has been able to squirrel away in a number of funds abroad. But, given the lack of transparency in the management of these funds, it has all become a very polemic issue. The fact is that these resources, which ***Ecoanalítica*** estimates to be around US$ 53.70 billion, are now of vital importance in mitigating the effects of the crisis that the country is facing.

It’s important to point out that not all these resources will be able to be used to help the Government meet its obligations. The resources are all in different degrees of liquidity; a lot of it is in bolivars, so to convert this into US-dollars would mean a drop in international reserves; some of what is in foreign currency is already earmarked for different projects (though we don’t rule out that the destination of these resources may be modified). Furthermore, almost 30% of the funds are invested in different types of titles (Sovereign bonds, Risk funds, Structured notes, and others), and even though we may not be sure which kind they may be, we do know that all their prices have bottomed out. Some of these instruments are even considered “toxic” or of poor credit quality.

Government Resources	Sept-08 (US$ MMM)
Cash	***38,3***
In VEF	**29,1**
BANDES	1,6
BDT	0,7
Deposits in the financial system	17,3
Fondo Miranda	0,1
National Treausury	4,5
FONDEN	4,9
In USD	**9,2**
FONDEN	3,0
National Treausury	0,8
Other Funds	4,5
PDVSA	0,9
Financial Assets	***15,4***
Sovereign Bonds	**5,4**
FONDEN	3,0
BDT+BANDES	2,4
Toxic Instruments	**10,0**
FONDEN	0,7
BDT	4,1
BANDES	5,2
Total	**53,7**

Source: Ecoanalítica

Even though it's true that the fiscal accounts situation is not critical, even for a low oil price scenario, it's equally true that in this scenario the Government doesn't have the same freedom to continue with its voracious fiscal spending program that it has been carrying out the last few years. In 2009, with an average oil price at US$ 48, the Government won't be able to continue to squirrel away extraordinary resources instead it will have to begin to use those resources that it had previously tucked away.

In a recent ***Ecoanalítica*** Weekly Report, we presented the results of a simulation which showed just how far resources would go to cover Government needs based on three different hypothetical oil prices for 2009 (US$75, US$60, and US$50 per barrel). The price that most fits the scenario we have been presenting here is US$50. In this scenario, the Government will have to cover commitments for around US$ 36.07 billion or VEF 104.60 billion if we make adjustments for the what we expect will be the official exchange rate then, 2.9 VEF/US$. This means that additional resources will run out at the beginning of 2009. This figure includes the cost of the recent nationalizations that are still pending and the Government's financing needs, and excludes that portion which we expect will be financed through more acquisition of debt.

But, the Administration still has a certain degree of freedom, and mechanisms, with which it can take pressure off the fiscal accounts. The Administration could increase the percentage of certain taxes such as the VAT, and re-introduce old taxes such as the Bank Debt Tax at a rate of 0.5%, it could also devalue the currency, and cutback significantly on public spending if it decided to eliminate certain social subsidies or special package deals handed out to other countries. Along these lines, the recent adjustments made to the financial conditions offered to PETROCARIBE countries, is a good example of the type of actions that Government could carry out.

Fiscal Balance of the Central Government % del PIB	
	US$ 48
GDP(US$ MMM)	323,5
Total Revenue	20
Non Oil Revenue	9,6
Oil Revenue	10,4
Primary Expenditure	25
Fiscal Result	-5
Amortization	2,1
Government Financing Requirements	7,1
Domestic Debt (US$ MMM)	2,5
Foreign Debt (US$ MMM)	0
Central Government Obligations US$ MMM	
Total Obligations	47,4
Total Debt	8,1
Net Obligations	**39,3**

Source: Ecoanalítica

Once again, the Executive Office will have to fall back on using the devaluation mechanism to partially adjust imbalances and to generate additional resources. At ***Ecoanalítica*** we have carried out an exercise which reflects the net effect of a devaluation on fiscal accounts. Just as the following table shows, for each VEF 0.1 (VEB

100) devaluated, the monthly effect on Government revenues is VEF 434 million, while the effect on spending is only VEF 87 million. So, the net monthly effect is VEF 347 million. In a devaluation of 34.9% is carried out, in other words, an increase of VEF 0.75 (VEB 750), in one year, the resources generated out of "thin air" would be VEF 31.23 billion (VEB 31 trillion), which adjust according to the exchange rate would equal US$ 10.77 billion.

Additional monthly income per each VEF 0,1 of devaluation (VEF Millions)

Effect over income		Effect over costs	
Oil Royalty	230	Interest	25
Oil income tax	129	Recovery	36
Custom	9	Others	26
New External Debt	40		
Others	26		
Total	**434**	**Total**	**87**
Monthly Net Effect		**347**	

Source: Ecoanalítica

With the expected oil price levels, it's clear that Venezuela is sitting on a time bomb, and the timer is ticking, leaving us with less and less room to maneuver. It seems like we will be left with a very compromised Government and fiscal imbalances which will ripple out through the rest of the economy.

	2008	2009	2010	2011	2012	2013
National Accounts						
Real GDP Growth (% Annual)	6,1	0,6	(4,4)	(3,6)	1,1	1,9
Oil Sector	3,6	2,5	2,0	2,0	2,5	2,5
Non Oil Sector	6,5	0,3	(5,5)	(4,6)	0,9	1,8
Consumption (% Annual)	10,7	0,1	(4,9)	(4,5)	1,6	1,7
Public Consumption (% Annual)	7,6	0,7	(5,5)	(4,5)	1,4	2,4
Private Consumption (% Annual)	11,3	(0,1)	(4,8)	(4,5)	2,2	1,6
Investment (% Annual)	11,7	1,2	(3,2)	(2,7)	0,6	1,1
Exports (% Annual)	1,5	1,1	0,8	0,8	1,1	1,1
Imports (% Annual)	22,1	(21,6)	(13,7)	(1,9)	7,9	2,4
GDP (US$ MMM)	304,9	323,5	234,4	233,9	255,0	298,4
GDP per Capita (US$)	10.960	11.457	8.178	8.040	8.635	9.955
Population (MM)	27,8	28,2	28,7	29,1	29,5	30,0
Inflation, Exchange and Interest Rates						
CPI Inflation-National (end of year) (%)	28,4	38,4	52,4	27,8	22,6	16,0
CPI Inflation (end of year) (%)	30,2	39,2	55,8	28,1	24,0	27,0
WPI Inflation (end of year) (%)	23,2	30,1	44,4	22,3	19,1	21,4
Official Exchange Rate (end of year)	2,2	2,9	6,1	7,3	8,4	9,3
Official Exchange Rate (Average)	2,2	2,8	5,8	7,2	8,3	9,2
TAM Interest Rate (end of year) (%)	24,2	25,5	36,3	23,4	20,0	22,4
TAM Interest Rate (Average) (%)	23,2	23,9	30,9	29,8	21,7	21,2
Lending Rate (end of year) (%)	16,2	16,5	23,5	17,9	15,3	14,6
M2 (end of year) (VEB Trillions)	196,5	243,0	374,0	465,0	552,0	646,0
M2 (% Annual)	26,0	23,7	53,9	24,3	18,7	17,0
Fiscal Policy Indicators						
Fiscal Revenue (% of the GDP)	24,5	21,0	26,6	26,2	26,0	24,2
Oil Revenue (% of the GDP)	15,0	10,4	12,1	11,7	11,5	10,1
Non Oil Revenue (% of the GDP)	9,5	9,6	12,4	12,6	13,0	13,1
Foreign Exchange Profits and Others (% of the GDP)	0,0	1,0	2,1	1,9	1,5	1,0
Total Expenditure (% of the GDP)	27,4	25,0	27,5	27,0	27,8	28,5
Primary Expenditure (% of the GDP)	25,4	22,9	25,2	24,2	25,0	25,6
Interest (% of the GDP)	2,0	2,1	2,3	2,8	2,8	2,9
Fiscal Balance (% of the GDP)	(2,9)	(4,0)	(0,9)	(0,8)	(1,8)	(4,3)
Primary Fiscal Balance (% of the GDP)	(0,9)	(1,9)	1,4	2,0	1,0	(1,4)
Amortization (% of the GDP)	2,7	2,3	3,2	2,9	3,0	3,1
Government Financing Requirements (% of the GDP) a	5,6	6,3	4,1	3,7	4,8	7,4
Quasi-fiscal Expenditure (% of the GDP)	6,0	4,2	4,8	4,2	4,0	3,8
Non - oil Quasi-fiscal Balance (% of the GDP)	(23,9)	(18,6)	(17,8)	(16,7)	(17,3)	(18,2)
Debt Profile						
Foreign Exchange Reserves (US$ MMM)	38,2	25,3	27,3	29,2	31,7	35,2
Total Public Debt (US$ MMM)	60,2	62,5	65,5	66,5	69,3	69,0
Domestic Debt (US$ MMM)	14,0	16,5	19,8	21,5	22,2	20,0
Foreign Debt (US$ MMM)	46,2	46,0	45,7	45,0	47,1	49,0
Total Debt (% of the GDP))	19,7	19,3	27,9	28,4	27,2	23,1
Total Foreign Debt (% of Exports)	53,1	91,4	76,1	76,2	73,6	74,1
Net Debt (US$ MMM)	(53,2)	(53,4)	(53,7)	(54,4)	(52,3)	(50,4)
Debt Service Rate b	5,2	9,1	7,6	7,7	7,1	6,9
Balance of Payments						
Oil Price (Brent)	106,5	55,5	67,9	65,0	70,0	72,0
Oil Price (Venezuelan Basket)	92,5	48,5	59,3	57,1	61,1	62,0
Diferential	86,9%	87,4%	87,3%	87,8%	87,3%	86,1%
Current Account (% of the GDP)	9,3	0,6	9,0	6,1	6,0	5,5
Current Account (US$ MMM)	28,3	2,0	21,1	14,4	15,4	16,5
Balance of Trade (US$ MMM)	34,2	7,8	25,8	20,4	20,5	20,7
Exports (US$ MMM)	87,0	50,3	60,0	59,0	64,0	66,2
Oil Exports (US$ MMM)	2,40	2,45	2,50	2,55	2,60	2,65
Imports (US$ MMM)	(52,8)	(42,5)	(34,2)	(38,6)	(43,5)	(45,5)
Services & Income Balance (US$ MMM)	(5,9)	(5,8)	(4,7)	(6,1)	(5,1)	(4,2)
Capital Account (US$ MMM)	(23,6)	(14,9)	(19,2)	(12,4)	(12,9)	(13,0)
Foreign Direct Investment (US$ MMM)	1,1	1,2	1,3	1,6	1,5	1,5
Labor Markets						
Unemployment (%)	7,5	11,0	13,1	13,5	13,0	11,9
Real Wage (% Annual)	8,7	(10,7)	(13,3)	(5,5)	(1,8)	2,6

(a) (Amort+Fiscal Deficit). (b) (Amort+Interest Ext Debt)/Export Good & Services. Forecast.

Source: Finance Ministry, Budget Office, Central Bank and Ecoanalítica